

Budget and Economic Update

Greater Philadelphia Chamber of Commerce
January 29, 2016

Independent Fiscal Office



Today's Presentation

➤ **Short-Term Economic Outlook.**

- Recent trends for 2015. Outlook for 2016.
- US and PA trends. Jobs, housing and inflation.

➤ **General Fund Revenue Outlook.**

- FYTD through January: estimates vs. actuals.
- FY 2015-16 revisions. Advance FY 2016-17 estimate.

➤ **Long-Term Budget Outlook.**

- Demographics, revenues and expenditures through FY 2020-21.

The Independent Fiscal Office

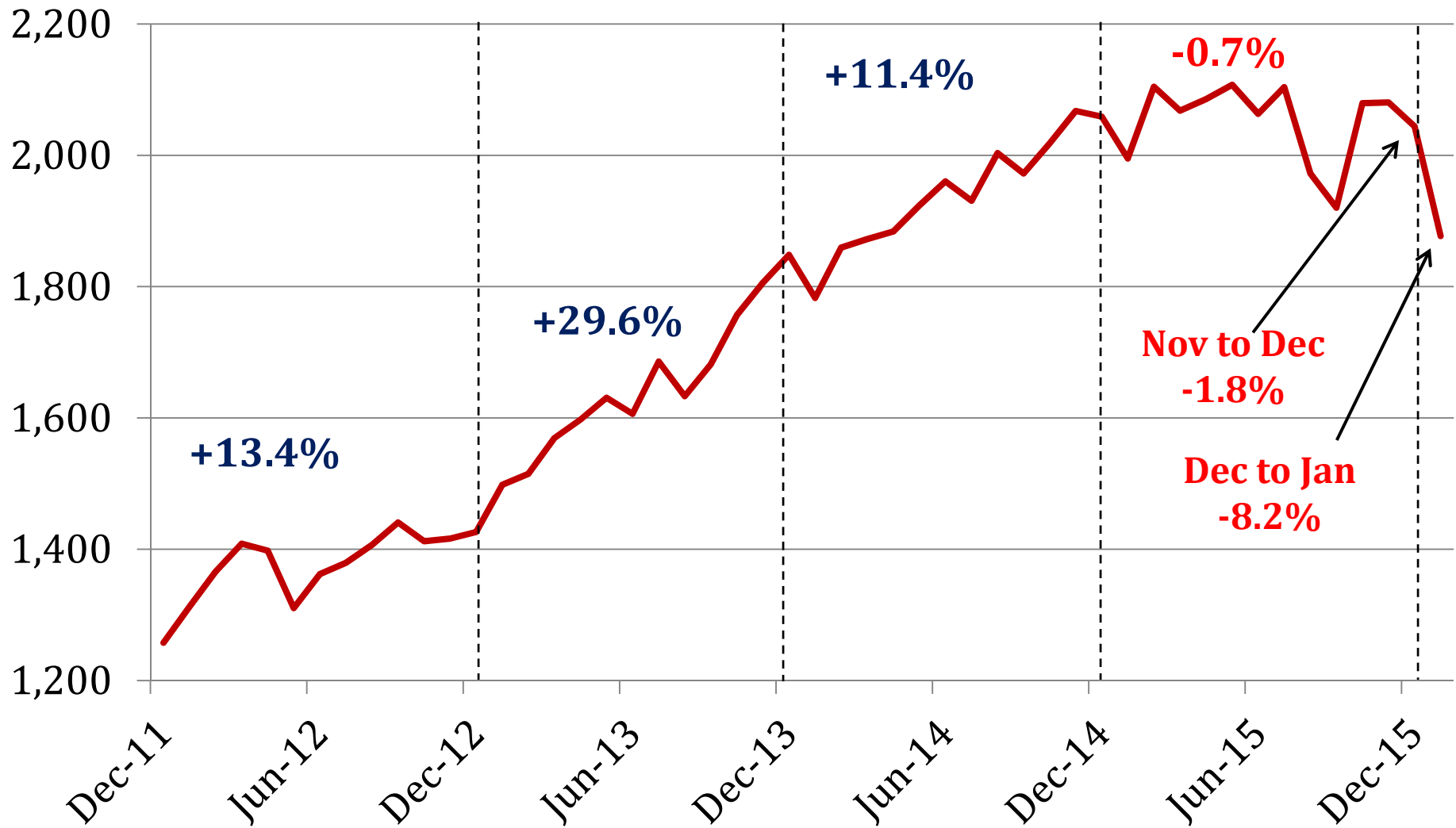
- **Act 120 of 2010 Creates Independent Fiscal Office.**
 - Hiring starts September 2011.
 - Similar to the Congressional Budget Office.
 - Revenue projections used for advisory purposes only.
- **Our Primary Duties:**
 - Annual Revenue Estimate: May 1 and June 15.
 - Economic and Budget Outlook: November 15.
 - Mid-Year Revenue Update: late January.
- **Office *Does Not* Make Policy Recommendations.**

Some US Economic Headwinds


	Growth Rates			
	2015 Q1	2015 Q2	2015 Q3	2015 Q4
Real GDP	0.6%	3.9%	2.0%	0.7%
Real Pers. Cons.	1.8%	3.6%	3.0%	1.8%
Domestic Profits	7.5%	1.1%	-4.0%	-7.0%
US Dollar Index	11.2%	12.1%	15.2%	11.9%
S&P 500 Index	10.4%	5.2%	-2.6%	-0.7%

Note: Values for Q4 GDP and PCE are projections from the Atlanta Federal Reserve GDPNow. Growth rates are quarterly annualized values. All other growth rates are year-over-year. Domestic Profits from IHS Global Insight. US Dollar Index is the Broad Trade Weighted Dollar Index from the Federal Reserve Board of Governors. S&P 500 rates computed from last day of trading quarter.

S&P 500 Index Falters

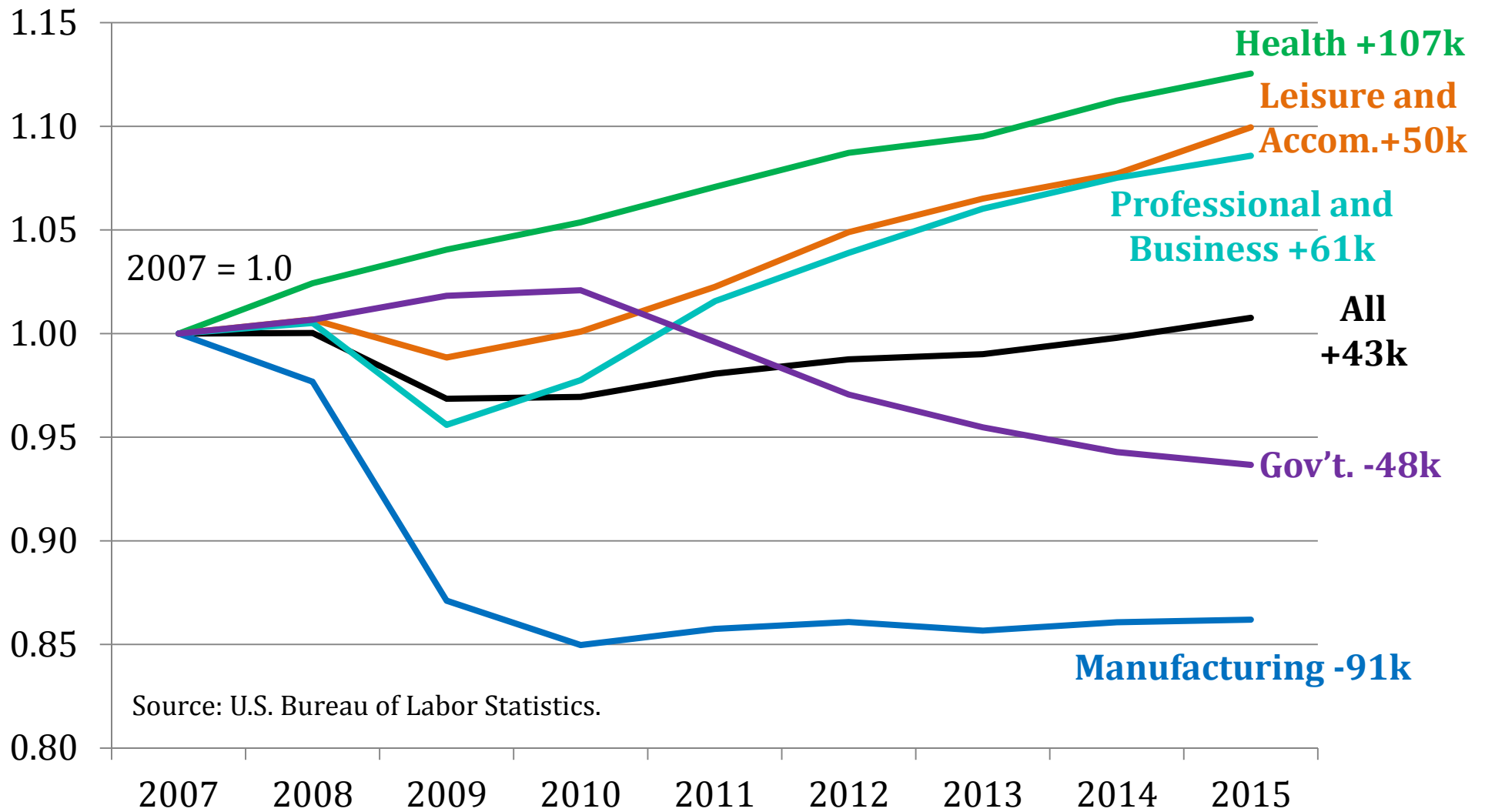


PA Economic Forecasts

		2015	2016	2017	Notes	
Real GDP	June 2015	1.9%	2.0%	2.0%	2015 is prelim	
	Jan 2016	1.8%	2.0%	2.2%		
Wages	June 2015	3.8%		3.9%	4.0%	some weakness
	Jan 2016	3.5%		3.8%	4.1%	
Philly CPI-U	June 2015	0.5%	1.9%	2.0%	no COLAs for 2015	
	Jan 2016	-0.1%	1.6%	2.0%		
Job Gains (000s)	June 2015	54.9	55.6	52.8	on target	
	Jan 2016	54.8	52.6	50.1		

Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecast by IFO.

2015 Jobs Surpass 2007 Level



PA Housing Market Solid

➤ **Strong Home Sales for 2015.**

- Sales of existing homes up +10% to +13%.
- Average prices increase modestly (+1.5%).

➤ **Mortgage Delinquency Rates Decline.**

- PA Peaks at 5.0% in 2010 Q2. US peaks at 8.9%.
- Since then: 4.7% (2013); 3.8% (2014); 2.2% (2015).

➤ **Share of Homeowners Underwater Declines.**

- PA: 2013 (7.4%); 2014 (6.9%); 2015 (5.4%).
- US: 2013 (13.3%); 2014 (10.8%); 2015 (8.1%).

PA Inflation Decelerates

➤ **Low Gas Prices Original Cause.**

- Rapid decline in August 2014.
- Begins to rise March 2015.
- Drops again July 2015.

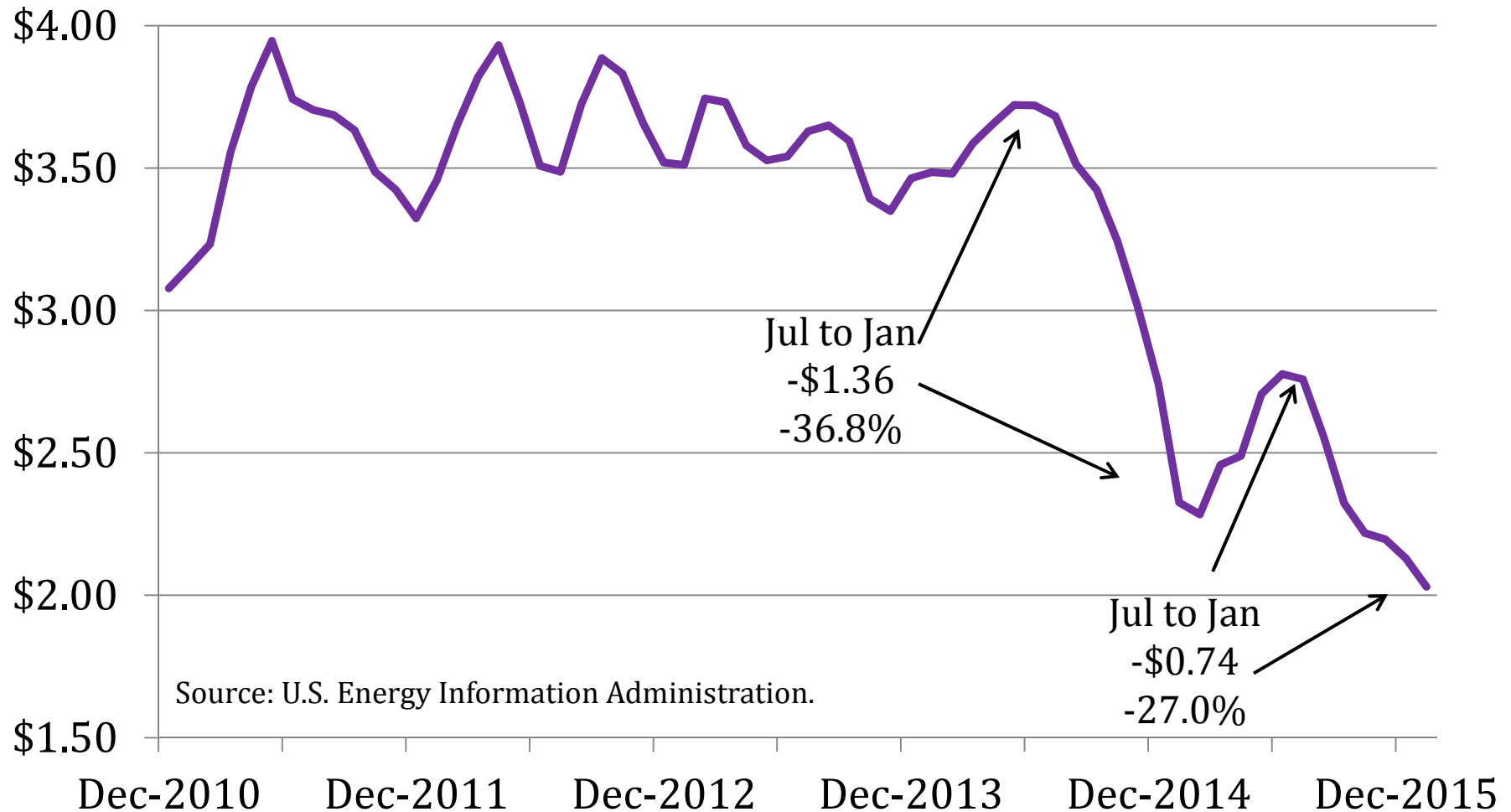
➤ **Deflation Has Now Spread to Other Products.**

- Furniture and clothing.
- Ripple effect from low gas prices?
- Strong dollar makes imports cheaper.

➤ **Notable Exception: Services.**

- Deflation is limited to goods or commodities.

Mid-Atlantic Gas Prices Plunge



PA Deflation

	Dec 2014	Jun 2015	Dec 2015	Weight
All Items – Philly CPI-U	0.6%	0.2%	-0.2%	100.0%
Gasoline	-21.5%	-25.4%	-20.4%	3.5%
Home Fuels/Utilities	-3.1%	-5.5%	-6.0%	5.8%
Clothing	-1.0%	-8.3%	-2.9%	3.1%
Home Furnishings	-1.9%	0.7%	-2.1%	4.0%
All Goods	-1.8%	-3.3%	-2.9%	34.4%
All Services	1.9%	2.1%	1.2%	65.6%
Core CPI-U: Excl. Energy	2.0%	1.9%	0.9%	91.9%

Source: U.S. Bureau of Labor Statistics. Growth rates are year-over-year change.

Revenue Outlook

Original Projection: June 15, 2015

Next Projection: May 1, 2016

General Fund Revenue Estimates

FY 2014-15	\$30,592
FY 2015-16 Estimate	\$30,722
Change	\$130
Growth Rate	0.4%

FY 2014-15 One Time Revenues

Large Inheritance Tax Payment	+\$100
Change Escheats Holding Period	+\$380
Transfers from Special Funds	<u>+\$322</u>
Total	\$802

Note: dollar amounts are in millions.

General Fund Estimate FY 2015-16

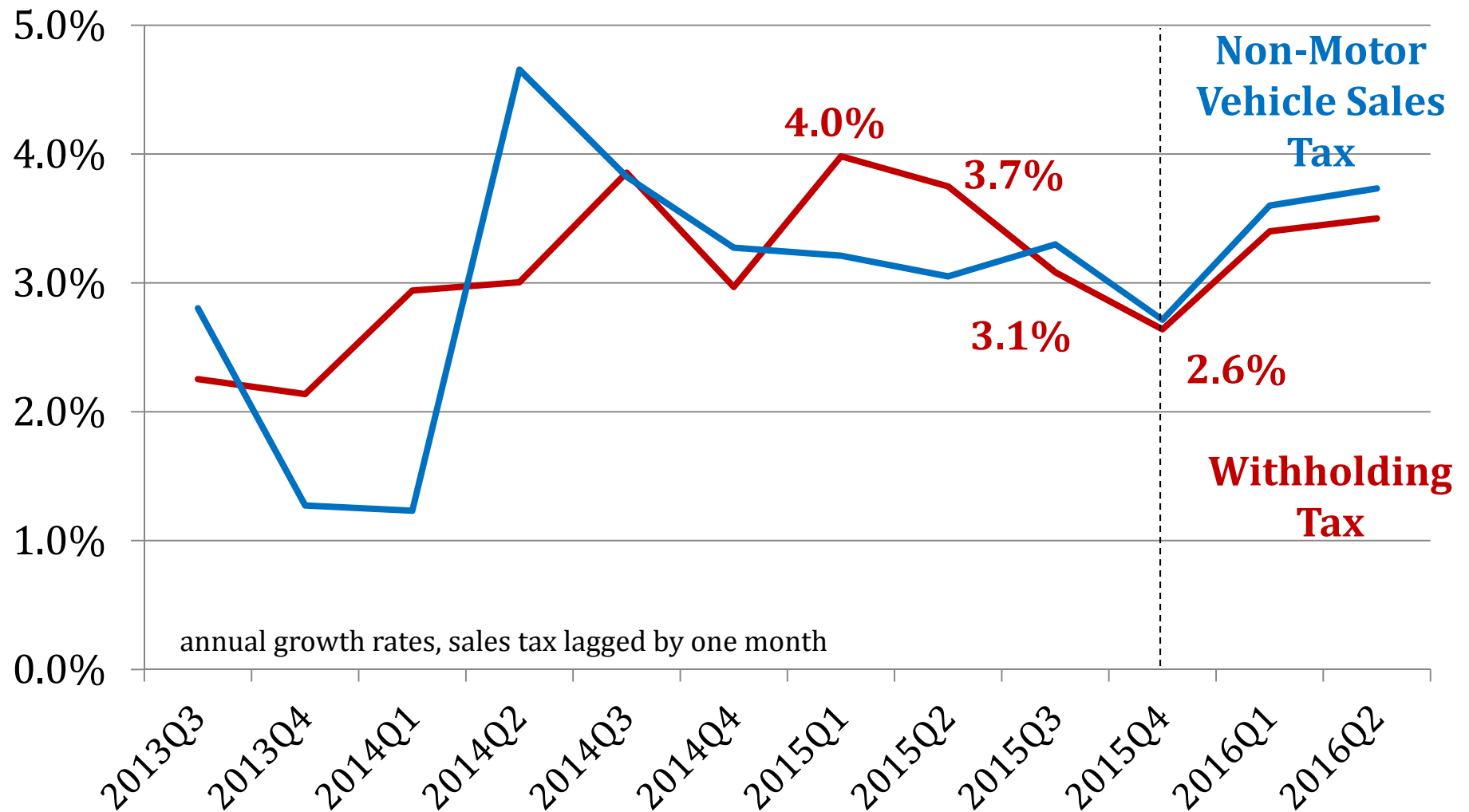
	<u>Through January</u>			<u>Revised Estimate</u>	
	Actual	Estimate	Diff	Amount	Change
General Fund	\$15,952	\$15,713	\$239	\$30,922	\$200
Corp. Net Income	1,370	1,396	-26	2,739	→ -50
Capital Stock	98	67	31	136	30
Sales and Use	5,838	5,828	9	9,830	→ -10
PIT – Withholding	5,389	5,425	-36	9,467	→ -48
PIT – Other	1,299	1,142	158	3,305	158
Realty Transfer	295	263	32	473	40
All Other Taxes	1,450	1,389	62	4,403	55
Non-Tax Revenue	212	203	9	569	25

Note: dollar amounts are in millions. January actuals are based on collections through 1/22/2016.

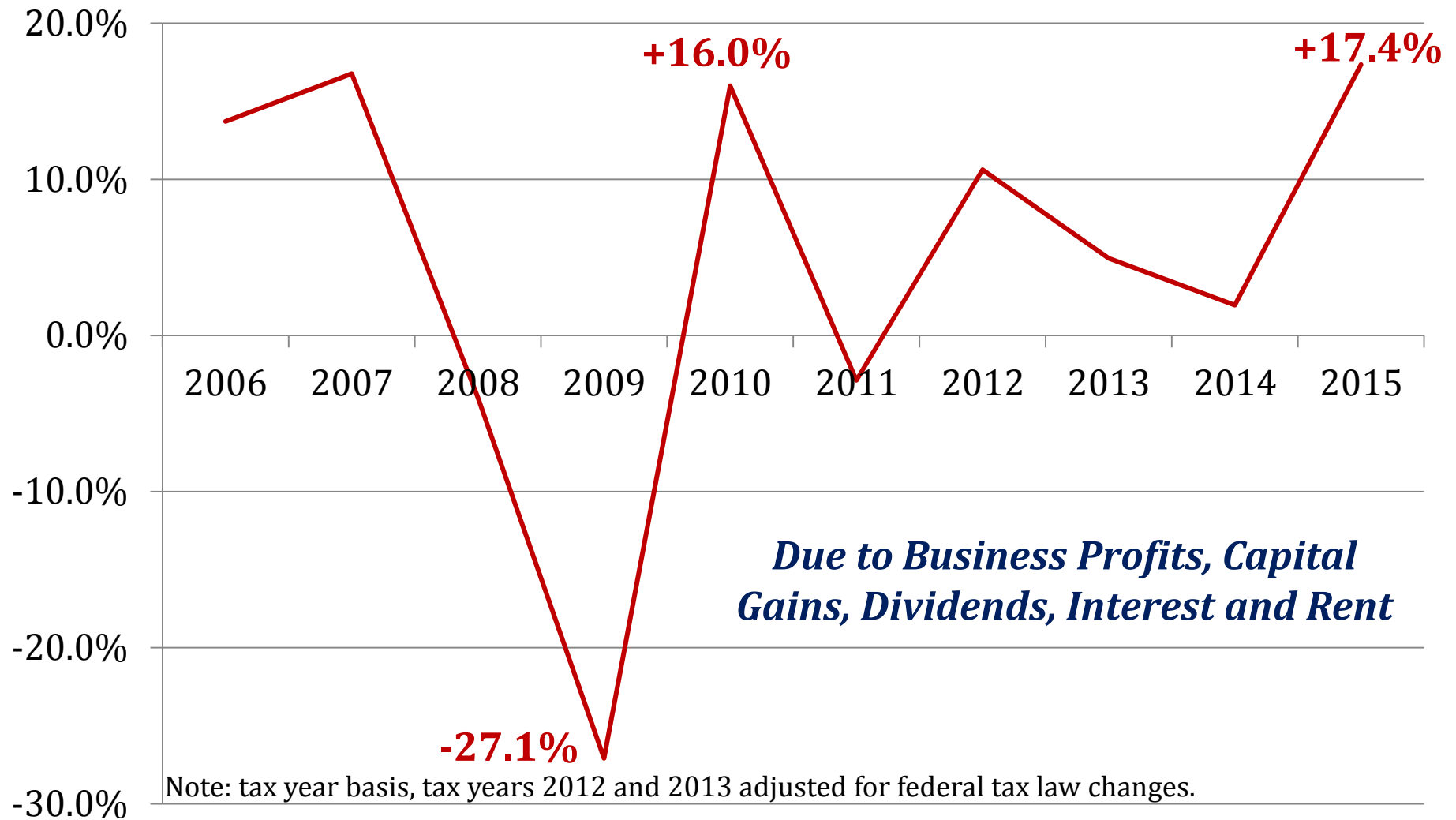
Two Outcomes: Personal Income Tax

- **Wage Income ~78% of Tax Base.**
 - Wage growth weakens in Q3 and Q4.
 - Lower withholding. Restrains growth of sales tax.
- **Business Profits and Capital Income (dividends, cap gains, interest, rent) ~22% of Tax Base.**
 - Very strong growth in estimated payments: ~+17%.
 - Unclear what income source drives that result.

Withholding and NMV Sales Tax



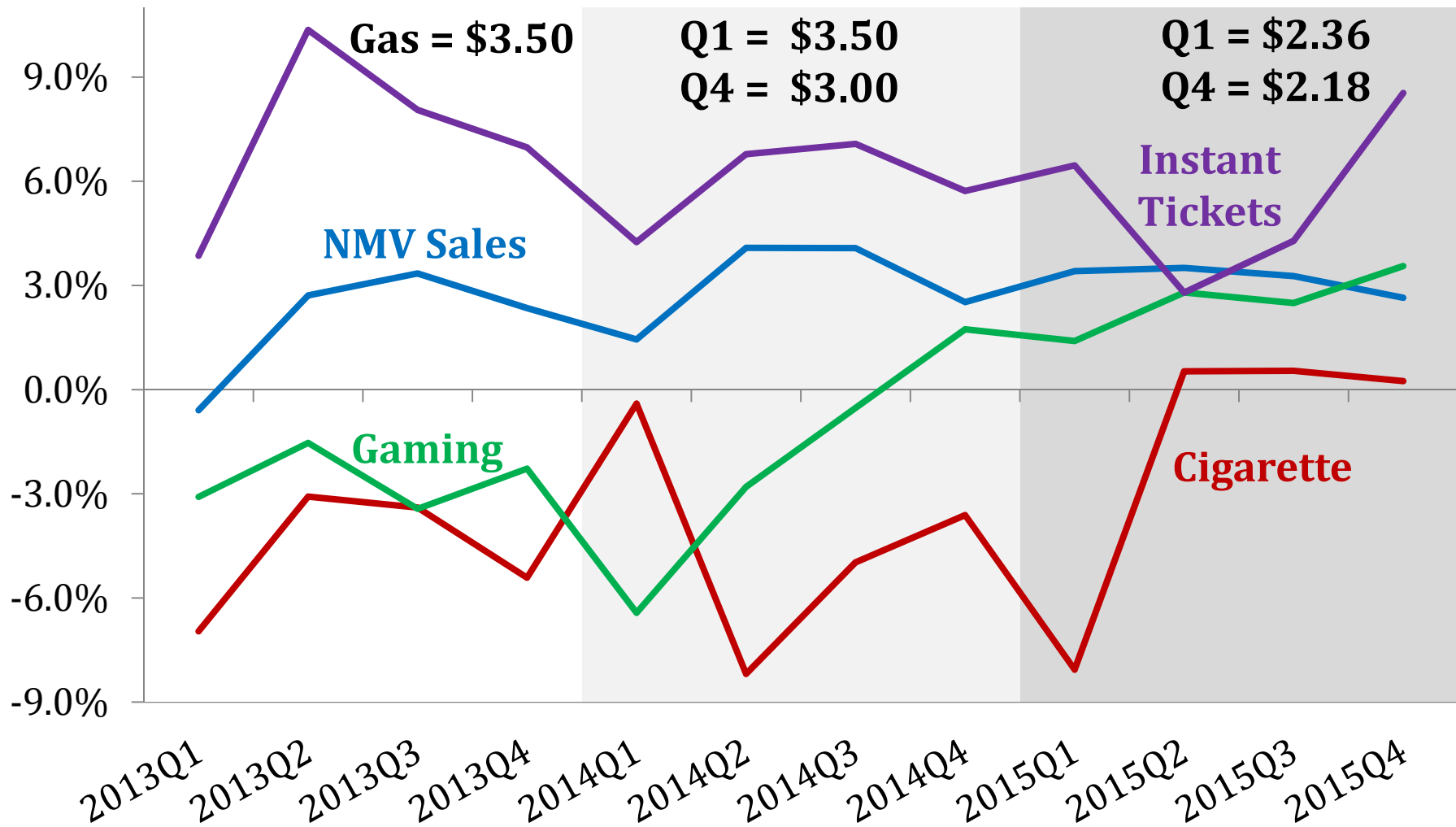
Strong PIT Estimated Payments



Are Low Gas Prices Boosting SUT?

- **Expected Boost to Sales and Use Tax.**
 - Projected \$50-\$75 million gain. Looks too high.
 - Dining Out and Car Purchases up, but other gains minor.
- **Cigarette Sales Appear to Benefit.**
 - Most sales take place at gas stations.
 - Slight increase in growth, as opposed to decline.
- **Slots and Table Games Appear to Benefit.**
 - Both show recent growth.
 - Lottery Instant Ticket sales also robust.

Low Gas Prices Affect Purchases



Note: Cigarette sales control for reduction due to the Philadelphia tax increase.

FY 2016-17 Advance Estimate

	2015-16	2016-17	Dollar	Growth
General Fund	\$30,922	\$31,525	\$604	2.0%
Corp. Net Income	2,739	2,775	36	1.3
Capital Stock	136	0	-136	n.a.
Sales and Use	9,830	10,178	348	3.5
PIT – Withholding	9,467	9,723	256	2.7
PIT – Other	3,305	3,490	186	5.6
Realty Transfer	473	496	23	4.9
All Other Taxes	4,403	4,425	22	0.5
Non-Tax Revenue	569	439	-130	-22.9

Note: dollar amounts are in millions.

Revenue Outlook Summary

- **Upsides and Downsides for Current Fiscal Year.**
 - Final PIT payment in April may be stronger.
 - Capital Gains is a wild card.
 - Withholding growth could be stagnant.
- **Stock Market Impact on Consumer Confidence?**
 - Possible, but unlikely. Labor market is healthy.
 - Other fundamentals are strong: debt levels, low interest rates and energy prices, housing market.

Long-Term Projections and Surplus/Deficits

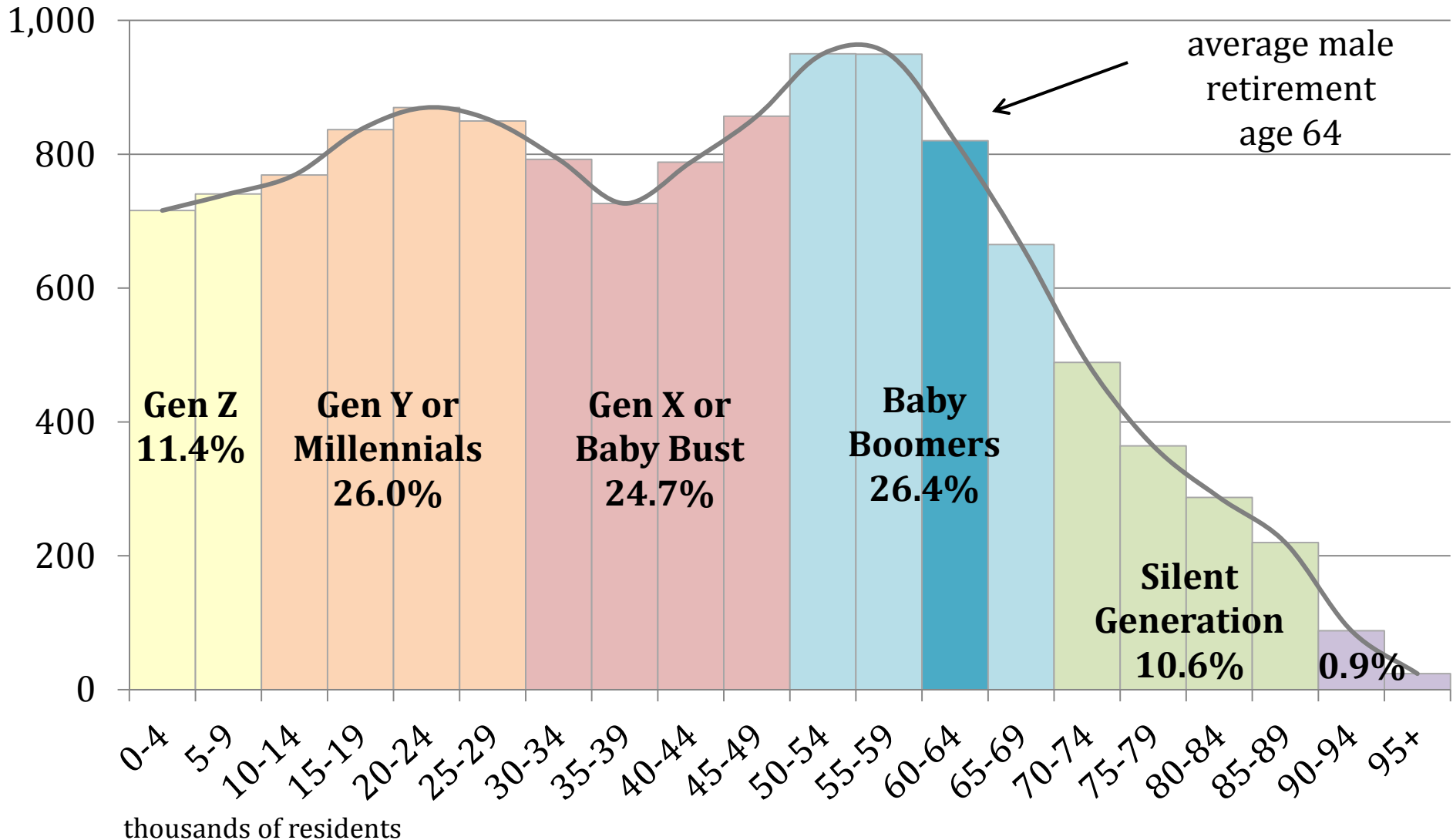
Quick word on demographic trends
Revenues and expenditures for FY 2015-16 and beyond
Structural imbalance

Snapshot: 2005 - 2015 - 2025

Age	Number of Residents			Gain or Loss		Avg. Ann. Growth	
	2005	2015	2025	2005-15	2015-25	2005-15	2015-25
0-19	3,226	3,062	3,048	-164	-14	-0.5%	0.0%
20-39	3,122	3,238	3,378	116	139	0.4%	0.4%
40-59	3,622	3,545	3,107	-77	-438	-0.2%	-1.3%
60-79	1,900	2,338	3,001	438	663	2.1%	2.5%
80+	<u>580</u>	<u>619</u>	<u>705</u>	<u>39</u>	<u>86</u>	<u>0.6%</u>	<u>1.3%</u>
Total	12,450	12,803	13,239	353	436	0.3%	0.3%

Note: thousands of residents. Source: Pennsylvania State Data Center.

Demographic Waves - 2015



FY 2015-16 Appropriations??

- **Starting Point: Appropriations from HB 1460.**
 - Version passed by the House and Senate.
 - Do not incorporate line-item vetoes made by the governor.

- **Two Exceptions:**
 - Line-item vetoes that reduced spending to the level in the “framework” agreement were used (-\$82 million).
 - Appropriations for state-related schools are based on the framework agreement .

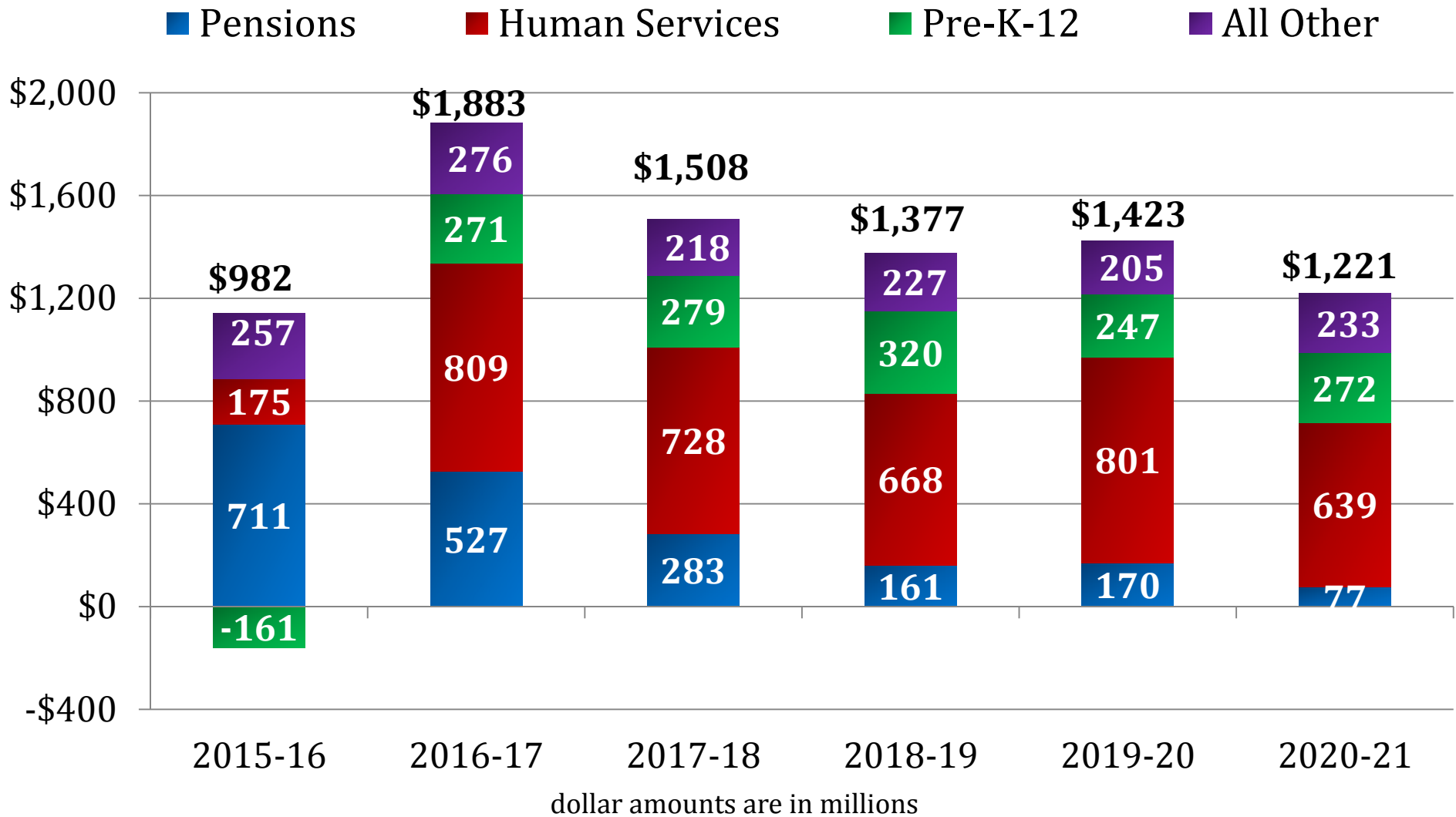
- **Appropriation Level Could Be Considered a Floor.**

Temporary Gains for FY 2015-16

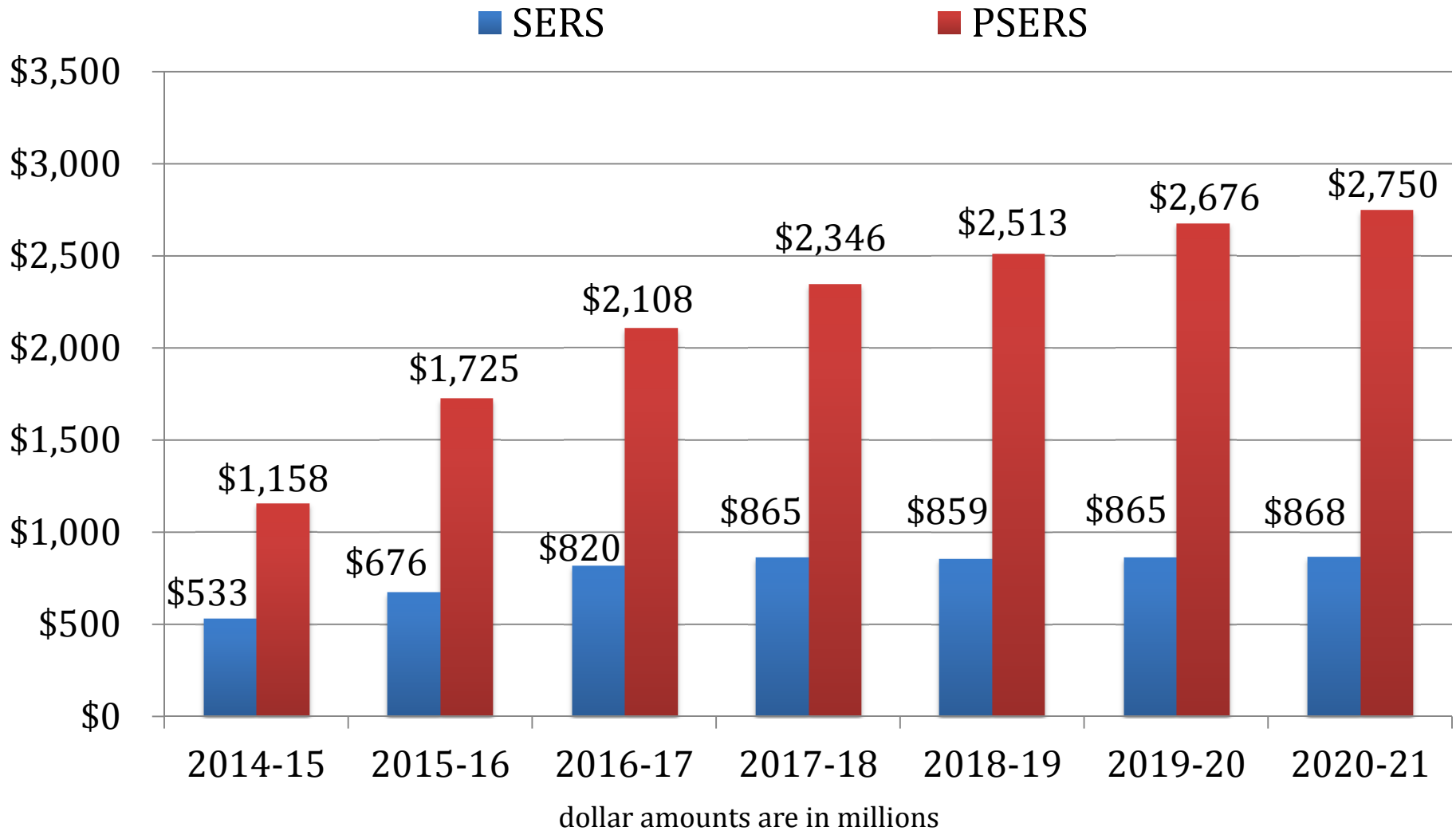
Delay County Child Welfare	-\$170
Delay School District Social Security	-\$90
Eliminate PlanCon	<u>-\$306</u>
Expenditure Reductions	-<u>\$566</u>
Last Year of Capital Stock	+\$136
Extra Withholding Payment	+\$110
Liquor Store Profits	+\$20
Transfers from Special Funds	<u>+\$26</u>
Revenue Gains	<u>+\$292</u>

Note: dollar amounts are in millions.

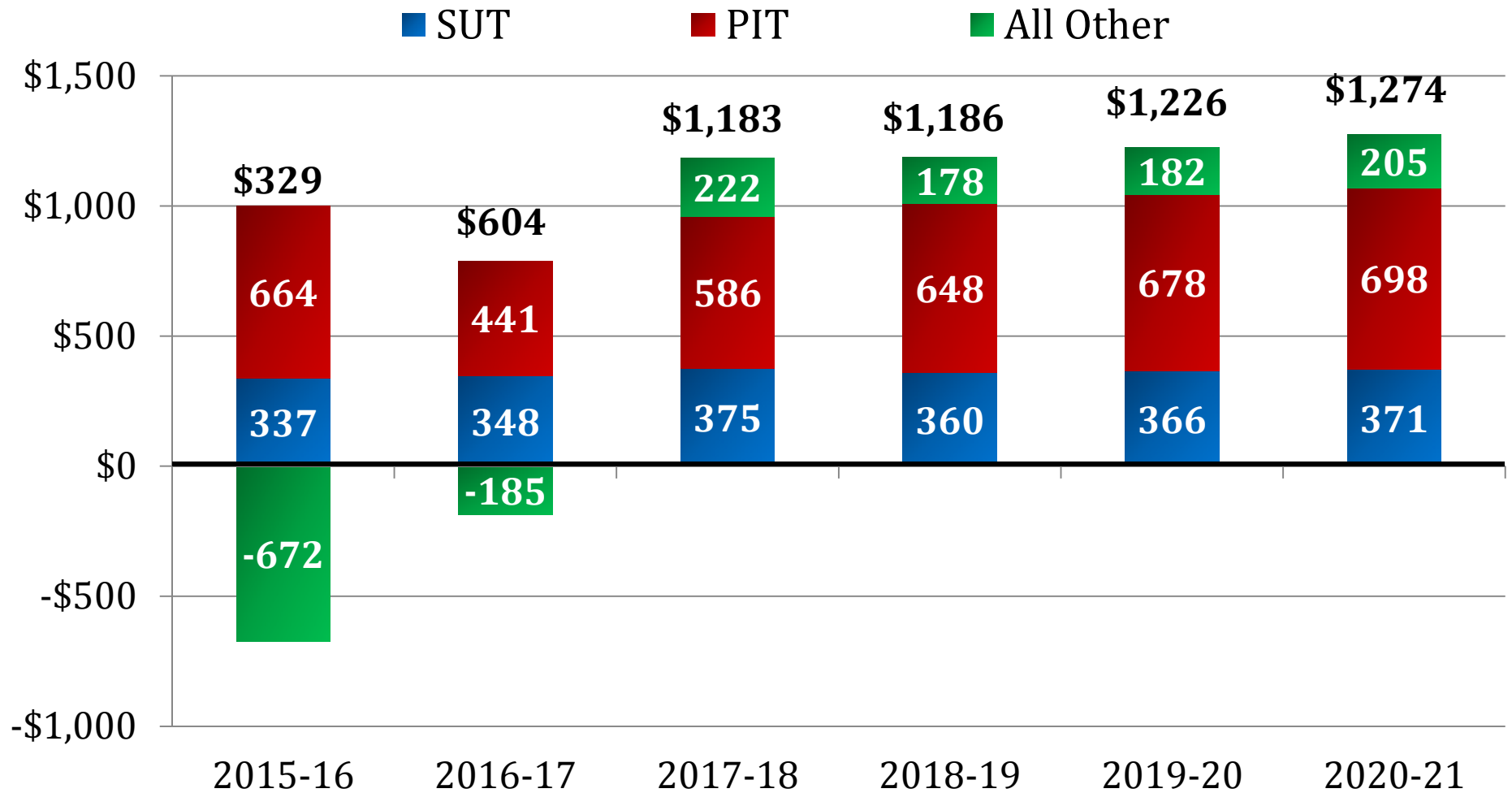
Contributions to Expenditure Growth



Growth in Pension Contributions



Contributions to Revenue Growth



dollar amounts are in millions

Long-Term Structural Imbalance

General Fund Balance Sheet

	15-16	16-17	17-18	18-19	19-20	20-21
Beginning Balance	\$266	--	--	--	--	--
Available Revenue	29,422	\$30,155	\$31,318	\$32,465	\$33,646	\$34,865
State Expenditures	<u>-30,181</u>	<u>-32,065</u>	<u>-33,573</u>	<u>-34,950</u>	<u>-36,373</u>	<u>-37,594</u>
Current Year Balance	-760	-1,910	-2,255	-2,486	-2,727	-2,729
Lapses and Supplementals	<u>175</u>	<u>50</u>	<u>75</u>	<u>100</u>	<u>100</u>	<u>100</u>
Ending Balance	-318	-1,860	-2,180	-2,386	-2,627	-2,629

Note: dollar amounts are in millions.

Long-Term Outlook Summary

- **Elements Driving Structural Deficit Unchanged.**
 - Demographic trends affecting revenues and expenditures.
 - Modest revenue growth and tax base erosion.
 - Cost drivers (e.g., pensions, Medical Assistance and debt service) continue to drive expenditure growth.

- **Recent Spending Bill Reduces Short-Term Deficit.**
 - Changes in reimbursements have temporary impact.
 - Has little impact on long-term structural deficit.

Questions / Discussion

- All Reports and Presentations posted on IFO website: www.ifo.state.pa.us.
- Next Release on May 1, 2016.
- Thank You!