

Revenue and Economic Update

July 10, 2018

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State Revenues Above February Forecast

Minnesota’s net general fund receipts for FY 2018 are now estimated to total \$22.034 billion, \$348 million (1.6 percent) more than projected in the February 2018 *Budget and Economic Forecast*. Higher than expected net individual income tax, corporate tax receipts, and other receipts more than offset net sales tax receipts that were less than forecast. General fund revenues for FY 2018 are now estimated to be 4.7 percent greater than in FY 2017. State revenues in the final quarter of FY 2018 were \$342 million more than forecast. (See page 4 for details.)

Net individual income tax receipts are estimated to end the year \$330 million (2.9 percent) more than forecast. Gross income tax receipts were \$275 million above the forecast, and refunds were \$54 million less than expected.

Net collections associated with tax year 2017 final returns and extensions were about \$280 million more than forecast. We will not know final tax year 2017 income tax liability until extension return filing and processing is completed at the end of 2018. However, we do know that about \$50 million of that variance is from taxes paid on the income of estates and trusts. It is also likely that non-wage income reported on returns filed by individuals—

particularly capital gains—grew faster in tax year 2017 than we had forecast.

Preliminary evidence from federal 2017 income tax returns processed through May 23, 2018, suggests that the share of U.S. capital gains realizations in adjusted gross income was 3.8 percent in 2017, compared to 2.9 percent 2016.¹ This represents roughly 31 percent year-over-year growth in capital gains on returns processed through May. We will know more about 2017 Minnesota non-wage income when we see information from a preliminary sample of 2017 tax returns in early 2019.

On net, payments generally associated with calendar year 2018 activity—income tax withholding and estimated payments, including those of fiduciaries and non-resident partnerships —were about \$50 million more than forecast. Withholding payments were \$10 million above the forecast, and estimated payments were about \$40 more than forecast.

Net general sales tax receipts are estimated to end FY 2018 \$56 million (1.0 percent) less than forecast. Lower than expected gross receipts and higher than expected refunds both contribute to that variance.

Summary of Revenues: Fiscal Year 2018

(\$ in millions)	February 2018			
	Forecast	Actual	\$ Difference	% Difference
Individual Income Tax	\$11,451	\$11,781	\$330	2.9%
General Sales Tax	5,489	5,433	(56)	(1.0)
Corporate Franchise Tax	1,301	1,321	20	1.6
Other Revenues	3,445	3,498	54	1.6
Total Revenues¹	\$21,686	\$22,034	\$348	1.6%

1. Totals may not add due to rounding.

¹ See late May filing statistics for 2017 and 2018 here: <https://www.irs.gov/statistics/filing-season-statistics>

We estimate that net corporate tax receipts ended FY 2018 \$20 million (1.6 percent) above the forecast. Gross receipts in excess of the forecast and lower than expected refunds both contribute to that variance. The estimated closing value for other net receipts is \$54 million more than forecast.

All FY 2018 results are preliminary and subject to change. The state’s fiscal year that ended June 30, 2018, will officially close on August 10. Values in the estimated closing column on page 4 reflect actual revenues attributable to FY 2018 as well as estimates of revenue accruals through closing and other pre-close adjustments. As of June 30, actual FY 2018 actual receipts were \$22.058 billion. Estimated accruals and pre-close adjustments subtract about \$25 million. This is primarily due to individual, corporate, and sales tax refunds attributable to FY 2018 that are expected to be paid out prior to the close. A complete reporting of FY 2018 revenues will be part of October’s *Revenue and Economic Update*. The next official forecast will be released in early December 2018.

Near-Term U.S. Outlook Steady, but Trade Tensions Escalate

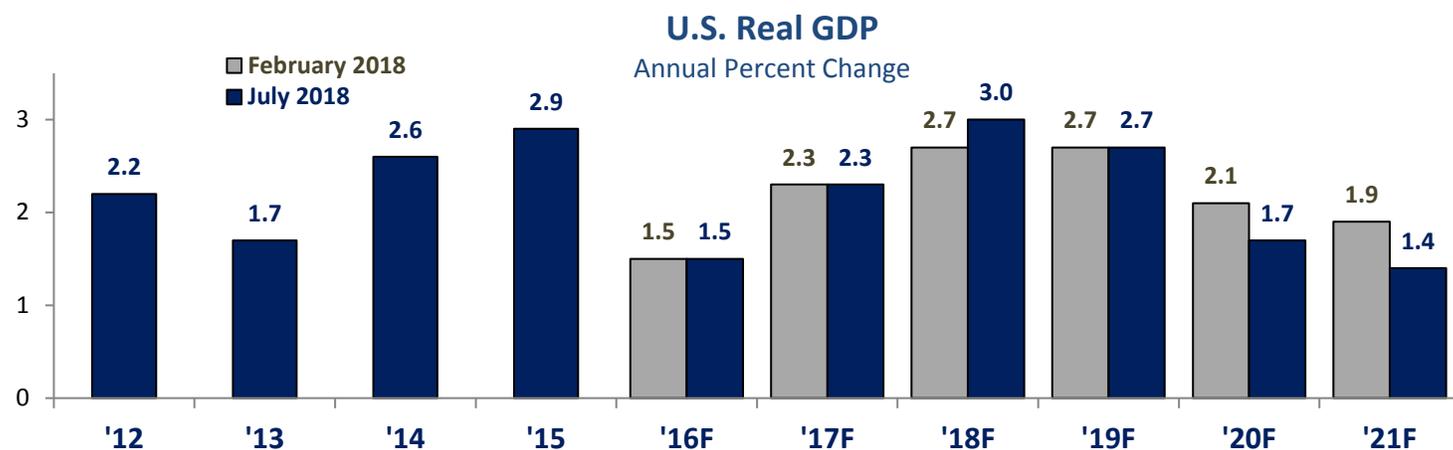
The near-term outlook for U.S. economic growth as measured by real GDP has improved since Minnesota’s *Budget and Economic Forecast* was last prepared in February 2018. Stronger-than-expected data on economic activity suggests U.S. growth accelerated in the second quarter, with second quarter growth now forecast to be 4.8 percent, nearly 3 percentage points higher than first-quarter growth of 2.0 percent. The largest factor contributing to the boost in second-quarter growth was increased exports in May, including a surge in soybean exports prior to tariffs enacted July 6, 2018.

In their July 2018 outlook, IHS Markit (IHS)—Minnesota’s macroeconomic consultant—expects a pickup in annual real GDP growth from 2.3 percent in 2017 to 3.0 percent in 2018. In February, IHS had expected 2.7 percent growth in 2018. Consumer spending fuels the acceleration this year, with support from ongoing improvements in household portfolios, employment opportunities, and personal income. In addition, IHS expects fiscal stimulus from the Tax Cut and Jobs Act (TCJA) to add several tenths to the GDP growth rate this year. That impact will wane in future years, with expected GDP growth falling to 2.7 percent in 2019, and further to 1.7 percent in 2020, and 1.4 percent in 2021.

The Bureau of Labor Statistics (BLS) reports that U.S. employers added 213,000 jobs in June, consistent with additions of 200,000 per month over the prior six months. The unemployment rate was 4.0 percent in June, and IHS expects it to average 3.8 percent over this year and fall to an average of 3.4 percent in 2019.

Compared to their February 2018 outlook, IHS has lowered growth expectations for 2019, 2020 and 2021. The current outlook incorporates the effects of new 25 percent U.S. tariffs on Chinese goods, as well as China’s retaliatory tariffs on U.S. goods. In the forecasts for 2019-2021, net exports are a larger drag than IHS expected in February. In the July outlook, net exports subtract more than 0.5 percentage points from real GDP growth in each of the next three years.

The IHS July baseline forecast for 2018 is slightly above the Blue Chip Consensus, the median of 50 business and academic forecasts, which expects 2.9 percent growth in 2018. The Blue Chip Consensus calls for 2.6 percent



Source: Bureau of Economic Analysis and IHS Markit.

growth in 2019, a bit slower than IHS' 2.7 percent forecast for that year.

As expected, the Federal Open Market Committee (FOMC) raised the federal funds rate target range by 25 basis points to 1.75-2.0 percent in June. This was the second increase of 2018, and is consistent with the Fed's view that the labor market is tightening. IHS' June outlook assumes two more 25-basis-point increases in the federal funds rate this year. IHS expects additional rate hikes to bring the upper end of the target range to 3.50 percent in 2020.

Forecast risks include the length of the current economic expansion—109 months, or 12 months away from being the longest on record—and international trade. While IHS has incorporated the impacts of the U.S.-China tariffs, they have not included the impacts on U.S. exports of retaliatory tariffs imposed by Canada, the EU, and Mexico. Policy uncertainty and supply chain disruption impose

costs on domestic manufacturers, as they diversify their input sources and postpone investment. In addition, if U.S. tariffs on both final and intermediate goods persist, they are likely to increase consumer prices and fuel inflation. The uncertainty about further actions by the U.S. and trading partners represents a risk to this forecast.

Since February, IHS has not changed the probabilities assigned to the baseline and alternative scenarios. They assign a probability of 65 percent to the July baseline outlook. They assign a 20 percent probability to a more pessimistic scenario, in which a correction to commercial real estate prices and declining consumer and business confidence trigger a two-quarter recession in 2019, slowing annual real GDP growth next year to 1.4 percent in 2019 and 0.4 percent in 2020. In IHS's more optimistic scenario, a pick-up in home purchases by young adults fuels the housing market and spurs growth to 4.3 percent in 2019. This scenario gets a 15 percent probability.

Comparison of Actual and Forecast Non-Dedicated Revenues¹

(\$ in thousands)

	Fiscal Year 2018			April-June 2018		
	FORECAST	ESTIMATED	VARIANCE	FORECAST	ACTUAL	VARIANCE
	REVENUES ²	CLOSING REVENUES ³	ACT-FCST	REVENUES	REVENUES	ACT-FCST
Individual Income Tax						
Withholding	9,057,300	9,067,097	9,797	2,315,968	2,298,717	(17,251)
Declarations	2,614,200	2,699,772	85,572	896,028	981,628	85,600
Miscellaneous	1,429,000	1,609,106	180,106	853,190	1,006,339	153,150
Gross	13,100,499	13,375,974	275,475	4,065,186	4,286,685	221,499
Refund	1,649,100	1,595,046	(54,053)	717,431	619,458	(97,972)
Net	11,451,400	11,780,928	329,528	3,347,755	3,667,226	319,471
Corporate Franchise Tax						
Declarations	1,199,742	1,230,265	30,523	363,117	434,213	71,097
Miscellaneous	278,293	224,663	(53,630)	(6,784)	(44,651)	(37,867)
Gross	1,478,035	1,454,928	(23,106)	356,333	389,562	33,229
Refund	176,934	133,485	(43,450)	59,204	32,083	(27,120)
Net	1,301,100	1,321,444	20,343	297,129	357,479	60,350
General Sales and Use Tax						
Gross	5,694,663	5,675,086	(19,577)	1,636,378	1,601,176	(35,202)
Mpls. sales tax transferred to MSFA	1,855	1,855	(0)	405	405	(0)
Sales Tax Gross	5,696,518	5,676,941	(19,578)	1,636,783	1,601,580	(35,203)
Refunds (including Indian refunds)	207,900	243,961	36,061	74,866	124,585	49,719
Net	5,488,618	5,432,980	(55,639)	1,561,917	1,476,995	(84,922)
Other Revenues:						
Net Estate	199,700	214,703	15,002	29,974	40,508	10,534
Net Liquor/Wine/Beer	90,750	91,766	1,016	28,237	29,912	1,675
Net Cigarette/Tobacco	583,990	563,779	(20,211)	170,545	156,859	(13,686)
Deed and Mortgage	249,022	250,158	1,136	73,580	75,612	2,032
Net Insurance Premiums Taxes	394,263	396,491	2,228	89,769	88,854	(915)
Net Lawful Gambling	71,200	75,848	4,649	22,864	25,499	2,635
Health Care Surcharge	287,233	281,939	(5,294)	119,365	109,914	(9,451)
Other Taxes	10,555	13,108	2,553	10,504	13,054	2,550
Statewide Property Tax	804,976	811,376	6,399	432,381	435,684	3,303
DHS SOS Collections	69,500	79,585	10,085	12,908	22,519	9,611
Investment Income	32,000	50,151	18,151	5,510	18,104	12,593
Tobacco Settlement	157,260	166,931	9,672	-	9,672	9,672
Dept. Earnings & MSOP Recov.	208,585	216,198	7,613	62,474	69,731	7,256
Fines and Surcharges	74,254	73,970	(284)	24,347	24,575	228
Lottery Revenues	64,562	69,273	4,712	27,338	34,458	7,120
Revenues yet to be allocated	(0)	2,701	2,701	(2,584)	(438)	2,146
Residual Revenues	152,032	145,139	(6,894)	55,419	54,948	(471)
Other Subtotal	3,449,881	3,503,116	53,235	1,162,631	1,209,463	46,832
Other Refunds	5,305	4,906	(399)	1,587	1,191	(397)
Other Net	3,444,576	3,498,211	53,634	1,161,044	1,208,272	47,228
Total Gross	23,724,934	24,010,960	286,026	7,220,933	7,487,290	266,358
Total Refunds	2,039,239	1,977,398	(61,842)	853,087	777,318	(75,770)
Total Net	21,685,695	22,033,562	347,867	6,367,845	6,709,973	342,127

1. This [document \(.xlsx\)](#) provides the data in table format.

2. February 2018 Budget & Economic Forecast

3. Reflects estimates of revenue accruals through FY 2018 closing (August 10) and other pre-close adjustments.