North Carolina Consensus Forecast
April 2024 Revision Summary

Forecast Highlights

- **The Consensus Forecast expects overall growth for the biennium**

  The forecast assumes that moderate growth will be sustained throughout the upcoming biennium.

- **Current year revenue is ahead of expectations**

  General Fund revenue is expected to exceed earlier projections by $413 million in the current fiscal year.

- **Next year increase**

  General Fund revenue is expected to increase by $1 billion, reaching $34.4 billion by the end of FY 2024-25.

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The Fiscal Research Division and the Office of State Budget and Management issued revised consensus revenue forecasts for the General Fund, Highway Fund, and Highway Trust Fund for the 2023-25 biennium on April 17, 2024. This report summarizes the forecasts for each fund, detailing the adjustments made to the revenues certified in the 2023 biennial budget.

General Fund

This April 2024 forecast update expects revenue to increase by $1.42 billion (2.1%) over the 2023-25 biennium. This revision is relative to the certified budget, which was based on the May 2023 consensus forecast and adjusted for revenue changes enacted during the 2023 Regular Session. General Fund revenue collections are now expected to total $34.13 billion in FY 2023-24 and $34.37 billion in FY 2024-25.

April 2024 Revised General Fund Consensus Revenue Forecast ($ in millions)

	FY 2023-24	FY 2024-25
Revised General Fund Revenue Forecast	$34,138.8	$34,369.3
Certified Revenue (S.L. 2023-134)	$33,725.7	$33,365.5
Change	$413.1	$1,003.8

Forecast Summary

The May 2023 consensus forecast was driven by several economic assumptions that were, as a group, described as a “slowcession.” That forecast anticipated stagnant growth through 2023 and slower-than-average growth over the remainder of the biennium. Inflation was expected to decline but remain above the Federal Reserve’s (“the Fed’s”) 2% target well into 2024, prompting the Fed to raise the target federal funds rate to 5% to increase the cost of consumer and business credit. This restrictive monetary policy was expected to decrease employment in 2023, while a full recovery was expected in the second year of the biennium. Higher inflation was expected to decrease consumer and business spending. This trend, combined with lower tax rates, was expected to reduce collections and lead to falling General Fund revenue in the second year of the biennium.

Several assumptions in that forecast came to fruition, while others did not. As predicted, inflation declined but remained above the 2% target, remaining at 3.5% year over year as of March 2024. The federal funds rate was higher than projected in the “slowcession” scenario, with an upper limit of 5.5% as of the March 2024 Federal Open Markets Committee meeting. With the Fed’s monetary policy set more restrictively than anticipated, many standard economic models would predict the economy tipping into recession due to decreased personal consumption and business investment. However, the most significant difference between the May 2023 forecast’s assumptions and economic reality was on the employment side.

Rather than shrinking, North Carolina's labor force grew by 1.5% year over year as of March 2024. The State's unemployment rate remained at 3.5% and there were 1.4 job openings per job seeker nationwide. Personal income tax collections were larger than the forecast's expectations and drove overall growth in General Fund revenues. While the State personal income tax rate was lowered statutorily, the growing size of the personal income tax base outweighed this effect. On net, there were increased collections.

- **Economic growth has been stronger than expected,** leading to increased overall tax collections.

Over the remainder of the biennium, this forecast expects an overall economic normalization. Inflation is projected to decline, leading to increased business optimism and consumer confidence. This decline will allow the Fed to begin lowering the federal funds rate in late 2024 or early 2025. Wage growth is expected to continue, though at a slower rate, boosting personal income tax collections. This wage growth will allow consumers to have more disposable income and increase their household purchases, increasing sales and use tax collections. Overall economic growth is expected to return to a level slightly below the pre-pandemic trend.

- **Personal income taxes** are the primary component of growth, increased by low unemployment and rising wages.

While the chance of a recession has diminished since the May 2023 consensus forecast, risks remain. If inflation does not decrease, or begins to increase again, the Federal Reserve is likely to hold interest rates steady or raise them. This could cause issues in the banking sector and real estate market, increasing the chance of a recession. Geopolitically, the Israeli-Palestinian conflict could escalate into a regional war, which could cause price increases in energy and consumer goods and interrupt global shipping. Finally, income tax collections from final payments due in mid-April are difficult to predict, as income from dividends, capital gains, and businesses can result in sizable positive or negative swings in collections. The Fiscal Research Division and Office of State Budget and Management will assess collections when this data becomes available in early May 2024 and issue a revised forecast if revenue deviates significantly from estimates.

- **Recession risk** has lowered. Inflation, geopolitics, and an "April Surprise" could negatively impact final collections.

The remainder of the General Fund section will detail the contribution of various tax schedules to the projected overall revenue for the current and upcoming fiscal years.

Current Fiscal Year Revenue (July 2023—June 2024)

The revised forecast for FY 2023-24 projects net General Fund revenue of $34.14 billion, an increase of $413 million (1.2%) from budgeted revenue and a 1.8% increase year over year. The May 2023 forecast expected FY 2023-24 revenue to increase relative to the prior year by 0.6%. This revision is primarily due to increased personal income and sales tax estimates, though offset somewhat by reduced estimates of business taxes and nontax revenue.

- Personal income tax is also partially increased by **correctly reclassifying** some corporate income as personal income.

Personal income taxes: The revised forecast projects net personal income tax collections of $17.02 billion, an upward revision of $438 million (2.6%) from budgeted revenue and a 1.5% increase year over year. In the first 9 months of the fiscal year, revenues have outpaced consensus targets. Revenue from withholdings has been consistently above targets, reflecting the strength of the labor market. Additionally, revenue from nonwithholding payments, such as estimated and final payments from business filers, has been above target. This is partly due to an accounting change discussed in the business taxes section below which transfers revenue previously accounted for as corporate income to personal income, at no net change to overall General Fund revenue.

The personal income tax rate was statutorily reduced from 4.75% in calendar year 2023 to 4.5% in calendar year 2024. This reduction slows revenue growth. However, the growth in the size of the tax base has outweighed the effect of a lower rate, leading to a net increase in collections.

- **Statutory reductions in personal income tax rates** are offset by a growing tax base.

Sales and use tax: The revised forecast projects net sales and use tax collections of $10.93 billion, an upward revision of $179 million (1.7%) from budgeted revenue and a 1.2% increase year over year. Revenue has been above the consensus forecast targets for the first 9 months of the fiscal year, and trends such as increased disposable income are expected to continue for the remainder of the fiscal year.

- **Sales tax** is revised upward due to strong year-to-date collections and increased consumption.

Business taxes: In the revised forecast, net corporate income taxes are projected to decline to $1.52 billion, a downward revision of $163 million (-9.7%) from budgeted revenue and a –6.8% decrease year over year. In the first 9 months of the fiscal year, corporate income tax collections are down significantly compared to consensus revenue targets.

This adjustment is due to a larger than expected shift in business tax collections from corporate income tax to personal income tax. Historically, personal income taxes paid by a corporate entity, such as those paid by an S-corporation on behalf of nonresident shareholders, have been recorded as corporate income taxes. However, this has recently been corrected by the Department of Revenue, shifting revenue from corporate income to individual income. While this accounting change has no impact on any taxpayer's liability to the State, it does require a change in the overall expected collections for corporate income tax. The forecast for individual income tax collections increased by an equal and offsetting amount due to this accounting adjustment.

- **Business taxes** see declines due in part to accounting changes that are offset by personal income tax increases.

Franchise tax estimates remain unchanged from the certified budget, with collections closely matching budgeted revenue. Insurance premiums tax is expected to rise to $1.29 billion, a $53 million (4.2%) increase over the certified budget, due to growth in premiums for property and auto insurance.

Nontax revenue: The revised forecast projects net nontax revenue collections of $1.64 billion, an $87 million (-5.0%) decrease from budgeted revenue but still a 21% increase year over year. Annual growth in nontax revenue is primarily driven by investment income, which is the return the State gains by investing the cash balances held in the General Fund into various assets. As interest rates have risen, this revenue source has grown in importance to account for nearly half of nontax revenue. While interest rates have been higher than projected, and cash balance projections have been on target, year to date returns have underperformed May 2023 expectations. Accordingly, expected collections have been adjusted downwards.

- **Nontax revenue** has not met expectations due to lower investment income.

Outlook for the Upcoming Fiscal Year (July 2024—June 2025)

FY 2024-25 revenue is estimated to be $34.37 billion, an increase of $1 billion, 3% over the budgeted amount and a 0.7% year over year increase. The FY 2024-25 forecast builds on the revised projections for the current fiscal year. Most of the upward revision is due to greater than expected income growth in the current fiscal year, much of which will continue to be reflected in the upcoming fiscal year's revenue. Wage increases are expected throughout the fiscal year, with the labor market slowing but continuing to grow overall. By compounding the gains from the current fiscal year, the overall tax base is expected to grow, even with tax rates declining for personal and corporate income taxes.

- **The personal income tax rate will be reduced again in 2025,** flattening year over year collections for FY 2024-25.
- The sales tax transfer to the Highway Fund and Highway Trust Fund **increases from 4% to 6%** in FY 2024-25. This reduces General Fund revenue.
- **Corporate profits** are expected to grow in calendar year 2024, boosting collections.
- **Higher interest rates** increase the interest earned on the State's cash balances. This is projected to increase investment income in FY 2024-25.
- **Sports wagering** estimates have increased by over 250% compared to budgeted revenue. This is due to an earlier start date than anticipated and higher initial collections.

Personal income taxes: The revised forecast projects FY 2024-25 net personal income tax collections of $16.98 billion, an upward revision of $703 million (4.2%) from budgeted revenue and a –0.2% decrease year over year. The personal income tax rate is set by statute to decline from 4.25% to 3.99% in calendar year 2025, leading to this year over year decline. Unemployment is expected to increase modestly above 4%, maintaining a competitive but cooled labor market. Lastly, the level shift from accounting for additional nonwithholding previously categorized as corporate income is maintained, increasing overall collections for personal income tax but reducing them by an equal amount for corporate income.

Sales and use tax: The revised forecast projects FY 2024-25 net sales and use tax collections of $11.04 billion, an upward revision of $260 million (2.4%) from budgeted revenue and a 1% increase year over year. Expected slower growth in inflation reduces the year over year growth of this schedule, but additional retail sales driven by the strong labor market are the source of the budget's overall revision. Per statute, 6% of sales and use tax are transferred to the Highway Fund and Highway Trust Fund. Overall, this forecast anticipates that transfer to send $711 million from the General Fund to those funds in FY 2024-25.

Business taxes: While FY 2024-25 net corporate income tax collections are reduced from budgeted levels due to accounting changes, high anticipated rates of corporate profit growth in calendar year 2024 are expected to yield 3.6% year over year increase to this schedule. This increase is despite the reduction in the tax rate from 2.5% in calendar year 2024 to 2.25% in calendar year 2025. Franchise tax estimates are unchanged from the certified budget, while growth in insurance premium tax is expected to be 6.1% year over year.

Nontax revenue: The revised forecast projects net nontax revenue collections of $1.59 billion, a $109 million (7.4%) increase from budgeted revenue and a 2.8% decrease year over year. This adjustment is due to higher expected interest rates than were predicted in May 2023. The forecast anticipates that the difference between expected returns and actual returns will continue. Even after adjusting for this difference, the higher rates predict an 11.9% increase over budgeted revenue for investment income.

Note: Sports Wagering

North Carolina's newest tax is an 18% charge on the gross wagering revenue generated from legal betting on sporting events. This tax came into effect concurrently with online betting legality on March 11, 2024, which was earlier than previously anticipated. While less than one month's data was available at the time this consensus forecast was generated, the strength of early collections led to a significant revision in revenue. Over the biennium, total General Fund revenue from sports wagering was revised upwards by $43 million (253%) based on March returns and seasonal trends in other states.

Highway Fund and Highway Trust Fund

The Highway Fund and Highway Trust Fund are the sources of State net appropriations for the North Carolina Department of Transportation. The April 2024 forecast revision expects revenue for these funds to increase by $207 million (1.9%) over the 2023-25 biennium. This revision is relative to the certified budget, which was based on the May 2023 consensus forecast and adjusted for revenue changes enacted during the 2023 Regular Session. Total transportation revenue collections are expected to total $5.27 billion in FY 2023-24 and $5.74 billion in FY 2024-25.

- **Total transportation revenues** are expected to be $207 million higher than previously forecasted.

April 2024 Revised Transportation Consensus Revenue Forecast ($ in millions)

	FY 2023-24	FY 2024-25
Revised Highway Fund Revenue Forecast	$3,030.1	$3,274.8
Certified Revenue (S.L. 2023-134)	$2,966.6	$3,195.6
Change	$63.5	$79.2
Revised Highway Trust Fund Revenue Forecast	$2,242.0	$2,467.5
Certified Revenue (S.L. 2023-134)	$2,199.2	$2,445.8
Change	$42.8	$21.7

The remainder of the transportation section will detail the contribution of various tax schedules to the projected overall revenue for the current and upcoming fiscal years.

- **The motor fuels tax rate** is expected to increase by half of one cent in calendar year 2025.

Motor fuels taxes: Taxes on motor fuels make up nearly half of transportation revenue. The revised forecast projects collections of $4.84 billion over the biennium, a $79 million (1.6%) increase from budgeted revenue. Total taxable gallons consumed is expected to rise from 6.36 billion in FY 2023-24 to 6.40 billion in FY 2024-25. While fuel efficiency as measured in miles per gallon continues to rise each year, and gallons consumed is flattening nationally, North Carolina's growing population generates increased consumption. The rate charged per gallon is expected to rise from 40.4 cents in calendar year 2024 to 40.9 cents in calendar year 2025 per statute due to population growth and estimated increases to energy costs. Three quarters of motor fuels tax revenues are deposited in the Highway Fund and one quarter in the Highway Trust Fund.

- **Highway use tax** is revised down in FY 2024-25 due in part to higher borrowing costs for car buyers.

Highway use tax: The highway use tax charged on vehicle purchases and long term leases makes up nearly one quarter of transportation revenue. The revised forecast projects collections of $2.24 billion over the biennium, a $29 million (-2.5%) decrease from budgeted revenue. With 9 months of collections recorded, this tax is on target for FY 2023-24 and was not revised from budgeted revenue. In FY 2024-25, highway use tax collections were reduced by $29 million (-2.5%) compared to budgeted revenues, as tightening consumer lending standards and higher than expected interest rates are predicted to reduce demand for vehicle purchases. Highway use tax is deposited in the Highway Trust Fund.

- Many **DMV fees will increase** in FY 2024-25 due to an inflationary adjustment in statute.

DMV fees: Fees charged by the Division of Motor Vehicles ("DMV") make up nearly one quarter of transportation revenue. The revised forecast projects collections of $2.31 billion over the biennium, a $38.8 million (1.7%) increase over budgeted revenue. DMV fees usually do not see large year over year changes as they are primarily a function of population growth, but collections are expected to increase from $1.06 billion in FY 2023-24 to $1.25 billion in FY 2024-25, a $186 million (17.5%) year over year increase. This is primarily due to the statutory quadrennial fee adjustment, which raises fees every 4 years based on the preceding 4 year rate of inflation. From 2019 to 2023, inflation rose by 19.1%, leading to the large adjustment in rates for fees including vehicle registration, driver license, and truck license fees. In comparison, the increase to fees in 2020 was 7.9%, due to lower inflation between 2015 and 2019. Most DMV fees are deposited in the Highway Fund.

Sales tax transfer: Per statute, 4% of general rate sales tax revenue is transferred to the transportation funds in FY 2023-24, rising to 6% in FY 2024-25. Increases to estimates of General Fund sales tax revenue increase the amount of this transfer. One quarter of the sales tax transfer is deposited in the Highway Fund and the other three quarters are deposited in the Highway Trust Fund.