

October 2013

Net State Revenues Tracking Forecast for First Quarter of Fiscal Year 2014

Net non-dedicated general fund revenues totaled \$4.086 billion during the first quarter of fiscal year 2014, \$2 million less than projected in February. Both the sales tax and the income tax showed positive variances for the quarter, with sales tax receipts \$46 million (4.2 percent) ahead of forecast and the income tax exceeding projections by \$27 million (1.3 percent). Other revenues were \$64 million (12.3 percent) lower than anticipated in February, and corporate tax receipts were \$11 million (3.1 percent) short of prior estimates.

Summary of Tax Receipts (July – September, 2013)

	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
	----- (\$ in millions) -----			
Income	\$2,128	\$2,155	\$27	1.3
Sales Tax	1,087	1,133	46	4.2
Corporate	353	342	(11)	(3.1)
Other	<u>520</u>	<u>457</u>	<u>(64)</u>	<u>(12.3)</u>
Total	\$4,088	\$4,086	\$(2)	(<.1)

Individual income tax withholding receipts during the first quarter of fiscal year 2014 fell below forecast by \$25 million, but larger estimated tax and miscellaneous payments combined to bring net individual income tax receipts above forecast for the quarter. A \$15 million (4.1 percent) shortfall in gross corporate tax payments was partially mitigated by refunds that were \$4 million lower than expected. Cigarette and tobacco tax revenues fell \$29 million (21.1 percent) short of expectations, accounting for almost half of the shortfall in other revenues.

This update is the first look at revenues since the 2013 legislature enacted significant changes in Minnesota's individual income, corporate income, sales and tobacco taxes. Forecast revenues for the quarter include approximately \$240 million that was expected to arise from the law changes. Actual state tax receipts during the quarter exceeded year-earlier levels by \$336 million (9.0 percent).

¹ Totals may not add due to rounding.

Fiscal Year 2013 Revenues Closed \$489 Million More Than Forecast in February

Net non-dedicated general fund revenues for the fiscal year that ended June 30, 2013, are now \$489 million above February's forecast, producing a variance that is \$26 million more than the \$463 million originally reported in the July *Revenue and Economic Update*. Much of the increase in the fiscal 2013 revenue variance is attributable to the timing of certain electronic payments for withholding, sales, and cigarette received at the end of June. That change more than offsets higher than estimated corporate and sales tax refunds paid prior to the fiscal year close.

Per a provision in 2013 session law, the \$489 million positive revenue variance for fiscal year 2013 was combined with changes in spending resulting in a \$636 million repayment of K-12 education and property tax recognition shifts.

Continued Federal Fiscal Uncertainty Creates Economic Drag

The U.S. economy has continued to grow at a modest pace in 2013, despite the federal budget cuts known as sequestration and significant uncertainty created by federal policymakers' failure to agree on a fiscal 2014 budget, leading to the shutdown of much of the U.S. government. Real GDP in the second quarter of 2013 is now reported to have grown 2.5 percent, with 1.9 percent growth projected for the second half of the year. Tight supplies of existing homes have helped boost home prices and support the construction industry's recovery. Job increases have averaged 180,000 per month in the past twelve months, but only 150,000 per month over the last three months.

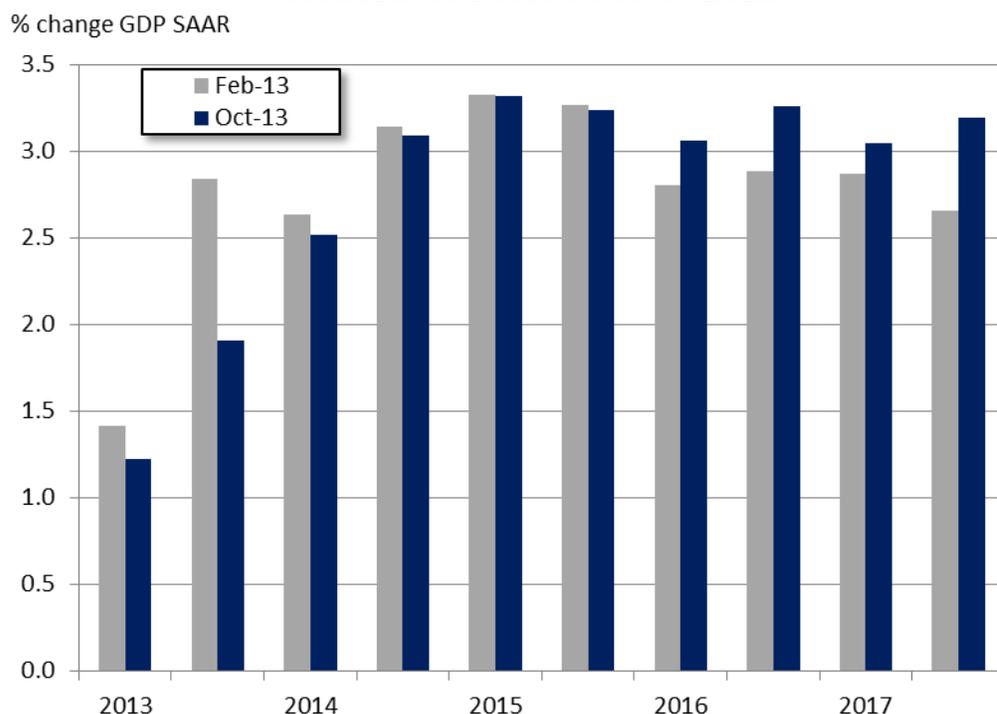
The October baseline forecast from IHS Global Insight (GI), Minnesota's macro-economic consultant, is less optimistic than their February forecast, which was used as the base for the 2014-15 revenue forecast and the 2016-17 revenue planning estimates. October's baseline forecast for 2013 real GDP growth is 1.5 percent, reduced from 1.9 percent in February. Since February, GI has reduced their projected 2014 real GDP growth rate from 2.8 to 2.5 percent and their 2015 growth rate from 3.3 to 3.2 percent.

GI's October baseline is similar to other economic forecasts for 2013 and 2014. September's Blue Chip consensus forecast for real GDP growth in 2013 is 1.6 percent, just above GI's 1.5 percent projection. Similarly, the Blue Chip consensus expects 2014 growth of 2.6 percent, compared to GI's 2.5 percent forecast. When the forecast horizon is extended to 2015 and 2016, however, GI's baseline is higher than Blue Chip's, with projected growth rates of 3.2 percent in both 2015 and 2016 compared to the consensus forecasts of 2.8 and 2.9 percent, respectively.

The federal government shutdown has already lasted longer than the single week assumed in GI's October baseline, which also includes full back pay for furloughed federal workers. GI expects Congress to raise the debt ceiling before the government's borrowing authority ends on October 17, 2013. Breaching the debt limit will leave the government with insufficient revenue to meet all of its obligations, causing some government payments to be delayed, partially fulfilled, or forgone. The impact of such an unprecedented event is unpredictable, although many observers believe it could significantly disrupt global financial markets.

As in their baseline, GI’s pessimistic scenario (20 percent probability) assumes that Congress acts to prevent a breach of the nation’s debt limit. In contrast with the baseline, tighter U.S. fiscal policy and a worse global outlook drag economic growth down to 1.3 percent in 2013 and 0.6 percent in 2014, barely avoiding a recession. In GI’s optimistic scenario (20 percent probability), federal policymakers avoid excessive fiscal restraint, producing significantly higher 2014 growth. October’s baseline was assigned a 60 percent probability, the same as in GI’s February’s forecast.

Real GDP Growth Expectations Reduced for Second Half of 2013



Source: Global Insight's October 2013 U.S. Economic Outlook

The harmful effect of a federal government shutdown will not be the same for all states. The largest impact will occur where exposure to federal civilian employment and federal spending are the greatest, such as around the Washington, D.C. area. In Minnesota, where federal employment and spending are not major components of the economy, the impact will be less apparent.

As in the rest of the country, full back pay for furloughed federal workers will lessen the impact of the shutdown in Minnesota. On the other hand, a prolonged shutdown will bring greater unpredictability and economic impact, as more federal payments to Minnesota residents are delayed or possibly foregone. More importantly, if failure by Congress to lift the debt ceiling sets off a global financial crisis, the potential impact on Minnesota’s economy and tax revenues will grow.

Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	September 2013 – Fiscal Year-to-Date			Fiscal Year 2013 Close		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	1,736,924	1,711,621	(25,303)	6,989,500	7,103,079	113,579
Declarations	328,812	352,731	23,920	1,633,080	1,799,944	166,864
Miscellaneous	82,012	110,924	28,911	1,318,321	1,336,024	17,703
Gross	2,147,748	2,175,276	27,528	9,940,900	10,239,046	298,145
Refund	20,036	20,559	523	1,292,400	1,226,500	(65,900)
Net	2,127,712	2,154,718	27,005	8,648,500	9,012,545	364,045
Corporate & Bank						
Excise						
Declarations	300,416	301,596	1,180	1,101,910	1,199,313	97,403
Miscellaneous	69,726	53,292	(16,434)	238,540	252,563	14,023
Gross	370,142	354,888	(15,254)	1,340,450	1,451,875	111,425
Refund	17,347	12,913	(4,434)	175,349	171,032	(4,318)
Net	352,795	341,975	(10,820)	1,165,100	1,280,843	115,743
Sales Tax						
Gross	1,132,404	1,168,206	35,802	5,068,901	5,029,547	(39,353)
Refunds	45,562	35,599	(9,963)	252,122	255,298	3,176
Net	1,086,842	1,132,607	45,764	4,816,778	4,774,249	(42,529)
Other Revenues:						
Estate	47,726	57,849	10,123	156,000	167,460	11,460
Liquor/Wine/Beer	15,869	17,746	1,878	84,630	83,248	(1,382)
Cigarette/Tobacco/Cont.						
Sub	137,188	108,261	(28,927)	191,060	205,391	14,331
Deed and Mortgage	37,764	44,589	6,825	204,900	215,515	10,615
Insurance Gross						
Earnings	72,986	79,642	6,657	304,900	332,843	27,943
Lawful Gambling	15,050	8,171	(6,879)	42,800	38,794	(4,006)
Health Care Surcharge	64,039	41,869	(22,171)	245,850	240,061	(5,789)
Other Taxes	184	182	(2)	19,418	22,988	3,570
Statewide Property Tax	16,524	20,897	4,373	816,701	811,388	(5,313)
DHS SOS Collections	13,023	13,718	695	47,900	51,306	3,406
Income Tax Reciprocity	0	0	0	0	0	0
Investment Income	667	0	(667)	3,600	3,669	69
Tobacco Settlement	100	0	(100)	165,144	170,060	4,917
Departmental Earnings	56,968	43,738	(13,230)	261,599	272,362	10,763
Fines and Surcharges	16,350	14,148	(2,203)	90,531	86,302	(4,229)
Lottery Revenues	8,452	4,730	(3,722)	61,854	66,197	4,343
Revenues yet to be allocated	0	398	398	0	10	10
Residual Revenues	22,405	21,475	(931)	185,608	184,534	(1,074)
County Nursing Home, Pub Hosp IGT	1,132	1,132	0	6,792	6,792	0
Other Subtotal	526,427	478,545	(47,882)	2,889,286	2,958,919	69,633
Other Refunds	5,945	22,025	16,080	63,258	80,704	17,446
Other Net	520,482	456,520	(63,962)	2,826,028	2,878,215	52,186
Total Gross	4,176,721	4,176,915	194	19,239,537	19,679,387	439,850
Total Refunds	88,889	91,095	2,206	1,783,130	1,733,535	(49,595)
Total Net	4,087,832	4,085,820	(2,013)	17,456,407	17,945,852	489,445