State of Maryland
Board of Revenue Estimates

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September 21, 2016

Honorable Lawrence J. Hogan Jr.
Governor, State of Maryland
State House
Annapolis, MD 21401

Dear Governor Hogan:

The Board of Revenue Estimates submits to you revised general fund revenue estimates for fiscal year 2017 and the first official estimates for fiscal year 2018. We have reviewed the current estimate for fiscal year 2017 in light of the most recent economic data and developments, as well as revenue collections for fiscal year 2016. Based on our analysis, the Board submits a revised estimate of general fund revenues for fiscal year 2017 of $16.635 billion and an estimate of $17.205 billion for fiscal year 2018. The fiscal year 2017 estimate represents a decrease of $365.1 million from the March estimate, upon which the fiscal year 2017 budget was based. This significant revision and the projection for fiscal year 2018 are the results of a weaker outlook for key underlying macroeconomic variables as well as variances from the prior year. General fund revenues are forecast to increase 2.7% in fiscal year 2017 and 3.4% in fiscal year 2018. Excluding the statutorily defined transfer tax distributions to the general fund, on-going general funds would increase 3.0% and 3.5% for fiscal years 2017 and 2018, respectively.

Prior year results serve as an immediate re-set to the base upon which the revenues are estimated. Therefore, it is not surprising to have a rather significant reduction in the revenue estimates following fiscal year 2016's closeout when revenues were $250.1 million below expectations. The significant variation from estimates for fiscal year 2016 rests with the income tax. Within the income tax, two factors are largely to blame: (1) weaker than expected results from final payments and higher refunds with tax returns for tax year 2015; and (2) weaker than expected receipts from income tax withholding, though a timing issue may have occurred and some of that variance is re-captured in the fiscal year 2017 estimate.

Further diminishing the projected revenue estimates is a reduction to the Board's economic outlook. The national economic expansion remains the slowest in post-World War II history. The national economy is only 10.5% larger than its pre-recession peak 8.5 years ago; post-recession expansions in the 1980s and 1990s yielded results three times larger at this point.

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Maryland continues, like Virginia, to be hampered relative to the nation by the ongoing direct and indirect effects of federal budget.

This new outlook better aligns the Board's projections with recent trends of continued, slow growth. It is prudent to acknowledge that growth rates, while continuing, have not increased substantially from year-to-year and prudent to resist increasing the outlook until broader improved results materialize. On the other hand, employment projections were increased for calendar year 2016 as reported growth from the Bureau of Labor Statistics through the first two quarters appears strong, up 1.9% and 2.0%, respectively, and unemployment remains low. Moreover, preliminary figures from the Department of Labor, Licensing, and Regulation (DLLR) serve to confirm the results for the first quarter (DLLR second quarter results not released until December). However, wage growth appears to not have followed the same trajectory of improvement. In fact, aggregate wage growth according to DLLR seems to have slowed to just 0.9% for the first quarter of 2016. Equally concerning is that withholding collections (highly correlated with aggregate wage growth) attributable to the second quarter of 2016 increased just 2.3%.

While there are certain nuanced timing issues to consider, results for this year yield relatively weak average wage growth (total wages divided by number of jobs). Reasons for the slowdown in average wage growth include: (1) the concentration of job growth is occurring in industries that pay wages below the statewide average; (2) a lack of inflation may be providing employers the ability to improve or maintain employees' standards of living with smaller increases (inflation in 2015 was essentially flat); (3) as the baby boomer generation retires at a significant rate, the upward movement for existing employees into the newly vacated positions is realized at lower pay rates; and (4) labor force productivity growth (a significant driver for real wage growth) has been relatively absent in this economic expansion.

The table below illustrates changes to the September 2016 economic outlook relative to the March 2016 outlook. While wages and employment have been discussed at length, it is worth noting that the growth rate in total personal income is reduced rather substantially. Wages, which are rising slowly, account for roughly half of personal income; however, non-wage income variables have also been reduced as part of this adjustment. This is attributable to several factors, most notably an expected delay in the Federal Reserve's actions to increase the federal funds rate and the corresponding negative impact that delay has on interest income.

Maryland Board of Revenue Estimates' Economic Forecast

Calendar	Employment		Aggregate Wages		Average Wages		Personal Income	
Year	Mar 16	Sep 16	Mar 16	Sep 16	Mar 16	Sep 16	Mar 16	Sep 16
2015	1.5%	1.5%	3.9%	3.9%	2.4%	2.4%	4.2%	4.0%
2016	1.3%	1.9%	4.2%	4.0%	2.9%	2.1%	4.6%	3.7%
2017	1.0%	1.0%	4.1%	3.9%	3.1%	2.9%	5.1%	4.4%
2018	0.8%	0.8%	4.0%	4.0%	3.2%	3.2%	4.5%	4.6%

The reductions in our macroeconomic outlook have direct consequences for the entire estimate, but are most explicit in the adjustments to the income and sales taxes. The good news is that the majority of the adjustment for 2016 wage growth occurs in the second quarter, and therefore is now history as part of fiscal year 2016. That said, we do need to see an acceleration in withholding growth for the rest of this year in order to attain this estimate; early fiscal year 2017 results indicate that we are on a reasonable path to that mark.

Additionally, our outlook for capital gains income is adjusted. Although capital gains constitute only 5% of personal income taxes collected, they have always been a source of extreme volatility in the estimates. Between 1980 and 2014, the average growth rate of capital gains was 13.5% and the median rate was 19.1%. However, in two thirds of those years, growth ranged between negative 22.0% and positive 49.0%. For 2015, we estimate capital gains to be negative 15.0%. This would mark the first year in which capital gains growth was negative outside of a recession or tax policy response since 1994 when capital gains were down 3.0%. While historically we have taken a risk averse strategy (generally estimating only 4% to 6%), we now believe it prudent to assume zero growth based on this volatility and the recent disconnect between the stock market being up and the anomaly of a significant negative capital gains estimate for 2015. This may seem to engender upside risk to the estimate, however, the downside risk is equally apparent.

Bottom line -- net income tax receipts (receipts before the share dedicated to the local income tax) are projected to grow 4.7% in fiscal year 2017 and 4.6% in fiscal year 2018. This is down from prior expectations for net receipts growth of 5.2% and 5.1%, respectively. Variations in the amount that goes to the local income tax reserve fund actually results in growth for the State's general fund of 5.2% for fiscal year 2017 while reducing the rate to 4.5% for fiscal year 2018.

The Board and the Revenue Monitoring Committee will continue to meet and analyze revenue and economic trends in anticipation of December's estimates.

Respectfully yours,

Peter Franchot

Peter Franchot, Chairman

Nancy K. Kopp

Nancy K. Kopp

David R. Brinkley

Maryland General Fund Revenues
Fiscal Years 2016 - 2018
($ in thousands)

	FY 2016			FY 2017				FY 2018	
	Official Estimate[1]	Actual	Difference	Current Estimate[1]	September Revision	Difference	% Growth	September Estimate	% Growth
INCOME TAXES									
Individual	8,779,118	8,517,585	(261,532)	9,270,074	8,963,525	(306,549)	5.2%	9,370,438	4.5%
Corporations	866,636	874,465	7,829	864,280	853,356	(10,924)	-2.4%	898,200	5.3%
Total	9,645,753	9,392,050	(253,703)	10,134,354	9,816,881	(317,473)	4.5%	10,268,638	4.6%
SALES AND USE TAXES	4,449,683	4,444,481	(5,202)	4,601,449	4,574,750	(26,699)	2.9%	4,725,297	3.3%
STATE LOTTERY RECEIPTS	520,373	529,754	9,381	519,518	512,662	(6,856)	-3.2%	523,889	2.2%
OTHER REVENUES									
Business Franchise Taxes	230,413	221,967	(8,446)	235,165	226,404	(8,761)	2.0%	193,099	-14.7%
Tax on Insurance Companies	297,613	287,407	(10,206)	308,658	294,802	(13,856)	2.6%	304,618	3.3%
Estate & Inheritance Taxes	251,128	261,932	10,804	198,502	207,815	9,313	-20.7%	184,766	-11.1%
Tobacco Tax	392,374	395,279	2,905	390,869	393,479	2,610	-0.5%	391,864	-0.4%
Alcoholic Beverages Excises	31,512	31,946	434	31,792	32,390	598	1.4%	32,839	1.4%
Motor Vehicle Fuel Tax	4,625	4,625	-	-	-			-	
District Courts	77,718	72,334	(5,384)	77,619	71,885	(5,734)	-0.6%	71,870	0.0%
Clerks of Court	37,553	34,203	(3,349)	39,278	36,947	(2,332)	8.0%	36,239	-1.9%
Hospital Patient Recoveries	59,713	57,499	(2,215)	58,348	58,348	-	1.5%	58,348	0.0%
Interest on Investments	11,000	15,008	4,008	20,000	20,000	-	33.3%	35,000	75.0%
Miscellaneous	323,284	334,145	10,861	321,885	326,020	4,135	-2.4%	332,353	1.9%
Total	1,716,931	1,716,344	(587)	1,682,116	1,668,088	(14,028)	-2.8%	1,640,995	-1.6%
TOTAL CURRENT REVENUES	16,332,740	16,082,630	(250,111)	16,937,437	16,572,382	(365,056)	3.0%	17,158,819	3.5%
Transfer Tax Revenues[2]	115,367	115,367	-	62,771	62,771	-	-45.6%	46,028	-26.7%
GRAND TOTAL	16,448,107	16,197,996	(250,111)	17,000,208	16,635,153	(365,056)	2.7%	17,204,847	3.4%

[1] Post the March 2016 official estimate, the 2016 Legislative Session resulted in an additional $3.6 million in estimated revenues for fiscal year 2016 and a reduction of $21.1 million in estimated revenues for fiscal year 2017; this table has been adjusted accordingly

[2] The Tax Property Article §13-209 has been been altered across several legislative session so as to provide various distributions to the general fund