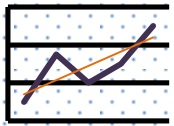


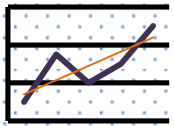
# **Economic and Budget Outlook: FY 2013-2017**

## **2012 Revenue Conference**



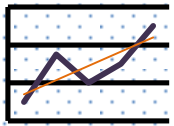
# Background

- Public Act 120 of 2010 requires Independent Fiscal Office to release a five-year outlook report.
  - Release date is November 15<sup>th</sup>.
  - Consider economics, demographics, revenues and expenditures.
- Act also requires Office to convene a revenue estimating conference by January 31<sup>st</sup> of each year.
- For this year, the Office has combined two events.



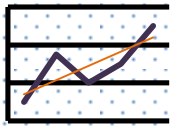
# Five-Year Outlook Report

- Report and presentations will be posted on website:  
[www.ifo.state.pa.us](http://www.ifo.state.pa.us)
- Modeling is simple and transparent.
  - Projections motivated by economics and demographics.
  - Focus on growth rates, not absolute levels.
- Use FY 2011-12 as the “base year” for all projections. Assume “Current Policy.” Apply economic and demographic growth rates.

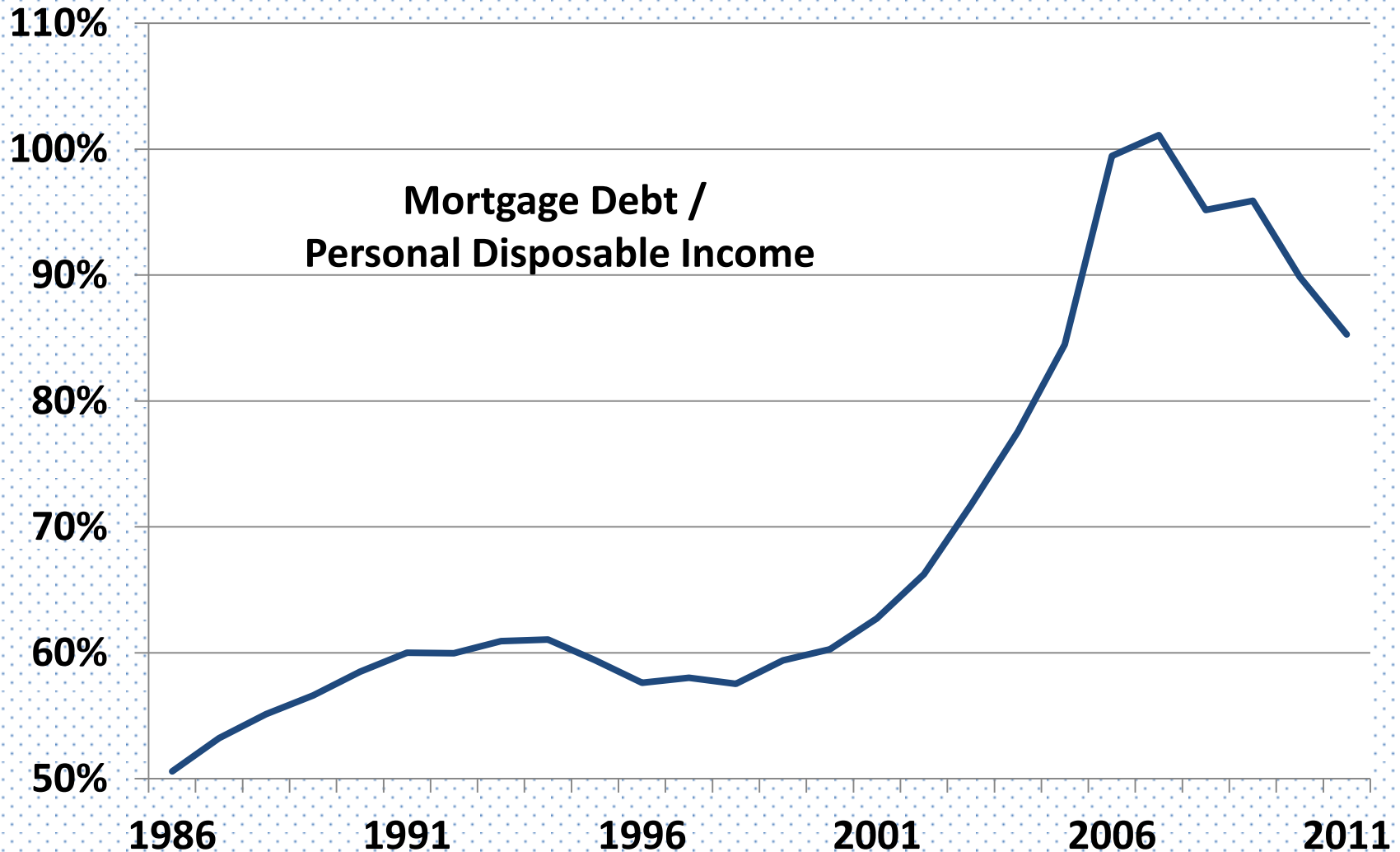


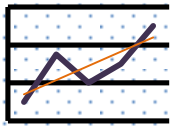
# The Economic Outlook

- Recession continues to restrain economic growth.
- Consumers: continue to deleverage.
- Financial Institutions: continue to write-off bad loans, reluctant to lend.
- Non-Financial Firms: profits at or near historic highs; reluctant to hire and invest until demand returns.
- When do these processes end?

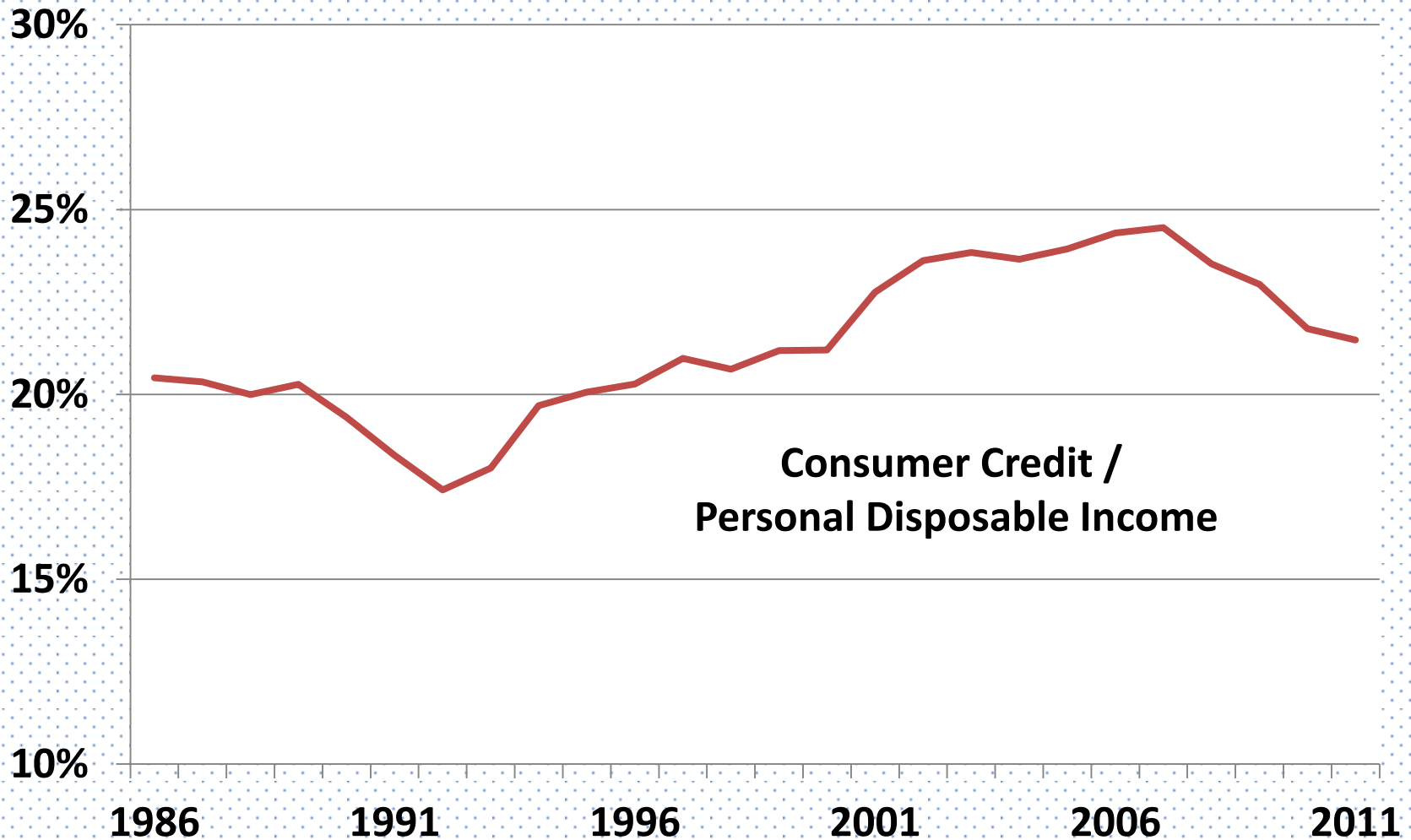


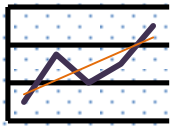
# Household Mortgage Debt Still High



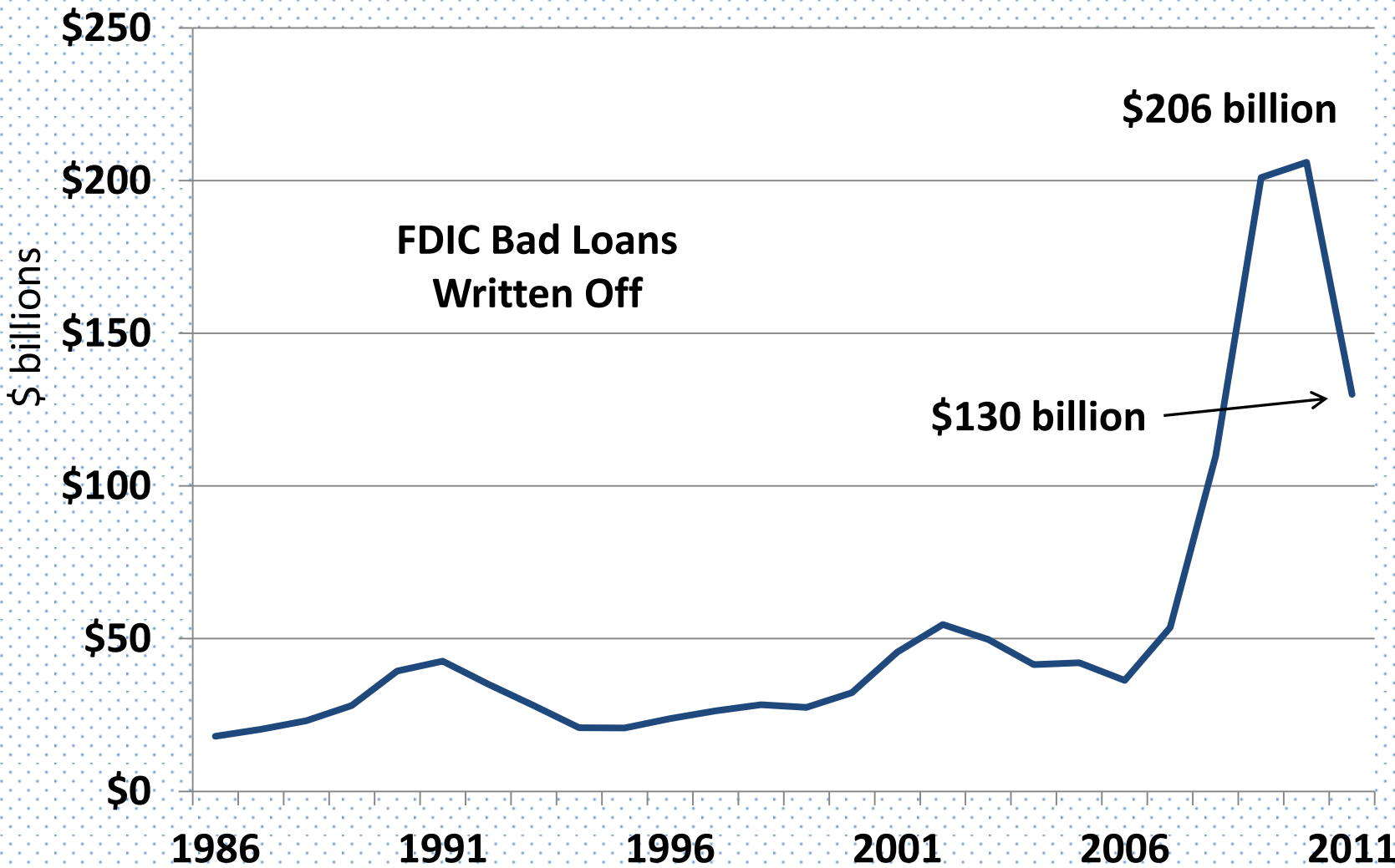


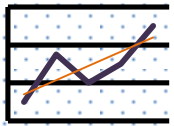
# Consumer Credit Balances Reduced



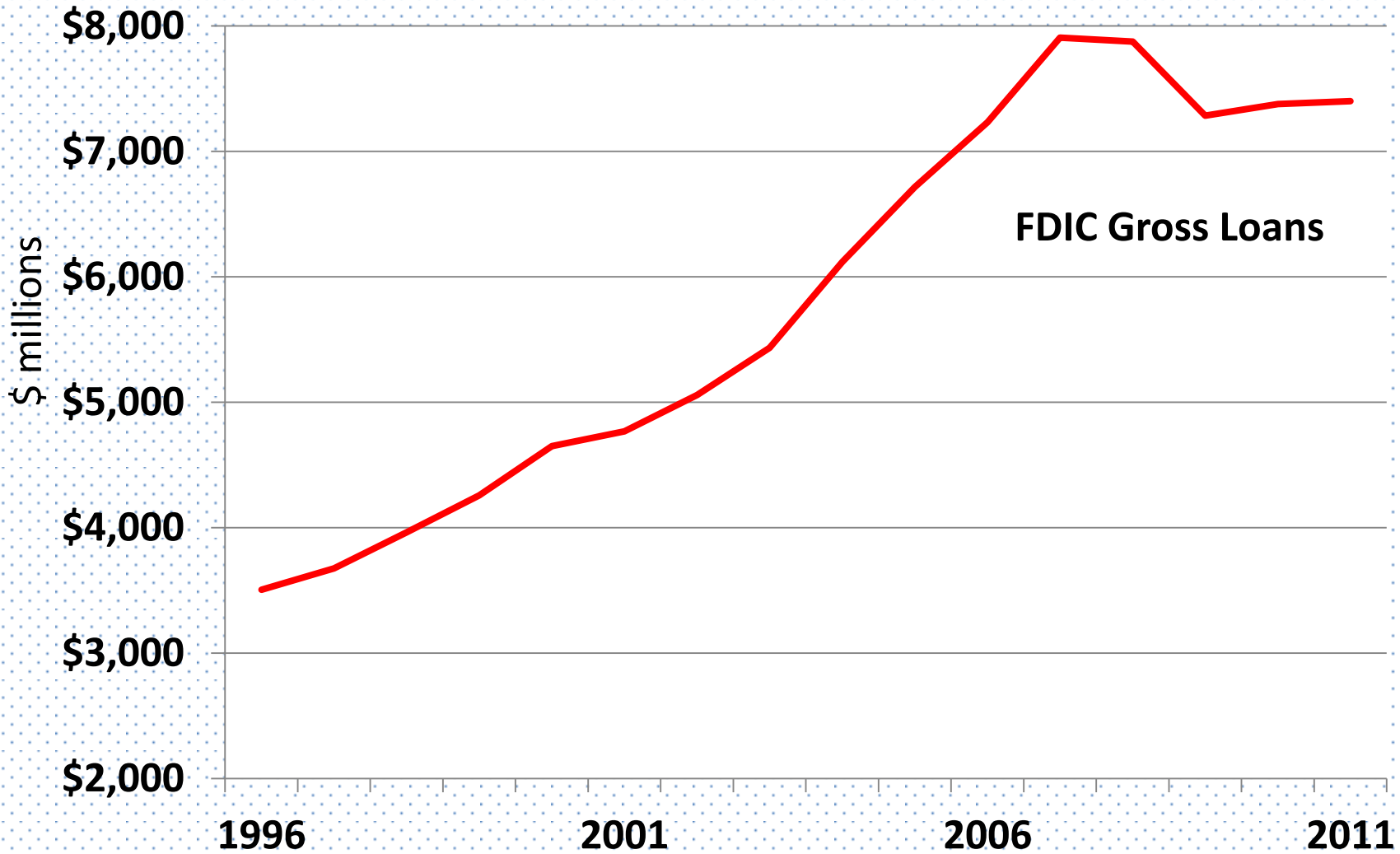


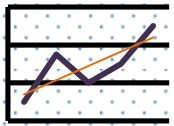
# Banks: Bad Loan Write-Offs Declining



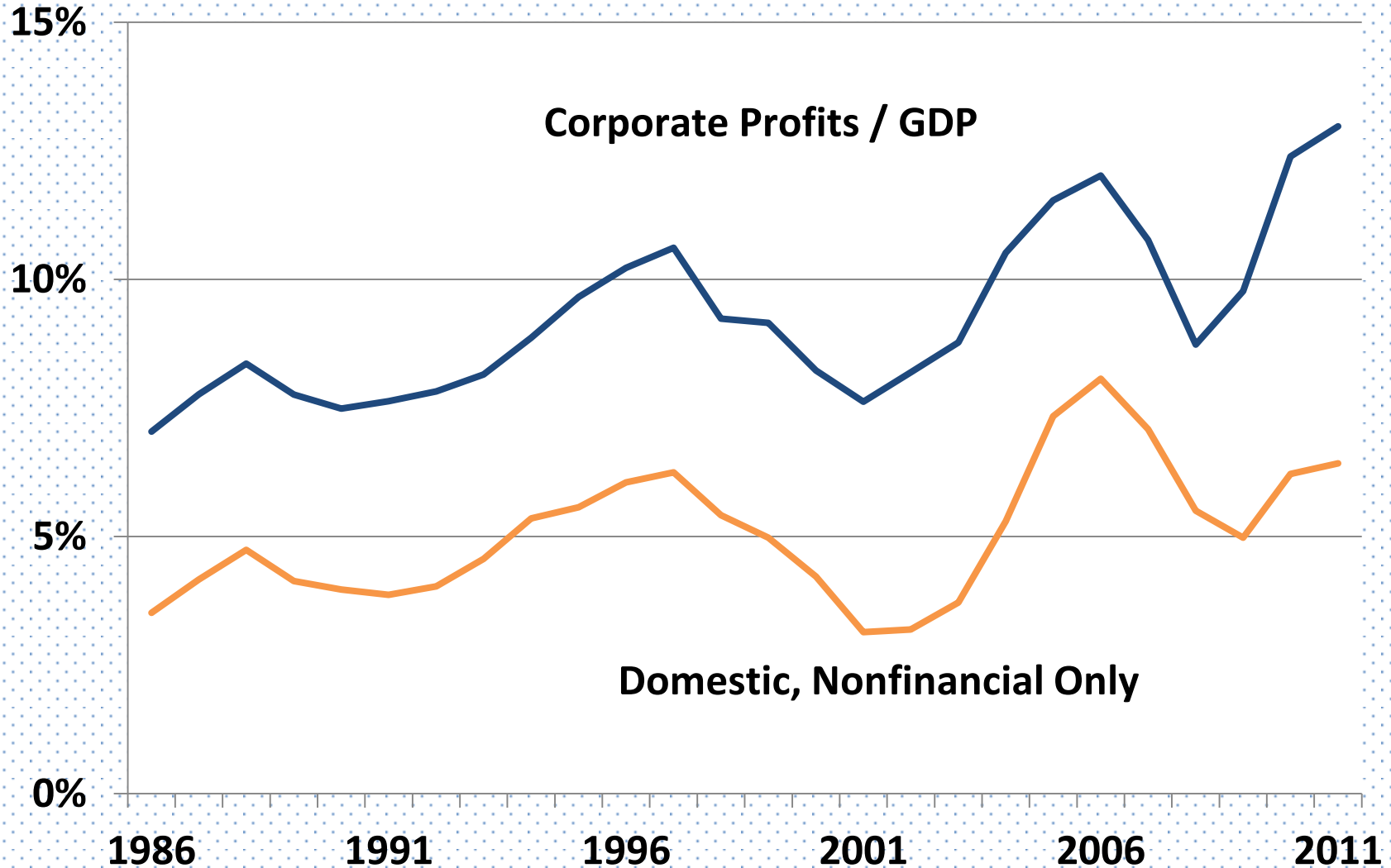


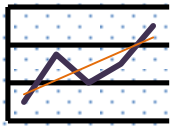
# Banks: Total Loans Up Slightly



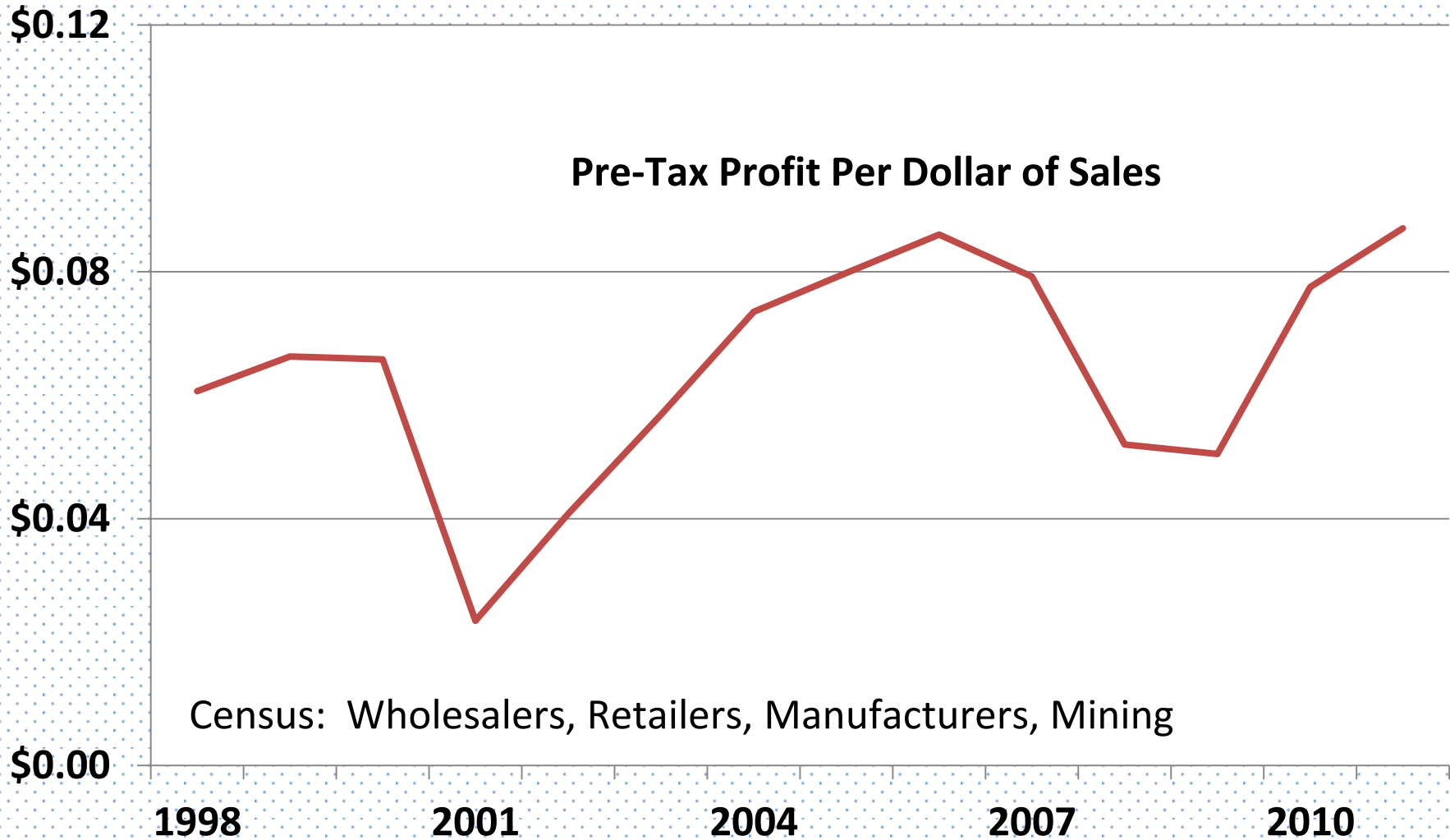


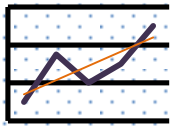
# Profits Are Strong



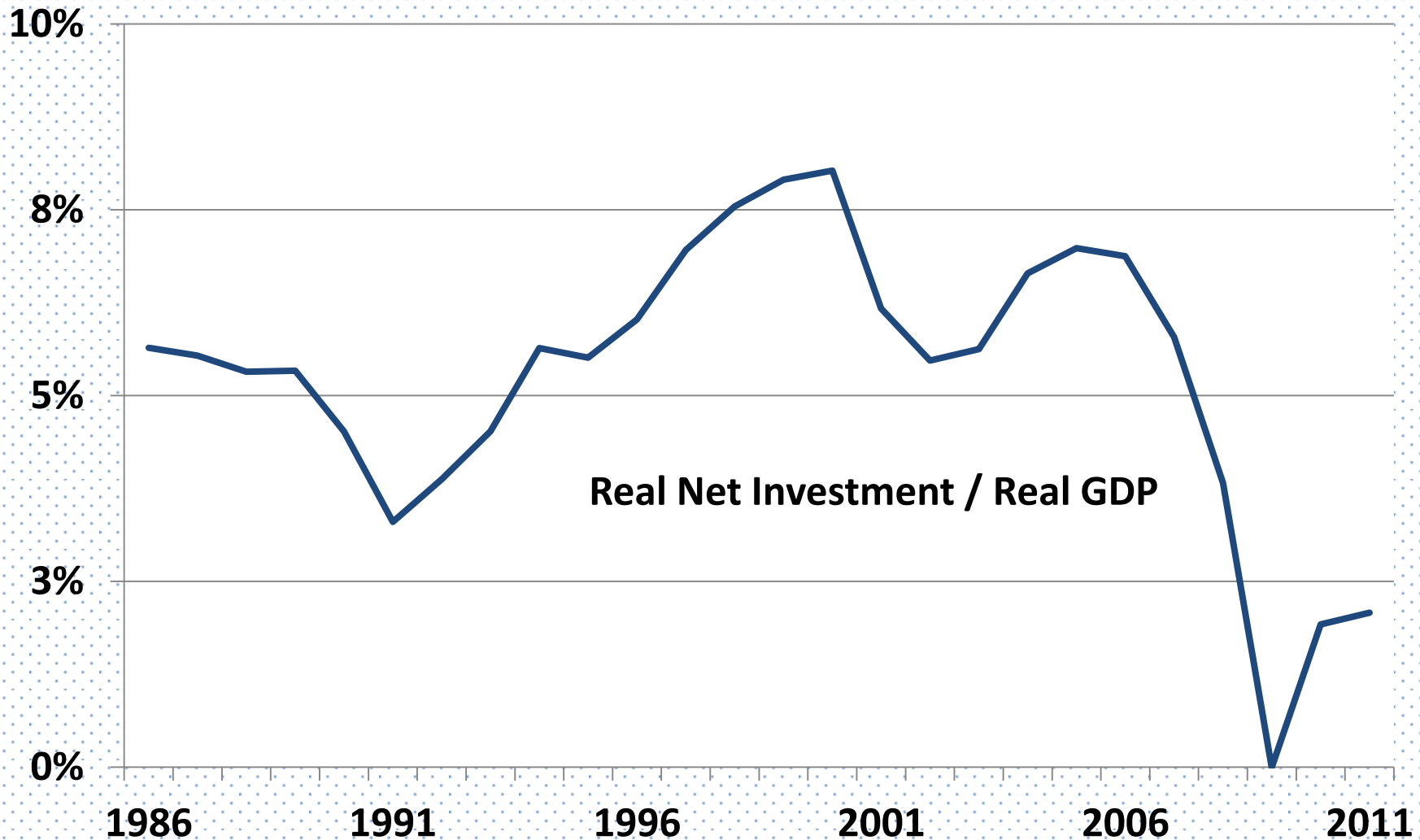


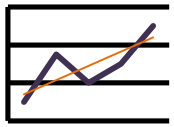
# Profits Margins at Historical Highs



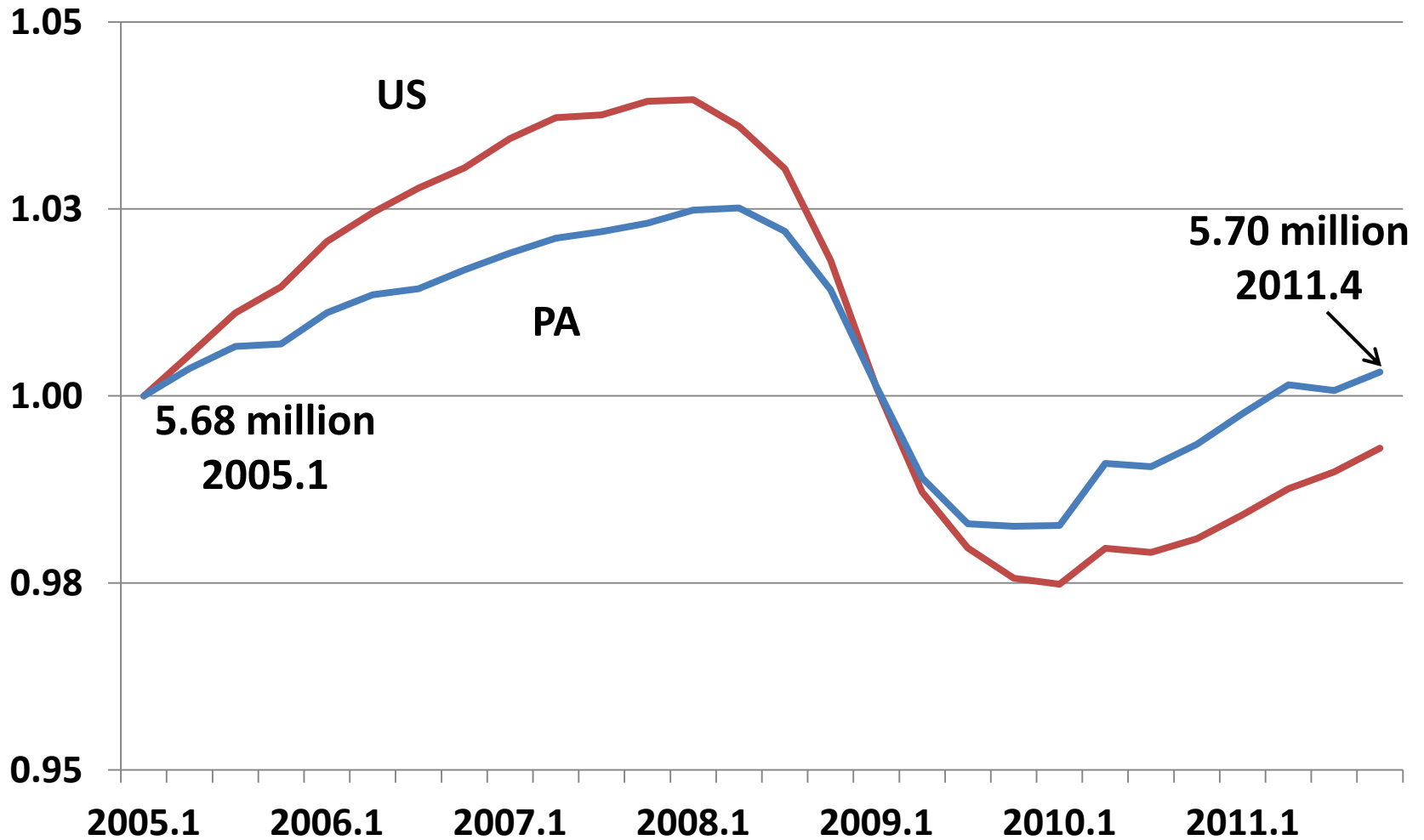


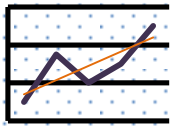
# Relative Net Investment Low





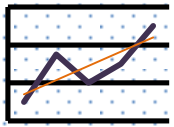
# PA Employment Returns to 2005 Q1 Level



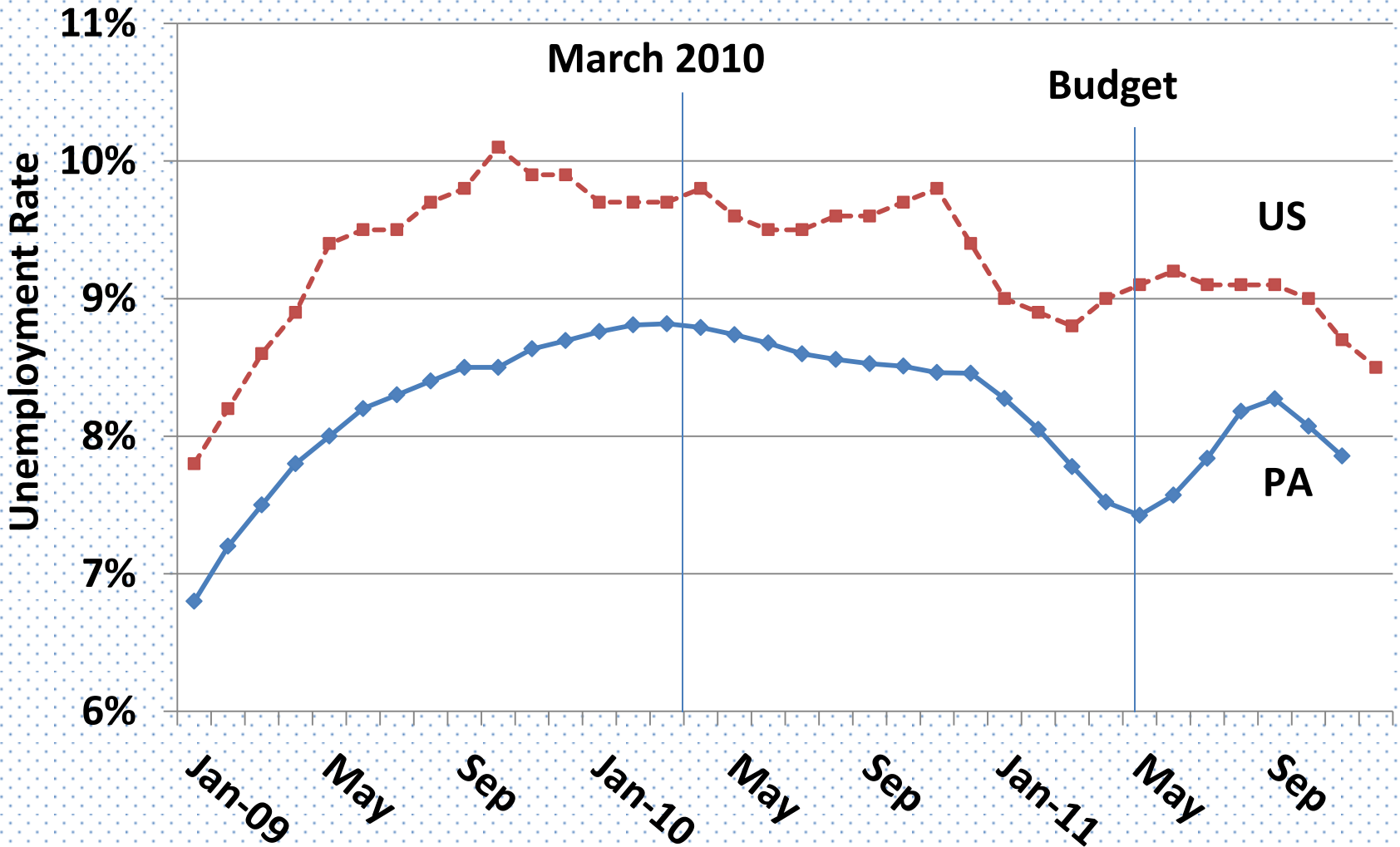


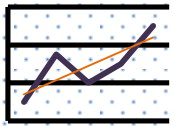
# Economic Forecast Weakens

			Annual Average Growth Rates or Levels				
			<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015-17</u>
Real Gross State Product							
	June 2011		2.5%	2.5%	2.6%	2.9%	2.2%
	January 2012		<u>1.8%</u>	<u>1.6%</u>	<u>2.4%</u>	<u>3.2%</u>	<u>2.3%</u>
	change		-0.7%	-0.9%	-0.2%	0.3%	0.2%
Payroll Employment (000s)							
	June 2011		5,717	5,828	5,903	5,975	6,100
	January 2012		<u>5,682</u>	<u>5,748</u>	<u>5,828</u>	<u>5,915</u>	<u>6,070</u>
	change		-35	-80	-75	-60	-31
Unemployment Rate							
	June 2011		7.5%	6.9%	6.5%	6.0%	5.0%
	January 2012		<u>7.9%</u>	<u>7.9%</u>	<u>7.8%</u>	<u>7.1%</u>	<u>5.8%</u>
	change		0.4%	1.0%	1.2%	1.2%	0.9%



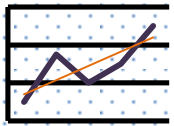
# Cause: Unexpected Labor Market Weakness





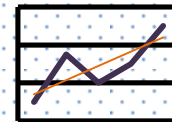
## Some Recent Encouraging Signs...

- US unemployment rate down to 8.5% in December.
- Consumer Confidence up sharply at end of year.
  - UM Index of Consumer Sentiment up 4th straight month.
  - Conference Board Consumer Confidence up 5th straight month. Gain from October to December largest since March 1991 (Gulf War jump).
- US Automakers have best year since 2008. Strong December.



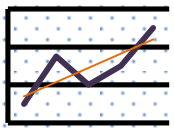
## Economic Outlook Summary

- Adjustment processes appear to be winding down.
  - Credit balances have stopped declining, increasing slowly.
  - Banks lending. Bad loans being flushed out.
  - Profits and Balance Sheets strong. Ready to expand.
- Consumer Sentiment/Confidence key. Base much of outlook on labor market reports, especially unemployment rate.
- For PA, state-local govt reductions appear to have abated for now.
- Some room for guarded optimism.



## Economic Outlook Summary

- Crucial short-term factors:
  - Potential for European debt crisis. Recent French downgrade. German economy contracts in 2011 Q4. Forecast assumes crisis averted, minor recession instead.
  - Extension of payroll tax cut. Economic forecast assumes full year extension.
  - Automatic spending cuts for 2013. Economic forecast assumes that does not occur as enacted.
- Under pessimistic scenario, US real GDP growth reduced from 2.0% to 0.2% for 2012. Unemployment rate back to 10% for 2013.

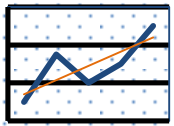


# Demographic Outlook

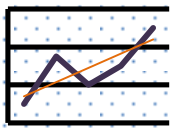
## Interim Population Projections

thousands of residents

Age Cohort	Levels		Share Total		Decade
	2010	2020	2010	2020	Growth
0 - 19 Years	3,179	3,124	25.0%	24.0%	-1.7%
20 - 39 Years	3,150	3,295	24.8%	25.3%	4.6%
40 - 54 Years	2,792	2,307	22.0%	17.7%	-17.4%
55 - 64 Years	1,622	1,824	12.8%	14.0%	12.4%
>= 65 Years	<u>1,959</u>	<u>2,450</u>	<u>15.4%</u>	<u>18.8%</u>	<b>25.0%</b>
<b>Total</b>	<b>12,702</b>	<b>13,000</b>	<b>100.0%</b>	<b>100.0%</b>	<b>2.3%</b>
Working Age	7,564	7,426	59.5%	57.1%	<b>-1.8%</b>



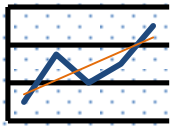
# The Revenue Outlook



# Economic Outlook - Pennsylvania

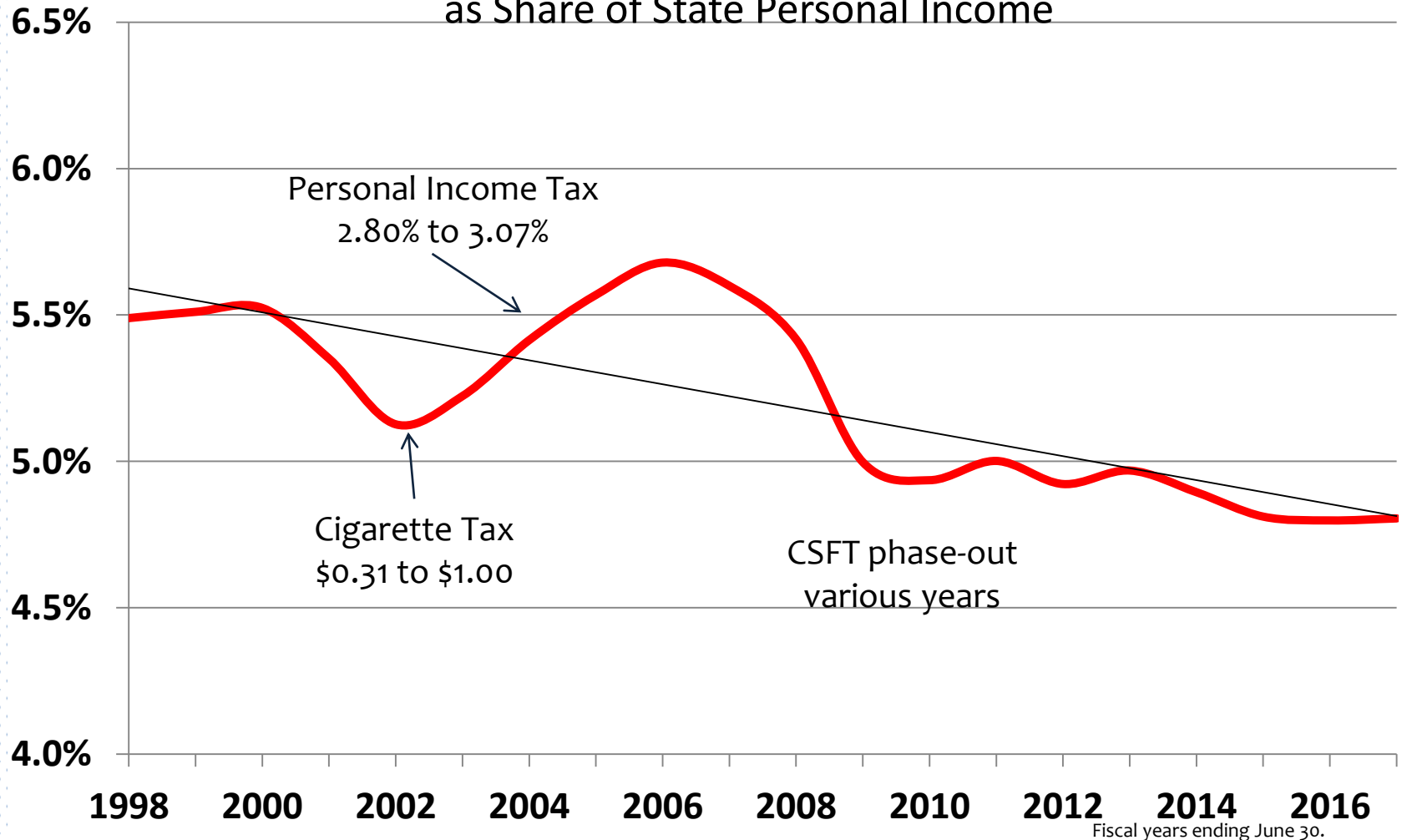
Economic Variable	2003- 2007	2008- 2010	2011- 2014	2015- 2017
Personal Income	4.5%	1.9%	2.6%	4.6%
Disp. Pers. Income	4.6%	2.8%	3.0%	4.4%
Wages	4.1%	1.2%	2.8%	4.3%
Employment	0.4%	-1.1%	0.9%	1.3%

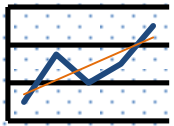
Average annual growth rates for the fiscal year ending June 30.



# General Fund Revenue Trend

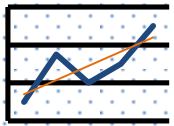
as Share of State Personal Income





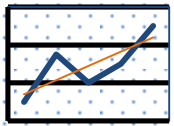
# Personal Income Tax

- Long-term – possible erosion of the tax base as working age population declines and the number of seniors increases.
- Short term – weaker than expected collections from employer withholding for the first half of the fiscal year.



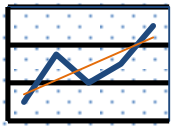
## Sales and Use Tax

- Long-term – gradual erosion of the tax base as consumption shifts to nontaxable goods and services. Increasing remote sales pose a challenge for revenue collection.
- Short-term – collections for the first six months of the fiscal year have displayed moderate growth, with motor vehicle sales showing particular strength.

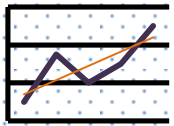


## Corporate Net Income Tax

- Actual year-to-date collections show a significant decline over the prior year.
- 100% bonus depreciation is likely having a significant impact on FY 2011-12 collections, but the effect should reverse for FY 2012-13.

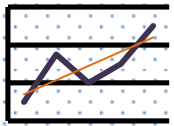


# The Expenditure Outlook



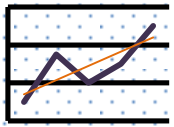
# Overview

- **State budgets for the upcoming FY are showing signs of slow economic recovery.**
- **Increases in (1) service populations, (2) costs to provide the services, and (3) service utilization are the biggest drivers of expenditures.**
- **Welfare, Education, Corrections, Pensions, & Debt Service comprise ~90% of total State GF budget**



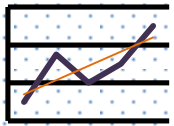
# Public Welfare

- **Comprises over 40% of total state GF budget**
  - Eligibility, cost, & utilization of services in MA program are the driving factors in growth of DPW expenditures
  - Over past decade, the “Big 5” MA expenditures have increased by \$2 billion or 65% FY 02/03, \$3.1 billion; FY 11/12 \$5.1 billion
- **Since Recession start: Nat’l MA enrollment increased by 8.8 million; Pa MA enrollment increased 165k**
  - Child enrollment
  - Federal policy changes



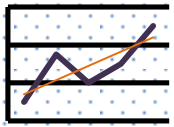
# Public Welfare

<u>Demographics and Populations</u>	<u>2011</u>	<u>Average Annual Growth Rates</u>			
		<u>2003-07</u>	<u>2008-10</u>	<u>2011-14</u>	<u>2015-17</u>
Age Cohort > 65	1,999,617	0.1%	1.1%	1.9%	2.4%
Medical Assistance Population	2,174,704	5.0%	3.2%	4.5%	4.1%
<u>General Fund Expenditures</u>					
Public Welfare	8,783	6.8%	-2.7%	8.0%	5.0%



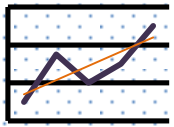
# Corrections

- **Correction budgets are the second fastest growing state expenditure next to Medicaid**
- **US total prison population decreased by 9,228 inmates by year end 2010**
  - **Collectively, US state prisons saw the biggest decrease of ~11k inmates, while federal prisons saw a slight increase**
- **During CY 2010, US prison releases exceeded prison admissions**



# PA Prison System

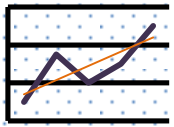
	1980	1990	2000	2010
# of Inmates	8,243	22,325	36,816	51,231
Cost per Inmate	\$11,447	\$18,269	\$28,762	\$32,986
Expenditures	\$94m	\$407m	\$1.17b	\$1.7b



# Corrections

## Average Annual Growth Rates

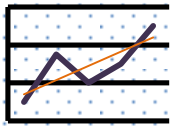
<u>Demographics and Populations</u>	<u>2011</u>	<u>2003-07</u>	<u>2008-10</u>	<u>2011-14</u>	<u>2015-17</u>
Inmate Population	51,467	2.8%	3.7%	1.6%	1.7%
<u>General Fund Expenditures</u>					
Corrections	1,629	3.7%	3.8%	6.9%	3.7%



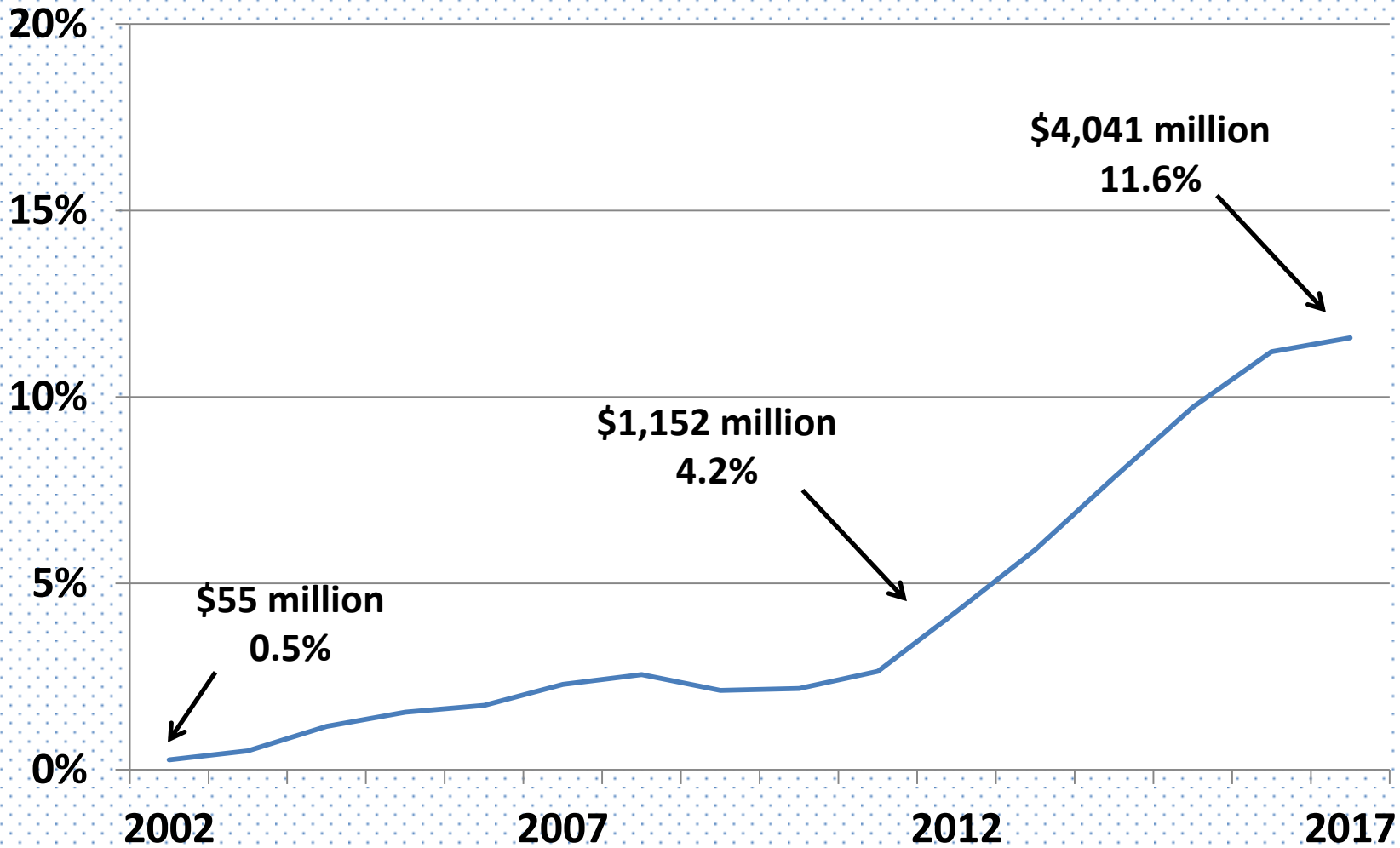
# Education

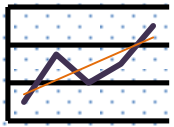
## Average Annual Growth Rates

<u>Demographics and Populations</u>	<u>2011</u>	<u>2003-07</u>	<u>2008-10</u>	<u>2011-14</u>	<u>2015-17</u>
Total Pupil Enrollment	2,053,732	-0.7%	-0.3%	-1.1%	1.2%
<u>General Fund Expenditures</u>					
Education	9,744	4.2%	0.5%	-1.0%	2.9%

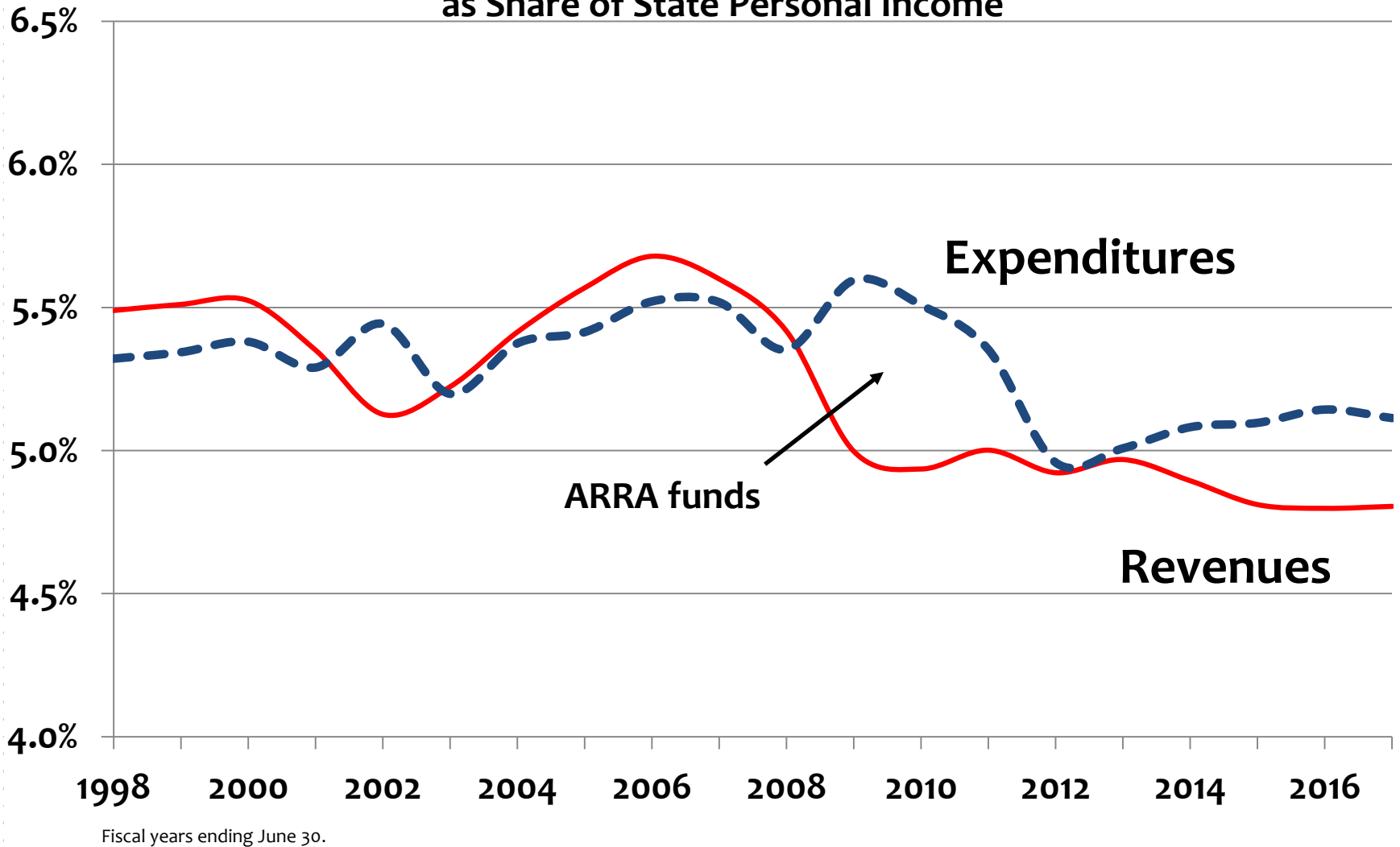


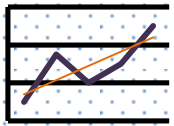
# Pension Contributions / Expenditures





# General Fund Revenues and Expenditures as Share of State Personal Income





## Conclusion

- Demographics suggest future budget pressures.
  - Elderly grow by 25% for 2010-20.
  - Working age population shrinks by -1.8% for 2010-20. Low total wage growth.
  - PA tax base contracts over long term.
- Pension obligations major driver of future expenditures.
- Uncertainty restrains short-run growth.
  - European debt crisis.
  - Federal fiscal policy.