

Commonwealth of Pennsylvania
2017 Revenue Conference

IFO Mid-Year Update





January 25, 2017

EMBARGOED UNTIL 4:00PM ON JANUARY 25, 2017

IFO Mid-Year Update

- ▶ **Presentation has three parts.**
 - Economic update. Unexpected broad weakness.
 - Revenue update for FY 2016-17.
 - Revenue forecast for FY 2017-18.
- ▶ **Theme: What is driving weakness?**
 - Base General Fund growth rate is ~0.0%.
 - Both economic and technical factors are cause.
 - Inflation, business spending and consumers.
- ▶ **No public presentation.**
 - But will be posted to IFO website.

Economic Forecast Comparison

		<u>Annual Growth Rates or Change</u>				
		2015	2016	2017	2018	
Real GDP	Jun 2016	1.7%	1.9%		2.0%	
	Jan 2017	2.8%	0.7%		1.7%	2.0%
Total Wages	Jun 2016	3.4%	3.2%		3.7%	
	Jan 2017	4.0%	2.5%		3.3%	3.8%
CPI-U	Jun 2016	-0.1%	1.2%		1.8%	
	Jan 2017	-0.1%	0.6%		1.8%	2.1%
Employment (000s)	Jun 2016	48.6	50.1		50.6	
	Jan 2017	48.6	43.5		50.0	48.9
<p>Note: Real GDP and Wage data revised from preliminary to final for 2015. Source: Historical data from U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecasts by IFO.</p>						

PA Employment Growth (000s)

	2014	2015	2016	2017
Mining-Logging	1.7	-3.6	-8.6	0.9
Construction	4.9	4.8	0.2	3.1
Manufacturing	3.0	0.5	-2.2	1.5
Wholesale-Retail	2.6	3.6	5.3	5.2
Transportation	7.5	10.1	5.2	4.4
Professional Services	13.6	13.4	12.0	10.9
Health-Social	14.4	11.7	15.9	15.3
Leisure-Hospitality	5.3	9.5	12.3	7.4
State-Federal Govt	-2.0	1.4	0.8	-1.2
Local Govt	-7.5	-7.5	-3.4	-1.6
All Other	<u>4.1</u>	<u>4.3</u>	<u>5.9</u>	<u>4.1</u>
Total Job Gains	47.6	48.6	43.4	50.0

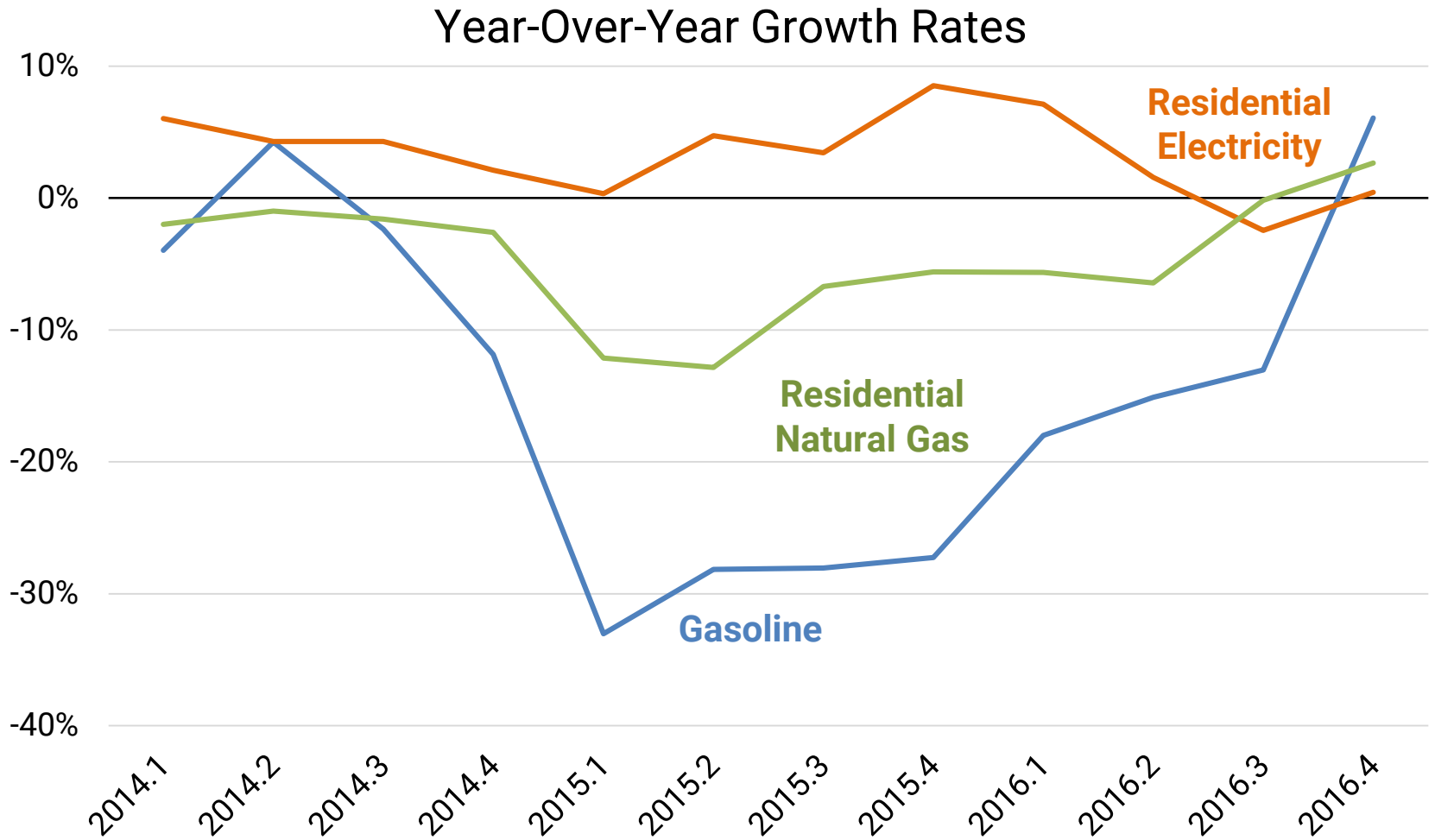
Note: Figures represent change in average level for calendar year.
 Source: U.S. Bureau of Labor Statistics. Forecast by IFO.

PA Inflation Picks Up

	<u>Year-Over-Year Increase</u>				
	2015.4	2016.1	2016.2	2016.3	2016.4
Philly CPI-U (100%)	-0.4%	0.2%	0.4%	0.6%	1.5%
Fuel-Utilities (5%)	-5.5	-4.8	-2.8	-1.6	0.2
Gasoline (3%)	-26.1	-17.7	-13.7	-9.8	7.2
Core CPI-U (92%)	1.1	1.2	1.1	1.1	1.5
Food (13%)	0.9	0.8	-0.5	-0.5	-0.9
Medical (9%)	3.1	3.0	3.7	4.0	3.4

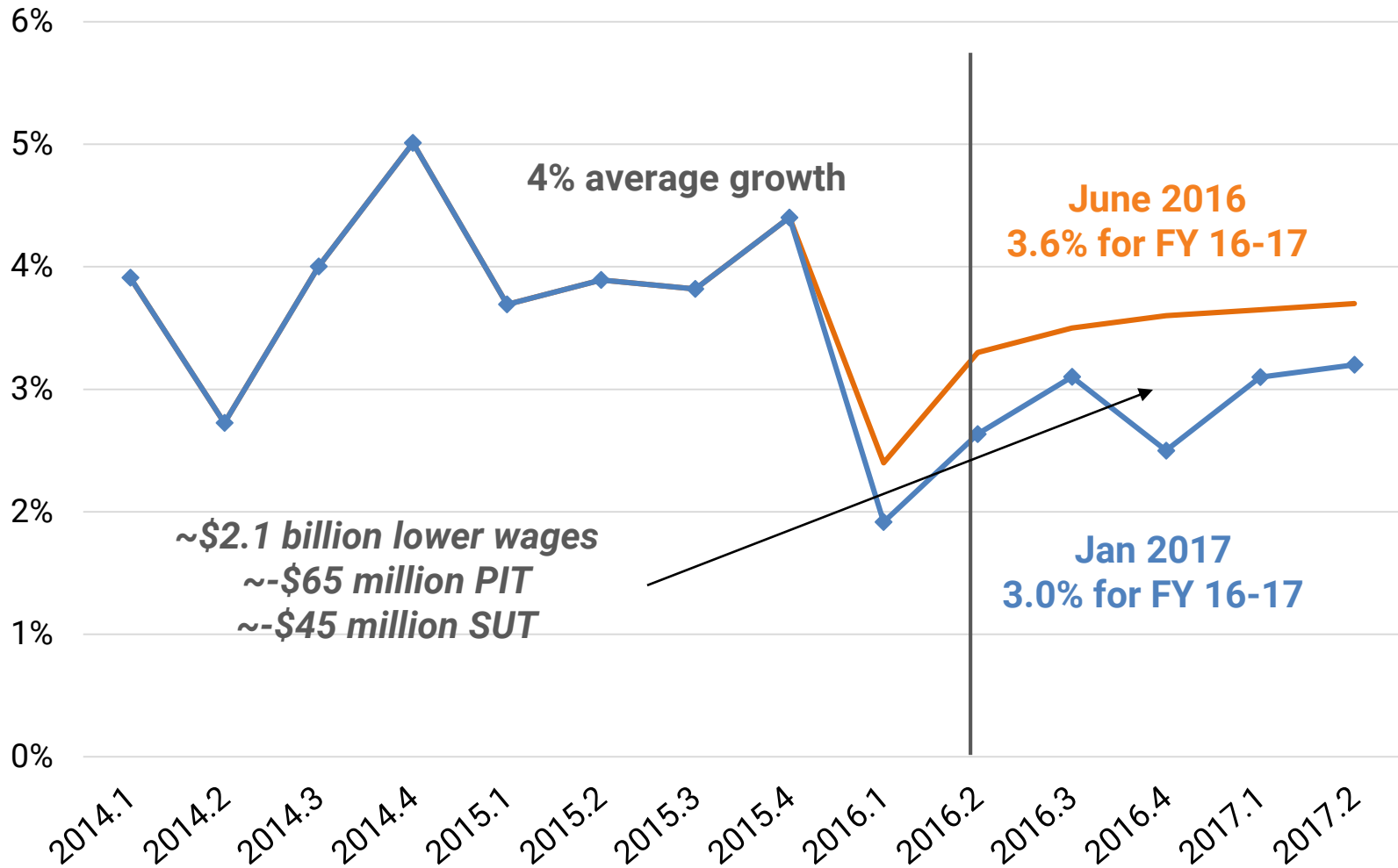
Note: Amounts in parenthesis represent weights used in CPI computation.
Core CPI-U excludes all energy purchases such as household fuel and gasoline.
Source: U.S. Bureau of Labor Statistics.

PA Energy Inflation Returns



Source: U.S. Energy Information Administration.

PA Wage Growth Underperforms



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

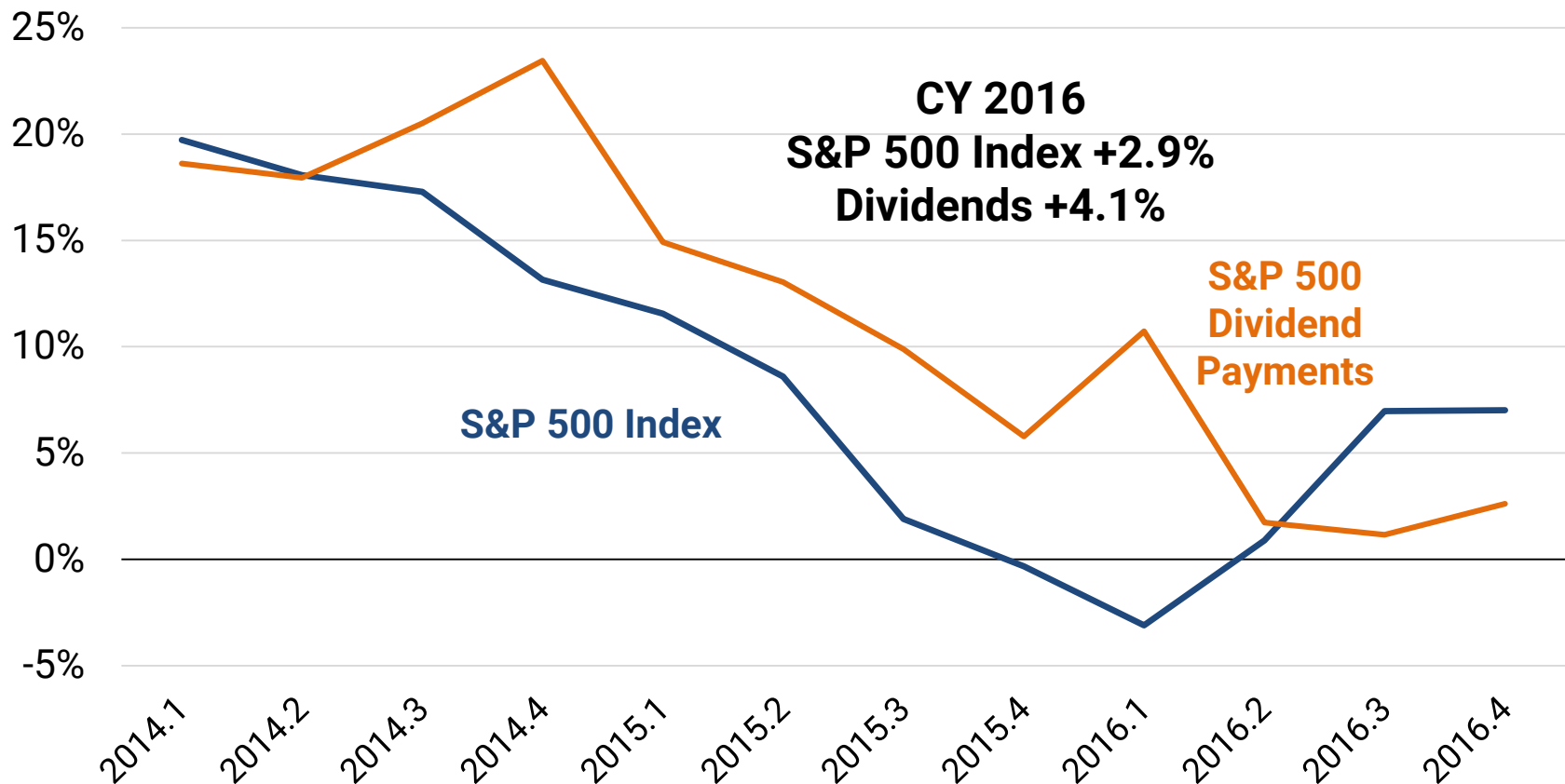
U.S. Profits and Business Investment

	<u>Year-Over-Year Growth Rate</u>				
	2012	2013	2014	2015	2016
Domestic Corporate Profits	15.0%	1.7%	6.2%	-2.2%	-1.5%
Non-Financial	10.7	6.9	5.5	-3.6	
Financial	31.0	-14.9	9.2	3.3	
Equipment Investment	10.8	4.6	5.4	3.5	-2.5
	2015.4	2016.1	2016.2	2016.3	2016.4
Domestic Corporate Profits	-13.7%	-8.3%	-7.7%	0.3%	11.3%
Non-Financial	-15.9	-6.9	-7.5	-2.9	
Financial	-4.8	-13.0	-8.5	11.9	
Equipment Investment	4.2	-1.0	-1.6	-4.6	-2.2

Note: Represents Economic Profits, which includes the Capital Consumption Adjustment for depreciation. Excludes foreign profits and Federal Reserve Profits. Includes both C and S corporations.
Source: U.S. Bureau of Economic Analysis. 2016 Q4 forecast from IHS Economics.

Financial Markets Recover

Year-Over-Year Growth Rates



Note: Dividend data for 2016 Q4 is an estimate.
Sources: Yahoo Finance and Factset.

Revenue Outlook

Original IFO FY 2016-17 Estimate

	Dollar Amount	Growth	Policy & Timing	Adjusted Growth
General Fund	\$32,510	5.2%	\$1,085	1.7%
Corporate Net Income	2,945	3.6	26	2.7
SUT - Non-Motor	8,859	4.9	90	3.8
SUT - Motor	1,382	2.6	0	2.6
PIT - Withholding	9,680	3.1	114	1.9
PIT - Other	3,376	8.4	33	7.3
Cigarette and OTP	1,331	46.0	448	-3.1
Inheritance	1,013	5.3	4	4.9
Loan and Transfers	266	n.a.	266	n.a.
All Other	3,658	-5.8	104	-8.5

Note: dollar amounts in millions.

General Fund Revenues Through January

	2015-16	2016-17	Actual Growth	Adjusted Growth
General Fund	\$15,900	\$16,085	1.2%	0.1%
Corporate Net Income	1,367	1,245	-8.9	-6.1
SUT - Non-Motor	5,048	5,110	1.2	0.8
SUT - Motor	782	790	1.0	1.0
PIT - Withholding	5,388	5,480	1.7	2.9
PIT - Other	1,279	1,230	-3.8	-3.8
Cigarette and OTP	529	765	44.6	-3.8
Inheritance	515	533	3.4	3.4
Cap. Stock & Franchise	98	32	-67.1	n.a.
All Other	894	900	0.6	-2.2

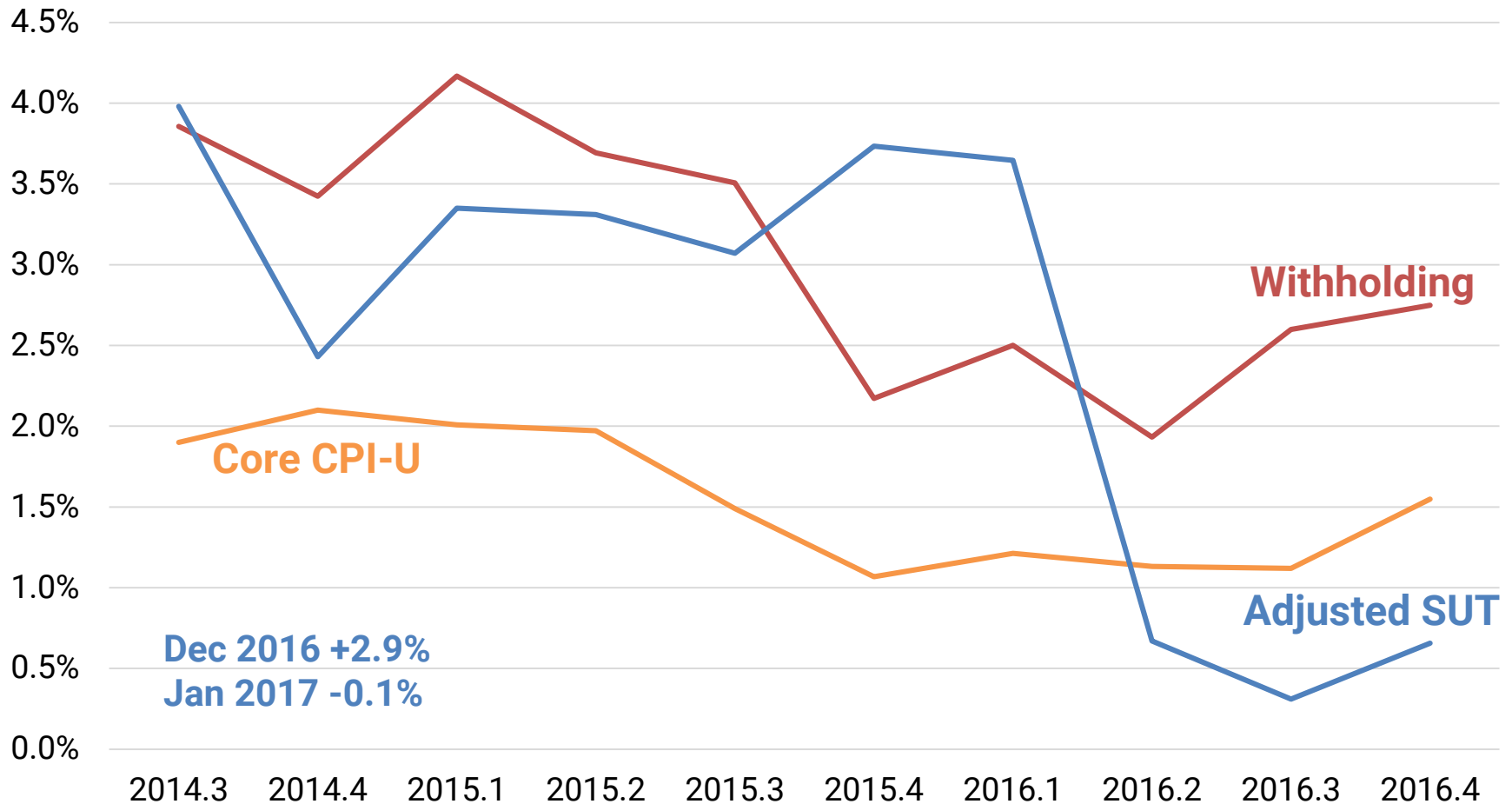
Note: Corporate net income adjusted for extra ERCA monies removed through January (\$39 million, to be deposited in June). Non-motor SUT and Tobacco adjusted for tax changes. PIT – withholding adjusted for extra due date. CSFT assumed to be zero both years.

IFO Revised Estimate FY 2016-17

	<u>Through January</u>			<u>Revised Estimate</u>	
	Actual	Estimate	Diff	Amount	Change
General Fund	\$16,085	\$16,456	-\$371	\$32,060	-\$450
Corporate Net Income	1,245	1,329	-84	2,845	-100
SUT - Non-Motor	5,110	5,300	-190	8,619	-240
SUT - Motor	790	805	-15	1,367	-15
PIT - Withholding	5,480	5,520	-40	9,620	-60
PIT - Other	1,230	1,289	-59	3,301	-75
Cigarette and OTP	765	755	10	1,347	15
Gross Receipts	40	32	8	1,300	40
Escheats	-40	-78	38	168	40
All Other	1,465	1,504	-39	3,494	-55

Note: dollar amounts in millions.

Non-Motor SUT Growth



Note: Adjusted SUT controls for expanded tax base and transfers. Uses one month lag to coincide with withholding and economic activity.

What Drives Weak Sales Tax?

- ▶ **Low inflation crimps pricing power.**
 - Last year Philly CPI-U $> 2.0\%$ was 2011.
 - Energy deflation. Now basics such as food and clothing.
 - Difficult for businesses to pass on costs. Hits profits.
- ▶ **Weak profits impact business purchases.**
 - Research suggests roughly 1/3 of SUT from business.
- ▶ **PA consumers reluctant to spend.**
 - Modest wage gains.
 - PA mortgage debt continues to fall (higher savings).
 - Auto loans remain strong.

PA Consumer Debt Growth

	<u>Year-Over-Year Growth Rates</u>				
	2015.3	2015.4	2016.1	2016.2	2016.3
Auto Loans (10%)	5.0%	8.6%	9.2%	9.4%	7.6%
Credit Card (7%)	3.0	5.2	4.5	1.8	3.6
Home Mortgage (60%)	1.4	0.0	2.7	3.0	-0.8
Home Equity (6%)	7.1	1.8	1.3	7.2	6.7
Student Loans (14%)	2.0	2.5	2.3	4.8	8.1
All Other (3%)	<u>11.6</u>	<u>8.3</u>	<u>10.7</u>	<u>2.5</u>	<u>-1.6</u>
Total (100%)	2.5	1.8	3.5	4.0	1.8
Exclude Student Loans	2.6	1.7	3.7	3.9	0.9


Note: Based on data from all consumers with a credit report. All Other includes personal loans and other miscellaneous lines of credit. Numbers in parenthesis represent share of total consumer debt for 2016 Q3.
 Source: Federal Reserve Bank of New York.

Strong Annual PIT Payment

April payment should have strong growth despite weak quarterly payments.

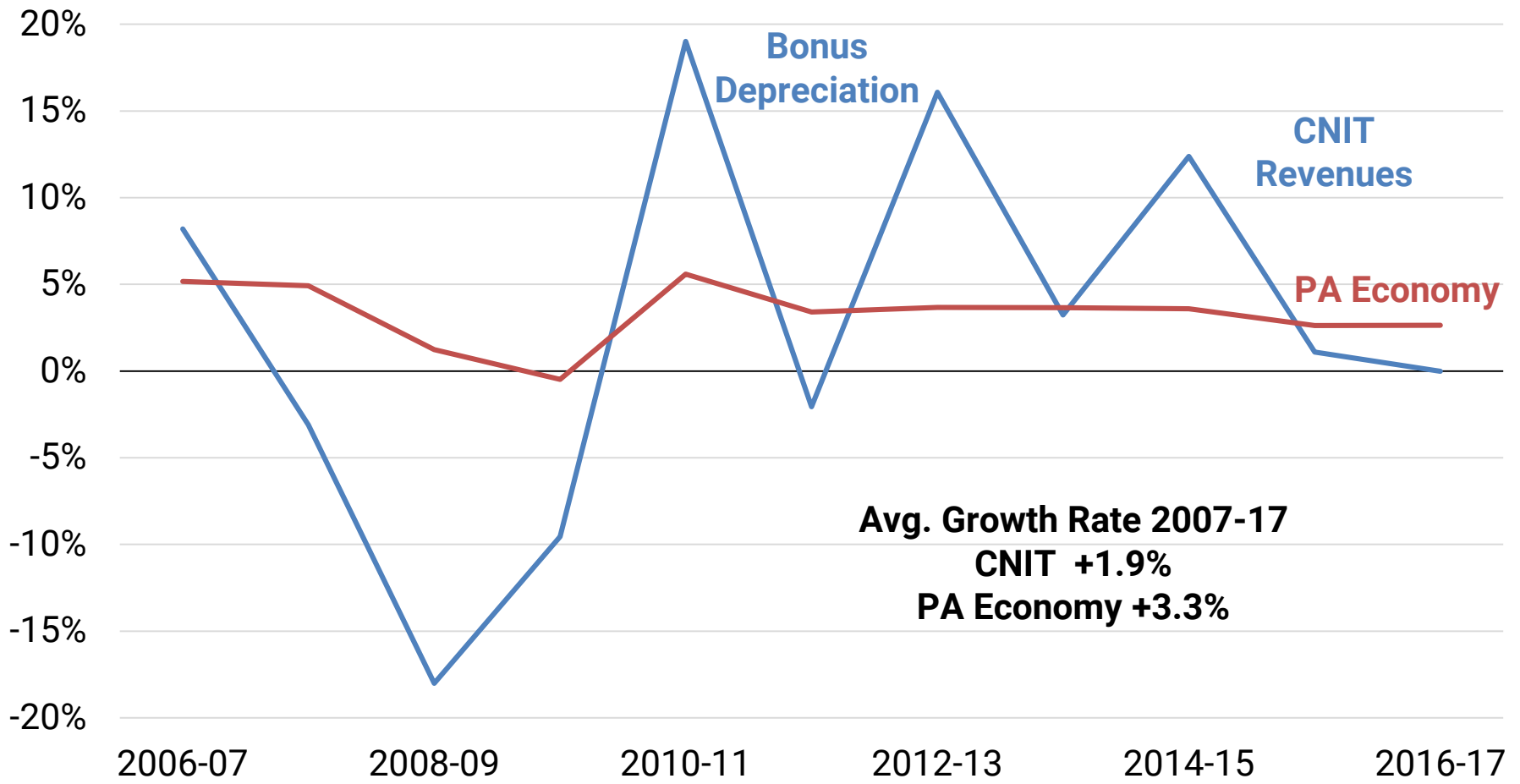
Tax Year	<u>Year-Over-Year Growth Rates (Quarterlies)</u>					Annuals	Combined
	Q1	Q2	Q3	Q4	Total		
2014	4.2%	0.1%	2.8%	0.1%	1.5%	6.8%	3.7%
2015	13.3%	17.2%	11.9%	20.1%	16.1%	-9.7%	5.4%
2016	3.1%	-10.6%	-4.2%	-0.9%	-3.1%	13.7%	2.9%

Note: Annual payments are for March to May only. Growth rate for 2014 controls for shift of revenues into tax year 2012 (\$130 million) due to federal tax law changes.


Annual Payment
\$1.12 billion

CNIT Growth Underperforms Economy

Annual Growth Rates: Corporate Net Income (CNIT) and PA Nominal GDP



Revisions to Estimates for Tax Policy

	<u>Original</u>		<u>Revised</u>		<u>Change</u>	
	16-17	17-18	16-17	17-18	16-17	17-18
Cigarette Tax	\$411.7	\$440.5	\$411.7	\$440.5	\$0.0	\$0.0
Other Tobacco	46.4	66.4	61.4	84.4	15.0	18.0
Liquor Code	72.8	81.8	43.5	62.1	-29.3	-19.7
Vendor Discount	61.5	70.4	61.5	70.4	0.0	0.0
Digital Downloads	45.7	59.2	80.2	112.2	34.5	53.0
Bank Shares	21.1	22.5	21.1	22.5	0.0	0.0
Table Games	17.6	18.2	17.6	18.2	0.0	0.0
Tax Amnesty	100.0	-10.0	100.0	-10.0	0.0	0.0

Note: dollar amounts in millions.

Lottery Sales

<u>Sales through January</u>			
	2015-16	2016-17	Growth
Instant Tickets	\$1,572	\$1,579	0.5%
Numbers	335	346	3.2%
In-State Lotto	141	142	0.7%
Multi-State Lotto	<u>350</u>	<u>226</u>	<u>-35.5%</u>
Total	2,398	2,293	-4.4%

Note: dollar amounts in millions. Multi-state lotto includes raffle.
Data for January are based on first three weeks of sales.

Enhanced Revenue Collections Account

	<u>Through January</u>		
	2015-16	2016-17	Change
Corporate Net Income	\$23.0	\$61.9	\$38.9
Sales and Use	60.5	49.3	-11.2
Personal Income	42.4	51.1	8.7
Gross Receipts	2.8	15.7	12.9
Inheritance	15.0	16.0	1.0
All Other	<u>4.2</u>	<u>1.3</u>	<u>-2.9</u>
Total	147.9	195.3	47.4

Note: dollar amounts in millions.
 Excludes PIT refunds. ERCA collections for FY 2016-17 are projected to total \$430 million, including \$100 million for tax amnesty (deposited to General Fund in June).

FY 2017-18 Revenue Outlook

- ▶ **Preliminary outlook for FY 2017-18 indicates a 1.8% growth rate.**
- ▶ **Underlying growth rate is 3.1% after adjusting for:**
 - Full-year collections from prior tax law changes.
 - One-time proceeds in FY 2016-17 from tax amnesty, fund transfers, loans from other funds, liquor modernization fees and litigation settlements.

FY 2017-18 Estimate

	Amount	Growth
General Fund	\$32,637	1.8%
Corporate Net Income	2,901	2.0
Sales and Use	10,252	2.7
Personal Income	13,381	3.6
Other Tax Revenue	5,500	0.8
Non-Tax Revenue	604	-29.1

Note: dollar amounts in millions.

Changes from Prior Estimates

	November 2016	January 2017	Total Revision
FY 2016-17	\$32,311	\$32,060	-\$250
FY 2017-18	\$32,971	\$32,637	-\$334
Two-year revision	n.a.	n.a.	-\$584

Note: dollar amounts in millions.

The IFO's revised estimate for FY 2016-17 is \$716 million lower than the official estimate certified by the governor in July.

Questions / Discussion

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