

# Revenue and Economic Update

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## Revenues Begin to Fall Below February Forecast

Minnesota’s net general fund receipts totaled \$2.592 billion during the months of February and March 2020, or \$103 million (3.8 percent) less than projected in the February 2020 *Budget and Economic Forecast*. Total net receipts for March were \$1.581 billion, \$62 million (3.8 percent) less than forecast. This shortfall reflects the pace of income tax refund processing, payment delays, and the beginning of the impact of deteriorating economic conditions on state tax revenues.

Receipts for the individual income tax, net sales tax, and other revenues were lower than expected for the period, while corporate tax receipts were higher than forecast. (See page 4 for details.)

Net individual income tax receipts during February and March were \$101 million (9.0 percent) less than forecast. Lower than expected gross tax receipts and higher than expected refunds both contributed to the negative variance.

Income tax withholding payments were \$5 million (0.3 percent) less than forecast. Minnesota unemployment insurance (UI) benefit claims surged during March, as social distancing and business suspension to combat the COVID-19 outbreak took hold. Because employers make withholding payments at the end of each pay period, the current shortfall does not reflect the full impact of those

layoffs on withholding receipts. The cumulative shortfall will grow as ongoing unemployment drives employer payrolls well below our forecast levels.

Estimated tax payments for February and March exceeded the forecast by \$2 million. In May, we will know estimated payments for the first quarter of calendar year 2020. Due to deteriorating economic conditions during March and April, we expect those payments to come in well below our February forecast.

Miscellaneous income tax payments—which include final payments associated with tax year 2019—were \$17 million less than forecast. Typically, most final payments and nearly all extension payments would be made later this month, giving us a fairly complete picture of total tax year 2019 payments. However, because this year Minnesota taxpayers are allowed to delay their final payments until July 15, we will not have complete information about tax year 2019 receipts until August. The timing of this signal will depend on the pace of tax return processing.

Individual income tax refunds, which are primarily associated with tax year 2019, were \$82 million higher than expected. We think this is due to faster than expected refund processing, and not necessarily lower than expected tax year 2019 liability.

## Summary of Revenues: February-March 2020

| (\$ in millions)                  | February 2020  |                |                | %             |
|-----------------------------------|----------------|----------------|----------------|---------------|
|                                   | Forecast       | Actual         | \$ Difference  | Difference    |
| Individual Income Tax             | \$1,113        | \$1,013        | \$(101)        | (9.0)%        |
| General Sales Tax                 | 817            | 803            | (14)           | (1.7)         |
| Corporate Franchise Tax           | 312            | 334            | 22             | 7.1           |
| Other Revenues                    | 452            | 442            | (10)           | (2.2)         |
| <b>Total Revenues<sup>1</sup></b> | <b>\$2,694</b> | <b>\$2,592</b> | <b>\$(103)</b> | <b>(3.8)%</b> |

1. Totals may not add due to rounding.

Net sales tax receipts were \$14 million (1.7 percent) below the forecast. Lower than expected gross sales tax receipts more than offset refunds that were below the forecast. Gross sales tax receipts for March were \$51 million (12.1 percent) below the forecast. We estimate that about \$50 million of the shortfall is due to businesses identified in Executive Order 20-04 delaying their remittances due March 20 until April 20.

Net corporate tax receipts exceeded the forecast by \$22 million (7.1 percent). Higher than expected corporate tax payments and lower than expected refunds both contributed to the positive variance. We expect corporate receipts, which are the state's most volatile tax revenue source, to fall short of forecast as weakened economic conditions lower corporate profits.

Other revenues were \$10 million (2.2 percent) below the forecast.

## U.S. Economic Outlook Crumbles

The outlook for near-term U.S. economic growth as measured by real GDP has dramatically weakened since Minnesota's *Budget and Economic Forecast* was prepared in February 2020, due to the outbreak of COVID-19 and the measures taken to prevent its spread. The Bureau of Economic Analysis (BEA) estimates that real GDP grew at an annual rate of 2.1 percent during the fourth quarter of 2019. Annual real GDP growth in 2019 was 2.3 percent. IHS Markit (IHS), Minnesota's macroeconomic consultant, is now forecasting a 5.4 percent contraction in real GDP in 2020. This occurs as consumers, previously touted the champions of the expansion, are unable to spend due to temporary business closures and stay at home orders to slow the spread of COVID-19. The contraction is further fueled by a collapse in oil prices, an auto industry shutdown, volatile financial markets, a rising unemployment rate, and a global recession this year.

The April outlook includes the impact of the \$2.3 trillion federal Coronavirus Aid, Relief, and Economic Security (CARES) Act. IHS characterizes the CARES Act as a modest stimulus that provides a small offset to the effects of the suspension of economic activity.

IHS expects the spread of COVID-19 to peak and then dissipate in the second calendar quarter of 2020, allowing social distancing restrictions to be lifted during the third quarter. Economic recovery begins in the third quarter,

and real GDP growth turns positive in the fourth. Real GDP growth in 2021 is projected at 6.3 percent. The recession is expected to dampen business investment, and slower growth in capital services will limit economic growth. Consequently, while the U.S. is forecast to regain full employment in 2024, IHS expects GDP in that year to remain about 1.5 percent below the level they forecast for 2024 in their March 2020 outlook.

Dramatically lower oil prices have the effect of lowering U.S. real GDP growth through lower production and reduced investment in equipment and structures in the U.S. energy sector. Lower gasoline prices can have an offsetting effect of stimulating consumer spending. This year, however, IHS expects the negative impact of lower energy sector production and investment to swamp the positive impact of lower gas prices, as consumer spending is restricted by social distancing measures.

The IHS April baseline forecast for 2020 is consistent with the Blue Chip Consensus, the median of 50 business and academic forecasts, which expects a 4.1 percent contraction in 2020. The Blue Chip Consensus calls for 3.8 percent growth in 2021, below IHS' 6.3 percent forecast for that year. For both years, the range of forecasts that make up the Blue Chip Consensus is unusually large, indicating uncertainty about the economic outlook.

The Bureau of Labor Statistics (BLS) reports that in March the seasonally adjusted U.S. unemployment rate rose to 4.4 percent, 0.9 percentage points higher than in February 2020 and 0.6 percentage points higher than a year earlier. IHS expects the unemployment rate to reach a high of 10.3 percent in the fourth quarter of 2020 before gradually drifting back down to pre-COVID19 levels in 2023. The labor force participation rate was 62.7 percent in March, compared to 63.4 percent in February and 63.0 percent one year ago. The BLS also reported that U.S. employers slashed 701,000 jobs in March in response to the viral outbreak.

In an attempt to keep financial markets stable, the FOMC cut rates by 50 basis points on March 3 and further by 100 basis points on March 16, bringing the effective target federal funds rate to zero. IHS expects the federal funds rate to remain near zero until late 2025.

IHS assigns a 45 percent probability to the April baseline outlook. They assign a 35 percent probability to a more pessimistic scenario, in which the COVID-19 outbreak causes a deeper recession, with even greater impacts on

production, employment and income. In their more optimistic scenario, IHS assumes a faster, “V-shaped” recovery. The spread of the virus is contained more quickly, and the peak is reached in April, jump-starting spending and an economic recovery. This scenario gets a

20 percent probability. IHS notes that, because economic outcomes depend on the pandemic’s course, all forecasts remain highly uncertain.



Source: Bureau of Economic Analysis and IHS Markit.

## Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

|                                     | Fiscal Year to Date 2020 |                   |                  | February-March 2020 |                  |                  |
|-------------------------------------|--------------------------|-------------------|------------------|---------------------|------------------|------------------|
|                                     | FORECAST                 | ACTUAL            | VARIANCE         | FORECAST            | ACTUAL           | VARIANCE         |
|                                     | REVENUES <sup>1</sup>    | REVENUES          | ACT-FCST         | REVENUES            | REVENUES         | ACT-FCST         |
| <b>Individual Income Tax</b>        |                          |                   |                  |                     |                  |                  |
| Withholding                         | 7,323,750                | 7,319,239         | (4,511)          | 1,687,500           | 1,682,989        | (4,511)          |
| Declarations                        | 1,242,419                | 1,244,708         | 2,289            | 33,008              | 35,297           | 2,289            |
| Miscellaneous                       | 723,474                  | 706,938           | (16,536)         | 271,327             | 254,791          | (16,536)         |
| Gross                               | 9,289,642                | 9,270,884         | (18,758)         | 1,991,835           | 1,973,077        | (18,758)         |
| Refund                              | 1,143,130                | 1,224,909         | 81,779           | 878,670             | 960,450          | 81,779           |
| Net                                 | 8,146,512                | 8,045,975         | (100,537)        | 1,113,165           | 1,012,628        | (100,537)        |
| <b>Corporate Franchise Tax</b>      |                          |                   |                  |                     |                  |                  |
| Declarations                        | 1,099,292                | 1,138,804         | 39,512           | 239,275             | 278,787          | 39,512           |
| Miscellaneous                       | 278,624                  | 260,701           | (17,924)         | 109,713             | 91,789           | (17,924)         |
| Gross                               | 1,377,916                | 1,399,504         | 21,588           | 348,988             | 370,576          | 21,588           |
| Refund                              | 192,681                  | 192,017           | (664)            | 36,754              | 36,090           | (664)            |
| Net                                 | 1,185,235                | 1,207,487         | 22,252           | 312,234             | 334,486          | 22,252           |
| <b>General Sales and Use Tax</b>    |                          |                   |                  |                     |                  |                  |
| Gross                               | 4,373,091                | 4,332,346         | (40,745)         | 864,640             | 823,895          | (40,745)         |
| Mpls. sales tax transferred to MSFA | 1,707                    | 1,654             | (53)             | 275                 | 222              | (53)             |
| Sales Tax Gross                     | 4,374,798                | 4,334,000         | (40,798)         | 864,915             | 824,117          | (40,798)         |
| Refunds (including Indian refunds)  | 129,580                  | 103,010           | (26,569)         | 47,693              | 21,124           | (26,569)         |
| Net                                 | 4,245,218                | 4,230,989         | (14,229)         | 817,222             | 802,994          | (14,229)         |
| <b>Other Revenues:</b>              |                          |                   |                  |                     |                  |                  |
| Net Estate                          | 119,733                  | 112,238           | (7,495)          | 28,972              | 21,477           | (7,495)          |
| Net Liquor/Wine/Beer                | 64,847                   | 63,174            | (1,673)          | 14,660              | 12,987           | (1,673)          |
| Net Cigarette/Tobacco               | 382,036                  | 391,357           | 9,322            | 59,677              | 68,999           | 9,322            |
| Deed and Mortgage                   | 204,515                  | 207,877           | 3,361            | 36,835              | 40,196           | 3,361            |
| Net Insurance Premiums Taxes        | 330,601                  | 326,846           | (3,755)          | 136,055             | 132,300          | (3,755)          |
| Net Lawful Gambling                 | 69,368                   | 72,441            | 3,073            | 16,915              | 19,988           | 3,073            |
| Health Care Surcharge               | 190,189                  | 170,199           | (19,990)         | 75,727              | 55,737           | (19,990)         |
| Other Taxes                         | 266                      | 269               | 3                | 34                  | 37               | 3                |
| Statewide Property Tax              | 373,187                  | 373,206           | 19               | -                   | 19               | 19               |
| DHS SOS Collections                 | 62,270                   | 71,161            | 8,891            | 11,410              | 20,301           | 8,891            |
| Investment Income                   | 62,558                   | 61,459            | (1,098)          | 13,721              | 12,623           | (1,098)          |
| Tobacco Settlement                  | 144,469                  | 144,469           | -                | -                   | -                | -                |
| Dept. Earnings & MSOP Recov.        | 159,712                  | 160,586           | 874              | 33,002              | 33,876           | 874              |
| Fines and Surcharges                | 47,809                   | 49,238            | 1,429            | 11,708              | 13,137           | 1,429            |
| Lottery Revenues                    | 34,335                   | 35,997            | 1,661            | 8,070               | 9,731            | 1,661            |
| Revenues yet to be allocated        | (53)                     | 1,971             | 2,024            | -                   | 2,024            | 2,024            |
| Residual Revenues                   | 87,699                   | 81,112            | (6,586)          | 5,972               | (615)            | (6,586)          |
|                                     |                          | -                 |                  |                     |                  |                  |
| Other Subtotal                      | 2,333,542                | 2,323,601         | (9,941)          | 452,756             | 442,815          | (9,941)          |
| Other Refunds                       | 4,325                    | 4,416             | 91               | 1,118               | 1,210            | 91               |
| Other Net                           | 2,329,217                | 2,319,185         | (10,032)         | 451,637             | 441,606          | (10,032)         |
| <b>Total Gross</b>                  | <b>17,375,897</b>        | <b>17,327,989</b> | <b>(47,908)</b>  | <b>3,658,494</b>    | <b>3,610,586</b> | <b>(47,908)</b>  |
| <b>Total Refunds</b>                | <b>1,469,715</b>         | <b>1,524,353</b>  | <b>54,637</b>    | <b>964,236</b>      | <b>1,018,873</b> | <b>54,637</b>    |
| <b>Total Net</b>                    | <b>15,906,182</b>        | <b>15,803,636</b> | <b>(102,545)</b> | <b>2,694,259</b>    | <b>2,591,713</b> | <b>(102,545)</b> |

1. February 2020 Budget & Economic Forecast.