



Minnesota Department of Finance

July 2008

FY 2008 Revenues Above Forecast, But... Prospects for FY 2009 Weaken

Minnesota's net general fund receipts for FY 2008 are now estimated to total \$16.257 billion, \$389 million (2.5 percent) more than forecast in February. The individual income tax and the corporate income tax accounted for more than 75 percent of the positive revenue variance.

Summary of Tax Receipts: (Fiscal Year 2008)

	<u>Estimate</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
	----- (\$ in millions) -----			
Income	\$7,607	\$7,784	\$177	2.3
Sales	4,580	4,577	(3)	(0.1)
Corporate	904	1,028	124	13.7
Motor Vehicles	176	186	10	5.7
Other	<u>2,601</u>	<u>2,682</u>	<u>81</u>	<u>3.1</u>
Total	\$15,868	\$16,257	\$389	2.5

The individual income tax had the largest dollar variance and the corporate franchise tax, the largest percentage variance since February's forecast. Net sales tax receipts were below forecast by less than 0.1 percent. Much of the \$177 million income tax variance came from payments accompanying individual income tax returns for tax year 2007. Those payments, including payments accompanying requests for extensions were a combined \$162 million more than anticipated. That gain was only partially offset by higher than anticipated refunds (see page 4). Individual withholding tax receipts were \$74 million above forecast. The large percentage variance in the corporate tax appears to be due to corporate profits in tax year 2007 and early 2008 exceeding forecast. Some of the weakness assumed in the forecast for the financial sector has yet to be reflected in state revenues.

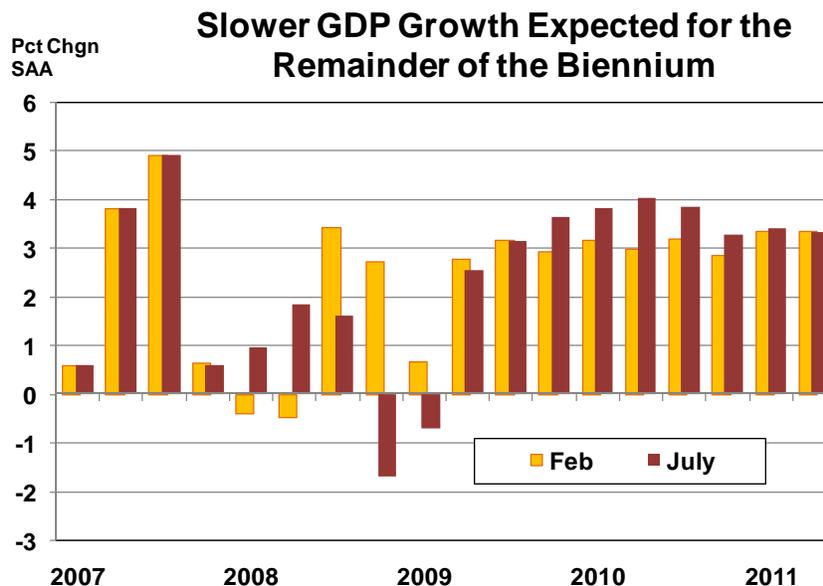
All FY 2008 results are preliminary and subject to change. As in past years forecasts for some revenue sources were adjusted to reflect anticipated accruals in this first report of receipts for the entire fiscal year. A complete accounting of FY 2008 revenues reflecting final closing will be part of the October *Economic Update*.

Slower Economic Growth, Higher Inflation in July Forecast

Thus far the U.S. economy has been stronger than was projected at the start of the year. Unfortunately, the good news ends there. Economists now see few signs that economic growth will return to its 3 percent, trend level before mid-2009. Energy prices have increased to levels well beyond those previously projected, housing markets remain severely depressed, and the financial sector’s problems have yet to be fully resolved. The current economic weakness is now expected to extend into early 2009.

Households received their stimulus package rebate checks ahead of schedule, but that simply shifted some rebate-related spending from the third and fourth quarters of this year into May and June. Accelerating payment of the rebates helped second quarter growth, but it also reduced the amount available for the remainder of the year. Just how far the outlook for the remainder of the year should be cut back depends on one’s forecasts for energy prices, housing prices, and housing sales as well as the outlook for the credit system, but forecasts are generally less optimistic than they were earlier this year. For example, the Blue Chip Consensus forecast now expects real growth at an annual rate of 1.3 percent in the third quarter and 0.6 percent in the fourth quarter. In February the Blue Chip Consensus expected growth rates of 2.3 and 2.5 percent respectively.

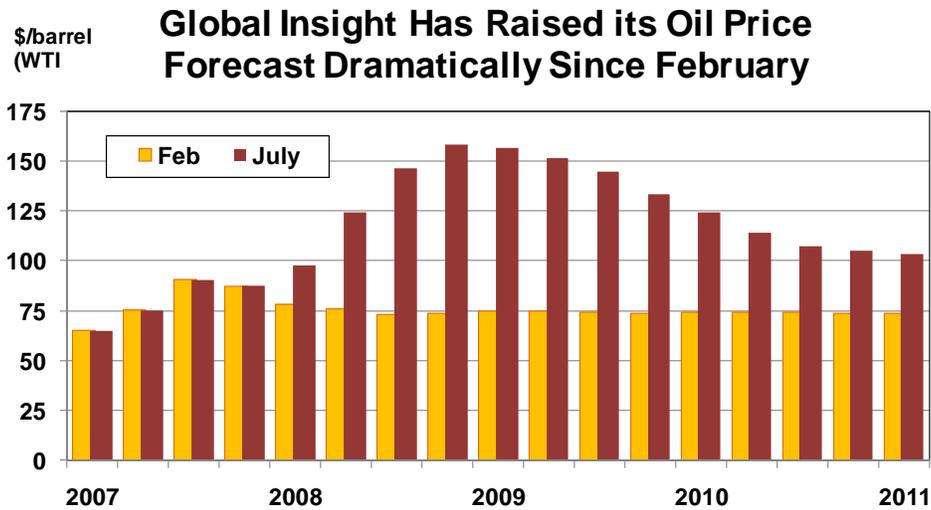
The short-term forecast from Global Insight Inc., (GII), the state’s national economic consultant is more optimistic than the Blue Chip Consensus for the third quarter, but considerably lower than the consensus for the fourth quarter and the first half of 2009. GII’s July baseline forecast is also more pessimistic than the GII baseline forecast used in February’s revenue forecast. Global Insight now expects real GDP growth at an annual rate of 1.6 percent in the current quarter, but then declines of 1.7 percent and 0.7 percent in the next two quarters. At the end of the current biennium GII now anticipates real GDP to be slightly more than 1 percent less than projected in February. GII believes energy and food prices will drive the CPI inflation rate up to 5.3 percent for 2008, more than double the 2.5 percent increase forecast in February.



Higher Oil Prices Expected Now and in the Future

In February, GII’s baseline forecast assumed oil prices would retreat from a fourth quarter 2007 peak of \$90 per barrel to \$73 per barrel by the end of 2008. February’s pessimistic, “double-dip recession” scenario had oil prices remaining above \$90 per barrel through mid summer, then retreating to \$80 per barrel by year’s end. Obviously, even the prices in the pessimistic scenario would look attractive today. Global Insight now expects oil prices to peak at \$160 per barrel in late 2008, and average more than \$146 per barrel in 2009.

Those higher oil prices explain much of the change in the GII baseline since February. They also are the reason Global Insight’s forecast is more pessimistic than some others. When oil prices go up, economic growth slows. While increases of the magnitude projected in the July baseline would, by themselves, be unlikely to cause the economy to decline, those increases coupled with the historic weakness in the housing sector and the continuing uncertainty in the financial industry create significant short term barriers to economic growth. Higher energy prices also have reduced the effectiveness of the stimulus package. And, along with higher food prices, current and projected increases in oil prices explain much of the increase in expected inflation.



Comparison of Actual and Estimated Non-Restricted Revenue

(\$ in thousands)

	<u>2008 Fiscal Year-to-Date</u>			<u>April - June 2008</u>		
	<u>FORECAST</u> <u>REVENUES</u>	<u>ACTUAL</u> <u>REVENUES</u>	<u>VARIANCE</u> <u>ACT-FCST</u>	<u>FORECAST</u> <u>REVENUES</u>	<u>ACTUAL</u> <u>REVENUES</u>	<u>VARIANCE</u> <u>ACT-FCST</u>
<u>Individual Income Tax</u>						
Withholding	5,988,567	6,062,469	73,902	1,467,300	1,497,123	29,823
Declarations	1,597,200	1,662,298	65,098	697,300	761,304	64,004
Miscellaneous	1,036,133	1,151,981	115,848	837,221	953,069	115,848
Gross	8,621,900	8,876,748	254,848	3,001,821	3,211,496	209,675
Refund	1,014,900	1,092,672	77,772	841,411	919,183	77,772
Net	7,607,000	7,784,077	177,076	2,160,410	2,292,313	131,903
<u>Corporate & Bank Excise</u>						
Declarations	916,078	956,223	40,145	195,644	257,618	61,974
Miscellaneous	198,007	249,688	51,681	6,928	14,036	7,108
Gross	1,114,085	1,205,911	91,825	202,572	271,654	69,082
Refund	210,300	178,234	(32,065)	49,630	18,005	(31,625)
Net	903,786	1,027,676	123,891	152,942	253,649	100,707
<u>Sales Tax</u>						
Gross	4,824,825	4,815,490	(9,335)	1,388,665	1,386,972	(1,693)
Refunds	245,179	238,064	(7,115)	70,813	60,090	(10,723)
Net	4,579,646	4,577,426	(2,220)	1,317,852	1,326,882	9,030
<u>Motor Vehicle Sales Tax</u>						
	176,465	186,321	9,856	44,512	52,592	8,080
<u>Other Revenues:</u>						
Estate	120,000	121,349	1,349	22,185	21,490	(695)
Liquor/Wine/Beer	74,205	73,108	(1,097)	24,822	23,688	(1,134)
Cigarette/Tobacco/Cont Sub	186,330	180,900	(5,430)	39,367	34,907	(4,460)
Deed and Mortgage	182,600	198,701	16,102	49,774	61,232	11,457
Insurance Gross Earnings	253,300	281,730	28,431	51,939	65,266	13,327
Lawful Gambling	49,966	48,034	(1,932)	17,308	16,609	(699)
Health Care Surcharge	210,766	214,975	4,209	51,404	52,218	813
Other Taxes	8,546	12,351	3,805	7,177	10,566	3,389
Statewide Property Tax	702,517	704,246	1,729	384,659	386,132	1,473
DHS SOS Collections	60,859	62,591	1,732	15,156	15,111	(45)
Income Tax Reciprocity	69,050	69,050	0	0	0	0
Investment Income	108,679	97,522	(11,157)	28,375	19,433	(8,942)
Tobacco Settlement	182,004	184,411	2,407	0	2,407	2,407
Departmental Earnings	223,695	241,322	17,627	36,088	49,212	13,124
Fines and Surcharges	69,087	78,061	8,974	23,470	30,295	6,824
Lottery Revenues	44,829	43,984	(844)	15,713	14,682	(1,031)
Revenues yet to be allocated	0	3,680	3,680	(1,340)	(1,866)	(526)
Residual Revenues	82,111	88,750	6,639	16,364	28,406	12,041
Sales Tax Rebates (all years)	0	0	0	0	0	0
County Nursing Home, Pub Hosp IGT	21,582	23,079	1,497	16,510	18,007	1,497
Other Subtotal	2,650,125	2,727,846	77,721	798,972	847,793	48,821
Other Refunds	48,828	46,199	(2,629)	9,536	17,913	8,377
Other Net	2,601,297	2,681,647	80,349	789,436	829,880	40,444
Total Gross	17,387,401	17,812,316	424,915	5,436,542	5,770,508	333,966
Total Refunds	1,519,206	1,555,169	35,963	971,390	1,015,191	43,802
Total Net	15,868,195	16,257,147	388,952	4,465,152	4,755,317	290,164