

Revenue and Economic Update

October 10, 2019

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State Revenues Above February Forecast

Minnesota’s net general fund receipts totaled \$5.147 billion during the months of July through September 2019, or \$217 million (4.4 percent) more than projected in the February 2019 *Budget and Economic Forecast* adjusted for legislative changes. Net individual income and sales tax receipts were above the forecast for the quarter, while net corporate tax and other revenues were less than expected.

Net individual income tax receipts were \$245 million (9.2 percent) more than forecast for the first three months of FY 2020. Higher than expected gross receipts and lower than expected refunds contributed to the positive variance. (See page 4 for details.) Payments associated with tax year 2019—income tax withholding and estimated payments—were about \$212 million above the forecast. The positive variance is largely due to timing of income tax payments and refunds across the months of FY 2020, and not to greater than expected economic activity. We now believe that we allocated too little of our FY 2020 estimated tax forecast to July-November 2019 (generating positive variances) and too much to December. We will adjust the allocation with the November 2019 *Budget and Economic Forecast*. We also believe that the withholding variance is primarily due to timing of tax receipts, rather than to higher than expected tax liability, and will result in larger refunds in the first half of CY 2020.

Income tax refunds for the quarter, which are largely associated with tax year 2018 filings, were \$13 million lower than forecast. Miscellaneous payments, also largely associated with 2018 returns, were \$20 million above the forecast. We will know final tax year 2018 income tax liability after all 2018 returns—including returns due October 15 from taxpayers requesting an extension—have been filed and processed. In early November we will estimate 2018 income tax liability based on returns processed to date.

Net corporate tax receipts were \$47 million (9.5 percent) below the forecast. This was due to both lower than expected corporate tax payments and refunds that were above the forecast.

Net sales tax receipts were \$28 million (2.2 percent) above the forecast. Higher than expected gross tax payments and sales tax refunds that were below the forecast contributed to the positive variance.

Other net revenues were \$10 million below the forecast due to lower than expected gross payments.

Summary of Revenues: July-September 2019

(\$ in millions)	February 2019			
	Forecast ¹	Actual	\$ Difference	% Difference
Individual Income Tax	\$2,672	\$2,917	\$245	9.2%
General Sales Tax	1,290	1,318	28	2.2
Corporate Franchise Tax	492	445	(47)	(9.5)
Other Revenues	477	467	(10)	(2.1)
Total Revenues²	\$4,930	\$5,147	\$217	4.4%

1. Adjusted for legislative changes.

2. Totals may not add due to rounding.

Fiscal Year 2019 Revenues Above the Forecast

Net general fund revenues for the fiscal year that ended June 30, 2019, are now \$722 million (3.2 percent) more than forecast in February, \$85 million more than the \$636 million variance we originally reported in the July 2019 *Revenue and Economic Update*. Sales tax and other revenues received between June 30 and the official close were higher than initially estimated. Corporate and sales tax refunds paid out during the period were lower than expected. Together, these factors resulted in the improved revenue position. The next official forecast will be released in early December 2019.

U.S. Outlook Weakens in Near-Term, Improves beyond 2020

The outlook for U.S. real GDP growth in 2019 has slightly weakened since Minnesota's *Budget and Economic Forecast* was prepared in February 2019, but expectations for growth beyond 2020 have improved. The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 2.0 percent during the second quarter of 2019, down from 3.1 percent in the first quarter. IHS Markit (IHS), Minnesota's macroeconomic consultant, expects GDP to grow 1.6 percent in the third quarter due to a slowdown in personal consumption expenditures. This brings IHS' forecast for 2019 real GDP growth to 2.3 percent, down from 2.4 percent in their February outlook.

IHS expects growth to decelerate from 2.3 percent in 2019 to 2.0 percent in 2020. They now expect 2.0 percent growth to continue through 2021, an improvement from 1.7 percent in their February outlook. The upward revision for 2021 was due to a stronger forecast for consumer spending, which is in turn driven by a higher expected income growth.

Despite the improvement to the 2021 outlook since February, a pattern of deceleration through 2023 remains in the IHS forecast. They expect annual real GDP growth to decline from 2.0 percent in 2021 to 1.7 and 1.4 percent in 2022 and 2023, respectively.

The IHS October baseline forecast for 2019 is consistent with the Blue Chip Consensus, the median of 50 business

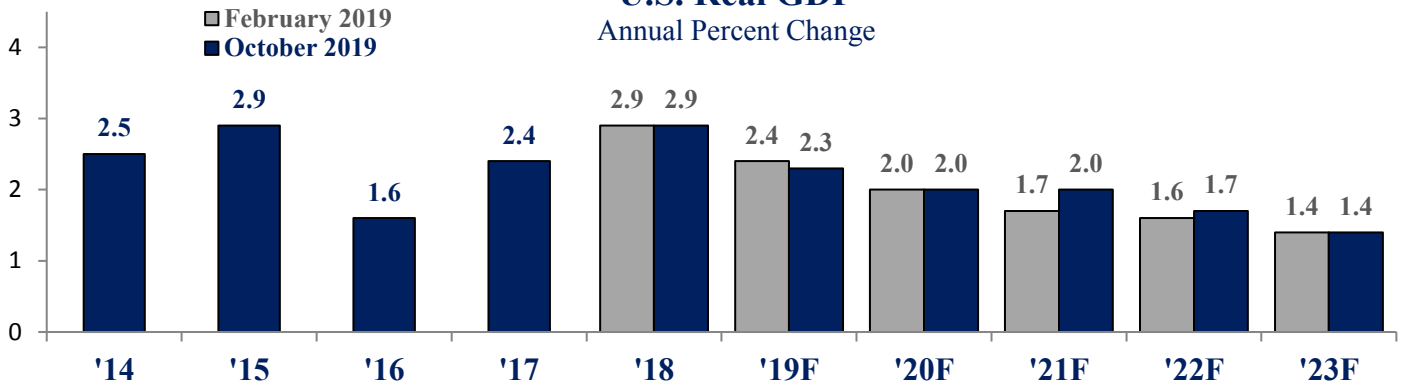
and academic forecasts. Both the Blue Chip Consensus and IHS expect 2019 GDP growth of 2.3 percent. The Blue Chip Consensus calls for 1.7 percent growth in 2020, slightly lower than the 2.0 percent forecast by IHS.

The Bureau of Labor Statistics (BLS) reports that in September the seasonally adjusted U.S. unemployment rate declined 0.2 percentage point to 3.5 percent, the lowest unemployment rate since December 1969, and 0.2 percentage point lower than one year ago. IHS expects the current unemployment rate, 3.5 percent, to be the cyclical low, and forecasts the rate to begin drifting up in late 2021. The labor force participation rate was 63.2 percent in September, 0.5 percentage point higher than one year ago. The BLS also reported that U.S. employers added 136,000 jobs in September. In 2018, payroll gains averaged 225,000 new jobs per month, while the September year-to-date average is 161,000.

At their September meeting, the FOMC lowered interest rates for the second time in 2019, cutting the federal funds rate by 0.25 percentage point, to a range of 1.75 to 2 percent. The decrease follows a 0.25 percentage point cut in July. Despite indications that the base outlook for the economy is solid, as evidenced by strong labor markets and firming inflation, the rate cuts provide additional insurance against downside risks from tariffs and slowing global growth. IHS expects one additional rate cut will occur in December, followed by a reversal in beginning in late 2020 and continuing into 2021 to keep pace with expected rising inflation.

In the October outlook, IHS assigns a probability of 55 percent to their baseline forecast, 35 percent to a more pessimistic scenario, and 10 percent to their optimistic outlook. This is a change from February, when the probabilities were 60, 25, and 15 percent, respectively. In the pessimistic scenario, a broad-based loss of confidence and risk aversion trigger a three-quarter recession starting in the third quarter of 2020. IHS assigns a 10 percent probability to a more optimistic scenario, in which productivity improvements boost incomes and, consequently, consumer spending. This scenario assumes that unemployment can fall to a lower level before it exerts inflationary pressure, keeping consumer price inflation lower than in the baseline.

U.S. Real GDP Annual Percent Change



Source: Bureau of Economic Analysis and IHS Markit.

Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2019			July-September 2019		
	FORECAST REVENUES ¹	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	9,452,300	9,532,417	80,118	2,227,217	2,284,347	57,130
Declarations	2,159,700	2,573,243	413,543	351,753	507,069	155,317
Miscellaneous	1,976,990	1,911,237	(65,753)	144,616	164,584	19,967
Gross	13,588,990	14,016,898	427,908	2,723,586	2,956,000	232,414
Refund	1,623,800	1,611,481	(12,320)	51,904	38,933	(12,970)
Net	11,965,190	12,405,417	440,227	2,671,682	2,917,067	245,385
Corporate Franchise Tax						
Declarations	1,502,540	1,598,437	95,897	456,382	422,707	(33,675)
Miscellaneous	228,285	225,225	(3,060)	65,982	54,939	(11,043)
Gross	1,730,825	1,823,662	92,837	522,363	477,646	(44,718)
Refund	207,202	163,648	(43,555)	30,673	32,823	2,150
Net	1,523,623	1,660,015	136,391	491,690	444,823	(46,867)
General Sales and Use Tax						
Gross	5,937,571	5,962,206	24,636	1,331,064	1,343,342	12,278
Mpls. sales tax transferred to MSFA	2,238	2,238	(0)	614	614	1
Sales Tax Gross	5,939,809	5,964,445	24,636	1,331,677	1,343,956	12,279
Refunds (including Indian refunds)	269,302	202,362	(66,940)	41,846	26,111	(15,735)
Net	5,670,507	5,762,083	91,576	1,289,831	1,317,845	28,014
Other Revenues						
Net Estate	193,700	224,996	31,296	35,676	33,365	(2,311)
Net Liquor/Wine/Beer	92,250	92,843	593	17,522	17,906	384
Net Cigarette/Tobacco	618,150	593,334	(24,816)	94,568	96,181	1,613
Deed and Mortgage	243,914	248,886	4,972	56,829	60,028	3,199
Net Insurance Premiums Taxes	405,784	405,380	(404)	98,790	99,144	354
Net Lawful Gambling	84,200	88,766	4,566	16,926	18,616	1,690
Health Care Surcharge	290,655	292,014	1,359	36,530	19,560	(16,970)
Other Taxes	19,955	21,390	1,435	-	0	0
Statewide Property Tax	809,108	810,627	1,519	16,497	14,377	(2,120)
DHS SOS Collections	72,250	81,659	9,409	19,307	21,171	1,864
Investment Income	75,000	89,731	14,731	18,750	21,105	2,355
Tobacco Settlement	160,161	162,765	2,604	100	100	-
Dept. Earnings & MSOP Recov.	208,217	217,874	9,657	35,924	39,463	3,539
Fines and Surcharges	72,058	73,316	1,258	13,685	12,604	(1,081)
Lottery Revenues	64,055	70,203	6,148	8,408	7,910	(498)
Revenues yet to be allocated	-	-	-	-	5,381	5,381
Residual Revenues	194,069	183,217	(10,852)	8,900	1,008	(7,892)
Other Subtotal	3,603,527	3,657,002	53,475	478,411	467,919	(10,491)
Other Refunds	6,103	6,116	13	1,351	676	(675)
Other Net	3,597,424	3,650,886	53,462	477,060	467,243	(9,816)
Total Gross	24,863,152	25,462,007	598,855	5,056,037	5,245,521	198,849
Total Refunds	2,106,408	1,983,606	(122,802)	125,775	98,543	(27,232)
Total Net	22,756,744	23,478,400	721,656	4,930,262	5,146,978	216,716

1. February 2019 Budget & Economic Forecast adjusted for legislative changes.