

# Revenue and Economic Update

January 10, 2018

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## Revenues Above November Forecast

Minnesota’s net general fund receipts totaled \$3.938 billion during the months of November and December 2017, or \$219 million (5.9 percent) more than projected in the November 2017 *Budget and Economic Forecast*. Receipts for the individual income tax, corporate tax, and other revenues were higher than expected for the quarter, while net sales tax receipts nearly matched the forecast.

Net individual income tax receipts during the last two months of 2017 were \$143 million (8.0 percent) more than forecast. Higher than expected gross tax receipts offset income tax refunds that were larger than forecast. (See page 3 for details.)

Estimated tax payments were \$101 million above the forecast. Even though tax payments are not due until January 15, many taxpayers make early payments on or before December 31 so they can deduct them from their federal tax returns for the tax year that just ended. Therefore, combining estimated tax receipts for December and January generally provides a more accurate picture of fourth quarter payments than December alone. This year, the anticipated loss of deductions for state taxes under the federal Tax Cuts and Jobs Act (TCJA) gave taxpayers a greater incentive than usual to make sure they had fully paid their 2017 state income tax liability before the end of the year. The larger than expected December receipts are

likely due to the incentive to accelerate payments, rather than to higher calendar year 2017 tax liability.

Net corporate tax receipts were \$43 million (19.9 percent) above the forecast. Higher than expected corporate tax payments and lower than expected refunds both contributed to the positive variance.

Other revenues were \$32 million (4.0 percent) more than projected. Among other revenues, the estate tax showed the largest variance, \$47 million above the forecast. This appears to be due to the normal irregularity of receipts from this tax.

## U.S. Economic Outlook Improves

The outlook for U.S. economic growth has improved since we last produced Minnesota’s *Budget and Economic Forecast* in November 2017. The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 3.2 percent during the third quarter of 2017, up a bit from the 3.1 percent growth in the second quarter, and bringing annual 2017 growth to 2.2 percent. IHS Markit (IHS), Minnesota’s macroeconomic consultant, expects an increase in economic growth from 2.2 percent in 2017 to 2.7 percent in 2018, followed by 2.6 percent in 2019. This acceleration is driven by continued, moderate growth in consumer spending and strong gains in business equipment investment. In addition, the TCJA is expected

## Summary of Revenues: November-December 2017

| (\$ in millions)                  | November 2017  |                |               |              |
|-----------------------------------|----------------|----------------|---------------|--------------|
|                                   | Forecast       | Actual         | \$ Difference | % Difference |
| Individual Income Tax             | \$1,797        | \$1,940        | \$143         | 8.0%         |
| General Sales Tax                 | 900            | 901            | 1             | 0.1          |
| Corporate Franchise Tax           | 218            | 261            | 43            | 19.9         |
| Other Revenues                    | 804            | 836            | 32            | 4.0          |
| <b>Total Revenues<sup>1</sup></b> | <b>\$3,719</b> | <b>\$3,938</b> | <b>\$219</b>  | <b>5.9%</b>  |

1. Totals may not add due to rounding.

to have a modest, positive effect on GDP growth, primarily through the impact of individual income tax rate cuts on consumer spending. The November 2017 IHS outlook projected weaker growth of 2.5 percent in 2018 and 2.2 percent in 2019. The IHS January baseline forecast for 2018 growth matches the Blue Chip Consensus, the median of 50 business and academic forecasts. The Blue Chip Consensus expects 2.4 percent growth in 2019, slower than IHS' 2.6 percent forecast for that year.

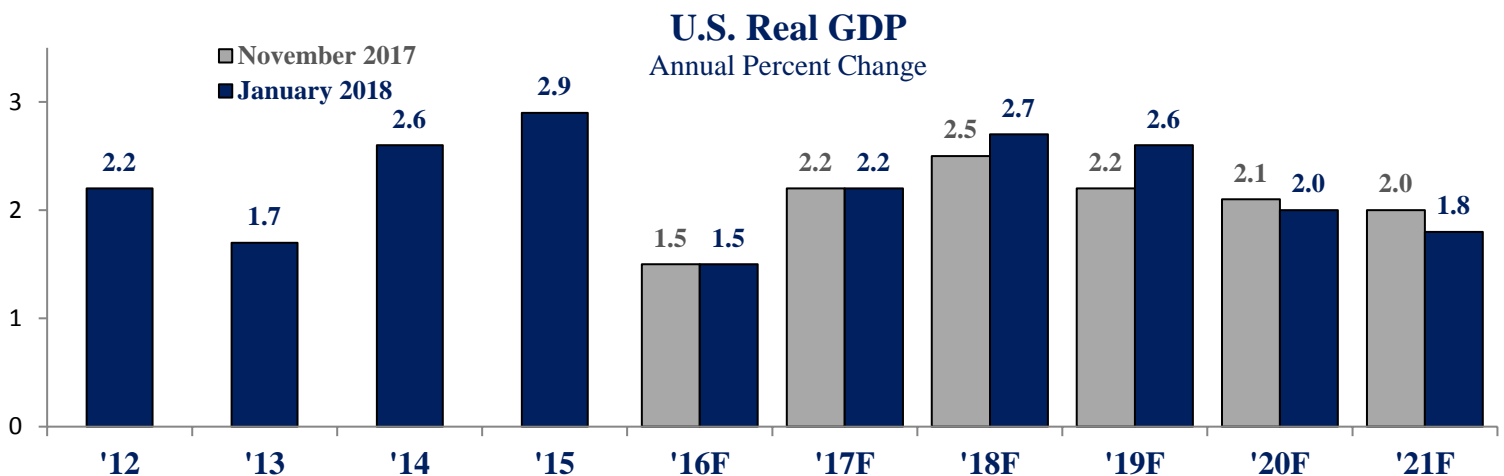
The consumer spending outlook continues to be supported by strong fundamentals, including rising home prices and stock portfolios, steady job growth, rising wages, and subdued inflation. In addition, IHS expects the TCJA's lower individual income tax rates to provide a small boost to consumer spending through 2020.

The Bureau of Labor Statistics (BLS) reports that in December the seasonally adjusted U.S. unemployment rate was 4.1 percent, 0.6 percentage points lower than a year earlier. In December, the estimated number of unemployed persons was almost unchanged over the month, but declined by 926,000 relative to a year earlier. Total nonfarm payroll employment increased by 148,000 in December. U.S. employers added around 175,000 jobs per month in 2017, slightly less than the job gains observed in 2016. The average workweek for all employees on private nonfarm payrolls held steady at 34.5 hours in December, and wage gains that month helped bring annual growth in average hourly earnings to 2.5 percent. IHS now expects an unemployment rate of 3.9

percent in 2018, followed by 3.7 and 3.8 percent in 2019 and 2020, respectively.

As expected, following its December meeting the Federal Open Market Committee (FOMC) raised the federal funds rate target range by 25 basis points to 1.25-1.50 percent. This was the third increase of 2017, and is consistent with a tightening labor market. However, some FOMC members disagreed with the December decision, preferring to see inflation rise before increasing interest rates any further. IHS' January outlook assumes three 25-basis-point increases in the federal funds rate in each of 2018 and 2019, followed by two in 2020. The rate is expected to reach a long-term equilibrium level of 3.45 in 2021.

Since November, IHS has not changed the probabilities they assign to the baseline and alternative scenarios. They assign a probability of 65 percent to the January baseline outlook. They assign a 20 percent probability to a more pessimistic scenario, in which a correction to commercial real estate prices and declining consumer and business confidence trigger a two-quarter recession in 2018, slowing annual real GDP growth this year to 1.0 percent. In IHS's more optimistic scenario, a pick-up in home purchases by young adults fuels the housing market, and improvements in productivity boost incomes and, consequently, consumer spending, raising real GDP growth starting in 2018. This scenario gets a 15 percent probability.



Source: Bureau of Economic Analysis and IHS Markit.

# Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

|                                     | Fiscal Year to Date 2018       |                   |                   | November December 2017 |                  |                   |
|-------------------------------------|--------------------------------|-------------------|-------------------|------------------------|------------------|-------------------|
|                                     | FORECAST REVENUES <sup>1</sup> | ACTUAL REVENUES   | VARIANCE ACT-FCST | FORECAST REVENUES      | ACTUAL REVENUES  | VARIANCE ACT-FCST |
| <b>Individual Income Tax</b>        |                                |                   |                   |                        |                  |                   |
| Withholding                         | 4,215,469                      | 4,249,348         | 33,879            | 1,483,350              | 1,517,229        | 33,879            |
| Declarations                        | 791,400                        | 892,506           | 101,106           | 325,752                | 426,857          | 101,106           |
| Miscellaneous                       | 294,038                        | 304,614           | 10,577            | 72,740                 | 83,317           | 10,577            |
| Gross                               | 5,300,906                      | 5,446,468         | 145,561           | 1,881,842              | 2,027,403        | 145,561           |
| Refund                              | 156,016                        | 158,605           | 2,588             | 84,598                 | 87,187           | 2,588             |
| Net                                 | 5,144,890                      | 5,287,863         | 142,973           | 1,797,244              | 1,940,217        | 142,973           |
| <b>Corporate Franchise Tax</b>      |                                |                   |                   |                        |                  |                   |
| Declarations                        | 555,084                        | 562,649           | 7,565             | 211,511                | 219,076          | 7,565             |
| Miscellaneous                       | 145,653                        | 179,153           | 33,499            | 48,268                 | 81,767           | 33,499            |
| Gross                               | 700,737                        | 741,802           | 41,064            | 259,779                | 300,843          | 41,064            |
| Refund                              | 60,224                         | 58,024            | (2,201)           | 42,258                 | 40,057           | (2,201)           |
| Net                                 | 640,513                        | 683,778           | 43,265            | 217,521                | 260,786          | 43,265            |
| <b>General Sales and Use Tax</b>    |                                |                   |                   |                        |                  |                   |
| Gross                               | 2,684,014                      | 2,696,435         | 12,421            | 930,233                | 942,654          | 12,421            |
| Mpls. sales tax transferred to MSFA | 984                            | 787               | (197)             | 393                    | 196              | (197)             |
| Sales Tax Gross                     | 2,684,998                      | 2,697,223         | 12,224            | 930,626                | 942,850          | 12,224            |
| Refunds (including Indian refunds)  | 75,045                         | 86,413            | 11,368            | 30,188                 | 41,556           | 11,368            |
| Net                                 | 2,609,954                      | 2,610,810         | 856               | 900,438                | 901,294          | 856               |
| <b>Other Revenues:</b>              |                                |                   |                   |                        |                  |                   |
| Net Estate                          | 66,578                         | 113,307           | 46,728            | 22,041                 | 68,769           | 46,728            |
| Net Liquor/Wine/Beer                | 40,074                         | 40,340            | 266               | 15,382                 | 15,648           | 266               |
| Net Cigarette/Tobacco               | 249,207                        | 234,535           | (14,672)          | 122,952                | 108,280          | (14,672)          |
| Deed and Mortgage                   | 113,532                        | 122,551           | 9,020             | 38,104                 | 47,123           | 9,020             |
| Net Insurance Premiums Taxes        | 179,105                        | 183,753           | 4,648             | 87,526                 | 92,174           | 4,648             |
| Net Lawful Gambling                 | 26,660                         | 29,783            | 3,122             | 8,613                  | 11,735           | 3,122             |
| Health Care Surcharge               | 92,792                         | 88,985            | (3,807)           | 51,236                 | 47,429           | (3,807)           |
| Other Taxes                         | 1                              | 1                 | 0                 | -                      | 0                | 0                 |
| Statewide Property Tax              | 375,497                        | 366,859           | (8,639)           | 195,031                | 186,392          | (8,639)           |
| DHS SOS Collections                 | 37,265                         | 40,996            | 3,731             | 9,912                  | 13,643           | 3,731             |
| Investment Income                   | 13,601                         | 19,150            | 5,549             | 1,800                  | 7,348            | 5,549             |
| Tobacco Settlement                  | 154,296                        | 157,260           | 2,964             | 154,196                | 157,160          | 2,964             |
| Dept. Earnings & MSOP Recov.        | 98,403                         | 99,247            | 844               | 45,159                 | 46,003           | 844               |
| Fines and Surcharges                | 32,330                         | 25,441            | (6,889)           | 11,981                 | 5,092            | (6,889)           |
| Lottery Revenues                    | 23,588                         | 19,640            | (3,948)           | 8,165                  | 4,216            | (3,948)           |
| Revenues yet to be allocated        | 946                            | 1,927             | 982               | (12,671)               | (11,689)         | 982               |
| Residual Revenues                   | 80,170                         | 71,889            | (8,281)           | 45,427                 | 37,146           | (8,281)           |
| Other Subtotal                      | 1,584,046                      | 1,615,664         | 31,618            | 804,852                | 836,470          | 31,618            |
| Other Refunds                       | 2,340                          | 2,170             | (170)             | 1,056                  | 886              | (170)             |
| Other Net                           | 1,581,706                      | 1,613,494         | 31,788            | 803,796                | 835,584          | 31,788            |
| <b>Total Gross</b>                  | <b>10,270,689</b>              | <b>10,501,156</b> | <b>230,468</b>    | <b>3,877,099</b>       | <b>4,107,566</b> | <b>230,468</b>    |
| <b>Total Refunds</b>                | <b>293,625</b>                 | <b>305,211</b>    | <b>11,586</b>     | <b>158,100</b>         | <b>169,685</b>   | <b>11,586</b>     |
| <b>Total Net</b>                    | <b>9,977,063</b>               | <b>10,195,945</b> | <b>218,882</b>    | <b>3,718,999</b>       | <b>3,937,881</b> | <b>218,882</b>    |

1. November 2017 Budget & Economic Forecast.