BUDGET AND ECONOMIC FORECAST

MINNESOTA

November 2020

Produced by Minnesota Management and Budget

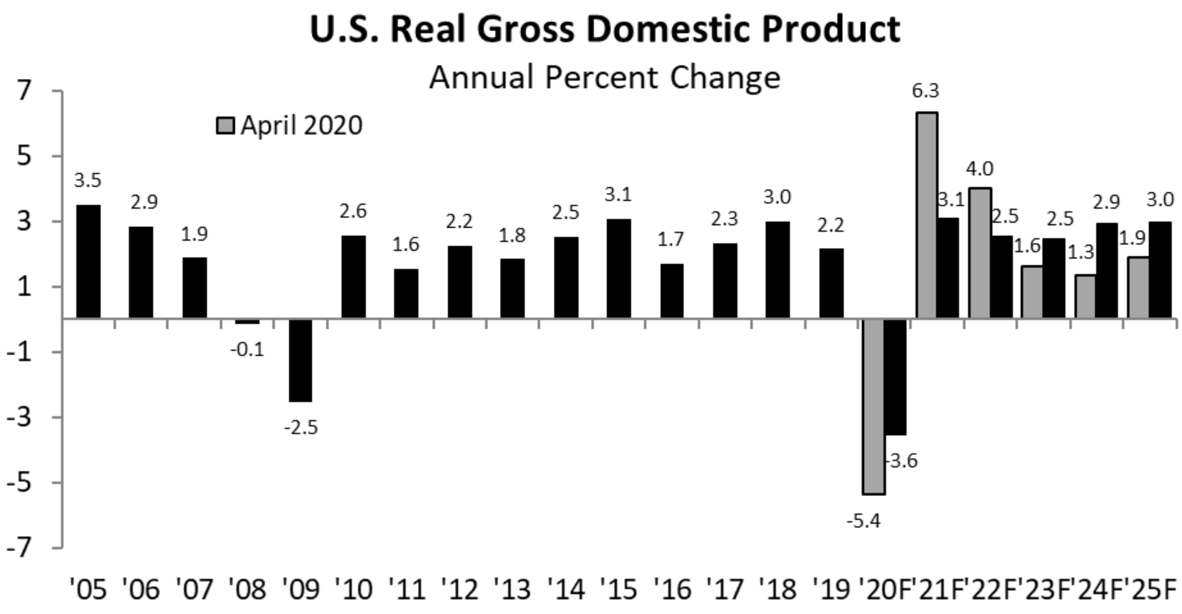
EXECUTIVE SUMMARY

Minnesota's economic and budget outlook have improved since May, when we released a budget projection just as the COVID-19 pandemic was taking hold. With this forecast, higher general fund revenues and lower expected spending result in a projected surplus of $641 million for the FY 2020-21 biennium. The improved budget outlook continues into FY 2022-23, but a $1.273 billion budgetary shortfall remains for that biennium. As the pandemic continues, economic challenges also persist. Minnesota has 184,000 fewer jobs than in February and, while the economic downturn has affected all Minnesotans, unemployment has disproportionately impacted lower wage workers.

Budget Forecast, FY 2020-23
November 2020 Forecast

($ in millions)	FY 2020-21	FY 2022-23	$ Change
Beginning Balance	**$3,971**	**$3,449**	
Revenues	47,100	49,494	
Expenditures	47,623	51,110	
Budget Reserve	2,377	1,866	(491)
Cash Flow Account	350	350	
Stadium Reserve	81	230	149
Budgetary Balance	**$641**	**$(633)**	
Shortfall (Excluding FY 2020-21)		***$(1,273)***	

U.S. Economic Outlook. The global COVID-19 pandemic ended a decade of economic expansion, during which U. S. real GDP growth averaged 2.3 percent per year. IHS Markit (IHS), Minnesota's macroeconomic consultant, is now forecasting U.S. real GDP to decline by 3.6 percent in 2020, a 1.8 percentage point improvement in the outlook since Minnesota's *Interim Budget Projection* was prepared in May. The improved forecast is due to higher consumer spending and business investment this year than had been expected in April. Annual growth is expected to return in 2021 at a rate of 3.1 percent and continue through the remainder of our forecast period. Real GDP is forecast to grow an average of 2.7 percent annually through 2025. IHS expects real GDP to regain its pre-pandemic peak in early 2022 and the economy to return to full employment in 2024.



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

The global COVID-19 pandemic ended a decade of economic expansion, during which U. S. real GDP growth averaged 2.3 percent per year. HIS is now forecasting U.S. real GDP to decline by 3.6 percent in 2020, a 1.8 percentage point improvement in the outlook since April. Annual growth is expected to return in 2021 at a rate of 3.1 percent and continue through the remainder of our forecast period.

The economic recovery is expected to be uneven, with GDP associated with production of goods having already reached its pre-pandemic level, and the service sector not fully recovering until a significant portion of the population is vaccinated against COVID-19.

Since the onset of the pandemic, consumers have shifted away from spending on the kinds of services most affected by social distancing. Instead, they are purchasing goods. In this forecast, IHS expects consumer spending on durable goods other than autos and medical devices to grow 7.3 percent in 2020, compared to a 9.2 percent decline in the April forecast. Conversely, consumer spending on other services, which includes face-to-face services, is expected to decline 11.2 percent this year, compared to a 14.3 percent decline in the April outlook.

The U.S. lost more than 22 million jobs in March and April, nearly 15 percent of the February workforce. The unemployment rate peaked at 14.7 percent in April. Although the economy has added back 12 million jobs, and the unemployment rate has fallen to 6.9 percent as of October, total employment is still 6 percent lower than it was in February. IHS forecasts total employment in the U.S. to fall by 5.6 percent in 2020. They expect employment to grow 3.6 percent in 2021 followed by slowing growth throughout the forecast horizon.

The U.S. outlook remains volatile and uncertain and depends critically on the path of the pandemic. In this forecast, IHS assumes that the rate of infections, hospitalizations, and deaths remain elevated until a COVID-19 vaccine is widely available, which they assume will be in the middle of next year. At that time, they expect the economy to transition from recovery to expansion, particularly in sectors hardest hit by social distancing and safety concerns, such as consumer spending on entertainment and travel.

In this outlook, IHS also assumes no further federal fiscal stimulus beyond measures already enacted. Additional federal support and a more rapid vaccination timeline would cause the economy to grow faster than shown in the November outlook.

Minnesota Economic Outlook. Through the most recent U.S. economic expansion—from July 2009 to February of this year—Minnesota experienced steady employment growth, adding 337,000 jobs. In February, employment had reached about 3 million. Then the pandemic took hold, restrictions were put in place, and Minnesota lost 388,000 jobs in March and April. As some restrictions were lifted, the state regained just over half that number of jobs through October, leaving employment 184,000 (6 percent) below the February level.

During the most recent months of job growth, Minnesota's unemployment rate fell from the May peak of 9.9 percent to 4.6 percent in October, well below the U.S. rate and 9th lowest among states. However, the last two months of employment decline have occurred because of Minnesotans leaving the labor force, rather than from unemployed workers finding jobs. Since February, 107,000 Minnesotans have left the labor force.

Unemployment in this economic downturn has disproportionately impacted lower-wage workers. Since March 16th, 57 percent of Minnesota initial Unemployment Insurance (UI) benefit claimants were in occupations with median wages in the bottom two wage quintiles. In addition, U.S. data show that this year the duration of unemployment has been longer for lower-wage workers than for those at higher wages. Consequently, unemployment since March has led to a smaller reduction in total wage and salary income than if the incidence and duration of unemployment had been more evenly distributed across wage levels. We now expect total wage income to decline 1.4 percent in 2020—an improvement from our May projection—and to grow moderately at an annual average of 4.8 percent through the rest of the forecast period. The improvement in the wage income forecast has led to increases in our income and sales tax forecasts.

Budget Outlook: Current Biennium. When the *May Interim Budget Projection* was released, a deficit of $2.426 billion was projected for the current biennium. Subsequent legislative changes in the 2020 regular session and multiple special sessions reduced the projected deficit in FY 2020-21 to $2.314 billion. Eight months into the pandemic, the budget outlook has improved from what was projected in May. A surplus of $641 million is now projected for FY 2020-21, an improvement of $2.955 billion compared estimates published at the end of the October special session.

Current Biennium: FY 202-21 General Fund Budget
End of Session vs. November 2020 Forecast

($ in millions)	End of October Special Session	November 2020 Forecast	$ Change	% Change
Beginning Balance	**$3,971**	**$3,971**	**$ -**	**0.0%**
Revenues	45,189	47,100	$1,912	4.2
Expenditures	48,680	47,623	(1,058)	(2.2)
Budget Reserve	2,377	2,377	-	
Cash Flow Account	350	350	-	
Stadium Reserve	66	81	15	
Forecast Balance	**$(2,314)**	**$641**	**$2,995**	

Revenues. Total general fund revenues for FY 2020-21 are now forecast to be $47.100 billion, $1.912 billion (4.2 percent) more than the May *Interim Budget Projection* adjusted for law changes since May. Total tax revenues for the biennium are forecast to be $44.835 billion, $1.767 million (4.1 percent) above the prior estimate. The forecasts for all major tax types are higher than in May. So far in FY 2021, actual net general fund revenues are $805 million (12.5 percent) higher than projected in May. These higher revenues raise the base—or starting point—for our forecasts of several tax types.

Current Biennium: FY 2020-21 General Fund Revenues

Change From End-of-Special-Session Estimates

($ in millions)	**End of October Special Session**	**November 2020 Forecast**	**$ Change**	**% Change**
Individual Income Tax	$24,264	$24,764	$500	2.1%
General Sales Tax	10,693	11,501	808	7.6
Corporate Franchise Tax	2,684	3,074	390	14.5
State General Property Tax	1,550	1,554	4	0.3
Other Tax Revenue	3,877	3,942	65	1.7
Total Tax Revenues	**$43,068**	**44,835**	**1,767**	**4.1%**
Non-Tax Revenues	1,486	1,543	58	3.9
Other Resources	635	722	87	13.7
Total Revenues	**$45,189**	**$47,100**	**$1,912**	**4.2%**

Net individual income tax receipts for the current biennium are now forecast to be $500 million (2.1 percent) more than the end-of-session estimate. A $274 million net income tax variance so far in FY 2021 and higher forecast wage growth in CY 2020 and CY 2021 offset a lower estimate for tax liability in 2019, the base year of this forecast.

The uneven impact of employment and wage losses during the pandemic-induced economic downturn has affected the way we construct our income tax forecast. Unemployment this year has disproportionately affected lower wage workers. Consequently, unemployment since March has led to a smaller reduction in total wage and salary income than if the incidence and duration of unemployment had been more evenly distributed across wage levels. In addition, concentrating wage losses among taxpayers with lower marginal effective tax rates reduces the income tax revenue loss arising from a given reduction in income. Adjusting for these effects raised our FY 2020-21 income tax forecast compared to what it otherwise would have been.

General sales tax revenue in FY 2020-21 is now forecast to be $808 million (7.6 percent) higher than the end-of-session estimate. Higher forecast gross receipts offset higher expected refunds. So far in FY 2021, net sales tax receipts are $380 million (25.7 percent) higher than we projected in May, raising the base for this forecast. In addition, faster expected growth in taxable sales and a higher share for Minnesota of total U.S. consumer spending raise the sales tax forecast for the current biennium.

Changes in consumer spending patterns during the pandemic have influenced our sales tax forecast. During the pandemic consumers have shifted their spending away from many types of services that are not taxable in Minnesota toward taxable goods. This shift in spending has contributed to higher fiscal-year-to date sales tax collections and to faster forecast growth in Minnesota's sales tax base.

The corporate franchise tax is forecast to generate $390 million (14.5 percent) more in FY 2020-21 than the prior estimate. The forecast change is due to a higher base of corporate receipts and higher expected growth in corporate profits. So far in FY 2021, net corporate receipts are $159 million (36.0 percent) more than we projected in May.

Expenditures. Spending estimates for FY 2020-21 are lower than prior estimates for the biennium. Expenditures in the current biennium are now expected to be $47.623 billion, a reduction of $1.058 billion (2.2 percent) from end of session estimates.

Current Biennium: FY 2020-21 General Fund Expenditures
Change From End-of-Session Estimates

($ in millions)	**End of October Special Session**	**November 2020 Forecast**	**$ Change**	**% Change**
E-12 Education	$19,999	$19,881	$(118)	(0.6)%
Property Tax Aids & Credits	3,883	3,950	22	0.6
Health & Human Services	14,691	13,772	(919)	(6.3)
Debt Service	1,098	1,056	(42)	(3.9)
All Other	9,009	9,009	(1)	(0.0)
Total Expenditures	**$48,680**	**$47,623**	**$(1,058)**	**(2.2)%**

A $919 million (6.3 percent) reduction in estimated spending for health and human services and a $118 million (0.6 percent) reduction in estimated spending for E-12 education account for the vast majority of the overall reduction in spending in FY 2020-21. These reductions are driven in large part by the continuation of the COVID-19 pandemic into calendar year 2021. The reduction in health and human services spending is largely due to the assumption that the federal public health emergency continues through June 30, 2021, generating two additional quarters of increased federal funding for Medical Assistance. Lower utilization of health care services relative to the previous forecast also contributes to this change. The change in E-12 Education is primarily due to a reduction in the number of pupils relative to previous projections, due to families delaying kindergarten or opting for private or homeschool options during the COVID pandemic.

Changes for the current biennium for other spending were modest. Debt service expenditures are $42 million (3.9 percent) lower than previous estimates due to slower spending on capital projects, a reduced August 2020 bond sale, and lower bond rates. Property tax aids and credits spending is $22 million (0.6 percent) higher than expected due largely to the growth in property tax refunds compared to previous forecast.

Budget Reserve and Cash Flow Account. Minnesota Statutes 16A.152 directs MMB to allocate funds to the budget reserve account up to the recommended budget reserve level when there is a projected surplus in the current biennium in the *November Budget and Economic Forecast.* The current budget reserve balance of $2.377 billion exceeds this target level so there is no additional allocation to the budget reserve with this *Budget and Economic Forecast*. The Cash Flow account balance is unchanged at $350 million.

Stadium Reserve. The FY 2020-21 projected balance of the stadium reserve account is $81 million, $15 million higher than prior estimates. In FY 2020, lawful gambling revenue available for stadium uses was $42 million, $1 million lower than end of session estimates. Although FY 2020 lawful gambling revenues were dampened due to COVID-19 pandemic and response, lawful gambling revenue available for stadium uses is expected to grow to $121 million by the end of FY 2025. Additionally, beginning January 2021 (FY 2021), the state will retain Minneapolis sales tax receipts to cover the payments the state remits on behalf of the city for stadium obligations.

Total state expenditures for the stadium, including those the state makes on behalf of the City of Minneapolis, were $42 million in FY 2020 and are expected to be $44 million by FY 2025. All revenue in excess of spending amounts is allocated to the stadium reserve. In FY 2021, $25 million is expected to be added to the stadium reserve, by FY 2025 the amount allocated to the reserve is expected to be $99 million. Given the increasing allocation amounts, the stadium reserve balance is expected to reach $419 million by FY 2025.

Budget Outlook: Next Biennium. The *May Interim Budget Projection*, adjusted for legislative changes in the summer and fall, estimated that spending would exceed revenue in the next biennium by almost $5 billion. Current law reduces the balance of the budget reserve by $491 million in FY 2022 and the stadium reserve growth impacts the general fund bottom line. After accounting for reserve changes and excluding the impact of the budgetary balance in the current biennium, prior projections estimated a $4.539 billion budgetary shortfall in FY 2022-23. With this updated forecast, the improved revenue outlook and lower spending estimates in the current biennium carry through the budget horizon into the FY 2022-23 biennium, resulting in a projected budgetary shortfall of $1.273 billion for the next biennium. This projected shortfall excludes any balance from the current biennium.

Next Biennium: FY 2022-23 General Fund Budget
Change From End-of-Session Estimates

($ in millions)	**End of October Special Session**	**November 2020 Forecast**	**$ Change**
Beginning Balance	**$480**	**$3,449**	**$2,969**
Forecast Revenues	46,524	49,494	2,970
Projected Spending	51,519	51,110	(409)
Budget Reserve	1,886	1,886	-
Cash Flow Account	350	350	-
Stadium Reserve	101	230	129
Budgetary Balance	**$(6,853)**	**$(633)**	**$6,220**
Shortfall (excluding FY 2020-21)	***$(4,539)***	***$(1,273)***	

Revenues. The current forecast for FY 2022-23 total revenues is $2.970 billion (6.4 percent) more than the end-of-session estimate. Total tax revenues for the next biennium are forecast to be $2.821 billion (6.3 percent) above the prior estimate. The forecasts for all major tax types are higher than prior estimates.

The income tax forecast change is due to both a higher base of income tax revenue from the higher forecast for FY 2020-21 and faster income growth, particularly wage income. On average, this forecast assumes a level of wage income that is 6.0 percent higher for CY 2022 and CY 2023 than we projected in May.

Next Biennium: FY 2022-23 General Fund Revenues

Change From End-of- Special-Session

($ in millions)	**End of October Special Session**	**November 2020 Forecast**	**$ Change**	**% Change**
Individual Income Tax	$25,105	$26,571	$1,466	5.8%
General Sales Tax	11,398	12,477	1,079	9.5
Corporate Franchise Tax	2,862	2,945	82	2.9
State General Property Tax	1,536	1,540	5	0.3
Other Tax Revenue	3,980	4,169	189	4.7
Total Tax Revenues	**$44,881**	**$47,702**	**$2,821**	**6.3%**
Non-Tax Revenues	1,390	1,419	29	2.1
Other Resources	253	373	121	47.7
Total Revenues	**$46,524**	**$49,494**	**$2,970**	**6.4%**

Higher expected sales tax refunds partially offset higher expected gross sales tax receipts to bring the net sales tax forecast $1.079 billion higher than the end-of-session estimate. The forecast change is due to both a higher base of gross sales tax receipts from the higher forecast for FY 2020-21 and higher growth in taxable sales.

Net corporate tax receipts are now forecast to be $82 million (2.9 percent) more than the prior estimate. The forecast change is due to both a higher base of gross corporate tax receipts from the higher forecast for FY 2020-21 and higher growth in corporate profits.

Expenditures. Forecast expenditures in the FY 2022-23 biennium are expected to reach $51.110 billion, down $409 million (0.8 percent) compared to prior estimates for the biennium. Reduced projections for health and human services spending accounts for $250 million (1.5 percent) of this change due to lower than expected spending for health care and an increase in the amount of federal participation in Medical Assistance. The path and duration of the pandemic, and the subsequent government response, remains uncertain, adding risk to this forecast.

A $154 million (0.7 percent) decrease in education aids is primarily driven by a decrease in estimated pupil counts seen in the previous biennium. Lower spending in debt service reflect lower interest rate assumptions on future bond sales ($19 million, 1.5 percent). These savings are partially offset by higher than anticipated spending in property tax aids and credits ($29 million, 0.7 percent) primarily due to increases the property tax refund program. Other areas of the state budget have little change compared to prior estimates, down $16 million (0.2 percent) for FY 2022-23.

Next Biennium: FY 2022-23 General Fund Expenditures
Change From End-of- Session

($ in millions)	End of October Special Session	November 2020 Forecast	$ Change	% Change
E-12 Education	$20,745	$20,591	($154)	(0.7%)
Property Tax Aids & Credits	4,170	4,200	29	0.7
Health & Human Services	16,757	16,507	(250)	(1.5)
Debt Service	1,276	1,257	(19)	(1.5)
All Other	8,571	8,555	(16)	(0.2)
Total Expenditures	**$51,519**	**$51,110**	**($409)**	**(0.8%)**

In accordance with Laws 2019, Special Session 1, Chapter 9, this forecast continues to assume, legislation will be enacted in the upcoming session based on strategies identified by the Blue Ribbon Commission, which lowers anticipated general fund spending by $100 million in FY 2022-23. If this does not occur, the balance of the general fund reserve will be reduced accordingly.

Budget Reserve. The budget reserve account balance in the next biennium is projected to be $1.886 billion, $491 million lower than the current biennium. In an effort at the time of passage to bring projected budgetary balance to the FY 2022-23 biennium, article 11, section 17 of Chapter 6 from the 2019 special session stipulated that the balance of the budget reserve account be reduced by $491 million on the first day of FY 2022. The stadium reserve balance is expected to reach $230 million by the end of the next biennium due to continued remittance of Minneapolis sales tax receipts and growth in lawful gambling tax receipts.

Budget Outlook: Planning Estimates. This forecast provides the first planning estimates for the FY 2024-25 biennium. While these estimates inherently carry a higher degree of uncertainty than estimates for FY 2021-23, they do present an outlook of longer run spending and revenue growth that will assist in budget planning when setting the FY 2022-23 budget.

Planning Horizon: General Fund Budget
By Biennium, FY2022-25, November 2020 Forecast

($ in millions)	**FY 2022-23**	**FY 2024-25**	**$ Change**	**Annual % Change**
Forecast Revenues	$49,494	$53,085	$3,591	3.6%
Projected Spending	51,110	53,637	2,527	2.4%
Difference	**$(1,616)**	**$(552)**		
Estimated Inflation (CPI)[1]	*$1,303*	*$2,915*		

Revenue growth into the FY 2024-25 planning horizon is higher than base level spending growth, suggesting long run structural budget improvement. However, spending continues to exceed

[1] Inflation calculation grows the estimated general fund spending base in each year by the projected CPI growth rate after removing special education, debt service, property tax refunds, and the state share for managed and long term care.

revenue in the FY 2024-25 in this forecast. As with the projections for FY 2022-23, spending estimates are not adjusted for inflation in most areas of the budget.

Projected inflation based on the Consumer Price Index (CPI) is now expected to be 2.2 percent and 2.6 percent in FY 2022 and FY 2023 followed by 2.7 percent and 3.0 percent in FY 2024 and FY 2025. After adjusting the spending base for programs with price increases included in the current law formula, applying the annual inflation rate, compounded over the two and four year periods, would add approximately $1.3 billion to the FY 2022-23 base and $2.9 billion to the FY 2024-25 base.