

October 2014

State Revenues Fall Below February Forecast for First Quarter of Fiscal Year 2015

Minnesota's net general fund receipts totaled \$4.297 billion during the first quarter of fiscal year 2015, \$46 million less than projected in the February 2014 *Budget and Economic Forecast*. Corporate tax receipts exceeded expectations, more than offsetting negative variances in the individual income and sales taxes. Lower than expected other revenues contributed the largest amount to the shortfall. In September, total receipts exceeded forecast by \$33 million, partly offsetting negative variances for the first two months of the quarter.

Summary of Tax Revenues: July – September, 2014

(\$ in millions)	February 2014 Forecast ¹	Actual	\$ Difference	% Difference
Individual Income Tax	\$2,322	\$2,297	\$(26)	(1.1)%
General Sales Tax	1,162	1,157	(6)	(0.5)
Corporate Franchise Tax	345	401	56	16.1
Other Revenues	512	442	(70)	(13.7)
Total Revenues²	\$4,342	\$4,297	\$(46)	(1.1)%

1. February 2014 *Budget and Economic Forecast* adjusted for legislative changes.

2. Totals may not add due to rounding.

Net other revenues were \$70 million (13.7 percent) lower than anticipated in February. Much of that negative variance (\$31 million) is from timing of health care surcharge receipts and is expected to reverse in the future. A \$17 million shortfall in cigarette and tobacco taxes is believed to be the result of higher than expected receipts at the end of the previous quarter.

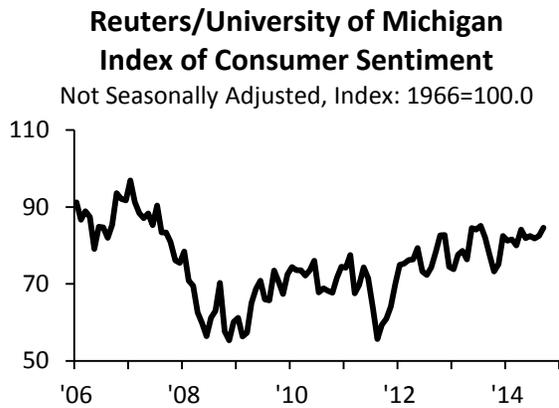
Individual income tax receipts during the quarter were \$26 million (1.1 percent) below forecast. Lower than expected withholding and estimated tax payments (declarations), together with refunds in excess of forecast, produced the shortfall. While withholding receipts came in below forecast for the first two months of the quarter, the month of September brought in \$10 million more withholding than expected.

Fiscal Year 2014 Revenues End \$186 Million above February Forecast

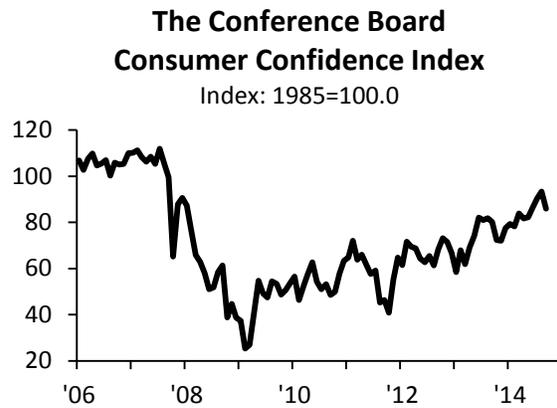
Net general fund revenues for the fiscal year that ended June 30, 2014, are now \$186 million more than forecast in February, producing a variance that is \$18 million more than the \$168 million originally reported in the *July Revenue and Economic Update*. Much of the increase in the revenue variance is due to lower than expected individual income tax refunds attributable to fiscal year 2014 and paid out between the end of the fiscal year and the official close. That change is partly offset by higher than estimated corporate tax refunds paid prior to the fiscal year close.

U.S. Economy Rebounded From its Winter Slump

The U.S. economy bounced back sharply from its winter slump in the early part of the year. The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 4.6 percent in the second quarter of 2014, compared to the first quarter when real GDP declined a revised 2.1 percent. The rebound was driven by a surge in fixed investment and exports, a rebuilding of depleted business inventories, and an increase in health care spending. Improved performance also reflects the effects from lower gasoline prices, stronger job creation, rising consumer confidence, and a pickup in vehicle sales and spending for other consumer durable goods. These changes strengthen the case for solid growth in the second half of 2014. MMB’s macroeconomic consultant IHS Economics (IHS) expects real GDP growth of about 3.0-3.7 percent for the third and fourth quarters of this year.

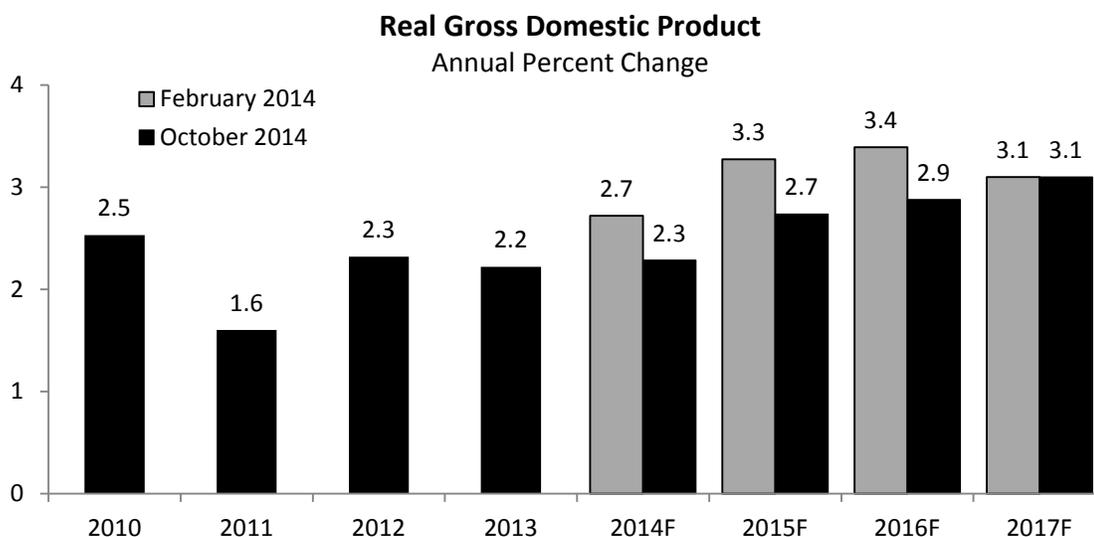


Source: Reuters/University of Michigan



Source: The Conference Board

An acceleration of growth is expected to continue through at least 2015. The October 2014 baseline from IHS now calls for real GDP growth of 2.3 percent in 2014, followed by 2.7 percent growth in 2015 and 2.9 percent growth in 2016. The February 2014 baseline projected stronger growth of 2.7 percent in 2014, followed by an increase of 3.3 percent growth in 2015 and 3.4 percent in 2016. The IHS October baseline forecast is similar to the Blue Chip Consensus, the median of 50 business and academic forecasts. The Blue Chip forecast is for 2.2 percent growth in 2014, followed by growth of 3.1 percent in 2015 and 2.9 percent in 2016.



Source: U.S. Bureau of Economic Analysis (BEA), IHS Economics (IHS)

Inflationary pressures continue to be of little concern. The IHS October baseline anticipates CPI increases of 1.8 percent in 2014, 1.4 percent in 2015, and 1.6 percent in 2016. February's inflation outlook was similarly subdued.

There are several key dependencies to the IHS economic outlook. First, stronger labor market conditions must begin to translate into improvements in household formation and labor force growth, which have all but ceased over the past year. Higher household formation rates boost housing demand, and labor force growth is an important component for overall economic growth. Second, the Federal Reserve's actions to tighten monetary policy next year must go smoothly. In the October baseline, IHS assumes that the Fed begins to raise the federal funds rate in June 2015. Finally, international economic and political risk must not cause undue harm. Foreign trade is expected to help drive overall economic growth during the second half of this year. The events in Ukraine and the Middle East, as well as the slowing economies in Europe, Japan, and Brazil, heighten the forecast risk from the international trade sector.

IHS assigns a probability of 70 percent to their October baseline scenario, and a 15 percent probability to more pessimistic and optimistic alternative scenarios, up from 60 percent and 20 percent respectively in February. In the pessimistic scenario, the U.S. economy stalls in late 2014 due to stagnant household formation and a weaker-than-expected housing market, just avoiding recession. In the optimistic scenario, higher-than-expected foreign growth and associated depreciation of the dollar deliver a boost to the U.S. economy later this year.

Comparison of Actual and Forecast Non-Restricted Revenues

(\$ in thousands)

	Fiscal Year-to-Date 2015 (July-September, 2014)			Fiscal Year 2014 Close		
	FORECAST REVENUES*	ACTUAL REVENUES	DIFFERENCE ACTUAL-FCST	FORECAST REVENUES*	ACTUAL REVENUES	DIFFERENCE ACTUAL-FCST
Individual Income Tax						
Withholding	1,827,600	1,800,769	(26,831)	7,475,700	7,478,528	2,827
Declarations	410,247	398,674	(11,573)	1,986,290	1,982,458	(3,832)
Miscellaneous	102,743	122,400	19,657	1,386,709	1,476,173	89,464
Gross	2,340,590	2,321,843	(18,747)	10,848,699	10,937,158	88,459
Refund	18,400	25,249	6,849	1,383,170	1,277,604	(105,566)
Net	2,322,190	2,296,594	(25,596)	9,465,530	9,659,554	194,024
Corporate & Bank Excise						
Declarations	306,301	355,553	49,252	1,260,631	1,245,161	(15,470)
Miscellaneous	52,201	54,581	2,380	243,197	202,996	(40,201)
Gross	358,502	410,134	51,632	1,503,828	1,448,157	(55,671)
Refund	13,123	9,251	(3,872)	166,511	169,949	3,438
Net	345,379	400,883	55,505	1,337,318	1,278,209	(59,109)
Sales Tax						
Gross	1,205,915	1,196,063	(9,852)	5,286,532	5,363,860	77,328
Mpls. sales tax transferred to MSFA		-	-	813	813	-
Sales Tax Gross	1,205,915	1,196,063	(9,852)	5,287,345	5,364,673	77,328
Refunds (including Indian refunds)	43,570	39,239	(4,331)	280,190	321,986	41,796
Net	1,162,345	1,156,824	(5,521)	5,007,155	5,042,687	35,532
Other Revenues:						
Net Estate & Gift Tax	47,200	33,013	(14,187)	173,400	177,432	4,032
Net Liquor/Wine/Beer	15,935	16,985	1,050	82,860	83,931	1,071
Net Cigarette/Tobacco	128,603	111,871	(16,732)	593,271	607,120	13,849
Deed and Mortgage	40,911	35,792	(5,120)	187,660	180,565	(7,095)
Net Insurance Gross Earnings	82,350	85,475	3,125	349,479	347,299	(2,180)
Lawful Gambling	10,550	8,753	(1,797)	40,900	43,488	2,588
Health Care Surcharge	72,661	41,662	(30,999)	289,219	287,554	(1,665)
Other Taxes	185	185	0	13,210	16,505	3,295
Statewide Property Tax	16,608	16,126	(482)	832,057	835,554	3,497
DHS SOS Collections	14,363	13,560	(803)	54,400	51,130	(3,270)
Income Tax Reciprocity	-	-	-	-	-	-
Investment Income	867	2,424	1,557	4,600	6,702	2,102
Tobacco Settlement	100	100	-	164,529	175,399	10,870
Dept. Earnings & MSOP Recov.	41,072	36,891	(4,181)	198,268	201,939	3,671
Fines and Surcharges	15,827	14,497	(1,330)	85,391	76,683	(8,708)
Lottery Revenues	8,634	6,616	(2,018)	60,458	55,741	(4,716)
Revenues yet to be allocated	-	64	64	(0)	(7)	(7)
Residual Revenues	17,108	18,128	1,020	150,663	147,425	(3,239)
County Nursing Home, Pub Hosp IGT	632	1,698	1,066	6,792	6,792	-
Other Subtotal	513,606	443,839	(69,767)	3,287,157	3,301,252	14,095
Other Refunds	1,198	1,487	289	7,033	6,052	(981)
Other Net	512,408	442,352	(70,056)	3,280,124	3,295,200	15,076
Total Gross	4,418,612	4,371,878	(46,734)	20,927,030	21,051,241	124,211
Total Refunds	76,291	75,225	(1,066)	1,836,903	1,775,590	(61,312)
Total Net	4,342,321	4,296,653	(45,668)	19,090,127	19,275,650	185,523

* February 2014 Budget & Economic Forecast adjusted for legislative changes.