

North Carolina



Financial Highlights
Fiscal Year End June 30, 2008

David McCoy, State Controller
North Carolina Office of the State Controller
<http://www.osc.nc.gov>



I am pleased to present you with the ***North Carolina Financial Highlights*** for the fiscal year ended June 30, 2008. This ***popular report*** represents our continuing commitment in providing the highest standards of financial management and reporting, as well as fiscal accountability of the resources of the State of North Carolina reporting entity. We hope that you find this report both informative and beneficial and we welcome any questions or comments. If you need additional copies, or have questions about this report, please contact either me or our Statewide Accounting Division staff at (919) 981-5454.

Thank you for your interest in the State of North Carolina.

Sincerely,

David McCoy
State Controller
December 19, 2008

Introduction

This popular report, *North Carolina Financial Highlights*, is intended to summarize basic financial information about our State. This information is supported in more detail in the State's Comprehensive Annual Financial Report (CAFR). The CAFR is prepared in accordance with generally accepted accounting principles and is independently audited by the North Carolina Office of the State Auditor. Much of the information in the CAFR is necessarily technical and complex. As a result, the full financial statements and note disclosures may not be as useful to the citizens of the State wishing to gain a more general understanding of the State's finances. Our report provides information at the government-wide level in addition to the major fund level, and certain selected statistical information cited in our CAFR. Coverage of legally separate, but related organizations is limited to universities and community colleges and is at a very high level.

The *popular report* is a report for the people. *North Carolina Financial Highlights* is the product of a coordinated effort on the part of state and local governments to issue simplified financial reports. It is our intent to provide you with information about the State's financial condition, without overwhelming detail and technical accounting terminology. This report contains financial information for the State's fiscal year ended June 30, 2008. The State's fiscal year starts July 1, and ends the following June 30. Information is presented in this report on the basis of generally accepted accounting principles (GAAP). This popular report and the State's complete financial statements, known as the CAFR, can be obtained on the internet at <http://www.osc.nc.gov>, by telephone at (919) 981-5454, or by writing to the N.C. Office of the State Controller, 1410 MAIL SERVICE CENTER, Raleigh, N.C. 27699-1410.



State Reporting Entity and Its Services

The State of North Carolina entity as reported in the CAFR includes all fund types of the departments, agencies, boards, commissions and authorities governed and legally controlled by the State's executive, legislative and judicial branches. In addition, the reporting entity includes legally separate component units for which the State is financially accountable. The component units are discretely presented in the government-wide financial statements. The State's discretely presented major component units are the University of North Carolina System; the State's community colleges; Golden LEAF, Inc., North Carolina Housing Finance Agency, and North Carolina State Education Assistance Authority.



The State and its component units provide a broad range of services to its citizens, including

- ◆ K-12 public education
- ◆ higher education
- ◆ health and human services
- ◆ economic development
- ◆ environment and natural resources
- ◆ public safety, corrections, and regulation
- ◆ transportation
- ◆ agriculture
- ◆ general government services

North Carolina State Flag

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

The Economy

The economy over the last twelve months has been battling significant headwinds caused by the slow unwinding of the housing market recession and the subsequent turmoil in the financial markets. The result is that both businesses and consumers will struggle until the financial markets stabilize and the housing market begins to recover.

Problems in the economy began to surface from significant losses in household wealth caused by the housing market recession. As early as 2006, troubles in the housing sector started to appear. At first, the housing slump seemed isolated to a few regions in the nation, but by the start of 2007 most of the nation was feeling the impact from a significant slowdown in housing. The drop in home purchases began to affect industries tied to home sales and construction. For example, retail sales items such as furniture and appliance purchases declined. The fallout from the housing recession began to impact financial markets as well, where loans and investments tied to real estate began to falter.

In the second quarter of 2007, the housing slowdown and financial market troubles deepened and began to show significant signs of affecting the overall economy. While some slowdown is expected in the middle of a business cycle, the impact of the financial market upheaval, exacerbated by the prolonged housing recession, put the economy perilously close to a recession and by the end of the second quarter of 2008 many economists were expecting a recession to occur.

Consumers were starting to feel the strain caused by a slowing economy. In addition to troubles in the housing and financial market, they faced higher commodity prices. Most noticeably they were paying higher prices at the gas pump and in grocery stores. Consumers were being hit hard by these economic conditions. Employment opportunities began to decline, real wages (adjusted for inflation) were falling, credit markets made it difficult to borrow money, and household debt was at an all time high. By the end of the summer of 2008, consumer confidence, as measured by the Consumer Confidence Index survey, dropped to recession-like levels.

One bright spot in the economy has been the global demand for U.S. products. In fact, one of the stronger facets of the nation's economy during 2007, were exports. Strong growth of global economies coupled with falling exchange rates for the dollar fueled demand for U.S. products. Exports helped bolster the national economy and soften the blow caused by problems in the housing and financial sectors.

For North Carolina, economic conditions did not begin to weaken until early in 2008. Through 2007, the State seemed less vulnerable to the nation's economic downturn, which was already well underway. By mid-summer 2008 however, many industry sectors in the State were beginning to feel the strain as financial market conditions deteriorated and consumer spending weakened further. Recent economic developments nationally, globally, and in the State indicate most of 2008, and all of 2009, will be characterized by stagnant employment growth, lower real wages and reduced consumer spending.

Financial Highlights — Fiscal Year 2008



North Carolina Economic Indicators

(% Change)

	<u>FY2006-07</u>	<u>FY2007-08</u>	<u>FY2008-09</u>	<u>FY2009-10</u>
	Actual	Actual	Projected	Projected
Personal Income	6.9%	5.4%	4.1%	3.4%
Wages & Salaries	7.3%	4.4%	2.5%	3.3%
Retail Sales	7.0%	4.9%	0.6%	2.7%
Unemployment Rate	4.7%	5.0%	7.1%	7.5%
Employment (Nonagricultural)	3.4%	1.7%	-0.8%	0.4%
Existing Single-family Home Sales	-0.1%	-21.3%	2.7%	9.8%
Average Hourly Earnings: Manufacturing	2.9%	3.2%	3.9%	3.0%

For North Carolina, the economic slowdown began in earnest the second quarter of 2008. Prior to then, it appeared the State might weather the economic turmoil experienced by some states and avoid recession-like conditions. The initially mild slowdown experienced by the State may be due in part to North Carolina's relatively mild housing problems. The State's housing bubble was limited to a few resort areas, therefore the statewide impact from the initial housing slowdown was far less severe than in many states. Through the first half of 2007, the State continued to experience strong population and employment growth. This growth helped dampen the impact from the housing slump. Even towards the end of 2007, the State's economy remained one of the few state economies still experiencing near-normal employment and income growth. However, by the spring of 2008, the national economic slowdown had spread to North Carolina and employment and income growth began to stall.

Thus, for FY2007-08, State economic indicators such as employment and income growth had noticeably slowed compared to the previous fiscal year. Going forward income growth is projected to continue to slow for the next two fiscal years with a modest rebound in wage and salary growth forecast for 2010. As with the nation, the majority of the housing slump's effects will have worked themselves out by 2009, but residual effects will continue to be a drain on the State's economy. For FY2008-09, the economic downturn and the strain on consumers will result in almost no growth in retail sales (0.6 percent) and falling employment (-0.8 percent).

As the State's economy suffers through the downturn, unemployment will increase and is projected to remain at, or above, 7 percent through 2009 and into 2010. This past year a drop in employment in the housing related industries including financial services, residential construction, and transportation occurred. Long-term negative growth trends in manufacturing continued as the State transitions away from traditional manufacturing jobs. In the last recession, manufacturing, particularly in the furniture and textile industries, shed jobs at a rate of 10 percent per quarter. The State's manufacturing sector will not be as vulnerable during this recession and job losses in this industry sector will continue but are not projected to fall at the accelerated pace experienced during the last recession.

Additionally, the recent financial market upheaval has had a detrimental impact on the financial service sector's employment. Current estimates indicate job losses in this sector will continue into 2010. Compounding problems in the job market will be employment cutbacks in the service and retail sectors due to falling consumer spending. Thus, the number of people employed in non-agricultural industries in the State are expected to decline in FY2008-09, and the following fiscal year only grow at a rate of 0.4 percent.

An indication of the magnitude of the recession in the housing market can be represented by the 21.3 percent decline of existing-home sales in FY2007-08. This pullback in the sale of real estate can take a long time to recover from and for stability to return to the real estate market. Once the housing market stabilizes and an economic recovery is underway, North Carolina's economy is expected to expand at a faster pace than the nation. This should bode well for overall employment in the State and help bolster income growth going into 2010. Employment losses in the manufacturing industries will continue, but growth in the service and technical industries should rebound and continue to be a major stimulus to economic growth.

There is little doubt that the State will experience an economic slowdown with recession-like conditions possible over the next couple of years, but it is in a position to perform better than the nation as a whole during this period and is expected to bounce back faster than many other regions of the country.



— Economic analysis prepared by Barry Boardman, Ph.D.,
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North Carolina General Assembly, Fiscal Research Division
October 31, 2008

North Carolina Sand Dunes

Photo Courtesy of NC Division of Tourism, Film, and
Sports Development.
Bill Russ, Photographer

