Minnesota
Department of Finance

January 1998 Economic Update

January 1998

State Revenues Continue Above Forecast

Net general fund revenues totaled $1.819 billion during November and December, $163 million (9.9 percent), more than forecast. Receipts for the 1998 fiscal year now total $4.991 billion. Individual income tax revenues were $95.6 million above forecast levels, while net sales tax receipts exceeded the forecast by $26.9 million. The corporate income tax and the motor vehicle excise tax had variances of $9.8 million and $8.2 million respectively. Other taxes and miscellaneous revenues exceeded the forecast by $22.7 million. Through the first half of the 1998 fiscal year receipts are 10.7 percent above last year's levels.

Summary of Tax Receipts: November - December 1997

	Forecast	Actual	Variance	Percent
	Dollars in Millions			
Individual	749.3	844.9	95.6	12.8
Sales	510.6	537.5	26.9	5.3
Corporate	129.0	138.8	9.8	7.6
Motor Vehicle	55.7	63.9	8.2	14.7
Other	211.6	234.4	22.7	10.7
TOTAL	1,656.2	1,819.5	163.2	9.9

Some of this large, positive revenue variance may reflect only differences in the timing of payments, not changes in underlying liability. Fourth quarter variances often must be re-confirmed after January because key events affecting both the income and sales tax span the close of the calendar year. Sales tax receipts from the December portion of the Christmas shopping season, for example, are not available until the end of January. Similarly, while fourth quarter individual estimated tax payments (declarations) are not due until January 15, some taxpayers find it beneficial to pay before the close of the 1997 calendar year, to make those payments deductible for federal tax purposes against income earned in tax year 1997. In recent years the proportion of compensation paid as bonuses has increased, and slight changes in the date on which bonuses are paid can shift withholding receipts from January into December. January's data will provide better information about the true variance in the sales tax and in withholding and estimated tax payments. That data will be incorporated in the February forecast.

400 CENTENNIAL BUILDING, 658 CEDAR STREET, ST. PAUL, MINNESOTA 55155 (651) 296-5900

Asia's Financial Problems Will Affect the U.S. Economy...

For more than 18 months economists have marveled over the U.S. economy's performance. Strong GDP growth, a steadily declining unemployment rate, and a low and declining inflation rate have led many forecasters to label current conditions as the best in a generation. The absence of any obvious potential threats to the continuation of this expansion only added to the general confidence in the outlook. Forecasters in 1997 were nearly unanimous calling for strong growth. Although those forecasts were not sufficiently optimistic, differences among forecasts last year were relatively small.

International financial developments this fall have brought that period of agreement to a close. There still seems to be little reason for concern about the fundamentals of the domestic economy, but the well publicized spread of financial problems across southeast Asia has significantly increased the likelihood that economic growth in the U.S. will slow substantially. Continuing uncertainty about how and when those problems will be resolved has added to the risk of all forecasts. As might be expected, there are now substantial differences in opinions among forecasters about the ultimate impact of Asia's problems on the U.S. economy, and a much wider than usual spread among economists in their outlook for economic growth in 1998.

But Forecasts of Impact on 1998 Vary

Almost no one expects a recession in 1998. Some Asian economies are in serious trouble, but the U.S. economy currently has so much momentum that it would take a more complete collapse of Asian finances than has presently occurred to bring the current U.S. expansion to an end. Asia is an important market for U.S. goods, and the devaluation of local currencies against the dollar will reduce U.S. exports, but sales to southeast Asia and Korea remain only a small part of total U.S. output. Ultimately, for a U.S. recession to occur an event which shatters consumer confidence, producing a decline in consumer spending and an increase in savings is probably necessary.

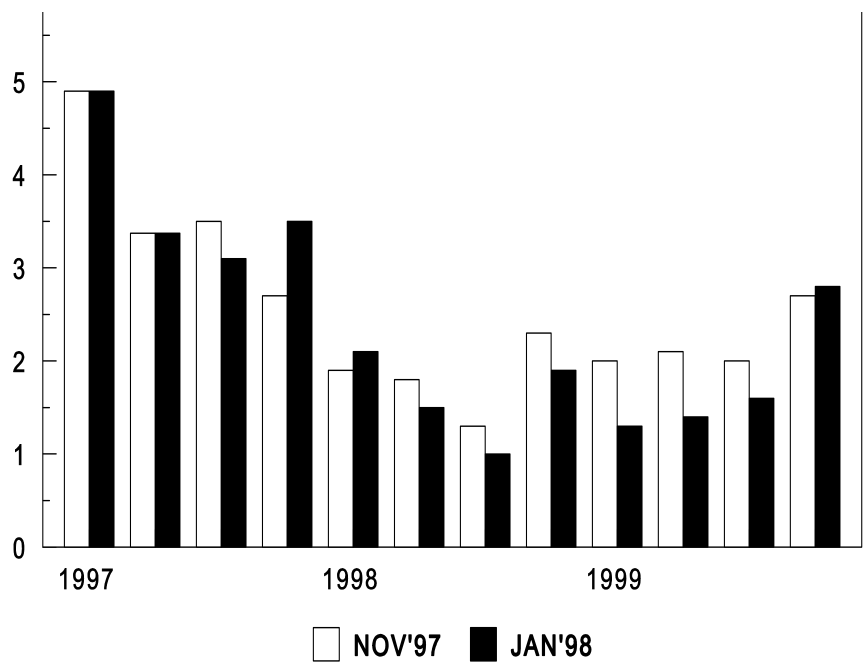
But, no one expects real GDP growth to continue at the 3.7 percent rate now expected for 1997 either. Economic growth at that level clearly cannot be sustained in the absence of substantial increases in productivity. Optimists among forecasters expect domestic demand to remain in high gear through 1998, offsetting much of the loss in export demand. Lower interest rates, which stimulate both business investment and spending on consumer durables, provide much of the stimulus in this scenario. A surge in home mortgage refinancings adds to household discretionary income , further stimulating consumer spending. With this scenario, more optimistic forecasters project real GDP growth rates for 1998 of just over 3 percent.

Others are less optimistic. Their scenarios include a somewhat greater reduction in U.S. exports, and increased substitution of imports for domestic goods by U.S. consumers. While they also expect interest rates to fall, the impact on business investment is limited by the increased import competition. Consumer spending, while increasing, grows more slowly than in the more optimistic scenarios. Anecdotal reports of disappointing Christmas sales and a build-up of unwanted inventories lend some credence to this position, but the first official data on the close of 1997 will not be released until late January. Using this scenario, annual growth rates of 2 percent or less for 1998 emerge.

DRI Outlook Cautious for 1998 and 1999

Data Resources Inc., (DRI), Minnesota's national economic consultant, is among the less optimistic group of forecasters. While their January Control is up from their December projection, they remain quite concerned about Asia's problems, noting that the "Asian outlook continues to deteriorate," and that "Asian financial markets are fragile". It is clear that the possibility of a policy mistake triggering a recession has greatly increased uncertainty associated with the economic outlook. Their principal alternative scenario (probability 25 percent) is now one which includes a recession in late 1998 brought on by a worsening and badly handled Asian crisis. As recently as November the principal alternative (probability 30 percent) was a scenario in which U.S. economic growth was so strong during 1998 and 1999 that inflation began to increase. In that scenario, Federal Reserve action to control inflation brought on a recession late in the year 2000. The probability attached to that scenario has now been cut to 20 per cent.

Slower Real GDP Growth Now Forecast



January's Control forecast calls for real GDP growth to average 1.8 percent during the first two quarters of 1998, and 1.4 percent for the next 5 quarters. On a fiscal year basis growth is now expected at 3.3 percent for 1998, little changed from the 3.2 percent used in November's revenue forecast. For 1999, growth is expected at only a 1.6 percent rate, down significantly from the 1.9 percent growth anticipated in November.

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

Four Major Revenues:	1998 Fiscal Year to Date Forecast Revenues	Actual Revenues	Variance Act-Fcst	November - December 1997 Forecast Revenues	Actual Revenues	Variance Act-Fcst
Individual Income Tax						
Withholding	2,000,412	2,071,732	71,320	680,100	751,420	71,320
Declarations	255,562	291,517	35,955	66,900	102,855	35,955
Miscellaneous	71,900	69,379	(2,521)	14,942	12,421	(2,521)
Gross	2,327,873	2,432,628	104,755	761,942	866,697	104,755
Refunds	36,200	45,357	9,157	12,624	21,781	9,157
Net	2,291,673	2,387,271	95,598	749,318	844,916	95,598
Corporate & Bank Excise						
Declarations	362,889	374,027	11,138	153,300	161,693	8,393
Miscellaneous	45,645	42,964	(2,681)	15,700	15,764	64
Gross	408,534	416,991	8,457	169,000	177,457	8,457
Refunds	52,986	51,606	(1,380)	40,000	38,620	(1,380)
Net	355,549	365,385	9,837	129,000	138,837	9,837
Sales Tax						
Gross	1,571,891	1,593,727	21,836	528,610	550,446	21,836
Refunds	56,386	51,319	(5,067)	18,027	12,960	(5,067)
Net	1,515,505	1,542,408	26,903	510,583	537,486	26,903
Motor Vehicle Excise	211,867	220,031	8,164	55,700	63,864	8,164
Other Revenues:						
Inherit/Gift/Estate	19,919	20,633	714	6,955	7,669	714
Liquor/Wine/Beer	26,093	25,758	(335)	10,003	9,668	(335)
Cigarette & Tobacco	76,330	77,791	1,461	29,969	31,430	1,461
Deed and Mortgage	57,248	55,862	(1,387)	18,414	17,028	(1,387)
Insurance Gross Earnings	59,142	48,429	(10,714)	57,229	46,515	(10,714)
Lawful Gambling	26,714	28,869	2,155	9,473	11,628	2,155
Health Care Surcharge	56,808	57,649	841	18,658	19,500	842
Other Taxes	643	509	(134)	300	166	(134)
General Fund RTC Revenues	17,809	16,638	(1,171)	5,565	4,394	(1,171)
Income Tax Reciprocity	37,923	37,872	(51)	37,923	37,872	(51)
Investment Income	51,843	65,245	13,402	15,320	28,722	13,402
Other and Unallocated	33,125	48,375	15,250	6,333	21,357	15,024
Other Subtotal	463,598	483,628	20,031	216,142	235,949	19,807
Other Refunds	10,524	7,583	(2,941)	4,500	1,559	(2,941)
Other Net	453,074	476,046	22,972	211,643	234,388	22,746
Total Gross	4,983,763	5,147,005	163,242	1,731,394	1,894,411	163,016
Total Refunds	156,096	155,865	(231)	75,151	74,920	(231)
Total Net	4,827,667	4,991,141	163,473	1,656,243	1,819,491	163,247