



North Carolina General Fund Revenue Consensus Forecast

FORECAST HIGHLIGHTS

■ The Consensus Forecast Expects Overall Growth for the Biennium

The forecast assumes that moderate growth will be sustained throughout the upcoming biennium.

■ Increasing Revenues

General Fund revenue is expected to increase by \$873 million and reach \$28.5 billion by the end of FY 2022-23.

■ Current Year Revenue Is Well Ahead of Expectations

With 7 months of data available, FY 2020-21 General Fund revenue appears on track to exceed this year's forecast by just over \$4.13 billion, for an expected fiscal-year-end total of approximately \$27.6 billion.

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The Fiscal Research Division and the Office of State Budget and Management have reached consensus on the revenue forecast for the 2021-23 biennium. This report summarizes the forecast.

Forecast Summary

The forecast expects FY 2020-21 collections to be well above the May 2020 forecast by \$4.1 billion (17.6%). We expect modest improvement throughout the upcoming biennium, with the worst economic impacts from the pandemic behind us. The current year's anticipated revenue surplus is helped significantly by Sales tax collections, which increased despite the pandemic. The surplus also comes from delayed tax payments that shifted a little over \$1 billion out of last fiscal year and into this one.

General Fund Consensus Summary (\$ in Millions)

Fiscal Year	Revenue	Change
2019-20	\$23,939.3	n/a
2020-21 (est.)	\$27,602.6	\$3,663.3
2021-22 (est.)	\$27,350.6	(\$252.0)
2022-23 (est.)	\$28,4761.5	\$1,110.9

The State's economy is in the recovery phase of the business cycle after the quick and sudden recession precipitated by the pandemic. The forecast assumes that economic conditions will continue to strengthen throughout the biennium. The drop in FY 2021-22 revenue shown above is caused by delayed tax payments in 2020, which artificially shifted \$1.08 billion in revenue out of FY 2019-20 and into the current fiscal year.

Current Fiscal Year Revenue

Revenue collections for FY 2020-21 are projected to surpass the May 2020 forecast by \$4.13 billion (17.6%), driven by personal income tax and sales tax collections. Several factors contributed to the significant surplus in these tax categories. Most notable are the following.

- **The Federal stimulus** had a much larger impact on the State's economy than we anticipated when we produced the May forecast. It stimulated consumer spending and helped many small business stay open. To date, the Federal relief programs have provided an estimated \$18 billion to North Carolina households and an estimated \$12.5 billion to businesses.
- A **"K-shaped recovery,"** in which different sectors of the economy recovered differently. Most of the State's tax revenue is generated by middle and upper income households. More of these higher-income employees maintained their

A K-shaped recovery has meant that sectors of the economy have recovered differently.

Personal Income taxes are estimated to finish much better than expected this fiscal year, with positive year-over-year growth

Sales tax growth is strong, partly due to a June 2018 U.S. Supreme Court ruling that led to increased sales tax collections from retailers located outside of North Carolina. As consumers moved their purchases online during the pandemic, the State was still able to collect taxes.

Business taxes include the Corporate Income tax, the Franchise tax, and the Insurance gross premium tax are all expected to post robust, positive year-over-year growth

jobs and experienced far less economic distress than with a typical recession. In higher-paying industries, jobs were often more suitable to transition into work-from-home status, which helped protect these paychecks. The bottom leg of the “K” is where the economic damage is occurring. This category includes service industries, especially in the Leisure and Hospitality and the Retail sectors, where many small businesses are just hanging on or have already closed their doors. Despite the very real economic damage in these sectors, the overall drop in tax revenue was much smaller than one would expect under a typical economic downturn. In fact, in many areas the economy has been growing compared with the same period last year.

The combined impact of Federal Stimulus payments and the K-shaped recovery meant that Personal Income withholding and Sales tax collections were surprisingly strong compared to what we expected back in May 2020.

Personal Income Tax: Personal Income tax withholding on wages and salaries is running nearly 4.2% above last fiscal year and the forecast assumes that trend will continue the rest of the fiscal year. Due to the pandemic, the Internal Revenue Service delayed the federal income tax due date from April 15, 2020 to July 15, 2020; the State similarly delayed the due date. When returns were filed, the State did experience a modest “April surprise.” As a reminder, April always has the potential to be an unpredictable collection month in which income from dividends, capital gains, and business income can vary considerably from year to year. This creates the potential for sizable swings in income tax collections and what we refer to as the “April Surprise,” or, in the case of 2020, the “April to July Surprise.”

Sales and Use Taxes: Although Sales tax collections dropped by over 10% in March and April, they rebounded and gained momentum as consumers adjusted their economic lives to the pandemic. As many consumers switched to online purchases, the State still was able to collect taxes due to the U.S. Supreme Court’s June 2018 ruling that required remote sellers to begin collecting Sales tax and subsequent State legislation that required online marketplace facilitators also to collect tax. Ultimately, collections have stabilized and are growing at a surprisingly strong 8.1%.

Business Taxes: Business tax collections on Corporate income, the Franchise tax, and the Insurance gross premium tax are all expected to post robust, positive year-over-year growth.

In addition to these increases, actions by the State and Federal governments to delay income and sales tax due dates resulted in a one-time revenue shift of \$1.08 billion out of FY 2019-20 and the current fiscal year.

For all of these reasons, current fiscal year General Fund revenue is forecast to increase by 15.3% over the amount collected in FY 2019-20. Even after controlling for the shift of \$1.08 billion due to delayed tax payments, the forecast expects growth of 6.0% in the current fiscal year as the economy rebounds from the pandemic-induced recession in the second quarter of 2020. Revenue is estimated to reach almost \$27.6 billion, yielding an estimated surplus of \$4,132.3 million (17.6%) over the \$23,466.3 billion amount projected in May 2020.

This increase comes despite a drop in non-tax revenue, particularly Investment Income and Judicial Fees, which have weakened due to very low interest rates and reduced court capacity due to COVID safety precautions.

For the upcoming biennium positive growth is expected but at a pace below the long-term historical average.

Despite solid revenue growth, a small segment of the workforce will remain un- or underemployed as long as COVID-19 is prevalent, and this will keep both the economy and revenue below their full potential rate of growth.

The State's mix of industries including the banking and tech sectors helped North Carolina recover faster than many other states.

A main assumption of the forecast is that the coronavirus will no longer be disrupting the economy by the second year of the biennium.

Both Personal Income and Sales tax will continue to be bolstered by federal relief and are expected to continue to improve throughout the biennium.

The forecast assumes that there will be at least another round of federal relief by spring. The timing and size of the relief adds uncertainty to the overall forecast.

Outlook for the Upcoming Biennium

The State's economy has only partially rebounded from the impact of the pandemic with 200,000 fewer people employed in the State than last February. However, overall economic activity has remained at or only slightly-below average. As mentioned, the unique nature of the pandemic's affect on the economy meant that a large swath of the economy was impacted less than it otherwise would have been in a typical recession. This unique impact for the economy also translated to unique outcomes for State revenue collections.

The State's industry mix includes large banking and technology sectors, which were in many respects unharmed by the pandemic's effects. This meant economic activity in the State recovered much faster than would ordinarily be expected coming out of a recession. Additionally, the State's tax structure is such that the majority of taxes are collected from middle and upper income households and large businesses, all of which experienced far less economic distress.

Going forward, these factors will allow General Fund revenues to grow at a pace slightly below what is expected during an period of economic expansion with growth of 3.1% (adjusted for the tax shift) and 4.1%, respectively, during the biennium. As long as the virus is prevalent this will keep both the economy and revenues below their full potential rate of growth.

One of the forecast's key assumptions is that the coronavirus's economic disruptions will be gone by the second year of the biennium, although the economy will still not be operating at full capacity. It will take until mid-2022 to repair some of the damage, rebuild some of the losses, and catch up to where we would be if the pre-pandemic economic trends had continued uninterrupted.

Personal Income Tax

Personal Income tax collections are estimated to continue to provide yearly growth that is slightly below the historical average. The first year's growth is due in part to federal stimulus and relief dollars combined with the unique economic impact of the pandemic. The size and timing of federal relief will impact collection growth.

Sales and Use Tax

Sales tax collections are forecast to increase by 3.1% and 3.8%, respectively, during the biennium. As with the Personal Income tax, this is slightly below the historical average. A key reason for continued growth in Sales tax collections is the Wayfair decision of 2018, which allows the State to collect from online sales.

Business Taxes

Corporate Income tax collections are often volatile, and after several years of solid growth, corporate profits are expected to moderate over the next several years. After adjusting for the shift in delayed payments, growth is expected to be a modest 3.0% over the biennium. The Franchise tax is far less volatile and growth over the biennium is expected to average 3.1%.

Recap

The 2021-23 biennium forecast reflects a forecast for modest economic growth. The forecast envisions that the economy will remain stable throughout the forecast period as the pandemic finally begins to recede later this calendar year. Finally, the forecast assumes that there will be at least another round of federal relief by spring. The timing and size of the relief adds some uncertainty to the overall forecast.