

INDEPENDENT FISCAL OFFICE
Matthew Knittel, Director

Testimony Before the House Appropriations Committee
February 10, 2014

Chairman Adolph, Chairman Markosek and members of the committee, thank you for the opportunity to testify.

The Independent Fiscal Office (IFO) provided background materials to the committee regarding the office, the economy and major General Fund revenue sources. I will not review that material in the limited time for opening remarks. Rather, I would like to summarize the IFO's economic and revenue outlook for the current and next fiscal year.

A core function of the IFO is the provision of revenue estimates for consideration by the General Assembly. Our next formal release will be on May 1, when our preliminary revenue estimate is due. By June 15, the office will release its official, or final, estimate for FY 2014-15.

Although the office will not provide a formal estimate until May 1st, I would like to take this opportunity to outline our current thinking about the revenue outlook and the economy.

FY 2013-14 Revenue Outlook

The IFO recently published a mid-year update of its revenue estimate for the current fiscal year and concluded that a \$150 million reduction to the estimate was warranted. (For comparison, our revised estimate is about \$112 million lower than the estimate certified by the Governor for the current fiscal year. The recent Executive Budget did not change the certified number.) The IFO's reduction was based on two factors:

- At the mid-point in the fiscal year, growth rates for the General Fund and its key revenue sources were below the IFO's expectations.
- For the remainder of the fiscal year, it is unlikely that growth will reach the levels necessary to meet the IFO's original estimate.

Although we have reduced our estimate, it still relies on stronger growth in the second half of the fiscal year. Factors that likely affected economic growth and tax revenues in 2013, such as the expiration of the federal payroll tax cut and the federal budget sequester, should be fully absorbed at this point. However, recent wage growth and consumer spending does not appear to be strong enough to meet our original estimate.

For the first half of the fiscal year, General Fund revenues grew by 0.5 percent. The second-half growth rate necessary to meet our revised estimate is 1.8 percent. The January through June growth rates for major General Fund revenue sources are as follows:

- Corporate net income tax: 1.7 percent (vs. 1.3 percent in the first half).
- Sales and use tax: 3.9 percent (vs. 2.3 percent in the first half).
- Personal income tax withholding: 3.6 percent (vs. 2.2 percent in the first half).

Unlike last year, we do not expect strong growth in the final payment for personal income tax this April. April 2013 revenues were artificially inflated because taxpayers accelerated the receipt or recognition of certain income at the end of 2012 to avoid federal tax increases that took effect in 2013. With this behavioral effect now removed, we expect annual personal income tax payments in the spring of 2014 to return to a more normal pattern. Therefore, our estimate anticipates a 3 percent reduction in annual payments received during the second half of the fiscal year.

2014 Economic Outlook

Economic data released at the end of 2013 suggest that conditions are favorable to facilitate stronger growth in the U.S. economy in 2014. Businesses have cash balances available to expand hiring and investment. Households are in better financial shape to increase spending because they have paid down debt, especially credit card debt. Gains in the stock market and housing markets for 2013 may bolster consumer confidence and give rise to a “wealth effect” that facilitates more consumer spending. However, recent revenue data suggest that these conditions have not yet translated into higher spending levels.

We believe that the key to tax revenue growth in 2014 will be the labor market. Wages are highly correlated with overall economic growth, personal income and sales and use tax revenues. An increase in consumer spending is not sustainable without growth in wages. For 2013, wage growth was modest due to low inflation and significant slack in

the labor market, which reduces worker leverage. In order for workers to realize wage gains, the slack must be removed from the labor market. Hiring must increase for an extended period of time before that can occur.

For 2014, the IFO projects Pennsylvania wage growth of 3.6 percent, compared to 2.6 percent for 2013. The growth rate can be decomposed into two parts: (1) 1.0 percent for job growth (about 57,000 new jobs) and (2) 2.6 percent for wage inflation, mostly pay raises to current workers. An improvement in the labor market would support stronger sales and use tax and employer withholding collections.

FY 2014-15 Revenue Outlook

Stable federal tax policy and the resolution of federal budget issues remove some of the sources of uncertainty that have affected the economic and revenue outlooks in recent years. The IFO's preliminary look at FY 2014-15 revenues indicates an increase of about 3 percent over the current year. This growth rate does not include any additional revenues that might be received due to:

- The expansion of small games of chance to bars, restaurants and taverns.
- Proposed legislative changes to reduce the holding period for unclaimed property or to transfer monies from the Oil and Gas Lease Fund.
- Additional slots or table games fees from new casino openings

Thank you. I would be happy to answer any questions that you might have.

Background Information for the House Appropriations Committee

prepared by the
Independent Fiscal Office



February 7, 2014



INDEPENDENT FISCAL OFFICE

Second Floor, Rachel Carson State Office Building
400 Market Street
Harrisburg, Pennsylvania 17105

February 7, 2014

Dear Chairmen Adolph and Markosek:

Thank you for the opportunity to submit information to the House Appropriations Committee prior to our testimony at the February 10th hearing.

The enclosed material provides background regarding the Independent Fiscal Office (IFO) and its duties. It also offers information regarding the latest economic projections and significant General Fund revenue sources.

The IFO regularly publishes various materials relating to the economy, revenues and other fiscal matters. The latest versions of the *Monthly Economic Report*, *Revenue Trends Report* and the *FY 2013-14 Mid-Year Update* are included in this packet for the information of committee members. Additional reports and studies are available on our website at www.ifo.state.pa.us.

I look forward to addressing questions from committee members regarding the office, the state economy and the revenue outlook for this fiscal year and next.

Sincerely,

MATTHEW KNITTEL
Director

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Independent Fiscal Office - Overview

Background

The office was created by Act 120 of 2010. Matthew Knittel has served as director since the inception of the office in September 2011, and currently he supervises a staff of eight. Analysts generally have backgrounds in economics or other disciplines with a quantitative emphasis. The FY 2014-15 Executive Budget proposes an appropriation of \$1.675 million for the office, which is the same as the amount appropriated for the current fiscal year. The office employed a summer intern and anticipates filling a vacancy created by the departure of a staff member.

Mission Statement

The Independent Fiscal Office (IFO) provides revenue projections for use in the state budget process along with impartial and timely analysis of fiscal, economic and budgetary issues to assist Commonwealth residents and the General Assembly in their evaluation of policy decisions. In that capacity, the IFO will not support or oppose any policy it analyzes, and will disclose the methodologies, data sources and assumptions used in published reports and estimates. The IFO will seek to establish collaborative relationships with the General Assembly, executive agencies and various non-governmental organizations that have an interest in the policy making process.

Role in the Budget Process

The statute creating the IFO outlines several points at which the office is required to provide budget-related information to policy makers. In addition to the statutory duties, the IFO seeks to work with the majority and minority chairs of the Appropriations Committees to analyze the state economy and revenues. The deadlines for budget-related duties are as follows:

- | | |
|-------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| November 15 | Prepare an assessment of the state's fiscal condition for the current year and the succeeding five fiscal years by taking account of the state economy, demographics, revenues and expenditures. |
| January 31 | Convene a revenue conference with the chairs of the Appropriations Committees, the Secretary of the Budget and the Secretary of Revenue to discuss economic trends and revenue performance. |
| May 1 | Provide an initial revenue estimate for the remainder of the current fiscal year and the succeeding fiscal year. |
| June 15 | Provide a final revenue estimate for the current fiscal year and the succeeding fiscal year. |

Other Services

When possible, the IFO also provides economic and revenue analysis to members of the General Assembly. The office does not intend to duplicate services provided by the standing committees, but it seeks to use available state, federal and private data sources to expand the types of information and analysis available to policy makers.

IFO Reports and Analyses

Monthly Reports:

- *Revenue Trends Report.* Displays monthly and fiscal year-to-date revenues and compares them to the same period of the prior year. Presents three-month and twelve-month growth rate trends.
- *Monthly Economic Report.* A concise listing of the latest economic releases for Pennsylvania and the U.S.

Revenue Estimates:

- *Initial Revenue Estimate.* Due by May 1 each year.
- *Official Revenue Estimate.* Due by June 15 each year.
- *Quarterly Revenue Estimates.* Issued after the beginning of the fiscal year. Provides a quarterly breakdown of the IFO's official estimate with adjustments for tax law changes enacted in conjunction with the state budget.
- *Five-Year Economic and Budget Outlook.* Due by November 15 each year.
- *Quarterly Revenue Review.* Published after each quarter to compare the IFO's revenue estimates to actual revenues.
- *Mid-Year Update.* Published in January. Revised revenue estimate for the current year based on actual collections for the first half of the fiscal year and expectations for the second half.

Special Reports and Analyses *(issued since January 1, 2013):*

- Proposed Sales Tax Exemption: Aircraft Sales, Parts and Maintenance and Repair
- Corporate Tax Base Erosion: Analysis of Policy Options
- An Analysis of Medicaid Expansion in Pennsylvania
- Pennsylvania Turnpike Toll Revenue Projections: CY 2013 to CY 2024
- Uncapping the Film Production Tax Credit: A Fiscal and Economic Analysis
- School Property Taxes Paid by Homesteads
- An Analysis of Michigan Property Tax Reform
- Analysis of Proposal to Replace School Property Taxes: House Bill 76 and Senate Bill 76
- Analysis of School Property Taxes Paid by Homeowners Age 70 and Older
- 2013 Tax Comparison Study
- The Pennsylvania Lottery: Historical Data and Interstate Comparisons

All reports published by the office are available on its website at www.ifo.state.pa.us.

Independent Fiscal Office – Summary of Revenue Estimates

FY 2013-14 IFO Official Revenue Estimate

(\$ millions)

Revenue Source	Estimate	Growth
General Fund - Total	\$29,154	1.8%
Corporate Net Income	2,460	1.5%
Sales and Use	9,239	3.9%
Personal Income	11,720	3.1%
All Other	5,736	-3.7%*

* 0.8% growth rate for "all other" if the capital stock and franchise tax is excluded.

Actual First-half Growth Rates and Second-half Growth Rates Necessary to Meet Estimate

Revenue Source	Actual 1 st Half	2 nd Half Needed
General Fund - Total	0.5%	2.7%
Corporate Net Income	1.3%	1.7%
Sales and Use	2.3%	5.5%
Personal Income	2.7%	3.3%

FY 2013-14 IFO Official Revenue Estimate – Mid-Year Update

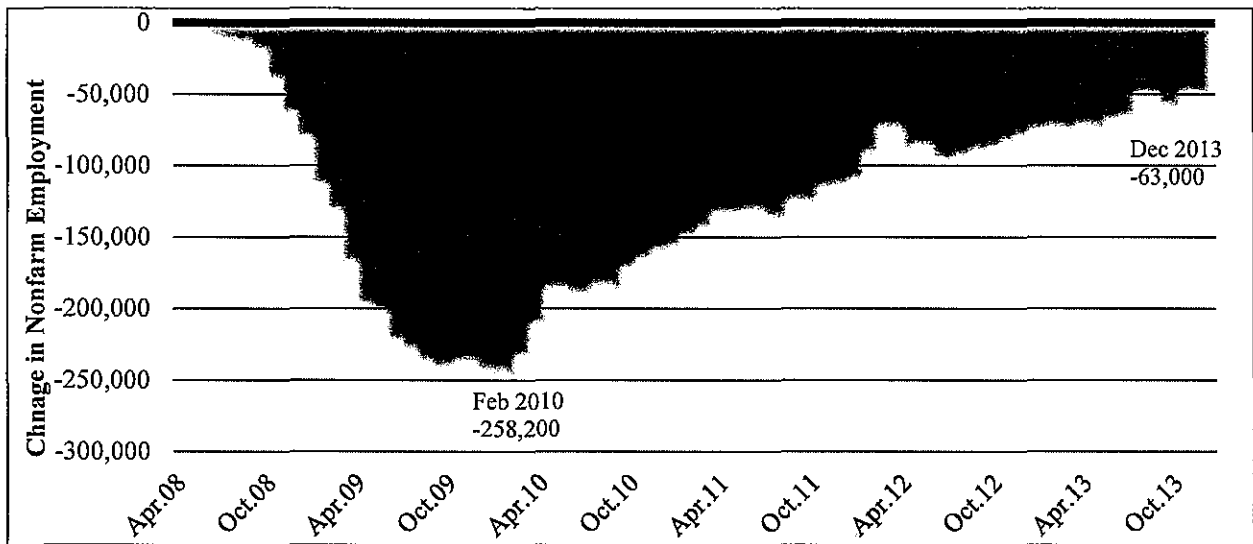
(\$ millions)

Revenue Source	Estimate Revision	Revised Estimate	Revised Fiscal Year Growth	Revised 2 nd Half Growth
General Fund - Total	-\$150	\$29,004	1.2%	1.8%
Corporate Net Income	0	2,460	1.5%	1.7%
Sales and Use	-70	9,169	3.1%	3.9%
Personal Income	-60	11,660	2.5%	2.4%
All Other	-20	5,716	-4.1%	-1.3%

The Pennsylvania Economy - Employment

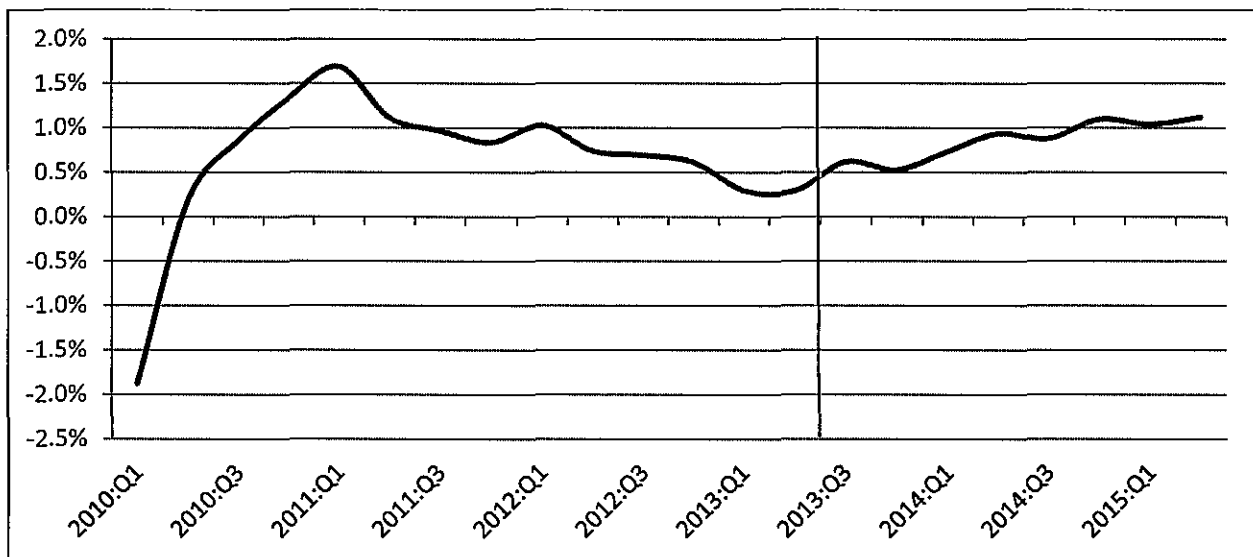
- In February 2010, Pennsylvania employment was 258,200 below its pre-recession peak. Employment has recovered somewhat since then, but it remains 63,000 below the peak.
- Employment growth in 2014 and 2015 is expected to be steady, but modest. At projected rates, the pre-recession peak could be reached in late 2014 or 2015.

PA Employment – Comparison to Pre-Recession Peak



April 2008 peak = 5,824,600 jobs. February 2010 trough = 5,566,400 jobs. December 2013 = 5,761,600 jobs.
 Current Employment Statistics, seasonally adjusted. Source: U.S. Bureau of Labor Statistics.

PA Nonfarm Employment – Year Over Year Growth Rates



Source: IHS Economics, January 2014 and the Independent Fiscal Office.

Employment – Total Job Gains / Losses Since the U.S. Peak

Pennsylvania (thousands of jobs)	2008 Q1	2013 Q4	change	percent
Natural Resource-Mining	21	35	14	65.2%
Construction	259	227	-32	-12.2%
Manufacturing	654	566	-88	-13.4%
Transportation-Utility	239	249	10	4.1%
Wholesale	240	225	-15	-6.3%
Retail	657	631	-26	-4.0%
Information	108	88	-19	-17.8%
Financial	331	311	-20	-6.0%
Professional	316	322	7	2.1%
Management	112	132	20	17.9%
Administrative	285	295	10	3.5%
Education	224	232	9	3.9%
Health	867	952	85	9.8%
Leisure-Hospitality	505	533	29	5.7%
Other Service	254	259	5	1.9%
Government	748	711	-37	-5.0%
Federal	103	97	-6	-6.1%
State	<u>645</u>	<u>614</u>	<u>-31</u>	<u>-4.8%</u>
Total	5,818	5,769	-50	-0.9%

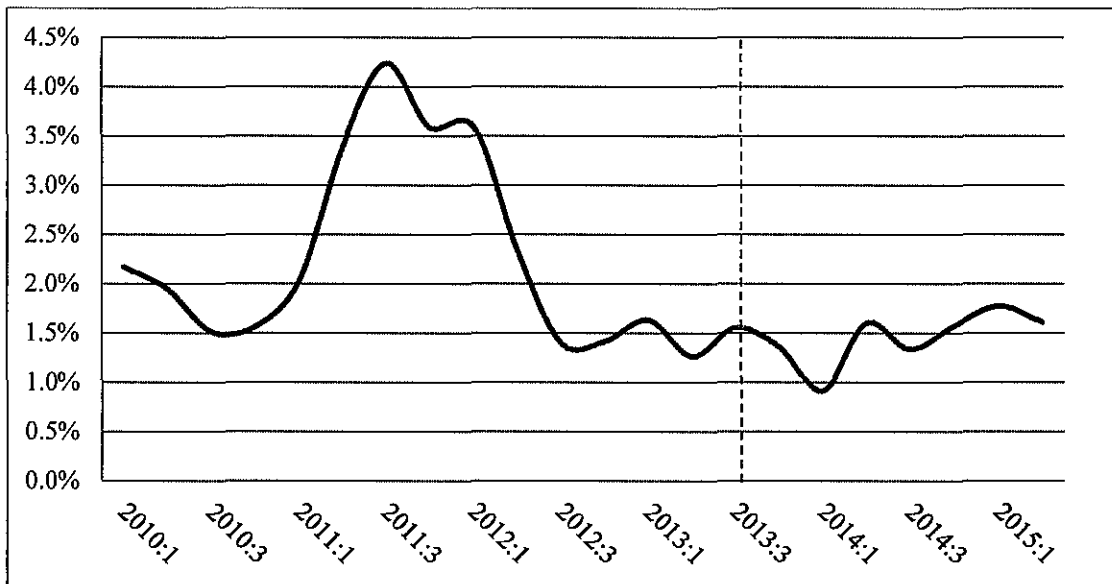
United States (thousands of jobs)	2008 Q1	2013 Q4	change	percent
Natural Resource-Mining	750	885	135	18.0%
Construction	7,445	5,849	-1,596	-21.4%
Manufacturing	13,694	12,013	-1,681	-12.3%
Transportation-Utility	5,109	5,077	-33	-0.6%
Wholesale	6,026	5,788	-238	-3.9%
Retail	15,535	15,324	-211	-1.4%
Information	3,022	2,685	-337	-11.2%
Financial	8,270	7,908	-362	-4.4%
Professional	7,819	8,196	377	4.8%
Management	1,902	2,057	155	8.1%
Administrative	8,270	8,513	243	2.9%
Education	2,994	3,398	403	13.5%
Health	15,652	17,432	1,780	11.4%
Leisure-Hospitality	13,539	14,287	748	5.5%
Other Service	5,531	5,498	-33	-0.6%
Government	22,416	21,860	-556	-2.5%
Federal	2,746	2,709	-37	-1.3%
State	<u>19,670</u>	<u>19,151</u>	<u>-520</u>	<u>-2.6%</u>
Total	137,973	136,768	-1,205	-0.9%

Sources: U.S. Bureau of Labor Statistics and IHS Economics, January 2014.

The Pennsylvania Economy – Inflation and Gasoline Prices

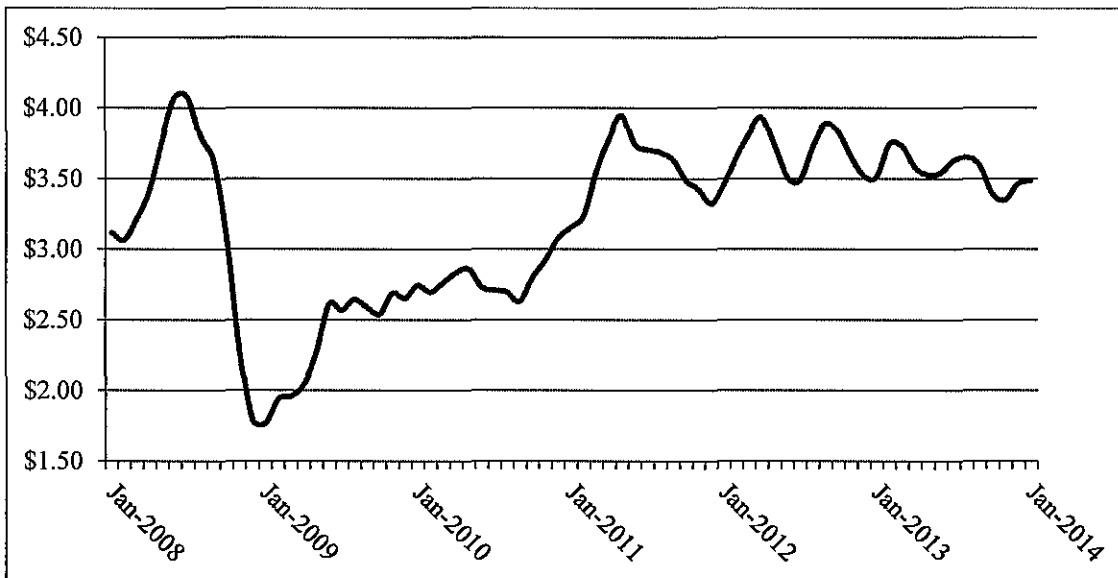
- Inflation is forecasted to remain low through 2014, but will pick up slightly with economic activity in early 2015.
- Monthly average gasoline prices were \$3.68 per gallon in 2012 and \$3.56 per gallon in 2013.

Consumer Price Index (PA-NJ-DE-MD)



Source: IHS Economics, January 2014.

Average Gasoline Prices: Central Atlantic Region

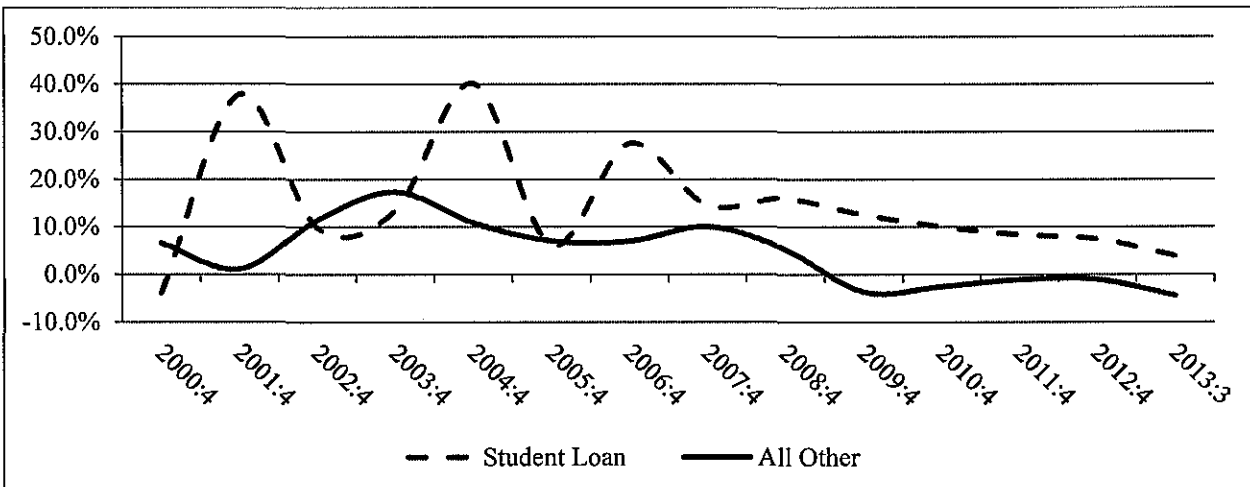


Regular unleaded gasoline. Source: Energy Information Administration.

The Pennsylvania Economy – Consumer Debt

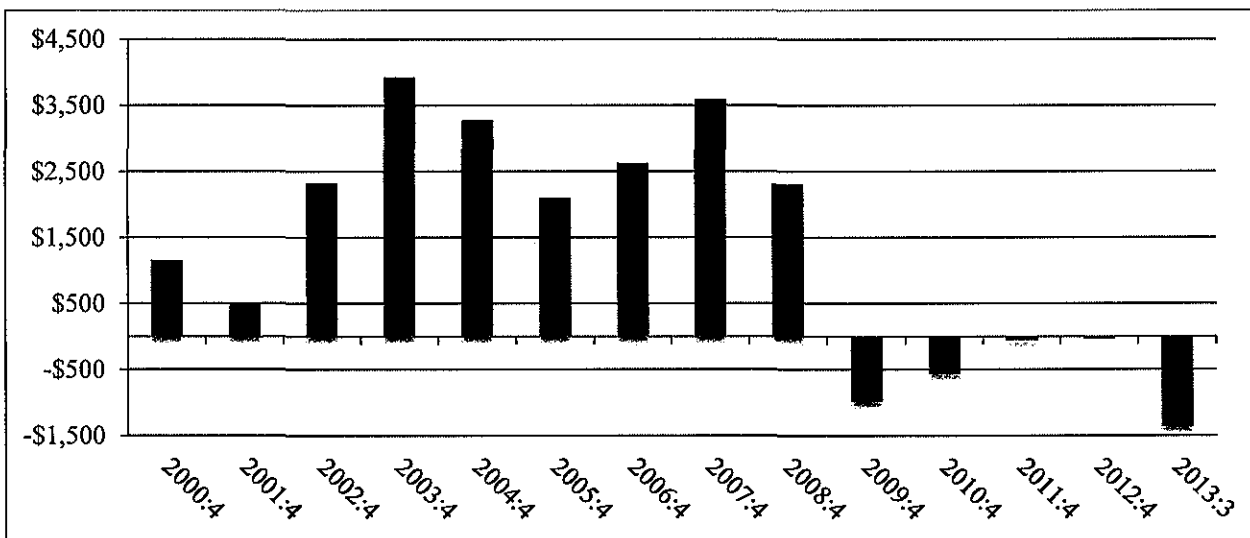
- While per capita student loan debt continues to rise (3.9 percent in 2013:3), consumers are paying down or taking on less “all other debt” on a per capita basis (-4.5 percent).
- Since the recession, consumer debt levels have been shrinking. In the third quarter of 2013, total per capita debt was down by \$1,360 from the previous year. The reduction is due to lower mortgage and credit card balances.

PA Student Loan and All-Other Debt Per Capita – Year Over Year Growth Rates



“All Other” includes mortgage, credit card, auto and other miscellaneous debt. Source: Federal Reserve Bank of New York.

PA Dollar Change in Per Capita Total Debt

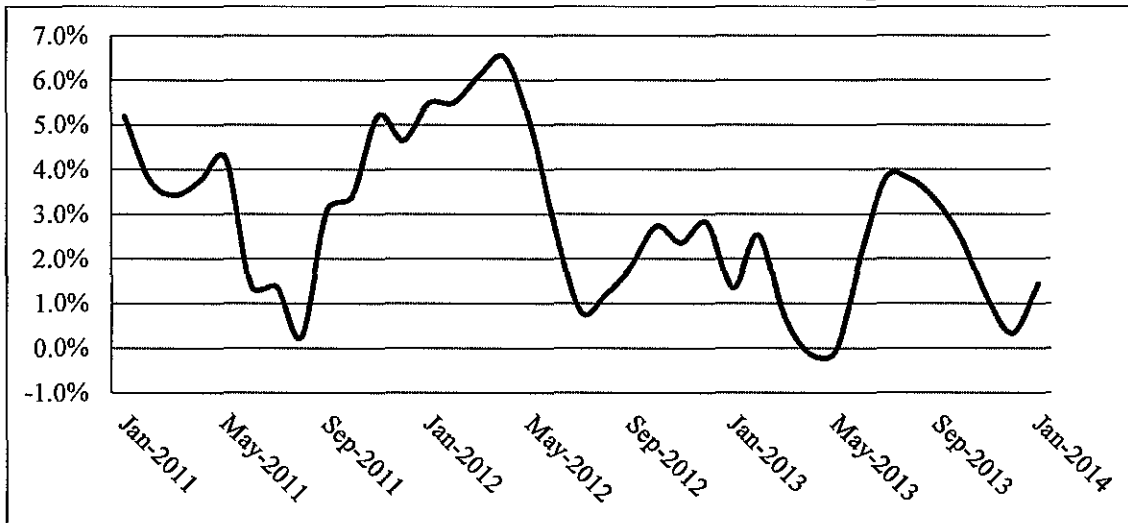


Source: Federal Reserve Bank of New York.

General Fund Revenues – Non-Motor Sales and Use Tax

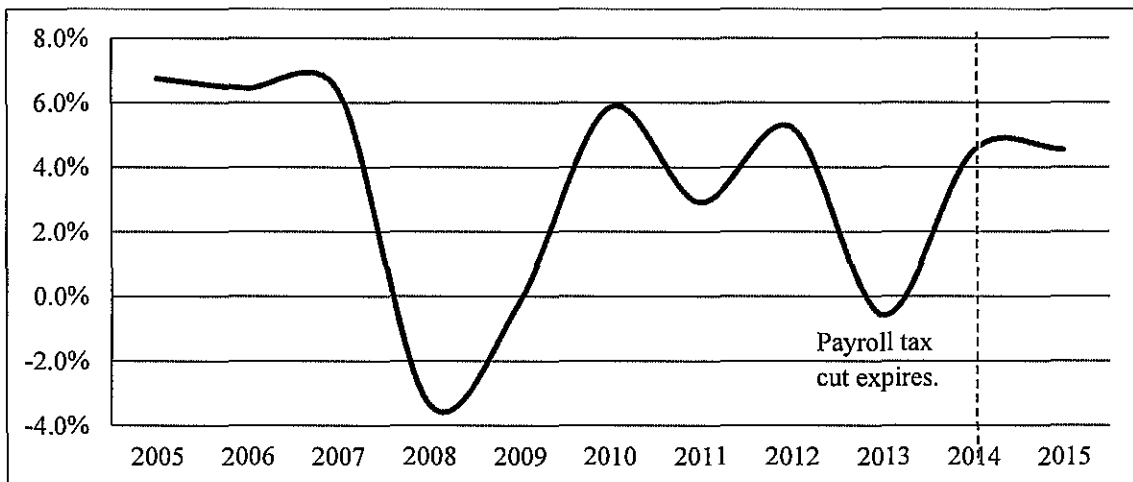
- Fiscal year-to-date collections through January grew by 2.0% over the same period last year. Collections are trending well below the levels the IFO anticipated at the time estimates were finalized in June.
- The growth of disposable current income (the amount consumers have available to spend after taxes) is expected to grow at 4.5% for 2014 and 4.6% in 2015, following a decline in 2013 due to the expiration of the payroll tax cut and modest wage growth.

Non-Motor Sales Tax Collections – Three-Month Average Growth Rate



Beginning in June 2011, collections are adjusted for mandated prepayments to allow a consistent comparison.

PA Disposable Current Income – Year Over Year Growth Rates

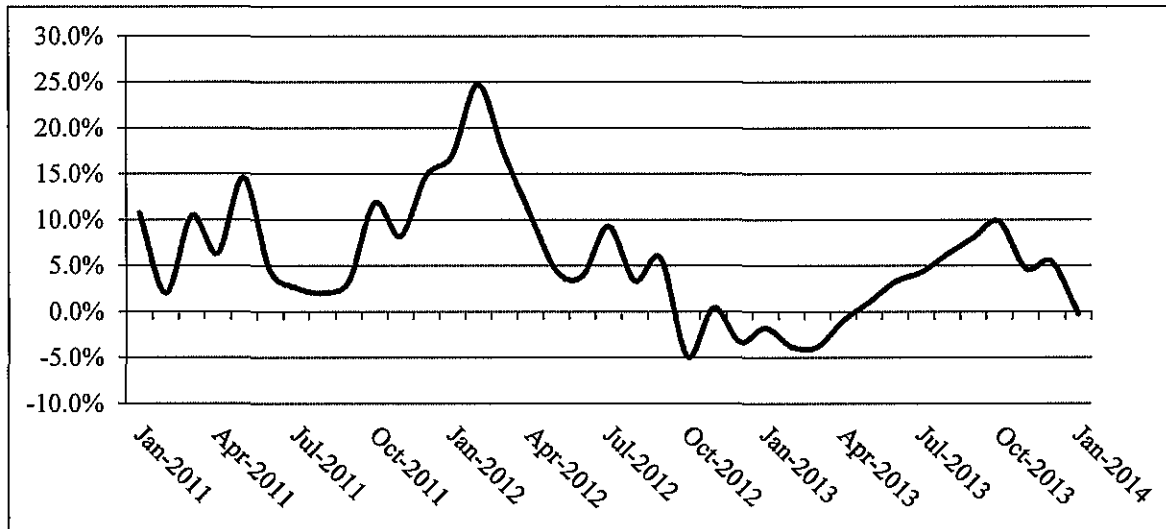


Source: Independent Fiscal Office.

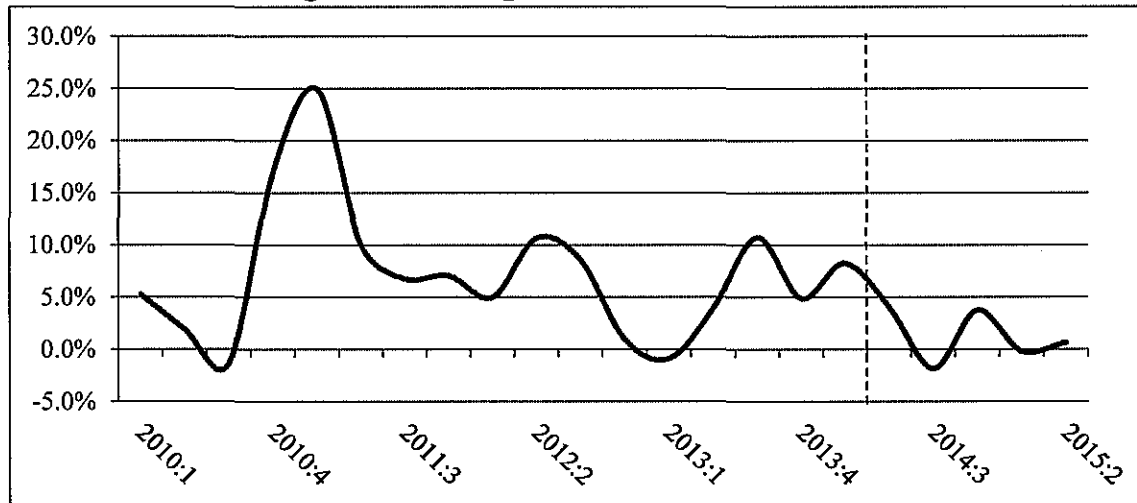
General Fund Revenues – Motor Vehicle Sales Tax

- Motor vehicle sales taxes have grown by 5.4% for the first half of this fiscal year.
- Pennsylvania new car and light truck registrations are forecasted to grow 3.0% in 2014 and 1.5% in 2015.

Motor Vehicle Sales Tax Collections – Three-Month Average Growth Rate



PA New Car and Light Truck Registrations – Year Over Year Growth Rates

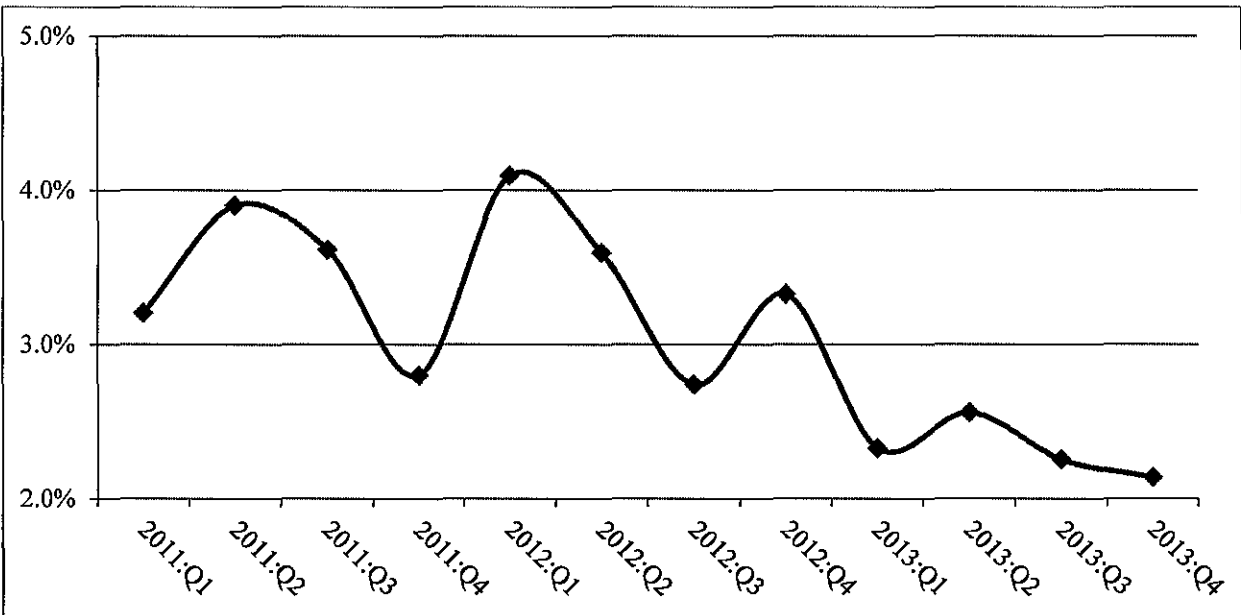


Number of units. Source: IHS Economics, January 2014 and the Independent Fiscal Office.

General Fund Revenues - Personal Income Tax Withholding

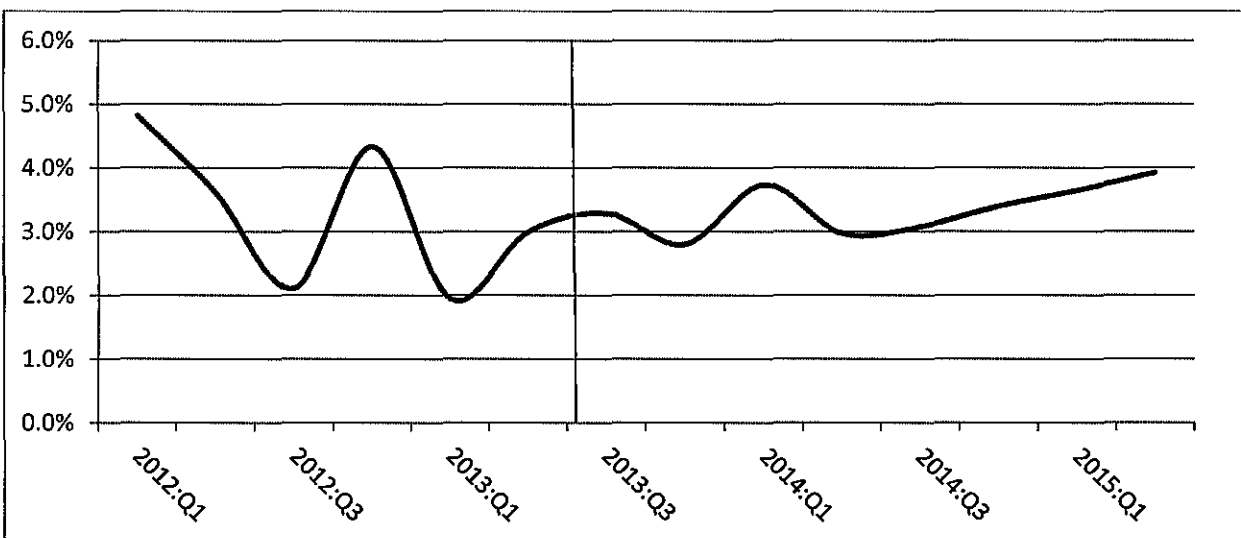
- While employer withholding revenues have grown over the previous year, the rate of growth has been declining since early 2012. For the fiscal year through January, revenues grew by 2.0%.
- The current IFO forecast projects modest wage growth in the 3% to 4% range through the middle of 2015.

PIT – Withholding Year Over Year Growth Rates



Quarterly revenues are aligned to allow for comparability based on payment due dates.

PA Wages – Year Over Year Growth Rates

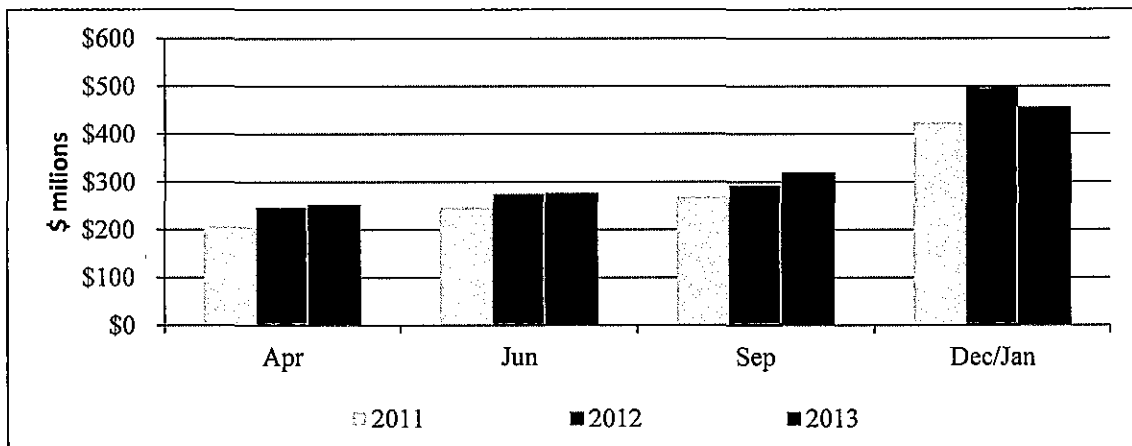


Source: IHS Economics, January 2014 and the Independent Fiscal Office.

General Fund Revenues - Personal Income Tax Nonwithholding

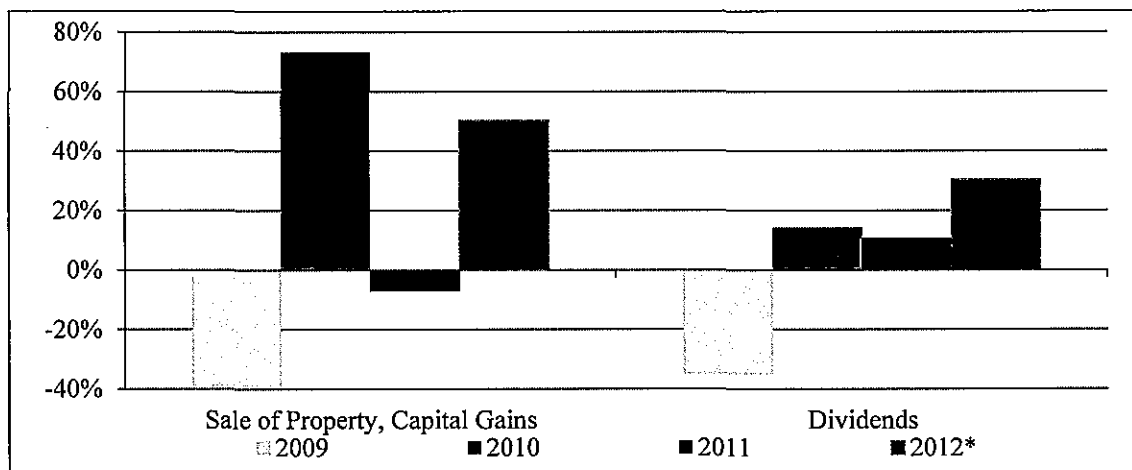
- Fourth quarter estimated payments for calendar year 2013 (December 2013 and January 2014) are down 8.4 percent over last year (see the first chart below). Quarterly payments, particularly the last quarter, tend to be a good predictor of the annual payment due in April of the following year.
- Tax return data support the view that taxpayers received dividends and accelerated the recognition of capital gains at the end of 2012 in anticipation of federal tax increases for 2013 (see second chart below). As a result, the growth rate of dividends and capital gains will be significantly lower in 2013. This translates into lower estimated and final payments for tax year 2013.

PIT – Quarterly Estimated Payments



The final quarterly payment for a calendar year is due the following January. Some of this revenue is typically collected in December, so these months are shown together.

PIT - Selected Nonwithholding Growth Rates



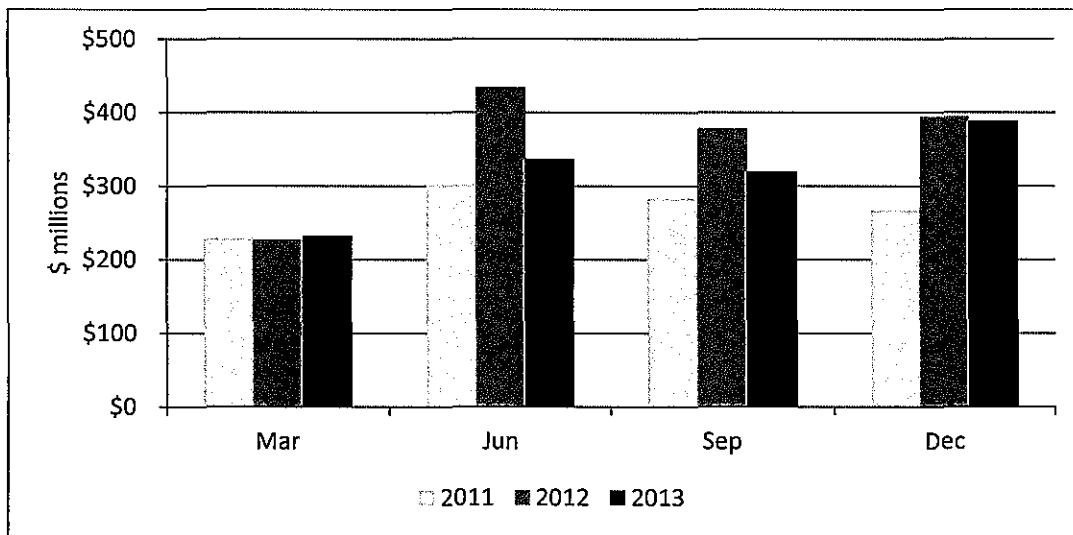
* 2012 growth rate is based on unpublished data as of January 10, 2014.

Source: PA Department of Revenue. PIT Statistics Booklets, Table 6. Calculations by the Independent Fiscal Office.

General Fund Revenues - Corporate Net Income Tax

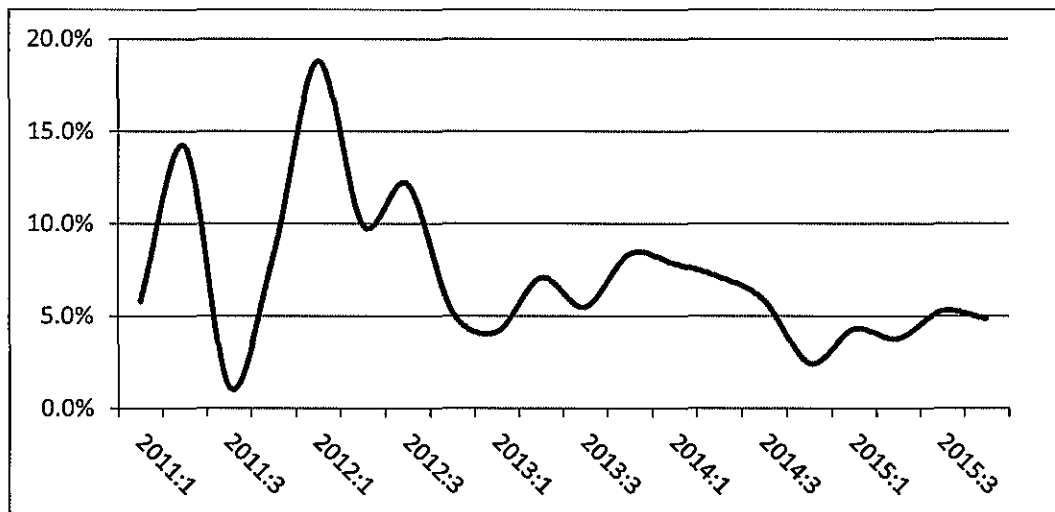
- Through January, corporate net income tax revenues increased by 3.1% over the prior fiscal year. Final payments (generally associated with tax year 2012) increased by 40% and estimated payments (generally associated with tax year 2013) declined by 5%. Weak estimated payments suggest that final payments in April may be modest.
- Domestic corporate profits are projected to grow modestly through 2015. In addition to profits, recent tax law changes will affect corporate net income tax receipts.

Corporate Net Income Tax – Quarterly Estimated Payments



The primary months for quarterly estimated payments are displayed.

Domestic Corporate Profits – Year Over Year Growth Rates

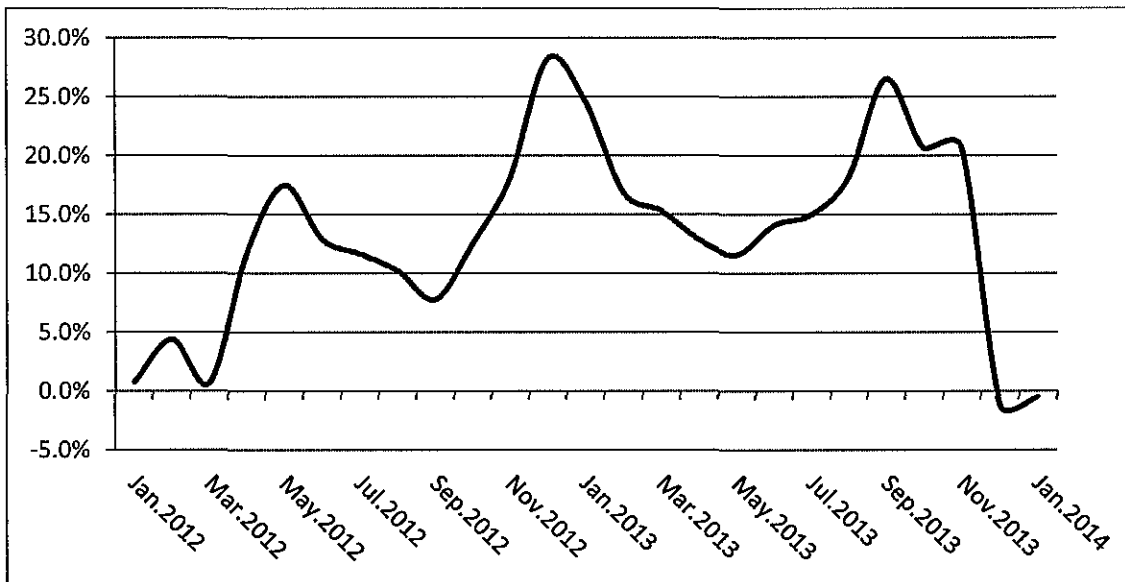


Source: IHS Economics, January 2014 U.S. forecast.

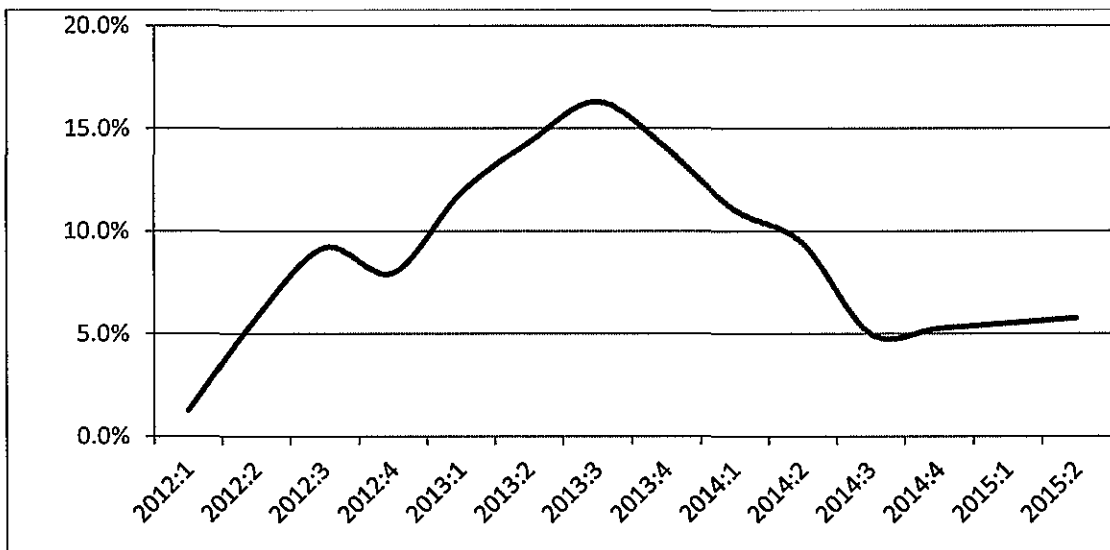
General Fund Revenues - Realty Transfer Tax

- Realty transfer tax revenues for the fiscal year have increased by 12% through January. However, the most recent three month trends have been negative.
- Housing sales are expected to grow according to IFO projections, but the rate of increase will decline.

Realty Transfer Tax – Three-Month Average Growth Rate



PA Housing Sales – Year Over Year Growth Rates



Source: IHS Economics, January 2014 and the Independent Fiscal Office.

U.S. NEWS

Wages Lurk as 2014 Growth Spoiler

By ERIC MORATH

A slowdown in U.S. income growth could short-circuit the surge in consumer spending that propelled the economic recovery in recent months.

As the holiday shopping season wrapped up, personal consumption rose a seasonally adjusted 0.4% in December from a month earlier, the Commerce Department said Friday. With a 0.6% increase in November, the final two months of 2013 marked the strongest consecutive gains since early 2012.

The upturn came while incomes were flat during the month. Real disposable income, which accounts for taxes and inflation, advanced just 0.7% during 2013. That was the weakest growth since the recession ended in 2009.

The income figures "raise a degree of caution for the near-term outlook because some pullback in spending growth seems likely," said Scott Brown, chief economist at financial firm Raymond James & Associates Inc. "We came into the year priced for a strong recovery, and now it looks like it might stumble a bit."

Weak income gains pose another risk to stronger growth this year, on top of unfolding

concerns about emerging markets and a pullback in support coming from the Federal Reserve's bond-buying program.

"We are concerned with consumers not having as much money to spend," said Joe Sheetz, chief executive of Sheetz Inc., a chain of gas stations and convenience stores. He noticed a drop-off in spending on govern-

Consumer spending finished 2013 on a strong note.

ment electronic-benefit cards in December, the month when federally funded jobless benefits expired for more than a million Americans.

The challenge Mr. Sheetz sees among consumers is underscored by his own firm. "We have not raised our starting wage for new hires since there has been no pressure to do so," he said, though he noted that most existing employees received some bump in pay last year.

Across 2013, the Commerce Department's broad measure of spending on everything from haircuts to refrigerators was up

3.1% from the prior year. That was the weakest annual increase since 2009 and below the 4.1% growth seen in 2012.

But the pace of spending was substantially stronger in the final six months of last year. Economic growth in the second half of 2013 represented the best finish to a year in a decade. Consumer spending, which makes up more than two-thirds of the nation's gross domestic product, was the primary driver.

Extending that performance—economic growth above 3%—will rest in large part on whether stronger wage gains emerge to embolden U.S. consumers, who saw surging stock prices and home values last year.

Many workers still have little leverage to demand higher pay, though some economists expect wages to grow a bit faster this year as hiring picks up.

"Job growth will likely spur wage growth and allow consumers to keep spending," said Bill Hampel, chief economist at the Credit Union National Association. "There are enough other tailwinds behind the economy."

Consumers have flexibility to save less or stop paying off debt for a few months in order to maintain higher spending levels, he said. The personal saving rate

fell to 3.9% in December from 4.3% in November. That suggests Americans may indeed be saving less in order to spend more.

Friday's report showed subdued inflation across the economy. The price index for personal consumption expenditures—the Fed's preferred inflation gauge—rose 1.1% in December from a year earlier. While the strongest since August, the figure remains well below the central bank's 2% inflation target.

Costs outside of rent have held flat or declined in the past year for Uncommon Goods, a Brooklyn, N.Y., online retailer that sells jewelry and home décor.

"I haven't seen a lot of inflationary pressures," said Chief Executive David Bolotsky. Shipping companies have lowered fuel surcharges, he said. That reflects gasoline prices' moderating from a year earlier.

Continued weak inflation could be a concern for Fed policy makers. The central bank said Wednesday it would reduce monthly bond purchases by another \$10 billion, the latest step in reining in its stimulus for the economy. Officials expect inflation to move closer to their target, but they said the pace of purchases could be adjusted if that outlook changes.

General Fund Revenue Estimate FY 2013-14 Mid-Year Update

Independent Fiscal Office
January 23, 2014

At the beginning of the fiscal year, the Independent Fiscal Office (IFO) forecasted FY 2013-14 General Fund revenues of \$29.154 billion. For comparison, the revenue estimate certified by the Governor and published by the Department of Revenue was \$29.116 billion, a difference of \$38.5 million.

The IFO reviewed its estimate based on actual collections for the first half of the fiscal year and expectations for the second half. Through December, revenues are \$65 million below the IFO estimate. Revenues have been characterized by weak nonmotor vehicle sales tax receipts and lackluster personal income tax remittances from wage and salary withholding.

The table below displays first half growth rates for the General Fund and its three largest revenue sources. It also shows the growth rates for the second half of the fiscal year that would be necessary to meet the IFO's published estimate.

FY 2013-14 Revenue Growth

	1st Half Growth	2 nd Half to Meet Estimate
General Fund -- Total	0.5%	2.7%
Corp.Net Income	1.3%	1.7%
Sales and Use	2.3%	5.5%
Personal Income	2.7%	3.3%

A significant acceleration in the rate of revenue growth would be necessary in the second half in order to meet these estimates. After a detailed analysis of General Fund revenue sources and trends, the IFO concludes that such growth is not likely. Therefore, a revision to the estimate is warranted.

The revision to the IFO estimate reduces FY 2013-14 revenue expectations by \$150 million, to \$29.005 billion. For comparison, this is about \$112 million below the estimate certified by the Governor at the beginning of the fiscal year.

The table below summarizes the revisions to the IFO estimate. Also, second half growth rates needed to meet the revised estimates are listed.

FY 2013-14 IFO Estimate Revisions

	Estimate Revision (\$ millions)	Revised 2 nd Half Growth
General Fund - Total	-\$150	1.8%
Sales and Use	-70	3.9%
Personal Income	-60	2.4%
All Other	-20	-1.3%

The following points provide some context for the major revisions to the revenue estimate.

- Through December, nonmotor vehicle sales tax increased by only 1.6 percent. Stronger than expected motor vehicle sales offset some of this weakness, but second half growth of 5.5 percent appears unlikely even with improved auto sales.
- Personal income tax (PIT) withholding from wages and salaries increased by 2.2 percent in the first half, well below the 3.6 percent projected for the full fiscal year. Employment and wage growth trends support a lower estimate for withholding revenues.
- PIT growth will be restrained by lower annual payments. Payments with the 2013 annual PIT returns (to be filed by April 2014) are expected to decline from the prior year. Prior year payments were higher than normal because some taxpayers received dividends or realized capital gains in 2012 instead of 2013 to avoid federal tax increases.

Depending on the performance of the Pennsylvania economy in the first six months of 2014, the revisions could prove to be conservative. However, marked improvement in jobs and wages, increased business investment and higher consumption of taxable goods and services would signal more sustainable growth and a better revenue outlook.

Monthly Economic Report

January 2014

United States Economic Indicators

	<u>Jan-13</u>	<u>Nov-13</u>	<u>Dec-13</u>	<u>Jan-14</u>	
Unemployment Rate The number of individuals unemployed divided by the labor force. ¹	7.9%	7.0%	6.7%	6.6%	▲
Monthly Net Job Gains (000s) Average net increase in payroll employment based on latest three months of data. ²	204.7	225.0	195.3	154.0	▼
Advance Retail Sales Year-over-year growth rate of retail sales based on latest three months of data. Includes purchases of gas and motor vehicles. ³	4.7%	4.0%	4.2%	n.a.	□
Residential Home Sales Year-over-year growth rate in the number of residential homes sold based on latest three months of data. ⁴	11.4%	4.5%	0.8%	n.a.	▼
Consumer Sentiment Index A diffusion index that reflects consumer optimism. A declining index signals increasing pessimism. ⁵	73.8	72.0	84.5	81.2	▲
Purchasing Managers Index (PMI) A diffusion index that reflects the relative health of the manufacturing sector. An index greater than 50 indicates that the sector is expanding. ⁶	53.1	57.3	57.0	51.3	▲
Average Gas Price National average price for one gallon of unleaded gasoline. ⁷	3.31	3.24	3.28	3.31	□
S&P 500 Index An index based on the stock prices of 500 top publicly traded corporations. Index values are from month end. ⁸	1,498	1,806	1,848	1,782	□
Consumer Price Index (CPI - U) Year-over-year change in average price level. Includes outlays for energy. ⁹	1.6%	1.2%	1.5%	n.a.	□
10-Year Treasury Yield on 10-year U.S. Treasury note. ⁸	2.02%	2.75%	3.04%	2.67%	□

Sources:

1/ U.S. Department of Labor - Survey of Households.
 2/ U.S. Department of Labor - Survey of Establishments.
 3/ U.S. Department of Commerce.
 4/ National Association of Realtors.
 5/ University of Michigan - Survey of Consumers.

6/ Institute of Supply Management.
 7/ Energy Information Administration.
 8/ Market data compiled by the Wall Street Journal.
 9/ U.S. Department of Labor - Bureau of Labor Statistics.

Monthly Economic Report

January 2014

Pennsylvania Economic Indicators

	<u>Jan-13</u>	<u>Nov-13</u>	<u>Dec-13</u>	<u>Jan-14</u>	
Unemployment Rate The number of individuals unemployed divided by the labor force. ¹	8.2%	7.3%	6.9%	n.a.	▲
Monthly Net Job Gains (000s) Average net increase in payroll employment based on latest three months of data. ²	4.0	0.6	-0.8	n.a.	▼
Sales-Use Taxes Year-over-year growth rate of sales taxes based on latest three months of collections. Excludes motor vehicle sales taxes. ³	0.3%	2.4%	1.1%	1.7%	□
Motor Vehicle Sales Taxes Year-over-year growth rate of motor vehicle sales taxes based on latest three months of collections. ³	-1.8%	4.3%	5.1%	-0.6%	▼
Realty Transfer Taxes Year-over-year growth rate of realty transfer taxes based on latest three months of collections. Monthly residential sales data are not available at state level. ³	24.6%	20.7%	-1.1%	-0.5%	▼
Current Business Outlook Index A diffusion index that measures the current outlook of manufacturing firms in the third federal reserve district (PA, NJ, DE). A negative number indicates increasing pessimism. ⁴	-5.6	9.2	6.4	9.4	▲
Average Gas Price Central Atlantic (PA, NY, NJ) average price for one gallon of unleaded gasoline. ⁵	3.51	3.35	3.46	3.49	□
Consumer Price Index (PA-NJ-DE-MD) Year-over-year change in average price level. Includes outlays for energy. Data are published on a bi-monthly basis. ⁶	1.8%	0.3%	1.2%	1.2%	□
Housing Starts (Building Permits) The growth rate of privately owned homes upon which construction was initiated during the latest three-month period.	7.2%	16.9%	15.6%	n.a.	▲

Sources:

1/ U.S. Department of Labor - Survey of Households.
2/ U.S. Department of Labor - Survey of Establishments.
3/ PA Department of Revenue.
4/ Federal Reserve Bank of Philadelphia.

5/ U.S. Energy Information Administration.

6/ U.S. Department of Labor - Bureau of Labor Statistics.

For non-release months, values held constant.

7/ U.S. Census Bureau- Building Permits.

Monthly Economic Report

January 2014

Quarterly United States Economic Indicators

	<u>2013.1</u>	<u>2013.2</u>	<u>2013.3</u>	<u>2013.4</u>	
Real Gross Domestic Product (GDP) The quarterly annualized growth rate of the U.S. economy. Excludes inflation. ¹	1.1%	2.5%	4.1%	3.2%	▲
Personal Income The year-over-year growth rate of U.S. personal income. Includes wages, interest, dividends, rents, pensions, business and transfer income. Includes any inflationary gains. ¹	2.8%	3.2%	3.8%	1.6%	▼
Corporate Profits The year-over-year growth rate of domestic and foreign profits of U.S. corporations. ¹	2.1%	4.5%	5.6%	n.a.	▲
FHFA House Price Index An index that measures the average price change of residential homes whose mortgages have been purchased or securitized by Fannie Mae or Freddie Mac. Rate is the year-over-year change in the index. ²	7.1%	7.5%	8.4%	n.a.	▲
U.S. Delinquent Debt Share of consumer debt more than 90 days delinquent. ³	6.1%	5.7%	5.3%	n.a.	▲

Quarterly Pennsylvania Economic Indicators

	<u>2013.1</u>	<u>2013.2</u>	<u>2013.3</u>	<u>2013.4</u>	
Personal Income The year-over-year growth rate of PA personal income. Includes wages, interest, dividends, rents, pensions, business and transfer income. Includes any inflationary gains. ¹	1.3%	2.6%	3.1%	n.a.	□
FHFA House Price Index An index that measures the average price change of residential homes whose mortgages have been purchased or securitized by Fannie Mae or Freddie Mac. Rate is the year-over-year change in the index. ²	2.3%	3.9%	4.8%	n.a.	▲
PA Delinquent Debt Share of consumer debt more than 90 days delinquent. ³	5.4%	5.5%	5.6%	n.a.	□

Sources: 1/ U.S. Bureau of Economic Analysis. 2/ Federal Housing Finance Agency. 3/ Federal Reserve Bank of New York.

Monthly Economic Report

January 2014

Impact of Labor Force Participation Rates on the Unemployment Rate

According to the U.S. Bureau of Labor Statistics' (BLS) preliminary unemployment data, the seasonally adjusted unemployment rate for Pennsylvania dropped 0.4 points to 6.9% in December. While this number may be revised, the reduction represents the largest monthly drop since July 1983 and the lowest unemployment rate since January 2009 (6.8%). Viewing this figure exclusively, it would appear that the Commonwealth's labor market is finally recovering. However, the labor news is not all positive. The BLS also reported that the number of non-farm, seasonally adjusted jobs for December was down 11,400 from November to 5.762 million, which is still 63,000 less than the peak pre-recession monthly jobs number (April 2008, 5.825 million jobs).

The reason the unemployment rate can drop at the same time as the number of jobs decreases is that the labor force (sum of those employed and unemployed) is also shrinking. Consequently, overall labor force participation rates are also viewed as another measure of the strength of the labor market. The labor force participation rate is defined by BLS as the labor force as a share of the civilian non-institutional population. The higher the labor force participation rate, the larger share of the working-age population who are working or seeking employment.

Since 1998, the Pennsylvania labor force participation rate has remained relatively stable, falling slightly from 64.0% in 1998 to 63.4% in 2013.¹ (See table below.) Over that same period, the U.S. labor force participation rate declined 3.9 percentage points (67.1% in 1998, 63.2% in 2013).² Most of the U.S. decline occurred from 2008 (66.0%) through 2013 (63.2%). One interesting trend in labor force participation rates has been the gradual increase in rates for individuals age 65 or older. Since 1998, the Pennsylvania age 65 and older labor force participation rate has increased from 10.0% (1998) to 17.6% (2013). Similar trends have been seen in the U.S. (11.9% in 1998, 18.7% in 2013). While this increase is somewhat significant, the largest movement in labor force participation rates by age group has occurred in the 16 to 19 age group. The Pennsylvania teen (age 16-19) labor force participation rate has fallen from 52.3% in 1998 to 40.4% in 2013. The rate for U.S. teens has seen an even more dramatic decline going from 52.8% (1998) to 34.4% (2013).

¹ Current Population Survey (CPS); Center for Workforce Information & Analysis.

² CPS, U.S. BLS. Calculations by the IFO included using an average of quarterly, seasonally adjusted labor force participation rates to calculate annual values.

Labor Force Participation Rate for Select Age Groups Over Time

Age Groups	1998	2003	2008	2013
Pennsylvania				
16-19	52.3%	46.7%	47.2%	40.4%
20-24	75.5	74.2	75.7	71.1
55-64	58.8	63.4	64.7	66.1
65+	10.0	13.1	16.3	17.6
Total	64.0	63.9	65.3	63.4
U.S.				
16-19	52.8	44.5	40.2	34.4
20-24	77.5	75.4	74.4	70.7
55-64	59.3	62.4	64.6	64.4
65+	11.9	14.0	16.8	18.7
Total	67.1	66.2	66.0	63.2

Source: Pennsylvania Data: CPS, Center for Workforce Information & Analysis. U.S. Data: CPS, BLS (Calculations by the IFO.)



Revenue Trends Report

January 2014

The Commonwealth collected \$2.36 billion in General Fund revenues for January, an increase of \$25 million (1.0%) compared to January 2013. Fiscal year-to-date revenues of \$14.65 billion are \$82 million (0.6%) above the previous fiscal year. Additional detail can be found below and on the next page.

- **Tax revenues** increased by \$9 million (0.4%). Increases in corporate taxes and sales tax were offset by a decline in personal income tax.
- **Sales and use tax** collections increased by \$24 million (3.0%) compared to January 2013.
 - Nonmotor vehicle deposits increased by \$27 million (3.9%), bringing the three and twelve-month growth rates to 1.7% and 1.8%, respectively.
 - Motor vehicle tax remittances declined by \$3 million (-3.6%). Fiscal year-to-date motor vehicle revenues are \$36 million (5.4%) higher than last year. Over the last three months revenues declined by 0.3%, and the twelve-month growth rate is 3.3%.
- **Personal income tax** remittances declined by \$34 million (-2.8%).
 - Withholding revenues increased by \$6 million (0.7%) for the month. The fiscal year-to-date growth rate is 2.0%, but the twelve-month growth rate is only 1.0%.
 - Nonwithholding receipts decreased by \$40 million (-9.9%), largely because quarterly payments were \$41 million (-10.4%) below the prior year. Fiscal year-to-date nonwithholding collections are slightly lower (-0.1%) than last year.

Change in General Fund Tax Revenues

(compared to same period in prior year; dollar amounts in millions)

Revenue Source	January 2014	FY 13-14 to Date	3 month rolling	12 month rolling
Corporate Net Income	\$21.9	\$35.7	\$53.0	\$126.5
percent change	32.4%	3.1%	10.1%	5.4%
Other Corporate	-\$8.8	-\$178.2	-\$74.7	-\$320.0
percent change	-17.2%	-42.0%	-40.0%	-11.0%
SUT - Nonmotor Vehicle	\$27.1	\$90.1	\$33.3	\$136.1
percent change	3.9%	2.0%	1.7%	1.8%
SUT - Motor Vehicle	-\$3.3	\$36.0	-\$0.8	\$38.4
percent change	-3.6%	5.4%	-0.3%	3.3%
PIT - Withholding	\$6.0	\$97.2	\$29.2	\$81.9
percent change	0.7%	2.0%	1.3%	1.0%
PIT - Nonwithholding	-\$40.5	-\$0.7	-\$41.3	\$226.3
percent change	-9.9%	-0.1%	-7.5%	8.6%
All Other Tax Revenue	\$6.7	\$36.3	-\$8.1	\$32.9
percent change	3.6%	2.4%	-1.3%	1.3%
Tax Revenue Total	\$9.2	\$116.3	-\$9.5	\$322.1
percent change	0.4%	0.8%	-0.1%	1.2%

General Fund Revenue Detail

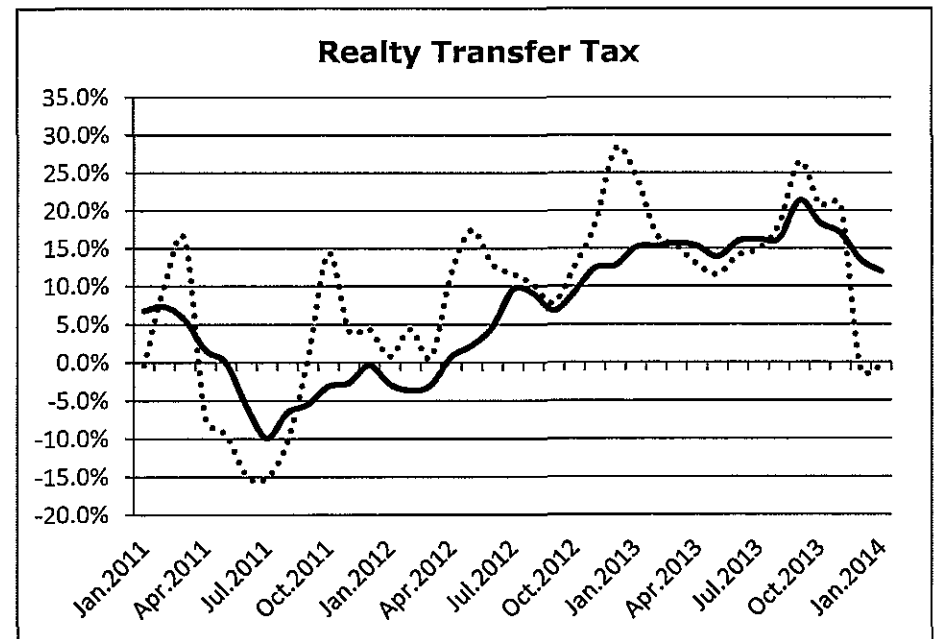
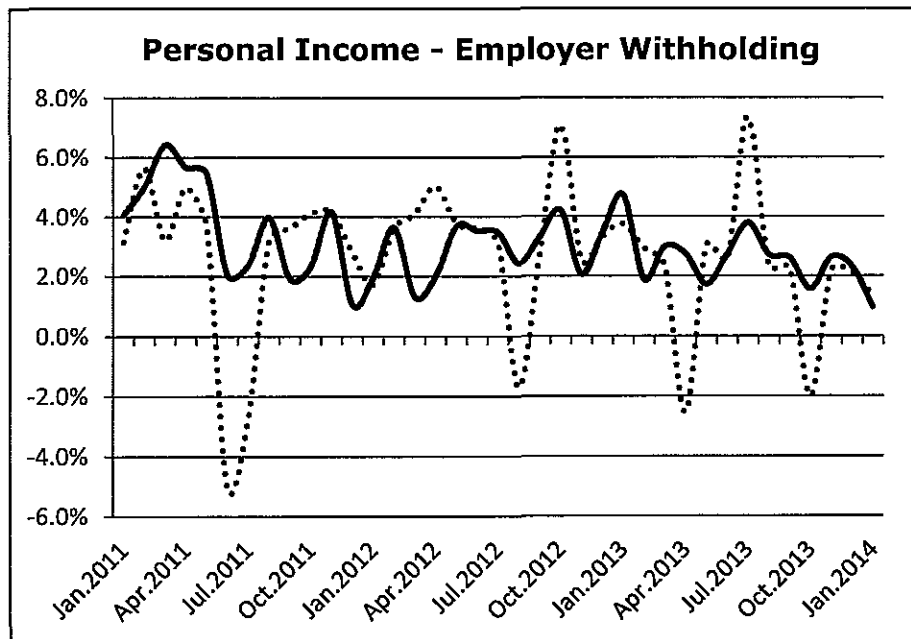
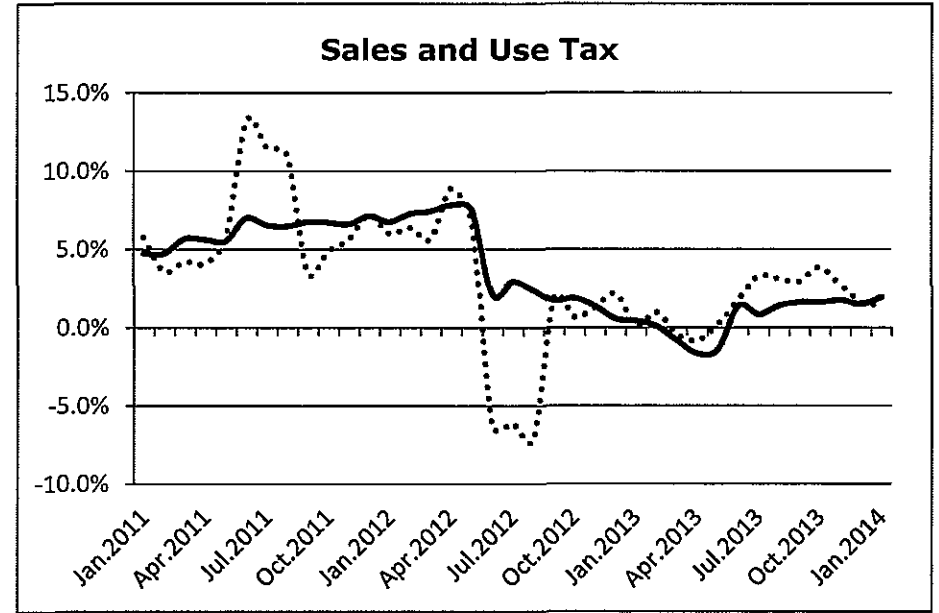
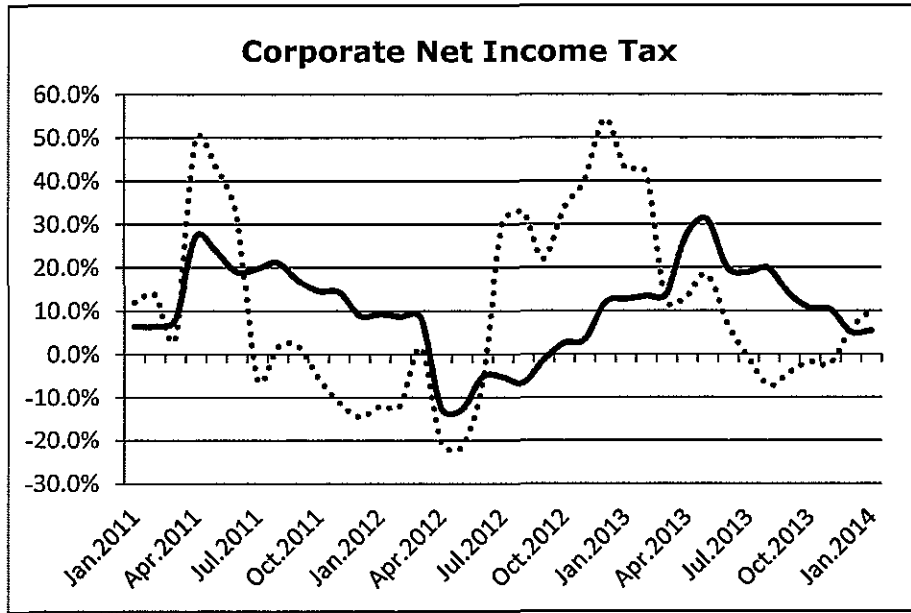
dollar amounts are in millions

	<i>Monthly Revenues</i>		<i>Fiscal Year to Date</i>		<i>Growth Rate Trends</i>	
	<u>January 2014</u>	<u>Percent Change ¹</u>	<u>January 2014</u>	<u>Percent Change ¹</u>	<u>Rolling Averages 3 mon.¹ 12 mon.¹</u>	
<u>Total General Fund</u>	<u>2,360.8</u>	<u>1.0%</u>	<u>14,646.4</u>	<u>0.6%</u>	<u>-0.1%</u>	<u>1.1%</u>
<u>Total Tax Revenue</u>	<u>2,335.3</u>	<u>0.4%</u>	<u>14,512.3</u>	<u>0.8%</u>	<u>-0.1%</u>	<u>1.2%</u>
<u>Total Corporation Taxes</u>	<u>131.9</u>	<u>11.0%</u>	<u>1,440.9</u>	<u>-9.0%</u>	<u>-3.1%</u>	<u>-3.7%</u>
Accelerated Deposits	0.5	n.a.	3.2	n.a.	n.a.	n.a.
Corporate Net Income	89.4	32.4%	1,194.6	3.1%	10.1%	5.4%
Capital Stock & Franchise	12.3	-51.3%	174.0	-44.4%	-50.1%	-41.1%
<u>Selective Business Total</u>	<u>29.7</u>	<u>7.5%</u>	<u>69.1</u>	<u>-35.5%</u>	<u>-12.8%</u>	<u>0.3%</u>
Gross Receipts	8.2	77.0%	35.5	-38.3%	18.4%	-3.9%
Utility Property	0.0	-100.0%	2.3	-34.1%	-92.0%	41.9%
Insurance Premiums	20.8	-6.6%	20.5	-17.9%	-6.3%	-4.7%
Financial Institutions	0.4	9.6%	8.3	-53.8%	-63.7%	24.4%
Other Sel. Business	0.2	-15.1%	2.5	-22.5%	-64.3%	4.2%
<u>Total Consumption Taxes</u>	<u>894.6</u>	<u>2.1%</u>	<u>6,169.6</u>	<u>1.7%</u>	<u>0.7%</u>	<u>1.3%</u>
<u>Sales and Use Total</u>	<u>814.2</u>	<u>3.0%</u>	<u>5,391.4</u>	<u>2.4%</u>	<u>1.4%</u>	<u>2.0%</u>
Nonmotor	727.3	3.9%	4,688.2	2.0%	1.7%	1.8%
Motor Vehicle	86.8	-3.6%	703.2	5.4%	-0.3%	3.3%
Cigarette	56.2	-10.5%	570.2	-5.1%	-6.7%	-5.0%
Malt Beverage	1.5	-26.6%	14.9	-1.2%	-3.8%	-2.5%
Liquor	22.8	7.2%	193.1	3.7%	3.4%	3.6%
<u>Total Other Taxes</u>	<u>1,308.8</u>	<u>-1.7%</u>	<u>6,901.8</u>	<u>2.3%</u>	<u>-0.2%</u>	<u>3.1%</u>
<u>Personal Income Total</u>	<u>1,197.8</u>	<u>-2.8%</u>	<u>6,130.2</u>	<u>1.6%</u>	<u>-0.4%</u>	<u>2.8%</u>
Withholding	831.0	0.7%	5,082.2	2.0%	1.3%	1.0%
<u>Nonwithholding</u>	<u>366.8</u>	<u>-9.9%</u>	<u>1,048.0</u>	<u>-0.1%</u>	<u>-7.5%</u>	<u>8.6%</u>
Quarterly	355.2	-10.4%	890.0	-1.4%	-8.5%	-0.4%
Annuals	11.6	5.8%	158.0	8.0%	6.3%	20.5%
Realty Transfer	31.4	7.7%	232.7	11.9%	-0.5%	11.9%
Inheritance	68.7	13.8%	481.9	6.9%	0.4%	7.1%
Table Games	8.7	26.6%	52.9	5.9%	12.6%	0.3%
Minor and Repealed	2.2	-0.4%	4.2	55.3%	2090.1%	-721.2%
<u>Total Nontax Revenue</u>	<u>25.6</u>	<u>150.4%</u>	<u>134.1</u>	<u>-20.4%</u>	<u>6.1%</u>	<u>-3.5%</u>
Liquor Store Profits	0.0	n.a.	0.0	n.a.	n.a.	0.0%
Lic, Fees & Misc - Total	19.5	321.2%	79.7	-37.4%	-6.5%	-3.1%
Fines, Pen & Int - Total	6.1	9.2%	54.4	32.0%	44.2%	-9.3%

¹ compared to the same period in the prior year

Three and Twelve-Month Revenue Growth Trends

compared to the same period in the prior year



dotted line = 3-month growth rate solid line = 12-month growth rate