

Revenue and Economic Update

October 10, 2022

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Revenues Above February 2022 Forecast

Minnesota’s net general fund receipts for the first quarter of FY 2023 are now estimated to total \$7.024 billion, \$289 million (4.3 percent) more than forecast in the February 2022 *Budget and Economic Forecast*. Net receipts exceeded the projection for all major tax types.

Net individual income tax receipts were \$6 million (0.2 percent) more than forecast for the first three months of FY 2023. Higher than expected gross receipts more than offset higher than expected refunds. (See page 4 for details.)

Income tax withholding receipts were \$86 million lower than forecast, but about \$35 million of that variance is due to our technical over-forecast of withholding in the first quarter of FY 2023, rather than lower than expected economic activity. Estimated income tax payments are \$81 million (20.3 percent) above the forecast.

Large amounts of Pass-Through Entity (PTE) tax payments for TY 2021 were made during FY 2022, contributing to the \$2.9 billion closing variance we are reporting for that fiscal year. Individuals with PTE income are able to claim credits for those payments on their TY 2021 individual income tax returns. We estimate that about \$800 million of PTE payments received in FY 2022 remains to be observed as credits on processed individual income tax returns. As TY 2021 individual extension returns are filed and return

processing continues, the remaining PTE credits will reduce income tax liability for individuals with PTE income. We expect this to result in refunds and transfers to estimated tax in excess of our forecast for the remainder of CY 2022. Higher than forecast refunds will result in a negative income tax variance for October, which we will report on November 10. Larger than forecast transfers to estimated tax will lower our expectations for estimated tax payments in the last two quarters of FY 2023.

Net sales tax receipts were \$146 million (7.6 percent) above the forecast. Higher than expected gross tax payments and sales tax refunds that were below the forecast both contributed to the positive variance.

Net corporate tax receipts were \$110 million (19.3 percent) above the forecast. This was due to both higher than expected corporate tax payments and lower than expected refunds.

Net other revenues were \$27 million (4.9 percent) above the forecast. Higher than expected gross receipts and lower than expected refunds both contributed to the positive variance.

Summary of Revenues: July-September 2022

(\$ in millions)	February	Actual	\$ Difference	% Difference
	Forecast			
Individual Income Tax	\$3,674	\$3,680	\$6	0.2%
General Sales Tax	1,933	2,079	146	7.6
Corporate Franchise Tax	569	679	110	19.3
Other Revenues	559	586	27	4.9
Total Revenues¹	\$6,735	\$7,024	\$289	4.3%

1. Totals may not add due to rounding.

Fiscal Year 2022 Revenues Above the Forecast

Minnesota’s net general fund receipts for FY 2022 are now estimated to total \$30.321 billion, \$2.918 billion (10.6 percent) more than projected in the February 2022 Budget and Economic Forecast. Net receipts from all major taxes exceeded the forecast. In the July 11 *Revenue and Economic Update*, we estimated that revenues would be \$2.927 billion more than forecast. The positive variance is now \$8 million smaller, because net revenues attributable to fiscal year 2022 that were received between the end of July and the official close were lower than our initial estimate. The next official forecast will be released in early December 2022.

Near-Term Recession Added to U.S. Economic Outlook

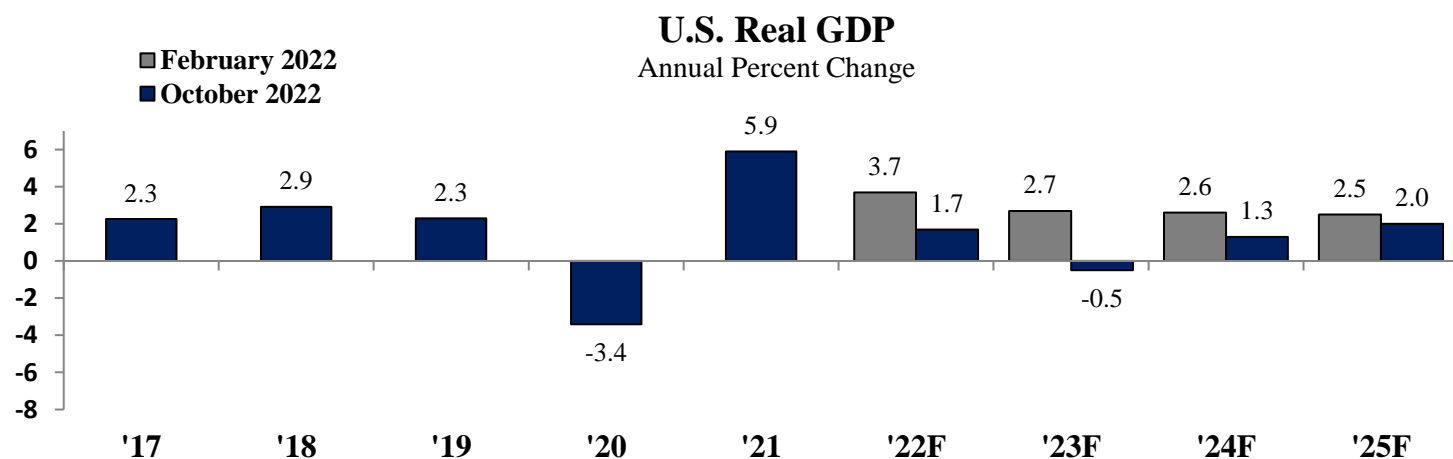
The outlook for U.S. real GDP growth in 2022 has weakened since Minnesota’s *Budget and Economic Forecast* was prepared in February 2022, and now incorporates a three-quarter recession beginning in the fourth quarter of 2022. In their October forecast, IHS Markit (IHS), Minnesota’s macroeconomic consultant, expects annual real GDP to grow 1.7 percent this year and decline 0.5 percent next year, compared to increases of 3.7 percent and 2.7 percent in their February forecast. IHS expects this will be a mild recession by historical standards with a weak recovery beginning in the third quarter of 2023. For years 2023 and 2024, the forecast for real GDP growth is now 1.3 percent in 2024 and 2.0 percent in

2025, compared to 2.6 and 2.5 percent in the February forecast.

The downward revision in the near-term economic outlook is the result of three factors. First, a higher than anticipated acceleration in inflation in August led the Federal Open Market Committee (FOMC) to increase the federal funds rate by 75 basis points at the September meeting. Second, the FOMC signaled a commitment to fighting inflation even at the risk of a recession. Third, in response to these developments, financial market conditions tightened considerably. Stock and bond prices fell, the dollar appreciated, and spreads between Treasuries and private bonds have widened. In response to these financial market changes, IHS has changed their forecast from a growth recession—with GDP growth below potential and upward pressure on the unemployment rate—to a true recession with contracting GDP.

BEA’s third estimate of real GDP in the second quarter of 2022 shows a decline of 0.6 percent (annual rate), following a decline of 1.6 percent in the first quarter. IHS has substantially lowered their forecast for real GDP growth in the third and fourth quarters of 2022 to 2.3 percent in the third quarter followed by a decline of 1.2 percent in the fourth quarter compared to 2.9 and 2.8 percent growth in the February forecast. In this forecast, the fourth quarter of 2022 is the first of three consecutive quarters of real GDP contraction.

The IHS October baseline forecast for 2022 is similar to the October Blue Chip Consensus, the median of 50 business and academic forecasts. The October Blue Chip Consensus calls for 1.6 percent growth in 2022, 0.1 percentage points



Source: Bureau of Economic Analysis and IHS Markit.

lower than IHS' forecast for this year. IHS' forecast for 2023 is lower than the Blue Chip Consensus. IHS expects real GDP to decline 0.5 percent in 2022, 0.7 percentage points slower than the Blue Chip Consensus of 0.2 percent growth next year.

The Bureau of Labor Statistics (BLS) reports that in September the seasonally adjusted U.S. unemployment rate was 3.5 percent, down from 3.7 percent in August and back to the unemployment rate in February 2020. The September data was completed before Hurricane Ian made landfall in Florida. Job growth continues to moderate, with employment rising by 263,000 in September, down from an average of 439,000 in the first eight months of 2022. The number of long-term unemployed (those jobless for 27 weeks or more) is 1.1 million, consistent with the rate in February 2020. With the inclusion of a recession in their forecast, IHS now expects the U.S. unemployment rate to increase in the fourth quarter of 2022 and reach a peak of 6.0 percent in late 2023 before beginning a gradual decline to 4.3 percent in 2029.,

The unemployment rate does not capture the fact that 106,000 fewer Americans are in the labor force now than in February 2020. The U.S. labor force participation rate was 62.3 percent in September, 1.1 percentage points lower than in February 2020. Although the payrolls numbers remain strong through September, the Job Opening and Labor Turnover Survey (JOLTS) shows signs of a weakening job market. The number of job openings dropped by 1.1 million in August, the steepest one-month decline since 2020 during the depth of the pandemic recession.

IHS expects the price of Brent crude oil to average \$97 per barrel in the fourth quarter this year and hover around \$90 per barrel in 2024.

IHS expects that the Federal Reserve will act aggressively to combat recent and expected inflationary pressures. In their October forecast, IHS expects that the FOMC will raise the federal funds rate to 3.5 percent in the fourth quarter this year, and that the rate will approach 5.0 percent from mid-2023 through mid-2024. The federal funds rate was 0.1 percent in the first quarter of 2022.

IHS raised their forecast for headline CPI inflation to 8.1 percent in 2022 and 4.2 percent in 2023, compared to 4.5 and 1.9 percent in 2022 and 2023 in their February forecast.

The alternative scenarios for the IHS October forecast are not yet available. The following alternatives are based on the September forecast. IHS assigns a 50 percent probability to the September baseline outlook. IHS assigned a 35 percent probability to a more pessimistic scenario, characterized by (1) an intensification of the Russia-Ukraine conflict that generates persistently higher energy and commodity prices, wider risk spreads, and slower global growth, and (2) a slower resolution of existing supply-chain issues. Growth in consumer spending and business fixed investment is diminished in 2022 and 2023, and the price of Brent crude oil remains substantially higher through 2025. As a result, GDP grows 1.3 percent in 2022 and -0.3 percent in 2023, compared to 1.7 percent and 0.9 percent in the baseline scenario. In the more optimistic scenario, IHS assumed (1) a stronger consumer and business response to the Infrastructure Investment and Jobs act (IIJA) and (2) a quicker resolution to the Russia-Ukraine conflict. Consumer spending and business fixed investment exhibit stronger growth in 2022 than in the baseline. In this scenario, GDP grows 1.8 percent in 2022 and 1.6 percent in 2023. The optimistic scenario received a 15 percent probability.

Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2022			July-September 2022		
	FORECAST REVENUES ¹	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES ¹	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	10,845,420	10,893,482	48,062	2,734,600	2,648,123	(86,477)
Declarations	2,128,805	3,199,329	1,070,524	398,051	478,668	80,617
Miscellaneous	2,047,413	2,304,781	257,367	138,784	170,939	32,156
Partnership & S Corporation Gross	<u>2,431,730</u>	<u>2,875,118</u>	<u>443,389</u>	<u>470,317</u>	<u>471,043</u>	<u>726</u>
Gross	17,453,368	19,272,711	1,819,343	3,741,751	3,768,773	27,021
Partnership & S Corporation Refunds	29,100	73,809	44,709	6,984	28,151	21,167
Individual, Fiduciary, & Withholding Ref.	<u>2,947,095</u>	<u>2,326,193</u>	<u>(620,901)</u>	<u>60,828</u>	<u>60,883</u>	<u>54</u>
Total Refunds	2,976,195	2,400,002	(576,193)	67,812	89,034	21,222
Net Income Tax	14,477,173	16,872,709	2,395,536	3,673,939	3,679,739	5,800
Corporate Franchise Tax						
Declarations	2,316,479	2,747,754	431,275	552,343	668,367	116,023
Miscellaneous	203,140	201,068	(2,072)	35,668	27,653	(8,015)
Gross	2,519,619	2,948,822	429,203	588,011	696,020	108,009
Refund	143,787	125,947	(17,840)	18,795	16,774	(2,021)
Net	2,375,832	2,822,875	447,043	569,216	679,246	110,030
General Sales and Use Tax						
Gross	6,799,130	6,802,810	3,680	1,964,253	2,095,502	131,250
MPLS Sales Tax Transferred to MSFA	-	-	-	-	-	-
MPLS Sales Tax w/Holding for NFL Stadium	21,215	23,018	1,803	5,426	5,427	1
Sales Tax Gross	6,820,345	6,825,828	5,483	1,969,679	2,100,929	131,250
Refunds (including Indian refunds)	217,547	176,394	(41,153)	36,482	21,733	(14,749)
Net	6,602,798	6,649,434	46,636	1,933,197	2,079,196	146,000
Other Revenues						
Net Estate	210,600	215,989	5,389	53,850	57,445	3,595
Net Liquor/Wine/Beer	104,550	104,754	204	21,189	21,441	252
Net Cigarette/Tobacco	598,240	577,870	(20,370)	107,762	90,934	(16,828)
Deed and Mortgage	416,893	403,761	(13,132)	76,386	72,052	(4,335)
Net Insurance Premiums Taxes	449,173	484,257	35,084	117,087	119,004	1,916
Net Lawful Gambling	164,750	179,900	15,150	35,943	37,102	1,159
Health Care Surcharge	330,772	257,836	(72,936)	40,383	8,479	(31,904)
Other Taxes	56,955	56,506	(449)	(1)	0	1
Statewide Property Tax	771,915	774,121	2,206	15,639	12,346	(3,293)
DHS SOS Collections	85,950	104,674	18,724	22,463	28,294	5,832
Investment Income	30,000	44,806	14,806	6,923	37,197	30,274
Tobacco Settlement	175,112	192,965	17,853	100	-	(100)
Dept. Earnings & MSOP Recovery	233,082	238,143	5,061	35,619	40,551	4,932
Fines and Surcharges	76,655	78,624	1,969	7,094	10,665	3,571
Lottery Revenues	72,986	78,702	5,716	10,073	14,081	4,008
Revenues yet to be allocated	0	-	(0)	-	20,621	20,621
Residual Revenues	176,696	188,638	11,942	9,360	16,314	6,954
Other Subtotal	3,954,331	3,981,546	27,215	559,871	586,526	26,656
Other Refunds	7,553	5,612	(1,941)	1,301	746	(555)
Other Net	3,946,778	3,975,934	29,156	558,570	585,780	27,210
Total Gross	30,747,663	33,028,907	2,281,244	6,859,312	7,152,248	292,936
Total Refunds	3,345,082	2,707,955	(637,127)	124,390	128,286	3,896
Total Net	27,402,581	30,320,952	2,918,371	6,734,922	7,023,961	289,040

1. February 2022 Budget and Economic Forecast.