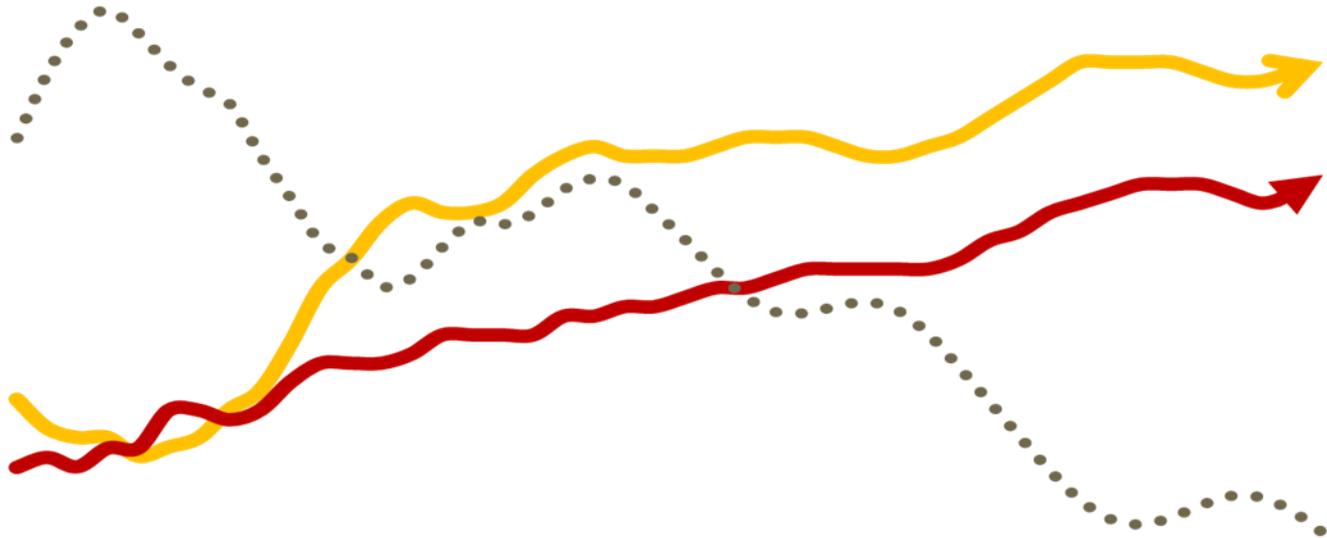


Quarterly General Fund Revenue Report



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

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Highlights

- » FY 2016-17 Revenue through December: 3.1% (\$322 million) above the 6-month revenue target.
- » Economic Outlook: The economy is on solid footing, and steady growth is expected to continue throughout the fiscal year.
- » Revenue Outlook: Improvements in employment set the stage for faster overall wage growth, which increases the likelihood of surpassing this fiscal year's revenue forecast.

FY 2016-17 Revenue Through December

- » General Fund revenue was \$321.9 million above the \$10.3 billion target for the first half of the fiscal year.
- » Second quarter revenue (Oct.-Dec.) was \$174.3 million above target. This is similar to the first quarter, which was \$158.3 million above target.

GENERAL FUND REVENUE THROUGH DECEMBER (\$ millions)					
	FY 2016-17				FY 2015-16
	Target	Actual (P)	\$ % Difference		Actual
Net Tax Revenue					
Individual Income	\$5,443.7	\$5,604.4	\$160.7	3.0%	\$5,384.5
Sales and Use	3,495.0	3,574.7	79.7	2.3	3,296.5
Corporate Income & Franchise	505.8	578.8	73.0	14.4	488.9
Other	550.3	544.4	(5.9)	(1.1)	556.4
Total Net Tax Revenue	\$9,994.8	\$10,302.3	\$307.5	3.1%	\$9,875.2
Nontax Revenue & Transfers	\$342.5	\$356.9	\$14.4	4.2%	\$376.1
Total General Fund Revenue	\$10,337.3	\$10,659.3	\$321.9	3.1%	\$10,251.2

FY 2016-17 Revenue Through December

» The main General Fund revenue sources are running ahead of expectations for the first half of the fiscal year.

1) **Personal Income Taxes: \$161 million above target for the year.**

- Growth is 5.3% over last year, helped by net wage & salary withholding at \$32 million above target (1.5%) and Estimated and Final Payments 6.2% above target.
- Withholding collections are slightly ahead of the target, consistent with the faster-than-projected growth pace for wage & salary growth.
 - Withholding and wages and salary income growth will track close together and are the least volatile source of our major income sources.
- Through the first-half of the fiscal year, net Individual Income Tax collections are 3.0% above target.

FY 2016-17 Revenue Through December

2) Sales Taxes: \$80 million above target.

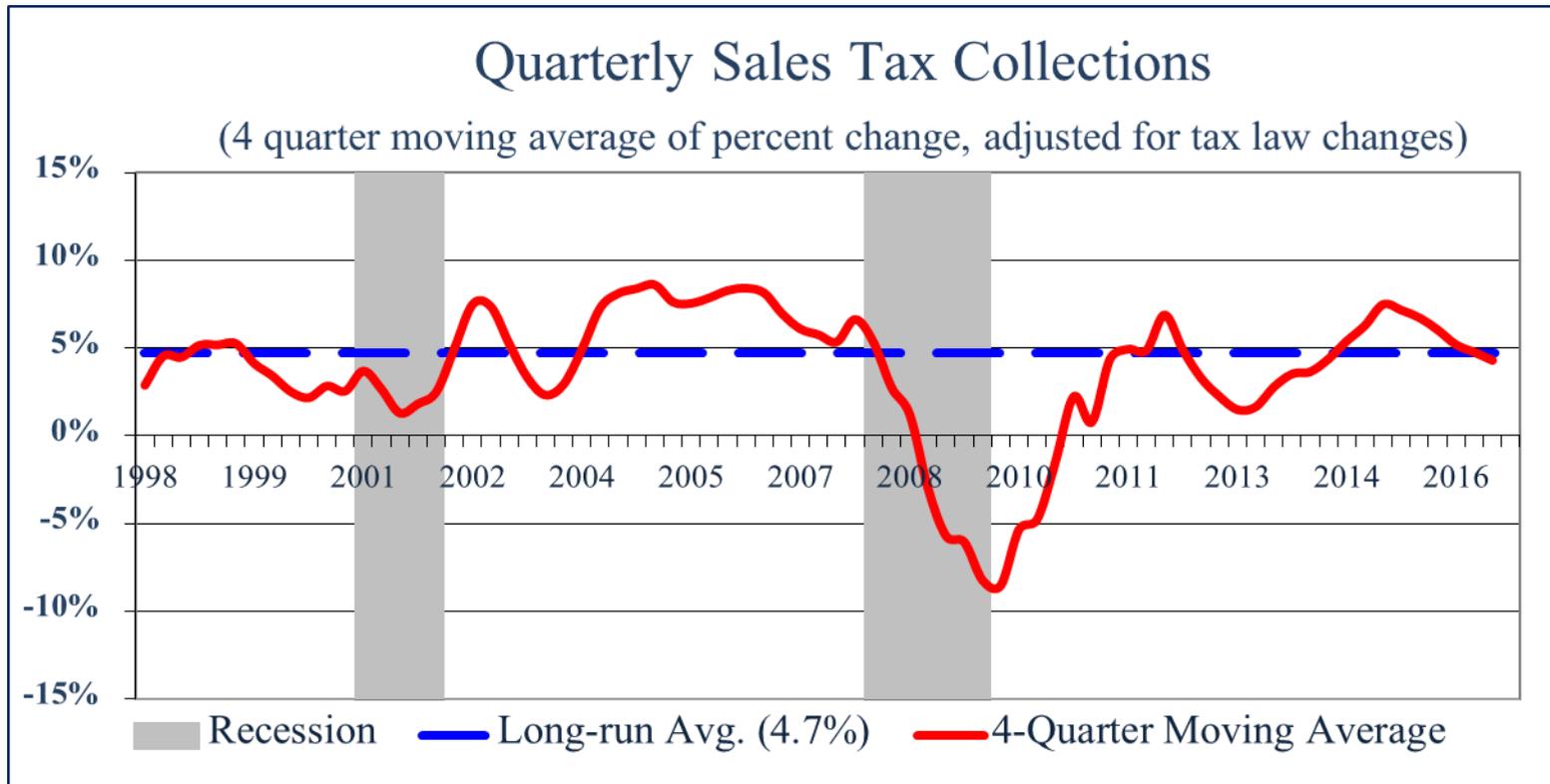
- Gross collections 1.0% above the target for the first 6 months; refunds and electricity/piped natural gas distributions are lower than targeted, which has added \$41 million to the target surplus.
- Collections have maintained the steady, moderate growth established last summer.
- Baseline collections for the first quarter of the fiscal year (adjusted for base and rate changes) were up 4.3% over the same period last year.
- The second quarter was up 5.0% compared to last year's second quarter.

FY 2016-17 Revenue Through December

3) **Corporate Income and Franchise Taxes: \$73 million above target.**

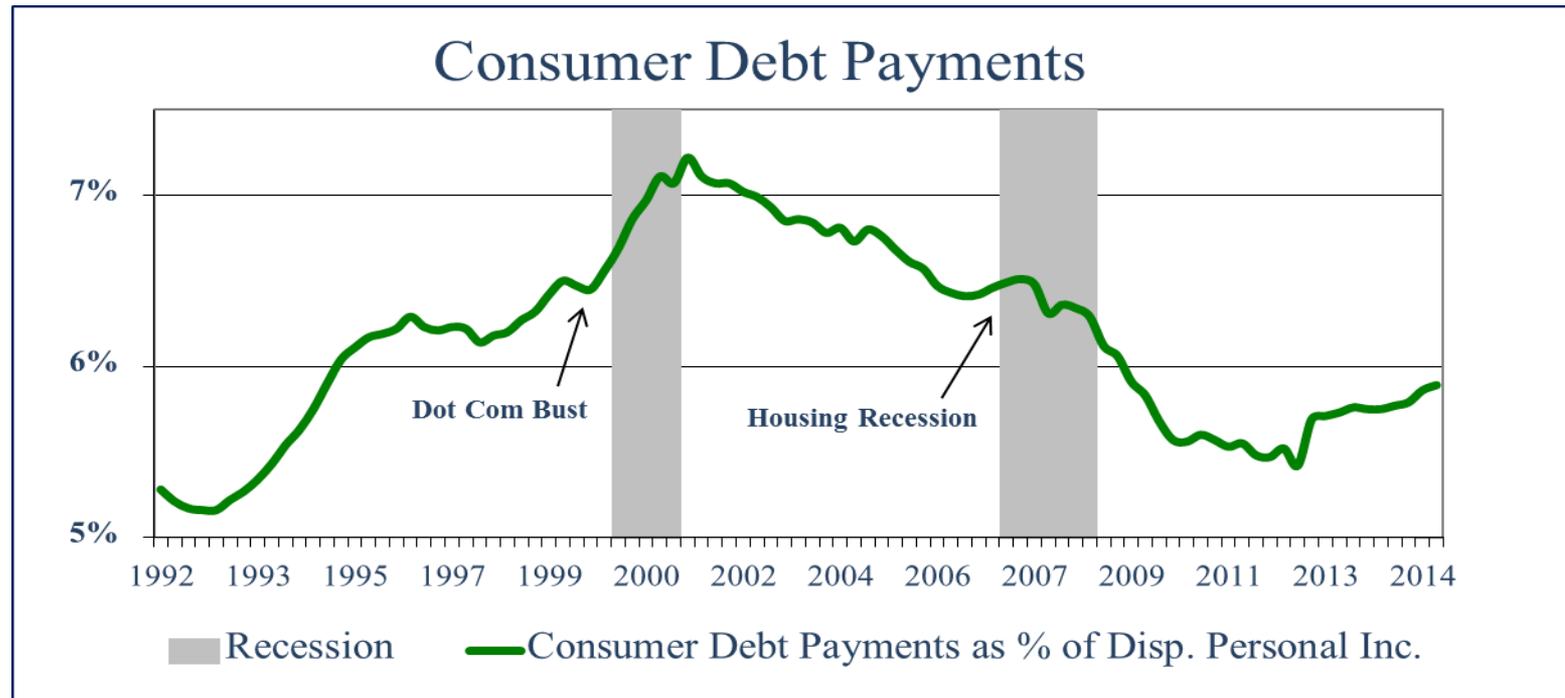
- Corporate tax payments can fluctuate considerably in the first half of the fiscal year if the State receives a few large tax payments or refunds on previous years' tax liabilities.
- When regular payments come due in March and April, a better picture overall corporate tax payments will develop.

Tracking Economy-Based Collections



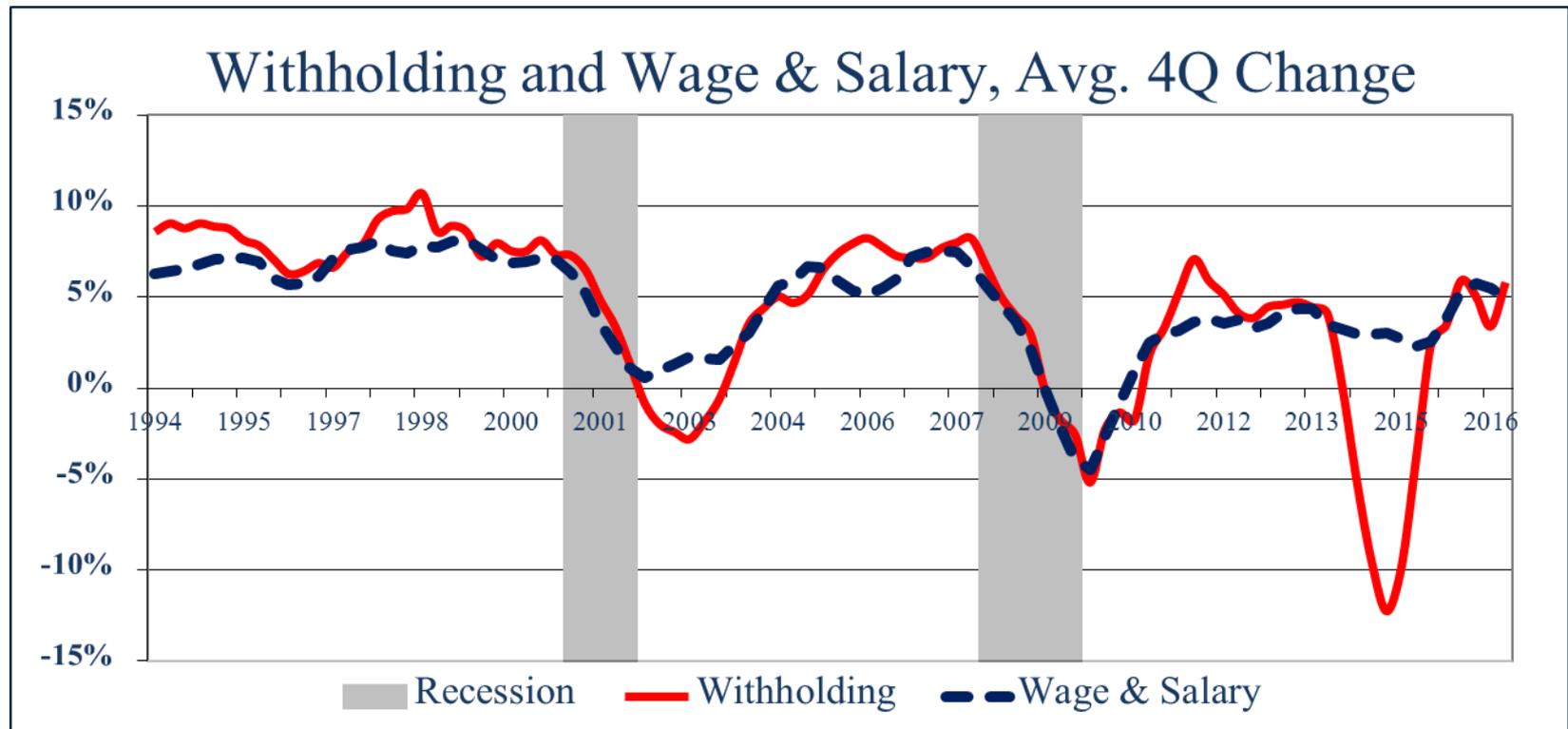
Baseline growth in the first-half of the fiscal year was 4.7%, which is ahead of the projected 4.5% growth rate for the fiscal year. The second quarter improved over the first quarter with growth of 4.9%.

Tracking Economy-Based Collections



In the 1990s, household debt grew rapidly and the 2000 recession did not slow this trend. Lower interest rates helped to lower debt payments after the recession. When the housing bubble burst, large sell-offs led to a decline in consumer debt. Since then purchases on credit have increased and are adding to the size of the State's Sales Tax base.

Tracking Economy-Based Collections



Net Withholding income growth (i.e., withholdings less refunds) fell dramatically in 2014 due to tax law changes in S.L. 2013-316. Those changes no longer affect the yearly average change, and income tax withholding and wage growth now are closely aligned as they have been in the past.

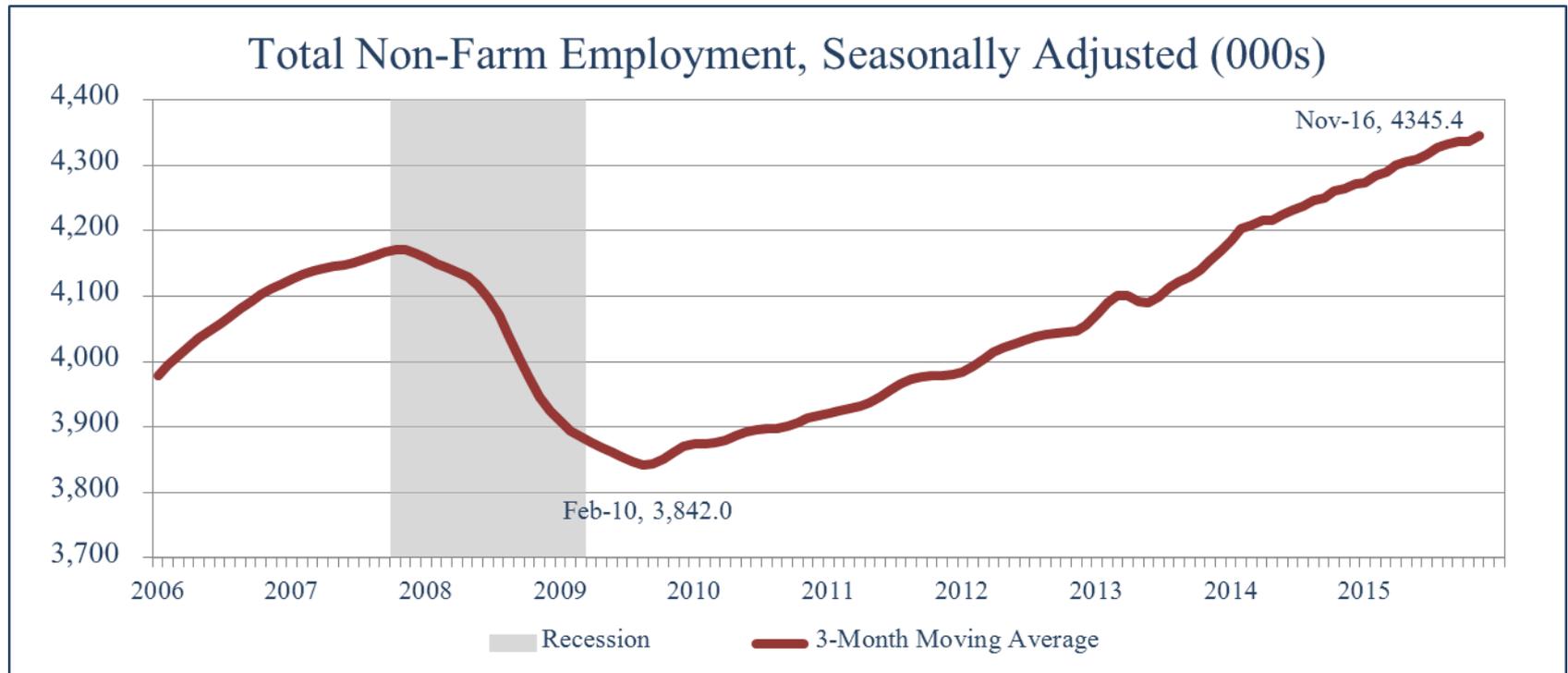
Economic Outlook

- » Since the Great Recession ended in 2009, the State's economy has struggled to maintain a moderate pace of growth. While positive progress was made, conditions were unsatisfactory with limited wage growth and higher than normal unemployment. Growth in the last two years, while still moderate, has quickened sufficiently to improve overall economic conditions in the State.
- » During the post-recession recovery, the State's economy has tracked closely with the nation's recovery. This trend is expected to continue as both the nation and the State continue to expand at a moderate, steady pace. For 2017, as is typical when the economy is on an upswing, the State's growth is expected to outpace the nation's

Economic Outlook

- » A stronger economy means the State's employment outlook has stabilized. Industry employment growth is expected to reach 2.2% this year. This would yield a net gain of 100,000 to 105,000 jobs in 2017.
- » Ongoing improvements in the economy have resulted in not only a stronger job market but the potential for improved individual wage growth. With unemployment down and a tighter labor market, there has been greater pressure on individual wages to increase. The most recent national economic data reported an uptick in hourly wages.
- » For the State, the increase in Personal Income withholding last year had more to do with the increase in the number of people employed rather than increases in wages of those already employed. Based on the national wage data and our current pace of employment growth, the prospects for individual wage growth this year should continue to improve.

Economic Outlook



Because the unemployment rate can sometimes be misleading with respect to economic conditions, we focus more on the employment level and employment growth rate (2.2% projected in 2017). The chart shows how employment has been on a modest, yet steady growth path since employment bottomed-out in February 2010.

Economic Outlook

- » Economic projections for the key economic indicators in 2017, especially employment and income, are for continued growth at a solid pace. This would mean economic conditions in the State would be at their best since the onset of the recession 10 years ago (December 2007).
- » While upturns and downturns in the economy are difficult to determine, for the near-term little risk exists for an economic downturn. A survey of economic forecasters by the Wall Street Journal places the risk of a recession in the next 6 months at only 20%.
- » Job markets are less volatile and inflation is under control – helped by low energy prices, and modest individual wage growth has finally emerged. The greatest economic risks on the current horizon continue to come from a global economic downturn brought on by the ongoing volatility in the Middle East, and potential economic weakness in China and India.

Revenue Outlook

- » With the State's economy on a path of stable economic growth, revenue growth should continue to follow the trend it has been on the last 6 months.
- » Since last May, when the current consensus revenue forecast was developed, the outlook for personal income growth has improved. This will reinforce the probability of meeting or surpassing the forecast.
- » With revenue 3.1% ahead of the consensus forecast through December, the current target surplus should help offset any "surprises" that occur the second half of the fiscal year, which tends to be more volatile.
 - It is important to note that April collections are nearly twice the amount of the other months and consist of potentially-volatile sources such as final individual and corporate income payments and refunds.
 - April almost always holds a surprise, and what happens in April often determines how we finish the fiscal year.

Conclusions

- » Revenue collections through December are 3.2% above the consensus target; individual income collections are the largest contributor to the target surplus.
- » As the economy continues to move forward, the pressure on job pay should continue to build. Growth in pay had been stagnant but as the economy nears full-employment we should begin to see greater upward movement on wages.
- » Inflation has been minimal with falling gas prices and stagnant wage growth. The forecast doesn't expect inflation to reach or surpass 2% until the end of the fiscal year, but higher energy prices and wage induced inflation are expected to add to inflation going into the next fiscal biennium.
- » For the first half of the fiscal year, General Fund revenue exceeded forecast expectations. With little change expected in the State's current economic conditions, the forecast for the rest of the fiscal year should continue to track ahead of projections by 2-3%. Only a big swing in April collections could noticeably impact this outlook.

Table and Chart Sources

- » Slide 2: NC Department of Revenue, compiled by the Fiscal Research Division
- » Slide 6: Fiscal Research Division calculations and estimates based on data provided by the NC Department of Revenue
- » Slide 7: U.S. Board of Governors of the Federal Reserve System
- » Slide 8: Bureau of Economic Analysis; NC Department of Revenue
- » Slide 11: U.S. Bureau of Labor Statistics