Minnesota
Department of Finance

October 1999

Economic Update

State Revenues Exceed Forecast During First Quarter of Fiscal 2000

Net general fund revenues totaled $2.631 billion during the first quarter of fiscal 2000, $59 million (2.3 percent) more than forecast in February. State revenues continue to benefit from a very strong state and national economy. While state general fund revenues are down 2.9 percent ($80 million) from those in the first quarter of fiscal 1999, last year=s revenues were boosted by the first installment of the tobacco settlement payment. After adjusting for that $240 million one-time event, first quarter 2000 revenues were up 6.5 percent from last year=s levels.

Summary of Tax Receipts: F.Y. 2000 to Date

	Forecast	Actual	Variance	Percent
	----------Dollars in Millions----------			
Individual	1,281.8	1,287.5	5.7	0.4
Sales	797.4	805.2	7.8	1.0
Corporate	184.2	182.2	(2.0)	(1.1)
Motor Vehicle	117.7	139.6	21.9	18.6
Other	190.5	216.2	25.8	13.5
TOTAL	2,571.5	2,630.7	59.2	2.3

Large percentage variances in motor vehicle sales tax receipts and other revenues accounted for much of the additional state revenue. Motor vehicle sales taxes exceeded forecast by $22 million (19 percent), as strong demand for cars and light vehicles, coupled with a recent increase in promotional activity raised U.S. light vehicle sales above the 17 million unit per year rate in the third quarter. If sales continue as expected for the remainder of this year, more cars and light trucks will be sold in 1999 than in any year in history. A large variance in inheritance and estate tax collections and greater than expected investment income were the major contributors to the $26 million variance in other revenues. Variances for the individual income tax, the sales tax, and the corporate income tax were small and well within historical norms, although withholding revenues and gross sales tax receipts were slightly below forecast levels. (See page 4.)

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Fiscal 1999 Forecast Variance Reduced by $26 Million

The preliminary revenue variance for fiscal 1999 has been reduced from that reported in the July *Economic Update*. Net general fund revenues excluding the sales tax rebate are now estimated to total $11.151 billion, $272 million more than forecast, but $26 million less than reported in July. Income tax refunds for tax year 1998 which were unprocessed on June 30 were larger than anticipated. A final report on F.Y. 1999 revenues will be released as part of the November revenue forecast.

F.Y. 1999 revenues are now reported including sales tax rebate payments assigned to that fiscal year. Nearly $17 million of those payments were recaptured by the state and applied against taxes owed in prior years, leaving a net change of $1.275 billion. For accounting purposes additional sales tax rebate payments totaling $6 million made following the initial distribution have been included in F.Y. 2000. Rebate payments to date total $1.298 billion.

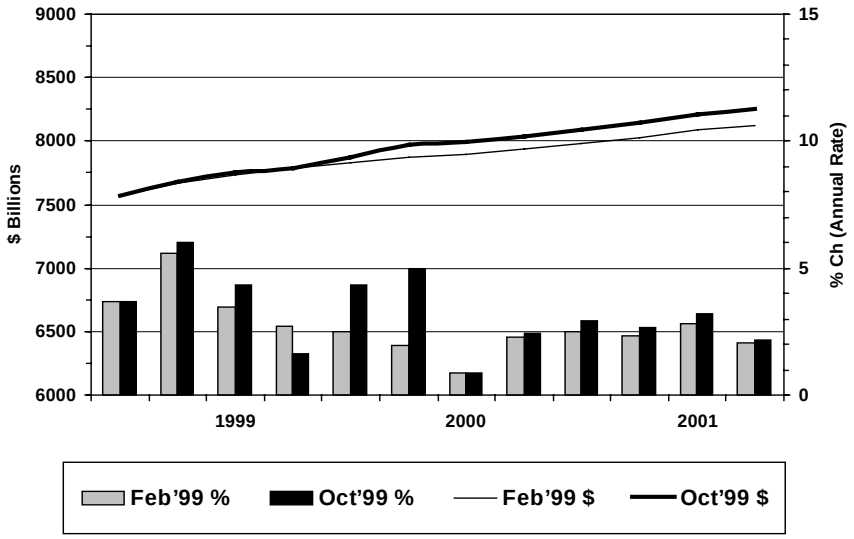
Strong U. S. Economic Growth Expected During Remainder of 1999

The U.S. economy ended the second quarter almost exactly on forecast. For the remainder of this year, however, economists' outlooks have grown increasingly optimistic. Even with the flooding which followed Hurricane Floyd and two Federal Reserve rate hikes (and the strong likelihood of a third in November) forecasters have raised their outlook for the last six months of 1999. Few see any reason for a major slowdown in consumer spending, so the additional economic activity expected from inventory rebuilding and increased foreign demand is anticipated to boost real GDP growth rates up to the 4.5 to 5.0 percent range during the second half of 1999.

Data Resources, Inc. (DRI), Minnesota's macroeconomic consultant, is among the many who have raised their forecast for the remainder of this year. DRI believes that higher interest rates will help cool the housing market and that auto sales simply cannot maintain the 17 million plus unit pace observed during the third quarter. They also recognize that some of the factors which have fueled consumers' eagerness to spend during recent months have been reversed. But jobs remain plentiful and pay increases have been good, and there is still little evidence of the inflationary pressures which might bring this remarkable expansion to a close. DRI now expects real GDP to grow at a 3.5 percent rate during fiscal 2000, up noticeably from February's Control forecast of 2.4 percent growth, but almost unchanged from July's projection. For fiscal 2001 real GDP growth of 2.6 percent is expected, up only slightly from the 2.2 percent growth rate in the February Control.

Almost all of the change in this biennium's outlook comes in the last half of 1999. Expected growth rates in 2000 and beyond differ little from those in February's forecast. The sizeable, near-term changes come largely from expected inventory rebuilding. Inventories at the end of the second quarter were quite low, and DRI believes that restoring them to normal levels will lift third quarter GDP substantially. DRI also expects inventories to continue to grow during the fourth quarter as firms seek to protect themselves against supplier slowdowns caused by year 2000 problems. The resulting level of GDP at the close of 1999 will be higher than previously forecast, raising the base to which future growth rates are applied. But, should this inventory rebuilding not occur, the outlook for the 2000-01 biennium is remarkably similar to February's forecast.

Economic Outlook Improves for Remainder of Biennium



While there is no recession in the five year horizon covered by the Control forecast, DRI acknowledges that a number of things could go wrong. The most likely is that inflation builds to a level which forces the Federal Reserve to raise rates and a recession follows. In this scenario (probability 30 percent) the economy turns down in 2002, although the recession could come as much as six months earlier or a year or more later, depending on when inflation becomes a serious problem. Although recessions are almost always triggered by increased inflation, DRI also assigns a 10 percent probability to a near term recession triggered by a stock market collapse of about 30 percent. The probability assigned to the Control forecast remains at 60 percent, the same as in February.

Revisions to National Income Accounts Will Change History and Forecast

In late October the U.S. Department of Commerce will release results from their comprehensive revision of the national income accounts. While most of those adjustments will have only a negligible impact on GDP, a change in the way business and government purchases of software are treated will add to GDP. The Department of Commerce indicates that this revision will increase 1996 GDP by about $115 billion. This change is also likely to increase the forecast growth rates for GDP in the current quarter and beyond. Some forecasters estimate that the definitional change alone may add 0.5 percent to their forecast for fourth quarter growth.

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

	1999 Fiscal Year to Date			July - Sept. 1999		
Four Major Revenues:	**Forecast Revenues**	**Actual Revenues**	**Variance Act-Fcst**	**Forecast Revenues**	**Actual Revenues**	**Variance Act-Fcst**
Individual Income Tax						
Withholding	4,490,825	4,534,928	44,103	1,074,884	1,070,893	(3,991)
Declarations	1,091,300	1,143,237	51,937	197,200	205,603	8,403
Miscellaneous	504,054	613,681	109,627(1)	38,900	39,434	534
Gross	6,086,189	6,291,846	205,667	1,310,984	1,315,930	4,946
Refunds	947,600	970,929	23,329	29,200	28,438	(762)
Net	5,138,589	5,320,917	182,338	1,281,784	1,287,491	5,707
Corporate & Bank Excise						
Declarations	774,800	791,705	16,905	175,260	176,642	1,382
Miscellaneous	109,149	96,319	(12,830)	19,200	18,113	(1,087)
Gross	883,949	888,024	4,075	194,460	194,755	295
Refunds	102,129	110,533	8,403	10,300	12,598	2,298
Net	781,820	777,492	(4,328)	184,160	182,158	(2,002)
Sales Tax						
Gross	3,618,592	3,634,534	15,943	835,496	832,146	(3,350)
Refunds	203,964	202,168	(1,796)	38,076	26,897	(11,179)
Net	3,414,628	3,432,366	17,739	797,420	805,249	7,830
Sales Tax Rebate	(1,300,000)	(1,292,014)	7,986	0	(5,874)	(5,874)
Motor Vehicle Sales	461,500	487,041	25,541	117,700	139,577	21,877
Other Revenues:						
Inherit/Gift/Estate	49,275	58,929	9,654	15,539	30,263	14,724
Liquor/Wine/Beer	58,076	58,818	742	11,889	12,178	289
Cigarette & Tobacco	182,185	178,837	(3,348)	35,403	38,985	3,582
Deed and Mortgage	142,800	152,747	9,947	39,970	40,047	77
Insurance Gross Earnings	167,500	166,962	(539)	1,700	2,455	755
Lawful Gambling	63,692	65,848	2,156	12,978	13,874	896
Health Care Surcharge	121,185	120,600	(585)	28,458	29,113	655
Other Taxes	3,732	3,347	(385)	799	298	(501)
General Fund RTC Revenues	20,836	22,414	1,577	5,208	4,184	(1,024)
Income Tax Reciprocity	39,367	39,367	0	0	0	0
Investment Income	192,000	205,734	13,734	26,954	32,058	5,104
Other and Unallocated	73,000	81,077	8,077(2)	13,451	20,789	7,338
Other Subtotal	1,113,649	1,154,679	41,030	192,348	224,242	31,894
Other Refunds	23,471	21,440	(2,031)	1,887	2,153	266
Other Net	1,090,178	1,133,239	43,061	190,461	222,090	31,629
Total Gross	10,863,870	11,164,111	300,241	2,650,988	2,700,777	49,789
Total Refunds	1,277,165	1,305,070	27,905	79,463	70,086	(9,377)
Total Net	9,586,705	9,859,041	272,336	2,571,525	2,630,691	59,167

(1) Includes $15,741 recaptured through sales tax rebate.

(2) Includes $1,241 recaptured through sales tax rebate.