NEW YORK STATE
ECONOMIC AND REVENUE REVIEW
SFY 2012-13

GLOBAL INSIGHT

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Executive Summary

In conjunction with IHS Global Insight, the Senate Finance Committee reviewed and analyzed the economic and revenue projections contained within the Executive Budget for SFY 2012-13. Based upon IHS Global Insight's February economic forecast, the Senate Finance Committee projects $290 million in General Fund revenues (inclusive of miscellaneous receipts and transfers) above the Executive Budget forecast for SFY 2012-13. This amount is enhanced by the estimate for the remainder of SFY 2011-12, which is $65 million above than the Executive estimate. Therefore, the two year General Fund receipts forecast is $355 million above the Executive forecast.

The General Fund is not the only fund of the State that receives tax revenues. New York has a variety of tax revenues that are divided among the General fund, special revenue funds, capital projects funds, and debt service funds. The revenues deposited into these other funds are then utilized for targeted spending purposes. In addition, certain tax revenues (e.g. petroleum business taxes and real estate transfer taxes) are exclusively deposited into these other funds. By aggregating all the revenues collected by the State in each fund, the Senate Finance Committee projects All Funds tax revenues to be $212 million above the Executive for SFY 2012-13. This amount is enhanced by the estimate of tax revenues for the remainder of the 2011-12 fiscal year which is $36 million above the Executive estimate. This results in a two year All Funds tax revenue forecast that is $248 million above the Executive projection.

The economy at the national level is measured by the Gross Domestic Product, which is the total amount of goods and services produced and the consumption of these goods and services.

Spending on these goods and services by the three sectors of the economy – the consumer, business, and government - influences the degree to which the economy will either expand or contract. Influencing these spending decisions are many different variables, such as inflation and interest rates, whose impacts on these spending decisions change from year to year. Economic growth is not only dependent upon growth in the production and consumption of goods and services of these sectors of the economy but, how each sector impacts growth in the other sectors.

Although the economy grew in 2010, the pace of that growth slowed over the course of the year as the temporary provisions of the American Recovery and Reinvestment Act expired revealing that the underlying economic issues, such as unemployment and high debt levels, were unresolved. In the first quarter of 2011, economic growth slowed to only 0.4 percent, generating fears of a double dip recession.

Since a major portion of ARRA allowed state and local governments to artificially inflate their spending, these governments subsequently faced large budget deficits due to the lack of significant revenue growth to replace the federal support. State and local governments were faced with additional spending reductions and tax increases in order to balance their budgets. In addition, some governments were facing bond defaults and bankruptcies.

Besides the issues facing the state and local governments in 2011, the financial markets continued to experience major volatility. The debt crisis in Greece continued and spread to other countries in the Eurozone. Similar to the financial market crisis in 2008, the European

Central Bank was forced to intervene and to inject liquidity into the marketplace. This translated into large swings in the American stock markets. Over the course of two weeks, the Dow Jones Industrial Average lost almost 15 percent of its value.

There were positive aspects in the economy in 2011. At the end of 2010, initial claims for unemployment insurance began decreasing. This decline in claims continued into 2011. Job creation returned, increasing by 1.2 percent, and the unemployment rate dropped from 9.6 percent to 9.0 percent.

The housing market was showing some signs of life. Although home prices were still declining due to the large inventory of homes on the market, home sales and housing starts were growing. Housing starts benefitted from a growth in the multi-family sector as the demand for rental housing increased.

The start of 2012 is showing further strengthening of economic growth as initial claims for unemployment insurance are continuing to decrease and employment growth increases. As the employment growth translates into wage and income growth, the consumer is gaining more confidence in the economy and has increased his spending.

However, there is a lot of uncertainty in different areas of the economy that can impact economic growth. The resolution of the Greek debt crisis as well as debt concerns in other European countries will have a significant impact on the financial markets. In addition, a large amount of fiscal stimulus (i.e. the Bush tax cuts and the payroll tax cut) are due to expire at the end of the year. The results of the elections in November could be a pre-cursor to the status of this fiscal stimulus going forward. As a result, the economy, as a whole, is projected to maintain growth throughout the year. Real GDP for the whole of 2012 is expected to grow at a rate of 2.1 percent.

At the state level, the economy is measured by the Gross State Product (GSP). The state economy, unlike the national one, has two major sectors – consumer and business – with government taking a more supporting role. With the volatility in the financial markets over the course of 2011 and its prominent role in the New York economy, economic and revenue growth was adversely affected; especially in relation to the interaction of financial sector bonuses on state revenues. In addition, the storms that caused major damage in the eastern and central portions of the state served to slow economic activity. Total real GSP grew by 5.6 percent in 2011; however, most of the economic growth occurred in the first half of the year. Economic growth in New York is projected to lag national economic growth in 2012; growing by 1.6 percent as compared to 2.1 percent at the national level.

As the economy grew, wages and personal income at both the national and state level have shown growth in 2011. Wages at the national and state level grew by 3.6 percent and 2.8 percent, respectively, while personal income grew by 4.7 percent and 3.8 percent, respectively. Growth in personal income in 2012 is projected to continue to grow at both the national and state levels as a result of the continued growth in the overall economy, growing by 3.5 percent and 3.1 percent, respectively.

As outlined in the following tables, total All Funds tax collections are estimated at $64.57 billion in SFY 2011-12. This estimate is $36 million above the Executive Budget forecast. For SFY 2012-13, All Funds tax revenues are expected to increase by $2.2 billion to $66.74 billion or $212 million above the Executive's projections.

Estimates for the remainder of the current fiscal year show the decline in bonus payments to the financial services industry that are paid in the fourth quarter and its impact on wages and consumption which is reflected in weakness in withholding and sales tax collections. IHS Global Insight's forecast of the overall national economy in 2012 is slightly weaker than the economic forecast presented by the Executive. This is especially apparent in corporate profit growth which factors in to corporate franchise tax collections. The forecast for the State economy in 2012 appears to be stronger than that of the Executive as employment and wage growth is projected to be stronger.

Although the forecast exhibits stronger revenue growth for the upcoming fiscal year based on the projection of stronger economic growth, there are both upside and downside risks associated with the forecast, as with any forecast. As stated above, the speed by which the Eurozone debt crisis is resolved will help ease the volatility of the financial markets. In addition, the uncertainty associated with events in the Middle East could cause a spike in oil prices, fueling inflation pressures.

On the positive side, increased employment and wage growth as a result of a more optimistic business outlook would have a positive impact on the State's personal income and sales tax revenues. Continued low mortgage rates and employment growth may spur additional consumers into the housing market, boosting sales and home prices. This, in turn, could boost additional sales tax revenues from the purchase of durable goods as well as real estate transfer tax revenues. Additional revenues realized by the State should support the State's reserve funds or be used to support state and local tax relief.

SFY 2011-12 General Fund Tax Collections

(Millions of Dollars)

	Senate Finance	Executive Budget	Variance
Personal Income Tax	**25,833**	**25,705**	**128**
Withholding	31,223	31,067	156
Estimated Payments	11,628	11,660	(32)
Final Returns	2,109	2,125	(16)
Other Payments	1,027	1,039	(12)
Gross Collections	45,987	45,891	96
Refunds	(7,153)	(7,227)	74
STAR	(3,293)	(3,293)	0
RBTF	(9,709)	(9,666)	(43)
User Taxes and Fees	**9,048**	**9,135**	**(87)**
Sales and Use	8,330	8,426	(96)
Cigarette/Tobacco	480	476	4
Alcoholic Beverage	238	233	5
Business Taxes	**5,910**	**5,868**	**42**
Corporate Franchise	2,843	2,825	18
Corporate Utilities	614	626	(12)
Insurance	1,238	1,274	(36)
Bank Tax	1,215	1,143	72
Other Taxes	**1,153**	**1,212**	**(59)**
Estate and Gift	1,136	1,195	(59)
Pari-mutuel Taxes	16	16	0
Other	1	1	0
Total General Fund Taxes	**41,944**	**41,920**	**24**
Miscellaneous Receipts	3,321	3,304	17
Transfers	12,015	11,990	25
Total General Fund Receipts	**57,279**	**57,214**	**65**

SFY 2012-13 General Fund Tax Collections

(Millions of Dollars)

	Senate Finance	Executive Budget	Variance
Personal Income Tax	**27,136**	**26,911**	**225**
Withholding	32,497	32,598	(101)
Estimated Payments	12,097	11,852	245
Final Returns	2,159	2,203	(44)
Other Payments	1,081	1,104	(23)
Gross Collections	47,834	47,757	77
Refunds	(7,223)	(7,446)	223
STAR	(3,322)	(3,322)	0
RBTF	(10,153)	(10,078)	(75)
User Taxes and Fees	**9,305**	**9,341**	**(36)**
Sales and Use	8,563	8,592	(29)
Cigarette/Tobacco	498	511	(13)
Alcoholic Beverage	244	238	6
Business Taxes	**5,983**	**5,977**	**6**
Corporate Franchise	2,889	2,844	45
Corporate Utilities	641	682	(41)
Insurance	1,290	1,322	(32)
Bank Tax	1,163	1,129	34
Other Taxes	**1,132**	**1,144**	**(12)**
Estate and Gift	1,113	1,127	(14)
Pari-mutuel Taxes	18	16	2
Other	1	1	0
Total General Fund Taxes	**43,556**	**43,373**	**183**
Miscellaneous Receipts	3,153	3,129	24
Transfers	12,296	12,213	83
Total General Fund Receipts	**59,005**	**58,715**	**290**

SFY 2011-12 All Funds Tax Collections

(Millions of Dollars)

	Senate Finance	Executive Budget	Variance
Personal Income Tax	**38,834**	**38,664**	**170**
Withholding	31,223	31,067	156
Estimated Payments	11,628	11,660	(32)
Final Returns	2,109	2,125	(16)
Other Payments	1,027	1,039	(12)
Gross Collections	45,987	45,891	96
Refunds	(7,153)	(7,227)	74
User Taxes and Fees	**14,598**	**14,719**	**(121)**
Sales and Use	11,861	11,997	(136)
Auto Rental Tax	109	104	5
Cigarette/Tobacco	1,657	1,665	(8)
Motor Fuel Tax	514	501	13
Highway Use Tax	134	134	0
Alcoholic Beverage	238	233	5
MTA Taxicab	85	85	0
Business Taxes	**8,003**	**7,922**	**81**
Corporate Franchise	3,271	3,231	40
Corporate Utilities	792	815	(23)
Insurance	1,388	1,413	(25)
Bank Tax	1,430	1,374	56
Petroleum Business	1,122	1,089	33
Other Taxes	**1,787**	**1,832**	**(45)**
Real Estate Transfer	634	620	14
Estate and Gift	1,136	1,195	(59)
Pari-mutuel Taxes	16	16	0
Other	1	1	0
Payroll Tax	**1,347**	**1,396**	**(49)**
Total All Funds Taxes	**64,569**	**64,533**	**36**

SFY 2012-13 All Funds Tax Collections

(Millions of Dollars)

	Senate Finance	Executive Budget	Variance
Personal Income Tax	**40,611**	**40,311**	**300**
Withholding	32,497	32,598	(101)
Estimated Payments	12,097	11,852	245
Final Returns	2,159	2,203	(44)
Other Payments	1,081	1,104	(23)
Gross Collections	47,834	47,757	77
Refunds	(7,223)	(7,446)	223
User Taxes and Fees	**15,003**	**15,076**	**(73)**
Sales and Use	12,204	12,246	(42)
Auto Rental Tax	112	109	3
Cigarette/Tobacco	1,690	1,733	(43)
Motor Fuel Tax	529	515	14
Highway Use Tax	137	147	(10)
Alcoholic Beverage	244	238	6
MTA Taxicab	87	88	(1)
Business Taxes	**8,154**	**8,152**	**2**
Corporate Franchise	3,351	3,299	52
Corporate Utilities	824	877	(53)
Insurance	1,428	1,463	(35)
Bank Tax	1,392	1,351	41
Petroleum Business	1,159	1,162	(3)
Other Taxes	**1,802**	**1,834**	**(32)**
Real Estate Transfer	670	690	(20)
Estate and Gift	1,113	1,127	(14)
Pari-mutuel Taxes	18	16	2
Other	1	1	0
Payroll Tax	**1,175**	**1,160**	**15**
Total All Funds Taxes	**66,745**	**66,533**	**212**

The National Economy

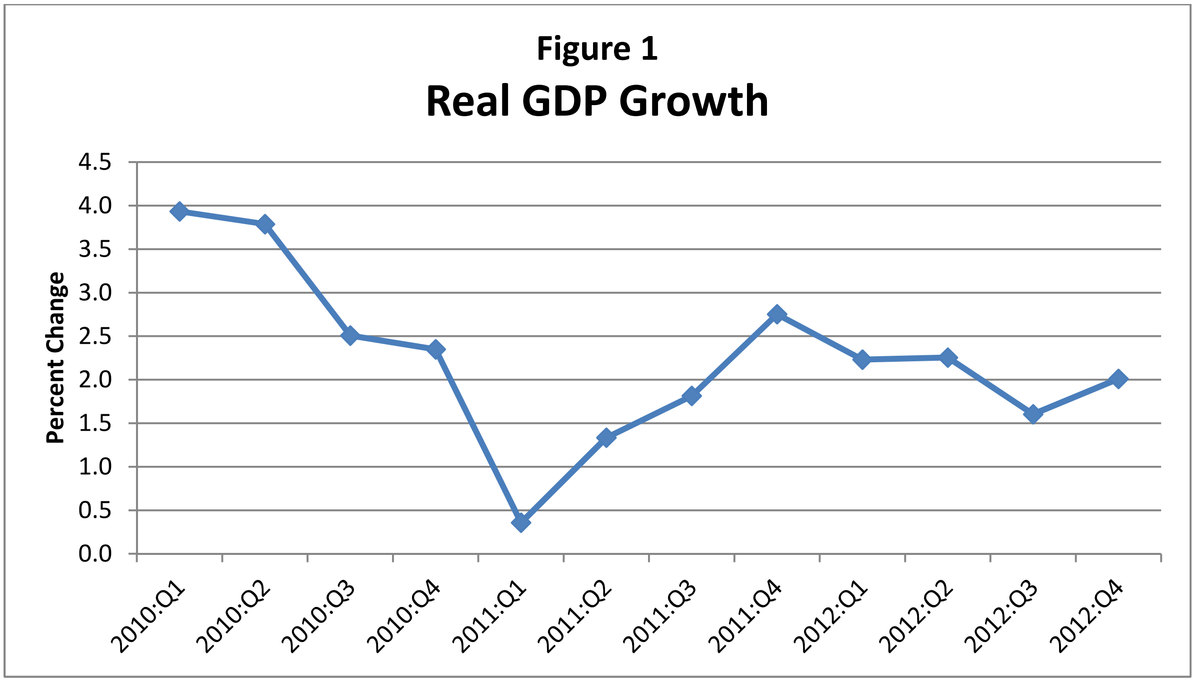
As a result of the bursting of the housing market bubble and the financial market crisis, the national economy in 2009 experienced the largest declines since the Great Depression. Consumers were saddled with large amounts of debt, lack of employment and declining incomes and home values. Businesses were realizing reduced revenues as the demand for their products declined which, in turn, caused them to reduce production and their workforces. State and local government tax revenues declined and budget deficits grew.

In order to address the financial market crisis and the tight credit market, the Federal government employed available monetary policy tools to reduce interest rates and to pump liquidity into the markets. The Federal government then turned to its fiscal policy tools in an attempt to jump start the economy through the enactment of the American Recovery and Reinvestment Act (ARRA). However, this stimulus was temporary and focused more on allowing state and local governments, which only account for approximately ten percent of the Gross Domestic Product (GDP), to continue government spending rather than putting money in the hands of primary drivers of economic growth, the consumer and businesses.

Although the debt financed federal spending did manage to boost the economy in 2009 and the first half of 2010, this economic growth subsided as the provisions of ARRA expired. Jobs were still being lost and the housing market was still depressed. With the lack of consumer demand, businesses were not increasing their production and postponing any spending on equipment and facilities. The national economy only increased by 0.4 percent in the first quarter of 2011; generating fears of a double dip recession.

Numerous shocks to the economy at both the international and domestic levels further constrained economic growth in 2011. In March, the devastating earthquake and tsunami in Japan caused interruptions in the global supply chains of autos, telecommunications and consumer electronics. The civil unrest in Northern Africa and the Middle East, known as the Arab Spring, raised concerns over oil supplies and the impact on gasoline prices. The continuation of the sovereign debt crisis in the Eurozone with the possibility of a default by Greece and debt concerns in Spain, Portugal, Ireland and Italy contributed to increased volatility in the financial markets. On the domestic front, severe weather, the possibility of a federal government shutdown, the debt ceiling crisis, and the political wrangling over the extension of the payroll tax cut and emergency unemployment insurance benefits served as a drag on an economy that had not fully recovered from the recession.

However, all the economic news was not bad. Businesses were upgrading their facilities and machinery to take advantage of the bonus depreciation offered by the Federal government; there was job growth, the unemployment rate decreased, and consumers were gaining confidence. After growing by 2.3 percent in the fourth quarter of 2010, economic growth, as measured by the change in the Gross Domestic Product (GDP), slowed to 0.4 percent in the first quarter of 2011. Even with all the negative economic shocks in 2011, the national economy still managed to grow. As shown in figure 1, the economy grew at an increasingly faster rate over the course of 2011 albeit at much lower levels than in 2010.



With all the positive traction that the national economy gained in 2011, there are still uncertainties facing the national economy in 2012. As a result of the sovereign debt crisis, the Eurozone fell into recession at the end of 2011 and Greece's debt problems have yet to be fully resolved. A renewed potential of unrest and conflict in the Middle East poses concerns for oil and gasoline prices. Finally, the presidential election and its impact upon the expiration of the Bush tax cuts, the payroll tax cut, and the emergency unemployment benefits as well as any impact of potential spending cuts from the spending sequester serve to constrain economic growth in 2012. As a result, real GDP for 2012 is projected to grow by 2.1 percent.

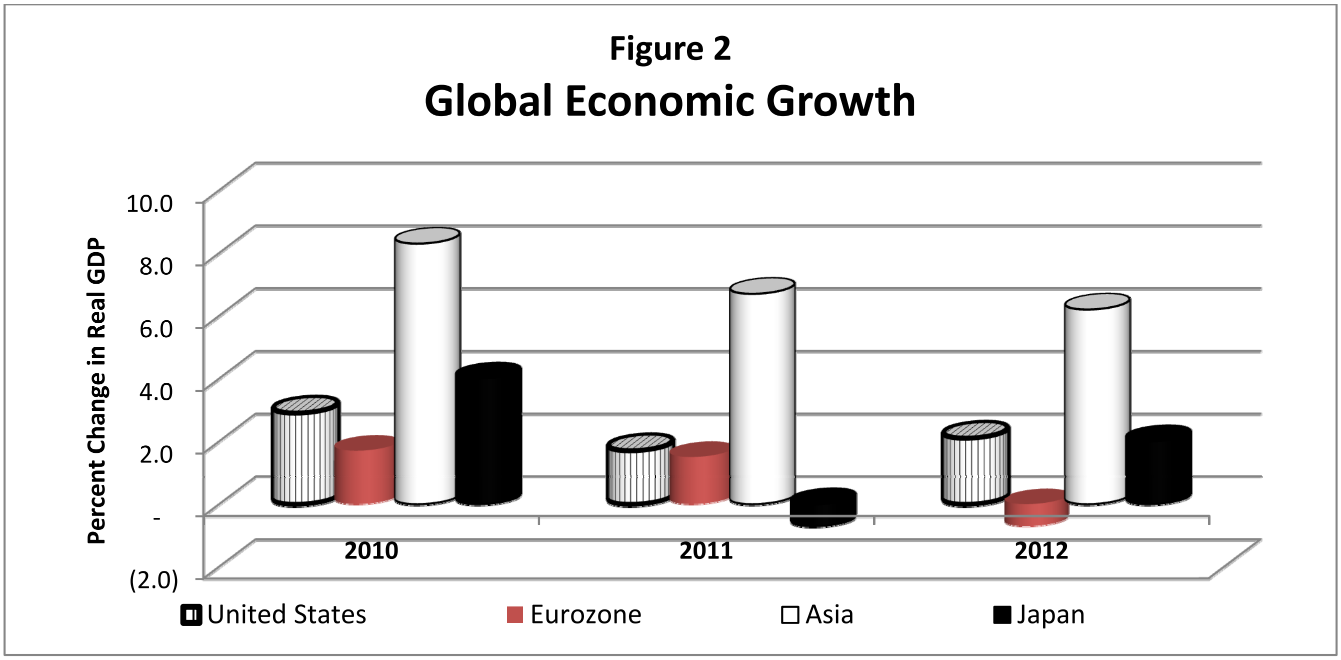
GLOBAL ECONOMY

Any changes in the global economy can have a significant impact on the national economy even though trade is not a major contributor to overall national economic growth, as measured by

GDP. This was demonstrated in 2011 as various international events created uncertainty in the economy, especially in the financial markets. The impact of these changes is reflected not only in relation to value of the dollar compared to other currencies but with the strengths or weaknesses of other national economies. This impact is primarily realized in the amount of imports and exports into and out of the United States.

Another result of economic strength in other countries is increased competition for resources. Prices for these resources increase; which fuels inflation. This has been evident in relation to oil prices. China, for example, has an increasingly stronger economy whose demand for energy has grown significantly. That demand causes large increases in oil prices as the world supply of oil is increasingly limited.

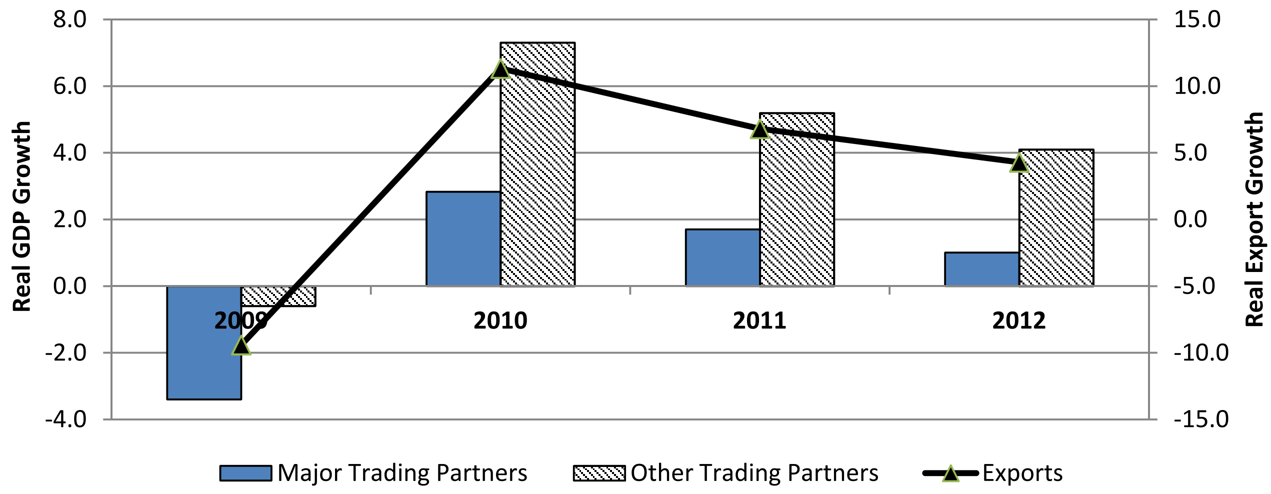
As shown in figure 2, the United States was not the only country to experience an economic slowdown in 2011. The natural disasters in March pushed Japan's economy into another recession and economic growth continued to slow in the Eurozone, causing it to slip into recession in the fourth quarter of 2011. For 2012, the U.S. and Japanese economies are projected to exhibit stronger growth; the latter primarily the result of rebuilding after the earthquake. The other Asian economies are projected to continue to slow as China faces the deflation of its own housing market bubble. Although the Eurozone recession is projected to be mild, economic growth is not projected until the second half of 2012.



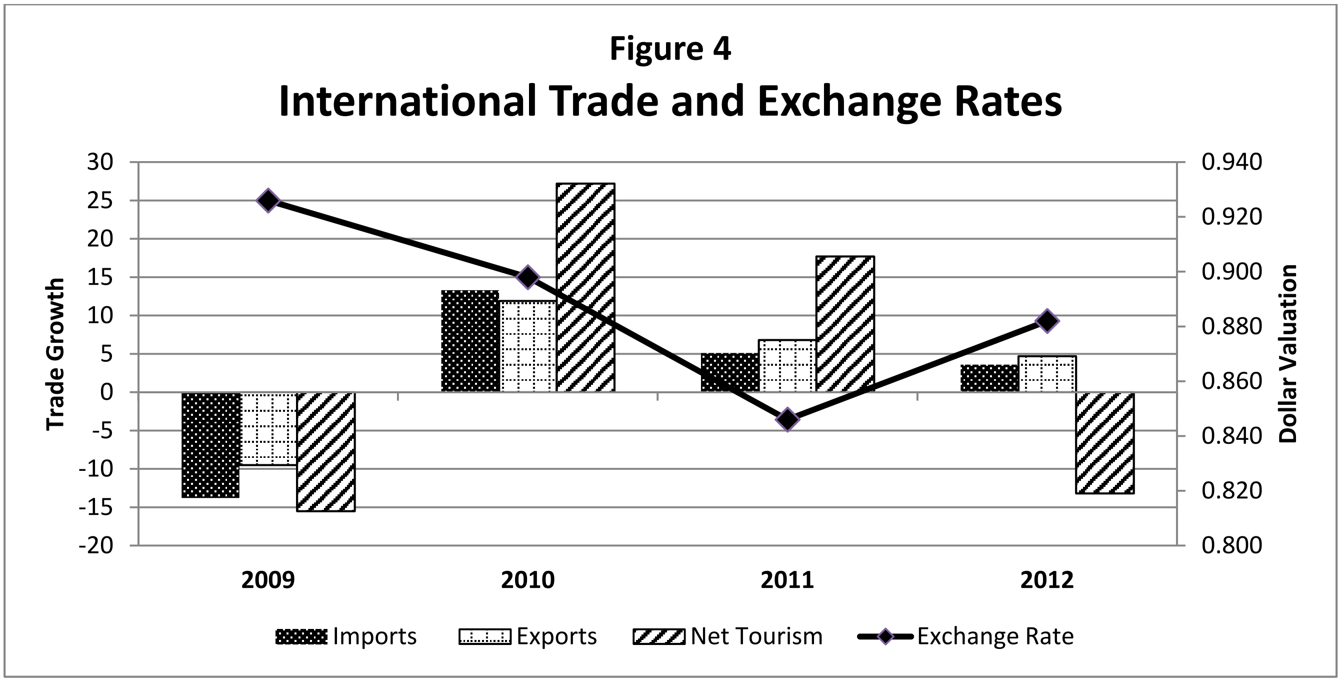
The strength of any nation's economy will have an impact not only on the demand for their domestic goods but, on the demand for other countries' goods as well. In addition, as the supply of business inputs becomes more globalized, a change in business spending and production in one country can impact business production in another. As the global economy came out of the recession in 2009, products and services exported out of the United States grew in 2010. However, as economic growth slowed in 2011, so too did the amount of exports. This slowdown in export growth is projected to continue into 2012.

Figure 3

Exports and Global Economic Growth



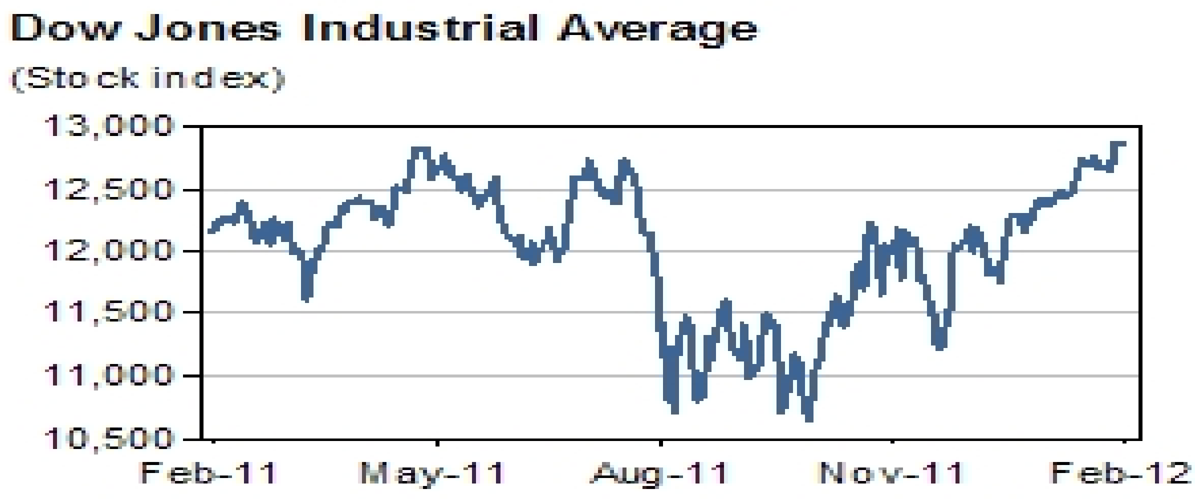
The value of a nation's currency also helps or hinders export and import growth. When the value of the currency increases, the price of domestic goods increases; making them more expensive compared to imported goods. Conversely, when the value of the currency declines, domestic goods become less expensive. When the value of a currency declines, that nation also becomes more attractive to foreign travelers. Not only are the goods less expensive but services, such as hotel rooms, are less expensive as well. As shown in figure 4, as the dollar depreciated, the net trade of tourism services (exports less imports) increased; more foreign travelers were visiting the United States. With the projected appreciation of the dollar in 2012 coupled with the slowdown in other economies, tourism to the U.S. is projected to decrease.



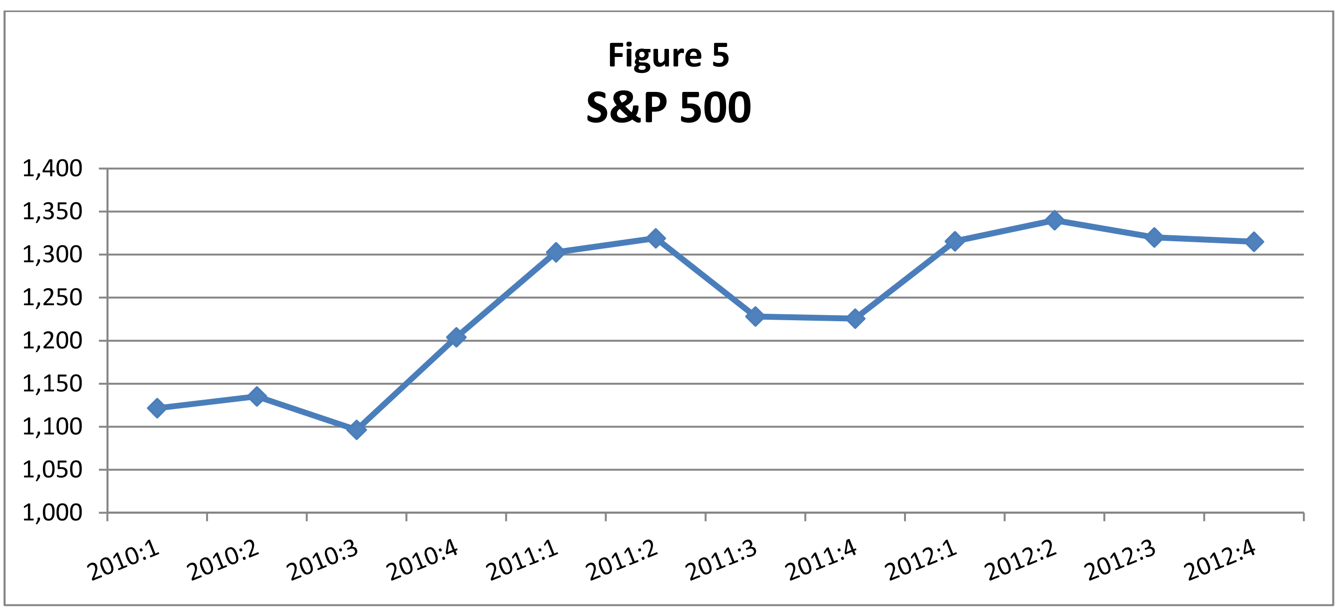
As the global recession impacted the global financial markets, dollar denominated assets became a safe haven for the world's investors in 2009. With less volatility in the financial markets and global economic growth in 2010, especially in the emerging markets, the dollar depreciated. However, as the sovereign debt crisis spread through the Eurozone in 2011, dollar denominated assets were once again in demand. In addition, long term interest rates in the US were higher than interest rates in its major trading partners. These factors increased the demand for the dollar causing it to appreciate.

FINANCIAL MARKETS

Not only were the financial markets reacting to domestic economic news throughout 2011 but, they were reacting to the global economic news as well. These economic shocks resulted in a large degree of stock market volatility.



By the end of 2010, the stock market, as measured by the Standard and Poor's 500 Index of Common Stocks (S&P 500), had returned to its pre-recession levels. Growth continued in the first half of 2011, increasing by approximately 10 percent. However, as the debt crisis in Europe spread and the possibility of a federal government default on its bonds loomed, the stock market declined, giving back almost all of the gains from the first half of the year.

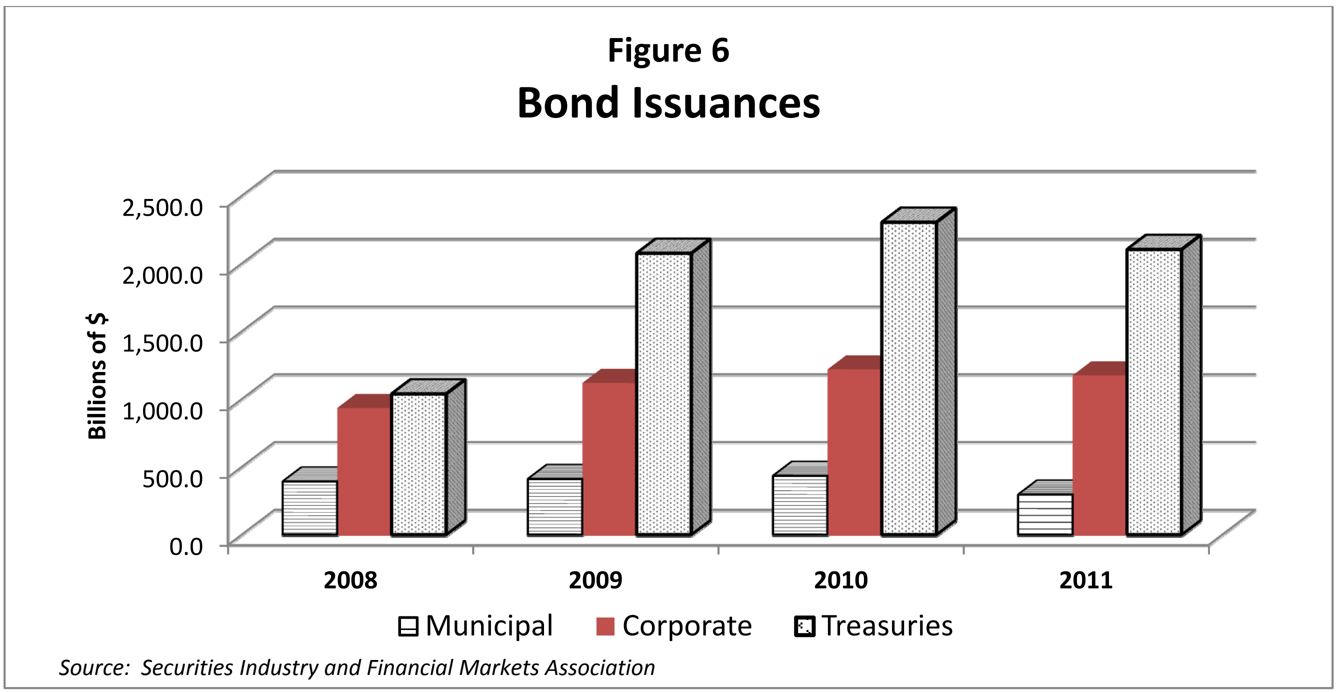


The positive signs for economic growth in 2012 will, in turn, provide for stock market growth. The robust growth the market is currently displaying will be tempered by the slowdown in the global economies and the timeframe for the resolution of the Eurozone debt crisis. As a result, stock market growth for all of 2012 is projected to be 4.2 percent.

When the sub-prime mortgage market collapsed, the credit markets tightened up. Buyers of municipal and corporate bonds purchased only highly rated bonds; imposing high premiums on the lower rated ones. With the “flight to safety” during the credit crisis, investors increased their purchases of treasury bonds while the amount of corporate and municipal bonds being sold declined. Investors continued this “flight to safety” in 2011 as stock market volatility remained throughout the year. The Federal Reserve’s policy of quantitative easing also caused the issuance of treasuries to grow exponentially, as shown in Figure 6.

As previously mentioned, the temporary fiscal stimulus provided to state and local governments under the American Recovery and Reinvestment Act (ARRA) allowed these governments to increase spending without addressing the underlying lack of revenue growth. As the fiscal stimulus went away, state and local governments were faced with budget deficits as their revenues stagnated due to the slow economic growth. Municipalities were forced to reduce their spending while others were facing rating downgrades and defaults.

During the credit crisis, a bonding program, Build America Bonds, was created to allow state and local government broader access to the capital markets through the issuance of taxable bonds. In order to constrain the increased debt service costs resulting from the issuance of taxable bonds, the Federal government provided a subsidy to the municipal governments equal to the interest rate differential between taxable and tax exempt bonds. Upon expiration of the Build America Bond program in 2010, municipalities reverted to the tax exempt bond market which serves a narrower set of investors. With the narrower market access and ratings downgrades, municipal bond issuances declined in 2011.



GOVERNMENT

FISCAL POLICY

Government policies are employed in an attempt to influence the overall economy, whether it be to stimulate spending or to control inflation. Although the economy is cyclical in nature, the government tries to ensure that the economy does not expand too quickly –causing inflation to spin out of control – or to slow down too quickly –resulting in a recession. There are two mechanisms by which government intervenes in the economy – fiscal policy and monetary policy.

Fiscal policy entails directing the economy through tax policy or through government spending. When the Federal government, or state and local governments, lower taxes, more money is put into the hands of the consumers and businesses to spend as they wish. To address the continued sluggishness in the economy, the Federal government enacted the Job Creation Act at the end of 2010. This Act extended the reduced personal income tax and capital gains tax rates ("Bush tax cuts") for two more years. Included in the Job Creation Act was a reduction in the Social Security payroll tax rates and an extension of unemployment benefits which were to expire at the end of 2011.

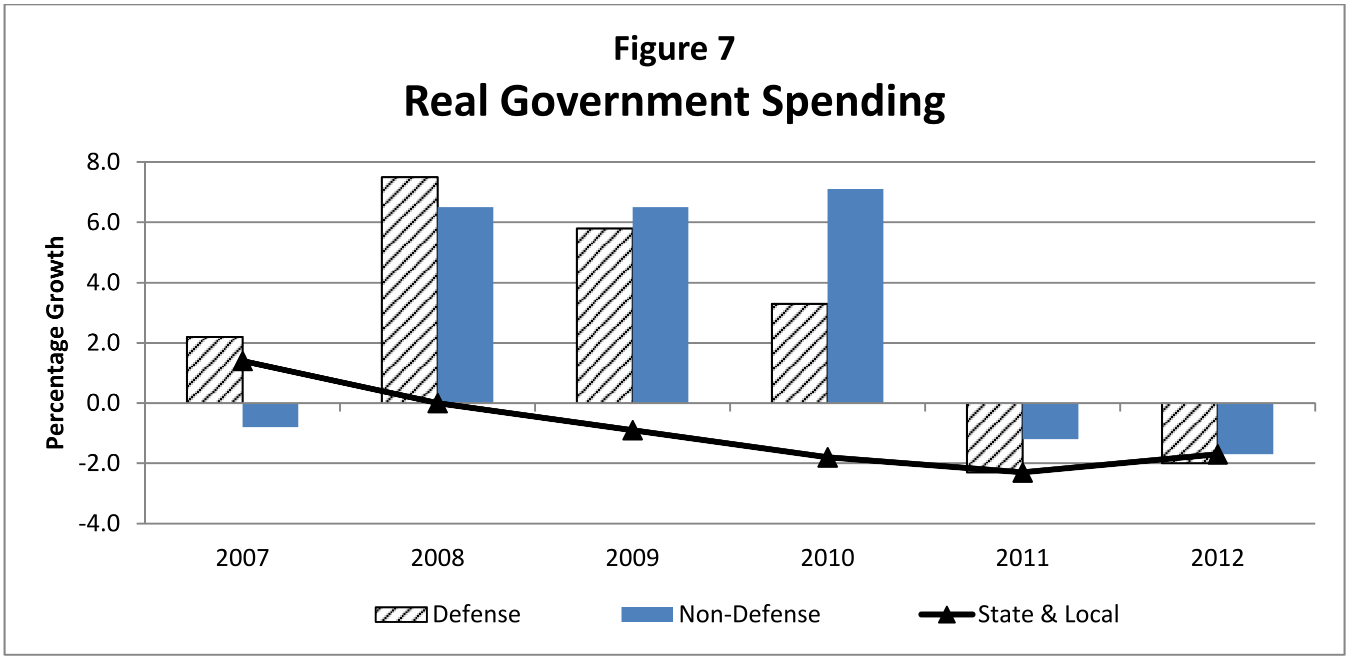
Due to the large budget deficits that arose as a result of the slow growth in the economy, the Federal government's ability to utilize fiscal policy was constrained. In addition, actions taken by the Federal government did not quell concerns over the state of the economy. In April, the government was facing a shutdown unless a spending deal could be reached which addressed the deficit. In August, the debate over increasing the nation's debt ceiling and the possibility of default on its debt led to a downgrade of the nation's bond rating by Standard & Poor's.

As part of the agreement to increase the debt ceiling, discretionary spending was reduced and a "budget super committee" was created to identify $1.2 trillion in spending reductions to eliminate the budget deficit. Without enactment of spending cuts by the committee, the Office of Management and Budget (OMB) would identify the spending items to be reduced.

As shown in figure 7, non-defense spending had declined prior to the recession. However, over the course of the recession, non-defense spending grew as a result of increased spending on Social Security and healthcare as well as the employment of fiscal policy through the Troubled Asset Relief Program (TARP). Both TARP and the American Recovery and Reinvestment Act (ARRA) provided additional funding to support state and local government spending as well as fiscal relief to businesses and consumers. Growth in non-defense spending, which includes entitlement spending, continued at the same pace in 2010 as a result of the continued downturn in the housing market, lack of job growth, and the extension of various provisions of ARRA. As the ARRA provisions expired and the concerns over the budget deficit rose, non-defense spending declined by 1.2 percent in 2011.

With the buildup of troops in relation to the "surge" in Iraq and the focus shifting to Afghanistan, defense spending grew significantly in 2008, increasing by 7.5 percent. As this operation wound down, the growth in defense spending slowed in 2009 and 2010. With the withdrawal of troops from Iraq in 2011, defense spending declined by 2.3 percent.

The budget super committee failed to come to an agreement on the $1.2 trillion in spending reductions. However, the triggered automatic spending cuts will not begin until January 2013. The federal government will still pursue a course of fiscal tightening with both defense and non-defense spending declining in 2012 by 2.0 and 1.7 percent, respectively.



Although spending by state and local governments accounts for a larger share of GDP, its contribution to economic growth varies widely due to their resources being more limited than those at the federal level. Primarily, state and local governments cannot deficit spend like the federal government.

Although state and local governments had their revenues decline in 2009, their spending was bolstered by federal funding through ARRA. With the expiration of the ARRA provisions that temporarily boosted government spending, state and local governments were now relying on tax increases as well as spending decreases to balance their budgets. As a result, state and local government spending in 2010 continued to decline.

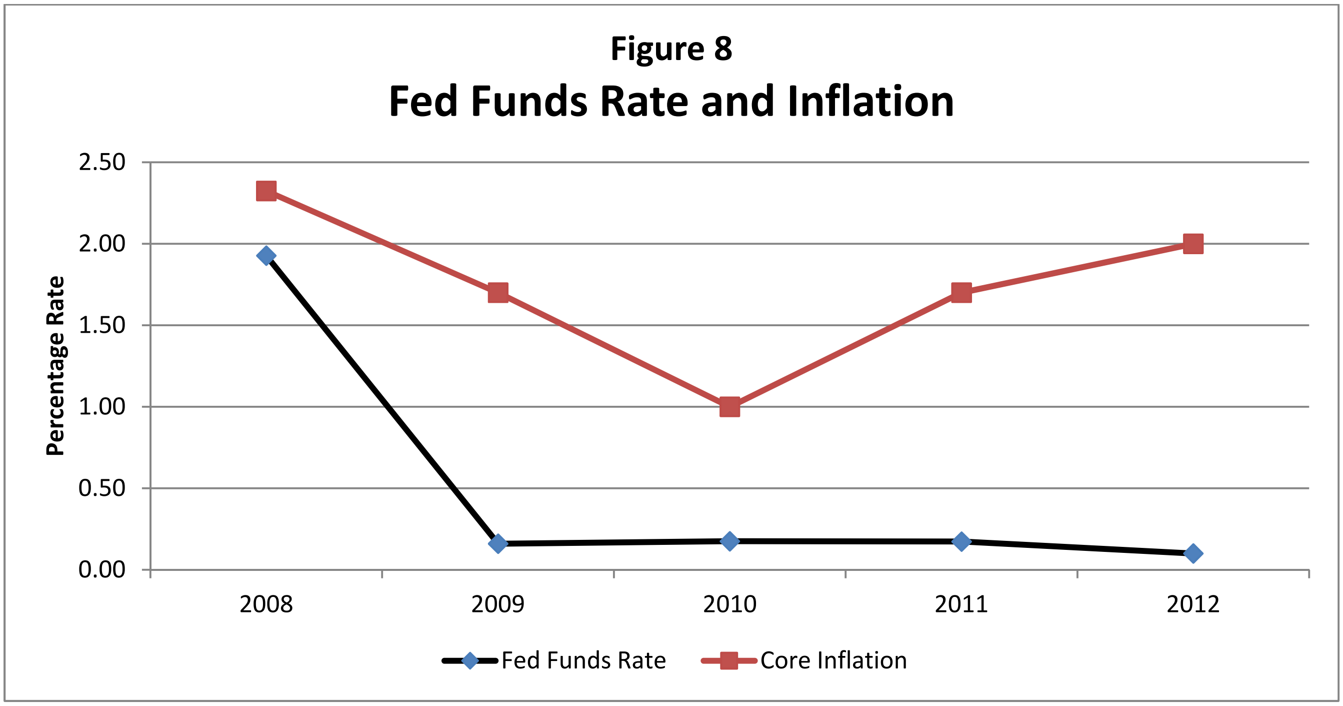
The continued economic uncertainty in 2011 in addition to the slow growth in tax revenues caused state and local governments to continue to decrease their spending. In addition, spending cuts at the federal level impact state and local government programs that rely on federal funding. With continued reductions in federal spending in 2012, state and local government spending is projected to continue to decline as well.

MONETARY POLICY

Monetary policy, under the control of the Federal Reserve Board, involves the manipulation of interest rates and the money supply. One of the ways that the Fed manipulates rates is through the interest rate on Federal Funds which is the rate used when banks loan money to each other. The Fed Funds rate then becomes a basis upon which banks set their own loan rates such as mortgage rates and personal loan rates. When the economy is slow, the Fed will decrease interest rates to reduce the cost of capital in order to spur spending by consumers and businesses; thus boosting the economy. However, if the Fed thinks the economy is growing too fast and inflation is too high, it will increase interest rates to slow down spending and encourage saving.

During the recession of 2001, the Fed reduced the Federal Funds rate to one percent in order to spur economic growth. Over the course of the next seven years, the Fed gradually increased rates as the economy recovered and the economic expansion took hold.

Similarly, in the recession of 2009, inflation was not a concern for the Fed. Instead, its concern was calming investors' fears and loosening the credit markets to allow money to flow through the economy. The Federal Reserve reduced the Fed Funds rate by approximately 400 basis points since the start of the recession in 2007. With the slow economic recovery and the volatility of the financial markets, the Federal Reserve maintained the Fed Funds rate in the 0.25 percent range.



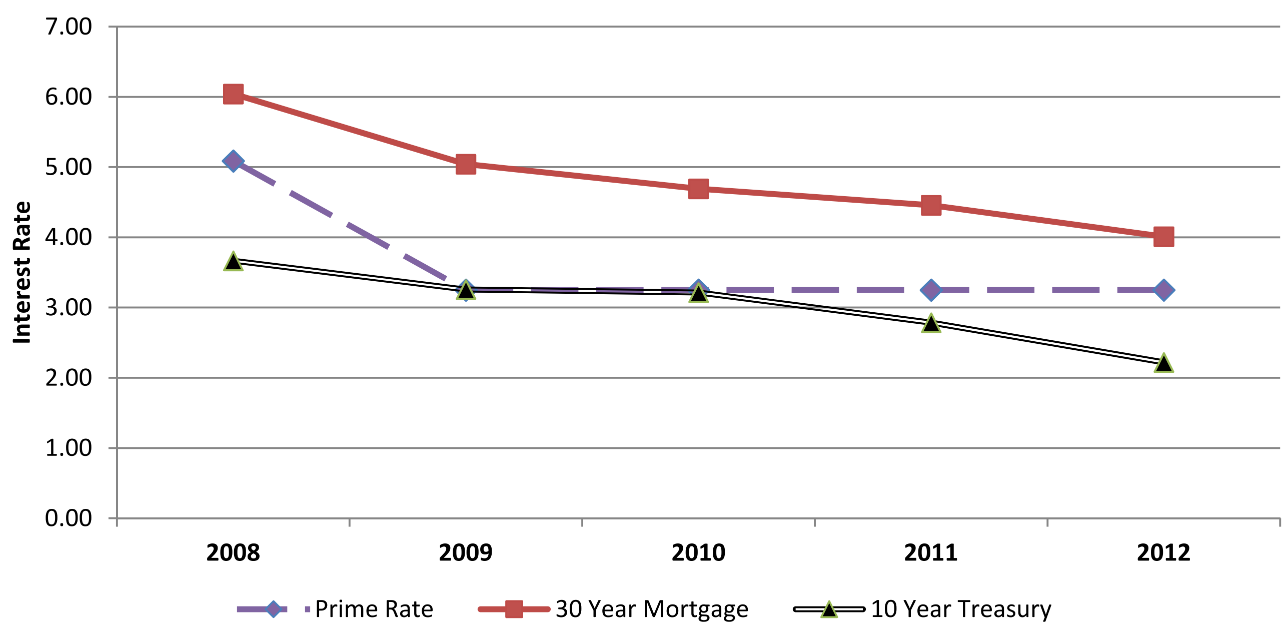
Another reason why the Federal Reserve has kept the Fed Funds rate low is that inflation has not been an issue. With the slowdown in the global economies, there are no inflation pressures from other countries. The slow economic recovery has constrained domestic inflation. As a result, the Federal Reserve is projected to maintain the Fed Funds rate in the range of zero to 0.25 percent throughout 2012.

Along with reducing the federal funds rate, the federal government uses monetary policy through what has been called Quantitative Easing. The first quantitative easing program in 2008, also known as the Troubled Asset Relief Program (TARP), allowed the U.S. Treasury to purchase mortgage backed securities from various financial institutions across the country. By purchasing these securities, the Treasury pumped liquidity, in the form of money supply, into the marketplace as well as improved the bottom line of the financial institutions. Due to the hesitancy to give out loans on the part of banks, increased liquidity allowed financial institutions the ability to make new loans to spur spending growth. The Federal Reserve also purchased Treasury bonds to inject additional money supply into the market and to keep interest rates low.

The U.S. Treasury employed another round of quantitative easing, known as QE2, by which it purchased up to $600 billion in long term treasuries. QE2 maintained low yields on treasuries which, in turn, decreased interest rates on consumer loans and mortgages that are tied to those yields. A third round of quantitative easing is projected for 2012 through the purchase of another $600 billion in long term treasuries.

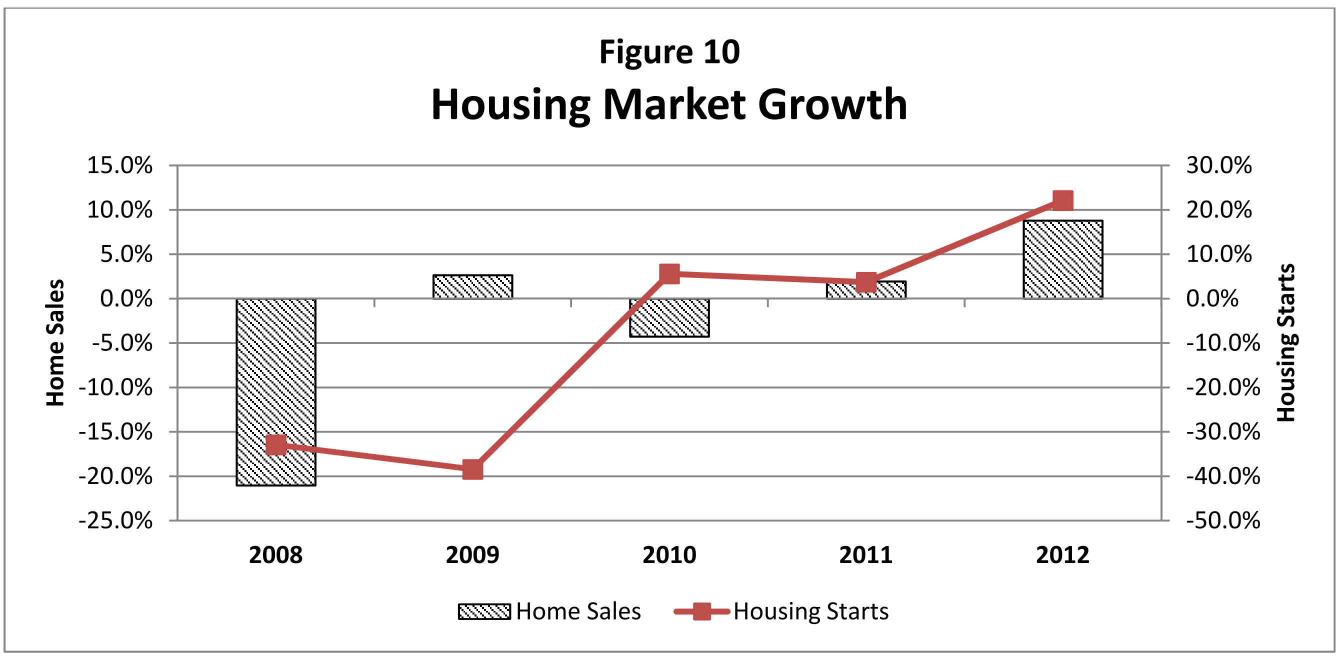
Figure 9

Interest Rates



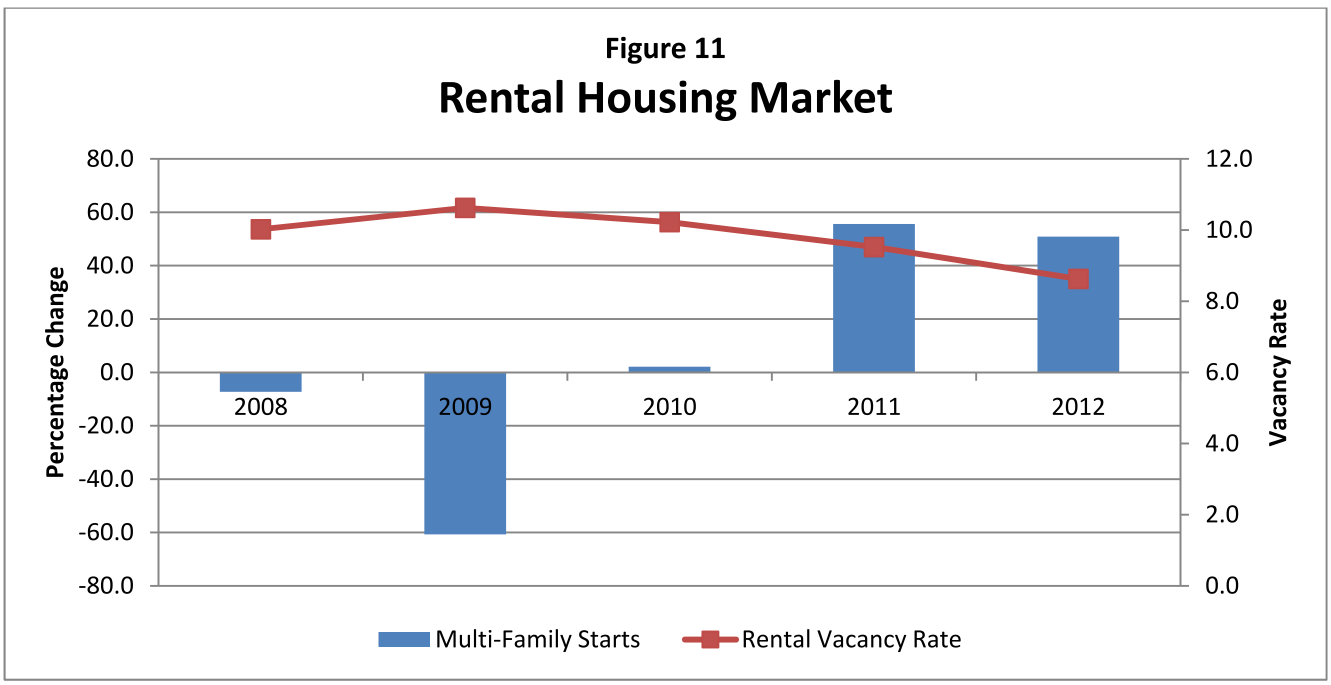
HOUSING MARKET

The housing market began to decline in 2007 as interest rates started to rise and the economy began to slow. With the collapse of the subprime mortgage market in 2008, all aspects of the housing market experienced significant declines. As part of the American Recovery and Reinvestment Act of 2009, a first time homebuyer's tax credit was enacted and was effective until the first quarter of 2010. This tax credit was able to spur growth in home sales, however, that growth was short lived. Once the tax credit expired, home sales declined in 2010, as shown in figure ten. In 2011, employment growth returned and incomes were rising. Combined with mortgage rates remaining at historical lows, the housing market brightened and home sales increased by approximately 2 percent.

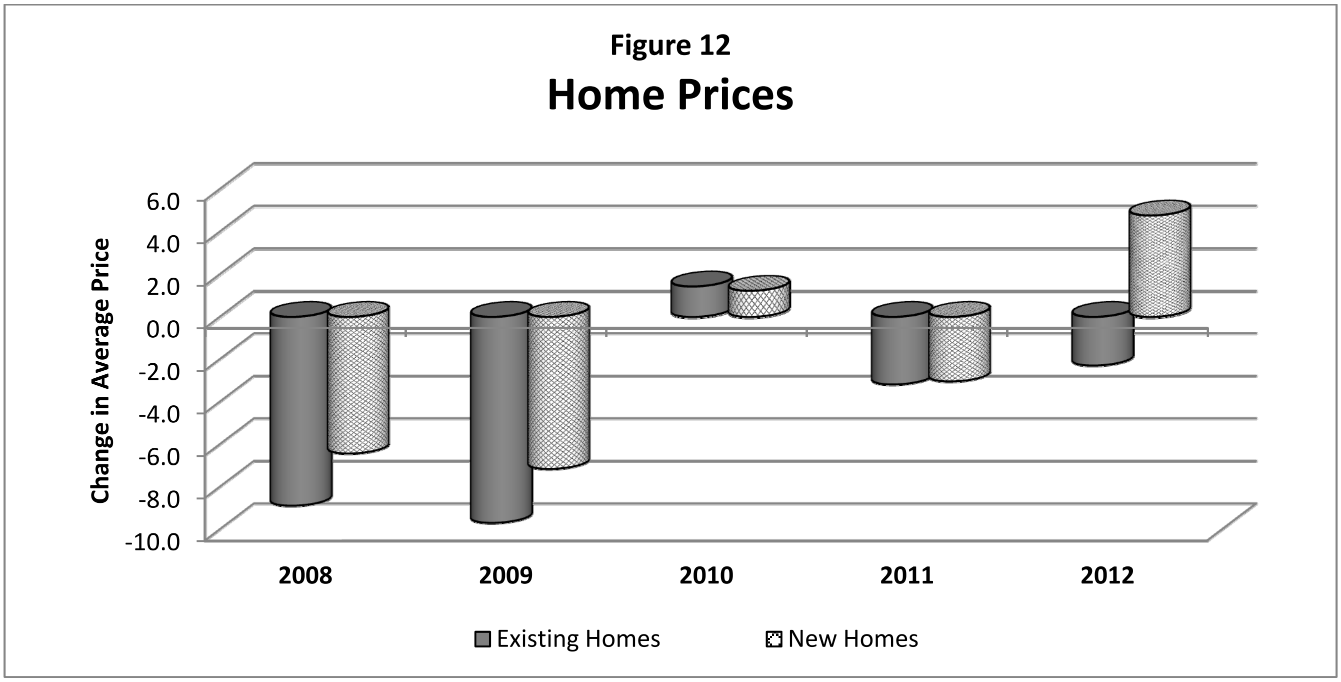


Housing starts began to recover in 2010 and exhibited some growth in 2011. While part of this growth was attributable to the homebuyer's tax credit, this growth is also due to growth in the number of multi-family housing developments being built rather than single family homes. In 2011, multi-family housing starts grew by over fifty percent while single family housing starts declined by over eight percent.

As shown in figure 11, the recession not only affected homeownership but, the rental housing market as well. In 2009, the rental vacancy rates increased which, in turn, resulted in a decline in the number of multi-family housing starts. As a result of the subprime mortgage crisis, there was increased scrutiny on the part of lenders and credit was not easily accessible. Those people who were willing to enter the housing market were now focusing on renting rather than home ownership.



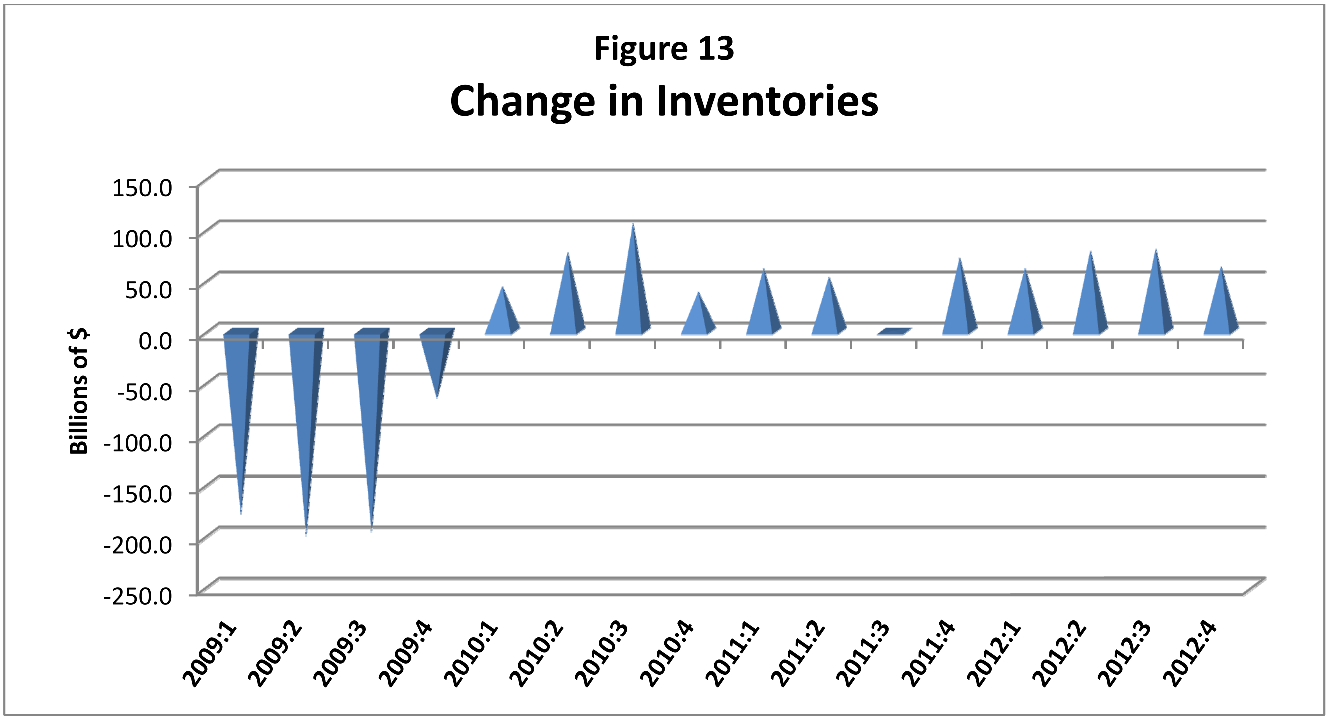
Even with the increased number of home sales in 2011, there was still a large inventory of homes in the marketplace. As a result of this over-supply, home prices have continued to fall.



As the economy is projected to strengthen in 2012 and mortgage rates are projected to remain low, the demand for housing is projected to increase. Housing starts for both single family homes and multi-family developments are projected to increase as well as the number of home sales. While the price of new homes is projected to increase in 2012, the average price of existing homes is projected to continue to decline; growth is not projected to return until 2013.

BUSINESS SPENDING

Over the course of the current recovery, businesses have been hesitant to make significant expenditures or to ramp up production even though their profits were growing. During the recession, businesses went through a period of inventory decumulation since consumer demand for their goods and services declined dramatically. When the economy started to grow again, businesses found themselves with depleted inventories and, as a result, needed to ramp up production.



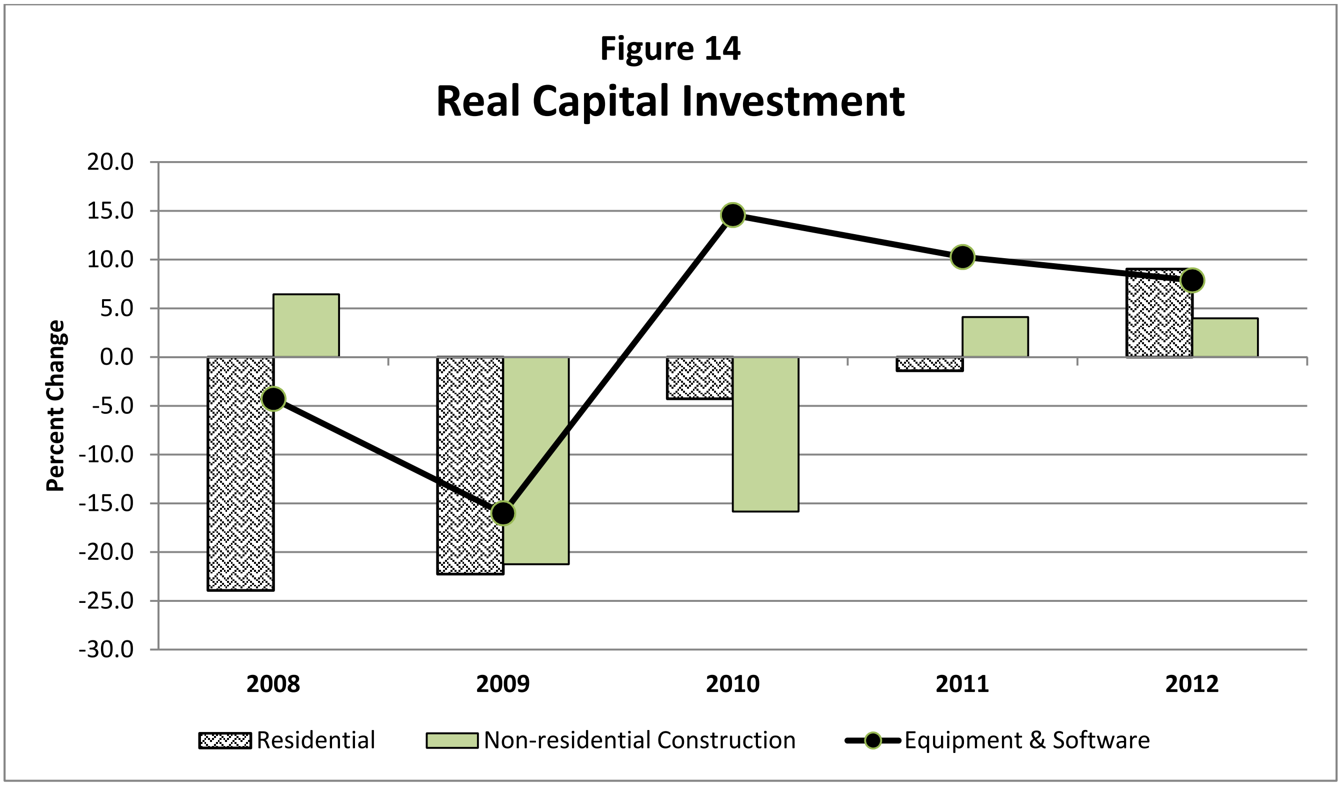
When economic growth started to slow down at the end of 2010, businesses slowed down their production and their inventory growth. With the volatility in the economy over the course of 2011, inventory decumulation started to set in and inventory growth did not occur in the third quarter. However, this business pessimism did not last long. Businesses were realizing increased sales in the fourth quarter and, as a result, had to increase their inventories to meet the demand. With increased optimism for the state of the national economy and consumer demand projected to increase, businesses are projected to maintain the same level of inventory growth throughout 2012 as they had at the end of 2011.

Similar to the events of the previous economic recovery, businesses were holding on to their cash and making do with their current equipment and facilities. In addition, lackluster consumer demand and tight credit markets did not provide any incentives for investment.

Equipment and software purchases by businesses comprise a majority of the investment spending due the changes in technology and the shorter useful life of equipment. Although businesses do need to maintain and renovate their facilities, capital investments in facilities have a much longer life.

When businesses were faced with the need to rebuild their inventories over the course of 2010, they were faced with the need to upgrade or replace their equipment and software in order to support their increased production. Combined with a fifty percent bonus depreciation incentive offered by the Federal government, this need resulted in an increase in equipment spending of almost fifteen percent.

At the end of 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act was enacted. This legislation increased the bonus depreciation amount from fifty percent to one hundred percent for the 2011 tax year. However, the benefit of this incentive was reduced by the slow economic growth and inventory decumulation in the third quarter of 2011. As a result, growth in investments in equipment and software decreased to approximately ten percent. With the expiration of the bonus depreciation, growth in equipment investment is projected to slow further to 7.9 percent.



As previously stated, facilities and their associated capital improvements have a much longer useful life than equipment. Prior to the recession, when businesses were expanding, they had a need for additional facility space as well as renovations to their operations. As consumer demand for their goods and services declined and the workforce shrunk, there was no need for expanded facilities. Although interest rates were still low in 2010, the economy had not recovered enough to warrant additional investment in structures; resulting in continued declines in 2010.

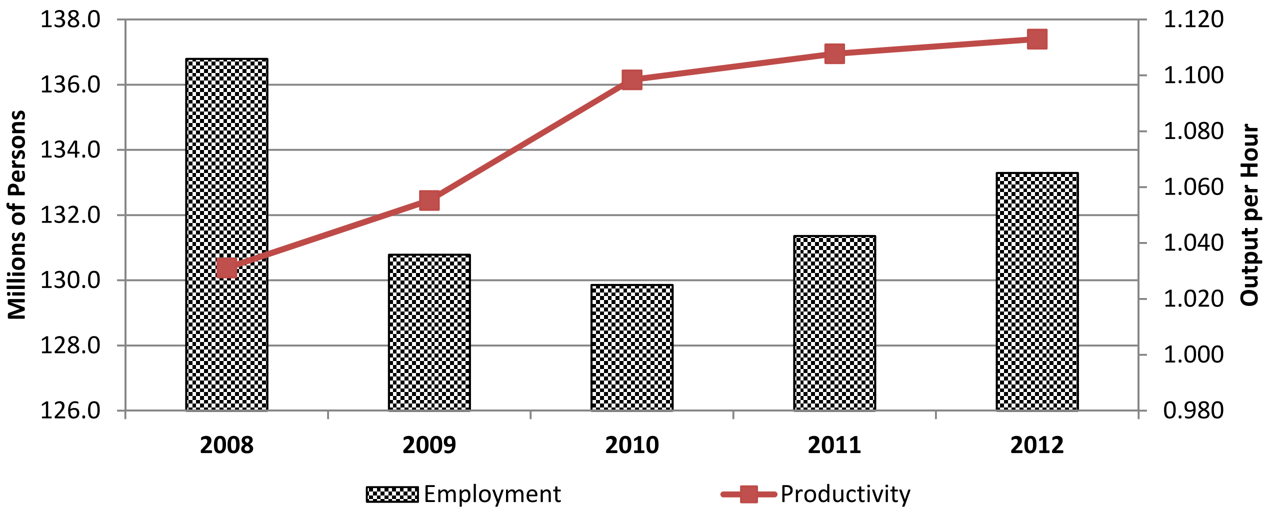
In 2011, there was a turnaround in non-residential construction, growth of 4.1 percent after two years of declines. This growth is mainly attributable to growth in construction for the power sector and the mining and petroleum sectors. Due to increased oil prices, the amount of drilling increased, resulting in this energy sector construction increase. All other business sectors were content with the production capacity of the facilities they had.

Growth in non-residential construction is projected to continue to grow at the same rate in 2012. Unlike 2011, where all the construction growth was concentrated in two business sectors, all business sectors are projected to increase their investments in their facilities in 2012, the largest growth coming from the manufacturing sector.

As capital investment by businesses declined, so did their investment in labor. With declining inventories, there was no need for the labor to produce these inventories. Therefore, businesses reduced their workforce. Even when the need for inventories returned, businesses, while investing in equipment, utilized their existing employees. As shown in the figure 14, employment decreased significantly in 2009 but productivity increased. As the economy continued to shed jobs in 2010, businesses were still getting increased productivity from their workers.

Job growth returned in 2011, increasing by 1.2 percent. Responding to historic high prices in precious metals, the mining sector realized the greatest amount of job growth, it only accounts for 0.6 percent of total non-farm employment. The sector with the second highest growth in employment was the professional and businesses services sector, bolstered by over eight percent growth from employment services businesses which include temporary employment agencies. Growth in employment in this sector is usually a pre-cursor to stronger overall job growth.

Figure 15
Employment and Productivity



Job growth is projected to continue into 2012, increasing by an additional 1.5 percent. The professional and businesses services sector is projected to continue to increase employment at a rate of over three percent; employment services businesses with projected growth of 7.4 percent.

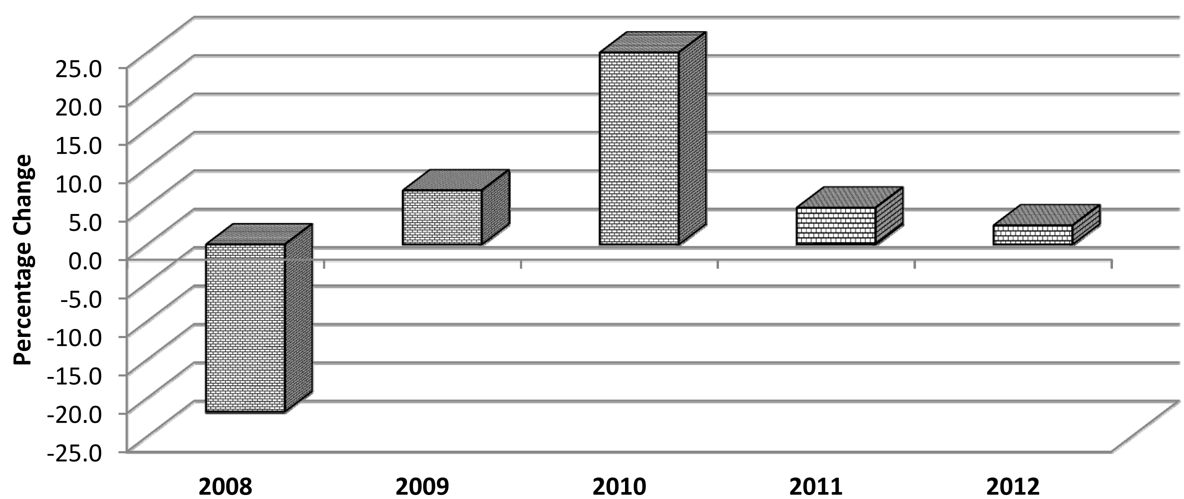
The severe economic downturn also impacted business' bottom line. Corporate profits showed a double digit decline in 2008. While this decline is attributable to all businesses, the financial markets realized the biggest decline due to the large decline in the stock market and the impact of the subprime mortgage collapse.

As the financial markets were the drivers of overall corporate profit decline in 2008, they were also a driver of corporate profit growth in 2009. The growth in the stock market and the infusion of the federal funds in the form of the TARP positively impacted their bottom lines. As the recession ended and the economy began to recover, businesses became more profitable. In addition, since businesses were realizing increased productivity with less workers, their profits increased significantly in 2010; corporate profits increased by approximately 25 percent.

As stock market volatility ensued in 2011, corporate profits weakened. Corporate profits for the non-financial sector increased by over ten percent in 2011. However, this growth was tempered by the weakness in financial sector profits. As a result, total corporate profits grew by 4.8 percent in 2011. With the projected low growth in the stock market in the first half of 2012, profits for the financial sector will be constrained, resulting in corporate profit growth of 2.5 percent in 2012.

Figure 16

Corporate Profit Growth

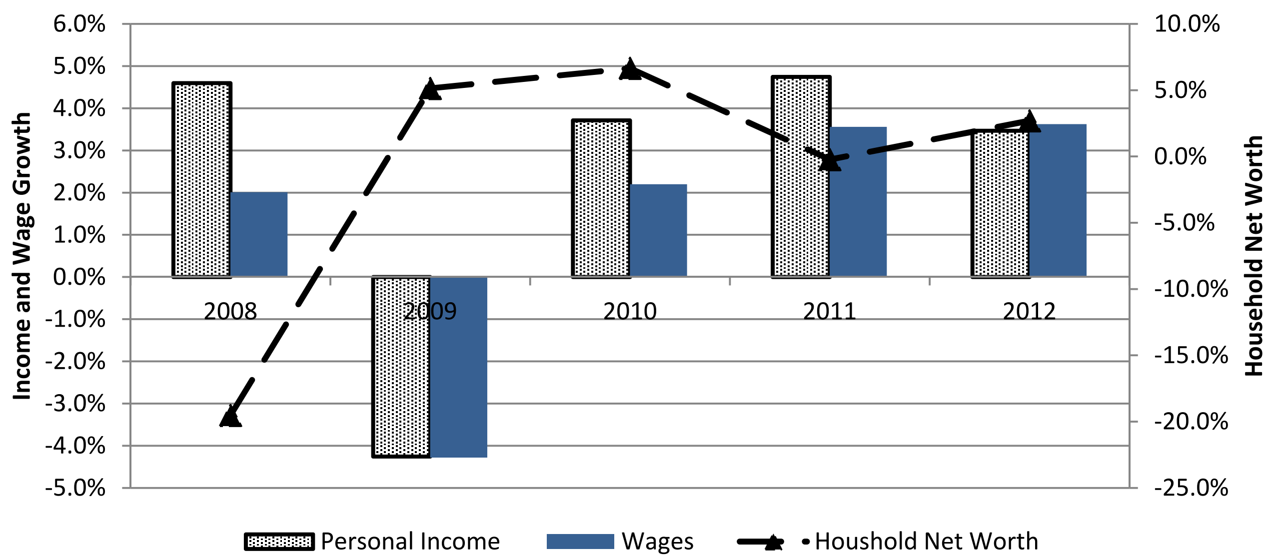


CONSUMER SPENDING

The consumer is the most significant contributor to economic growth. As a result, the amount of money that he has in his pocket will drive his consumption choices. With the decline of the housing market in 2008, consumers realized large declines in their household net worth as the values of their homes declined.

As job losses mounted in 2009, both wages and personal income decreased. However, household net worth exhibited growth even though the housing market was still depressed. This increase was a result of growth in the value of a household's equity holdings. In addition, as the credit markets tightened, consumers were not increasing their household debt.

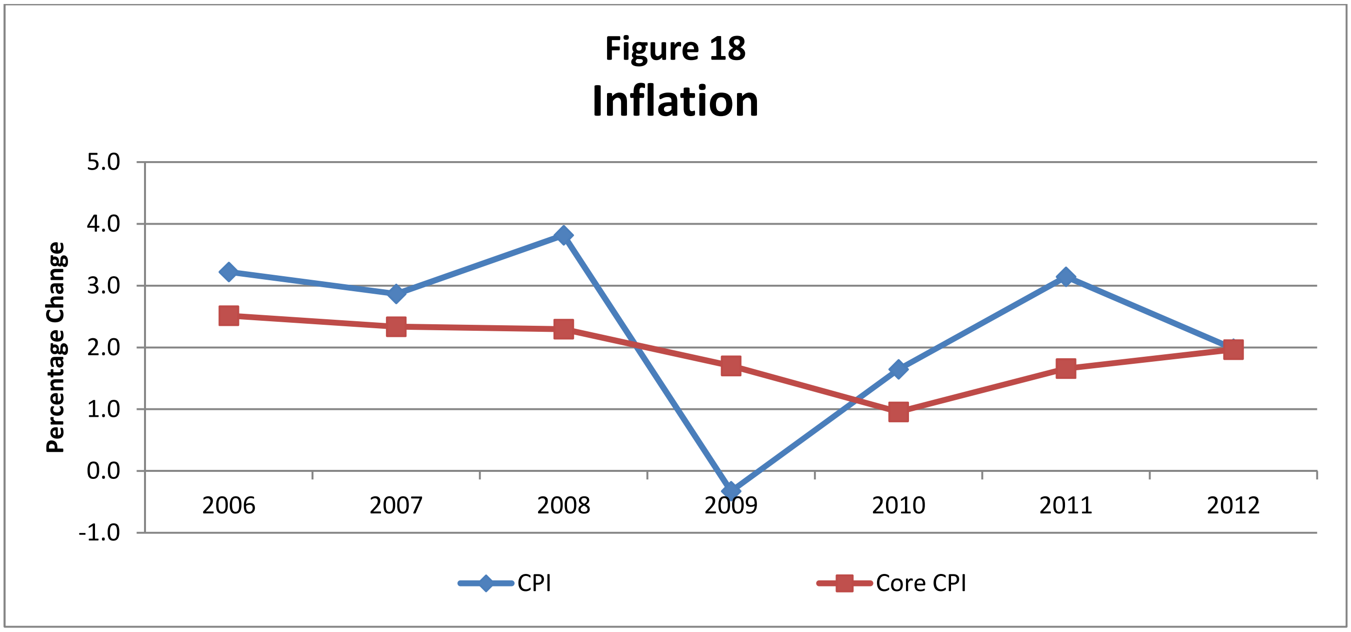
Figure 17
Income and Net Worth



Although job losses continued to mount in 2010, wages did manage some growth, growing by two percent. Personal income fared better in 2010 due to the stock market gains that increased dividend income and growth in proprietor's income. With job growth in 2011, wages increased at a stronger pace of 3.6 percent. Besides the growth in wages, personal income benefitted from the payroll tax cut that was enacted as part of the Job Creation Act of 2010. In addition, dividend income continued to grow as well as proprietor's income.

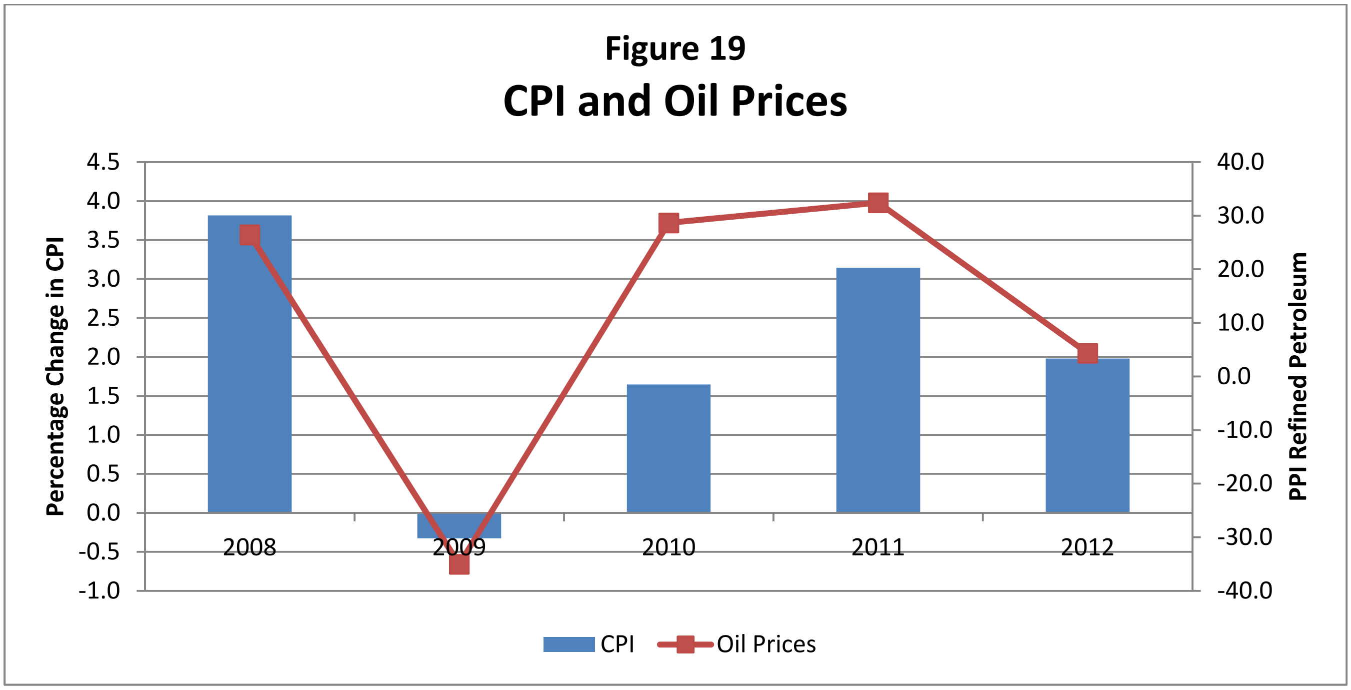
As job growth continues in 2012, wages are projected to continue to grow at the same rate. However, growth in personal income is projected to slow from 2010 levels due to the projected slowdown in stock market growth, reducing dividend income.

While income and wages are a major factor influencing consumption, the rate at which prices are increasing, also known as inflation, is a significant influence. This is especially true in relation to the prices of necessities, such as food and energy. Increases in the prices of theses goods limits the amount of money a consumer has for discretionary spending. In addition, increases in energy costs impacts the price of finished goods as businesses take the cost of energy in the production process into account when pricing their goods.



With the global recession, there was a period of deflation in 2009, as shown in figure 17. However, during this same time period, core inflation decreased but, was still positive. This difference between the two indices was due to a large decrease in oil prices which are excluded in the calculation of core inflation. As the economy began to grow in 2010, inflation increased.

Figure 18 shows the relationship between the inflation rate and oil prices. As mentioned above, oil prices decreased significantly which, in turn, caused a drop in the Consumer Price Index, the measure of inflation. With the subsequent rise in oil prices during the current recovery, inflation has also risen. Growth in oil prices is projected to slow in 2012, resulting in a slower rate of inflation.



However, oil prices were not the only factor impacting inflation in 2011. Food prices, especially farm products, realized significant growth. This can be attributable to the impact of the weather on crops in various sections of the country. In the first quarter of 2011, the southern portion of the country, specifically Florida, experienced extremely cold weather which impacted the orange crop. Tornadoes in the Mid-West and drought conditions in Texas had a negative impact on crops as well. Inflation in these prices is projected to slow in 2012, reducing overall inflation.

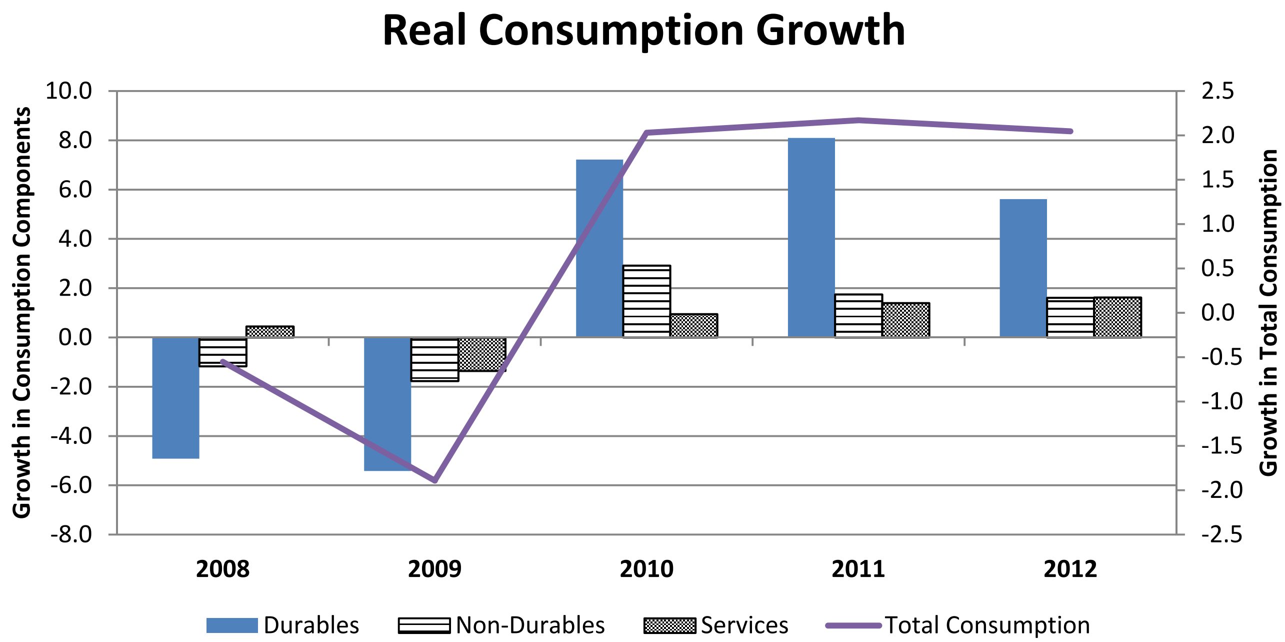
With the slow growth in the economy and increases in the prices of food and energy, businesses are hesitant to pass on the increased price of inputs into the prices of their finished goods. As shown, core inflation continued to decrease in 2010 even though the recession had ended. As job creation returned in 2011 and increased labor costs were factored into prices, core inflation accelerated from 1.0 percent to 1.7 percent.

As consumers realized a precipitous drop in their household wealth as a result of job losses and declining home values, they kept tight control over their budgets; decreasing their spending on all components of consumption in 2009.

The consumption of non-durable goods and services accounts for approximately 87 percent of all consumption expenditures; 65 percent of these consumption expenditures come from services. Services include not only personal services, restaurant meals and travel, but also include a consumer’s housing expenses, utility expenses, and health care. The main components of non-durable goods are clothing, food, and fuel. As a result, growth in these components drive consumption growth.

With the enactment of the American Recovery and Reinvestment Act, the federal government put additional money in the consumer’s pocket as a result of a variety of tax incentives. The Making Work Pay credit, along with the sales tax deduction for new vehicles, restrained the drop in consumption in 2009. In 2010, there was the return of wage growth as well as personal income growth, In addition, some of the ARRA provisions enacted in 2009 were realized in consumers’ annual personal income tax returns. As a result, consumption was positively impacted in 2010.

Figure 20



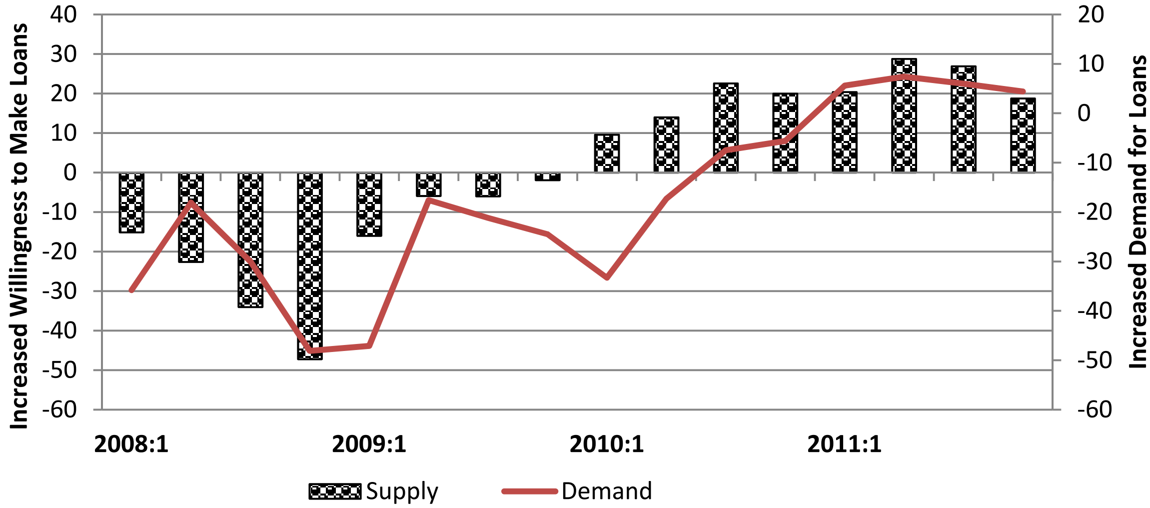
There was no acceleration in consumption growth in 2011 although there was considerable wage growth and personal income growth. This is due to the increased inflation rate for 2011, inflation of 3.1 percent, which eroded a portion of the consumer's purchasing power from his income growth. Consumption growth is projected at two percent for 2012 as the consumption of durable goods slows and growth in both the consumption of non-durable goods and services remains at 2011 levels.

Figure 20 illustrates that during the course of the recession, banks were not willing to make loans to consumers. As the economy recovered, more and more financial institutions were willing to loosen their credit standards and make more loans. However, with the mortgage crisis and the reduced personal income, consumers were also not willing to take on additional debt. Even as more banks were willing to lend in 2010, demand for consumer credit was still negative.

With job growth returning in 2011 and interest rates still low, consumers became more willing to take on additional debt. The largest increase in demand for consumer loans resulted from increased demand for automobile loans rather than credit cards.

Figure 21

Credit Conditions



Source: Federal Reserve Board, Senior Loan Officer Opinion Survery

RISKS TO THE FORECAST

Calendar year 2012 comes with a lot of uncertainty which will also continue into 2013. Similar to 2011, international events will play a major role in and provide significant uncertainty to economic growth in 2012.

The Eurozone debt crisis has yet to be completely resolved. The European Central Bank has been closely monitoring the situation in Greece and other Euro nations and has been willing to inject liquidity into the market. However, Greece has not fully resolved its debt problems and whether its debtors will accept a significant reduction in the face value of the bonds. The financial markets have retained a high degree of volatility in the first months of the year.

If the volatility in the market continues, investors could employ a "flight to safety" and increase their purchases of U.S. Treasuries. In addition, the credit markets could tighten once again, putting downward pressure on the housing market and dampening consumer confidence.

The Arab spring continues into 2012. This unrest as well as Iran's hostile overtures to interrupt oil supplies could cause a spike in oil and gasoline prices. This would result in higher than projected inflation and the Federal Reserve may be forced to increase interest rates ahead of schedule. Increases in oil prices and their impact on the costs of producing and transporting goods as well as the impact on the consumer's discretionary spending are a major concern. Businesses would realize increased production costs, limiting job creation.

The Federal government did extend the payroll tax cut and the emergency unemployment benefits. However, these and the Bush tax cuts are due to expire at the end of the year. The expiration of these tax cuts along with the imposition of the new Medicare tax on investment income that will take effect on January 1 will reduce personal income; thus, reducing the consumer's spending power. In addition, the across the board spending cuts are to take effect in January 2013 as well. With the presidential election looming and the desire to keep the budget deficit in check, whether legislation will be enacted to address these issues is unclear.

United States Economic Outlook
(Dollar Figures in Billions of Dollars)

	2011	2012	2013	2014
GDP	$15,088	$15,599	$16,177	$16,999
Percent Change	3.9	3.4	3.7	5.1
Real GDP	$13,313	$13,597	$13,908	$14,369
Percent Change	1.7	2.1	2.3	3.3
Consumption Expenditures	$9,421	$9,614	$9,807	$10,026
2005 Dollars, Percent Change	2.2	2.0	2.0	2.2
Government Expenditures	$2,502	$2,457	$2,412	$2,390
2005 Dollars, Percent Change	(2.1)	(1.8)	(1.8)	(0.9)
Investment Expenditures	$1,795	$1,950	$2,080	$2,312
2005 Dollars, Percent Change	4.7	8.6	6.7	11.2
Change in Inventories	$45	$62	$45	$46
2005 Dollars, Percent Change	(26.0)	37.2	(26.8)	2.5
Exports	$1,776	$1,852	$1,983	$2,133
2005 Dollars, Percent Change	6.8	4.3	7.1	7.6
Imports	$2,189	$2,268	$2,353	$2,449
2005 Dollars, Percent Change	5.0	3.6	3.7	4.1
CPI - All Urban, Percent Change	3.1	2.0	1.8	1.9
CPI - Core, Percent Change	1.7	2.0	1.9	2.1
Pretax Corporate Profits	$1,954	$1,936	$1,937	$2,016
Percent Change	8.5	(0.9)	0.0	4.1
After-tax Corporate Profits	$1,489	$1,508	$1,614	$1,690
Percent Change	5.7	1.3	7.0	4.8
Personal Income	$12,961	$13,411	$13,942	$14,630
Percent Change	4.7	3.5	4.0	4.9
Wages and Salaries	$6,636	$6,877	$7,159	$7,487
Percent Change	3.6	3.6	4.1	4.6
Nonagricultural Employment, Millions	129	131	134	137
Percent Change, Seasonally Adjusted	1.2	1.5	1.5	1.7
Unemployment Rate	9.0	8.3	8.1	7.5
Interest Rates				
T-Bill Rate, 3-Month	0.05	0.05	0.06	0.09
T-Note Rate, 10-Year	2.79	2.22	2.69	2.91
T-Bond Rate, 30-Year	3.91	3.19	3.62	3.84
Standard and Poor's 500 Stock Index				
Percent Change	11.4	4.2	3.1	5.4

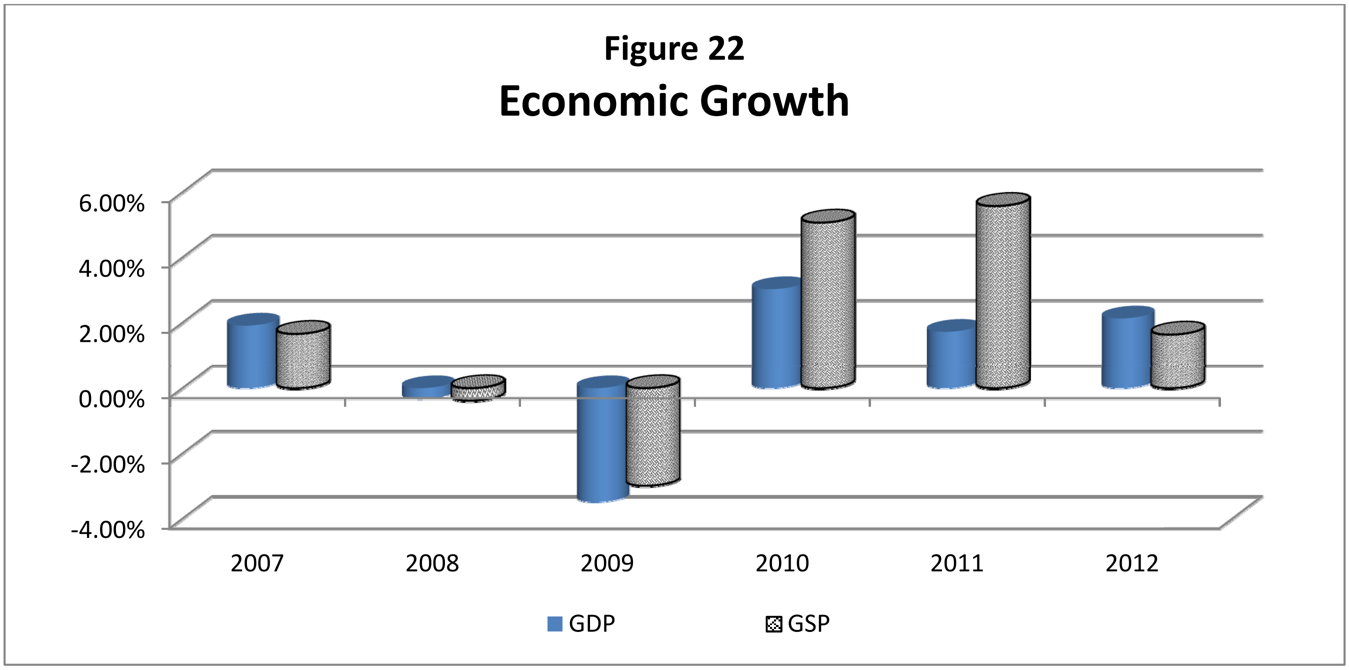
Source: IHS Global Insight US Macroeconomic Forecast: February 2012

The New York Economy

Similar to the use of the Gross Domestic Product to measure the state of the national economy, the Gross State Product (GSP) is used to measure the state of the New York economy. Gross State Product focuses primarily on the output of the various industries within the State since products made in New York are utilized and consumed both in the state as well as other states. The output of all these industries are then combined to determine the aggregate GSP.

Although most factors that impact the national economy will also impact the New York economy, changes in some of these factors will have a small impact on the New York economy while others will have a significant impact. For example, interruptions in oil supplies from the Middle East may result in increased drilling domestically, resulting in job and revenue growth in states such as Texas or Alaska.

With New York City's position as the financial capital, events that impact the financial market have a significant impact on the New York economy. This was particularly apparent in 2009 as shown in figure 22. The stock market was still showing volatility and the S&P Index declined by over 22 percent in 2009. Corporate profits were also continuing to decline. As a result, the New York economy declined by 3.0 percent.



However, since the financial markets were a beneficiary of the fiscal and monetary policies employed by the Federal government in 2009 and 2010, New York's economy was able to recovered at a much stronger pace than the nation. In addition, even though the financial services industry was decreasing employment it was able to increase the productivity of the remaining employees. Another factor that contributed to this stronger growth is the New York housing market as a whole was not as adversely impacted by the housing market decline as in other parts of the country.

Although the financial markets were volatile due to the Eurozone debt crisis and other economic news in 2011, the stock market increased by over eleven percent. This growth, along with moderate corporate profit growth, allowed the New York state economy to grow at a much faster pace than the national economy in 2011.

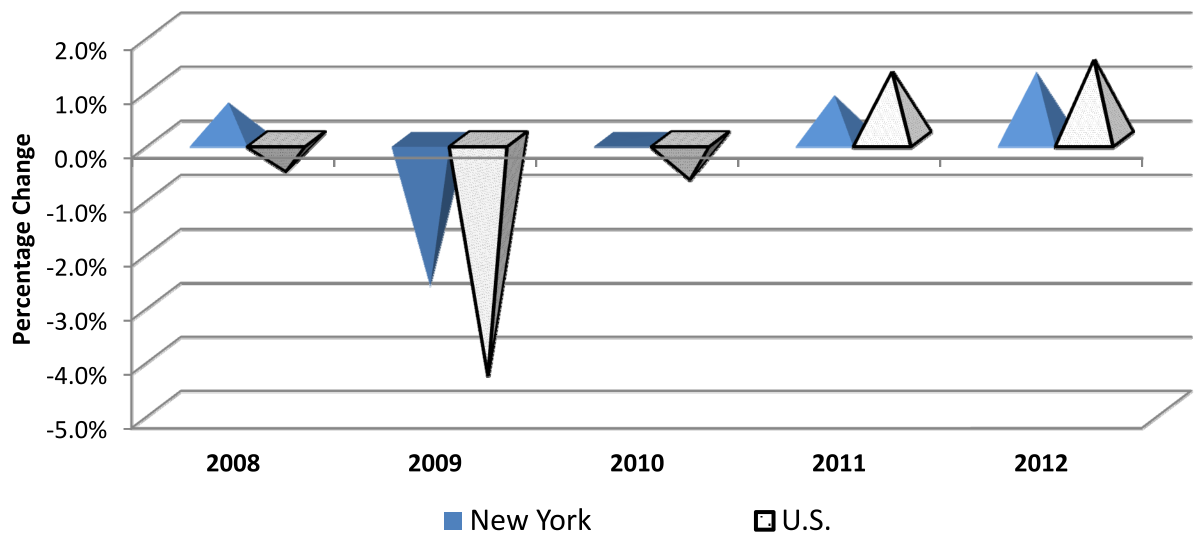
However, this growth was primarily realized within the first half of the year. In August and September, Hurricane Irene and Tropical Storm Lee caused significant damage to the Eastern and Central portions of the state, disrupting economic production in those areas. With the projected slowdown in the financial markets in 2012 and the rebuilding after the storms, growth in the New York state economy is projected to slow to 1.6 percent, slower than national growth of 2.1 percent.

EMPLOYMENT

In 2008, employment in the State as a whole grew by 0.7 percent whereas employment began to decline at the national level, decreasing by 0.6 percent. Although employment declined in 2009, decreasing by 2.7 percent, the decline was not as severe as the 4.4 percent decline in national employment. New York fared slightly better than the nation as a whole in 2010. New York employment remained flat while national employment decreased by 0.7 percent. Similar to national level, job growth in 2011 also returned to New York, growing by 0.8 percent.

Figure 23

Employment Growth



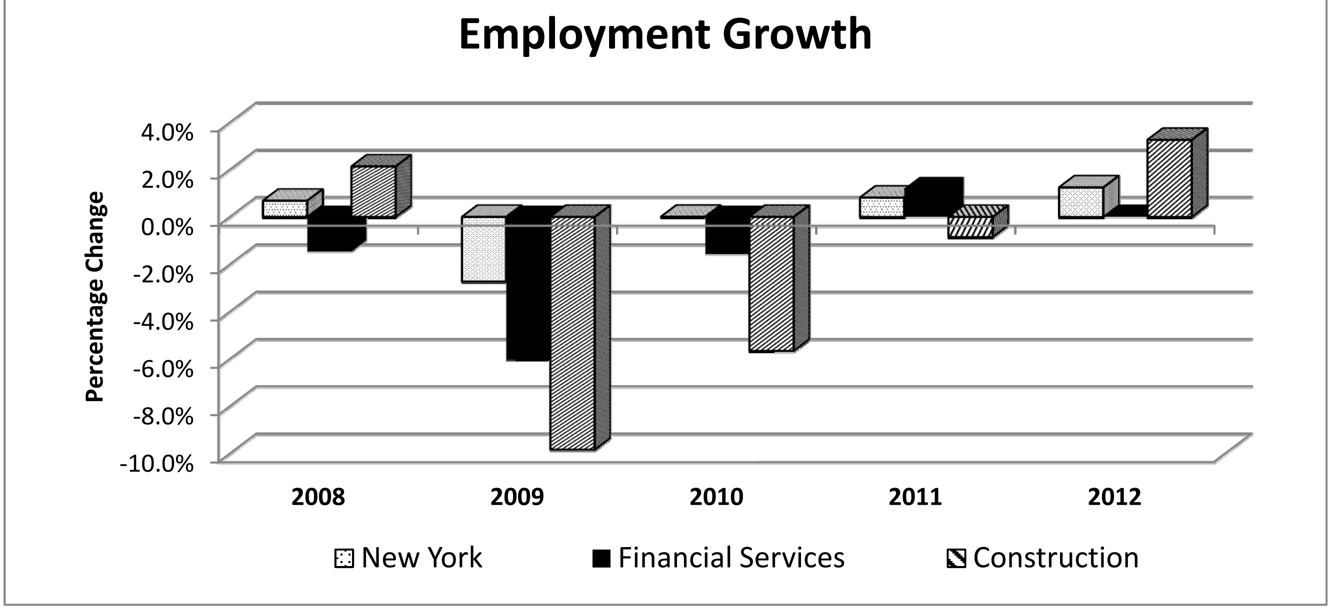
In 2012, employment growth in New York is expected to continue to mirror national employment growth, increasing by 1.2 percent. Growth in employment in the construction industry is projected to return while, due to fiscal constraints as a result of the slow economic growth, state and local government employment is projected to decline. In turn, the unemployment rate in New York is projected to decrease to 7.2 percent; down from 8.0 percent in 2011.

Profits earned by Wall Street firms, as reported by the Securities Industry and Financial Markets Association, realized significant growth during the economic expansion of the last decade. The decline in employment that had occurred during the recession of 2001 turned into employment growth for the financial industry. However, as the economy began to slow in 2007, so did the profits and employment growth of these firms. As the credit crisis hit in 2008, the financial institutions began realizing significant losses. With these revenue losses, employment in the financial activities sector started to decline, declining by 1.5 percent in 2008. In the next two years, the industry continued shedding jobs, a decline of 6 percent and 1.6 percent, respectively.

In 2011, the financial activities industry was growing and jobs were being created. However, this job creation was realized primarily in the first half of the year. As market volatility continued in the second half of the year and the profits of Wall Street firms diminished, hiring was put on hold.

The other industry that was hit hard by the economic downturn was the construction industry. With the decline in the housing market and tight credit conditions, the construction industry started to realize a significant decrease in employment, decreasing by almost ten percent. As housing starts began to grow in 2011, especially multi-family housing starts, construction job losses began to abate. With the projected increase in housing starts in 2012, the construction job market is projected to turn around; job growth is projected at 3.3 percent.

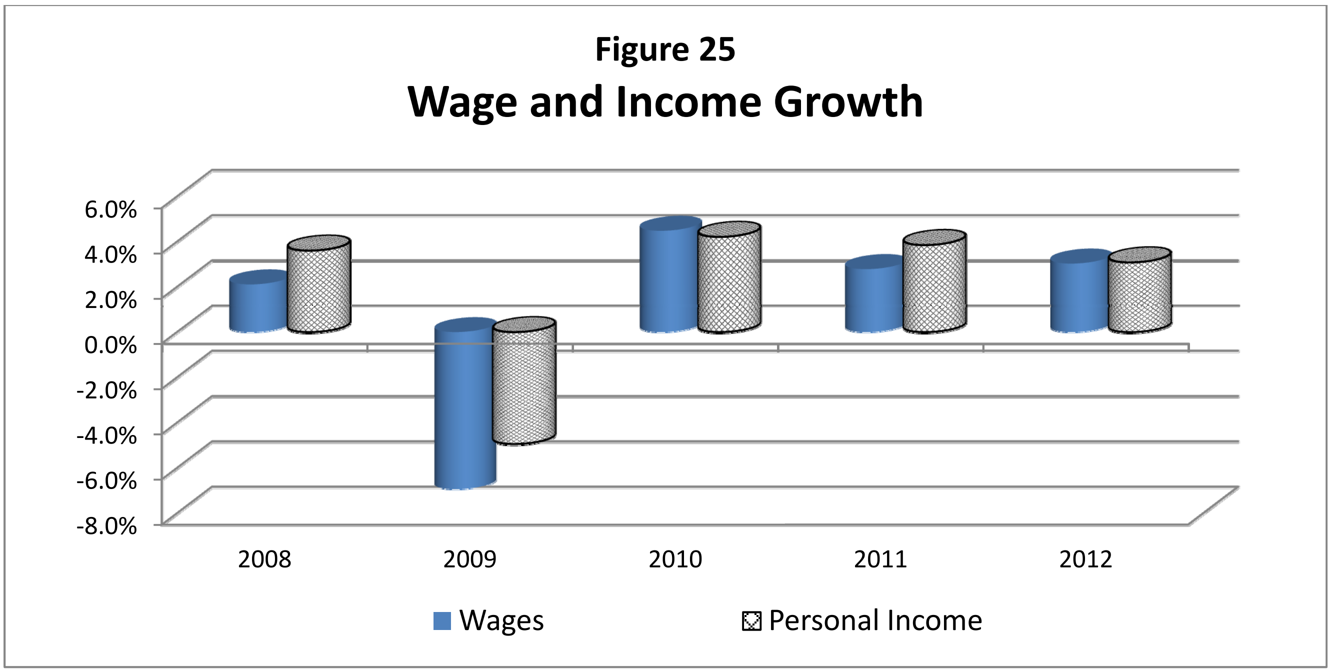
Figure 24



WAGES

The payment of year end bonuses by the financial services industry plays an important part in New York's wage and income growth. Due to the timing of the payment of Wall Street bonuses, these bonuses are usually paid in the first quarter of the succeeding year, wage growth in New York is influenced by the performance of the industry in the previous year. Although the financial markets recorded large revenue losses in 2008 and bonuses that year declined by forty-seven percent, wages did not exhibit large declines until 2009 due to the timing of the bonus payments. Similarly, wage growth in 2010 reflected not only the economic recovery but also the increase in bonuses from 2009.

Due to the public and political backlash over the payment of large bonuses during the financial market crisis and the subsequent bailout by the Federal government, the method by which bonuses were paid changed. A larger percentage of bonus compensation is being paid with stock options by which the recipient must hold the stock for a specified number of years to exercise the options. As a result, wage growth is impacted by these changes, increasing by 2.8 percent in 2011. Wage growth is projected to continue into 2012, increasing by 3.0 percent, reflecting the projected increase in employment even though financial services bonuses for 2011 declined by approximately 30 percent.



HOUSING MARKET

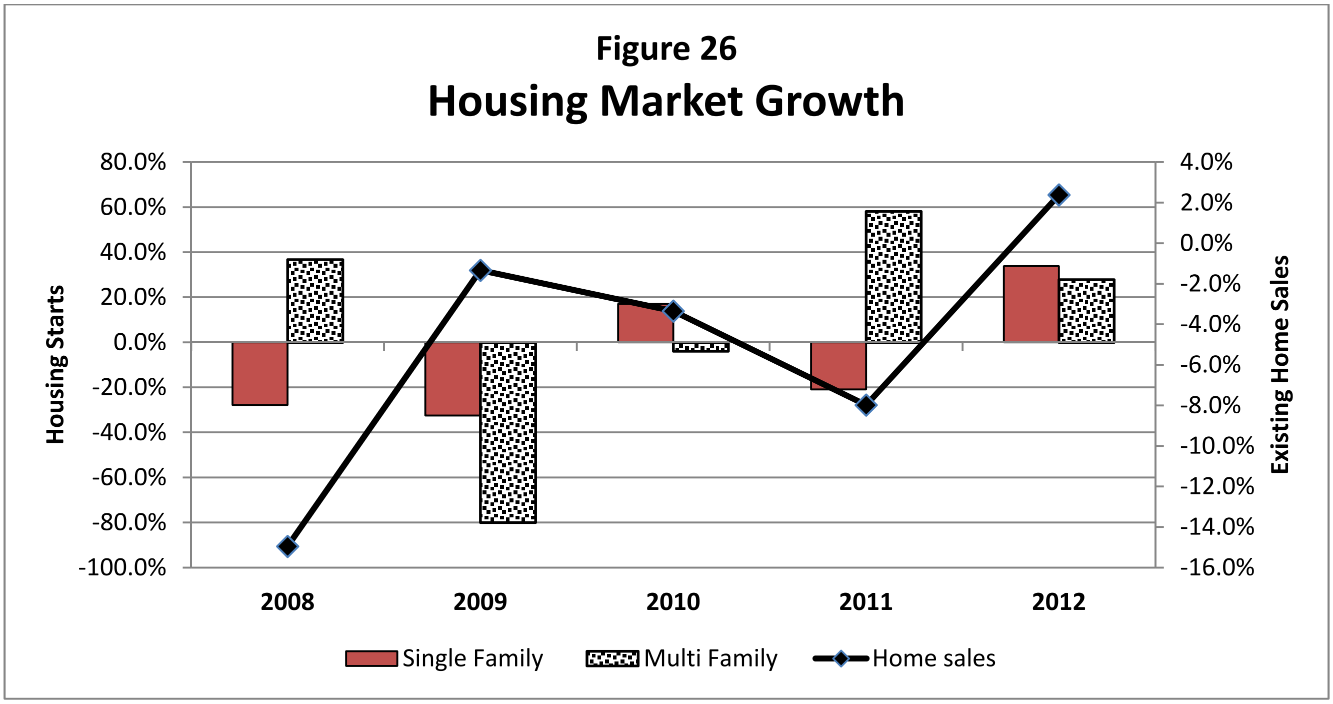
Although the bursting of the housing market bubble did affect New York, its impact on New York's housing market was less severe than in other parts of the nation. As the subprime mortgage crisis unfolded in 2008, both home sales and housing starts throughout the nation realized significant declines. In New York, however, housing starts increased even though existing home sales were declining. This paradox was a result of an increase in the number of multi-family housing starts which more than offset the decline in single family housing starts.

In 2009, as the full impact of the recession was felt, both single family and multi-family housing starts declined. In addition, while the first time homebuyer's tax credit boosted existing home sales throughout the nation, it had a less positive impact in New York. Home sales continued to decline in 2009 and 2010.

Similar to the rebound in housing starts at the national level, housing starts were exhibiting growth in 2010. Although a portion of the national growth was attributable to growth in multi-family housing starts, New York's growth was primarily concentrated in the single family sector.

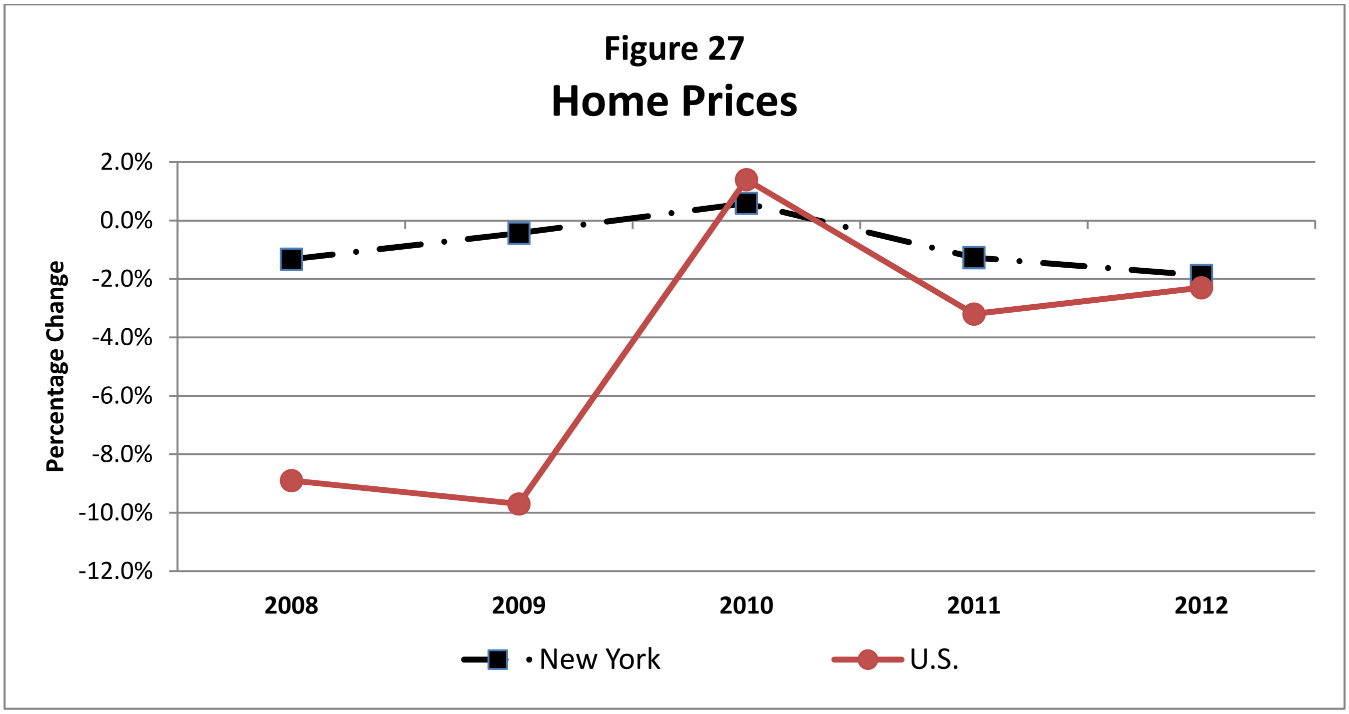
Even though the economy was growing in 2011, such growth was slow and there was a significant amount of uncertainty. Although there was increased demand for housing, that demand was focused in the rental market. Even though mortgage rates were low, New York residents were opting to rent rather than buy. As a result, multi-family housing starts increased by over 50 percent while single family housing starts and existing home sales continued to decline.

With continued job and wage growth projected for 2012, all sectors of the housing market in New York are projected to grow. Both single family and multi-family housing starts are projected to post double digit growth. Existing home sales are projected to end the four year trend of annual declines, instead, increasing by over 2.0 percent.



Average home prices, on the other hand, did not decline as significantly as they did at the national level. While the average, existing home price at the national level declined by close to ten percent in 2009, the average price in New York was relatively flat, decreasing by only 0.4 percent. With the improved economy in 2010, housing prices increased by 0.6 percent, offsetting the 2009 decline.

As the economy slowed in 2011 and the demand for housing focused on the rental market, home prices declined once more, decreasing by 1.3 percent. For 2012, home prices are projected to follow the national trend, declining by 1.9 percent.

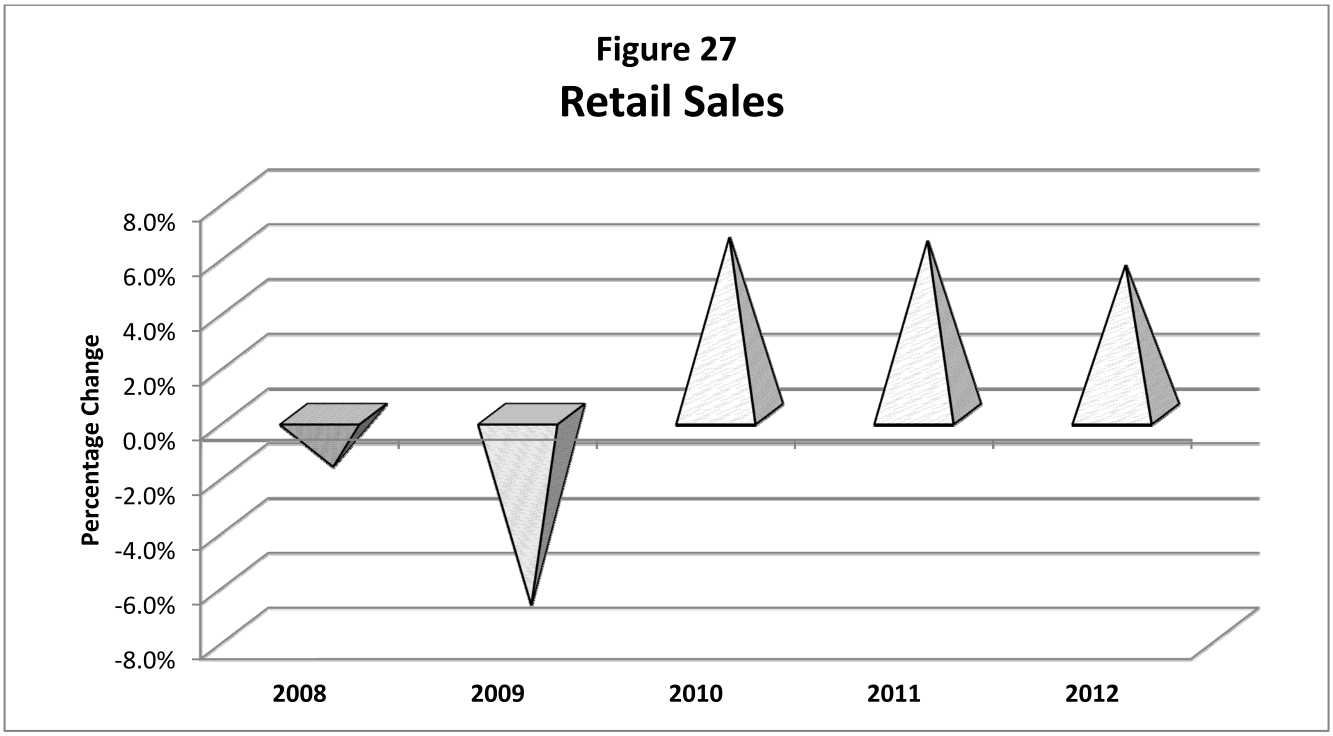


CONSUMPTION

Consumption, as a component of the Gross Domestic Product, is comprised of the consumption of goods as well as services, including housing, health care, and utilities. While not a perfect proxy for consumption at the national level, the change in the amount of retail sales in New York reflects how the changes in the economy have impacted the consumer's spending behavior.

Similar to consumption growth at the national level, retail sales rebounded in 2010 as both increased wage and personal income grew. These sales also benefitted from the large increase in financial sector bonuses in the first quarter of the year which increased consumers' disposable income.

As the global economy grew in 2010 and the dollar depreciated, foreign travelers realized greater buying power in relation to the cheaper U.S. dollar. Tourism spending increased over five percent at the national level. As New York is a top travel destination, this growth in tourism spending translated into retail sales growth in New York as well.



In 2011, personal income and wage growth slowed. Besides the slowdown in economic growth, financial sector bonuses had declined, reducing disposable income. However even though the global economy was slowing, the dollar was still depreciating and tourism grew, albeit at a slower pace than in 2010. As a result, the growth in retail sales slowed slightly, decreasing from 6.5 percent in 2010 to 6.3 percent.

Retail sales are projected to continue to grow at 5.5 percent in 2012. This growth is a reflection of the stronger projected employment growth. However, tourism will become a drag on retail sales growth as the dollar is projected to appreciate and growth in the global economy is projected to slow.

New York State Economic Outlook
Calendar Year
(Dollar Figures in Billions of Dollars)

	2011	2012	2013	2014
Gross State Product	**$1,213**	**$1,249**	**$1,292**	**$1,353**
Percent Change	4.6	3.0	3.4	4.7
Real Gross State Product	**$1,092**	**$1,110**	**$1,131**	**$1,163**
Percent Change	5.6	1.6	1.9	2.8
Nonagricultural Employment, Thousands	**8,625**	**8,733**	**8,874**	**8,995**
Percent Change	0.8	1.2	1.6	1.4
Unemployment Rate	**8.0**	**7.2**	**6.8**	**6.5**
Personal Income	**$976**	**$1,006**	**$1,044**	**$1,097**
Percent Change	3.8	3.1	3.8	5.0
Wages and Salaries	**$535**	**$551**	**$575**	**$601**
Percent Change	2.8	3.0	4.4	4.5
Retail Sales	**$238**	**$251**	**$263**	**$274**
Percent Change	6.3	5.5	4.5	4.2
Housing Starts, Thousands	**19.5**	**25.4**	**32.8**	**38.9**

Source: IHS Global Insight New York State Economic Forecast, February 2012

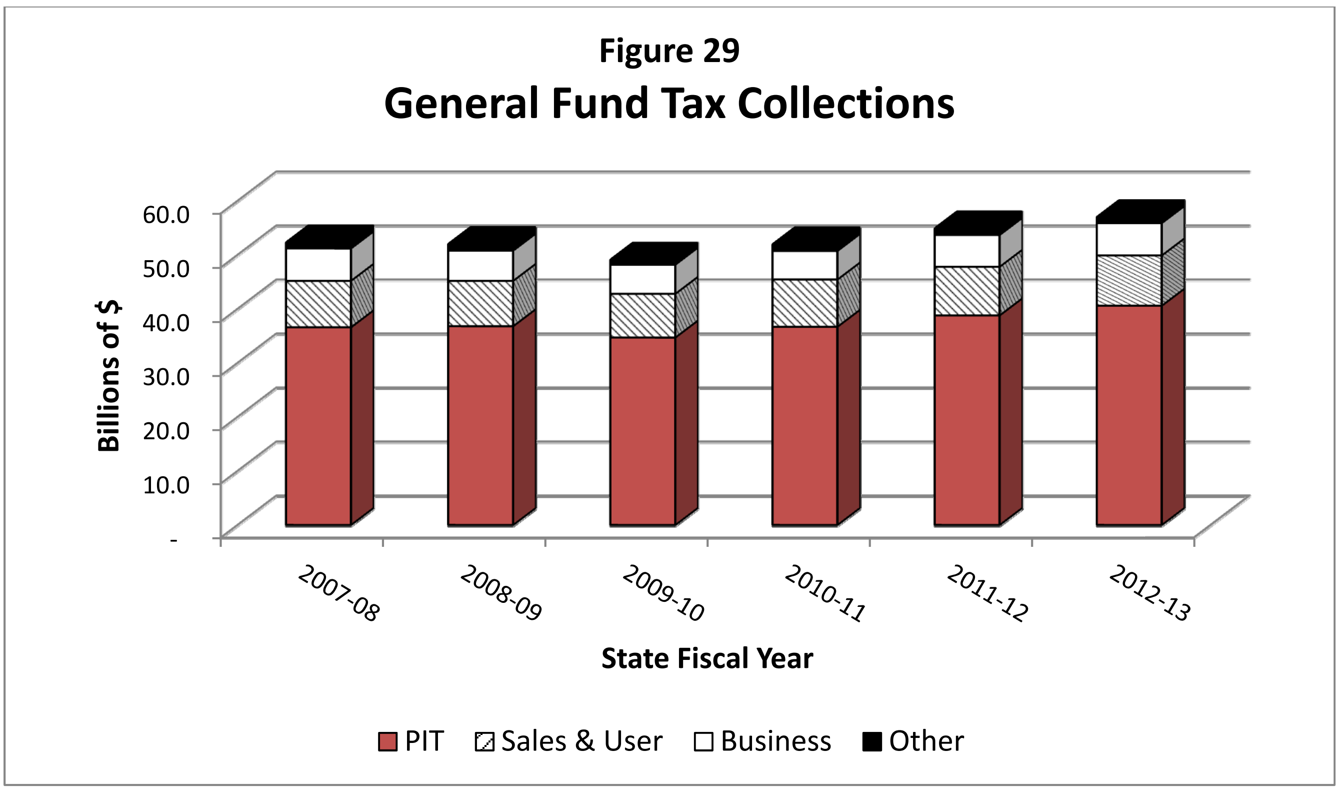
New York State Economic Outlook
Fiscal Year
(Dollar Figures in Billions of Dollars)

	2011	2012	2013	2014
Gross State Product	**$1,189**	**$1,233**	**$1,269**	**$1,321**
Percent Change	6.0	3.7	2.9	4.1
Real Gross State Product	**$1,077**	**$1,101**	**$1,120**	**$1,146**
Percent Change	7.3	2.2	1.7	2.4
Nonagricultural Employment, Thousands	**8,582**	**8,672**	**8,807**	**8,933**
Percent Change	0.6	1.0	1.6	1.4
Unemployment Rate	**8.2**	**7.6**	**7.0**	**6.7**
Personal Income	**$952**	**$986**	**$1,025**	**$1,069**
Percent Change	4.3	2.8	3.9	4.3
Wages and Salaries	**$528**	**$540**	**$563**	**$587**
Percent Change	3.3	2.3	4.3	4.4
Retail Sales	**$231**	**$245**	**$257**	**$268**
Percent Change	5.8	5.9	5.2	4.2
Housing Starts, Thousands	**18.7**	**21.5**	**29.5**	**36.5**

Source: IHS Global Insight New York State Economic Forecast, February 2012

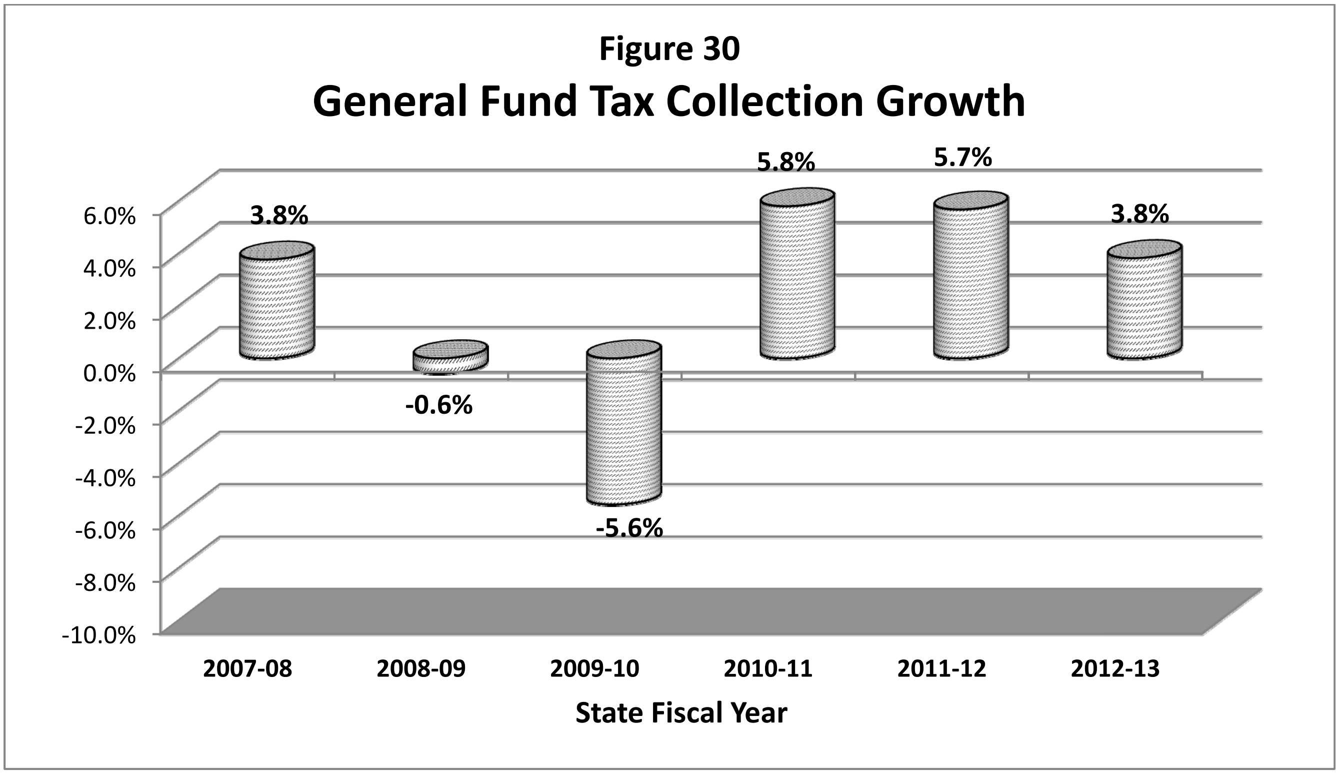
Revenue Outlook

The New York State Senate Finance Committee generates its revenue estimates using IHS Global Insight's forecasts of national and state economic growth. The economic data is utilized in the New York State Tax Revenue and Economy Model (NYSTREM) – an econometric model developed and operated by IHS Global Insight – to generate the Committee's independent revenue estimates. As summarized in the Appendix of this report, NYSTREM is designed to capture historical and the latest forecast information on the US economy, the New York State economy, and New York State tax revenues and use that information to generate a forecast for each State tax revenue stream.



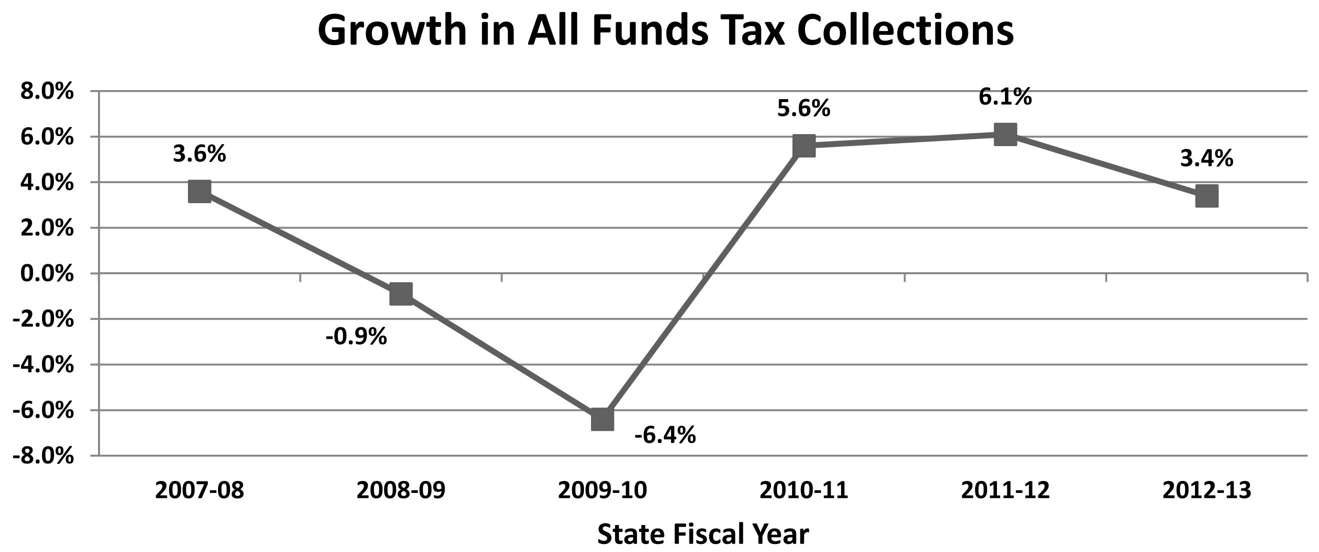
Using the NYSTREM model, the Senate Finance Committee expects gross General Fund tax collections in SFY 2011-12, excluding the STAR and debt service funds, to increase by 5.7

percent to $54.9 billion. On an All Funds basis, gross collections are expected to increase by 6.1 percent to $64.6 billion in SFY 2011-12. These increases are primarily the result of the return of growth in employment as well as the continued impact of tax law changes.



In SFY 2012-13, the Senate Finance Committee projects that General Fund tax collections, excluding special revenue transactions, will increase by 3.8 percent to $57.0 billion. All Funds collections will increase by 3.4 percent to $66.7 billion. This increase reflects the continued growth in the economy as well as the full year impact of the changes to the personal income tax that were enacted in December 2011.

Figure 31



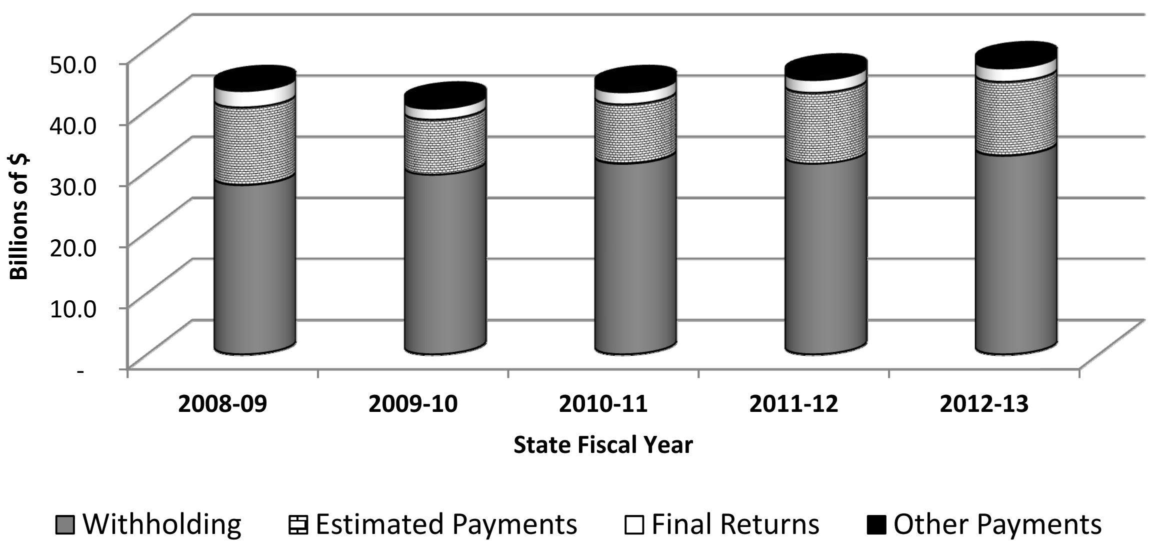
Personal Income Tax

Personal income tax collections account for over half of all New York tax collections and over two thirds of General Fund tax collections (net of reserves). The personal income tax is imposed on all types of income a person may receive (e.g. wages, interest income, dividends, and capital gains). In addition, the personal income tax is imposed on the income of New York's small businesses, such as sole proprietorships, partnerships, and limited liability companies. This income is subsequently offset by certain deductions as enumerated in either the Internal Revenue Code or the New York State Tax Law. For SFY 2011-12, total General Fund personal income tax collections, net of $13.0 billion in reserve transactions, are estimated to increase by 7.2 percent. This increase reflects wage and personal income growth in 2011 offset by the personal income tax changes enacted in December 2011.

In SFY 2012-13, total personal income tax collections, net of $13.5 billion in deposits to the reserve funds, are projected to increase by 4.6 percent to $40.6 billion. This increase is a result of continued growth in the economy offset by tax law changes enacted in SFY 2011-12.

Figure 32

Gross Personal Income Tax Collections



PIT Components

The withholding tax and estimated payments are methods by which the taxpayer can equalize his personal income tax payments over the course of the tax year as opposed to being liable for one, lump sum payment. When a person receives income, primarily wages, the appropriate tax is withheld and remitted to the State at the time the income is received. Withholding tax collections in the current fiscal year are estimated to remain at $31.2 billion, no growth from SFY 2010-11.

Although there was wage growth as well as employment growth in 2011, the lack of growth in withholding is due to the large decline in Wall Street bonuses as well as the tax cuts enacted at the end of December 2011. Withholding collections in the fourth quarter of the fiscal year historically have accounted for over thirty percent of total withholding for the year. This is due to the payment of bonuses by the financial services industry for their performance in the previous calendar year. However, due to the financial market volatility over the course of 2011 and the decrease in revenues of securities industry firms, bonuses paid within this last quarter have declined by approximately 30 percent. In addition, the compensation structure of financial services employees has changed since the public backlash over bonuses being paid to financial companies who had received government support through the TARP. Many businesses in the industry have changed the method by which bonus compensation is paid by either: paying bonuses in the form of stock options by which the recipient must hold the stock for a specified number of years to exercise the options or incorporating into wages what they would have paid their employees in bonuses.

In December 2011, the state personal income tax was changed to re-structure the income tax brackets to provide reductions in tax rates to middle class taxpayers and to reduce the tax rates that were imposed in 2009. These new tax rates took effect on January 1, 2012 which reduces withholding payments in the fourth quarter of the current fiscal year.

Withholding collections in SFY 2012-13 are projected to increase by 4.1 percent resulting from the projected increase in employment and wage growth offset by the full year impact of the rate reductions that were enacted at the end of 2011.

Another method by which the State collects the personal income tax throughout the tax year is through estimated payments. These payments are made when a taxpayer does not pay the income tax through withholding, such as a self employed individual, and/or has a significant amount of non-wage income not subject to withholding but subject to the personal income tax. These payments are made quarterly throughout the fiscal year. These collections are the most volatile portion of the personal income tax due to the fact that a taxpayer must "forecast" his tax liability for the year.

Estimated tax payments are also made when a taxpayer requests an extension for the submission of his annual return. Upon the request of the extension, the taxpayer estimates what his final tax liability will be for the previous tax year and remits the estimated tax, net of any withholding or previous estimated tax payments.

The most common form of income that is paid through estimated tax payments is capital gains, which are incurred through the sale of an asset. Most people associate capital gains with the stock market. However, as a result of the significant growth in the housing market, the real estate market had been a major contributor to capital gains realizations during the economic expansion. As the housing market declined, there has been less speculation in real estate by investors which decreased its contribution to capital gains realizations.

Another contributor to the strength or weakness of estimated payment growth is proprietor's income. This type of income includes all the self-employed businesses who earn their money through their business profits and not through the traditional withholding of wages.

Estimated tax payments are estimated to be 19.3 percent higher in SFY 2011-12; an increase of approximately $1.9 billion. This growth reflects a large increase, approximately 50 percent, in the amount of estimated payment made with extension requests for the 2010 tax year. In SFY 2012-13, estimated payments are projected to increase by 4.1 percent, to $12.1 billion. This increase reflects personal income growth in 2011 that is reflected in the extension payments that taxpayers remit as well as growth in the stock market and proprietors' income.

Third, the personal income tax is collected through the annual returns taxpayers must file. The annual return is essentially a reconciliation of a taxpayer's taxable income (gross income less deductions) and taxes paid through withholding or estimated payments throughout the preceding calendar year. As such, additional tax liability due or refunds are considered the "settlement" of a taxpayer's personal income tax. Payments made through the filing of annual returns are estimated to increase by 7.4 percent in SFY 2011-12. Since final return payments are based on a taxpayer's income for the previous calendar year, this increase is primarily the result of strong stock market growth in 2010. In SFY 2012-13, collections from final returns are projected to increase by 2.4 percent, to $2.15 billion. This increase is due to personal income growth in 2011.

The amount of refunds to be paid to taxpayers is estimated to be 8.2 percent lower in SFY 2011-12. The decrease in refunds in SFY 2011-12 is attributable to the shift of $500 million in refunds paid in the first quarter of SFY 2010-11 that would have been paid in the fourth quarter of SFY 2009-10.

The amount of refunds paid in the final quarter of the fiscal year is constrained in order to maintain cash flow between fiscal years. Due to the advent of electronic filing, there have been a larger amount of refunds being claimed in the January to March period. In order to ensure that taxpayers receive their refunds in a timely manner, the amount of refunds to be issued had been capped at $1.75 billion prior to SFY 2009-10. To deal with a cash flow crisis in SFY 2009-10, the amount of refunds paid in the fourth quarter was reduced to $1.25 billion. The amount of refunds paid in the fourth quarter of SFY 2010-11 was reinstated at the $1.75 billion level.

The decline in refunds in SFY 2011-12 is also attributable to the deferral of certain tax credits that was enacted as part of the SFY 2010-11 budget. For SFY 2012-13, refunds are projected to decline by 1.1 percent. This reflects the last year of the credit deferral as well as non-wage income growth.

Lastly, personal income tax collections are composed of assessments imposed upon taxpayers as a result of the audit process and filing fees imposed on limited liability companies. Assessments not only consist of any overdue taxes but the interest and penalties imposed upon such liability. Other collections are estimated to decrease by 3.4 percent to $1.03 billion in SFY

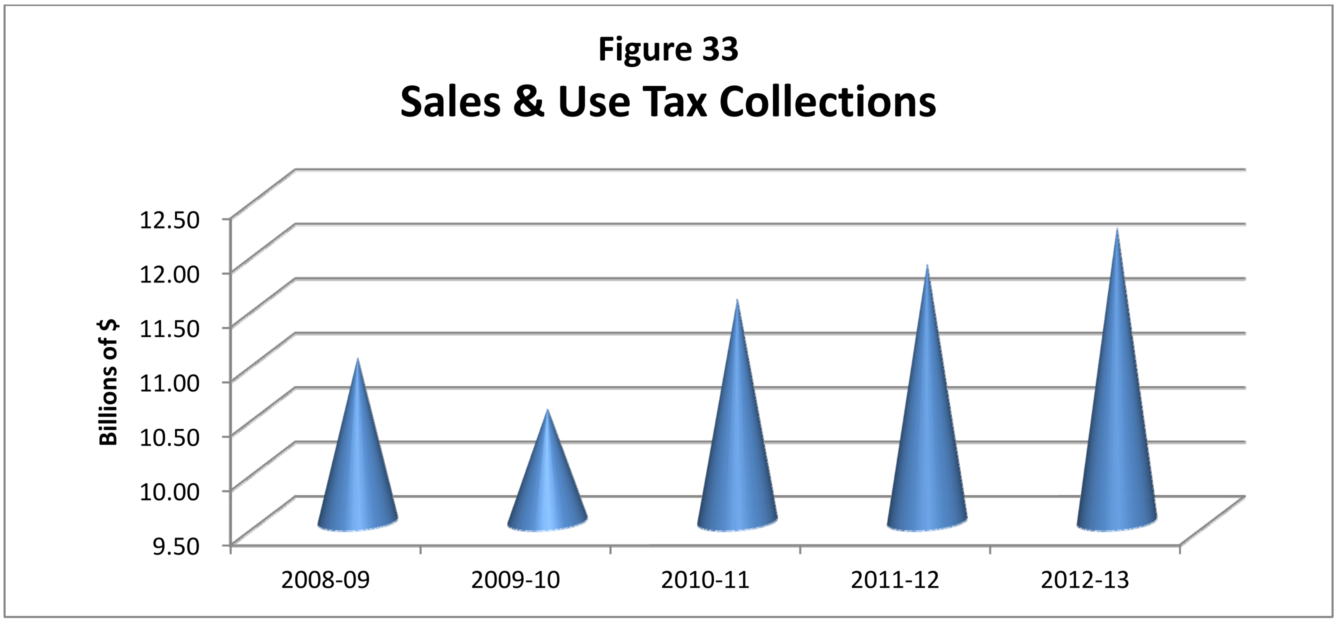
2011-12. In SFY 2012-13, other payments are projected to continue to decrease by 5.3 percent, to $1.08 billion.

A portion of income tax collections are deposited to a special revenue fund and a debt service fund. The STAR reserve is a special revenue fund that receives a portion of personal income tax collections to reimburse school districts for the reduction in their property tax collections as a result of the STAR program.

The Revenue Bond Tax Fund (RBTF) is a debt service fund into which twenty-five percent of personal income tax receipts (net of refunds and the STAR deposit) are deposited. This fund is used to pay the debt service on the State's PIT revenue bonds. Any funds in excess of the required debt service payments are transferred back to the General Fund. Deposits to the RBTF are estimated to increase by 7.3 percent in SFY 2011-12. This increase is reflective of the increase in personal income tax collections during the year. Deposits into the RBTF are projected to be 4.6 percent higher in SFY 2012-13. This increase is due to higher projected personal income tax receipts as a result of personal income and wage growth.

User Taxes and Fees

User taxes, also known as consumption taxes, are what their name implies - taxes on the use or consumption of different items in the State. These taxes consist of the sales and use tax, the auto rental tax, the cigarette tax, the motor fuel tax, alcoholic beverage taxes, the highway use tax and the MTA taxicab surcharge. Some of these taxes are only deposited to the General Fund; some are deposited only to special revenue funds; while others are deposited to a combination of funds.



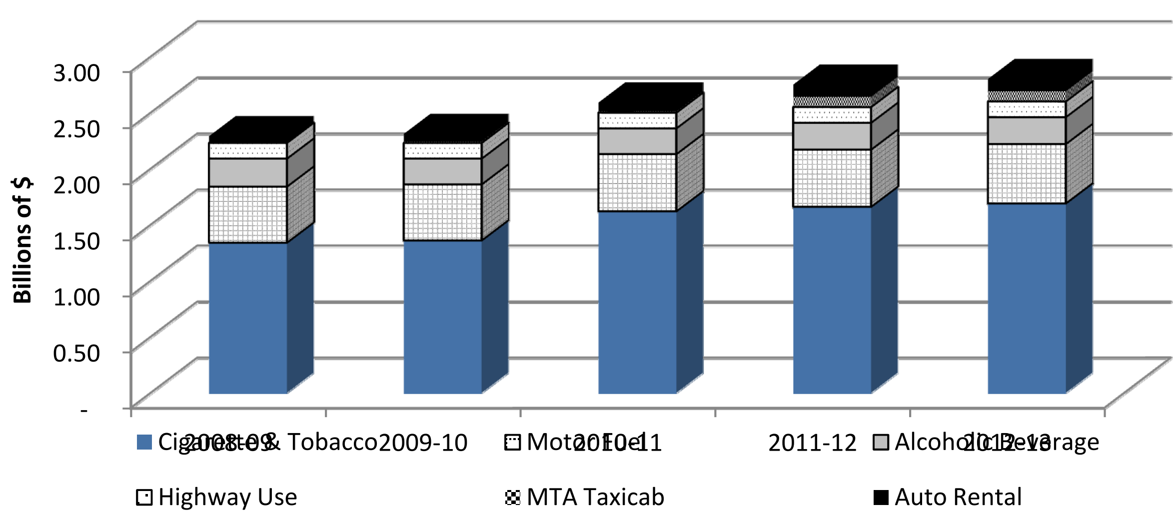
Sales and use tax collections comprise a large portion of the tax collections in this category. Receipts from this tax are deposited into the General Fund, a Special Revenue fund (the Metropolitan Transportation Operating Account), and a debt service fund (the Local Government Assistance Tax Fund). In SFY 2011-12, General Fund receipts are estimated to increase by 3.0 percent, to $8.33 billion. This increase reflects the projected increase in consumption offset by the reinstatement of the sales tax on clothing at $55 per item of clothing. On an All Funds basis, sales and use tax collections are estimated to increase by 2.8 percent to $11.9 billion in SFY 2011-12. All Funds collections are increasing less than General Fund collections because there is weaker sales growth in the Metropolitan Commuter Transportation District.

In SFY 2012-13, General Fund receipts are projected to increase by 2.8 percent to $8.56 billion due increased income and consumption growth, slightly offset by the reinstatement of the sales tax exemption on clothing at $110 per item of clothing in April 1, 2012. All Funds sales and use tax receipts are projected to increase by 2.9 percent; again reflecting the effect of wage and consumption growth.

Receipts from the cigarette tax are deposited to the General Fund and the HCRA funds while receipts from the tobacco tax are deposited solely to the General Fund. General Fund collections for cigarette and tobacco taxes in SFY 2011-12 are estimated to realize no growth from SFY 2010-11. All Funds collections for SFY 2011-12 are estimated to increase by 21.5 percent. This increase is the result of the full year impact from the increase in the tax rate on cigarettes from $2.75 per pack to $4.35 per pack and the increase in the tax on tobacco products.

Figure 34

All Other Use Tax Collections



In 2011, the State won their court case against the Native American retailers allowing the prior approval system to be substituted for the former coupon system. This prior approval system allows taxes on cigarettes that are destined for sale to New Yorkers to be collected prior to the cigarettes arriving on the reservation. This new enforcement tool along with a decision by the Federal Postal Service to stop shipping cigarettes had a positive effect on cigarette tax revenues.

In SFY 2012-13, General Fund cigarette and tobacco tax collections are projected to continue to increase by 3.8 percent. This increase is due to the full year impact of the prior approval system for cigarette distribution to the reservations and the proposed changes to the calculation of the tobacco tax for cigars and loose tobacco. All Funds cigarette and tobacco tax collections are projected to increase by 2.0 percent in SFY 2012-13.

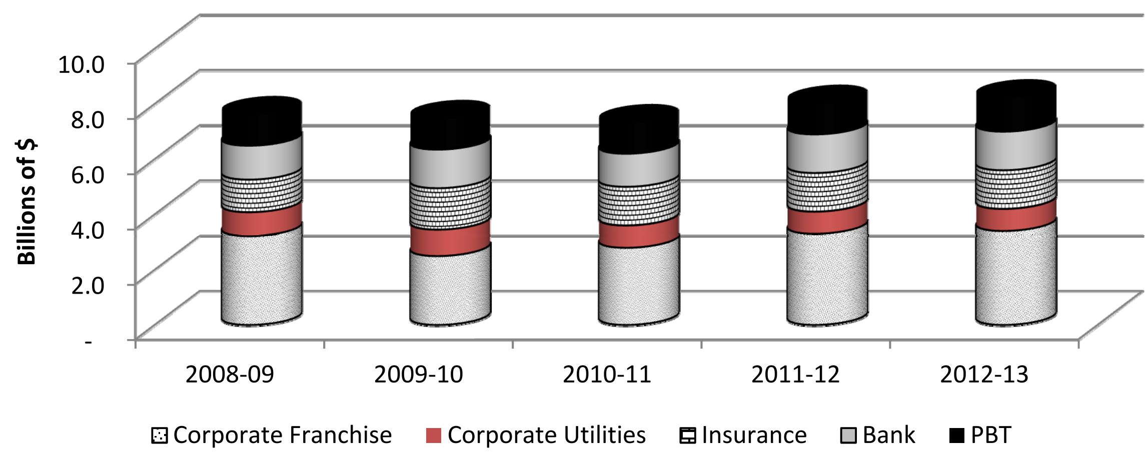
The only other user tax that is deposited to the General Fund is the Alcoholic Beverage Tax which is estimated to increase by 3.5 percent to $238 million in SFY 2011-12. In SFY 2012-13, these tax collections are projected to decrease by 2.5 percent, increasing to $244 million.

All Funds collections of the remaining user taxes are estimated to increase by 2.4 percent to $842 million in SFY 2011-12. For SFY 2011-12, collections from these other taxes are projected to increase by 2.7 percent, increasing to $865 million.

Business Taxes

Business taxes in New York are imposed on various aspects of a business' income. The corporate franchise tax and the bank tax are imposed on a business' entire net income; the corporate utility tax is imposed on the gross receipts of the business; and the insurance tax is imposed on premiums. The petroleum business tax is imposed on the gross receipts from the sale of various petroleum products by the business. However, any increase/decrease in liability for the petroleum business tax is pegged to an inflation index.

Figure 35
Business Tax Collections



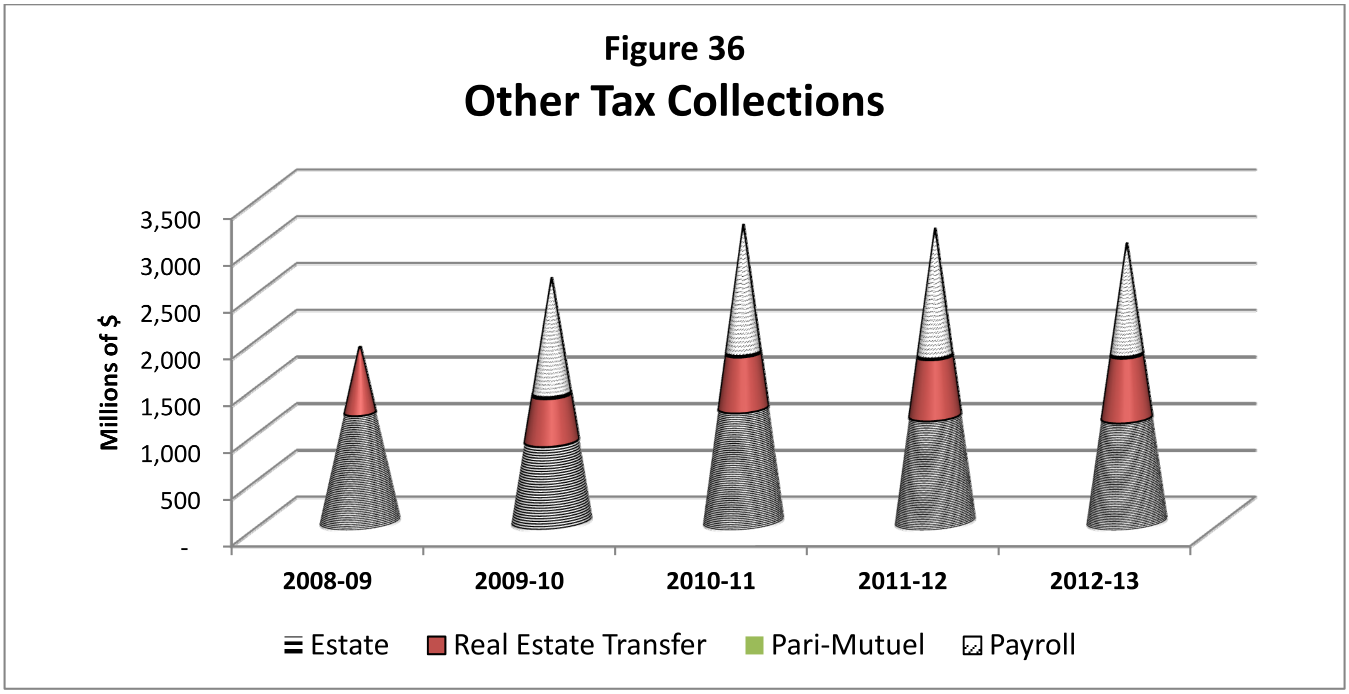
General Fund business tax collections are estimated to increase by 12.0 percent to $5.9 billion in SFY 2011-12. This increase is due to increased audit collections as well as the continued impact of the deferral of tax credits. On an All Funds basis, business taxes are estimated to increase by 9.9 percent to $8.0 billion. This increase is due to the factors enumerated above as well as an increase in collections from the petroleum business tax as a result of the five percent increase in the tax rate due to the increase in the Producer Price Index.

General Fund and All Funds business taxes in SFY 2012-13 are projected to increase by 1.2 percent to $5.99 billion and by 2.9 percent to $8.15 billion, respectively. This increase reflects slower corporate profits growth, a reduction in audit receipts, and a 2.1 percent increase in the petroleum business tax rate.

Other Taxes

Other taxes consist of the estate tax, the real estate transfer tax, the pari-mutuel tax, the boxing and wrestling exhibitions tax and the MTA payroll tax. Both the real estate transfer tax and the MTA payroll tax are deposited solely to special revenue funds while the remainder of the taxes are deposited solely to the General Fund.

General Fund receipts of these taxes are estimated to decrease by 6.8 percent to $1.15 billion in SFY 2011-12. This decrease is primarily due to the reduction in the number of super large estates settled in the current fiscal year. In SFY 2012-13, General Fund receipts are projected to decrease by 1.8 percent to $1.13 billion; reflecting the projected slow growth in the stock market as well as continued declines in home prices.



All Funds collections of other taxes are estimated to decrease by 1.3 percent to $3.13 billion in SFY 2011-12 and are projected to decrease by 5.0 percent to $2.98 billion in SFY 2012-13. The decrease in the current fiscal year is attributable to the decrease in estate tax collections, as mentioned above, offset by a slight increase in real estate transfer taxes and MTA payroll tax colletions. The continued decrease in collections in SFY 2012-13 reflects the decrease in estate tax collections. This decrease is attributable to a decrease in MTA payroll tax collections as a result of the December legislation that reduced the tax rate on small businesses and exempted all schools.

APPENDIX

THE NEW YORK STATE TAX REVENUE AND ECONOMY MODEL

Technical Characteristics

This report represents a continuation of the long-standing relationship between the Senate Finance Committee and IHS Global Insight. Prior to 1995, IHS Global Insight (formerly WEFA) produced both the economic and revenue forecasts and issued a final report to the Senate Finance Committee. Under a relationship now in its tenth year, IHS Global Insight continues to produce the economic and tax revenue forecasts using the New York State Tax and Revenue Model (NYSTREM) and serves in an advisory capacity to the Senate Finance Committee in the development of revenue forecasts.

The New York State Tax Revenue and Economy Model (NYSTREM) was developed for the New York State Senate by IHS Global Insight to provide forecasts of quarterly tax revenues, by tax category, on a timely basis with the greatest accuracy possible. The model captures the latest historical and forecast information of the U.S. economy, the New York State economy, and New York State tax revenues.

The model and forecasting procedures have the following characteristics and considerations:

- the model is based on economic theory and tax revenue accounting relationships;

- tax variables are first seasonally adjusted to obtain consistency with other seasonally adjusted national and New York State data in modeling and forecasting processes, and are transformed back into non-seasonally adjusted variables to reflect the seasonality of tax collections;
- the New York State economy part of the model belongs to the system of IHS Global Insight's Quarterly State Econometric Model. This system is composed of 51 state and D.C. models, which is further linked to IHS Global Insight's national social and economic forecasting system;
- all of the expertise of the IHS Global Insight Regional Economics Group is embedded in the modeling and forecasting processes;
- the Senate Finance Committee has access to the latest historical data and IHS Global Insight's forecast of the U. S. economy each month; and
- NYSTREM is implemented in AREMOS, IHS Global Insight's proprietary, state-of-the-art, econometric, PC-based software, providing the New York Senate Finance Committee with the ability to carry out simulations of the model as needed.

Equations in the model were estimated with the most appropriate methods that econometrics theory suggests based on the availability and characteristics of the data. Because state tax revenue is determined by the state, as well as the national economy, many U.S. and New York State economic and social variables must be used to provide an explanation of New York State tax revenue. Therefore, besides forecasting New York State's tax revenue, NYSTREM also forecasts the State's following variables:

- 2-digit manufacturing (26 components) and 1-digit non-manufacturing employment (29 components);
- 13 components of real income;
- 15 components of nominal income;
- 25 components of population by age;
- 1 component of net migration by age;
- 8 components of household by age and sex of head;
- 2 components of retail sales;
- housing starts, sales and prices;
- passenger motor vehicle registration;
- pari-mutuel racing attendance;
- total retail sales; and
- alcoholic beverage sales volume.

IHS Global Insight needs to process hundreds of endogenous and exogenous data series for estimating equations in the model and producing the forecasts.