June 2019 Revenue Forecast

Overview of Economic Outlook

In the June 2019 Revenue Forecast the Legislative Council Staff and the Office of State Planning and Budgeting predict continued economic growth but recognize that several indicators show signs that the rate of growth will slow.

The economy has grown for 10 years and in July it will become the longest economic expansion in US history. The expansion has led to low unemployment and low underemployment. In the past quarter there has been an uptick in unemployment, a positive sign which means that people have come back into the workforce and it makes it easier for firms to find employees. During this long expansion wages have increased and Colorado's rate of increase for personal income has outpaced the nation's rate. Personal income in Colorado increased by 5.7% in 2018 and in Colorado the average hourly wage is $30.17. Overall inflation has remained low.

SHORT TERM

- Economy continues to grow in longest expansion
- Colorado's state economy is strong

Gross Domestic Product (GDP) grew 4.2% in the second quarter of 2018 and it has come down to 3.1% in the first quarter of 2019. Overall, the nation's GDP is expected to grow at 2.4% in 2019 and 1.8% in 2020. Colorado's economy is one of the strongest state economies in the US and in 2018 the state's economy grew by 3.5%. While there has been strong economic growth, several components of GDP show signs of slowing down. The personal consumption expenditures component of GDP is losing momentum and has slowed in each of the last 4 quarters. Net exports have been highly variable over the last 5 quarters. Another leading indicator is the level of manufacturing, and the manufacturing index has dipped. Many manufacturers are concerned about trade uncertainties and are considering altering their supply chains. The trade tariffs are cause for a level of uncertainty to both forecasts in the longer term.

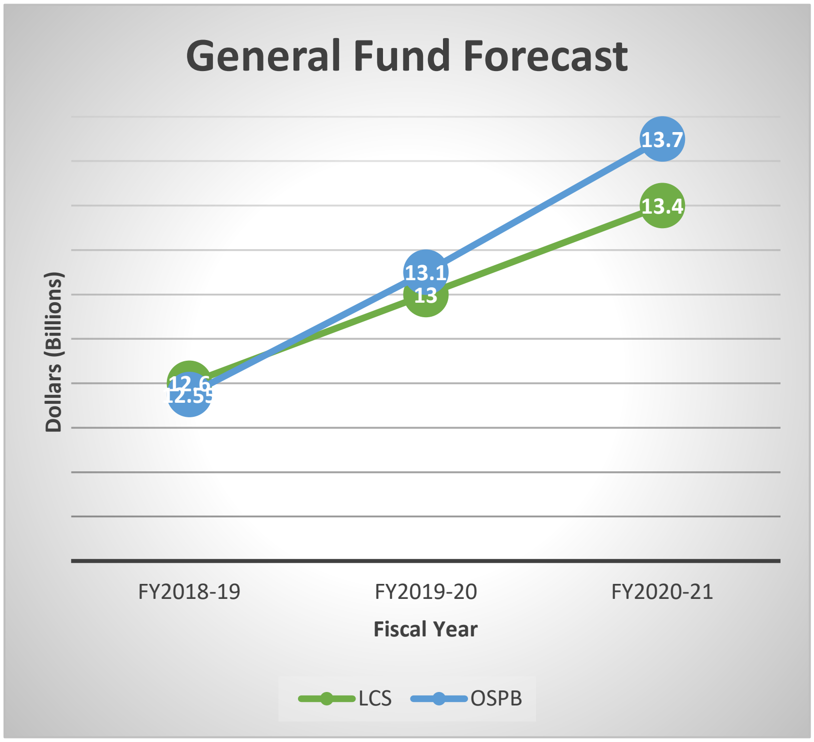
Late in the economic cycle, the economy tends to slow down because of wage pressures and inflationary pressures, but the economy still has not shown signs of overheating and the Federal Reserve has not been raising interest rates. Legislative Council Staff does not predict a near term recession or an overheating economy, but rather a slowdown in growth.

One risk OSPB saw was related to trends in bank lending standards. Bank lending standards to commercial borrowers typically tighten before a recession. In the fourth quarter of 2018 there were slightly more banks that were tightening standards compared to those loosening. However, in the first quarter of 2019, that ratio has bounced back with slightly more banks loosening standards than tightening standards.

LONG TERM

- Slow-down in the rate of economic growth
- Trade tariffs may disrupt supply chains

General Fund Forecast



Both Legislative Council Staff and the Office of State Planning and Budgeting revised their General Fund revenue forecasts upward from the March 2019 forecast predictions. LCS revised their FY2018-19 General Fund revenue prediction up by $495.5 million, FY2019-20 revenue up by $388.6 million and FY2020-21 up by $438.9 million. Similarly, OSPB revised their projections up. For FY2018-19 they revised the March 2019 forecast up by $270 million and the FY2019-20 forecast up by $114.4 million.

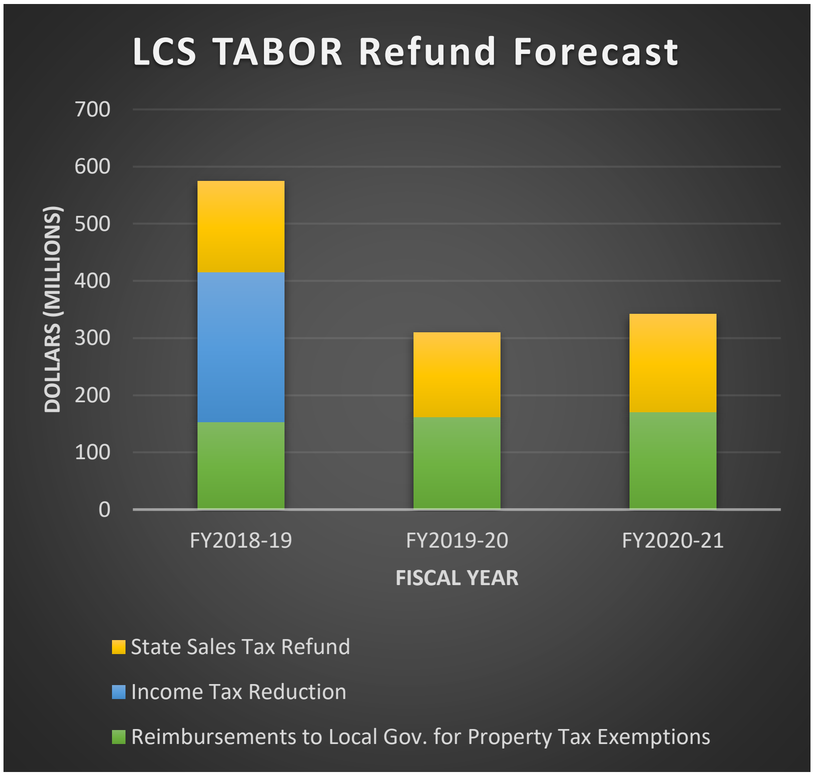
LCS forecasts a 7.9% General Fund revenue increase from FY2017-18 to FY2018-19. By FY2020-21 LCS predicts a 3.1% growth rate in General Fund revenue from the previous year while OSPB predicts a 4.4% growth rate.

These upward revisions were largely due to stronger than expected income tax returns from both personal income and business income after the March revenue forecast. In March, the income tax estimated payments were coming in lower than expected. These income tax revenues dipped in March, but they have rebounded. This shift in the timing is thought to be due to the federal Tax Cuts and Jobs Act (TCJA). There is some uncertainty whether this growth is ongoing or one time. Recent decisions in two court cases related to corporate income tax refunds, *Oracle* and *Agilent,* also led to a net increase for the current fiscal year of $78.1 million. A portion of the increase in the outyear revenue forecasts was due to legislation passed at the end of the 2019 legislative session. HB19-1240, Sales And Use Tax Administration, added $40.5 million because of changes to sales tax administration for marketplace facilitators and HB19-1245, Affordable Housing Funding From Vendor Fee Changes, which added $23.1 million General Fund due to changes made to the vendor fee.

In each quarterly revenue forecast hearing, LCS typically shares a figure of how much more revenue lawmakers have to spend, save, or refund to taxpayers above the previous year, holding appropriations constant. Some JBC members in the past have criticized this figure because it does not contain required increases in appropriations or changes to caseload. During the June Revenue Forecast, LCS gave three of these types of figures based on different appropriation assumptions. Holding appropriations constant, the legislature would have $763.1 million more to spend or save in FY2020-21. However, if appropriations grow by inflation plus population growth, then the lawmakers would have $338.2 million over the previous year. If appropriations grow by 6%, which is the typical expansionary growth of appropriations, then there is a deficit of $13 million.

TABOR Outlook

In March, LCS only forecast a TABOR surplus in the current year of FY2018-19, but because of the forecasted increased General Fund revenues, LCS now predicts a TABOR refund in all three of the forecast years.



There are three TABOR refund mechanisms that are triggered depending on the amount of revenue above the Referendum C cap. The first mechanism is a reimbursement to local governments for lost revenue from the Senior Homestead and Disabled Veterans Property Tax Exemptions. For any other mechanisms to be triggered, these reimbursements have to be fully funded. An income tax rate reduction is second mechanism and it is triggered only if there is enough revenue to pay for entire refund. Third is a six tier sales tax refund mechanism. For FY2018-19 to trigger the income tax reduction there must be a TABOR surplus of roughly $400 million. LCS forecasts $574.7 million above the Referendum C cap in FY2018-19, $310 million above the cap in FY2019-20, and $342.1 million above the cap in FY2020-21. The expected TABOR refund for FY2018-19 is large enough to trigger an income tax rate reduction that would be paid out in the following year. OSPB predicts revenue above the Referendum C cap of $295.6 million in FY2018-19, $412.2 million in FY2019-20, and $623 million in FY2020-21. OSPB predicts the FY2020-21 TABOR surplus will be paid out through all three refund mechanisms. Part of the

$1.2 billion in TABOR refunds from FY2018-19 to FY2020-21

According to the LCS forecast, in each of the next three years, TABOR revenue will exceed the Referendum C cap and cause refunds totaling over $1 billion.

difference in the TABOR forecasts from LCS and OSPB are because of debate on whether money from a late settlement is TABOR exempt or non-exempt.