General Fund Tax Revenue Forecasts of the Council on Revenues

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General Fund tax revenues (1.8%) in FY 2014 was adversely impacted by certain factors.

- In FY 2014, the State's General Fund tax revenues were $5.37 billion, down by 1.8% from the previous year.
- Total personal income in Hawaii grew by 2.9%, but
  - General Excise Tax (GET) collections fell by 2.2% and owing to a special GET allocation of $55.5 million to the Hawaii Hurricane Relief Fund, the GET allocated to the General Fund fell by 4.1%.
  - Collections of the Individual Income Tax rose by only 0.6%.
- Tax law changes (e.g., Act 105) and the special GET allocation reduced General Fund tax revenues in FY 2014 compared to FY 2013.
- Without the tax law changes or the special GET allocation, the General Fund tax revenues might well have grown slightly in FY 2014.

Growth in General Fund tax revenue has turned positive in FY 2015

- In the first six months of FY 2015:
  - General Fund tax revenues are up by 6.3% compared to FY 2014.
  - Collections of the General Excise Tax (GET) are up by 7.1%, and GET allocations to the General Fund (after the special allocation to the Hawaii Hurricane Relief Fund) are up by 7.4% compared to FY 2014.
  - Collections of the Individual Income Tax are up by 8.5% compared to FY 2014.
- Changes in tax laws are not expected to have much effect on the growth rate for General Fund tax revenues from FY 2014 to FY 2015.

How the Council produces its forecasts

- The Tax Department asks Council members to provide certain forecasts for key economic variables that help determine General Fund tax revenues, such as construction, total personal income, inflation, and visitor arrivals.
- The Department enters the economic forecasts into econometric models to predict tax revenues over the budget period.
- The models also take account of things like tax law changes and collection lags.
- The Tax Department also provides information on the recent trends in tax collections and any issues of tax administration that might affect General Fund tax revenues, such as unusual delinquent tax collections or lags in processing of returns and payments.

How the Council produces its forecasts (Cont.)

- When the Council meets, it evaluates the results of the econometric models and examines recent trends in collections.
- The Council also considers other economic or political changes that might materially affect tax collections.
- The members then agree on their official forecasts for growth rates of overall General Fund tax revenues.
- The Tax Department takes the official growth forecasts and adjusts the variables in one of its econometric models to produce forecasts for the individual tax types that are consistent with the Council's overall forecasts.

The Council's forecast for FY 2015 and FY 2016

- The Council's current forecast is that General Fund tax revenues will grow by 4.5% in FY 2015, to $5.61 billion.
- The revenue growth for the first six months of the fiscal year (6.3%) is higher than the forecast rate for the full year.
- The last six months of the fiscal year generally provide more than half of the total General Fund tax revenues ---holiday season, April 20 deadline, etc.
- The revenues for the remainder of the fiscal year (January through June) will have to surpass those for the same period last year by only 2.8% if we are to meet the forecast.
- The growth rate forecast for FY 2016 is 5.5%.

Here are the Council's forecasts for FY 2015 and beyond

Table 1

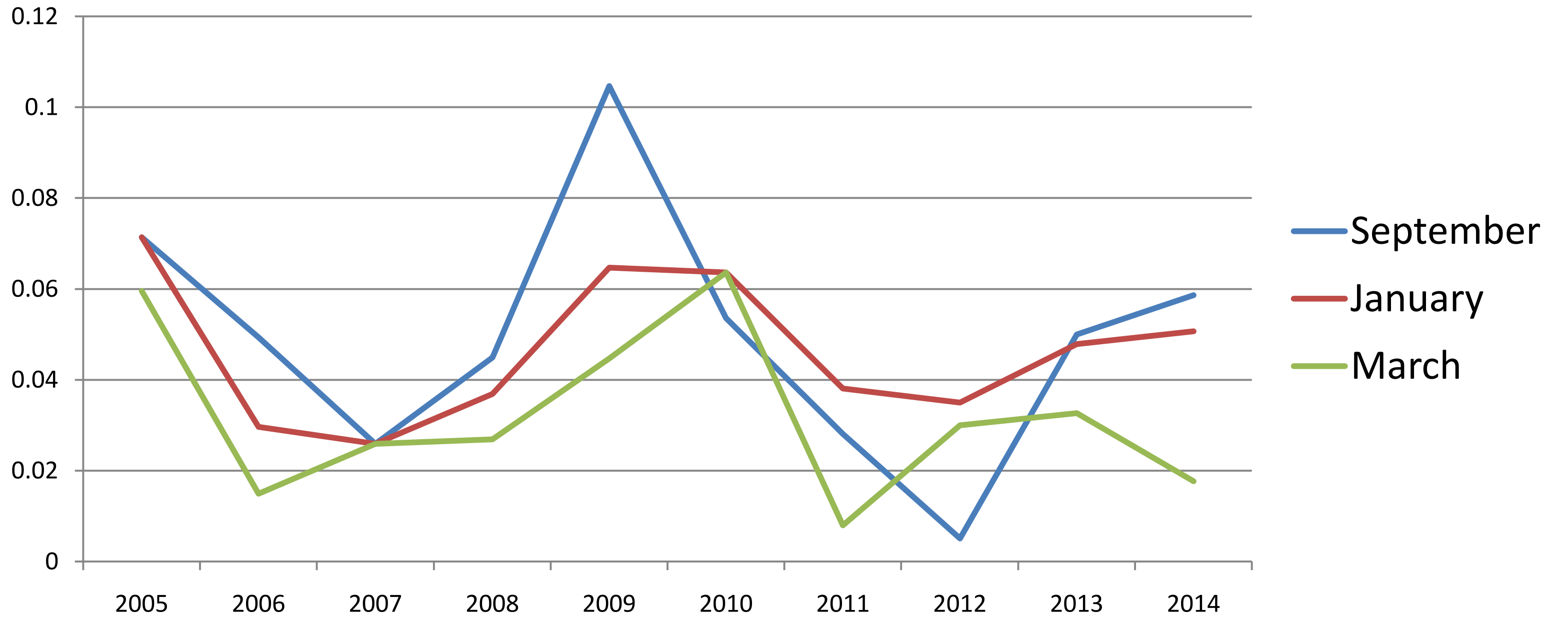
Fiscal Year	General Fund tax revenues ($ billions)	Growth from previous year
2015	$5.61	4.50%
2016	$5.92	5.50%
2017	$6.25	5.50%
2018	$6.59	5.50%
2019	$6.95	5.50%
2020	$7.33	5.50%
2021	$7.74	5.50%

Forecasting and forecast errors

- Here is the growth rate that would be projected if we utilize the low, high, and average shares of revenue for the six months of the fiscal year, i.e., January through June, based upon the share of total annual collections received as of the end of December.
- The projections are done after removing the effects of one-off events, such as the refund delays in FY 2010 and the allocations to the Hawaii Hurricane Relief Fund in FY's 2014 and 2015.
- Using the low, high and average of the shares over the past decade:
  - The low projected revenue growth rate is -4.5%
  - The high projected revenue growth rate is 15.2%
  - The average projected revenue growth rate is 6.7%.
- Because of the wide range of potential forecasts, this exercise shows how forecasting is challenging. The following figure shows the size of the errors in the Council's General Fund tax revenue forecasts in recent years.
- The figure shows the error in the September, January and March forecasts.

A Picture of the forecast errors in recent years

Absolute Values of Forecast Errors (in percents)



Some additional factors to consider

- The U.S. economy appears to be growing nicely. Nominal GDP growth was 3.6% in FY 2014 and 4.3% in the first quarter of FY 2015 (using Hawaii's fiscal year).
- Japan appears to have adopted a policy of monetary easing to help it economy. At the end of calendar year 2014, the yen hit a seven year low relative to the dollar.
- A weaker yen will adversely affect Hawaii's visitor industry by raising the price of a Hawaii vacation for Japanese visitors.

Additional factors (Cont.)

- Low interest rates and an improving economy have led to five straight years of growth in auto sales in the United States.
- But sales of autos (and other consumer durables) may enter a cyclical decline if the need for them becomes sated, which may slow growth in the U.S. economy.
- Some geopolitical events could hurt future economic prospects. For example, weakness in the euro area, especially among the heavily indebted members, might bring a financial crisis.

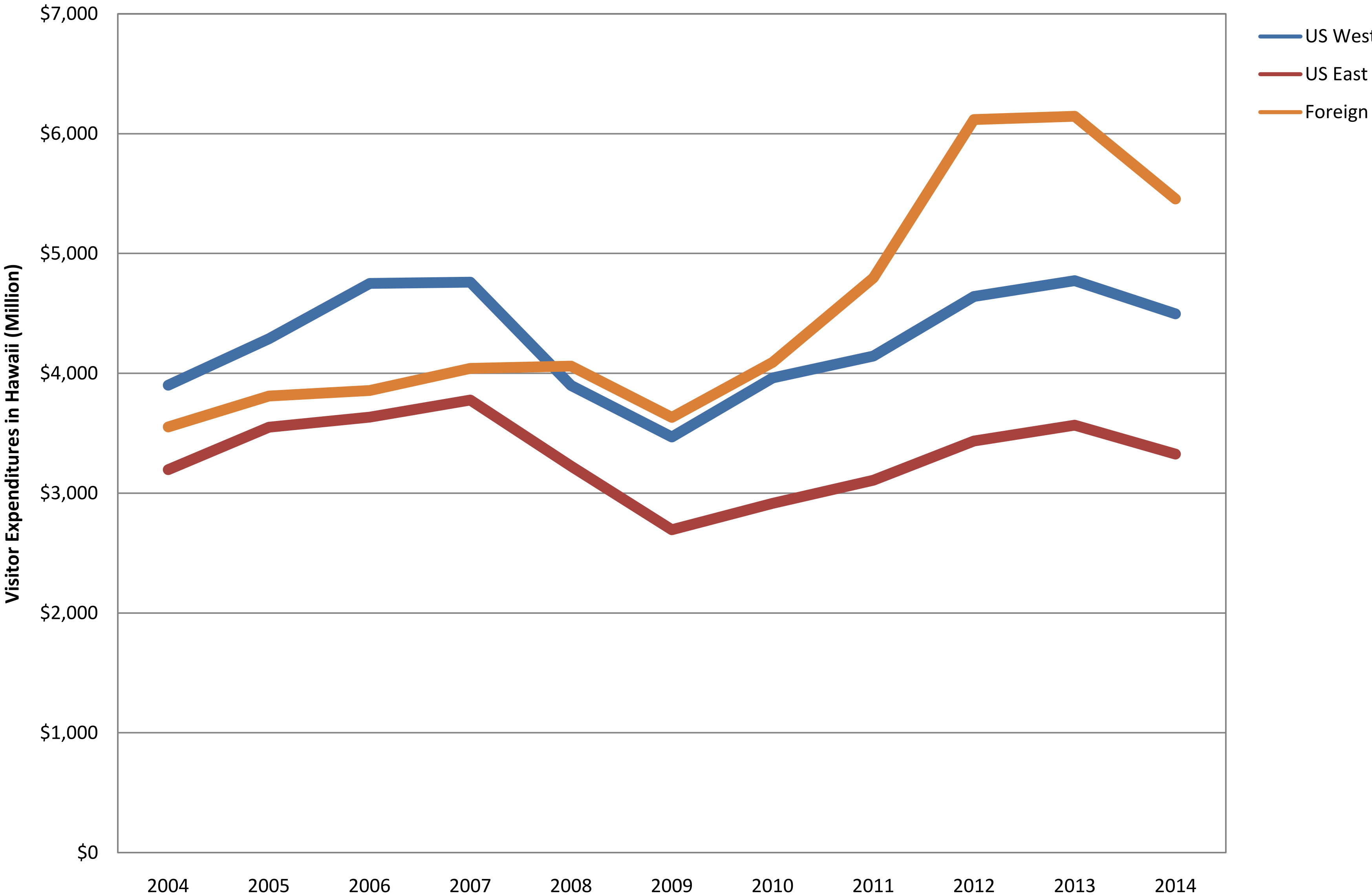
Additional Factors (Cont.)

- Economic growth in China appears to be slowing, but easing of visa requirements and growing knowledge of Hawaii may offset adverse effects on Chinese visitors to Hawaii.
- Hawaii may be well known in parts of Southern China, but in Northeastern China (Shanghai, Beijing) it is not as well known as other destinations with popular TV shows/movies (Seattle, Mauritius, Thailand).

Additional Factors (Cont.)

- The Fed is expected to raise interest rates this summer. If they do, it will be an encouraging sign that the U.S. economy is improving.
- The consequences for Hawaii are ambiguous, however, because higher interest rates would tend to strengthen the dollar in foreign currency markets.
- A stronger dollar may hurt foreign tourism in Hawaii, i.e., making Hawaii travel more expensive, and may curb the gains from increased domestic visitors.
- Figure 2 shows what has happened to visitor expenditures in Hawaii in recent years.

Visitor Expenditures in Hawaii by Major Market Areas



Note: *Visitor expenditures for 2014: Jan-Nov figure (year-to-date)

Additional factors (Cont.)

- Global oil prices have fallen dramatically.
- The drop in oil prices by itself should help Hawaii's economy. It should reduce transportation costs and give consumers and businesses more money to spend, including on trips to Hawaii.
- However, the drop may also be a symptom that global economic growth is slowing, which would be bad for tourism and Hawaii's economy.

Effects of legislation

- The Council adopted specific adjustments recommended by the Department of Taxation to reflect effects of tax law changes that will change General Fund tax revenues in FY 2015 or later years relative to their level in FY 2014, including the following:
- Act 107, SLH 2014 reestablishes the Energy Systems Development special fund. It also extends the $1.05 per barrel rate for the Environmental Response Tax (which was set to expire at the end of FY 2015) through FY 2030, as well as the allocations of the tax to the General Fund. The effect on General Fund tax revenues is estimated to be a loss of $2.6 million for FY 2015 and annual revenue gains of $15.5 million for FY's 2016 through 2030.
- Act 163, SLH 2014 increases allocations of the Conveyance Tax to the Rental Housing Trust Fund from 30% to 50% beginning July 1, 2014. The annual General Fund revenue loss is estimated to be $11.5 million per year beginning in FY 2015.

Effects of legislation (Cont.)

- Act 174, SLH 2014 increases allocations of the Transient Accommodations Tax to the counties from $93 million to $103 million for FY's 2015 and 2016. The General Fund revenue loss is $10 million in each year.
- Act 163 made permanent the GET exemption for certain expenses paid by hotel operators and timeshare projects and removed the cap on the aggregate amount of the exemptions that can be claimed. The Act is estimated to reduce GET collections in FY's 2015 and beyond by about $7 million less than it did in FY 2014.
- Act 62, SLH 2011, allocates GET revenues directly to the Hurricane Relief Fund to replace amounts that were taken in prior years. The Act reduces allocations to the General Fund by $55.5 million in each of FY's 2014 and 2015.