Economic Update

Minnesota Department of Finance

July 2000

State F.Y. 2000 Revenues Exceed Forecast

Minnesota's net general fund receipts for F.Y. 2000 are now estimated to total $11.881 billion, $260 million, (2.2 percent) more than forecast. The total revenues do not reflect the projected $637 million sales tax rebate which is to be paid from F.Y. 2000 revenues, but which had not been paid on June 30. That payment will reduce F.Y. 2000 closing revenues and estimated receipts. Preliminary closing revenues which reflect that adjustment will be reported in October's *Economic Update*.

Summary of Tax Receipts: F.Y. 2000

	Forecast	Actual	Variance	Percent
	--------------------Dollars in Millions--------------------			
Individual	5,463.0	5,559.1	96.1	1.8
Sales	3,714.4	3,753.3	38.9	1.0
Corporate	742.1	814.4	72.3	9.7
Motor Vehicle	527.0	539.7	12.7	2.4
Other	1,174.5	1,214.5	40.0	3.4
TOTAL	11,621.0	11,881.0	260.0	2.2

Receipts from each of the four major revenue sources exceeded forecast. About 40 percent of the total revenue variance came from higher than anticipated tax year 1999 individual and corporate income tax settle-up payments and lower than projected corporate refunds. (See page 4.) Variances for the state's two largest revenue sources, the individual income tax and the sales tax, were both below 2 percent, and the motor vehicle excise tax variance was 2.4 percent. The corporate income tax, however, had a 9.7 percent variance, reflecting stronger than expected corporate profits during tax year 1999. Other revenues were up by $40 million (3.4 per cent). Investment income accounted for nearly $19 million of that variance.

All F.Y. 2000 results are preliminary and subject to change. As is customary in this first report of receipts for the entire fiscal year, forecasts for some revenue sources have been reduced to adjust for anticipated accruals.

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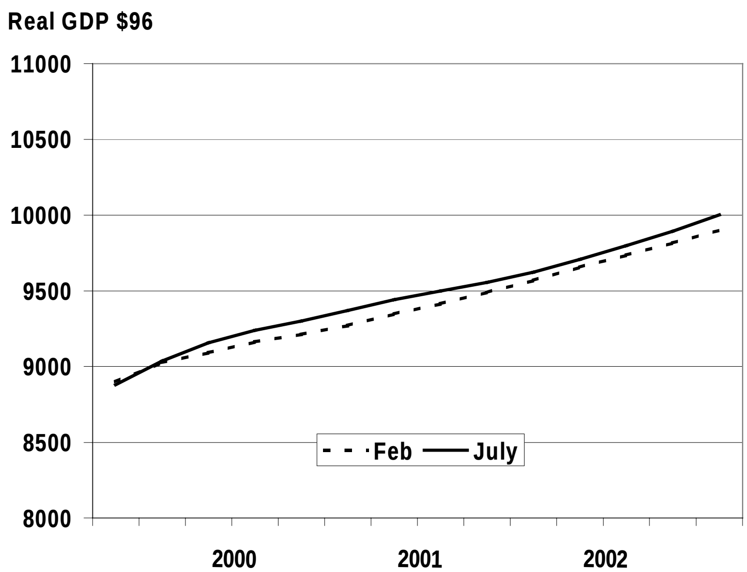
Inflation Outlook Remains the Key to Future Fed Action

Signs of a slowdown in the U.S. economy are now appearing. Private sector job growth during the second quarter averaged only 110,000 per month, the smallest increase since fourth quarter 1995, and retail sales, excluding autos, grew by less than 0.2 percent per month during the past three months. Those growth rates, while healthy, are well below those of late 1999 and early 2000. But, at this point in the business cycle, evidence of slower growth is seen as good news by economists since it may indicate no need for further Fed interest rate increases.

Recession is not a worry. Most analysts believe that Chairman Greenspan's economic mid-course correction continues right on track. His goal - the much sought "soft landing" - is to slow demand sufficiently to remove incipient inflationary pressures, without creating an actual decline in output. While it will take at least 9 more months for the full impact of the past year's 6 interest rate hikes to work through the system, almost all forecasters expect economic growth to continue through 2001.

Economic Outlook Remains Strong



July's Control forecast from Data Resources Inc.(DRI), Minnesota's national macro-economic consultant, reflects the consensus view. Extremely strong real GDP growth in late 1999 and early 2000 has lifted their July forecast above February's, with projected real GDP growth rates for calendar 2000 and 2001 now at 4.7 and 2.8 percent respectively. The Blue Chip Consensus outlook is similar with real growth rates of 4.8 percent in 2000, and 3.3 percent in 2001. DRI continues to assign a 55 percent probability to the Control scenario. The principal alternative (probability 35 percent) has a recession beginning in 2003, while a probability of 10 percent is assigned to a scenario in which a stock market slump and weakened Asian economies cause a recession in mid 2001.

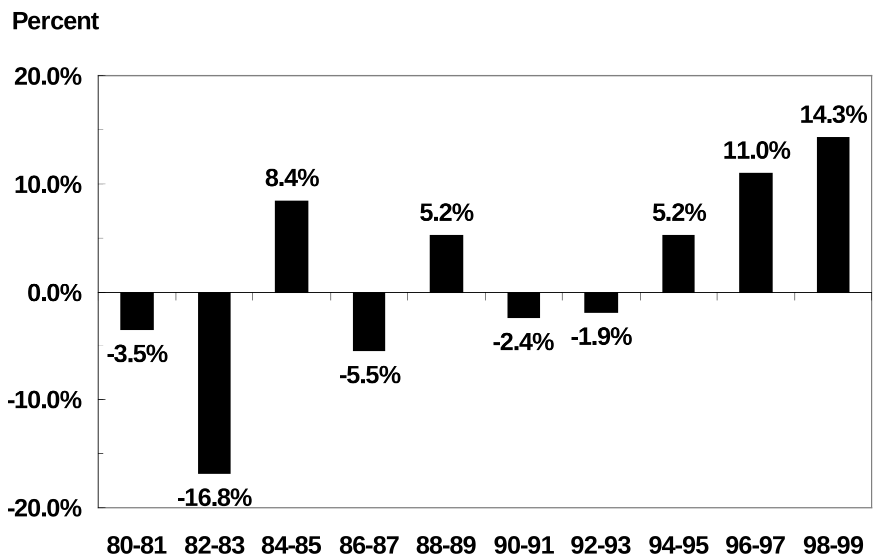
Forecasts Are Predictions of the Future, Not Guarantees

A recent *Wall Street Journal* article (July 3, 2000, p. A2) noted that the gap between the economy's actual growth rate and the average growth rate forecast by their panel of Wall Street economists has widened considerably since 1995. During the past four years the *Journal* reported, their panel's average forecast for annual real GDP has been about 1½ percentage points less than the rate at which the economy ultimately grew. The extended period of stronger than normal economic growth which began in 1995 has taken almost all forecasters by surprise.

Those findings were not news to macro-economic forecasters. Economists are well aware of the size of recent forecast errors and they have been re-examining assumptions and re-estimating models to improve forecast accuracy. An unexpected surge in productivity, well managed monetary and fiscal policy, and just plain good luck are given much of the credit for the economy's strong recent performance. The U.S. economy's ability to shrug off potentially serious threats--including both the 1997-98 Asian financial crisis and the international financial disruptions triggered by Russia's financial problems -- has left everyone impressed with its resilience. But, few believe that we are in a new economy in which business cycles are obsolete.

Last October's benchmark national income account revisions have now been fully incorporated into forecasting models. The revised models better reflect recent experience, and they yield a sustainable, long term growth rate more than a percentage point higher than believed likely as recent as 18 months ago. By early January, most forecasts had been increased significantly, and revisions and upward adjustments continue.

There Have Been Shortfalls in Five of the Last Ten Biennia
Surplus/Shortfalls as Percent of Enacted Spending



Revenue forecasts from the federal government and state governments have also proven to be conservative during the past 5 years. The stronger than anticipated real GDP growth boosted employment and wages, as well as corporate profits and the stock market. And, driven in part by the stock market's boom, net capital gains income more than tripled between 1994 and 1998. All of that additional economic activity caused the federal and state tax base to grow more rapidly than projected, and revenue collections exceeded forecasts. Tax law changes, particularly a change in the federal capital gains tax rate, gave a second, unanticipated boost to state revenues.

In each of the last three biennia Minnesota revenues exceeded the forecast by more than 5 percent. Over the longer run, however, the record is mixed. As the graph above shows, since 1980 state revenues have been just about as likely to fall short of projections as exceed them. With the exception of 1986-87 when revenues were below forecast even though the economy was strong, revenues tend to exceed the forecast in good times and fall short when times are hard.

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

	2000 Fiscal Year to Date			April – June 2000		
Four Major Revenues:	**Forecast Revenues**	**Actual Revenues**	**Variance Act-Fcst**	**Forecast Revenues**	**Actual Revenues**	**Variance Act-Fcst**
Individual Income Tax						
Withholding	4,573,100	4,595,441	22,341	1,109,700	1,123,106	13,406
Declarations	1,144,800	1,160,077	15,277	451,000	468,642	17,642
Miscellaneous	583,020	677,748	94,728	481,478	576,206	94,728
Gross	6,300,920	6,433,266	132,346	2,042,178	2,167,955	125,777
Refunds	837,926	874,123	36,197	758,246	794,443	36,197
Net	5,462,994	5,559,143	96,149	1,283,932	1,373,512	89,580
Corporate & Bank Excise						
Declarations	772,400	800,673	28,273	185,900	190,065	4,165
Miscellaneous	97,810	120,591	22,781	20,411	34,822	14,411
Gross	870,210	921,264	51,054	206,311	224,887	18,576
Refunds	128,100	106,857	(21,243)	35,289	24,481	(10,808)
Net	742,110	814,407	72,297	171,022	200,406	29,384
Sales Tax						
Gross	3,906,900	3,930,899	23,999	1,131,295	1,151,644	20,349
Refunds	192,519	177,593	(14,926)	53,550	36,355	(17,194)
Net	3,714,381	3,753,306	38,925	1,077,746	1,115,289	37,543
Sales Tax Rebate	(9,761)	(9,389)	372	51	548	497
Motor Vehicle Sales	527,000	539,711	12,711	144,297	158,920	14,623
Other Revenues:						
Inherit/Gift/Estate	85,000	83,891	(1,109)	13,477	13,817	340
Liquor/Wine/Beer	60,021	62,138	2,117	18,705	20,160	1,455
Cigarette & Tobacco	176,481	180,859	4,378	51,700	56,720	5,020
Deed and Mortgage	137,100	141,493	4,393	29,282	30,731	1,449
Insurance Gross Earnings	172,400	177,453	5,053	87,329	70,025	(17,304)
Lawful Gambling	63,795	65,435	1,640	21,176	22,472	1,297
Health Care Surcharge	124,906	125,887	981	38,601	39,357	756
Other Taxes	3,187	3,267	80	2,498	2,482	(16)
General Fund RTC Revenues	22,780	8,272	(14,508)	8,981	181	(8,800)
Income Tax Reciprocity	46,475	46,475	0	0	0	0
Investment Income	134,347	153,131	18,784	34,139	49,749	15,610
Tobacco Settlement	104,926	104,926	0	0	0	0
Other and Unallocated	76,413	91,441	15,028	21,077	24,540	3,463
Other Subtotal	1,207,831	1,244,669	36,838	326,965	330,233	3,269
Other Refunds	23,579	20,804	(2,775)	11,535	10,306	(1,229)
Other Net	1,184,252	1,223,865	39,613	315,430	319,927	4,498
Total Gross	12,803,100	13,060,421	257,321	3,851,097	4,034,187	183,090
Total Refunds	1,182,124	1,179,377	(2,747)	858,619	865,585	6,965
Total Net	11,620,976	11,881,044	260,068	2,992,478	3,168,602	176,125