North Carolina General Fund Revenue Consensus Forecast: May 2022 Revision

Forecast Highlights

- **Upward Revision**

  Biennial General Fund revenue is expected to be $6.2 billion (10.8%) higher than the certified budget.

- **Job Growth is Stronger than Expected**

  Recent revisions to employment data show stronger than estimated job growth.

- **Inflation** reached a 40-year high in March 2022 at 8.5%.

- **Significant stock market returns and corporate profits** in 2021 were not anticipated and generated significant revisions to the forecast.

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The Fiscal Research Division and the Office of State Budget and Management have reached a consensus on a revised General Fund revenue forecast for the FY 2021-23 biennium.

This May 2022 forecast update expects revenue to increase by $6.20 billion (10.8%) over the two fiscal years of the 2021-23 biennium. This revision is relative to the certified budget, which was based on the June 2021 consensus forecast, with adjustments for changes enacted during the 2021 Regular Session. General Fund revenue collections are now expected to total $32.65 billion in FY 2021-22 and $30.71 billion in FY 2022-23.

May 2022 Revised General Fund Consensus Revenue Forecast ($ in millions)

	FY 2021-22	FY 2022-23
Revised General Fund Revenue Forecast	$32,651.2	$30,709.6
Certified Revenue	$28,409.9	$28,751.6
Change	$4,241.3	$1,958.0

Forecast Summary

Broad measures of employment and economic activity demonstrate that the State's economy has recovered from the depths of the pandemic-induced recession more quickly than anticipated in the June 2021 forecast and is now in the expansion phase of the business cycle.

Based on data available at the time of the June 2021 forecast, State employment was thought to be well below pre-pandemic levels, so the State was not expected to fully recoup job losses incurred as a result of the pandemic until early in calendar year 2022. However, a strong, upward revision to employment data released by the federal Bureau of Labor Statistics in March 2022 meaningfully shifted our understanding of the State's economic performance during the pandemic. The revised figures show that job growth was considerably stronger than initially estimated. State employment had returned to pre-pandemic levels by the summer of 2021 and, by March 2022, already exceeded our pre-pandemic forecast. The strong job market induced wage gains in excess of last year's forecast.

The June 2021 forecast expected an acceleration in inflation observed in the spring of 2021 to moderate quickly, as these price increases were largely concentrated in a few categories where prices had initially been cut at the beginning of the pandemic, such as airfare and hotels.

Contrary to expectations, inflation became widespread and surged to 8.5% in March 2022, the highest level seen since January 1982. Nevertheless, consumer demand outpaced inflation, as consumers continued to spend down savings accumulated

The revised forecast does not foresee a near-term recession.

Inflation is expected to decelerate but remain high during FY 2022-23, particularly because of uncertainty surrounding future consumer spending.

This year's "April Surprise" was especially positive, leading to final and extension payments now projected to exceed prior projections by over $1.4 billion.

Sales tax and corporate income tax collections are both estimated to exceed the previous forecast.

The likelihood of actual collections deviating from this forecast is heightened because the Department of Revenue was still processing April returns when this forecast was produced and last year's State budget allowing certain business entities to change how they pay income tax.

during the pandemic. Record-breaking stock market returns and corporate profits in 2021 were also unanticipated and generated significant revisions to the forecast.

The forecast for the upcoming fiscal year envisions slower economic growth as the current outlook faces significant headwinds. There is an elevated risk of recession during the forecast period given geopolitical uncertainty and evolving monetary policy by the Federal Reserve to address high inflation. Despite this risk, the forecast for the upcoming fiscal year does not foresee a near-term recession.

The forecast assumes inflation will decelerate but remain elevated during FY 2022-23. After mounting an especially robust recovery, corporate profits are expected to moderate. The trajectory of consumer spending is uncertain because it is unclear whether consumers will continue to spend accumulated savings in an uncertain inflationary environment. This forecast takes a conservative approach and assumes that continuing inflation and an uncertain economic outlook will significantly slow consumer demand as consumers become less willing to absorb price increases.

Current Fiscal Year Revenue

Revenue collections for FY 2020-21 are projected to surpass budgeted revenue by $4.24 billion (14.9%), based on strong year-to-date collections.

This revision is driven primarily by individual income tax collections. Collections from final income tax payments, typically due in mid-April, are difficult to predict because income from dividends, capital gains, and businesses can result in sizable swings in collections, which we refer to as the "April surprise." Because this year's April surprise was vastly higher, final and extension payments are now projected to exceed expectations by over $1.4 billion. Further, wage growth and the strong job market produced unexpected increases in individual income tax withholdings. Changes in the predicted timing of some individual income tax refunds, described in more detail in the next section, also boosted the current year forecast.

Sales and use tax collections are estimated to finish well ahead of forecast due to strong consumer spending and inflation. Corporate income tax collections also contributed to the revision because of stronger than expected corporate profits.

Even though only two months are left in the current fiscal year, the potential for actual collections to deviate from this forecast is heightened for two reasons:

- The Department of Revenue was still processing tax returns received in April at the time of this forecast, so complete tax season data was not yet available.
- The Current Operations Appropriations Act of 2021 (S.L. 2021-180, Sec. 42.5) included a provision that allows certain business entities to elect to pay the individual income tax that would normally be reported on a shareholder's or partner's tax return. This provision is expected to be revenue-neutral, but the transition may create significant timing-related revenue variances in quarterly income tax payments this year, potentially shifting some payments that we would expect to receive in the current fiscal year into the upcoming fiscal year.

FY 2022-23 Revenue

FY 2022-23 revenue is estimated to be $30.71 billion, an increase of $1.9 billion, 6.8% over the budgeted amount.

The FY 2022-23 forecast builds on the revised projections for the current fiscal year. Most of the upward revision is due to greater than expected income growth in

Individual and corporate income tax revenue's high performance is partially due to one-time revenues unlikely to occur again in the upcoming year.

Although year over year revenues from the certified budget are expected to grow by 1.2% in FY 2022-23, revenues are expected to decline by 5.9% relative to the prior year primarily due to timing issues.

Greater than expected sales tax and use revenues significantly contributed to the forecast's upward revision.

the current fiscal year, much of which will continue to be reflected in the upcoming fiscal year's revenue.

However, the strength in individual and corporate income tax revenue in the current year was partially due to income considered one-time in nature and is unlikely to recur in the upcoming fiscal year. While the certified budget expected FY 2022-23 revenue to grow by 1.2% year over year, this forecast expects a 5.9% decline in revenue relative to the prior year for the following reasons:

- Some of the increase in withholdings during FY 2021-22 was likely due to one-time bonus income payments.
- Surging stock prices in 2021 likely contributed to the "April surprise" in the current year.
- Proposed legislation to increase federal tax rates on corporate and capital gains, previously anticipated to become law, may have prompted corporate and individual taxpayers to shift income into 2021, boosting FY 2021-22 revenue at the expense of FY 2022-23.
- The Current Operations Appropriations Act of 2021 (S.L. 2021-180, Sec. 42.5) included a provision that allows certain business entities to elect to pay the individual income tax that would normally be reported on a shareholder's or partner's tax return. This provision is expected to be revenue-neutral, but the transition may create significant timing-related revenue variances in quarterly income tax payments this year, potentially shifting some payments that we would expect to receive in the current fiscal year into the upcoming fiscal year.

Higher expected sales tax and use revenues also significantly contributed to the upward revision.