

Budget and Economic Update

Presentation to the Pennsylvania Institute of Certified Public Accountants
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Main Themes

PA economy performed as expected in 2018

- GDP, wage and jobs growth was close to forecast

Other factors driving large revenue gains for FY 18-19

- Taxation of internet sales (permanent gain)
- Corporate profits (both permanent and temporary)
- Income shifting and gaming expansion (temporary)

Economic fundamentals remain solid, but decelerating

- Evidence in labor and housing markets

Economic Growth Close to Projections

	Forecast	2016	2017	2018	2019
Real GDP	June 2018	0.6%	1.8%	2.3%	2.2%
	May 2019	1.1%	1.7%	2.1%	1.9%
Wages-Salaries	June 2018	1.3%	3.8%	4.3%	4.2%
	May 2019	1.3%	4.0%	4.0%	4.0%
New Jobs (000s)	June 2018	50.0	62.9	62.5	57.1
	May 2019	48.8	58.8	65.6	57.7
U.S. Corp Profits	June 2018	-4.1%	3.1%	6.3%	4.5%
	May 2019	-5.4%	1.2%	10.7%	4.3%

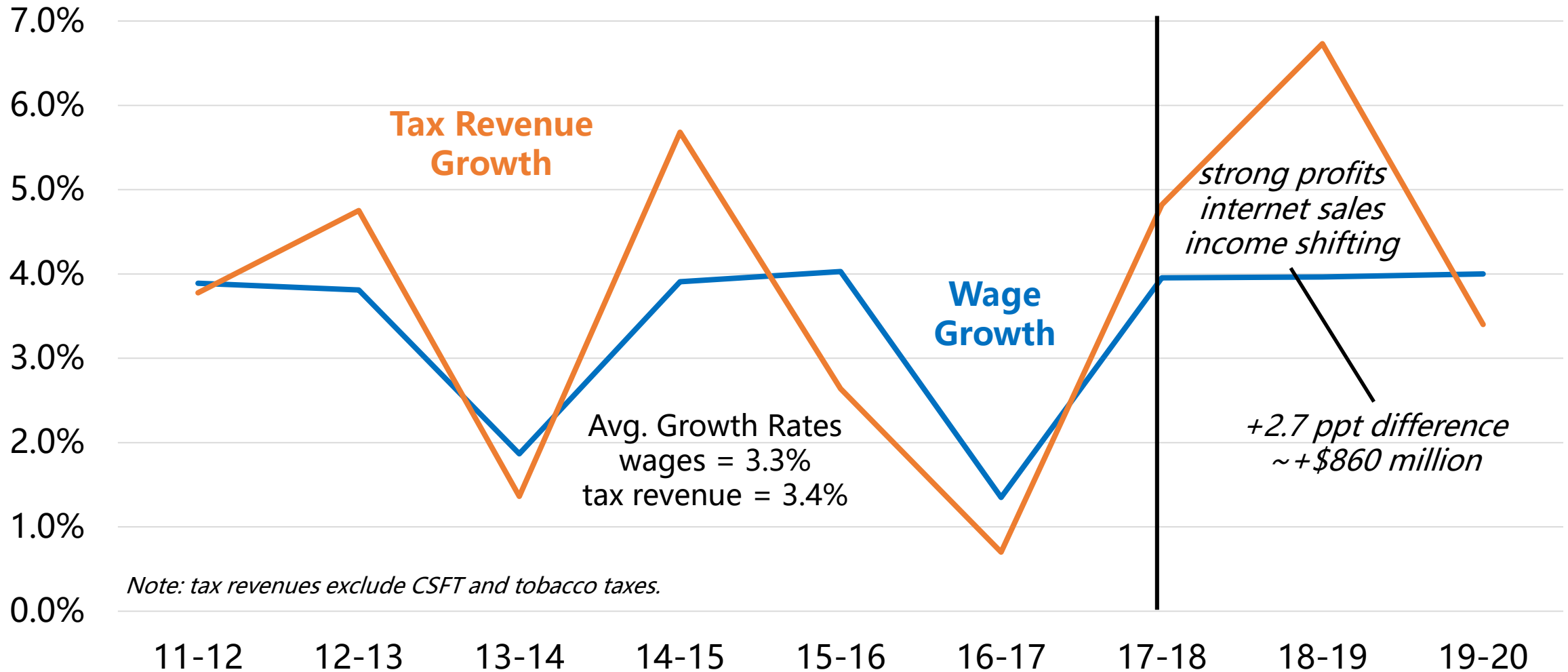
Note: Data in blue are preliminary or forecasts. Corporate profits are non-financial, domestic profits.
Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics.

PA Economic Forecast vs Long-Run Growth

	2013-18	2018	2019	2020
Real GDP	1.8%	2.1%	1.9%	1.9%
Wages-Salaries	3.4%	4.0%	4.0%	4.1%
New Jobs (000s)	46.8	65.6	57.7	54.6
Philadelphia CPI-U	0.9%	1.3%	1.6%	2.0%
U.S. Corporate Profits	1.8%	10.7%	4.3%	4.5%

Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics. Corporate profits are domestic, non-financial profits only.

Wages vs Tax Revenue Growth



Recent PA Economic Growth Rates

	2018.1	2018.2	2018.3	2018.4	2019.1
Real GDP	0.7%	4.0%	3.2%	2.5%	n.a.
Wages-Salaries	4.1%	4.0%	3.5%	4.2%	3.8%
Net New Jobs (000s)	69.6	68.4	64.1	60.4	50.8
Philadelphia CPI-U	0.5%	1.6%	1.7%	1.3%	1.5%
Mid-Atlantic Gasoline	13.7%	22.8%	7.7%	-5.3%	-0.8%
Home Price Index	5.9%	5.4%	4.7%	5.3%	5.0%
Zillow Home Sales	0.9%	6.1%	7.2%	-0.4%	-1.5%

Note: All growth rates are year-over-year except real GDP. All GDP data are preliminary. Other data largely final.
 Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Federal Housing Finance Authority, Zillow.

Change in PA Payroll Employment (000s)

	2016	2017	2018	2019 Q1
Mining-Logging	-9.0	1.7	1.9	1.2
Construction	3.7	9.9	7.0	8.6
Manufacturing	-8.0	2.0	6.3	0.6
Wholesale-Retail	-4.5	-7.8	-2.9	-10.1
Transportation-Storage	9.2	7.3	9.1	10.0
Professional Services	14.2	5.3	3.5	-0.8
Healthcare-Social Assistance	22.4	26.4	27.2	27.1
Leisure-Hospitality	12.4	9.1	4.9	7.8
State-Federal Government	1.1	-0.2	-1.3	1.0
Local Government	-2.3	0.5	1.0	-0.7
All Other Sectors	<u>9.6</u>	<u>4.5</u>	<u>8.9</u>	<u>6.1</u>
Total Change	48.8	58.8	65.6	50.8

Note: Professional Services includes the Management and Administrative sectors. Value for 2019 Q1 is annualized change for the first quarter.
Source: U.S. Bureau of Labor Statistics.

FYTD Revenues Through May

	May 2018	May 2019	Dollar Change	Growth Rate
General Fund Revenues	\$31,483	\$31,779	\$296	0.9%
Corporate Net Income	2,318	2,825	508	21.9%
Gross Receipts	1,143	1,221	78	6.9%
Sales – Non-Motor	8,148	8,769	620	7.6%
Sales – Motor Vehicle	1,269	1,362	93	7.3%
PIT – Withholding	9,268	9,638	371	4.0%
PIT – Other	2,992	3,254	262	8.8%
All Tobacco	1,190	1,132	-57	-4.8%
All Other Tax	2,688	2,775	87	3.2%
All Non-Tax	2,468	803	-1,665	-67.5%

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

Actual Revenues vs. IFO Estimate

	FY 2018-19 (through May)		
	Actual	Estimate	\$ Diff
General Fund Revenues	\$31,779	\$30,871	\$908
Corporate Net Income	2,825	2,502	324
Gross Receipts	1,221	1,200	22
Sales – Non-Motor	8,769	8,502	267
Sales – Motor Vehicle	1,362	1,300	62
PIT – Withholding	9,638	9,655	-17
PIT – Other	3,254	3,152	102
All Tobacco	1,132	1,137	-5
All Other Tax	2,775	2,717	58
All Non-Tax	803	706	97

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

Strong March-April Revenue Growth Rates

	Personal Income	Sales and Use	Corporate Net Income	Personal Income Federal Conformity?
Pennsylvania	31.1%	6.8%	15.5%	does not conform
New Jersey	56.8%	4.7%	n.a.	does not conform
New York	49.2%	4.9%	28.9%	rolling conformity
Ohio	53.6%	3.4%	n.a.	static conformity
North Carolina	41.6%	6.1%	26.4%	static conformity
Michigan	39.7%	2.1%	16.8%	rolling conformity
Massachusetts	58.6%	6.7%	43.5%	static pre-TCJA conf

Note: Growth rates compare collections for March and April 2019 to 2018.
Sources: Various state agency websites. Conformity status from Tax Foundation.

Corporate Income and Sales Drive Large Gains

	Annual Dollar Change			
	15-16	16-17	17-18	18-19
Total Tax Revenues	\$766	\$495	\$1,251	\$1,980
Non-Motor Vehicle Sales	281	190	351	580
Corporate Net Income	31	-91	128	514
PIT Withholding	319	223	422	391
PIT Non-Withheld	79	-65	313	289
Motor Vehicle Sales	21	20	26	101
Capital Stock + Tobacco	-107	316	-61	-57
All Other Taxes	141	-99	73	161

Note: Dollar amounts are in millions. PIT is personal income tax. Excludes non-tax revenues.

PIT Forecast Underpredicts FY 18-19

	June 2018 Projected	May 2019 Revised	\$ Diff		
Withholding	\$10,450	\$10,427	-\$23		
Non-Withholding	\$3,530	\$3,652	<u>\$122</u>		
Underprediction			\$99		
Stronger Income Shifting			\$49		
Stronger Fundamentals			\$50		
<u>Growth Rates for Personal Income Tax Data Fields</u>					
	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Business Profits	4.6%	6.9%	0.3%	0.5%	12.0%
Capital Gains	22.8%	1.5%	-11.9%	25.0%	10.0%
Dividends	28.9%	-2.7%	-13.4%	16.4%	12.0%
Note: Dollar amounts are in millions. Data in blue are preliminary or projections. Shaded area denotes income shifting.					

Forms of Payment Shifts Due to Tax Law Change

PIT	Tax Year				
	2012-18	2015	2016	2017	2018
Quarterly	3.5%	16.1%	-3.2%	11.5%	-5.6%
Finals	<u>4.2%</u>	<u>-7.5%</u>	<u>-0.9%</u>	<u>6.4%</u>	<u>25.7%</u>
Total	3.8%	4.8%	-2.2%	9.3%	7.4%

Sales Tax Forecast Underpredicts FY 18-19

	June 2018 Projected	May 2019 Revised	Difference
Non-Motor Vehicle	\$9,324	\$9,569	\$245
Motor Vehicle	\$1,427	\$1,493	<u>\$66</u>
Underprediction			\$312
Stronger Internet Revenues (permanent)			\$165
Mix of Vehicle Purchases (unclear)			\$50
Stronger Effect TCJA of 2017 (temporary)			\$25
Strong Consumer Confidence (unclear)			\$73

Note: Dollar amounts are in millions.

Sales and Use Tax Base Expansion

	14-15	15-16	16-17	17-18	18-19	19-20
Total Sales and Use	\$9,493	\$9,795	\$10,004	\$10,381	\$11,063	\$11,470
Growth Rate	4.0%	3.2%	2.1%	3.8%	6.6%	3.7%
Less: Internet Sales Collections	\$143	\$221	\$284	\$378	\$602	\$696
Adjusted Sales and Use	\$9,350	\$9,574	\$9,720	\$10,003	\$10,460	\$10,774
Growth Rate	3.2%	2.4%	1.5%	2.9%	4.6%	3.0%

Note: Dollar amounts are in millions. Internet Sales Collections includes (1) e-commerce/nexus, (2) digital downloads and (3) marketplace sales (Act 43 of 2017).

CNIT Forecast Underpredicts FY 18-19

	AAGR FYE 11-18	Growth 18-19			
U.S. Corporate Profits	3.2%	10.7%			
PA Corp Net Income Revenues	<u>4.4%</u>	<u>17.9%</u>			
Growth Rate Differential	+1.2%	+7.2%			
Underprediction		\$311			
Stronger Profits		\$150			
Income Shifting/NOL changes/Base Expansion		\$161			
Estimated Tax Payments (Annual Growth)	<u>March</u>	<u>June</u>	<u>Sept</u>	<u>Dec</u>	
2018	9.0%	5.5%	20.0%	25.7%	
2019	-1.8%				

Note: Profits are domestic, non-financial profits on a calendar year basis. FYE is fiscal year ending. Millions of dollars.
Source: Corporate profits data from U.S. Bureau of Labor Statistics, NIPA Table 6.16D.

Initial Estimate for FY 2019-20

	Dollar Amount	Dollar Change	Growth Rate
General Fund	\$35,759	\$993	2.9%
Total Tax Revenue	35,164	1,181	3.5%
Corporate Net Income	3,512	119	3.5%
Gross Receipts	1,225	1	0.1%
Sales and Use	11,470	407	3.7%
PIT – Withholding	10,852	424	4.1%
PIT – Other	3,806	154	4.2%
All Tobacco	1,222	-39	-3.1%
All Other Tax	3,077	114	3.8%
All Non-Tax	595	-187	-23.9%

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

Summary

Increase to IFO Official Estimate of +\$866 million

- Translate to Executive Budget Official Estimate: +\$790 million

FY 19-20 tax revenue growth rate of 3.5%

- Somewhat weaker than wage growth at 4.0%
- Certain forecasts revert to historical (lower growth) relationships
- Exact magnitude of income shifting not known
- International issues loom larger than normal