



Minnesota Department of Finance

April 1998

Revenues Below Forecast in February and March

Net general fund revenues for February and March totaled \$1.565 billion, \$34 million (2.1 percent) below forecast. Receipts for the first three quarters of this fiscal year total \$7.633 billion, 7.8 percent more than in the first three quarters of fiscal 1997.

Summary of Tax Receipts: February - March 1998

	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
-----Dollars in Millions-----				
Individual	718.5	649.1	(69.4)	(9.7)
Sales	447.7	468.9	21.2	4.7
Corporate	195.9	208.9	13.0	6.6
Motor Vehicle	60.2	60.5	0.3	0.5
Other	<u>176.3</u>	<u>177.4</u>	<u>1.1</u>	0.6
TOTAL	1,598.6	1,564.7	(33.9)	(2.1)

Withholding tax receipts were nearly \$72 million below levels forecast for February and March, accounting for all of this quarter's negative variance. Receipts exceeded forecast for each of the other major sources of revenue. Other revenues also exceeded forecast levels despite a \$20.6 million shortfall in insurance gross premiums tax receipts in February and March. (See page 4) Much of that shortfall appears to be due to differences in the timing of receipts and is expected to be made up in early April.

Timing differences may also have contributed to the negative variance in withholding revenue, although the current difference between actual and forecast withholding receipts is too large to be fully explained in that way. Withholding tax receipts will be watched closely over the next quarter for signs that the current forecast for individual income tax liability should be changed. Often, quarterly variances in withholding are ultimately offset by changes in refunds paid or in the final payments which accompany taxpayers' returns at the close of the tax year. When that occurs the timing of receipts changes from that forecast, but total income tax revenue for any tax year remains unchanged.

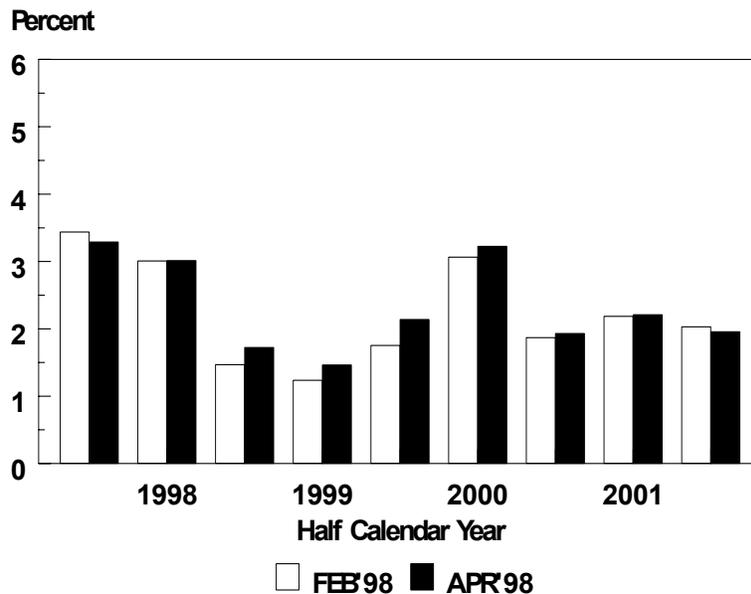
Individual income tax receipts include only withholding and individual estimated tax payments. Refunds and final payments for tax year 1997 are not reported during the processing season. They will be reported in the July *Economic Update* after processing of timely 1997 returns has been completed.

U.S. Economy Was Strong in First Quarter 1998, But Asian Related Slowdown Is On the Way

The U.S. economy continued to surge during the first three months of 1998. More than 600,000 new jobs were added, unemployment rates are at the lowest levels in a quarter century, interest rates are low and appear to be heading lower, and inflation continues to remain well under control. Most forecasters now believe that real GDP grew at better than a 3 percent annual rate during the first quarter of 1998 even after taking into account the significant reductions in export demand caused by the currency devaluations and general economic malaise covering much of Asia.

The economy's strong performance thus far in 1998 does not mean that the potential impact of Asia's problems on the U.S. was overstated. Nor should it be interpreted as an indication that we have weathered the worst of the shocks and that strong economic growth will continue for the remainder of the year. Instead, it is likely that much of the economic strength observed during the past three months has been borrowed from the future. A combination of low interest rates and unseasonably warm winter weather appears to have stimulated domestic spending sufficiently during the normally slow winter months to make up for the drop off in export demand.

Little Change in Economic Outlook



Most forecasters expect the economy to slow noticeably over the next six months. Export demand for U.S. products is expected to continue to weaken as the backlog of “pre-devaluation” orders from Asia is eliminated, and *El Niño*'s favorable seasonal impacts disappear. While many believe that interest rates will fall further over the next 9 months, most forecasters believe the additional stimulation provided by lower interest rates will be more than offset by the drop in exports to Asia. While currencies have stabilized everywhere but Indonesia, recessions in Korea, Thailand and

Malaysia promise to continue on into 1999. Japan, which had previously been thought likely to avoid a recession, also now seems to once again be facing several quarters of economic decline. Data Resources Inc., (DRI) Minnesota's national economic consultant continues to believe that the Asian slowdown will be more severe than the consensus view. The April DRI Control forecast is slightly more optimistic than February's, but changes in the outlook were minor. DRI now expects real GDP growth at a 2.0 percent annual rate during fiscal 1999, up slightly from the 1.8 percent growth rate forecast in February. The outlook for growth in fiscal 1998 remains unchanged. DRI assigns a probability of 55 percent to the Control forecast, the same as in February. The probability assigned to the alternatives has changed slightly however. DRI thinks the likelihood of a 1998 recession, brought on by further financial collapse in Asia, has fallen; so the probability assigned to their pessimistic scenario has been reduced to 20 percent. The principal alternative is now the Boom-Bust scenario in which the economy grows more rapidly than anticipated, then enters a recession in 2000. That scenario is assigned a probability of 25 percent.

Unemployment in Minnesota at Record Lows

Unemployment rates in Minnesota have been at record lows during the last three months. The state's seasonally adjusted unemployment rate of 2.5 percent in February was the lowest monthly rate on record, 0.2 percent below January's rate of 2.7 percent, the previous low. Credit for the record will need to be shared between the strong state and national economy and the mild winter, which allowed weather related layoffs to be held below normal levels, but even without *El Niño* Minnesota's unemployment rate would have been well below its historical average. Employers are finding it difficult to add workers, and concerns about a labor shortage are being voiced.

Neighboring states are seeing the same thing. Indeed, unemployment in the entire upper Midwest is well below February's national average of 4.6 percent. North Dakota and Nebraska both had unemployment rates of 1.9 percent, Iowa and South Dakota had rates of only 2.6 percent, and Wisconsin a rate of 3.1 percent.

Unemployment rates in Minnesota are unlikely to remain at current levels after the one-time benefits of the warm winter disappear. Still, even if the economy slows as expected from its current pace, employers are not likely to observe much slack in the labor market for some time to come. Labor force participation rates in this state are among the highest in the nation, leaving little room for additional workers to be drawn into the workforce. The strong economies in adjoining states are likely to continue to limit the number moving to Minnesota in search of employment opportunity. In recent years migration from California and Texas has increased, but the economic outlook for those states has improved. That is expected to restrain future migration from those more heavily populated states to Minnesota. Since the number of individuals reaching working age both nationally and in Minnesota will grow more slowly in coming years, the low unemployment economies we are observing in Minnesota and other states in the upper Midwest are likely to become the norm in the future.

Comparison of Actual and Estimated Non-Restricted Revenues (\$ in thousands)

	<u>1998 Fiscal Year to Date</u>			<u>February - March 1998</u>		
	<u>Forecast Revenues</u>	<u>Actual Revenues</u>	<u>Variance Act-Fcst</u>	<u>Forecast Revenues</u>	<u>Actual Revenues</u>	<u>Variance Act-Fcst</u>
Four Major Revenues:						
Individual Income Tax						
Withholding	3,142,627	3,070,672	(71,955)	694,600	622,645	(71,955)
Declarations	542,912	545,419	2,507	23,900	26,407	2,507
Miscellaneous	84,420	84,420	0	(0)	(0)	0
Gross	3,769,959	3,700,511	(69,448)	718,500	649,052	(69,448)
Refunds	46,599	46,599	(0)	0	(0)	(0)
Net	3,723,360	3,653,912	(69,448)	718,500	649,052	(69,448)
Corporate & Bank Excise						
Declarations	583,712	600,235	16,523	180,200	196,723	16,523
Miscellaneous	76,357	73,960	(2,397)	24,700	22,303	(2,397)
Gross	660,069	674,195	14,126	204,900	219,026	14,126
Refunds	66,632	67,786	1,154	9,000	10,154	1,154
Net	593,437	606,409	12,972	195,900	208,872	12,972
Sales Tax						
Gross	2,404,400	2,417,176	12,776	475,653	488,429	12,776
Refunds	91,060	82,600	(8,460)	27,960	19,500	(8,460)
Net	2,313,340	2,334,576	21,236	447,693	468,929	21,236
Motor Vehicle Excise	308,700	308,979	279	60,216	60,495	279
Other Revenues:						
Inherit/Gift/Estate	30,591	33,091	2,500	6,489	8,989	2,500
Liquor/Wine/Beer	40,662	39,265	(1,398)	9,500	8,102	(1,398)
Cigarette & Tobacco	120,469	117,522	(2,947)	28,335	25,388	(2,947)
Deed and Mortgage	83,044	84,451	1,407	13,925	15,332	1,407
Insurance Gross Earnings	97,275	76,607	(20,668)	48,772	28,104	(20,668)
Lawful Gambling	42,613	42,431	(182)	10,114	9,932	(182)
Health Care Surcharge	90,384	85,814	(4,570)	24,817	20,247	(4,570)
Other Taxes	773	762	(10)	173	163	(10)
General Fund RTC Revenues	27,214	28,086	873	4,986	5,859	873
Income Tax Reciprocity	37,872	37,872	0	0	0	0
Investment Income	108,259	122,572	14,313	25,161	39,474	14,313
Other and Unallocated	63,853	72,736	8,883	8,523	17,406	8,883
Other Subtotal	743,009	741,209	(1,799)	180,795	178,996	(1,799)
Other Refunds	14,584	11,709	(2,874)	4,503	1,630	(2,874)
Other Net	728,425	729,500	1,075	176,292	177,366	1,074
Total Gross	7,886,136	7,842,070	(44,066)	1,640,064	1,595,999	(44,066)
Total Refunds	218,874	208,694	(10,180)	41,464	31,284	(10,180)
Total Net	7,667,262	7,633,376	(33,886)	1,598,600	1,564,715	(33,886)