

# Minnesota Department of Finance

October 2007

## State Receipts Continue Above Forecast

Net-non-dedicated general fund revenues totaled \$3.482 billion during the first quarter of fiscal 2008, \$58 million (1.7 percent), more than end-of-session estimates. Individual income tax receipts were up \$50 million, 2.9 percent over February's forecast. Net corporate tax receipts were \$28 million (9.4 percent) less than forecast.

### July – September 2007

	<u>Estimate</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
	-----	(\$ in millions)	-----	
Income	\$1,703	\$1,753	\$50	2.9
Sales	1,004	1,028	24	2.4
Corporate	299	271	(28)	(9.4)
Motor Vehicles	47	50	3	6.0
Other	<u>371</u>	<u>380</u>	<u>9</u>	<u>2.4</u>
Total	\$3,424	\$3,482	\$58	1.7

Individual income tax receipts accounted for the majority of the positive variance. Withholding payments, the state's largest source of revenues, were \$20 million (1.4 percent) more than forecast during July, August, and September, and third quarter estimated payments exceeded estimates by \$24 million (see page 4). Much of the \$24 million sales tax variance came from lower than anticipated refunds. Gross receipts from the sales tax were just \$6 million above forecast. While corporate earnings reports remain strong, corporate estimated tax payments have lagged. Corporate estimated payments were \$40 million below forecast and \$50 million less than was received during this quarter a year ago.

Net non-dedicated general fund revenues for fiscal 2007 are now reported to be \$146 million above forecast, \$12 million less than reported in July's *Economic Update*. The reduction in the FY 2007 revenue variance was caused by small increases in tax refunds for all taxes compared to the July 1 estimates. Final revenue results will be reported in the state's Consolidated Annual Financial Report. That report will be available in December.

**Forecasters Cut Back 2008 Outlook --Housing, Credit, and Oil Prices Remain Concerns**

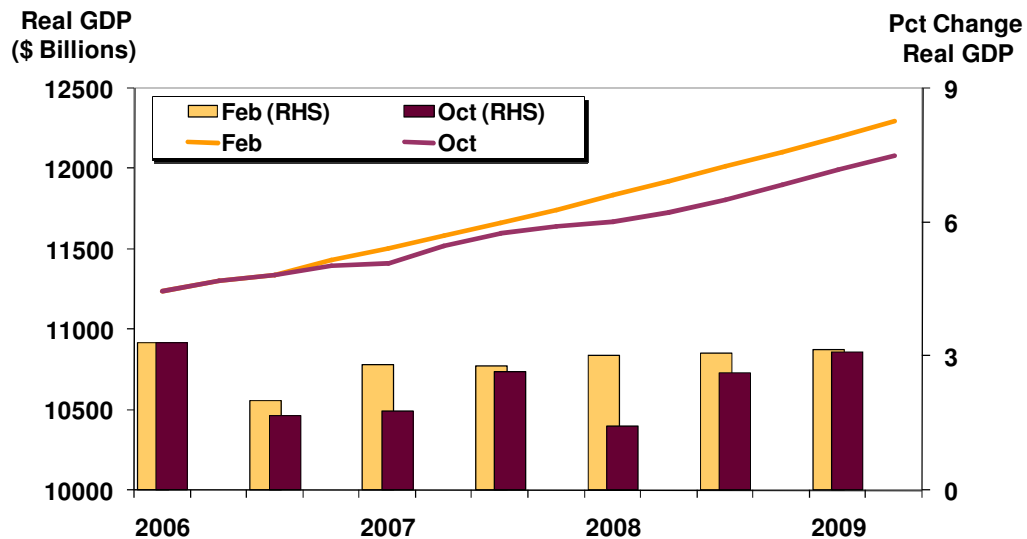
Few economists were surprised by the housing sector's performance in the third quarter. Starts, sales, and prices had been trending down for more than a year and home mortgage delinquencies and foreclosures also were known to be substantially above year earlier levels. What was a surprise was the impact that uncertainty in the sub-prime loan market had on global credit markets. For a brief period short-term liquidity was a worldwide concern as lenders holding sub-prime credits struggled to adjust their portfolios to reflect the increased risk of default. Quick injections of liquidity by the U.S. Federal Reserve Bank and the European Central Bank helped avert a more serious credit squeeze, but for a short time at least, there was a real possibility that the credit market's problems could spillover into the broader economy and create widespread economic difficulties.

The U.S. economy appears to have navigated through that potentially damaging squall with only minor damage, but further tests are likely in the next 12 months. The largest portion of the non-prime adjustable mortgage resets remains on the horizon and the housing sector recession appears likely to deepen and extend well into 2008. Some observers see oil prices remaining at the \$80 plus level for several years into the future. Others note that the U.S. economic outlook will depend heavily on net exports for the next year or more, and that weaker overseas growth would cause U.S. growth rates to drop even further. And, there are concerns that the combination of declining home prices and higher energy prices will cause U.S. consumer spending to drop more than anticipated. There also was some good news--revised data show the August jobs market was not as weak as originally thought. But even with that substantial revision, employment growth during the third quarter averaged less than 100,000 per month, well below the level needed to match the growth in the work force.

These concerns led most forecasters to materially reduce their outlook for 2008. Forecasters have also raised their estimates of the probability of a recession in 2008 or early 2009. Global Insight Inc.(GII), the state's national economic consultant, is among those who made a significant changes to their mid-range economic outlook. After factoring in the further impacts of a credit squeeze on the housing sector and oil prices remaining above \$70 dollar per barrel, GII now projects real GDP growth rates of less than 2 percent for the fourth quarter of 2007 and the first half of 2008. While real GDP growth moves back to the 3 percent level during the last half of 2008, the outlook for real growth through the remainder of the biennium is materially weaker than that used in February's state revenue forecast.

GII now forecasts real GDP growth rates of 2.0 percent in calendar 2007 and 2008, and 2.9 percent in calendar 2009. In February, their forecast called for growth at a 2.7 percent annual rate in 2007, a 3.0 percent rate in 2008, and a 3.2 percent rate in 2009. Global Insight's forecast for 2007 is identical to the October Blue Chip Consensus outlook, but their 2008 outlook for real GDP growth is less optimistic than the Blue Chip's projection of 2.4 percent. Global Insight's forecast of 2.0 percent real GDP growth for 2008 puts them in the bottom 20 percent of the Blue Chip forecast panel.

### October Global Insight Forecast Calls for Slower Real GDP Growth Through End of Biennium



Despite higher oil prices and a weaker dollar, Global Insight does not expect inflation to be a problem through the end of the current biennium. Increasing slack in the economy is expected to lead to less pressure on prices. While GII’s current forecast of 2.7 percent CPI growth in 2007 is well above the 1.5 percent increase called for in February’s forecast, the 1.8 percent inflation rates projected for both 2008 and 2009 are lower than the 2.3 percent and 2.1 percent CPI increases in Global Insight’s February baseline. The Blue Chip Consensus CPI forecast is less optimistic than GII’s, calling for 2.7 percent growth in 2007 and 2.4 percent in 2008.

The probability that the current economic expansion is coming to an end has increased in recent months. Global Insight now assigns a 30 percent probability to their more pessimistic, hard landing scenario. That scenario includes a recession starting in the fourth quarter of 2007 and extending until mid 2008. GII’s pessimistic scenario in late February, which did not contain a recession, was given a probability of 15 percent. The probability for October’s baseline scenario was set by GII at 55 percent, 5 percent less than assigned to February’s baseline. A more optimistic scenario, where the economy does not slow appreciably over the next nine months, is assigned a probability of 15 percent.

## Comparison of Actual and Estimated Non-Restricted Revenues

(\$ in thousands)

	Fiscal Year 2007			Fiscal Year 2008 July - September 2007		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
<b>Individual Income Tax</b>						
Withholding	5,753,500	5,777,609	24,109	1,380,220	1,399,939	19,719
Declarations	1,498,910	1,521,976	23,066	289,916	314,262	24,346
Miscellaneous	937,190	1,012,340	75,150	69,692	66,278	(3,413)
Gross	8,189,600	8,311,925	122,325	1,739,828	1,780,480	40,652
Refund	1,096,100	1,081,070	(15,030)	36,739	27,598	(9,141)
Net	7,093,500	7,230,856	137,355	1,703,088	1,752,882	49,793
<b>Corporate &amp; Bank Excise</b>						
Declarations	1,191,000	1,120,981	(70,019)	290,200	250,295	(39,905)
Miscellaneous	161,500	207,490	45,990	31,815	38,974	7,159
Gross	1,352,500	1,328,471	(24,029)	322,015	289,269	(32,746)
Refund	174,600	157,370	(17,230)	23,200	18,044	(5,156)
Net	1,177,900	1,171,101	(6,799)	298,815	271,225	(27,589)
<b>Sales Tax</b>						
Gross	4,757,000	4,769,491	12,491	1,062,190	1,068,309	6,119
Refunds	237,662	263,614	25,952	58,013	40,336	(17,677)
Net	4,519,338	4,505,877	(13,461)	1,004,177	1,027,973	23,796
<b>Motor Vehicle Sales Tax</b>						
	241,286	247,163	5,877	47,016	50,305	3,288
<b>Other Revenues:</b>						
Estate	116,000	110,893	(5,107)	27,500	34,048	6,548
Liquor/Wine/Beer	72,916	73,010	94	14,988	13,969	(1,019)
Cigarette/Tobacco/Cont Sub	192,412	195,551	3,140	43,350	46,866	3,516
Deed and Mortgage	251,000	261,126	10,126	51,191	44,917	(6,275)
Insurance Gross Earnings	285,100	267,032	(18,068)	64,200	60,762	(3,438)
Lawful Gambling	55,481	53,852	(1,629)	11,663	9,068	(2,595)
Health Care Surcharge	208,068	211,897	3,829	51,139	50,936	(203)
Other Taxes	7,125	9,002	1,877	279	199	(79)
Statewide Property Tax	663,372	665,744	2,372	99	574	475
DHS SOS Collections	52,921	61,835	8,914	16,657	12,515	(4,142)
Income Tax Reciprocity	63,481	63,481	0	0	0	0
Investment Income	86,500	105,133	18,634	8,867	24,308	15,441
Tobacco Settlement	180,605	183,911	3,307	0	100	100
Departmental Earnings	242,000	246,648	4,648	49,770	49,451	(320)
Fines and Surcharges	103,500	106,076	2,577	22,452	17,839	(4,613)
Lottery Revenues	51,384	53,486	2,102	7,342	7,494	152
Revenues yet to be allocated	0	1	2	0	3,861	3,861
Residual Revenues	118,571	113,640	(4,932)	7,631	8,749	1,118
Sales Tax Rebates (all years)	(1)	0	1	0	0	0
County Nursing Home, Pub Hosp	25,577	26,282	705	1,698	1,676	(22)
Other Subtotal	2,776,010	2,808,601	32,591	378,827	387,332	8,506
Other Refunds	46,091	55,179	9,088	7,813	7,724	(89)
Other Net	2,729,919	2,753,422	23,503	371,013	379,608	8,595
<b>Total Gross</b>	<b>17,316,397</b>	<b>17,465,651</b>	<b>149,254</b>	<b>3,549,875</b>	<b>3,575,695</b>	<b>25,820</b>
<b>Total Refunds</b>	<b>1,554,453</b>	<b>1,557,233</b>	<b>2,780</b>	<b>125,765</b>	<b>93,702</b>	<b>(32,063)</b>
<b>Total Net</b>	<b>15,761,943</b>	<b>15,908,418</b>	<b>146,475</b>	<b>3,424,110</b>	<b>3,481,993</b>	<b>57,883</b>