

Revenue and Economic Update

October 12, 2020

mn.gov/mmb

Revenues Above May 2020 Projection

Minnesota’s net general fund receipts for the first quarter of FY 2021 are now estimated to total \$5.270 billion, \$593 million (12.7 percent) more than projected in the May 2020 *Interim Budget Projection*. Net receipts exceeded the projection for all major tax types.

Net individual income tax receipts were \$165 million (6.0 percent) more than projected for the first three months of FY 2021. Higher than expected gross receipts more than offset refunds that were higher than projected. (See page 4 for details.)

Income tax withholding receipts were \$28 million lower than projected, however, this is the result of timing of receipts and not lower than expected economic activity. We believe this negative variance partly offsets higher than projected withholding receipts in June.

Estimated income tax payments (labeled declarations on page 4) were \$161 million higher than projected. We believe that roughly \$100 million of this variance is due to payments that were shifted from FY 2020 into FY 2021, because taxpayers may have believed the due date for Minnesota estimated payments was the same as the due date for federal estimated payments, which had been delayed to July 15.

So far in tax year 2020, estimated income tax payments are about two percent lower than the same period one year ago. This is a smaller decline that we projected in May and may be due to taxpayers following a safe harbor rule that allows them to avoid penalties by making withholding plus estimated payments equivalent to last year’s liability. If at the end of this year they estimate their tax year 2020 liability to be lower than last year, we may see a decline in 4th quarter estimated payments in January 2021.

Net sales tax receipts were \$271 million (26.0 percent) above the projection. Higher than expected gross tax payments and sales tax refunds that were below the forecast both contributed to the positive variance. For the period of March through September, adjusted for law changes, sales tax receipts are about 3.8 percent lower than during the same period one year ago. This is a smaller decline that we projected in May, suggesting that taxable sales have been higher than we expected.

Net corporate tax receipts were \$126 million (31.9 percent) above the projection and 16.8 percent higher than the same period one year ago. This was due to both higher than expected corporate tax payments and lower than expected refunds.

Summary of Revenues: July-September 2020

(\$ in millions)	May 2020			
	Projection	Actual	\$ Difference	% Difference
Individual Income Tax	\$2,741	\$2,906	\$165	6.0%
General Sales Tax	1,043	1,314	271	26.0
Corporate Franchise Tax	394	520	126	31.9
Other Revenues	500	531	31	6.2
Total Revenues¹	\$4,677	\$5,270	\$593	12.7%

1. Totals may not add due to rounding.

Fiscal Year 2020 Revenues Above the Forecast

Net general fund revenues for the fiscal year that ended June 30, 2020, are now \$53 million (0.2 percent) less than projected in May. In the July 31 revenue update memo, we estimated that revenues would be \$58 million less than projected. The negative variance is now \$5 million smaller, because net revenues attributable to fiscal year 2020 that were received between the end of July and the official close exceeded our initial estimate. The next official forecast will be released in early December 2020.

U.S. Economic Outlook Improves

The outlook for U.S. real GDP growth in 2020 has improved since MMB's *Interim Budget Projection* was released in May, while the ongoing COVID-19 pandemic continues to challenge the U.S. economy. The Bureau of Economic Analysis (BEA) estimates that real GDP decreased at an annual rate of 31.4 percent during the second quarter of 2020, the steepest quarterly decline on record. IHS Markit (IHS), Minnesota's macroeconomic consultant, is now forecasting a 3.5 percent decline in real GDP in 2020, up from a 5.4 percent decline in the April forecast, which informed our *Interim Budget Projection*. The change between April and October is driven by upward revisions to consumption and investment, which were partly offset by lower net exports.

IHS anticipates strong GDP growth of 32.7 percent in the third quarter of this year, followed by a deceleration to 3.7 percent in the fourth quarter heading into 2021. The deceleration is primarily attributed to the rate of COVID-

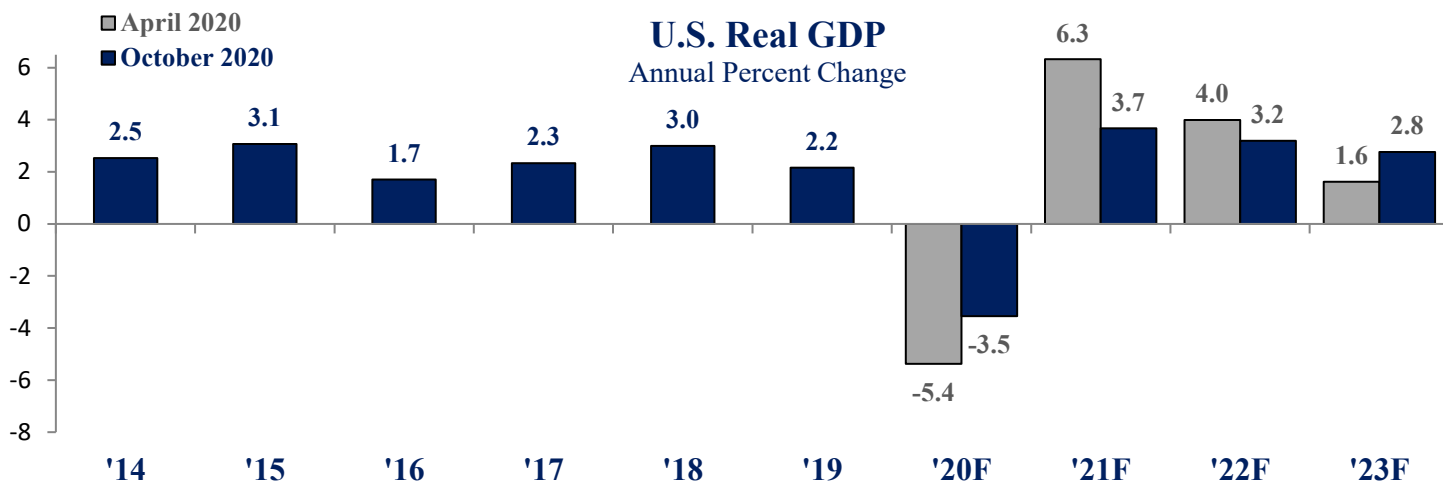
19 cases remaining elevated this fall as cooling temperatures move activities indoors and in-person classes resume. IHS expects as COVID cases remain elevated that consumers will be reluctant to return to pre-pandemic behaviors, and states will remain cautious about reopening. Additionally, the impact of stimulus measures already enacted is expected to fade in early 2021.

IHS assumes a vaccine will be available in mid-2021, with a significant percentage of the population vaccinated by mid-2022. This will allow the economy to transition from recovery to expansion, particularly in sectors hardest hit by social distancing and virus concerns, such as consumer spending on healthcare, entertainment, and travel. IHS forecasts real GDP to grow 3.7 percent in 2021 and 3.2 percent in 2022. They expect GDP to surpass the pre-pandemic peak in late 2021 and the economy to regain full employment in mid-2023.

The October outlook assumes Congress will fund emergency unemployment benefits of an additional \$300 per month for October through December, as well as a second round of stimulus checks disbursed in the fourth quarter.

Oil prices remain below early-2020 levels and continue to dampen U.S. real GDP growth through reduced production and diminished investment in equipment and structures in the U.S. energy sector. IHS expects oil prices to gradually rise, reaching the level at which U.S. drilling and production can stabilize in late 2021.

The IHS October baseline forecast is above the Blue Chip Consensus, the median of 50 business and academic forecasts. IHS expects real GDP to decline 3.5 percent in



Source: Bureau of Economic Analysis and IHS Markit.

2020, a smaller contraction than the Blue Chip Consensus of a 4.0 percent decline this year. The Blue Chip Consensus calls for 3.9 percent growth in 2021, above IHS' 3.7 percent forecast for next year.

The Bureau of Labor Statistics (BLS) reports that in September the seasonally adjusted U.S. unemployment rate was 7.9 percent, down from 14.7 percent at the peak of unemployment reported in April, when most of the country was under stay at home orders. The number of unemployed persons also fell by 1.0 million to 12.6 million. IHS expects that unemployment will remain above 8 percent until late this year and then gradually drift down, reaching pre-COVID levels in 2024. The unemployment rate does not capture those who have exited the labor force during the pandemic. The U.S. labor force participation rate was 61.4 percent in September, up from 60.8 in May, but still much lower than 63.2 percent one year ago. The BLS reported that U.S. employers added 661,000 jobs in September. The economy has 10.7 million fewer jobs than before the pandemic, with roughly half the jobs recovered from the peak of unemployment in April.

In an attempt to keep financial markets stable, the FOMC cut rates by 50 basis points on March 3 and further by 100 basis points on March 16, bringing the effective target federal funds rate to zero. IHS expects the federal funds rate to remain near zero until late 2026, when the economy is beyond full employment and inflation is above the Fed's target of two percent.

IHS assigns a 50 percent probability to the October baseline outlook. Their alternative scenarios depend on different paths for the pandemic. They assign a 30 percent probability to a more pessimistic scenario, characterized by an upturn in COVID-19 cases. This slows the pace of reopening, and the persistent threat hampers consumer spending. In this scenario, the recovery takes longer, with GDP surpassing the previous peak in mid-2022, compared to late 2021 in the baseline. In the more optimistic scenario, IHS assumes the daily number of new COVID-19 cases falls more rapidly than the baseline, and better containment of the disease supports higher levels of economic activity than in the baseline. In this scenario, GDP surpasses the previous peak in mid-2021, six months earlier than in the baseline. The optimistic scenario receives a 20 percent probability.

Comparison of Actual and Projected Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2020			July-September 2020		
	PROJECTED REVENUES ¹	CLOSING REVENUES	VARIANCE ACT-FCST	PROJECTED REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	9,603,939	9,697,024	93,085	2,174,800	2,147,006	(27,794)
Declarations	2,367,300	2,342,899	(24,401)	456,357	617,854	161,496
Miscellaneous	2,158,761	1,952,164	(206,597)	146,434	193,637	47,203
Gross	14,130,000	13,992,086	(137,914)	2,777,591	2,958,497	180,906
Refund	1,852,600	1,897,957	45,357	36,847	52,759	15,912
Net	12,277,400	12,094,129	(183,271)	2,740,744	2,905,738	164,994
Corporate Franchise Tax						
Declarations	1,580,720	1,614,836	34,115	348,523	433,561	85,038
Miscellaneous	207,370	182,597	(24,773)	65,832	97,547	31,715
Gross	1,788,090	1,797,433	9,342	414,354	531,108	116,753
Refund	233,267	217,158	(16,110)	20,483	11,553	(8,931)
Net	1,554,823	1,580,275	25,452	393,871	519,555	125,684
General Sales and Use Tax						
Gross	5,858,497	5,946,441	87,944	1,074,197	1,330,672	256,475
Mpls. sales tax transferred to MSFA	2,120	2,118	(2)	606	-	(606)
Sales Tax Gross	5,860,617	5,948,559	87,942	1,074,802	1,330,672	255,869
Refunds (including Indian refunds)	186,102	203,055	16,953	31,941	16,439	(15,502)
Net	5,674,515	5,745,504	70,989	1,042,861	1,314,233	271,371
Other Revenues:						
Net Estate	163,900	146,738	(17,161)	40,050	51,889	11,839
Net Liquor/Wine/Beer	95,260	94,239	(1,021)	17,929	20,445	2,516
Net Cigarette/Tobacco	577,270	581,021	3,751	87,564	107,709	20,145
Deed and Mortgage	291,633	304,946	13,313	57,839	72,556	14,717
Net Insurance Premiums Taxes	421,727	416,845	(4,882)	102,219	111,807	9,587
Net Lawful Gambling	79,750	78,599	(1,151)	9,539	21,203	11,664
Health Care Surcharge	303,777	272,737	(31,040)	78,708	20,900	(57,807)
Other Taxes	19,755	15,707	(4,048)	-	1,763	1,763
Statewide Property Tax	726,660	753,318	26,657	13,338	34,040	20,702
DHSSOS Collections	78,650	92,124	13,474	20,288	23,794	3,507
Investment Income	70,000	74,055	4,055	2,500	4,634	2,134
Tobacco Settlement	154,254	152,282	(1,972)	100	-	(100)
Dept. Earnings & MSOP Recov.	220,854	230,268	9,414	37,325	36,085	(1,240)
Fines and Surcharges	74,965	66,379	(8,587)	14,526	2,795	(11,731)
Lottery Revenues	61,500	70,752	9,253	8,782	11,319	2,537
Revenues yet to be allocated	(0)	-	0	-	3,430	3,430
Residual Revenues	106,642	131,246	24,604	10,454	6,600	(3,854)
Other Subtotal	3,446,598	3,481,256	34,659	501,160	530,969	29,808
Other Refunds	6,003	6,843	840	1,338	146	(1,192)
Other Net	3,440,594	3,474,414	33,819	499,822	530,823	31,001
Total Gross	25,225,305	25,219,335	(5,970)	4,767,908	5,351,245	583,337
Total Refunds	2,277,973	2,325,012	47,040	90,610	80,896	(9,714)
Total Net	22,947,332	22,894,322	(53,010)	4,677,298	5,270,348	593,050

1. May 2020 Interim Budget Projection.