

# Revenue and Economic Update

July 11, 2022

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## Revenues Above February 2022 Forecast

Minnesota's net general fund receipts for FY 2022 are now estimated to total \$30.329 billion, \$2.927 billion (10.7 percent) more than projected in the February 2022 *Budget and Economic Forecast*. Net receipts from all major taxes exceeded the forecast. State revenues in the final quarter of FY 2022 were \$2.260 billion (29.5 percent) more than forecast in February. (See page 4 for details.)

Net individual income tax receipts are estimated to end the year \$2.389 billion (16.5 percent) more than forecast. Gross income tax receipts were \$1.801 billion above the forecast, and refunds were \$588 million less than expected. Declarations exceeded the forecast by \$1.061 billion, and miscellaneous payments, consisting mostly of final payments, exceeded the forecast by \$254 million. We estimate that about \$1.181 billion of the net income tax variance (\$921 million from declarations and \$261 million from miscellaneous payments) reflects higher-than-forecast TY 2021 income tax liability.

Gross partnership and SCorp tax payments for FY 2022 were \$439 million more than forecast, and refunds for these entities were \$36 million above the forecast, generating a net variance of \$404 million. Pass-Through Entities (PTEs) are a subset of partnerships and SCorps. We estimate that about \$1.359 billion of the PTE payments received in FY 2022 remains to be claimed as credits on individual income tax returns.

As TY 2021 individual extension returns are filed and return processing continues, the remaining PTE credits will reduce income tax liability for individuals with PTE income. We expect this to result in refunds and transfers to estimated tax in excess of our forecast for the first six months of FY 2023. In our prior revenue reports this year, we estimated the share of the individual income tax variance arising from the PTE timing shift. These estimates assumed that PTE credits would result in equivalent income tax refunds. However, recent reports from processed returns indicate that many taxpayers with PTE credits are receiving smaller refunds than the size of their credit, because in the absence of the credit they would have had a balance due. This makes it difficult for us to know what share of the remaining estimated \$1.359 billion in PTE *credits* are yet to be paid out in *refunds*. We expect to be able to determine final combined PTE and individual income tax liability for TY 2021 in late January 2023, when return processing is complete.

Income tax withholding receipts exceeded the forecast by \$47 million, and estimated income tax payments (included in declarations on page 4) were about \$139 million more than expected. These amounts reflect CY 2022 economic activity.

Net general sales tax receipts are estimated to end FY 2022 \$88 million (1.3 percent) above the forecast. Gross

## Summary of Revenues: Fiscal Year 2022

(\$ in millions)	February 2022	Estimated	\$ Difference	% Difference
	Forecast	Closing Revenues		
Individual Income Tax	\$14,477	\$16,866	\$2,389	16.5%
General Sales Tax	6,603	6,690	88	1.3
Corporate Franchise Tax	2,376	2,813	437	18.4
Other Revenues	3,947	3,959	13	0.3
<b>Total Revenues<sup>1</sup></b>	<b>\$27,403</b>	<b>\$30,329</b>	<b>\$2,927</b>	<b>10.7%</b>

1. Totals may not add due to rounding.

sales tax payments were \$53 million above the forecast, and refunds were \$35 million lower than expected.

Net corporate receipts were \$437 million (18.4 percent) more than forecast. Gross corporate tax payments were \$423 million above the forecast, and refunds were \$14 million lower than expected. Other net revenues were \$13 million (0.3 percent) more than expected.

All FY 2022 results are preliminary and subject to change. The state's fiscal year that ended June 30, 2022, will officially close on August 20. Values in the estimated closing column on page 4 reflect actual revenues attributable to FY 2022 as well as estimates of revenue accruals through closing and other pre-close adjustments.

As of June 30, total FY 2022 revenue was \$30.426 billion. Estimated accruals and pre-close adjustments subtract about \$97 million on net. Non-tax revenues that will be received or recognized between the end of the fiscal year and the close add an estimated \$68 million. Income, corporate, and sales tax refunds attributable to FY 2022 and expected to be paid out before the close subtract \$165 million. A complete reporting of FY 2022 revenues will be part of October's *Revenue and Economic Update*.

## U.S. Economic Outlook Weakened

The outlook for U.S. real GDP growth for the forecast horizon has weakened since Minnesota's *Budget and Economic Forecast* was prepared in February 2022. In their July forecast, IHS Markit (IHS), Minnesota's macroeconomic consultant, expects annual real GDP to grow 1.4 percent this year and 1.3 percent next year, compared to 3.7 percent and 2.7 percent in their February forecast. For years 2024-2025, the forecast is also lower

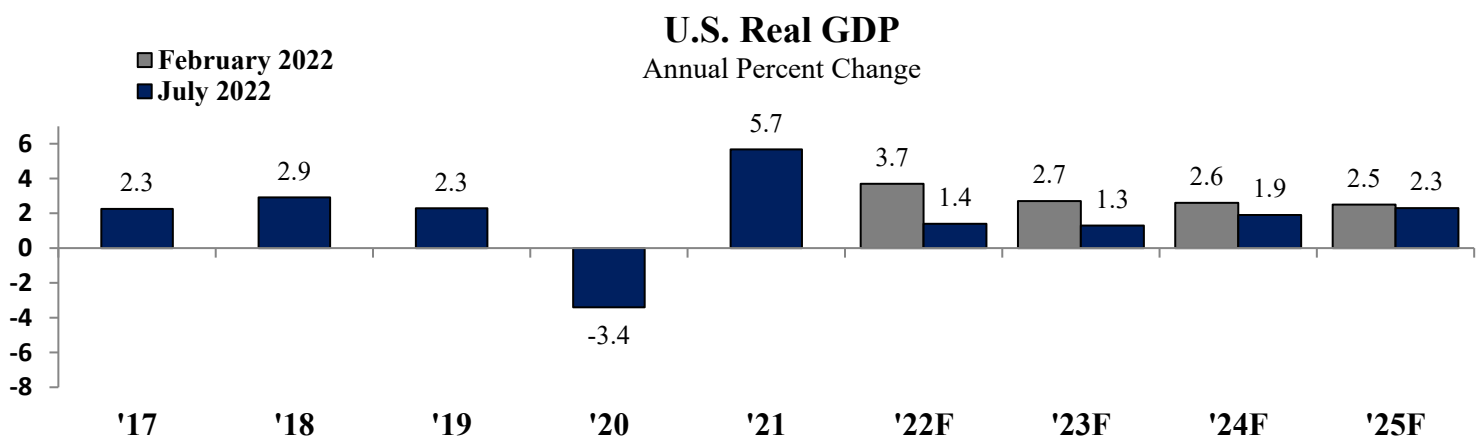
than in February, with IHS anticipating growth of 1.9 percent in 2024 and 2.3 percent in 2025.

Downgrades to the near-term forecast since February have been driven by three main developments. First, Russia's invasion of Ukraine, which began in late February and continues today, has contributed to persistent price pressures (particularly food and energy), tighter financial conditions, and lower global growth potential. Second, a significant drop in net exports in the first quarter and an expected pullback in inventory investment in the second quarter reduced U.S. economic growth early in the year. Third, the Federal Reserve's recent and expected tightening of monetary policy in response to persistently high inflation is expected to restrict near-term growth.

BEA's third estimate of real GDP in the first quarter of 2022 shows growth of -1.6 percent (annualized), 3.3 percentage points lower than IHS' February forecast. IHS has lowered their forecast for real GDP growth in the second quarter to a -1.8 percent annualized rate from 4.3 percent in their February outlook.

IHS expects the price of Brent crude oil to remain above \$100 per barrel through the third quarter of 2023, before subsiding to \$87 in the fourth quarter of 2024.

The IHS July baseline forecast for 2022 is lower than the most recent Blue Chip Consensus, the median of 50 business and academic forecasts. The July Blue Chip Consensus calls for 2.0 percent growth in 2022, 0.6 percentage points higher than IHS' forecast for this year. IHS expects real GDP to grow 1.3 percent in 2023, higher than the Blue Chip Consensus of 1.1 percent growth next year.



Source: Bureau of Economic Analysis and IHS Markit.

The Bureau of Labor Statistics (BLS) reports that in June the seasonally adjusted U.S. unemployment rate was 3.6 percent, down from 14.7 percent at the peak of unemployment reported in April 2020 and only 0.1 percentage points higher than the pre-pandemic level in February 2020. The unemployment rate has been 3.6 percent for the past four months. The BLS reports that roughly 5.9 million people remain unemployed, only 0.2 million more than in February 2020. Nonfarm payroll employment rose by 372,000 in June. The number of long-term unemployed (those jobless for 27 weeks or more) is 1.3 million, about 0.2 million more than in February 2020. IHS expects that the U.S. unemployment rate will gradually climb from a low of 3.6 percent in the second quarter this year to 4.3 percent in mid-2023 and 4.9 percent in mid-2024.

The unemployment rate does not capture those who have exited the labor force during the pandemic. The U.S. labor force participation rate was 62.2 percent in June, 0.6 percentage points higher than in June 2021 but 1.2 percentage points lower than in February 2020.

IHS expects that the Federal Reserve will act aggressively to combat recent and expected inflationary pressures. In their July forecast, IHS expects that the Federal Open Market Committee (FOMC) will raise the federal funds rate to 3.0 percent in the fourth quarter this year, and that

the rate will remain above 3.0 percent through mid-2024. The federal funds rate was 0.1 percent in the first quarter.

The alternative scenarios for the IHS July forecast are not yet available. The following alternatives are based on the June forecast. IHS assigned a 50 percent probability to their June baseline outlook. The alternative scenarios were weighted toward the downside. IHS assigned a 35 percent probability to a more pessimistic scenario, characterized by (1) an intensification of the Russia-Ukraine conflict that generates persistently higher energy and commodity prices, wider risk spreads, and slower global growth, and (2) a slower resolution of existing supply-chain issues. Growth in consumer spending and business fixed investment is diminished in 2022 and 2023, and the price of Brent crude oil remains substantially higher through 2025. As a result, GDP grows 1.4 percent in 2022 and -0.4 percent in 2023, compared to 2.5 percent and 1.8 percent in the baseline scenario. In the more optimistic scenario, IHS assumed (1) a stronger consumer and business response to the Infrastructure Investment and Jobs act (IIJA) and (2) a quicker resolution to the Russia-Ukraine conflict. Consumer spending and business fixed investment exhibit stronger growth in 2022 than in the baseline, and the price of Brent Crude oil remains below the baseline assumption through mid-2022. In this scenario, GDP grows 3.0 percent in 2022 and 2.7 percent in 2023. The optimistic scenario received a 15 percent probability.

# Comparison of Actual and Forecast Non-Dedicated Revenues

(\$ in thousands)

	Fiscal Year 2022			April-June 2022		
	FORECAST REVENUES <sup>1</sup>	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES <sup>1</sup>	ACTUAL REVENUES	VARIANCE ACT-FCST
<b>Individual Income Tax</b>						
Withholding	10,845,420	10,892,412	46,992	2,663,294	2,649,918	(13,376)
Declarations	2,128,805	3,189,659	1,060,854	850,200	1,906,847	1,056,647
Miscellaneous	2,047,413	2,301,323	253,909	1,453,799	1,643,461	189,662
Partnership & S Corporation Gross	<u>2,431,730</u>	<u>2,871,171</u>	<u>439,441</u>	<u>690,449</u>	<u>585,716</u>	<u>(104,783)</u>
Gross	17,453,368	19,254,564	1,801,196	5,657,792	6,785,942	1,128,150
Partnership & S Corporation Refunds	29,100	64,723	35,623	4,606	26,267	21,661
Individual, Fiduciary, & Withholding Ref.	<u>2,947,095</u>	<u>2,323,507</u>	<u>(623,587)</u>	<u>1,719,105</u>	<u>990,351</u>	<u>(728,755)</u>
Total Refunds	2,976,195	2,388,230	(587,964)	1,723,711	1,016,618	(707,093)
Net Income Tax	14,477,173	16,866,334	2,389,160	3,934,081	5,769,324	1,835,243
<b>Corporate Franchise Tax</b>						
Declarations	2,316,479	2,743,836	427,357	668,531	1,028,167	359,636
Miscellaneous	203,140	199,271	(3,869)	33,132	45,175	12,043
Gross	2,519,619	2,943,107	423,488	701,663	1,073,342	371,679
Refund	143,787	129,980	(13,807)	62,324	63,727	1,403
Net	2,375,832	2,813,126	437,294	639,338	1,009,614	370,276
<b>General Sales and Use Tax</b>						
Gross	6,799,130	6,851,858	52,728	1,791,347	1,816,168	24,820
MPLS Sales Tax Transferred to MSFA				-	-	-
MPLS Sales Tax w/Holding for NFL Stadium	21,215	21,216	0	5,304	5,304	0
Sales Tax Gross	6,820,345	6,873,073	52,728	1,796,651	1,821,472	24,821
Refunds (including Indian refunds)	217,547	182,612	(34,935)	89,115	72,520	(16,595)
Net	6,602,798	6,690,461	87,663	1,707,536	1,748,952	41,416
<b>Other Revenues</b>						
Net Estate	210,600	214,248	3,648	48,646	51,293	2,647
Net Liquor/Wine/Beer	104,550	105,098	548	34,417	34,930	513
Net Cigarette/Tobacco	598,240	578,573	(19,667)	187,438	182,839	(4,599)
Deed and Mortgage	416,893	403,754	(13,139)	127,308	114,343	(12,965)
Net Insurance Premiums Taxes	449,173	483,911	34,738	94,210	112,647	18,437
Net Lawful Gambling	164,750	182,390	17,640	43,784	55,822	12,038
Health Care Surcharge	330,772	247,255	(83,517)	159,246	95,884	(63,362)
Other Taxes	56,955	56,507	(448)	53,896	53,439	(457)
Statewide Property Tax	771,915	774,121	2,205	414,502	418,980	4,478
DHS SOS Collections	85,950	104,705	18,755	16,113	29,233	13,120
Investment Income	30,000	44,917	14,917	11,900	28,082	16,182
Tobacco Settlement	175,112	192,965	17,853	13,429	30,972	17,543
Dept. Earnings & MSOP Recovery	233,082	231,571	(1,511)	65,104	69,714	4,610
Fines and Surcharges	76,655	72,932	(3,724)	40,088	35,831	(4,256)
Lottery Revenues	72,986	79,250	6,264	29,105	32,574	3,469
Revenues yet to be allocated	0	14,297	14,297	(2,811)	7,946	10,757
Residual Revenues	176,696	177,635	939	53,062	46,771	(6,290)
Other Subtotal	3,954,331	3,964,130	9,799	1,389,436	1,401,300	11,084
Other Refunds	7,553	4,813	(2,740)	2,882	1,471	(1,411)
Other Net	3,946,778	3,959,317	12,540	1,386,554	1,399,829	13,275
<b>Total Gross</b>	30,747,663	33,034,874	2,287,211	9,545,542	11,082,055	1,536,513
<b>Total Refunds</b>	3,345,082	2,705,635	(639,446)	1,878,032	1,154,336	(723,697)
<b>Total Net</b>	27,402,581	30,329,239	2,926,657	7,667,510	9,927,719	2,260,210

1. February 2022 Budget and Economic Forecast.