

Revenue and Economic Update

January 2022

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Revenues Above November 2021 Forecast

Minnesota’s net general fund receipts for November and December of 2021 are now estimated to total \$4.954 billion, \$833 million (20.2 percent) more than forecast in the November 2021 *Budget and Economic Forecast*. However, a substantial portion of December collections are Pass-Through Entity Tax (PTE) estimated payments that will be credited against business owners’ individual income tax liability for TY 2021, lowering income tax final payments and raising refunds in CY 2022. We estimate that about \$471 million of the \$833 million overall variance arises from this timing shift.

Because forecast receipts are now updated to reflect the November 2021 *Budget and Economic Forecast*, the fiscal year-to-date variance is the same dollar amount as the quarterly variance, \$833 million above the forecast, which is 6.9 percent of fiscal year-to-date forecast revenues.

Net individual income tax receipts were \$242 million (14.9 percent) more than forecast for November and December. Higher than expected gross receipts and refunds that were below the forecast both contributed to the variance. (See page 4 for details.)

Starting in TY 2021, pass-through businesses, typically S-Corporations and partnerships, may choose to pay a state-level PTE tax, which is deductible on their federal returns and credited against Minnesota individual income tax. While there is no net state revenue impact of the PTE, it

can change the timing of receipts. In the November 2021 *Budget and Economic Forecast*, we assumed that some pass-through businesses would start making estimated payments on the PTE as early as December 2021, so the payments could be deducted from their 2021 federal income tax. We now estimate that end-of-year PTE payments by partnerships exceeded our forecast and are responsible for about \$74 million of the \$242 million individual income tax variance for November and December. We expect the credits for these payments to reduce TY 2021 individual income tax liability by the same amount, lowering final payments and raising refunds during CY 2022.

Note that PTE payments are co-mingled in the collections data with minimum fees and payments made by pass-through businesses for their non-resident partners and shareholders. We have inferred the amounts of PTE payments from these collections, but we will not observe the actual amounts until TY 2021 tax returns have been filed and processed.

Income tax withholding receipts were \$56 million (3.0 percent) higher than forecast, and estimated income tax payments (labeled declarations on page 4) were \$14 million (9.1 percent) lower than forecast.

Income tax refunds were \$113 million (24.4 percent) lower than forecast. We believe this is largely due to the timing

Summary of Revenues: November-December 2021

(\$ in millions)	November 2021			
	Forecast	Actual	\$ Difference	% Difference
Individual Income Tax ¹	\$1,626	\$1,869	\$242	14.9%
General Sales Tax	1,114	1,183	69	6.2
Corporate Franchise Tax ¹	481	991	510	106.0
Other Revenues	899	911	12	1.3
Total Revenues²	\$4,121	\$4,954	\$833	20.2%

1. Includes Pass-through Entity Tax payments that will be credited against TY 2021 Individual Income Tax
 2. Totals may not add due to rounding.

of tax return processing, rather than higher than expected TY 2020 liability.

Net sales tax receipts were \$69 million (6.2 percent) higher than forecast. Higher than expected gross tax payments and sales tax refunds that were below the forecast both contributed to the positive variance.

Net corporate receipts were \$510 million (106.0 percent) more than forecast. Higher than expected gross tax payments and lower than expected refunds both contributed to the positive variance. We estimate that end-of-year PTE payments by S-corporations are responsible for about \$397 million of the \$510 million corporate income tax variance for November and December. We expect the credits for these payments to reduce TY 2021 individual income tax liability by the same amount, lowering individual income tax final payments and raising refunds during CY 2022.

Net receipts from other taxes were \$12 million (1.3 percent) higher than forecast. Higher than expected gross tax payments and lower than expected refunds both contributed to the positive variance.

U.S. Economic Outlook Weakened, Inflation Revised Upward

The outlook for U.S. real GDP growth in years 2022-2025 has weakened since Minnesota’s *Budget and Economic Forecast* was prepared in November 2021. In their January forecast, IHS Markit (IHS), Minnesota’s macroeconomic

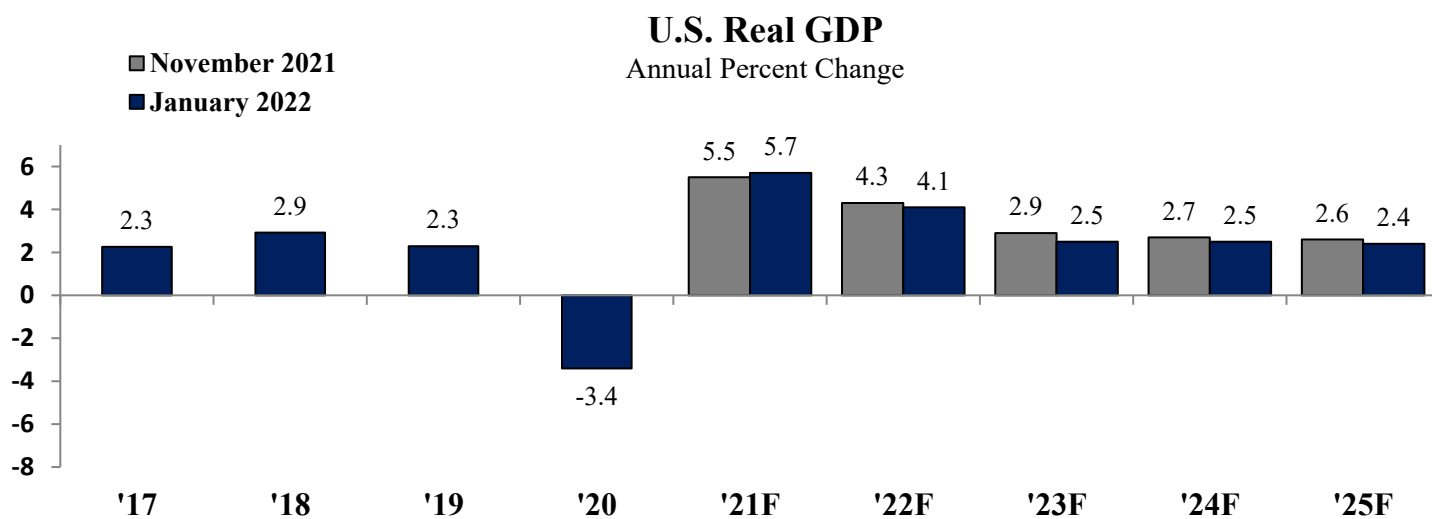
consultant, expects annual real GDP to have grown 5.7 percent in 2021, a slight improvement from 5.5 percent in the November forecast. For years 2022-2025, the forecast for real GDP growth has been revised down to 4.1 percent in 2022, 2.5 in 2023, 2.5 in 2024, and 2.4 in 2025.

The downward revision in the economic outlook for 2022 is mainly due to a pull-forward of inventory investment from 2022 into late 2021. IHS also expects the rapid spread of the Omicron strain of the coronavirus to temporarily depress consumer spending on services early in 2022. However, IHS expects that a transition from COVID-19 pandemic to endemic will continue, as more of the population is vaccinated or naturally immunized, and behavior adjusts to living with the risks associated with the virus.

The downward revision in real GDP growth for years 2023-2025 is driven by capacity constraints, including lower forecasts for labor force participation, that cause real GDP to approach trend growth instead of above-trend growth, as was assumed in IHS's November forecast.

Since September 2021, IHS’ forecasts have reflected the impact of the Infrastructure Investment and Jobs Act (IIJA). IHS has not included any impacts from the Build Back Better (BBB) reconciliation bill, which has yet to pass Congress.

IHS now expects the federal funds rate to remain near zero until May 2022, when they expect the Federal Reserve to begin raising that policy rate. IHS forecasts three total rate increases in 2022. Their expected “lift-off”



Source: Bureau of Economic Analysis and IHS Markit.

occurs 11 months earlier than IHS expected in November and is driven both by recent observed inflation that was higher than expected and by upward revisions in near-term forecasted inflation. IHS has raised their forecast for headline CPI inflation to 4.7 percent in 2021 and 4.2 percent in 2022, compared to 4.5 percent in 2021 and 3.3 percent in 2022 in their November forecast. IHS expects inflation to subside later this year and into 2023 as supply-chain issues are resolved and workers re-enter the labor force. IHS expects the Federal Reserve to tolerate inflation slightly above 2 percent beyond 2023.

BEA's third estimate of real GDP in the third quarter of 2021 shows growth of 2.3 percent (annual rate), 0.3 percentage points higher than IHS' November forecast. IHS has substantially increased their forecast for real GDP growth in the fourth quarter to a 6.8 percent annual rate, up from 4.4 percent in their November outlook, primarily due an unexpected surge in exports and inventories in October and an increase in inventory investment.

IHS expects the price of Brent crude oil to peak at \$79 per barrel in late 2021, followed by a deceleration to below \$70 per barrel by late 2023.

The IHS January baseline forecast for 2022 is slightly higher than the January Blue Chip Consensus, the median of 50 business and academic forecasts. The Blue Chip Consensus calls for 3.9 percent growth in 2022, 0.2 percentage points lower than the IHS forecast of 4.1 percent growth this year. IHS expects real GDP to grow 2.5 percent in 2023, 0.1 percentage points lower than the Blue Chip Consensus of 2.6 percent growth next year.

The Bureau of Labor Statistics (BLS) reports that in December the seasonally adjusted U.S. unemployment rate was 3.9 percent, down from 14.8 percent at the peak of unemployment reported in April 2020, but still 0.4 percentage points higher than the pre-pandemic level in February 2020. The BLS reports that roughly 6.3 million people remain unemployed, 0.6 million more than in

February 2020 but 4.5 million less than a year ago. Non-farm payroll employment rose by 199,000 in December. The number of long-term unemployed (those jobless for 27 weeks or more) is 2.0 million, 0.9 million more than in February 2020 but 2.0 million less than a year ago. IHS expects that the U.S. unemployment rate will decline through mid-2022, reaching an average of 3.5 percent in the third quarter of 2022.

The unemployment rate does not capture the net loss of 2.3 million Americans from the labor force since February 2020. The U.S. labor force participation rate was 61.9 percent in December, 1.5 percentage points lower than in February 2020. The labor force participation rate has hovered within a range of 61.4 to 61.9 percent since June 2020.

IHS assigns a 50 percent probability to the January baseline outlook. They assign a 30 percent probability to a more pessimistic scenario, characterized by (1) weaker consumer spending as consumers turn more cautious in the face of an alarming rise in COVID-19 cases and hospitalizations, and (2) an intensifying of existing supply-chain issues that continue to restrict production and consumption of durable goods. Businesses scale back their investment plans in response to both factors. As a result, real GDP grows 5.6 percent in 2021 and 2.7 percent in 2022, compared to 5.7 and 4.1 in the baseline outlook. In their more optimistic scenario, IHS assumes that consumer spending, productivity growth, and business investment are stronger relative to the baseline. This scenario assumes that the IJJA has a greater economic impact than in the baseline, and consumers spend down more of the excess savings accumulated over 2020 and 2021. Additionally, this scenario assumes the current wave of COVID cases peaks quickly and dissipates, allowing consumer spending to resume more quickly than the baseline. In this scenario, GDP increases 5.7 percent in 2021 and 5.8 percent in 2022. This optimistic scenario receives a 20 percent probability.

Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2022			November-December 2021		
	FORECAST REVENUES ¹	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES ¹	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	5,166,341	5,222,521	56,180	1,844,100	1,900,280	56,180
Declarations	759,712	746,105	(13,607)	148,884	135,277	(13,607)
Miscellaneous ²	421,796	508,333	86,537	97,031	183,568	86,537
Gross	6,347,849	6,476,959	129,110	2,090,015	2,219,125	129,110
Refund	604,688	491,377	(113,311)	463,583	350,272	(113,311)
Net	5,743,161	5,985,582	242,421	1,626,432	1,868,853	242,421
Corporate Franchise Tax						
Declarations	1,147,203	1,217,029	69,826	423,757	493,583	69,826
Miscellaneous ²	253,629	661,926	408,297	100,848	509,145	408,297
Gross	1,400,832	1,878,955	478,123	524,605	1,002,728	478,123
Refund	82,982	51,022	(31,960)	43,417	11,457	(31,960)
Net	1,317,850	1,827,933	510,083	481,188	991,271	510,083
General Sales and Use Tax						
Gross	3,300,151	3,344,079	43,929	1,156,413	1,200,342	43,929
Mpls. sales tax transferred to MSFA	-	-	-	-	-	-
MPLS Sales Tax w/Holding for NFL Stadium	11,467	10,608	(859)	3,594	2,735	(859)
Sales Tax Gross	3,311,618	3,354,687	43,070	1,160,007	1,203,076	43,070
Refunds (including Indian refunds)	85,580	59,616	(25,964)	45,627	19,663	(25,964)
Net	3,226,037	3,295,071	69,033	1,114,380	1,183,413	69,033
Other Revenues:						
Net Estate	103,061	105,346	2,286	33,019	35,305	2,286
Net Liquor/Wine/Beer	45,871	46,161	290	16,090	16,380	290
Net Cigarette/Tobacco	253,414	260,923	7,509	98,777	106,286	7,509
Deed and Mortgage	182,143	195,910	13,768	59,146	72,913	13,768
Net Insurance Premiums Taxes	208,695	213,001	4,306	98,333	102,638	4,306
Net Lawful Gambling	73,040	78,138	5,097	25,398	30,495	5,097
Health Care Surcharge	99,858	78,262	(21,596)	71,869	50,273	(21,596)
Other Taxes	0	3,004	3,004	-	3,004	3,004
Statewide Property Tax	355,932	349,405	(6,526)	179,827	173,301	(6,526)
DHSSOS Collections	41,193	46,339	5,145	14,252	19,398	5,145
Investment Income	10,518	9,971	(548)	4,595	4,047	(548)
Tobacco Settlement	154,467	161,683	7,216	154,367	161,583	7,216
Dept. Earnings & MSOP Recov.	108,183	94,107	(14,076)	51,156	37,080	(14,076)
Fines and Surcharges	28,267	20,763	(7,503)	12,644	5,141	(7,503)
Lottery Revenues	26,946	29,865	2,919	15,160	18,079	2,919
Revenues yet to be allocated	146	107	(39)	-	(39)	(39)
Residual Revenues	112,489	122,317	9,829	65,855	75,683	9,829
County Nursing Home, Pub Hosp IGT						
Other Subtotal	1,804,222	1,815,303	11,081	900,487	911,568	11,081
Other Refunds	1,849	1,390	(458)	1,218	760	(458)
Other Net	1,802,374	1,813,913	11,539	899,269	910,809	11,539
Total Gross	12,864,520	13,525,904	661,384	4,675,114	5,336,498	661,384
Total Refunds	775,099	603,406	(171,693)	553,845	382,152	(171,693)
Total Net	12,089,422	12,922,498	833,077	4,121,269	4,954,346	833,077

1. November 2021 Budget and Economic Forecast.

2. Includes Pass-Through Entity Tax Payments that will be credited against TY 2021 Individual Income Tax.