

# Revenue and Economic Update

January 10, 2019

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## Revenues Below November Forecast

Minnesota’s net general fund receipts totaled \$3.723 billion during the months of November and December 2018, or \$102 million (2.7 percent) less than projected in the November 2018 *Budget and Economic Forecast*. Net receipts for the individual income tax and other taxes were less than forecast, offsetting higher than expected net corporate and sales tax revenues for the quarter.

Net individual income tax receipts during the last two months of 2018 were \$169 million (9.3 percent) less than forecast. Lower than expected gross tax receipts and higher than expected refunds both contributed to the negative income tax variance. (See page 4 for details.)

Estimated tax payments were \$128 million below the forecast. Even though tax payments are not due until January 15, in the past many taxpayers made early payments on or before December 31 so they could deduct them from their federal tax returns for the tax year that just ended. Therefore, combining estimated tax receipts for December and January has generally provided a more accurate picture of fourth quarter payments than December alone. In 2018, the limitation on deductions for state taxes under the federal Tax Cuts and Jobs Act reduced the incentive for taxpayers to make sure they had fully paid their state income tax liability before the end of the year. At the time of the November 2018 *Budget and Economic Forecast*, we assumed that some taxpayers—for example, taxpayers who didn’t adjust their long-standing habit of accelerating payments and those who can deduct

state taxes paid on investment income when calculating their federal Net Investment Income Tax—would still accelerate their 2018 Minnesota tax payments. We now know that fewer taxpayers accelerated payments than we had assumed, consistent with lower December payments. The combined December and January payments will indicate whether this is the complete explanation, or if fourth quarter payments were lower than we estimated.

Individual income tax refunds for November and December were \$42 million higher than forecast. About \$19 million of this variance was due to larger than expected refunds paid to fiduciaries, which are estates and trusts subject to the income tax.

Net sales tax receipts were \$34 million (3.6 percent) more than forecast. Higher than expected gross receipts and lower than expected refunds both contributed to the positive variance.

Net corporate tax receipts were \$50 million (20.0 percent) above the forecast. Corporate tax receipts that were above the forecast more than offset higher than expected refunds.

Other revenues were \$16 million (2.0 percent) less than projected. Among other revenues, the estate tax showed the largest positive variance, \$19 million above the forecast, and the largest negative variance was in cigarette and tobacco taxes (\$17 million).

## Summary of Revenues: November-December 2018

(\$ in millions)	November 2018			
	Forecast	Actual	\$ Difference	% Difference
Individual Income Tax	\$1,810	\$1,641	\$(169)	(9.3)%
General Sales Tax	937	970	34	3.6
Corporate Franchise Tax	248	298	50	20.0
Other Revenues	830	814	(16)	(2.0)
<b>Total Revenues<sup>1</sup></b>	<b>\$3,825</b>	<b>\$3,723</b>	<b>\$(102)</b>	<b>(2.7)%</b>

1. Totals may not add due to rounding.

## U.S. Economic Outlook Weakens

The outlook for U.S. economic growth as measured by real GDP has weakened since Minnesota's *Budget and Economic Forecast* was prepared in November 2018. The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 3.4 percent during the third quarter of 2018, slowing from 4.2 percent growth in the second quarter, and bringing estimated annual 2018 growth to 2.9 percent. IHS Markit (IHS), Minnesota's macroeconomic consultant, now expects a decrease in economic growth from 2.9 percent in 2018 to 2.5 percent in 2019. This occurs as the contributions to growth from federal fiscal stimulus declines, monetary policy becomes more restrictive, tariffs dampen business investment, global growth weakens, and a strong U.S. dollar relative to our trading partners' currencies pulls down net exports. After mid-2020, a demographically driven decline in the labor force participation rate is expected to further reduce growth. The downshift continues, with annual real GDP growth expected to decelerate from 2.5 percent annually in 2019 to 2.0 percent in 2020 and 1.5 percent in both 2021 and 2022.

Compared to their November outlook, IHS has marked down annual growth 0.1 to 0.2 percentage point in each year from 2019-2022. These revisions are primarily the result of a drop in equity values in December, which reduces household wealth and, thus, consumer spending. Because IHS believes that the drop in stock prices was partly due to investors' concerns about rhetoric from the White House, rather than economic fundamentals, they expect valuations to recover over the next couple of years.

The January IHS outlook was completed before the partial U.S. government shutdown went into effect, and therefore does not include the impacts of the shutdown. IHS expects that a shutdown that extends beyond the first week of January will have a modest drag on GDP.

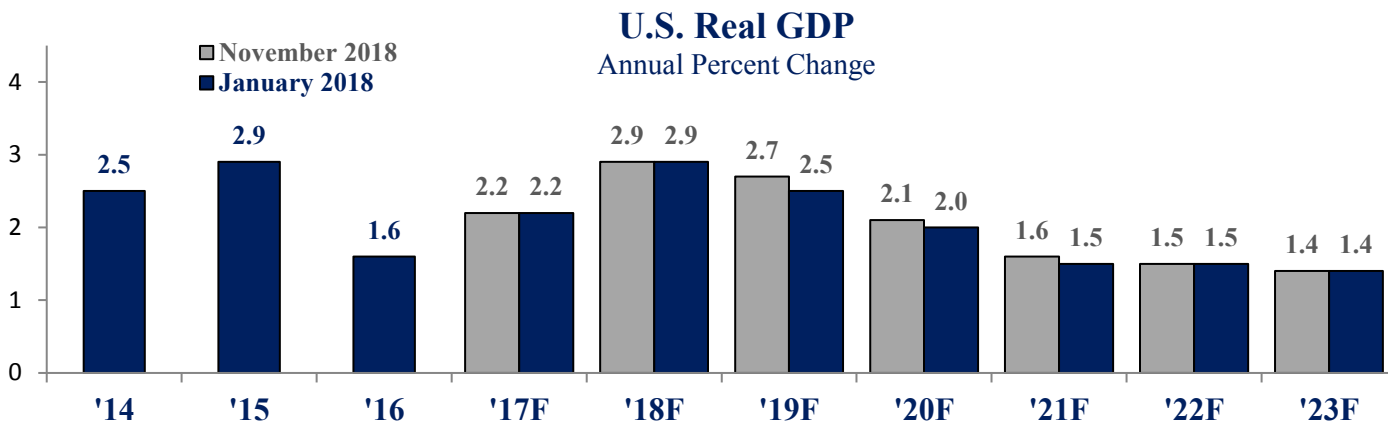
The IHS January baseline forecast for 2019 is slightly below the Blue Chip Consensus, the median of 50 business and academic forecasts, which expects 2.6 percent growth in 2019. The Blue Chip Consensus calls for 1.9 percent growth in 2019, below the IHS' 2.0 percent forecast for that year.

The Bureau of Labor Statistics (BLS) reports that in December the seasonally adjusted U.S. unemployment rate crept up to 3.9 percent, 0.3 percentage points lower than a year earlier, but 0.2 percentage points higher than in November and the highest since July, 2018. The slight uptick in the unemployment rate reflects new workers being drawn back into the labor force. The labor force participation rate was up to 63.1 percent in December, compared to 62.7 percent one year ago. The BLS also reported that U.S. employers added 312,000 jobs in December, well ahead of year-end expectations.

As expected, following its December meeting the Federal Open Market Committee (FOMC) raised the federal funds rate target range by 25 basis points to 2.25-2.50 percent. This was the fourth increase of 2018, and is consistent with a tightening labor market. IHS' January outlook changed their assumption from three 25-basis-point increases in 2019 to two, in May and October, and further from two increases in 2020 to one increase in June, 2020. The rate is expected to reach a long-term equilibrium level of 3.25 in 2021, lowered from previous peak rate of 3.43.

Since November, IHS has not changed the probabilities assigned to the baseline and alternative scenarios. They assign a probability of 60 percent to the January baseline outlook. They assign a 25 percent probability to a more pessimistic scenario, in which a broad-based loss of confidence and risk aversion trigger a three-quarter

recession in 2020. In IHS's more optimistic scenario, faster productivity growth boost incomes and, consequently, consumer spending and housing starts, raising real GDP growth 0.6 points ahead of the baseline in 2019. 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)

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(\$ in thousands)

	Fiscal Year to Date 2019			November-December 2018		
	FORECAST REVENUES <sup>1</sup>	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
<b>Individual Income Tax</b>						
Withholding	4,519,558	4,528,747	9,188	1,597,219	1,606,407	9,188
Declarations	750,200	621,745	(128,455)	236,599	108,144	(128,455)
Miscellaneous	320,668	312,613	(8,054)	67,192	59,138	(8,054)
Gross	5,590,427	5,463,105	(127,321)	1,901,010	1,773,688	(127,321)
Refund	159,747	201,544	41,797	90,962	132,760	41,797
Net	5,430,680	5,261,561	(169,119)	1,810,047	1,640,929	(169,119)
<b>Corporate Franchise Tax</b>						
Declarations	679,563	758,253	78,690	224,508	303,198	78,690
Miscellaneous	146,745	122,248	(24,498)	68,328	43,831	(24,498)
Gross	826,309	880,501	54,192	292,836	347,029	54,192
Refund	65,144	69,649	4,505	44,496	49,001	4,505
Net	761,165	810,852	49,687	248,340	298,027	49,687
<b>General Sales and Use Tax</b>						
Gross	2,807,753	2,820,996	13,242	995,840	1,009,082	13,242
Mpls. sales tax transferred to MSFA	1,171	1,165	(7)	364	357	(7)
Sales Tax Gross	2,808,885	2,822,160	13,276	996,164	1,009,440	13,276
Refunds (including Indian refunds)	88,455	68,204	(20,251)	59,361	39,110	(20,251)
Net	2,720,430	2,753,957	33,527	936,803	970,330	33,527
<b>Other Revenues:</b>						
Net Estate	108,637	127,898	19,261	19,887	39,149	19,261
Net Liquor/Wine/Beer	40,614	40,303	(311)	15,587	15,276	(311)
Net Cigarette/Tobacco	275,389	258,820	(16,569)	114,810	98,241	(16,569)
Deed and Mortgage	114,394	116,907	2,513	41,258	43,771	2,513
Net Insurance Premiums Taxes	189,328	179,649	(9,678)	93,785	84,106	(9,678)
Net Lawful Gambling	31,676	35,529	3,854	10,148	14,002	3,854
Health Care Surcharge	95,435	0,143	(5,292)	50,526	45,234	(5,292)
Other Taxes	2,238	2,252	14	-	14	14
Statewide Property Tax	365,987	364,752	(1,235)	195,022	193,787	(1,235)
DHSSOS Collections	37,910	40,121	2,211	10,947	13,157	2,211
Investment Income	29,239	35,229	5,990	7,646	13,636	5,990
Tobacco Settlement	150,604	150,713	109	150,504	150,613	109
Dept. Earnings & MSOP Recov.	101,229	86,523	(14,706)	46,836	32,130	(14,706)
Fines and Surcharges	23,461	29,983	6,522	5,795	12,317	6,522
Lottery Revenues	21,070	26,754	5,684	8,404	14,088	5,684
Revenues yet to be allocated	(0)	(402)	(402)	5,866	5,464	(402)
Residual Revenues	132,407	118,265	(14,143)	54,014	39,871	(14,143)
Other Subtotal	1,719,616	1,703,439	(16,178)	831,035	814,857	(16,178)
Other Refunds	2,051	2,153	102	1,084	1,186	102
Other Net	1,717,565	1,701,285	(16,280)	829,951	813,671	(16,280)
<b>Total Gross</b>	10,945,237	10,869,206	(76,031)	4,021,045	3,945,014	(76,031)
<b>Total Refunds</b>	315,397	341,550	26,153	195,903	222,057	26,153
<b>Total Net</b>	10,629,840	10,527,655	(102,184)	3,825,141	3,722,957	(102,184)

1. November 2018 Budget & Economic Forecast.