

# Revenue and Economic Update

October 10, 2017

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## State Revenues Below February Forecast

Minnesota’s net general fund receipts totaled \$4.558 billion during the months of July through September 2017, or \$66 million (1.4 percent) less than projected in the February 2017 *Budget and Economic Forecast* adjusted for legislative changes. Receipts for the individual income tax, sales tax, and other revenues were below the forecast for the quarter.

Net individual income tax receipts were \$42 million (1.6 percent) less than forecast for the first three months of FY 2018. Lower than expected gross tax receipts more than offset refunds that were below the forecast. (See page 4 for details.) Payments associated with tax year 2017 economic activity—income tax withholding and estimated payments—were about \$61 million below the forecast. Estimated tax payments for the quarter were about 2.1 percent lower than payments during the same period one year ago.

Income tax refunds for the quarter, which are largely associated with tax year 2016 filings, were \$24 million lower than forecast. That variance, however, likely is due to the timing of return processing rather than higher tax liability. We will know final tax year 2016 income tax liability after all 2016 returns—including returns due October 16, from taxpayers requesting an extension—have been filed and processed. In early November we will estimate 2016 income tax liability based on returns processed to date.

Net sales tax receipts were \$12 million (1.0 percent) below the forecast. Lower than expected gross sales tax payments more than offset refunds that were less than forecast.

## Fiscal Year 2017 Revenues Match the Forecast

Net general fund revenues for the fiscal year that ended June 30, 2017, are now \$1 million (0.0 percent) less than forecast in February, nearly wiping out the negative \$104 million variance we originally reported in the July 2017 *Revenue and Economic Update*. Higher than expected tax and non-tax payments received and lower than expected refunds paid out between the end of the fiscal year and the official close explain the improved revenue position. The next official forecast will be released in early December 2017.

## U.S. Economy Stable Despite Natural Disasters and Lack of Fiscal Stimulus

Despite recent natural disasters that will increase the short-run volatility of U.S. economic growth and the federal government’s inaction on fiscal stimulus, the U.S.

### Summary of Revenues: July-September 2017

(\$ in millions)	February 2017			
	Forecast <sup>1</sup>	Actual	\$ Difference	% Difference
Individual Income Tax	\$2,609	\$2,567	\$(42)	(1.6)%
General Sales Tax	1,235	1,222	(12)	(1.0)
Corporate Franchise Tax	353	353	0	0.0
Other Revenues	427	415	(12)	(2.8)
<b>Total Revenues<sup>2</sup></b>	<b>\$4,625</b>	<b>\$4,558</b>	<b>\$(66)</b>	<b>(1.4)%</b>

1. Adjusted for legislative changes.

2. Totals may not add due to rounding.

economic outlook remains stable. The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 3.1 percent during the second quarter of 2017, up from the first quarter's 1.2 percent growth. The rebound was driven by a surge in private inventory investment and personal consumption expenditures, an acceleration of exports, and an increase in federal government spending. These positive factors were partly offset by a deceleration in residential fixed investment and exports and a downturn in state and local government spending.

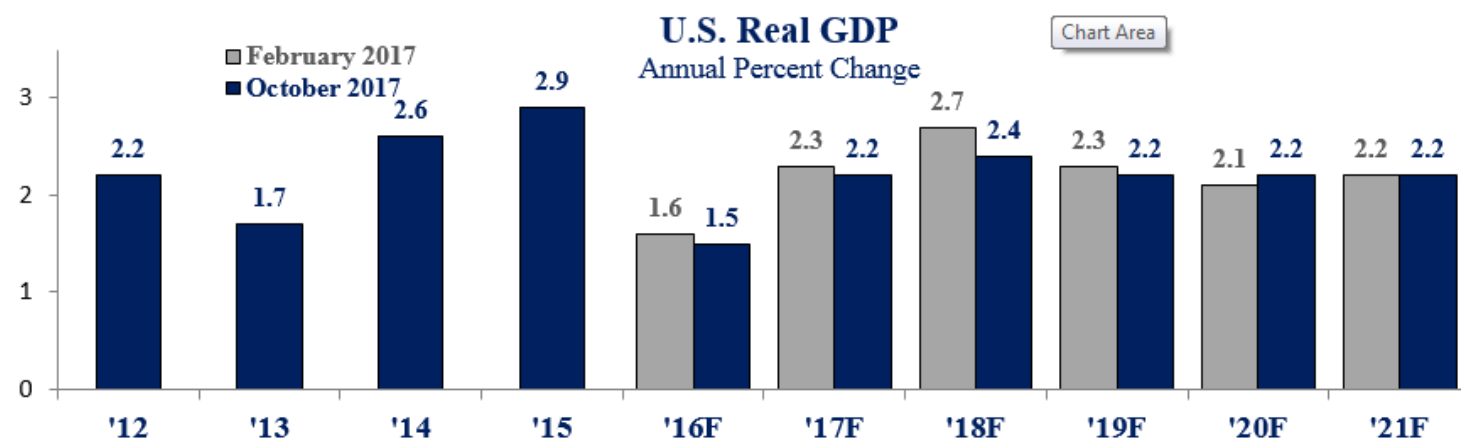
Overall, the U.S. economic fundamentals are encouraging. Minnesota's macroeconomic consultant IHS Markit (IHS) expects annualized real GDP growth of 2.2 percent in 2017. Growth in real consumer spending will remain the largest contributor to real GDP growth. Gains in employment, real incomes, stock prices, and home values will continue to improve household finances. On the other hand, business fixed investment has decelerated after two quarters of solid growth. The disruptions caused by recent natural disasters are expected to shift growth from the third quarter to the fourth quarter of this year and the first quarter of next year. Inventory investment is expected to promote growth at the end of 2017 as production recovers, damaged assets are replaced, and rebuilding begins. IHS estimates that the effect of natural disasters will subtract 1.2 percentage points from third quarter growth and boost fourth quarter growth by 0.9 percentage points.

Both imports and exports have increased relative to last year. The fading effect of the strong dollar combined with solid world demand have improved exports, while stronger domestic demand has strengthened import growth. With the U.S. economy continuing to out-perform the economies of almost all of its major trading partners,

the dollar is expected to gain some strength over the last quarter of this year and beginning of next year.

The outlook for 2018 remains uncertain. Recent natural disasters will exacerbate economic volatility through the first quarter of 2018. At the same time, expectations for fiscal stimulus effects in 2018 have faded. With their October baseline, IHS has removed their previous assumptions of tax cuts and infrastructure spending that would boost growth in 2018. IHS now expects annual real GDP growth of 2.4 percent in 2018, followed by a steady 2.2 percent pace over the following three years. The IHS October baseline forecast for 2017 growth matches the Blue Chip Consensus, the median of 50 business and academic forecasts.

The Bureau of Labor Statistics (BLS) reports that in September the seasonally-adjusted U.S. unemployment rate declined by 0.2 percentage points to 4.2 percent, 0.7 percentage points lower than a year earlier. In September, the estimated number of unemployed persons declined by 331,000 to 6.8 million, 1.1 million fewer than a year earlier. Total nonfarm payroll employment was stable in September with a slight, apparently hurricane-induced, reduction of 33,000 jobs. U.S. employers have added 172,000 jobs per month so far this year, maintaining the solid job gains observed in 2016. The average workweek for all employees on private nonfarm payrolls marginally changed to 34.4 hours in September, and wage gains in this month helped bring annual growth in average hourly earnings to 2.9 percent. IHS now expects the 2017 unemployment rate to be 4.4 percent, followed by a stable path of 4.3 percent in each year until 2020.



Source: Bureau of Economic Analysis and IHS Markit.

At the September meeting, the Federal Open Market Committee did not alter the federal funds rate, however they announced the start of the balance sheet reduction process. The Federal Reserve is likely to raise interest rates again in December, but this will be contingent on the behavior of inflation over the next few months. The Fed will also take into consideration the extensive but temporary disruptions caused by the recent natural disasters, the behavior of labor markets, and the strength of the U.S. dollar. IHS' forecast assumes a 25-basis-point increase in the federal funds rate in December, followed

by subsequent increases intended to bring the rate to 3.00 percent by the end of 2019.

In their October outlook, IHS assigns a 65 percent probability to their baseline forecast and a 20 percent probability to a more pessimistic scenario, in which real GDP growth slows to 0.7 percent in 2018. They assign a 15 percent probability to an optimistic scenario characterized by 3.4 percent growth in 2018. In their February outlook, IHS assigned probabilities of 25 and 15 percent to the pessimistic and optimistic scenarios, respectively.

## Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2017			July-September 2017		
	FORECAST REVENUES <sup>1</sup>	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
<b>Individual Income Tax</b>						
Withholding	8,566,972	8,655,041	88,070	2,070,400	2,037,411	(32,989)
Declarations	2,376,100	2,293,897	(82,203)	461,243	433,181	(28,061)
Miscellaneous	1,658,329	1,511,194	(147,135)	135,653	131,031	(4,623)
Gross	12,601,401	12,460,132	(141,269)	2,667,296	2,601,622	(65,673)
Refund	1,413,700	1,528,967	115,266	57,922	34,082	(23,840)
Net	11,187,700	10,931,165	(256,535)	2,609,374	2,567,541	(41,833)
<b>Corporate Franchise Tax</b>						
Declarations	1,207,159	1,158,592	(48,566)	310,138	305,779	(4,359)
Miscellaneous	202,292	223,453	21,161	68,735	56,060	(12,675)
Gross	1,409,451	1,382,045	(27,406)	378,873	361,840	(17,034)
Refund	267,227	176,666	(90,561)	25,529	8,582	(16,947)
Net	1,142,223	1,205,378	63,155	353,345	353,258	(86)
<b>General Sales and Use Tax</b>						
Gross	5,621,896	5,623,672	1,776	1,261,705	1,246,373	(15,332)
Mpls. sales tax transferred to MSFA	1,664	1,860	196	444	444	0
Sales Tax Gross	5,623,560	5,625,532	1,972	1,262,148	1,246,817	(15,332)
Refunds (including Indian refunds)	276,301	220,405	(55,897)	27,640	24,704	(2,936)
Net	5,347,259	5,405,127	57,869	1,234,508	1,222,113	(12,396)
<b>Other Revenues:</b>						
Net Estate	139,100	128,834	(10,266)	39,387	33,733	(5,653)
Net Liquor/Wine/Beer	88,430	88,257	(173)	16,778	17,940	1,162
Net Cigarette/Tobacco	623,590	647,930	24,339	102,657	78,773	(23,884)
Deed and Mortgage	241,317	245,015	3,698	49,129	53,503	4,374
Net Insurance Premiums Taxes	372,552	376,933	4,381	91,708	91,598	(111)
Net Lawful Gambling	62,000	63,889	1,889	12,074	13,314	1,240
Health Care Surcharge	276,115	279,203	3,088	18,038	19,407	1,369
Other Taxes	2,655	7,738	5,083	-	1	1
Statewide Property Tax	838,331	858,390	20,058	16,391	1,698	(14,693)
DHS SOS Collections	56,425	86,421	29,996	14,106	19,891	5,785
Investment Income	26,000	36,561	10,561	4,750	8,617	3,867
Tobacco Settlement	158,453	168,226	9,773	100	100	-
Dept. Earnings & MSOP Recov.	200,429	221,261	20,832	36,468	34,828	(1,640)
Fines and Surcharges	79,142	80,508	1,366	13,315	14,542	1,226
Lottery Revenues	65,111	65,355	244	9,008	11,412	2,404
Revenues yet to be allocated	(0)	19	19	-	8,975	8,975
Residual Revenues	145,575	154,780	9,205	3,360	8,075	4,715
County Nursing Home, Pub Hosp IGT	6,226	6,227	1	1,557	-	(1,557)
Other Subtotal	3,381,452	3,515,546	134,093	428,825	416,406	(12,419)
Other Refunds	5,405	5,292	(113)	1,426	973	(453)
Other Net	3,376,047	3,510,253	134,206	427,398	415,432	(11,966)
<b>Total Gross</b>	<b>23,015,864</b>	<b>22,983,254</b>	<b>(32,609)</b>	<b>4,737,142</b>	<b>4,626,684</b>	<b>(110,457)</b>
<b>Total Refunds</b>	<b>1,962,634</b>	<b>1,931,330</b>	<b>(31,304)</b>	<b>112,516</b>	<b>68,340</b>	<b>(44,176)</b>
<b>Total Net</b>	<b>21,053,230</b>	<b>21,051,924</b>	<b>(1,306)</b>	<b>4,624,625</b>	<b>4,558,344</b>	<b>(66,281)</b>

1. February 2017 Budget & Economic Forecast adjusted for legislative changes.