

*Commonwealth of Pennsylvania*  
Initial Revenue Estimate

May 2, 2017



# The Big Picture

## ▶ The Economic Forecast.

- General weakness. All forecasts underperform.
- An exception: PA labor market posts solid gains.
- Recent U.S. data confirm weak PA trends: 2017 Q1 Real GDP +0.7% growth, +0.3% consumer spending.

## ▶ The Revenue Forecast.

- All forecasts except tobacco and IPT underperform.
- Base growth rate for FYTD is negative (-1.0%).
- Net revenue gains from transfers / tax law changes.

# Change to PA Economic Forecast

		Growth Rates or Change		
		2016	2017	2018
<b>Real PA GDP</b>	June 2016	1.9%	2.0%	n.a.
	May 2017	0.6%	1.8%	1.9%
<b>Philly CPI-U</b>	June 2016	1.0%	1.6%	n.a.
	May 2017	0.6%	2.0%	2.0%
<b>Wages-Salaries</b>	June 2016	3.2%	3.7%	n.a.
	May 2017	2.8%	3.5%	3.8%
<b>Job Gains (000s)</b>	June 2016	50.1	50.6	n.a.
	May 2017	52.2	55.7	54.1

# Change in Payroll Employment (000s)

	2015	2016	2017
Mining-Logging	-3.8	-9.0	-1.4
Construction	6.5	3.7	7.5
Manufacturing	0.0	-9.3	-2.1
Wholesale-Retail	1.0	-2.7	0.3
Transportation	11.2	9.0	6.2
Professional Services	18.0	14.4	13.2
Health-Social	11.2	23.7	18.7
Leisure-Hospitality	7.5	13.1	9.6
Local Gov't	-6.8	-0.9	-0.7
State-Federal Gov't	0.3	0.9	0.1
All Other	1.5	9.3	4.4
<b>Annual Job Gains</b>	<b>46.7</b>	<b>52.2</b>	<b>55.7</b>

Note: Professional Services includes the Management and Administrative sectors.  
 Source: U.S. Bureau of Labor Statistics.

# Recent Economic Trends

	2016.1	2016.2	2016.3	2016.4	2017.1
PA Real GDP	0.2%	0.1%	0.2%	n.a.	n.a.
PA Wages-Salaries	1.8%	2.8%	4.0%	2.8%	3.2%
PA Job Gains (000s)	53.4	41.3	52.8	61.2	70.4
Philly CPI-U	0.3%	0.4%	0.4%	1.5%	2.1%
PA Home Price Index	2.2%	3.1%	3.8%	3.6%	n.a.
Mid-Atlantic Gasoline	-18.0%	-15.1%	-13.0%	6.1%	25.8%
U.S. Domestic Profits	-8.3%	-7.7%	0.3%	8.0%	n.a.
S&P 500	-5.6%	-1.3%	6.7%	6.4%	19.3%

Note: All growth rates are year-over-year. Wage growth for 2017 Q1 is an estimate by IFO based on withholding tax revenues. Corporate domestic profits exclude the Federal Reserve. Home price index represents increase in average market value of existing homes.  
 Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Energy Information Administration, Federal Housing Finance Agency.

# Historical Growth Rates

	2012	2013	2014	2015	2016	2017
PA Real GDP	1.6%	1.9%	1.8%	2.8%	0.6%	1.8%
PA Wages-Salaries	3.7%	1.8%	3.9%	4.0%	2.8%	3.5%
PA Job Gains (000s)	39.9	14.3	47.4	46.7	52.2	55.7
Philly CPI-U	1.8%	1.2%	1.3%	-0.1%	0.6%	2.0%
PA Home Price Index	-0.8%	1.0%	1.9%	2.9%	3.2%	3.8%
Mid-Atlantic Gasoline	3.6%	-3.4%	-3.4%	-29.2%	-10.5%	23.0%
U.S. Domestic Profits	15.0%	1.7%	6.2%	-2.2%	-2.2%	n.a.
S&P 500	8.7%	19.1%	17.5%	6.8%	1.5%	17.9%

Note: Growth rates for 2017 for gasoline and S&P 500 based on data for January through April. Other growth rates are projections.

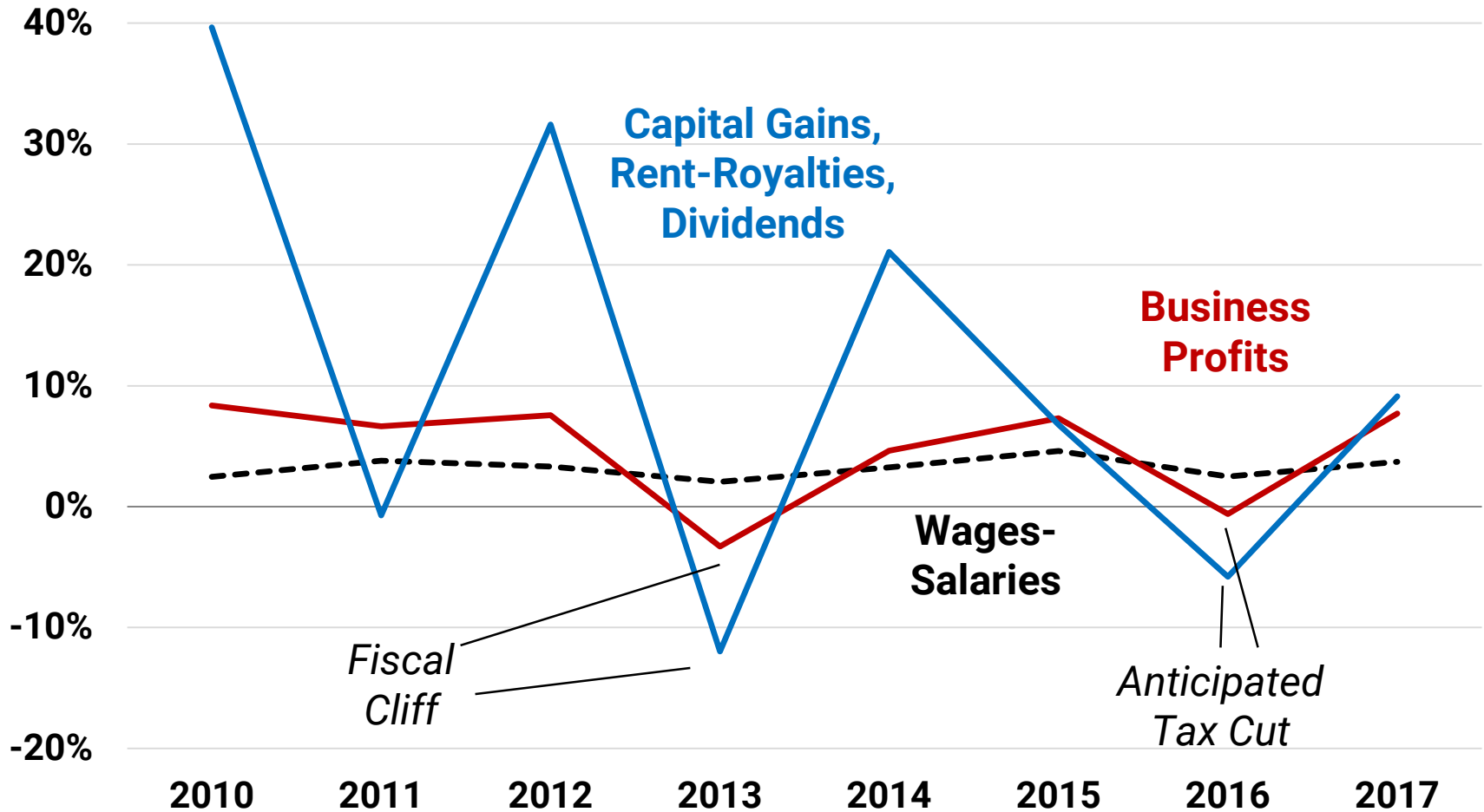
Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Energy Information Administration, Federal Housing Finance Agency.

# Factors That Restrain Revenues

- ▶ **Economic factors all have negative impact.**
  - Wage growth underperforms despite strong labor market.
  - Business investment disappoints, but picking up.
  - Natural gas prices collapsed; lower royalty payments.
- ▶ **Technical factors work in same direction.**
  - Income growth does not translate into spending growth.
  - Recent demographic trends do not reverse.
    - Net out migration continues.
    - Lack of population growth.
  - Data suggest material income shifting from 2016 to 2017.

# Income Reported on PA Returns

## Annual Growth Rates, Personal Income Tax





# Revenue Forecast

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# Actual Revenues Through April

	April 2016	April 2017	Dollar Change	Annual Growth	Base Growth <sup>1</sup>
<b>General Fund</b>	<b>\$25,897</b>	<b>\$25,823</b>	<b>-\$73</b>	<b>-0.3%</b>	<b>-1.0%</b>
Corp. Net Income	2,254	1,929	-325	-14.4%	-5.1%
Gross Receipts	1,293	1,210	-83	-6.4%	-5.5%
Sales and Use	8,086	8,188	102	1.3%	0.8%
PIT - Withholding	7,847	8,001	155	2.0%	3.3%
PIT - Other	2,627	2,531	-96	-3.7%	-4.0%
All Tobacco	749	1,099	350	46.7%	-5.3%
All Other Tax	2,467	2,312	-154	-6.3%	-4.0%
All Non-Tax	574	554	-21	-3.6%	-25.3%

Note: Dollar amounts are in millions. PIT is personal income tax.

<sup>1</sup> Base growth rate controls for (1) changes in tax law that impact revenues, (2) an extra withholding day last fiscal year and (3) one-time transfers.

# Actual Revenues vs. IFO Estimate

	FY 2016-17 (through April)		
	Actual	Estimate	Difference
<b>General Fund</b>	<b>\$25,823</b>	<b>\$26,514</b>	<b>-\$691</b>
Corp. Net Income	1,929	1,932	-3
Gross Receipts	1,210	1,237	-27
Sales and Use	8,188	8,472	-285
PIT - Withholding	8,001	8,048	-47
PIT - Other	2,531	2,801	-270
All Tobacco	1,099	1,083	16
All Other Tax	2,312	2,387	-74
All Non-Tax	554	554	0

Note: Dollar amounts are in millions. PIT is personal income tax.

# Revision to FY 2016-17 Estimate

**Net Revision = -\$695 million**

Gains		Losses	
Capital Stock & Fran.	\$25	Corp. Net Income	-\$159
Insurance Premiums	\$20	Other Corporate	-\$68
All Tobacco	\$28	Sales and Use	-\$290
Liquor Store Profits	\$75	PIT - Withholding	-\$62
Transfers	\$169	PIT - Other	-\$297
		All Other	-\$136
<b>Subtotal</b>	<b>\$317</b>	<b>Subtotal</b>	<b>-\$1,013</b>

Note: Dollar amounts are in millions. PIT is personal income tax.

# FY 2016-17 Estimate Reconciliation

	Amount
<b>Revision to IFO's July 2016 full-year estimate</b>	<b>-\$695</b>
Less: Difference between IFO and DOR official	<u>\$266</u>
<b>IFO full-year shortfall compared to DOR official</b>	<b>-\$961</b>
Less: May/June gain; timing issues (IFO estimate)	\$90
Less: Expected June transfer from the WCF	<u>\$165</u>
<b>DOR fiscal year-to-date shortfall through April</b>	<b>-\$1,216</b>

Note: Dollar amounts are in millions. The May/June gain and expected June transfer are included in the IFO full-year shortfall but are not reflected in the DOR fiscal year-to-date shortfall through April.

# Notes on FY 2016-17 Revision

- ▶ **U.S. corp. profits decline in 2015 and 2016.**
  - Has not occurred outside recession for several decades.
  - Energy sector hit hard. Widespread declines in 2016.
- ▶ **Taxable consumer spending very weak.**
  - Base non-motor SUT growth is +0.1% Jan-April 2017.
  - Much lower than income growth (~+3.0% to +3.5%).
- ▶ **Probable income shifting from 2016 to 2017.**
  - Net business profits and capital gains.
  - PA April final payments down from last year (-4%).
  - U.S. April final payments also down (-5% to -7%).

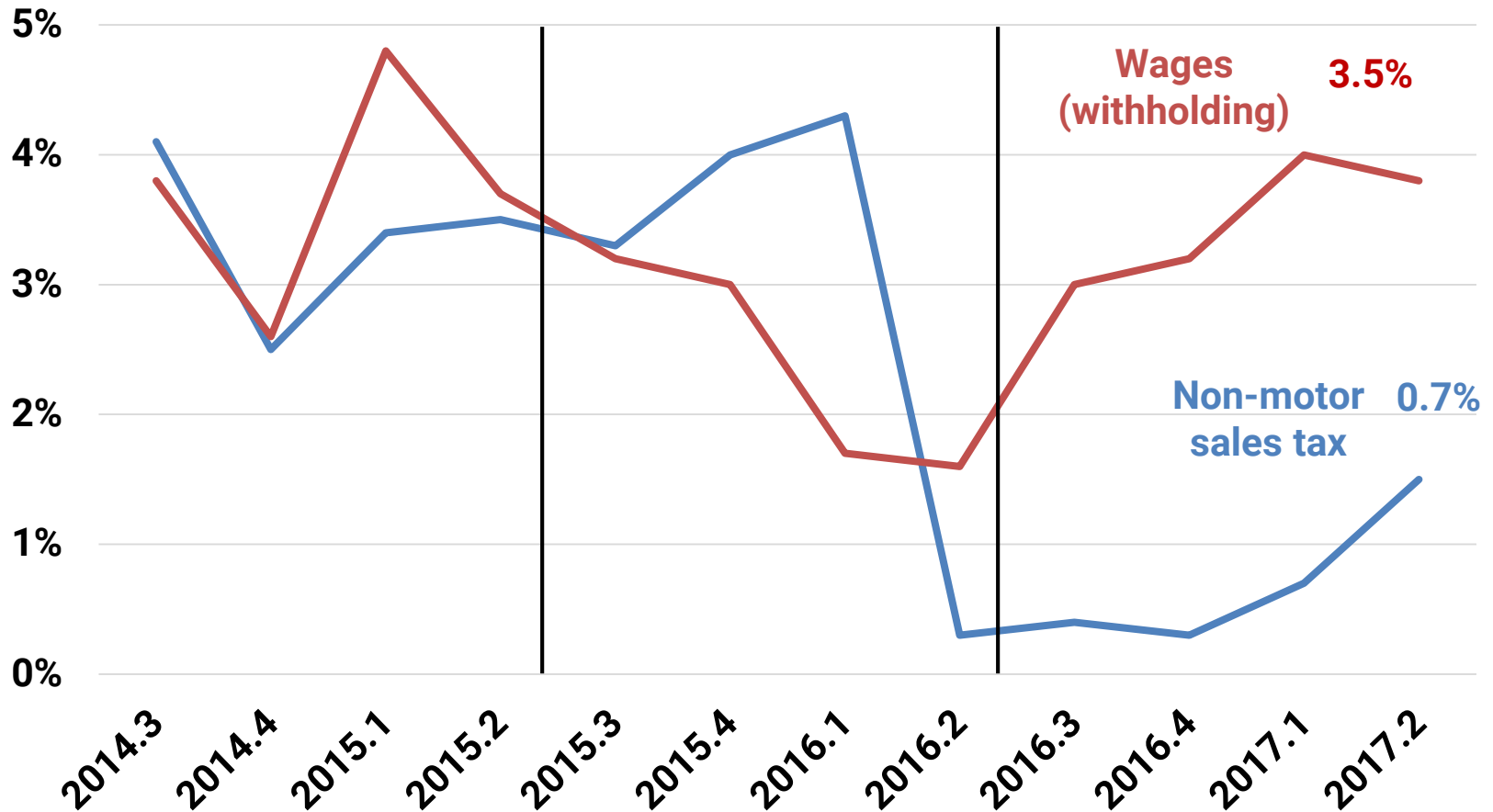
# U.S. Corporate Profits Decline Again

	Annual Growth Rate			
	2013	2014	2015	2016
<b>U.S. Domestic Profits</b>	<b>2.4%</b>	<b>6.1%</b>	<b>-2.6%</b>	<b>-1.5%</b>
Financials	-14.1	7.7	4.2	3.1
Non-Financials	7.4	4.3	-4.5	-3.7
Manufacturing	8.6	4.7	-8.2	-7.2
Petroleum-Coal	-4.6	4.7	-87.1	***
Wholesale Trade	5.5	2.7	2.4	-12.3
Retail Trade	0.3	8.6	6.5	4.7
Transport-Storage	-5.9	17.4	14.6	-7.0
Information	24.7	-6.4	2.3	10.7
Exclude Petroleum-Coal	7.9	3.8	-1.0	-2.1

Source: U.S. Bureau of Economic Analysis, NIPA Table 6.16D. Financials excludes Federal Reserve.

# Income vs. Spending Trends

## Year-Over-Year Growth Rates



Note: Sales tax growth rate controls for tax law changes and transfers. Data are lagged one month to coincide with withholding. Withholding growth rate controls for any extra deposit days in quarter.



# Initial Revenue Estimate FY 2017-18

	2016-17		2017-18	
	Amount	Growth	Amount	Growth
<b>General Fund</b>	<b>\$31,815</b>	<b>3.0%</b>	<b>\$32,447</b>	<b>2.0%</b>
Corp. Net Income	2,786	-2.0%	2,884	3.5%
Gross Receipts	1,228	-5.9%	1,251	1.9%
Sales and Use	9,950	1.6%	10,205	2.6%
PIT – Withholding	9,618	2.4%	9,954	3.5%
PIT – Other	3,078	-1.2%	3,354	8.9%
All Tobacco	1,360	49.2%	1,364	0.3%
All Other Tax	2,755	-4.9%	2,775	0.7%
All Non-Tax	1,040	61.6%	660	-36.5%

Note: Dollar amounts are in millions. PIT is personal income tax.

# Factors That Affect FY 2017-18 Growth

	Amount	Growth
<b>Underlying Base Estimate</b>	<b>\$32,969</b>	<b>3.6%</b>
Annualize P/Y Tax Law Change	76	
Slots License Fee	50	
Philadelphia Cigarette Transfer	-10	
Capital Stock & Fran. Phase-Out	-25	
Liquor Store Profits	-32	
Credits and Settlements	-40	
Tax Amnesty	-110	
Special Fund Transfers	-431	
<b>Final Estimate</b>	<b>\$32,447</b>	<b>2.0%</b>

Note: Dollar amounts are in millions.

# General Fund Revenue Comparison

	2016-17	2017-18
<b>IFO (May 2017)</b>	<b>\$31,815</b>	<b>\$32,447</b>
Growth Rate	3.0%	2.0%
<b>Executive Budget (Feb 2017)<sup>1</sup></b>	<b>\$32,302</b>	<b>\$32,619</b>
Growth Rate	4.5%	1.0%
Dollar Difference	<b>-\$487</b>	<b>-\$172</b>
<b>Two-Year Total</b>		<b>-\$658</b>

Note: Dollar amounts are in millions. The FY 2016-17 IFO forecast is \$961 million below the administration's official estimate issued in July 2016.

<sup>1</sup> FY 2017-18 Executive Budget, General Fund Financial Statement, p. C1.5. Excludes revenue proposals.

# Lottery Sales Turn Negative

	12-13	13-14	14-15	15-16	16-17
<b>Gross Ticket Sales</b>	<b>\$3,700</b>	<b>\$3,800</b>	<b>\$3,820</b>	<b>\$4,135</b>	<b>\$4,005</b>
Instant Tickets	2,305	2,445	2,592	2,793	2,805
Numbers Games	631	611	597	581	595
In-State Lotto	279	296	250	265	248
Multi-State Lotto	485	447	381	497	357
<b>Growth Rates</b>	<b>6.3%</b>	<b>2.7%</b>	<b>0.5%</b>	<b>8.3%</b>	<b>-3.2%</b>
Instant Tickets	8.0%	6.1%	6.0%	7.8%	0.4%
Numbers Games	-2.3%	-3.1%	-2.4%	-2.6%	2.4%
In-State Lotto	2.8%	6.2%	-15.4%	0.2%	-6.5%
Multi-State Lotto	13.0%	-7.7%	-14.8%	30.3%	-28.1%

Note: Dollar amounts are in millions. In-State Lotto includes Raffle.

# Recapitulation

- ▶ **PA economic forecast slightly weaker.**
  - Job market as expected. Wages somewhat weaker.
  - Housing underperforms slightly, but picking up.
  - Corporate profits notably weaker. Non-corporate too.
- ▶ **Other factors contribute to shortfall.**
  - An income-spending disconnect. May be related to low business profits. Consumer confidence remains high.
  - Income shifting very likely from 2016 to 2017.
- ▶ **Mixed signals for tax year 2017.**
  - First PIT estimated payment very weak (-5%).
  - March-April CNIT estimated payments up +13%.

# Questions / Discussion

Updated Estimate Mid-June

Presentation to be  
Posted at IFO website

[www.ifo.state.pa.us](http://www.ifo.state.pa.us)