

2015 Revenue Conference

Mid-Year Update

**Independent Fiscal Office
Commonwealth of Pennsylvania**



Today's Presentation

- Economic Outlook for 2015 and 2016.
 - Forecasts: June 2014 vs. January 2015.
 - Drop in gas prices: SUT and other impacts.
 - Real wage growth: boost to consumer confidence?

- FY 2014-15 General Fund Revenues.
 - Performance through January.
 - Revisions to FY 2014-15 estimate.
 - Implications for next year.

- Advance Look at FY 2015-16 Revenues.

PA Economic Forecasts

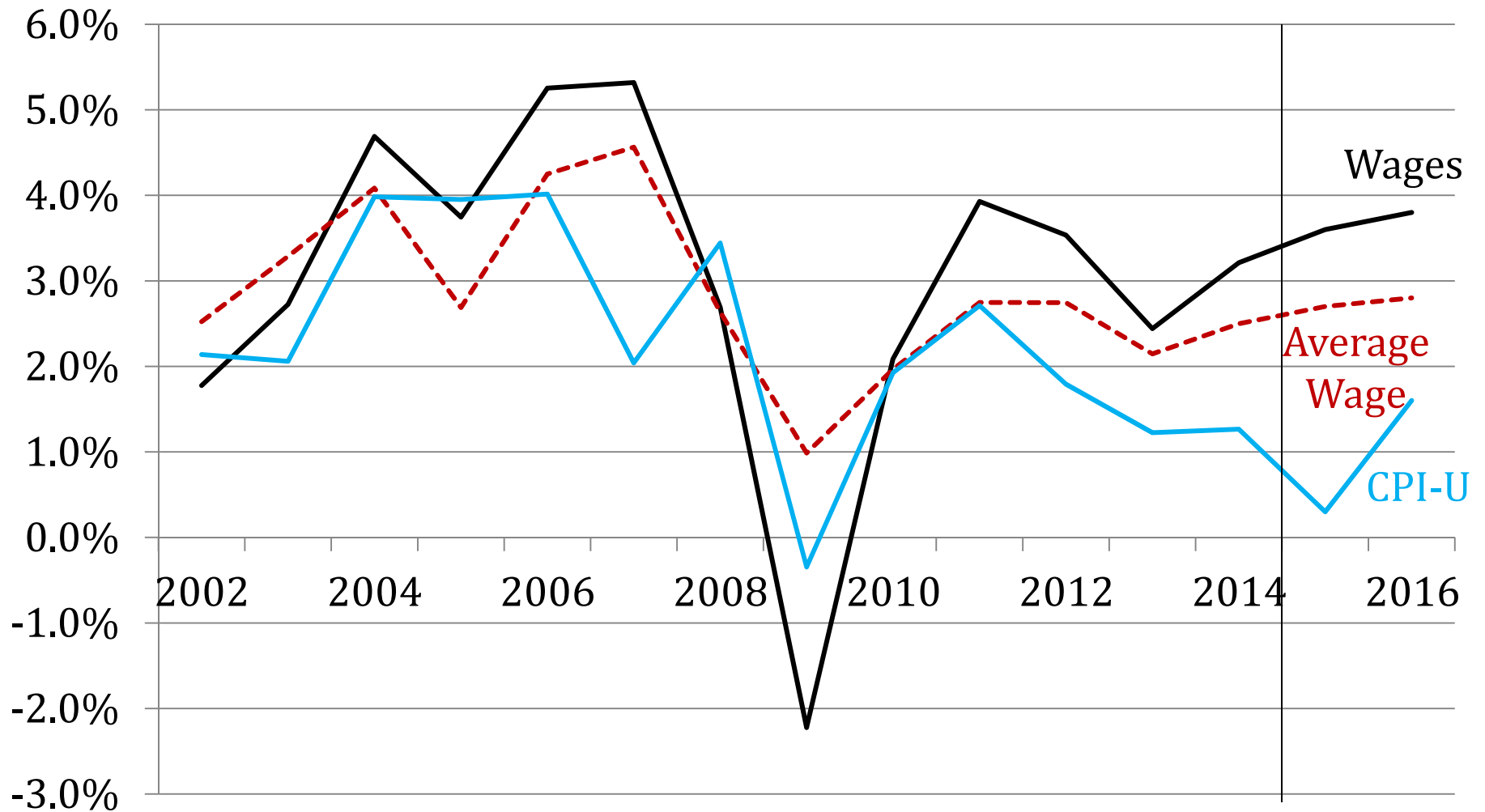
		2014	2015	2016	Notes
Real GDP	June 2014	1.6%	1.8%	n.a.	low worker productivity
	Jan 2015	1.2%	1.5%	1.7%	
Philadelphia CPI-U	June 2014	1.7%	2.2%	n.a.	possibly negative
	Jan 2015	1.3%	0.3%	1.6%	
Total Wages	June 2014	3.2%	3.8%	n.a.	some risks
	Jan 2015	3.2%	3.6%	3.8%	
Average Job Gains (000s)	June 2014	40.3	52.9	n.a.	hit target
	Jan 2015	41.7	48.7	54.8	
Average Wage	June 2014	2.4%	2.9%	n.a.	key assumption
	Jan 2015	2.5%	2.7%	2.8%	

Annual Job Gains and Losses (000s)

	2011	2012	2013	2014	2015
Construction	6.9	3.1	0.1	7.9	7.5
Wholesale-Retail	5.3	4.7	0.4	4.5	5.2
Professional Services	11.5	14.3	11.0	8.2	6.9
Health and Social	14.7	14.2	5.1	7.0	12.7
Administrative	15.3	2.1	6.0	0.4	2.4
Leisure-Hospitality	10.7	13.2	9.4	10.6	10.0
Government	-19.3	-19.0	-12.0	-5.3	-3.3
All Other	<u>18.5</u>	<u>7.3</u>	<u>-3.3</u>	<u>8.4</u>	<u>7.3</u>
Total Job Gains	63.7	39.9	16.6	41.7	48.7

Source: U.S. Bureau of Labor Statistics. 2014 is preliminary. 2015 estimate by IFO.

PA Economic Growth Rates



Forecast: Very Low Inflation

- June Forecast Called for 2.2% Inflation in 2015.
 - Revised down to 0.3%. Could be negative (IHS Economics).
 - Due to low gasoline prices. Low utility prices too.
 - Strong dollar also makes imports cheaper.

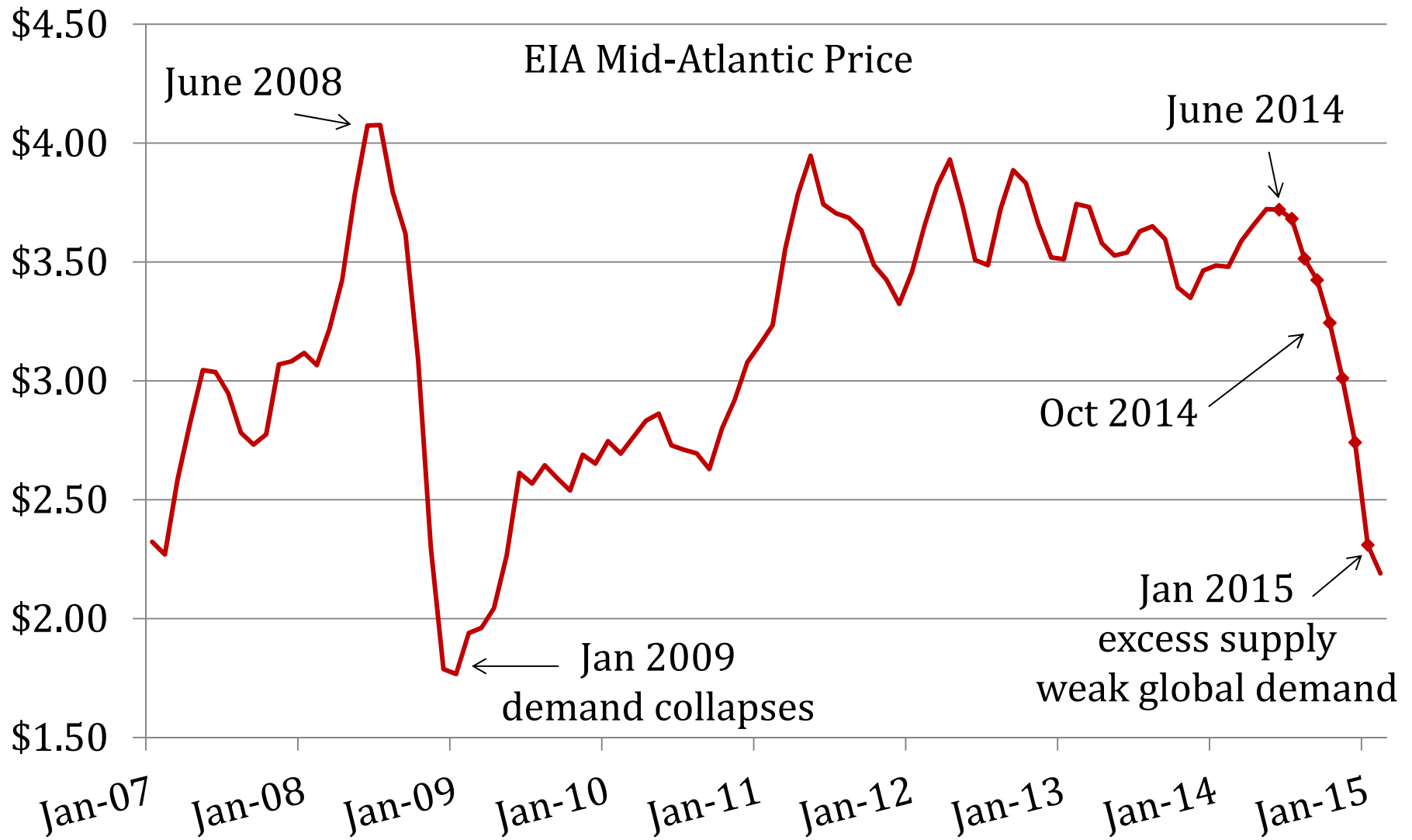
- Why Does This Matter?
 - Tax revenues include inflation.
 - Inflation is transmitted to tax revenues through (1) higher prices (SUT) and (2) higher wages (PIT).
 - Expenditure impact unclear (e.g., contracts and healthcare).
 - Inflation is a “wash” over long-term, but not short-term.

Gas Prices Drive Low Inflation

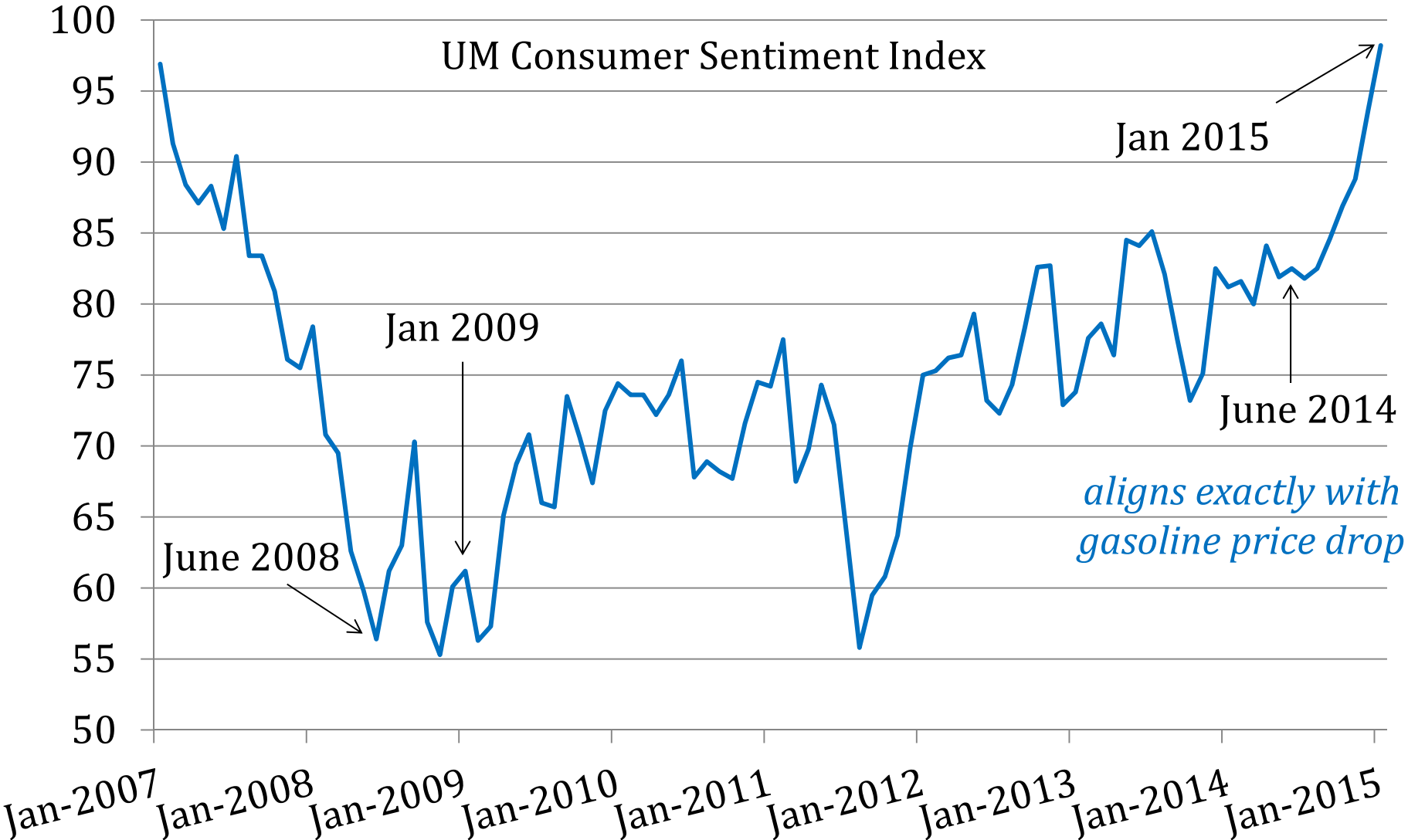
	CY 2013	CY 2014	Dec-13 to Dec-14	CPI Weight
All Items – Philadelphia CPI-U	1.2%	1.3%	0.6%	100.0%
Food and Beverage	1.3%	2.0%	3.6%	13.8%
Housing				
Shelter	1.4%	2.3%	2.2%	35.1%
Fuels and Utility	-0.7%	0.1%	-3.1%	6.0%
Furnishings	-2.2%	-2.9%	-1.9%	4.1%
Transportation				
Car, Public Transit, Other	2.8%	0.6%	2.0%	9.5%
Gasoline	-3.8%	-2.7%	-21.5%	4.5%
Medical Care	2.2%	2.5%	3.5%	7.1%
All Other	2.3%	1.8%	2.7%	19.8%
All Items Less Energy	1.6%	1.7%	2.0%	

Source: U.S. Bureau of Labor Statistics. CPI-U weight represents 2011 and 2012.

Monthly Average Gas Price



Consumer Sentiment Surges



Savings from Gas Price Drop

- Average Gasoline Price Decline Year-Over-Year:
 - Avg. Price Jul to Dec 2014: **-7.0%**.
 - Avg. Price Jan to Jun 2015: **-38.7%**.
 - Assumes prices do not fall further from latest value.
- Gross Savings Are Significant for FY 2014-15.
 - PA Consumers ~ \$3.0 to \$3.5 billion.
 - PA Businesses ~ \$1.5 to \$2.0 billion (less clear).
- Forecast Assumes a Continuation to FY 2015-16.
 - OPEC maintains output. U.S. shale operations (TX, ND).
 - Weak global demand: EU and China.

The Potential Revenue Impact

- Two Key Assumptions.
 - Two-thirds of savings are spent (Moody's in WSJ).
 - Sixty percent spent on taxable items (CES).

- Consumers: Sales and Use Tax Impact.
 - Jul to Dec 2014: +\$10 to \$15 million.
 - Jan to Jun 2015: +\$45 to \$60 million.
 - Other secondary effects as well.

- Businesses: Lower Costs Increase Net Profits.

Low Inflation = Real Wage Growth (?)

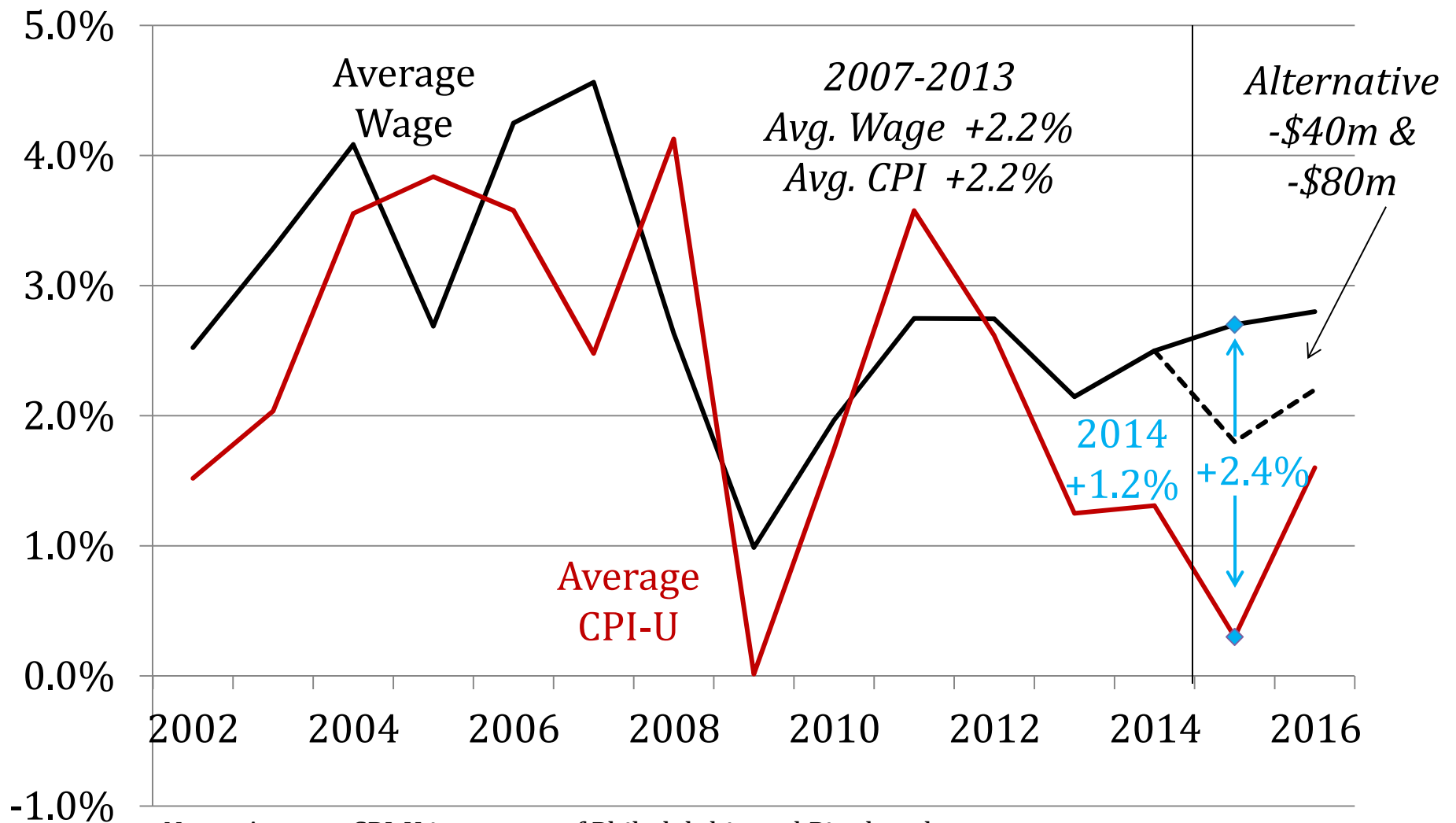
➤ Real Wage Growth = Avg. Wage Growth - Inflation.

- For 2007 to 2013: avg. wage growth = inflation. No gains.
- Some separation in 2014.
- Forecast assumes a large gain in 2015.

➤ Why Does This Matter?

- Higher Personal Income Tax revenues.
- Bolsters consumer confidence. Encourages spending.
- A sign of economic recovery. Less labor market slack?

Average Wage vs. Inflation



Note: Average CPI-U is average of Philadelphia and Pittsburgh metro areas.



Revenue Outlook

IFO General Fund Estimate

Revenue Source	FY 14-15 Estimate	Growth
General Fund - Total	\$29,957	4.7%
Corporate Net Income	2,484	-0.7
Sales and Use	9,463	3.7
Personal Income	12,027	5.2
Other Tax Revenue	4,949	-1.6
Non-Tax Revenue	1,034	103.1

Dollar amounts are in millions.

Estimate Comparison

- Published IFO and DOR estimates for FY 2014-15 differed by \$224 million (\$57 million for the first seven months of the fiscal year and \$167 million for the final five months).

	<u>Fiscal Year Estimate</u>		
	IFO	DOR	Difference
General Fund - Total	\$29,957	\$30,181	-\$224
Corporate Net Income	2,484	2,501	-17
Sales and Use	9,463	9,477	-14
Personal Income	12,027	12,033	-6
All Other Tax Revenue	4,949	5,097	-148
Non-Tax Revenue	1,034	1,072	-38

Dollar amounts are in millions.

IFO General Fund Estimate

Revenue Source	<u>FY 2014-15 (through Jan.)</u>		
	Actual	Estimate	Difference
General Fund - Total	\$15,698	\$15,280	\$418
Corporate Net Income	1,348	1,164	184
Sales and Use	5,647	5,578	69
Personal Income	6,322	6,327	-5
Other Tax Revenue	1,902	1,758	144
Non-Tax Revenue	478	454	24

Dollar amounts are in millions. FYTD actuals updated on Feb. 2nd to reflect January collections.

Updated FY 2014-15 Forecast

Net Change: +\$250 million

Increases		Decreases	
Corporate Net Income	\$230	Non-Tax	-\$160
Sales and Use	160	Personal Income	-55
Inheritance	100	Bank Shares	-15
All Other	<u>30</u>	All Other	<u>-40</u>
Subtotal	520	Subtotal	-270

Dollar amounts are in millions.

Corporate Net Income

- For the FYTD, CNIT is up +12.9% (+\$184m overage).
- Through 2014 Q3, national domestic non-financial profits up only 1.1%.
 - 2014 forecasts: CBO (0.0%) and IHS Economics (+0.1%).
- About \$130 million of the FYTD overage is due to strong final payments for TY 2013. Unusual payment pattern.
- Adding monies to an old tax year (2013) may not affect the estimate for the current tax year (2014).

July to January	+\$184
February to June	<u>+46</u>
Total Change	+230

Sales and Use Tax

- Additional consumer spending directly attributable to lower gasoline prices contributes ~\$60 million to the updated estimate.
- Another \$100 million partially due to dramatic improvement in consumer confidence. An indirect effect of lower gasoline prices.

	Nonmotor	Motor	Total
July to January	+\$20	+\$49	+\$69
February to June	<u>+80</u>	<u>+11</u>	<u>+91</u>
Total Change	+100	+60	+160

Inheritance Tax

- Year-to-date revenues include an unexpected \$100 million payment from one estate. The estimate does not include any additional remittances from that estate.
- Except for the unexpected one-time payment, revenues are meeting estimate.

July to January	+\$106
February to June	<u>-6</u>
Total Change	+100

Non-Tax Revenues

- Licenses and Fees reduced by \$50 million because a casino license fee included in the estimate will not be received.
- Miscellaneous Revenues reduced by \$95 million because a projected transfer from the Oil and Gas Lease Fund will not occur.
- Estimate still includes \$150 million for Escheats change.

Non-Tax Revenues (excludes liquor store profits)

	Lic. & Fee	Misc.	Other	Total
July to January	-\$10	+\$12	+\$23	+\$25
February to June	<u>-65</u>	<u>-107</u>	<u>-13</u>	<u>-185</u>
Total Change	-75	-95	+10	-160

Personal Income Tax

- Concerns about wage growth in 2015 motivate a minor reduction in withholding.
- Recent trends in quarterly payments motivate a small downward revision to the April final payment.
- Projected growth in April payment still strong (+17.5%).

	Withheld	Quarterly	Annual	Total
July to January	+\$11	-\$8	-\$8	-\$5
February to June	<u>-16</u>	<u>-12</u>	<u>-22</u>	<u>-50</u>
Total Change	-5	-20	-30	-55

Bank Shares Tax

- Unanticipated late payments provided additional revenue early in the fiscal year.
- March 2015 payments reduced as firms utilize a large stock of overpayment credits (\$76 million from the prior tax year) to reduce remittances.

July to January	+\$18
February to June	<u>-33</u>
Total Change	-15

What Motivates Revisions?

➤ Economic and Policy Factors	~+\$220 million
• Sales and use tax (gasoline/confidence)	+\$160 million
• Corporate tax (2014/15 tax liability)	+100 million
• Personal income tax	-20 million
• Cigarette tax	-20 million
➤ Technical Factors	~+\$30 million
• Non-tax (transfers and casino licenses)	-\$160 million
• Inheritance tax payment	+100 million
• Corporate tax (2013 and earlier tax liability)	+130 million
• Personal income tax and other	-40 million

FY 2015-16 Revenue Outlook

- Economic and policy factors affecting FY 2014-15 revenues are carried forward to next fiscal year.
- Technical factors, such as non-recurring transfers and payments in FY 2014-15, are not carried forward. The absence of these “one-timers” restrains overall revenue growth in FY 2015-16.
- Preliminary revenue outlook for FY 2015-16 indicates a growth rate of about 1.3%.

Questions/Discussion

Presentation to be
Posted at IFO website
www.ifo.state.pa.us