

Pennsylvania Institute of CPAs

**Matthew Knittel
Independent Fiscal Office
September 24, 2013**

Today's Presentation

- Economic Outlook: Has it improved since spring?
 - Short Answer: No.
 - Economy has absorbed some hits.
 - A few more to come.

- Tax Revenues.
 - Best real-time indicator of PA economic conditions.

- Upcoming Studies.
 - HB 76 and SB 76.
 - Five-Year Outlook.

PA Economic Outlook Weakens



annual growth rate or levels

	<u>2012</u>	<u>2013</u>	<u>2014</u>
Wages and Salaries			
Dec 2012 Forecast	3.4%	3.2%	4.0%
May 2013 Forecast	3.0%	2.8%	4.1%
Sept 2013 Forecast	3.0%	1.7%	3.9%
Job Gains (000s)			
Dec 2012 Forecast	34	68	79
May 2013 Forecast	44	32	67
Sept 2013 Forecast	44	25	68

Source: IHS Global Insight.

The Elusive Recovery

- Recovery never takes off.
 - Previously, consumers were retrenching.
 - Paying down debt: deleveraging.

- Now, other factors responsible.
 - Government tightening.
 - Firms not investing due to uncertainty; weak demand.

- Federal and state gov'ts unlikely to contribute.
 - Federal – debt ceiling debate, continuing sequester.
 - State and Local – pensions and health care benefits.
 - Monetary Policy - pull back to start soon.

Contributions to U.S. Real Growth

	<u>2012</u>	<u>2013</u>	<u>2014</u>
Real Economic Growth	2.8%	1.6%	2.6%
1 Consumer Purchases	1.5%	1.3%	1.7%
2 Investment	1.4%	0.7%	1.2%
a Non-Residential	1.1%	0.3%	0.6%
b Residential	0.3%	0.4%	0.5%
3 Net Exports	0.1%	0.1%	-0.4%
4 Government	-0.2%	-0.4%	0.0%
a Federal	-0.1%	-0.4%	0.0%
b State-Local	-0.1%	-0.1%	0.0%

Source: IHS Global Insight and U.S. Bureau of Economic Analysis.

Headwinds - Federal Policy

- Expiration of Payroll Tax Cut and the Sequester.
 - \$5.3 billion reduction in 2013 PA Disposable Income.
 - Spending Sequester - \$85 billion for FFY 2013 (US total).

- Debt Ceiling debate – possibility of gov't shut down.
 - Temporary hit to financial markets.
 - More lasting hit to consumer confidence.

- Monetary Policy – start of the Fed “taper”?
 - In June, Fed says taper would start soon and end when unemployment rate at roughly 7% (mid-2014).
 - But unemployment rate is falling for wrong reasons.

Federal Reserve

- Current Policy: QE3.
 - Sept 2012: Commits to purchase \$85 billion of securities per month.
 - Hold down long-term interest rates such as mortgages.
 - Really: induce some inflation.

- Fed likely to “taper” or reduce purchases during next few months.
 - Long term: big issue is how the Fed will manage the sale of the assets it holds in its portfolio.
 - How will that impact interest rates?

Federal Reserve Balance Sheet

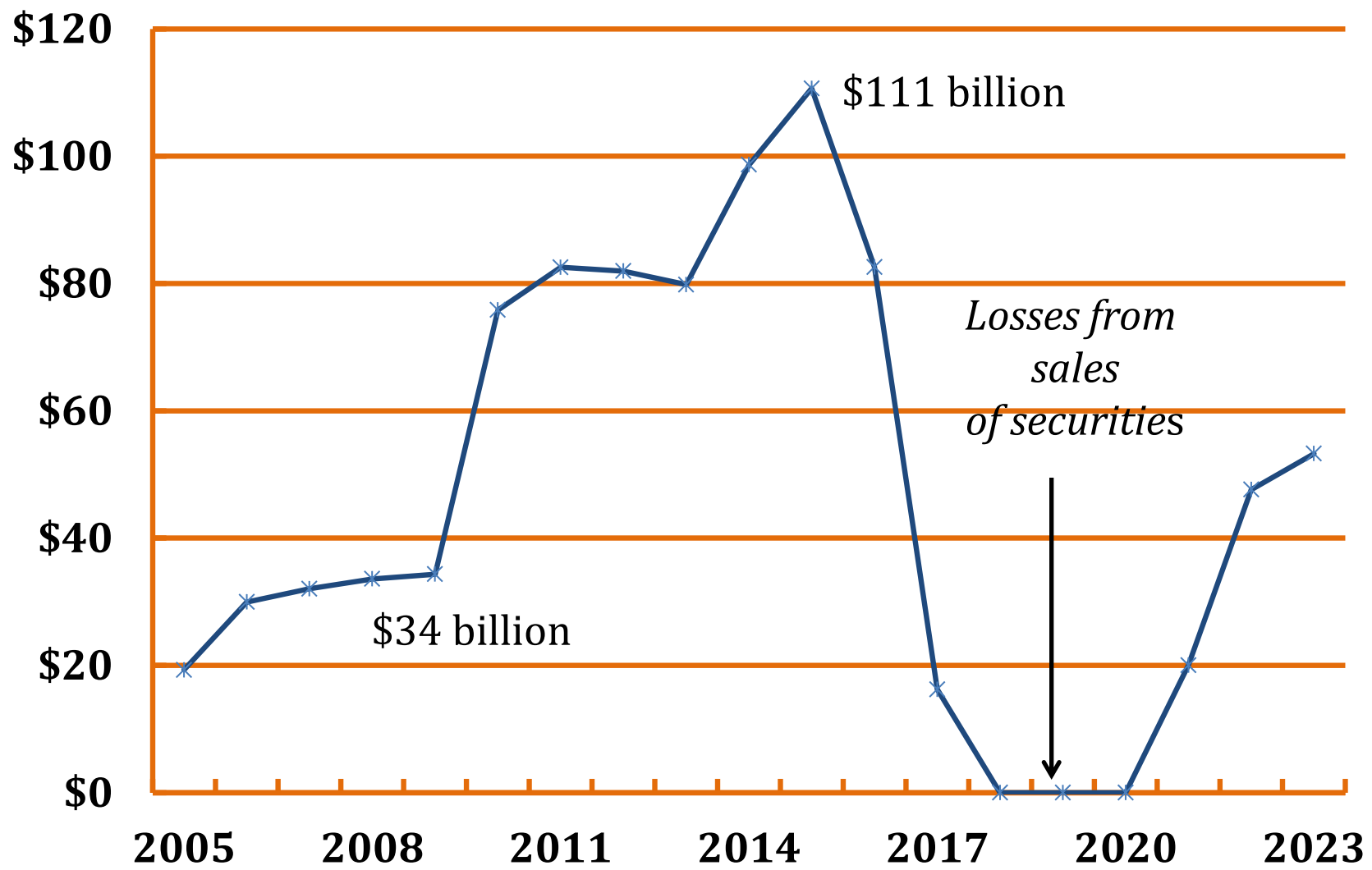
billions of dollars

	Sept <u>2007</u>	Sept <u>2010</u>	Sept <u>2013</u>
US Treasury Securities	\$780	\$809	\$2,048
Federal Agency Debt	\$0	\$154	\$64
Mortgage Backed Securities	\$0	\$1,086	\$1,337
All Other	<u>\$119</u>	<u>\$298</u>	<u>\$309</u>
Total Assets	\$898	\$2,347	\$3,758
Currency in Circulation	\$810	\$952	\$1,205
All Other	\$75	\$400	\$259
Reserve Balances	<u>\$13</u>	<u>\$995</u>	<u>\$2,293</u>
Total Liabilities	\$898	\$2,347	\$3,758

Source: Federal Reserve Board, Factors Affecting Reserve Balances, Table H.4.1

CBO Forecast of Federal Reserve Earnings IFO

billions of dollars



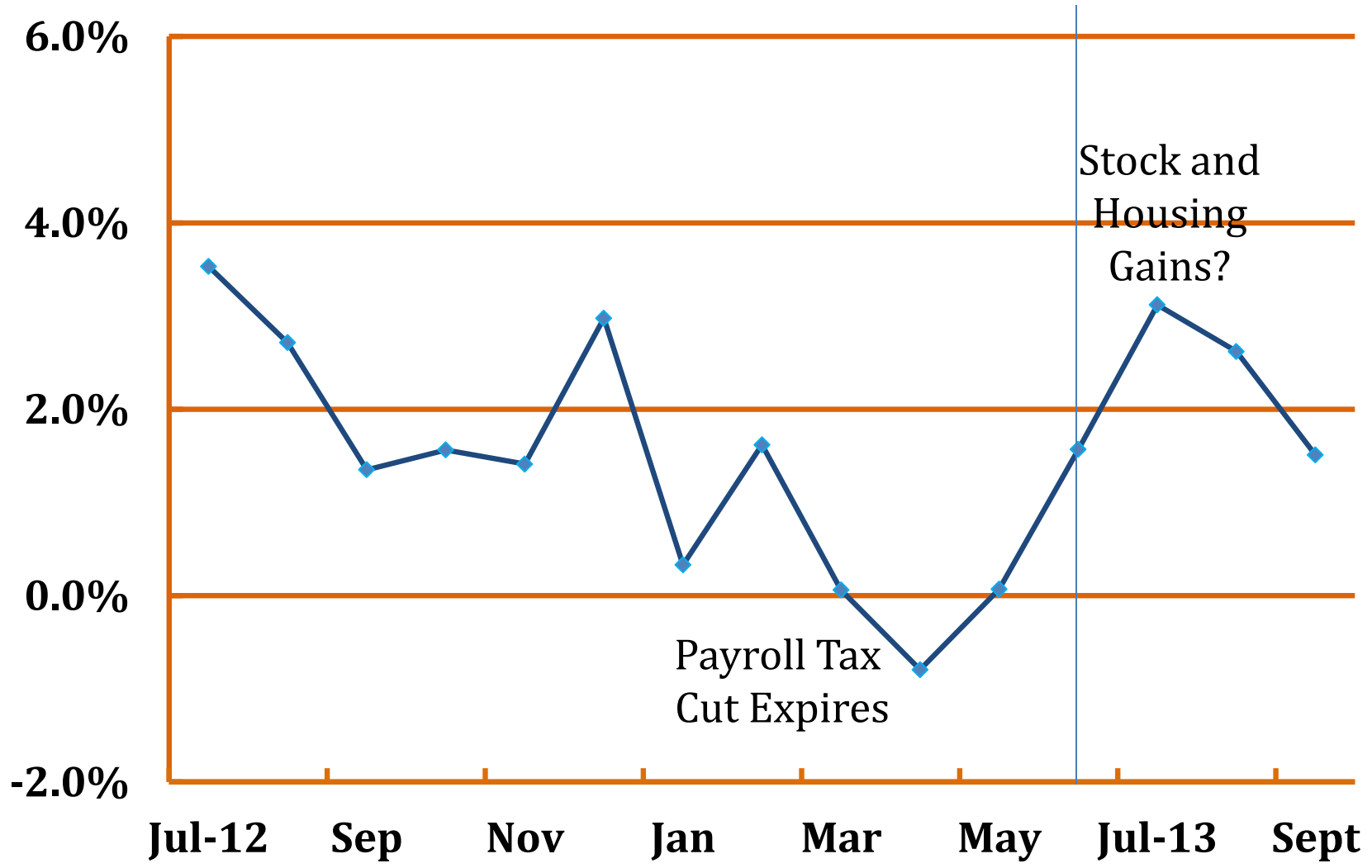
How Are Revenues?

- Revenues best indicator of PA economy.
- Often a disconnect between economic forecast and real time revenue data.
- Look at data from first quarter of FY 2013-14.

Are PA Consumers Spending?

- Sales Taxes nearly one-third of General Fund.
- Non-Motor Sales Tax collections remain weak.
 - For first quarter of FY 2013-14, revenues up 1.5%.
 - Inflation is approximately 1.5%.
- But, Motor Vehicle Sales Tax up roughly 7.0%.
 - Nationally, sales up roughly 10%.
 - Some pent-up demand effects (temporary).
 - Low interest rates.
 - Looser credit conditions.

Non-Motor Sales Tax: 3-Month Moving Avg. annual growth rate



U.S. Consumer Spending

year over year growth

Thru June
2012 vs 2013

Total, Excluding Autos	2.8%
Furniture & Electronics	1.2%
Building & Garden Equipment	5.4%
Food and Beverage	2.5%
Health & Personal	0.2%
Gasoline Stations	-0.1%
Clothing	2.4%
General Merchandise	0.3%
Non-Store (e-commerce)	10.5%
Food Services	3.9%

Source: U.S. Department of Commerce, Monthly Retail Trade Survey.

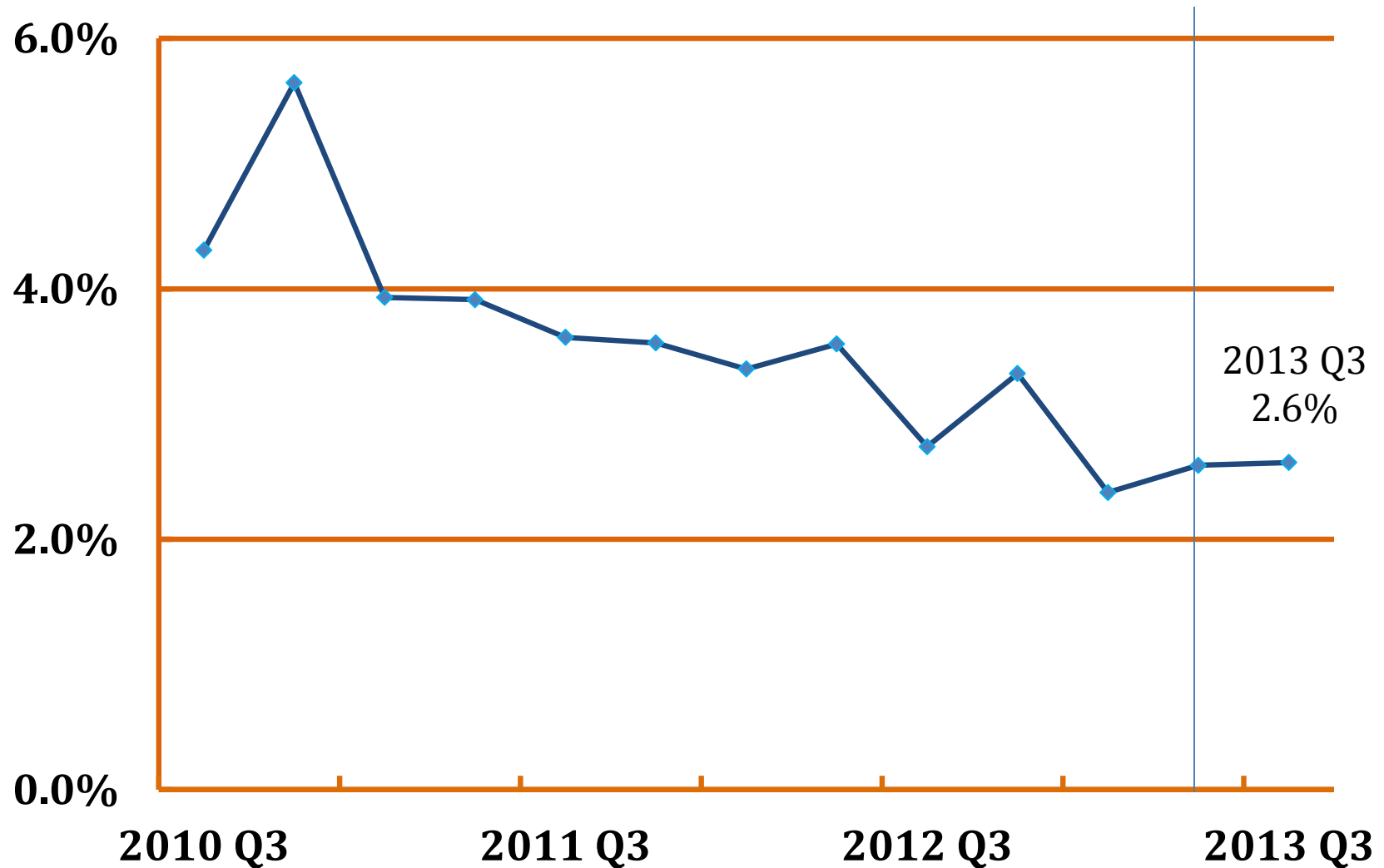
Are PA Firms Hiring?

- Wage withholding comprises nearly one-third General Fund revenues.

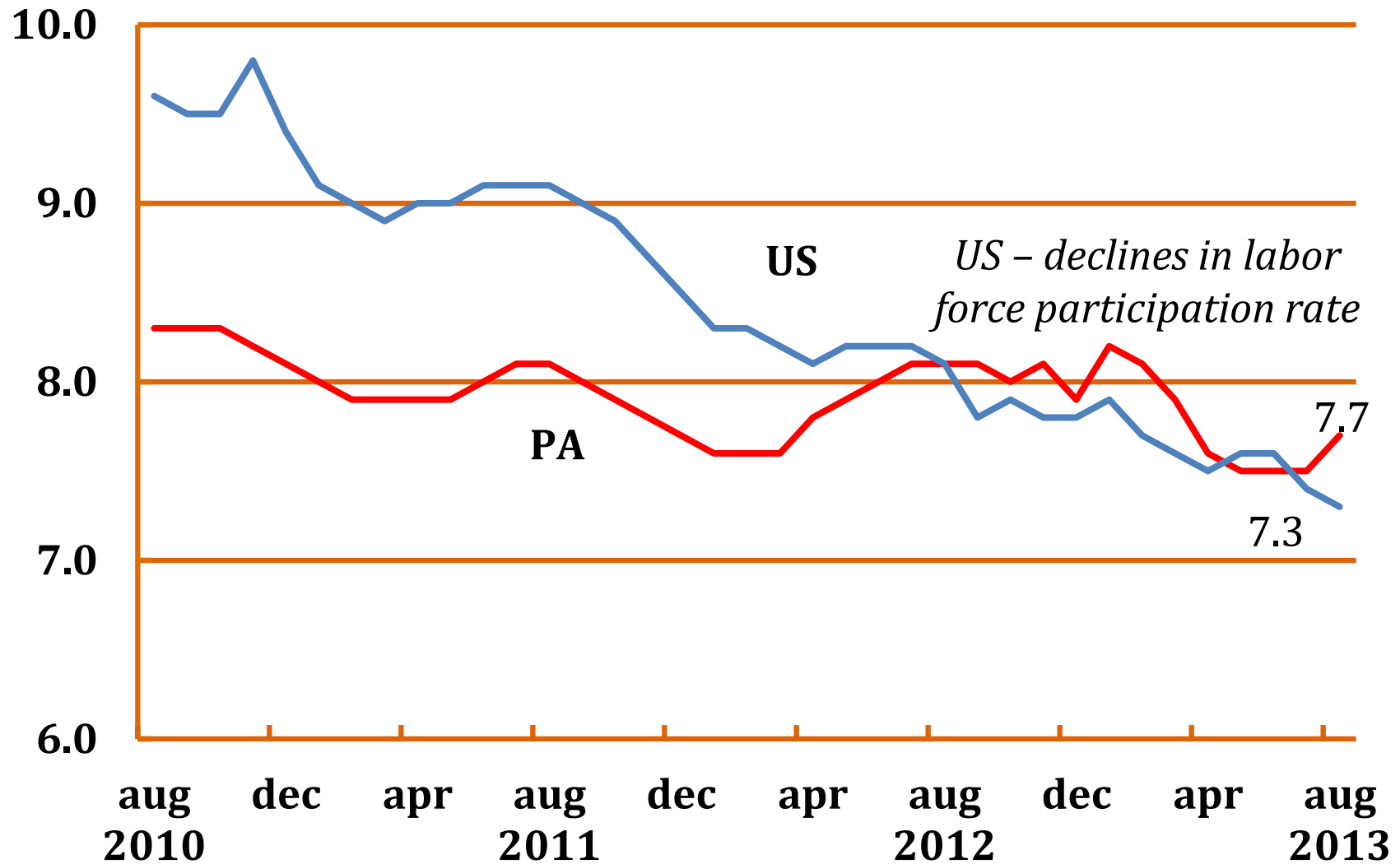
- Growth in withholding will reflect two factors:
 - Increase in number of jobs.
 - Any wage and salary growth due to raises or inflationary adjustments.
 - Gains very modest.
 - Consistent with weak hiring.

Withholding Tax Revenues

year-over-year growth rate



Monthly Unemployment Rates



PA Job Gains and Losses Since Recession

thousands

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>Net</u>
All Jobs	-184	7	65	44	25	-45
Health / Social Assist	14	11	15	16	15	70
Prof / Management	-10	1	12	13	11	26
Leisure / Hospitality	-13	7	13	14	6	26
Manufacturing	-70	-14	5	2	1	-75
Information / Financial	-18	-14	-4	0	0	-35
State-Local Gov't	7	-2	-14	-17	-4	-31
Construction	-30	-9	7	3	0	-29
Wholesale-Retail	-37	-2	7	6	-4	-29
Federal Gov't	1	4	-7	-2	-4	-8
All Other	-29	24	32	9	4	41

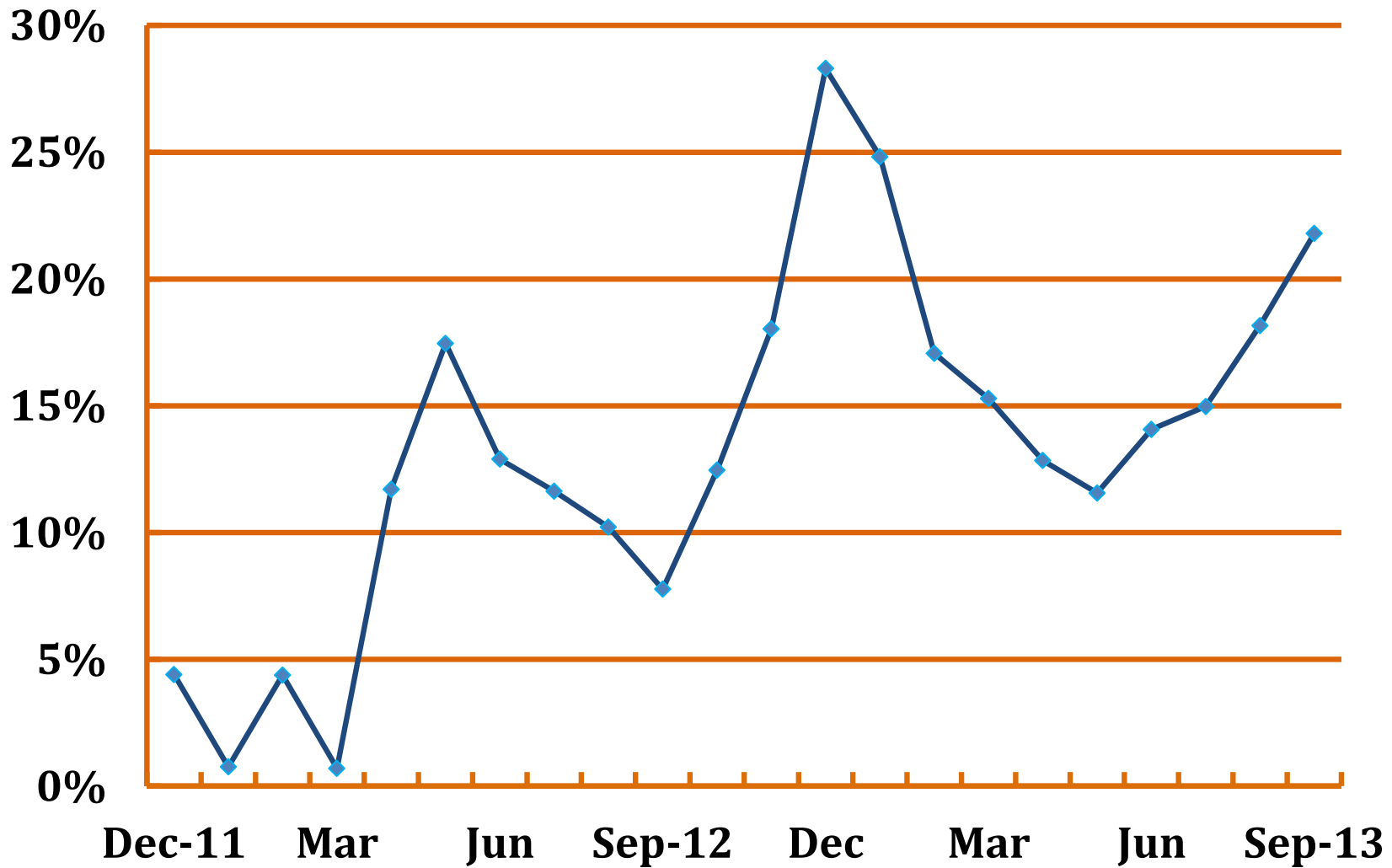
The Bright Spot: Housing

- Very strong growth in Realty Transfer Tax collections.

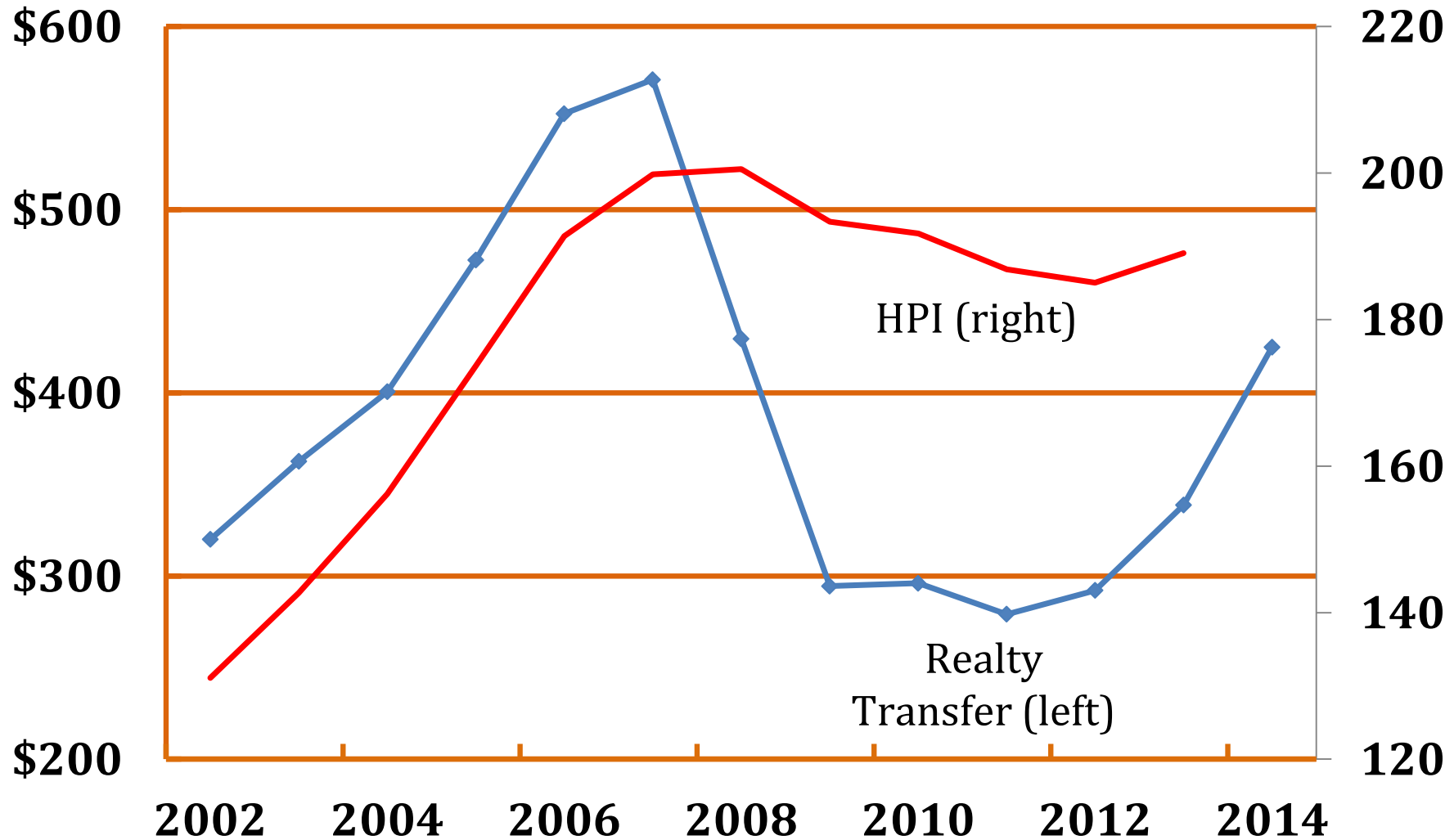
- Reflects gains in number home sold and average price.
 - Most is quantity impact, not prices.

- Still far below FY 2006-07 peak: \$571 million.
 - FY 2013-14 projection is \$425 million.

Realty Transfer Tax: 3-Month Moving Avg. annual growth rate



Realty Transfer Tax Revenues and PA Home Price Index (HPI)



Other Tax Revenues 2013 Q3

- As expected, Corporate Net Income revenues flat or declining slightly.
 - Impact of bonus depreciation after FY 2012-13.
 - Full phase-in of 100% sales factor.

- Personal Income Quarterlies also look flat.

- Outlook for Annual Payment very cautious.
 - Stole some capital gains last year.

General Fund Revenue Comparison

fiscal years, millions of dollars

	<u>2012-13</u>	<u>2013-14</u>
Ind. Fiscal Office (June 2013)	\$28,647	\$29,073
Plus: Policy Changes	\$0	\$82
Total	\$28,647	\$29,155
Percent Change	3.5%	1.8%
Official Estimate (June 2013)	\$28,647	\$29,116
Percent Change	3.5%	1.6%
Dollar Difference	\$0	\$39

Some Recent/Upcoming Releases

- An Analysis of Michigan Property Tax Reform.
 - Released last week.

- HB 76 and SB 76: To be Released Soon.

- Five-Year Outlook Report – November 15.
 - Projections for FY 2013-14 to FY 2018-19.
 - Demographics, Economics, Expenditures, Revenues.
 - Special Reports.
 - Last Year: Pensions and Affordable Care Act.

Property Tax Reform

- Last year, IFO analyzes HB and SB 1776.
 - Finds \$1.5 to \$2.0 billion annual revenue shortfall.
 - Sponsors make several changes to add revenues.
 - Personal Income Tax to 4.24% (previously 4.01%).

- Michigan Property Tax Reform.
 - Known as Proposal A – 1994.
 - Higher Sales (4.0% to 6.0%) and Other taxes.
 - Eliminates most local school operating property tax for homesteads.
 - But no taxation of services.

Five-Year Outlook Report

Table 16
Expenditures vs. Revenues, FY 2012-13 to FY 2017-18
 (\$ millions)

	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
Revenues	28,745	29,515	30,536	31,452	32,337
Expenditures	<u>28,750</u>	<u>29,899</u>	<u>31,100</u>	<u>32,076</u>	<u>33,090</u>
Difference	-6	-384	-563	-624	-753
Refunds	-1,311	-1,346	-1,392	-1,434	-1,475
Net Difference	-1,317	-1,730	-1,956	-2,058	-2,227

Table 10
General Fund Expenditures

<u>Agency</u>	<u>2012-13</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
Education	10,960	11,425	11,954	12,499	12,810	13,107
Public Welfare	10,585	10,959	11,385	11,836	12,314	12,796
Corrections	1,867	1,901	1,941	1,983	2,036	2,104
Treasury	1,145	1,245	1,302	1,354	1,382	1,440
PHEAA	386	393	403	410	417	425
DCED	238	243	248	254	259	265
Health	190	195	201	207	213	219
All Other	<u>2,287</u>	<u>2,390</u>	<u>2,466</u>	<u>2,557</u>	<u>2,645</u>	<u>2,735</u>
Total	27,658	28,750	29,899	31,100	32,076	33,090
Pensions	1,163	1,651	2,159	2,685	2,950	3,178
Non-Pension	<u>26,495</u>	<u>27,099</u>	<u>27,740</u>	<u>28,415</u>	<u>29,126</u>	<u>29,913</u>
Total	27,658	28,750	29,899	31,100	32,076	33,090
Growth Rates						
Pensions		41.9%	30.8%	24.4%	9.9%	7.7%
Non-Pension		2.3%	2.4%	2.4%	2.5%	2.7%
Total		3.9%	4.0%	4.0%	3.1%	3.2%

Thank you.

Presentation available at:

ifo.state.pa.us