

Revenue and Economic Update

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State Revenues Below February Forecast

Minnesota’s net general fund receipts for FY 2017 are now estimated to total \$20.949 billion, \$104 million (0.5 percent) less than projected in the February 2017 *Budget and Economic Forecast*. Lower than expected net individual income tax receipts more than offset net sales, corporate, and other tax receipts that exceeded the forecast. General fund revenues for FY 2017 are now estimated to be 0.3 percent greater than in FY 2016. State revenues in the final quarter of FY 2017 were \$127 million less than forecast. (See page 4 for details.)

Net individual income tax receipts are estimated to end the year \$260 million (2.3 percent) less than forecast. Gross income tax receipts were \$142 million below forecast, and refunds were \$118 million larger than expected.

Net collections associated with tax year 2016 final returns and extensions were about \$292 million below the forecast. We will not know final tax year 2016 income tax liability until extension return processing is completed at the end of 2017. However, data from the Quarterly Census on Employment and Wages (QCEW) now suggests that Minnesota wage and salary income grew about one percentage point more slowly in 2016 than we had forecast in February. That is consistent with tax year 2016 net income tax receipts coming in short of forecast. In addition, non-wage income—particularly capital gains—

may have grown more slowly in 2016 than we had forecast. The Congressional Budget Office (CBO) has speculated that weak federal income tax payments for 2016 may be due in part to taxpayers shifting payments from 2016 into later years in anticipation of federal tax rate cuts. We will know more about 2016 Minnesota non-wage income when we see information from a preliminary sample of 2016 tax returns in early 2018.

On net, payments generally associated with calendar year 2017 activity—income tax withholding and estimated payments—were about \$32 million more than forecast. Withholding payments were above the forecast, offsetting lower than expected estimated payments. About \$15 million of the positive withholding variance appears to be due to timing of withholding collections, rather than increased economic activity.

Net general sales tax receipts are estimated to end FY 2017 \$13 million (0.2 percent) above the forecast. Lower than expected sales tax refunds more than offset gross tax payments that were below the forecast. Net corporate receipts for FY 2017 were \$59 million (5.2 percent) more than projected. As with the sales tax, lower than expected corporate refunds more than offset gross tax payments that were below the forecast. Other revenues for FY 2017 exceeded the forecast by \$84 million (2.5 percent).

Summary of Revenues: Fiscal Year 2017

(\$ in millions)	February 2017	Estimated	\$ Difference	% Difference
	Forecast	Closing ¹		
Individual Income Tax	\$11,188	\$10,928	\$(260)	(2.3)%
General Sales Tax	5,347	5,360	13	0.2
Corporate Franchise Tax	1,142	1,201	59	5.2
Other Revenues	3,376	3,460	84	2.5
Total Revenues²	\$21,053	\$20,949	\$(104)	(0.5)%

1. Reflects actual revenue attributable to FY 2017, estimates of revenue accruals through closing (August 11), and other pre-close adjustments.
 2. Totals may not add due to rounding.

This report only reflects net general funds revenues. It does not present a complete budget picture, because it does not report the state’s FY 2017 spending. Moreover, all FY 2017 results are preliminary and subject to change. The state’s fiscal year that ended June 30, 2017, will officially close on August 11. Values in the estimated closing column on page 4 reflect actual revenues attributable to FY 2017 as well as estimates of revenue accruals through closing and other pre-close adjustments. As of June 30, total FY 2017 revenue was \$21.043 billion. Estimated accruals and pre-close adjustments subtract about \$93 million. This is primarily due to individual, corporate, and sales tax refunds attributable to FY 2017 that are expected to be paid out prior to the close. A complete reporting of FY 2017 revenues will be part of October’s *Revenue and Economic Update*. The next official forecast will be released in early December 2017.

While Awaiting Fiscal Stimulus, U.S. Economy Remains Stable

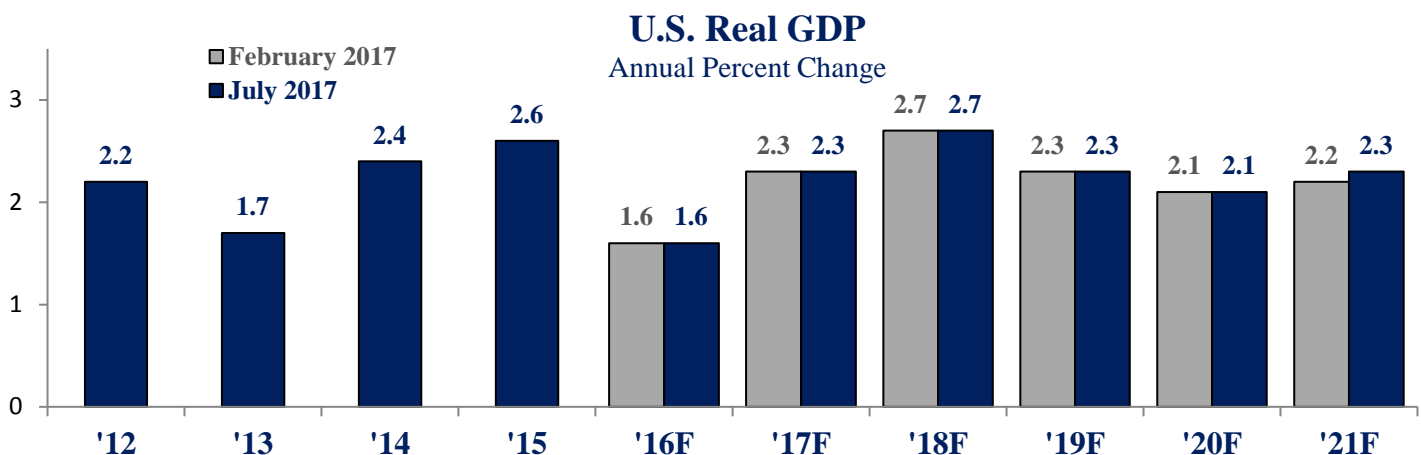
The U.S. economic outlook is little changed since February, when we last produced *Minnesota’s Budget and Economic Forecast*. The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 1.4 percent during the first quarter of 2017, down from 2.1 percent growth in the fourth quarter of 2016. A first quarter deceleration in private inventory investment and personal consumption expenditures and a downturn in government spending were partly offset by faster growing net exports and fixed investment.

The strength of underlying fundamentals driving final domestic demand, and in particular consumption,

supports the case for sustained economic growth in the second half of 2017. Minnesota’s macroeconomic consultant IHS Markit (IHS) expects annualized real GDP growth of about 2.3 percent for the remainder of the year, as strong gains in consumer spending and residential and nonresidential fixed investment offset the effects of imports and an inventory deceleration that is expected to be a drag on growth in the third and fourth quarters of 2017.

The outlook for 2018 is considerably more uncertain. IHS continues to expect federal fiscal stimulus in the form of personal and corporate tax cuts and an infusion of infrastructure spending, although they now expect a smaller package than they had included in the February outlook. IHS expects the stimulus to boost 2018 GDP growth to 2.7 percent. However, even if the stimulus is not implemented, IHS believes that economic fundamentals are solid enough to maintain a pace of real GDP growth of about 2.3 percent in 2018. IHS expects annual real GDP growth to slow to 2.3 percent in 2019 and 2.1 percent in 2020, rebounding in 2021 to 2.3 percent. The IHS July baseline forecast for 2017 growth is similar to the Blue Chip Consensus, the median of 50 business and academic forecasts, which expects 2.2 percent growth in 2017. The Blue Chip Consensus expects 2.4 percent growth in 2018, slower than IHS’ 2.7 percent forecast for that year.

The Bureau of Labor Statistics (BLS) reports that in June the U.S. unemployment rate slightly increased 0.1 percentage points to 4.4 percent on a seasonally adjusted basis. Since the beginning of the year, the unemployment rate has declined by 0.4 percentage points, and the number of unemployed has decreased by 658,000. U.S.



Source: Bureau of Economic Analysis and IHS Markit.

employers added 180,000 jobs per month so far this year, maintaining the solid job gains observed in 2016. The average workweek for all employees on private nonfarm payrolls rose by 0.1 hour to 34.5 hours in June, and wage gains in this month helped bring annual growth in average hourly earnings to 2.5 percent. IHS now expects the unemployment rate to fall over the next three years: to 4.4 percent in 2017 and further to 4.1 and 3.9 percent in 2018 and 2019, respectively.

As expected, following its June meeting the Federal Open Market Committee raised the federal funds rate target range by 25 basis points to 1.00 to 1.25 percent. The Fed announced its plan for normalizing its balance sheet and reinforced that it is likely this year to begin cutting back the reinvestments in its Treasury and mortgage-backed

securities portfolio. The medium term projections for interest rates are more or less unchanged. IHS expects gradual increases in the fed funds target during each of the next three years, reaching 3.00 percent by the end of 2019.

In their July outlook, IHS assigns a 60 percent probability to their baseline forecast and a 25 percent probability to a more pessimistic scenario, in which real GDP growth slows to 1.7 percent in 2018. They assign a 15 percent probability to an optimistic scenario characterized by 3.7 percent growth in 2018. These are the same probabilities as in IHS' February outlook.

Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2017			April-June 2017		
	FORECAST REVENUES ¹	ESTIMATED CLOSING REVENUES ²	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES ²	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	8,566,972	8,655,009	88,037	2,164,900	2,202,931	38,031
Declarations	2,376,100	2,292,590	(83,509)	1,024,808	942,039	(82,769)
Miscellaneous	1,658,329	1,511,780	(146,549)	1,098,743	967,732	(131,011)
Gross	12,601,401	12,459,379	(142,022)	4,288,451	4,112,702	(175,749)
Refund	1,413,700	1,531,867	118,167	479,518	609,959	130,440
Net	11,187,700	10,927,512	(260,189)	3,808,932	3,502,744	(306,189)
Corporate Franchise Tax						
Declarations	1,207,159	1,157,926	(49,232)	343,773	371,065	27,292
Miscellaneous	202,292	224,379	22,087	(33,592)	(5,075)	28,517
Gross	1,409,451	1,382,305	(27,145)	310,180	365,989	55,809
Refund	267,227	180,856	(86,372)	97,452	48,417	(49,036)
Net	1,142,223	1,201,450	59,226	212,728	317,572	104,844
General Sales and Use Tax						
Gross	5,621,896	5,614,298	(7,598)	1,605,476	1,606,099	623
Mpls. sales tax transferred to MSFA	1,664	1,664	-	379	362	(16)
Sales Tax Gross	5,623,560	5,615,962	(7,597)	1,605,855	1,606,461	607
Refunds (including Indian refunds)	276,301	255,728	(20,574)	120,987	130,210	9,223
Net	5,347,259	5,360,235	12,976	1,484,868	1,476,251	(8,617)
Other Revenues:						
Net Estate	139,100	130,233	(8,868)	40,836	36,157	(4,679)
Net Liquor/Wine/Beer	88,430	88,260	(171)	27,363	28,685	1,322
Net Cigarette/Tobacco	623,590	648,267	24,676	176,226	189,140	12,914
Deed and Mortgage	241,317	245,015	3,698	71,494	71,533	39
Net Insurance Premiums Taxes	372,552	376,935	4,383	84,845	88,336	3,490
Net Lawful Gambling	62,000	64,113	2,113	20,444	21,680	1,236
Health Care Surcharge	276,115	272,935	(3,180)	105,788	103,166	(2,621)
Other Taxes	2,655	7,748	5,093	2,071	7,149	5,078
Statewide Property Tax	838,173	854,170	15,997	450,185	466,018	15,833
DHS SOS Collections	56,425	86,410	29,985	2,124	20,592	18,468
Investment Income	26,000	31,966	5,966	5,808	9,150	3,342
Tobacco Settlement	158,453	168,226	9,773	-	9,773	9,773
Dept. Earnings & MSOP Recov.	200,429	215,346	14,917	51,131	61,437	10,305
Fines and Surcharges	79,142	78,151	(991)	25,971	24,770	(1,201)
Lottery Revenues	65,111	61,732	(3,379)	28,404	25,923	(2,481)
Revenues yet to be allocated	(0)	5,524	5,524	(70)	5,202	5,272
Residual Revenues	145,635	124,312	(21,323)	33,668	40,347	6,679
County Nursing Home, Pub Hosp IGT	6,226	6,226	-	1,698	1,698	-
Other Subtotal	3,381,354	3,465,570	84,215	1,127,986	1,210,755	82,769
Other Refunds	5,405	5,293	(112)	1,667	1,219	(449)
Other Net	3,375,949	3,460,277	84,327	1,126,319	1,209,536	83,217
Total Gross	23,015,766	22,923,216	(92,549)	7,332,472	7,295,907	(36,564)
Total Refunds	1,962,634	1,973,743	11,110	699,625	789,805	90,180
Total Net	21,053,132	20,949,473	(103,659)	6,632,847	6,506,103	(126,744)

1. February 2017 Budget & Economic Forecast

2. Reflects estimates of revenue accruals through FY 2017 closing (August 11) and other pre-close adjustments.