

# Revenue and Economic Update

October 10, 2016

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## State Revenues Below February Forecast for First Quarter of Fiscal Year 2017

Minnesota's net general fund receipts totaled \$4.457 billion during the months of July through September 2016, or \$97 million (2.1 percent) less than projected in the February 2016 *Budget and Economic Forecast* adjusted for legislative changes. Receipts from all major tax types were below the forecast for the quarter. In September, total net revenues were \$24 million (1.2 percent) less than forecast, adding to negative variances for the months of July and August.

Net individual income tax receipts were \$29 million (1.1 percent) less than forecast for the first three months of FY 2017. Lower than expected gross tax receipts and larger than forecast refunds generated the negative variance. (See page 4 for details.) Payments associated with calendar year 2016 economic activity—income tax withholding and estimated payments—were about \$16 million below the forecast.

Income tax refunds for the quarter, which are associated with tax year 2015 filings, were \$21 million larger than forecast. That variance, however, may be due to the timing of tax return processing rather than lower tax liability. We will know final tax year 2015 income tax liability after all 2015 tax returns—including returns due October 17 from taxpayers requesting an extension—have been filed and processed. In early November we will estimate

2015 income tax liability based on returns processed to date.

Net sales tax receipts were \$28 million (2.3 percent) below the forecast. Lower than expected gross sales tax payments and larger than forecast refunds generated the negative variance.

Lower than expected gross corporate tax payments brought net corporate tax receipts \$18 million (5.2 percent) below the February forecast.

## Fiscal Year 2016 Revenues \$220 Million above February Forecast

Net general fund revenues for the fiscal year that ended June 30, 2016, are now \$220 million more than forecast in February, producing a variance that is \$10 million less than the \$230 million originally reported in the July 2016 Revenue and Economic Update.

Lower than expected other revenues received between the end of the fiscal year and the official close were partially offset by lower than expected individual income, corporate, and sales tax refunds paid prior to the fiscal year close. A \$1.3 million increase to the forecast for 2015 legislative session law changes reduces the positive variance for departmental earnings and Department of Human Services collections relative to what we reported in July.

## Summary of Revenues: July-September, 2016

| (\$ in millions)                  | February 2016 Forecast | Actual         | \$ Difference | % Difference  |
|-----------------------------------|------------------------|----------------|---------------|---------------|
| Individual Income Tax             | \$2,523                | \$2,494        | \$(29)        | (1.1)%        |
| General Sales Tax                 | 1,237                  | 1,209          | (28)          | (2.3)         |
| Corporate Franchise Tax           | 353                    | 335            | (18)          | (5.2)         |
| Other Revenues                    | 441                    | 419            | (21)          | (4.9)         |
| <b>Total Revenues<sup>1</sup></b> | <b>\$4,554</b>         | <b>\$4,457</b> | <b>\$(97)</b> | <b>(2.1)%</b> |

<sup>1</sup>. Totals may not add due to rounding.

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## Uncertainty in U.S. Economic Outlook

The U.S. economy faces a high degree of uncertainty related to the outcome of the presidential election, the choices of the Federal Reserve, and possible production cuts by OPEC. Nevertheless, IHS—Minnesota’s macroeconomic consulting firm—believes the last three disappointing quarters will be followed by a small pickup in real GDP growth for the remainder of this year.

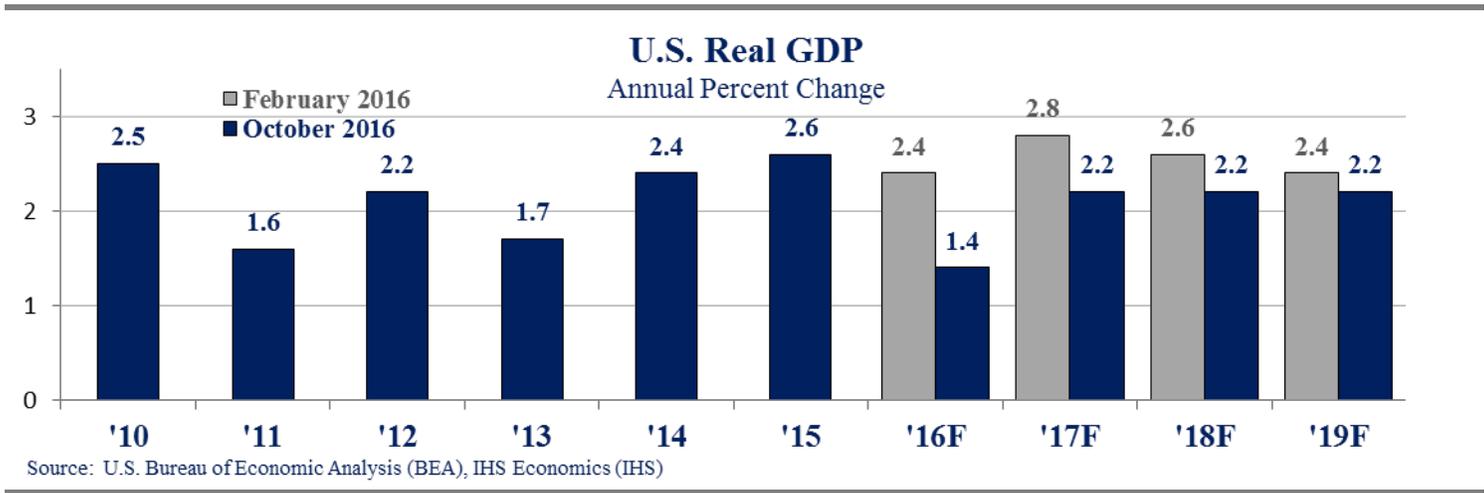
The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 1.4 percent in the second quarter of 2016, up from 0.8 percent growth in the first quarter. Inventory investment was an important drag in the second quarter, subtracting 1.2 percentage points from real GDP growth. IHS expects the inventory drag to gradually subside and become positive through 2017. The recovery in commodity prices is stimulating an increase in capital spending in mining and petroleum industries and is expected to contribute to growth going forward. In the IHS outlook, real consumer spending remains the mainstay of the economy, while improved trends in housing and capital spending will also support growth.

IHS expects the unemployment rate to remain stable at 4.9 percent. There is clear evidence that the pace of employment gains is slowing, consistent with an economy that is either at, or rapidly approaching, full employment.

Continued improvement in U.S. economic growth is expected through at least 2017 and 2018. The October 2016 baseline from IHS now calls for real GDP growth of 1.4 percent in 2016, followed by 2.2 percent growth in 2017 and 2.2 percent growth in 2018. The February 2016 IHS outlook, which informed MMB’s *February 2016 Budget and Economic Forecast*, projected stronger growth this year of 2.4 percent, followed by 2.8 percent in 2017 and 2.6 percent in 2018. The IHS October baseline forecast is very similar to the Blue Chip Consensus, the median of 50 business and academic forecasts. The Blue Chip forecast is for 1.5 percent growth in 2016, followed by an increase of 2.2 percent in 2017.

At its mid-September meeting, the Fed kept its target range for the federal funds rate at 0.25-0.50%. IHS expects the Fed to raise the benchmark interest rate at the mid-December monetary policy meeting, pushing the federal funds rate target to 0.50-0.75%.

OPEC’s oil exporting countries declared that they plan return to a supply management agreement when they meet in November. While an agreement to cut production would increase prices in the short term, it is uncertain whether OPEC can impose enough supply discipline to persistently support long-term prices. Additionally, there is uncertainty from the impacts of Hurricane Matthew, which could affect U.S. fourth-quarter growth.



## Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

|                                     | Fiscal Year 2016 Close            |                                 |                               | July – September FY2016           |                                 |                           |
|-------------------------------------|-----------------------------------|---------------------------------|-------------------------------|-----------------------------------|---------------------------------|---------------------------|
|                                     | FORECAST<br>REVENUES <sup>1</sup> | ACTUAL<br>REVENUES <sup>2</sup> | DIFFERENCE<br>ACTUAL-<br>FCST | FORECAST<br>REVENUES <sup>1</sup> | ACTUAL<br>REVENUES <sup>2</sup> | DIFFERENCE<br>ACTUAL-FCST |
| <b>Individual Income Tax</b>        |                                   |                                 |                               |                                   |                                 |                           |
| Withholding                         | 8,178,206                         | 8,163,256                       | (14,950)                      | 1,971,700                         | 1,965,564                       | (6,136)                   |
| Declarations                        | 2,371,500                         | 2,354,888                       | (16,613)                      | 452,468                           | 442,520                         | (9,949)                   |
| Miscellaneous                       | 1,577,200                         | 1,597,844                       | 20,644                        | 121,108                           | 128,713                         | 7,605                     |
| Gross                               | 12,126,907                        | 12,115,987                      | (10,919)                      | 2,545,276                         | 2,536,796                       | (8,480)                   |
| Refund                              | 1,411,306                         | 1,377,081                       | (34,225)                      | 22,494                            | 43,008                          | 20,514                    |
| Net                                 | 10,715,600                        | 10,738,906                      | 23,306                        | 2,522,782                         | 2,493,788                       | (28,993)                  |
| <b>Corporate Franchise Tax</b>      |                                   |                                 |                               |                                   |                                 |                           |
| Declarations                        | 1,200,189                         | 1,292,189                       | 92,000                        | 302,126                           | 296,833                         | (5,293)                   |
| Miscellaneous                       | 312,574                           | 319,024                         | 6,451                         | 69,285                            | 56,508                          | (12,777)                  |
| Gross                               | 1,512,762                         | 1,611,213                       | 98,451                        | 371,411                           | 353,341                         | (18,070)                  |
| Refund                              | 188,267                           | 138,116                         | (50,151)                      | 18,147                            | 18,565                          | 418                       |
| Net                                 | 1,324,495                         | 1,473,097                       | 148,602                       | 353,264                           | 334,776                         | (18,488)                  |
| <b>General Sales Tax</b>            |                                   |                                 |                               |                                   |                                 |                           |
| Gross                               | 5,533,004                         | 5,552,997                       | 19,992                        | 1,260,988                         | 1,244,163                       | (16,825)                  |
| Mpls. Sales Tax Transferred to MSFA | 1,686                             | 1,686                           | 0                             | 505                               | 505                             | 0                         |
| Sales Tax Gross                     | 5,534,690                         | 5,554,683                       | 19,993                        | 1,261,493                         | 1,244,668                       | (16,825)                  |
| Refunds (including Indian Refunds)  | 300,713                           | 321,963                         | 21,249                        | 24,207                            | 35,687                          | 11,480                    |
| Net                                 | 5,233,977                         | 5,232,720                       | (1,257)                       | 1,237,286                         | 1,208,981                       | (28,305)                  |
| <b>Other Revenues:</b>              |                                   |                                 |                               |                                   |                                 |                           |
| Net Estate                          | 179,900                           | 183,217                         | 3,316                         | 40,350                            | 25,701                          | (14,649)                  |
| Net Liquor/Wine/Beer                | 86,060                            | 88,447                          | 2,387                         | 16,347                            | 17,025                          | 678                       |
| Net Cigarette/Tobacco               | 629,170                           | 617,947                         | (11,223)                      | 104,944                           | 113,246                         | 8,302                     |
| Deed and Mortgage                   | 217,125                           | 226,002                         | 8,877                         | 50,568                            | 52,739                          | 2,171                     |
| Net Insurance Premiums Taxes        | 362,669                           | 363,137                         | 469                           | 88,913                            | 88,932                          | 18                        |
| Net Lawful Gambling                 | 54,950                            | 56,258                          | 1,307                         | 10,690                            | 11,293                          | 603                       |
| Health Care Surcharge               | 274,307                           | 275,245                         | 937                           | 21,578                            | 18,489                          | (3,089)                   |
| Other Taxes                         | 3,005                             | 7,276                           | 4,271                         | 188                               | 183                             | (5)                       |
| Statewide Property Tax              | 841,080                           | 853,780                         | 12,700                        | 16,929                            | 15,531                          | (1,398)                   |
| DHS SOS Collections                 | 44,884                            | 54,946                          | 10,062                        | 11,984                            | 15,790                          | 3,806                     |
| Investment Income                   | 13,000                            | 18,887                          | 5,887                         | 3,250                             | 5,934                           | 2,684                     |
| Tobacco Settlement                  | 162,336                           | 171,238                         | 8,903                         | 100                               | 100                             | 0                         |
| Dept. Earnings & MSOP Recov.        | 205,103                           | 210,234                         | 5,131                         | 36,953                            | 36,615                          | (338)                     |
| Fines and Surcharges                | 81,539                            | 80,017                          | (1,522)                       | 14,546                            | 5,991                           | (8,555)                   |
| Lottery Revenues                    | 63,452                            | 66,224                          | 2,772                         | 13,701                            | 9,787                           | (3,914)                   |
| Revenues yet to be allocated        | 0                                 | 0                               | 0                             | 0                                 | 20                              | 20                        |
| Residual Revenues                   | 174,906                           | 170,391                         | (4,515)                       | 9,452                             | 2,136                           | (7,316)                   |
| County Nursing Home, Pub Hosp IGT   | 6,792                             | 6,792                           | 0                             | 1,698                             | 1,132                           | (566)                     |
| Other Subtotal                      | 3,400,278                         | 3,450,038                       | 49,760                        | 442,192                           | 420,645                         | (21,547)                  |
| Other Refunds                       | 5,205                             | 5,564                           | 359                           | 1,464                             | 1,349                           | (115)                     |
| Other Net                           | 3,395,074                         | 3,444,474                       | 49,400                        | 440,728                           | 419,296                         | (21,432)                  |
| <b>Total Gross</b>                  | <b>22,574,637</b>                 | <b>22,731,921</b>               | <b>157,284</b>                | <b>4,620,372</b>                  | <b>4,555,450</b>                | <b>(64,922)</b>           |
| <b>Total Refunds</b>                | <b>1,905,491</b>                  | <b>1,842,724</b>                | <b>(62,767)</b>               | <b>66,312</b>                     | <b>98,609</b>                   | <b>32,297</b>             |
| <b>Total Net</b>                    | <b>20,669,146</b>                 | <b>20,889,197</b>               | <b>220,051</b>                | <b>4,554,060</b>                  | <b>4,456,841</b>                | <b>(97,219)</b>           |

1. February 2016 *Budget & Economic Forecast* adjusted for legislative changes.

2. Reflects estimates of revenue accruals through FY 2016 closing (August 12) and other pre-close adjustments.