

State Revenues Exceed February Forecast

Minnesota's net general fund receipts for FY 2015 are now estimated to total \$20.363 billion, \$555 million (2.8 percent) more than projected in the February 2015 *Budget and Economic Forecast*. Higher than expected individual and corporate income tax receipts account for nearly all of the additional FY 2015 revenue. General fund revenues in FY 2015 are now estimated to be 5.6 percent greater than in FY 2014. State revenues for the final quarter of FY 2015 were \$455 million more than forecast. (See page 4 for details.)

Summary of Tax Revenues: Fiscal Year 2015

(\$ in millions)	February 2015 Forecast	Estimated Closing ¹	\$ Difference	% Difference
Individual Income Tax	\$10,045	\$10,415	\$369	3.7%
General Sales Tax	5,162	5,163	1	0.0
Corporate Franchise Tax	1,317	1,441	124	9.4
Other Revenues	3,284	3,345	61	1.9
Total Revenues²	\$19,808	\$20,363	\$555	2.8%

1. Reflects actual revenue attributable to FY 2015, estimates of revenue accruals through closing (August 14), and other pre-close adjustments.

2. Totals may not add due to rounding.

About three-quarters of the \$369 million individual income tax variance appears to be due to higher than expected tax year 2014 liability. Payments accompanying final 2014 tax returns and extensions were about \$237 million more than forecast, and individual income tax refunds were about \$42 million less than prior estimates. MMB economists believe the additional revenue is primarily due to larger than expected capital gains realizations and other non-wage income in 2014. Individual income tax withholding receipts exceeded the forecast by \$25 million, and estimated tax payments were \$29 million more than expected. These amounts are payments for 2015 tax liability. Variances in receipts from non-resident partners, non-resident S-Corp shareholders, and fiduciaries explain the remainder of the FY 2015 individual income tax variance.

Corporate tax receipts for FY 2015 were \$124 million (9.4 percent) more than projected. Gross tax payments in excess of the forecast and lower than expected refunds both contribute to the positive corporate tax variance. Other revenues for FY 2015 exceeded the forecast by \$61 million. Higher than anticipated cigarette and tobacco tax receipts contributed half of that additional revenue. Net general sales tax receipts ended FY 2015 less than \$1 million above forecast. Gross sales tax receipts exceeded projections by \$36 million (0.7 percent), but these were offset by higher than anticipated sales tax refunds.

All FY 2015 results are preliminary and subject to change. The state's fiscal year that ended June 30, 2015, will officially close on August 14. Values in the estimated closing column on page 4 reflect actual revenues attributable to FY 2015 as well as estimates of revenue accruals through closing and other pre-close adjustments. As of June 30, total FY 2015 revenue was \$20.347 billion. Estimated accruals and pre-close adjustments add \$16 million. A complete reporting of FY 2015 revenues will be part of October's *Revenue and Economic Update*. The next official forecast will be released in early December 2015.

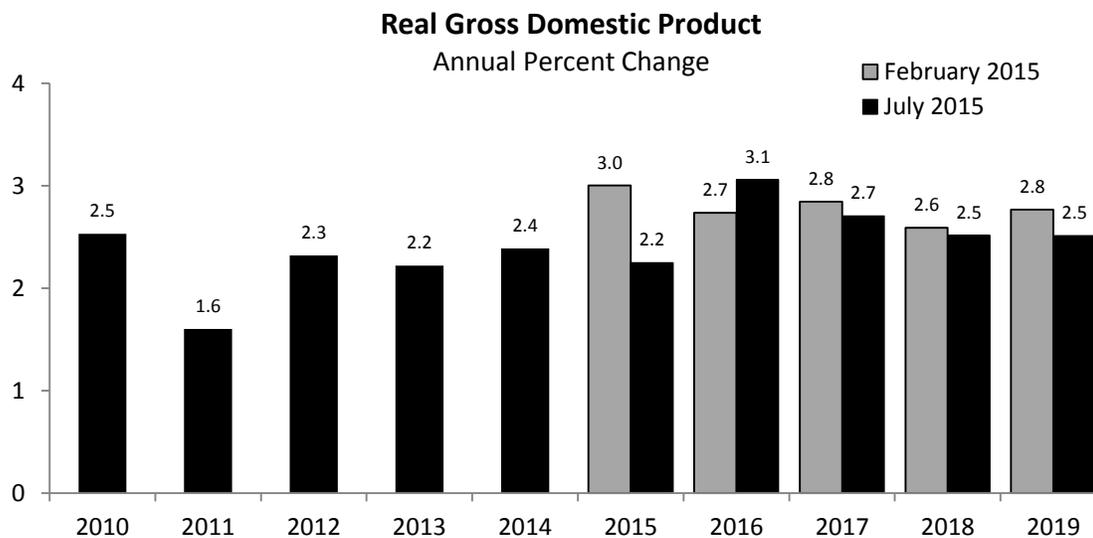
A Mid-Year Assessment of the U.S. Economy

The U.S. economy got off to another slow start in 2015. The Bureau of Economic Analysis (BEA) estimates that real GDP fell at an annual rate of 0.2 percent during the first quarter of the year, down from 2.2 percent growth in the prior quarter. The first quarter slowdown is attributed to a number of temporary factors. Severe winter weather conditions in the Northeast and Midwest took a bite out of home construction and auto sales. Slower oil drilling activity in the wake of falling crude prices hit business investment in that sector hard and fast. The since-resolved West Coast port labor dispute delayed deliveries of manufactured inputs and retail goods. Finally, the stronger dollar cut into net exports.

Nonetheless, transitory factors that weakened first-quarter growth appear to have faded. The economy is now finding greater support in more recent measures of underlying economic activity. The labor market continues to tighten, growth in total compensation is accelerating, home and vehicle sales have ratcheted back up, and confidence among consumers is near recovery highs. As a result, MMB's macroeconomic consultant IHS Economics (IHS) expects real GDP growth to rebound to 2.4 percent (annual rate) in the second quarter of 2015 before expanding nearer to 3 percent in the second half of the year and into 2016.

The slow start to 2015 is expected to weaken this year's overall economic performance. After 2.4 percent real GDP growth in 2014, the July 2015 baseline from IHS now calls for still tepid growth of 2.2 percent in 2015, followed by 3.1 percent growth in 2016. The February 2015 baseline projected stronger overall growth of 3.0 percent in 2015 and 2.7 percent in 2016. The IHS July baseline forecast is very similar to the Blue Chip Consensus, the median of 50 business and academic forecasts. The Blue Chip forecast is for 2.4 percent growth in 2015, followed by an increase of 2.8 percent in 2016.

Inflation is following an expected lower path this year, as lower-priced gasoline and imported consumer goods have put further downward pressure on already low inflation. The IHS July 2015 baseline anticipates consumer prices (CPI) to rise by just 0.2 percent in 2015. The February 2015 baseline projected a decline of 0.7 percent in 2015. Even so, IHS continues to believe lower gasoline prices are transitory and will correct in the medium-term. Thus the July baseline expects the CPI to bounce back by 1.8 percent in 2016, similar to the 2.3 percent CPI growth expected for 2016 last February.



There have been no changes in the probabilities assigned to the baseline or alternative forecast scenarios since February. IHS continues to assign a probability of 70 percent to their July 2015 baseline scenario, and a 15 percent probability to more pessimistic and optimistic alternative scenarios. In the pessimistic scenario, the U.S. economy stalls in early-to-mid 2015 due to lingering consumer spending weakness, lower-than-expected wage and productivity growth, and stagnant household formation, which weakens the housing market. In the optimistic scenario, higher-than-expected productivity and foreign growth deliver a boost to the U.S. economy in mid-to-late 2015.

Supply Glut, Falling Prices Test Minnesota's Iron Ore Industry

Cooling demand in China, combined with a global supply glut of steel, has led to a collapse in prices for both finished steel and its primary raw material, iron ore. Prices for iron ore have fallen by more than half in the past 18 months, from \$135/ton in early 2014 to below \$50/ton in early July. That squeezes producers' profit margins.

Slumping global prices coupled with the stronger dollar is also making foreign steel less expensive, sparking a surge in U.S. imports, including by auto makers. In response, domestic steelmakers have cut prices, curbed production, and reduced demand for Minnesota taconite iron ore, the source of approximately 75 percent of total U.S. production. This has led to the idling or slowing of mining operations on Minnesota's Iron Range in recent months, directly affecting more than a thousand workers. That accounts for nearly one-fourth of northeastern Minnesota's 4,400 iron ore mining jobs in 2014. It also impacts jobs and income in support industries, including utilities, transportation and manufacturing.

Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2015			April – June FY2015		
	FORECAST REVENUES ¹	ESTIMATED CLOSING ²	DIFFERENCE ACTUAL-FCST	FORECAST REVENUES ¹	ESTIMATED CLOSING ²	DIFFERENCE ACTUAL-FCST
Individual Income Tax						
Withholding	7,906,292	7,931,297	25,005	2,026,432	2,018,350	(8,082)
Declarations	2,170,600	2,294,896	124,296	903,307	1,027,143	123,836
Miscellaneous	1,390,595	1,562,133	171,538	854,737	1,030,124	175,386
Gross	11,467,487	11,788,326	320,838	3,784,476	4,075,616	291,140
Refund	1,421,990	1,373,686	(48,304)	516,473	459,818	(56,656)
Net	10,045,497	10,414,640	369,142	3,268,003	3,615,798	347,796
Corporate Franchise Tax						
Declarations	1,296,033	1,365,290	69,257	332,240	367,318	35,077
Miscellaneous	229,757	249,081	19,324	(26,535)	(18,421)	8,114
Gross	1,525,790	1,614,370	88,581	305,705	348,896	43,192
Refund	208,678	173,491	(35,187)	66,285	57,941	(8,344)
Net	1,317,112	1,440,879	123,768	239,420	290,955	51,535
General Sales Tax						
Gross	5,514,596	5,550,698	36,102	1,583,050	1,608,139	25,089
Mpls. Sales Tax Transferred to MSFA	1,960	1,360	(601)	981	380	(601)
Sales Tax Gross	5,516,556	5,552,058	37,502	1,584,031	1,608,519	24,488
Refunds (including Indian Refunds)	354,850	389,590	34,740	135,837	152,524	16,687
Net	5,161,706	5,162,468	762	1,448,194	1,455,995	7,802
Other Revenues:						
Net Estate Tax	136,500	146,136	9,636	38,997	43,576	4,579
Net Liquor/Wine/Beer	84,870	84,368	(502)	26,116	26,772	656
Net Cigarette/Tobacco	592,010	622,421	30,411	170,891	198,573	27,682
Deed and Mortgage	198,204	207,333	9,128	58,838	69,987	11,149
Net Insurance Gross Earnings	366,889	350,999	(15,890)	81,588	80,065	(1,524)
Lawful Gambling	46,350	49,191	2,841	16,641	16,618	(23)
Health Care Surcharge	286,423	280,467	(5,957)	103,956	99,931	(4,024)
Other Taxes	17,026	17,372	346	16,256	16,586	330
Statewide Property Tax	824,287	838,080	13,794	433,006	446,393	13,387
DHS SOS Collections	60,550	70,781	10,231	8,473	14,257	5,784
Investment Income	10,000	13,659	3,659	2,182	3,926	1,744
Tobacco Settlement	162,823	170,747	7,924	118	8,024	7,906
Dept. Earnings & MSOP Recov.	198,095	206,519	8,424	67,062	60,562	(6,500)
Fines and Surcharges	81,826	75,918	(5,907)	33,670	23,536	(10,134)
Lottery Revenues	57,269	60,374	3,105	25,538	20,719	(4,818)
Revenues yet to be allocated	(0)	1,811	1,811	(846)	1,810	2,656
Residual Revenues	159,872	148,208	(11,665)	55,071	53,367	(1,704)
County Nursing Home, Pub Hosp IGT	6,792	6,327	(465)	1,698	1,698	-
Other Subtotal	3,289,786	3,350,711	60,925	1,139,255	1,186,402	47,147
Other Refunds	5,855	5,800	(55)	1,458	1,200	(258)
Other Net	3,283,932	3,344,912	60,980	1,137,797	1,185,201	47,405
Total Gross	21,799,619	22,305,464	505,846	6,813,466	7,219,433	405,967
Total Refunds	1,991,372	1,942,566	(48,806)	720,053	671,483	(48,570)
Total Net	19,808,246	20,362,898	554,652	6,093,413	6,547,950	454,537

1. February 2015 Budget & Economic Forecast.

2. Reflects estimates of revenue accruals through FY 2015 closing (August 14) and other pre-close adjustments.