Minnesota Department of Finance

February 2005

February 2005 Economic Forecast

Highlights

FY2005 Outlook Improves, Forecast Balance is $175 Million

The forecast for FY2005 revenues has increased by $157 million from November's estimate. When combined with changes in projected current law spending, a $175 million budget balance is projected for 2005. As in November, this balance is allocated by current law. The forecast balance first must replace $25 million taken from the budget reserve for FY2005 spending enacted in the current legislative session. The remaining $150 million must be used to further reduce school aid payment shifts.

Projected FY2006-07 Budget Gap Was $700 Million – Now $466 Million

General fund revenues for the 2006-07 biennium are now forecast to total $29.711 billion, $234 million (0.8 percent) more than November's estimate. Projected current law spending remains unchanged. The improved revenue outlook reduces the projected FY2006-07 budget shortfall from $700 million to $466 million.

Little Change in U.S. Economic Outlook

There were only small changes in Global Insight's baseline forecast for the U.S. economy. Real GDP growth rates for calendar 2005 through calendar 2007 remain just above 3 percent, the same as in November. There was no major change in the inflation outlook. The CPI is expected to increase at a 1.5 percent rate in FY2006 and a 1.8 percent rate in FY2007.

FY2008-09 Planning Estimates Improve Slightly

The small increase in revenues forecast for FY2006-07 carries forward into planning estimates for the following biennium. FY2008-09 biennial revenues are now projected to be $277 million more than November's estimate, while expenditures are expected to be $63 million higher. Revenues now are projected to exceed current law expenditures in FY2008 by $134 million and by $570 million in FY2009. The planning estimates do not include general inflation in FY2008-09 spending.

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Budget Update and Outlook

Current Law Allocates $175 Million FY2005 Forecast Balance to Reserve and Shift Buy-Back

A balance of $175 million is now forecast for the end of FY2005. The revenue forecast is up $150 million. Net savings from forecast expenditure changes and action by the 2005 legislature add another $25 million.

FY2004-05 Forecast (Before Allocation)
($ in millions)

	November Forecast	Legislative Action	Forecast Changes	Revised Forecast
Beginning Balance	$ 369			$ 369
Revenues	28,673	6	150	28,829
Expenditures	28,039	31	(25)	28,045
Cash Flow Acct	350			350
Budget Reserve	653	(25)	---	628
Balance	**$ 0**	**---**	**---**	**$ 175**

The projected $175 million estimated balance is, as in November, allocated by current law to restore state reserves and buy back K-12 school payments shifts.

The $175 million projected balance is automatically distributed as follows:

- $25 million to restore the budget reserve to $653 million, replacing money used to fund FY2005 supplemental appropriations.
- $150 million to increase FY2005 education aid payments, changing the K-12 payment percentages to 84.3 and 15.7 percent.

After allocation, as in November, the ending balance now forecast for June 30, 2005 is zero.

FY2006-07 Budget Gap Reduced from $700 Million to $466 Million

The projected budget shortfall for FY2006-07 is now $466 million, down $234 million from November's estimate. Higher forecast revenues account for all of the change. Increases in current law spending resulting from legislative action in 2005 are almost completely offset by a corresponding decrease in forecast spending for FY2006-07.

FY2006-07 Forecast
Change from November 2004 Estimates

($ in millions)

	November	February	Difference
Revenues	$29,477	$29,711	$234
Expenditures	30,177	30,177	0
Projected Shortfall	**($700)**	**($466)**	**$234**

FY2006-07 forecast revenues are $234 million more than November's estimates. Modest increases in projected receipts from the individual income tax, the corporate income tax, and the sales tax account for all of the additional revenue.

Expenditure estimates for the next biennium are nearly identical to those forecast in November. The impacts of additional spending enacted for FY2005, along with a slight increase in the forecast for K-12, are largely offset by savings in health and human services programs and other spending reductions.

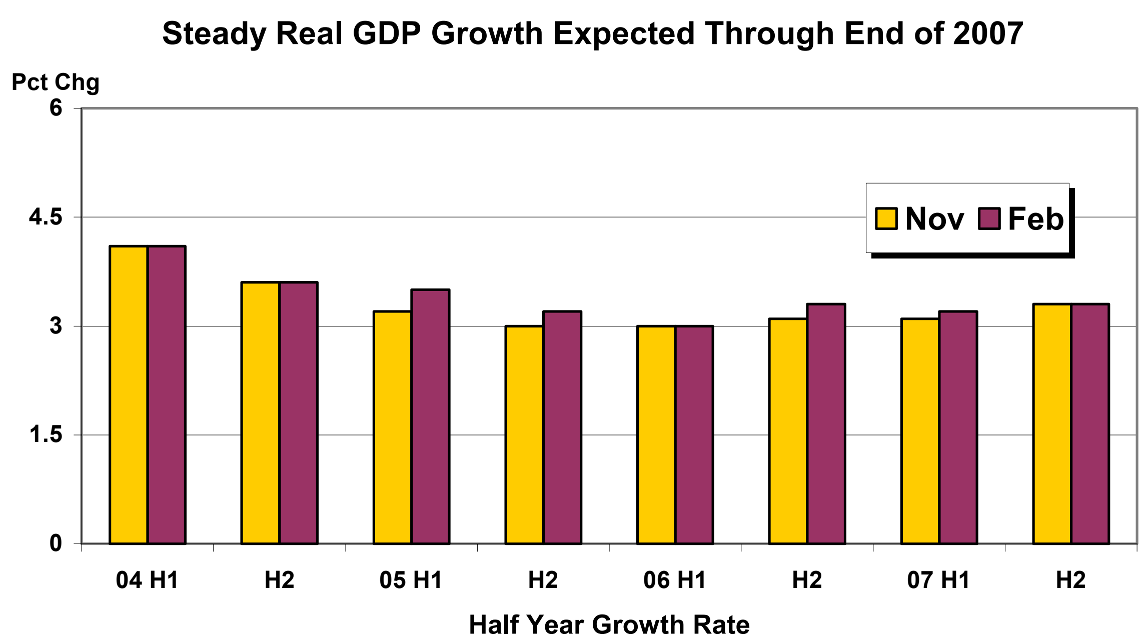
FY2006-07 spending includes provisions currently in law and is adjusted only for enrollment and caseload in K-12 education, higher education, human services and corrections. Expenditures do not include general inflation increases beyond those that are integrated in the health care components of the forecast.

General inflation is expected to average just under 1.7 percent per year in FY2006-07. Adjusting spending for that level of inflation would add approximately $700 million to spending.

More of the Same in Forecast for 2005, 2006, and 2007

There has been little change in the consensus outlook for the U.S. economy. And, the economic growth rates currently projected for 2005, 2006, and 2007 continue to look remarkably similar to those observed in 2004. Real GDP is projected to continue growing at roughly the 2004 rates through the first half of 2005. Then, the gradual interest rate increases engineered by the Fed beginning late last spring start to slow the economy. The slowdown is brief and scarcely noticeable though, since the increased demand for U.S. exports brought on by a declining dollar replaces much of the domestic consumer and business spending lost to higher interest rates. Even with a weaker dollar, inflation remains under control as lower energy costs offset modest increases in the prices of other goods and services.

Forecasters agree on the most likely sources of potential problems, and the trade deficit and the federal budget deficit appear at the top of every list. Those problems are, if anything even more worrisome than in November. Everyone hopes for an orderly decline in the value of the dollar, but currency markets can be very volatile. The U.S. job market also continues to be lethargic adding an average of just over 150,000 jobs per month since May. That is sufficient to cover normal labor force growth, but it will not provide the income growth needed to support a strong, consumer-driven economic expansion.

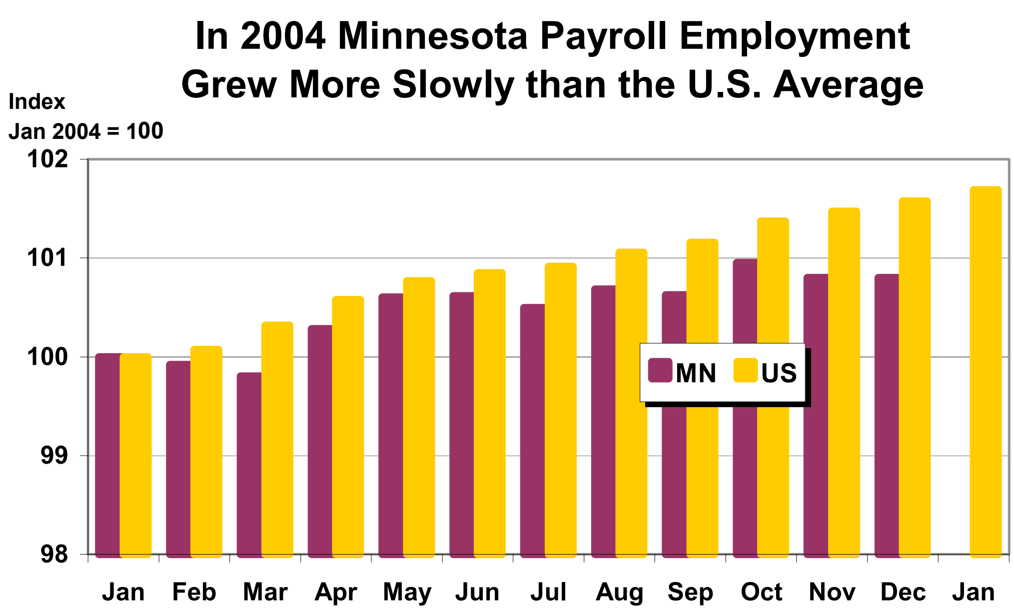


The February baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, remains very similar to the consensus forecasts for 2005, 2006 and 2007. Real GDP growth of 3.5 percent is expected in 2005, followed by 3.1 percent growth in 2006, and 3.2 percent in 2007. November's forecast anticipated slightly weaker real growth, but higher inflation. When nominal growth rates are compared, differences between the forecast almost disappear. GII currently believes the CPI will increase by 2.0 percent in calendar 2005, then by 1.6 percent in 2006 as oil prices begin to decline. In 2007 the CPI is projected to increase by 2.0 percent.

As in November GII assigns a 60 percent probability to their baseline forecast. A slightly more optimistic scenario in which oil prices are lower and productivity higher continues to be assigned a probability of 20 percent. A more pessimistic scenario, which includes an extended slowdown but no recession, is also assigned a probability of 20 percent.

Minnesota's Economy Softened in Late 2004

After closely tracking the national economy in 2001 and 2002, and outperforming it in 2003 Minnesota's economy added jobs more slowly than the national average during 2004. Payroll employment in 2004 grew by 23,000 jobs, but just 5000 of those jobs were added in the last 8 months of the year. Between May and December payroll employment in Minnesota grew by just 0.2 percent, while nationally employment grew by 0.8 percent. If Minnesota had grown as rapidly as the national average the state would have 20,000 more jobs at the start of 2005 than it does. During November and December employment actually declined in Minnesota. Nationally, it grew by 0.1 percent.



It is not clear what is holding back job growth in Minnesota, or where the weaknesses in the economy are. Manufacturing employment in the U.S. and in Minnesota has fallen since mid 2000, but when viewed on a percentage basis the decline was less in Minnesota than nationally. Minnesota added just over 3,000 manufacturing jobs in 2004 a growth rate of 0.9 percent. U.S. manufacturing employment grew by just 0.2 percent.

Strong employment growth is expected in Minnesota during 2005. More than 44,000 jobs are expected to be added between fourth quarter 2004 and fourth quarter 2005, an average of 11,000 new jobs per quarter. Manufacturing employment is expected to grow by 6,600 by the end of 2005 and 15,700 by the end of 2007. By the end of 2007 total employment in Minnesota is projected to reach 2.778 million, 103,000 more than at the end of 2004.

Revenue Outlook Up $157 Million in Current Biennium

Revenues for 2004-05 are now forecast to total $28.829 billion, up $157 million (0.5 percent) from November's estimates. The forecast for non-dedicated revenues increased $155 million (0.6 percent). The individual income tax, the corporate income tax, and the sales tax were the sources of almost all of the addition to the FY2005 revenue forecast.

2004-05 Revenue Forecast
($ in millions)

	November Forecast	February Forecast	$ Change	% Change
Revenues				
Income tax	$11,819	$11,885	$66	0.6
Sales Tax	8,300	8,327	27	0.3
Corporate Income	1,393	1,457	64	4.6
Motor Vehicle	540	537	(3)	(0.6)
Statewide Property	1,217	1,217	0	0.0
Major Taxes	23,269	23,423	154	0.6
Other Non-Dedicated	3,824	3,825	1	0.0
Non-Dedicated Revenues	**27,093**	**27,248**	**155**	**0.6**
Transfers, Other	1,579	1,581	2	0.0
Total	**$28,672**	**$28,829**	**$157**	**0.5**

Changes in most major taxes were small. The forecast for corporate income tax receipts increased more on a percentage basis, but even that increase was well within normal forecast variation for that highly volatile revenue source. The forecast for sales tax refunds in FY2005 was reduced by $33 million. In the absence of that change in projected refunds the sales tax forecast would have been below November's estimate.

Small Increase in Projected FY2006-07 Revenues

State revenues for the 2006-07 biennium are expected to reach $29.711 billion, $234 million (0.8 percent) more than forecast in November. Receipts from the five major taxes are now forecast to be $25.623 billion, $259 million more than November's estimate. A slight decline is projected for other tax and non-tax receipts.

2006-07 Revenue Forecast
($ in millions)

	November Forecast	February Forecast	$ Change	% Change
Revenues				
Income tax	$13,412	$13,483	$71	0.5
Sales Tax	8,733	8,849	115	1.3
Corporate Income	1,380	1,469	89	6.4
Motor Vehicle	550	531	(19)	(3.5)
Statewide Property	1,289	1,291	2	0.2
Major Taxes	25,364	25,623	259	1.0
Other Non-Dedicated	3,700	3,674	(26)	(0.7)
Non-Dedicated Revenues	**29,064**	**29,297**	**233**	**0.8**
Transfers, Other	413	414	1	0.0
Total	**$29,477**	**$29,711**	**$234**	**0.8**

There were only small changes in the economic outlook, so the changes in both the individual income and sales taxes for FY2006-07 were also small. The sales tax showed the largest increase, up $115 million. Lower projected sales tax refunds accounted for $51 million of that change. The corporate income tax showed the largest percentage increase as much of the FY2005 increase in revenues is projected to carry forward to the next biennium.

Little Change in Forecast Spending for FY2004-05 and FY2006-07

Forecast spending for FY2004-05 was $6 million above November's estimates. FY2005 deficiency appropriations increased spending $31 million primarily in human services and public safety areas. This increase, however, was largely offset by savings elsewhere including lower K-12 estimates, a reduction in tax refund interest payments, and an expected increase in year-end cancellations. The additional school shift buy-back triggered by the forecast will add $150 million to K-12 spending in fiscal 2005, increasing total spending by $150 million to $28.195 billion.

FY2004-05 Spending

($ in millions)

	Nov	Feb	Change
K-12 Education	$11,903	$11,898	$(5)
Health and Human Services	7,245	7,262	17
All Other Spending	8,891	8,885	(6)
*K-12 Shift Buy-Back	0	150	150
Total	**$28,039**	**$28,195**	**$156**

Estimates for FY2006-07 spending remain largely unchanged at $30.177 billion. Interim legislative action in 2005 increased estimated spending $42 million, the continuing impact of supplemental appropriations made for fiscal year 2005.

This increase and slightly higher spending for K-12 education were largely offset by other forecast changes. Savings in health and human services spending, tax refund interest payments, and debt service account for almost all of the forecast reductions.

FY2006-07 Spending

($ in millions)

	Nov	Feb	Change
K-12 Education	$11,969	$12,013	$44
Health and Human Services	8,684	8,632	(52)
All Other Spending	9,524	9,533	9
Total	**$30,177**	**$30,177**	**$0**

FY2008-09 Planning Outlook Improves Slightly

The budget outlook in FY2008 and FY2009 has also improved since November. General fund revenues for FY2008-09 are $277 million higher than November's projections, while projected spending is $63 million higher than previous estimates. The structural balance between ongoing revenues and spending has increased to $134 million for FY2008 and to $570 million for FY2009.

FY2008-09 Planning Estimates / Structural Balance

($ in millions)

	FY2008	FY2009
Projected Revenues	**$15,680**	**16,413**
Projected Spending	**15,546**	**15,843**
Difference	**$134**	**$570**

These planning estimates of current law revenues and expenditures are presented to identify longer term impacts of budget actions. Revenue planning estimates are based on an assumed long-term real GDP growth rate. Expenditure estimates assume current laws and policies adjusted for caseload, enrollment and other forecast variables in major program areas.

Since the impact of inflation is not generally reflected in the expenditure projections, it is important to recognize that increases in state spending could be significantly greater than that shown. Inflation for 2008-09 is expected to average 2.1 percent. Uniformly adjusting spending for inflation would add about $2 billion to the expenditure projections for FY2008-09.

The inflation estimate, however, could overstate FY2008-09 spending pressures since it compounds inflationary costs over four years. Nor does it make allowance for the fact that a budget will be set this year for 2006-07. Planning estimates become more meaningful when specific budget proposals for FY2006-07 are being considered and a starting point for the following biennium is being established.

Finally, the forecast is based on current law; the planning estimates do not reflect the Governor's budget recommendations, nor do they anticipate any future legislative changes. The impact of the February forecast may vary depending on the specific components of the Governor's budget or legislative proposals.

A complete version of the February 2005 forecast can be found at the Department of Finance's World Wide Web site at – www.finance.state.mn.us. This document is available in alternate format.

Forecast Fundamentals: About the Revenue and Expenditure Forecast

The February forecast updates the state's financial outlook for fiscal 2005 and provides a new estimate of expected revenues and expenditures for the FY2006-07 budget considerations now underway in the legislature. It also updates the planning estimates for the FY2008-09 biennium. The forecast and planning estimates are revised to reflect the most recent information about the national and state economic outlook, as well as caseload, enrollment and cost projections. No adjustments are made for future cost of living spending increases except for those contained in statute.

The revised revenue estimates reflect changes in Global Insight's national economic outlook since November, changes in the Minnesota economy, and recent revenue collection experience. Income tax receipts include fourth quarter estimated tax payments and January withholding tax collections. Sales tax receipts include results from the Christmas shopping season.

Revenue estimates for the current year and the next biennium are based on econometric models that forecast the Minnesota economy. The revenue forecast is prepared based on a national economic forecast provided by Global Insight Inc., (GII). That national forecast is then reviewed by Minnesota's Council of Economic Advisors. A summary of their comments is found in the "Economic Summary." The "Economic Outlook" which follows provides a more comprehensive overview of the outlook for the U.S. and Minnesota economies. The revenue planning estimates for the 2008-09 biennium are obtained from slightly less complex models but are based on the Global Insight baseline forecast for 2008 and 2009.

Expenditure estimates in most areas are shown at the level of the appropriation made during the 2004 legislative session adjusted for changes enacted early in the 2005 legislative session. Entitlement programs such as K-12 education, intergovernmental aids, health care, and family support are forecast based on expected changes in eligibility, enrollment and average cost. No adjustments for inflation are made in future spending except where required in statute.

The expenditure forecast reflects only current law. It does not reflect the Governor's budget recommendations or any potential legislative actions. There is a distinct difference between the forecast and a budget proposal, but the two are often confused. Presentation of the current law forecast for various areas will likely be accompanied by discussion of possible future legislative changes. The forecast provides a current law framework for analyzing the Governor's or legislative budget proposals. The forecast of spending for any area for the next biennium does not preclude the governor or the legislature from proposing and enacting budget changes that would lead to significantly different spending levels than shown in this forecast.

Economic Summary

The U.S. economic outlook for 2005 and 2006 is almost unchanged from November. Real GDP growth rates above 3 percent are still expected in each of the next two years and inflation is projected to remain well under control. The Federal Reserve continues to move interest rates to a "neutral level" at a "measured pace." And, as in November, economists believe that while growth in consumer spending will slow slightly, strong spending for business capital goods will take up the slack. Energy prices are not thought to be a problem, retreating to the $40 per barrel level by the end of this year, and falling to $35 per barrel by the end of 2006. The dollar is expected to weaken further, and the trade deficit, while widening at present, is projected to begin to decline as a cheaper dollar makes U.S. goods more competitive.

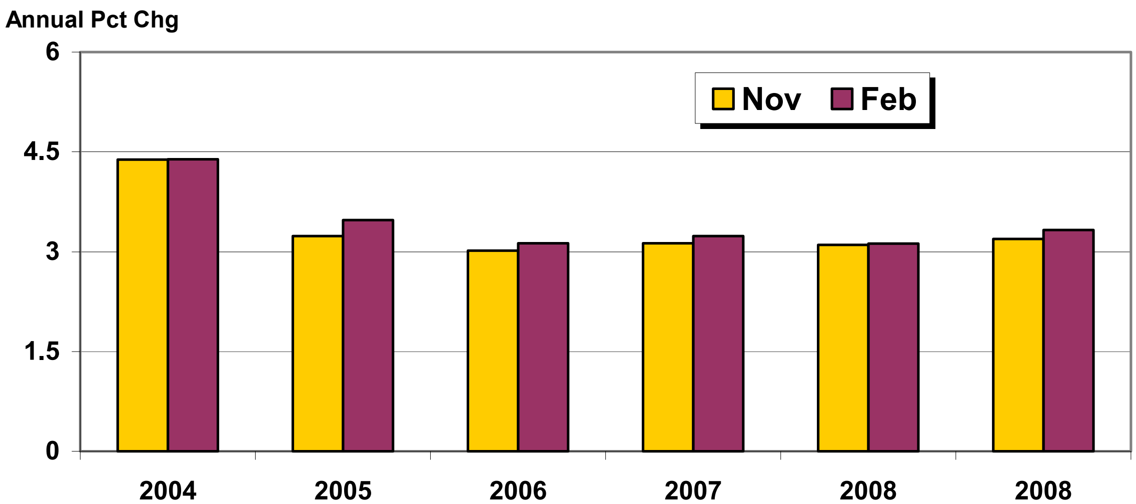
Forecasters' longer-term concerns have not disappeared though. The outlook for the federal budget deficit remains depressing and the potential risks from the expanding trade deficit are, if anything, even more worrisome than in November. Fed Chairman Greenspan believes the current account problem will be self-limiting, but the increased reliance on purchases of U.S. Treasuries by foreign governments and central banks has heightened the risk of an unpleasant surprise should the U.S. trade balance continue to deteriorate. Continuing lethargy in the job market also remains a concern as October's good payroll employment report was followed by three months of mediocre job growth. Since June U.S. employment has grown by just barely enough to absorb the new workers entering the workforce. But, as in November, few economists expect those longer-term concerns to dampen U.S. economic growth rate over the next 12 to 18 months.

The February baseline forecast from Global Insight Inc (GII), Minnesota's national economic consultant, is consistent with the consensus outlook for real GDP growth over Minnesota's forecast horizon. GII expects real GDP growth rates of 3.5 percent in 2005, 3.1 percent in 2006, and 3.2 percent in 2007. Differences between their baseline forecast and others' forecasts are minor. February's Blue Chip Consensus forecast is only slightly more optimistic, calling for 3.6 percent growth in 2005 and 3.4 percent in 2006. January's national economic outlook from the Congressional Budget Office (CBO) used real GDP growth rates of 3.8 percent for 2005 and 3.7 percent for 2006. The President's Office of Management and Budget (OMB) assumed real GDP growth of 3.6 percent in 2005 and 3.5 percent in 2006 in their recently released FY2006 federal budget.

The Global Insight baseline forecast also remains optimistic about the inflation outlook over the 2005-07 forecast horizon. GII projects the CPI to increase at a 2.0 percent annual rate in 2005, then at a 1.6 percent annual rate in 2006, and a 2.0 percent annual rate in 2007. The Blue Chip, CBO and OMB inflation forecasts are similar to the GII baseline, although slightly higher.

GII assigns a probability of 60 percent to their baseline forecast. A scenario containing stronger productivity growth, more robust foreign economic growth, further increases in business capital spending and slightly lower oil prices is assigned a 20 percent probability. This more optimistic scenario adds significantly to growth in 2006 and 2007. A more pessimistic scenario which contains higher inflation, higher interest rates, and higher oil prices is also assigned a probability of 20 percent. Although the pessimistic scenario does not include a recession, economic growth rates in 2006 and 2007 are well below the baseline forecast.

Outlook for Real GDP Growth in 2005-09 Has Changed Only Slightly Since November



As in November Council members agreed that GII's baseline forecast was consistent with the consensus short-term outlook for the U.S. economy. Forecasts of most Council members were slightly more optimistic about the prospects for 2005 than GII, but all agreed that the differences in outlook were minor. For 2006, the GII baseline was more optimistic than the forecasts of some members and less optimistic than others. Again, however, differences were small.

While most Council members believed that the economy was as likely to outperform the baseline forecast as fall short of the growth projected, several were concerned that 2006 could be substantially weaker than in the baseline forecast. By that time higher interest rates should begin to have an impact on U.S. economic growth, and if economic growth in the rest of the world is unable to pick up the slack the U.S. economy could slow more than the consensus currently expects.

Department of Finance economists warned that Minnesota's economy does not seem to be growing as fast as the national economy in recent months. Since May Minnesota employment has grown by just 0.2 percent, or less than 5,000 jobs. The U.S. economy grew by 0.8 percent over that same time period. In recent months both initial unemployment claims and continuing unemployment claims have begun to edge back up, moving closer to levels associated with the weak labor markets of 2001-03. Historically, Minnesota has added jobs faster than the U.S. average.

Council members continue to urge the state to maintain a budget reserve of 5 percent of biennial expenditures, now when economic times are good. The Council also continues to believe that projecting future expenditures without making any allowance for inflation except where required under current law understates the severity of any financial problems the state will face in future biennia.

ECONOMIC OUTLOOK

The U.S. economy began 2005 on solid ground. Oil prices are down only modestly from their October peak, but they seem to be doing little harm except to the budgets of low-income households. And, so far, the falling dollar has not adversely affected interest rates or inflation. For months there have been few, if any, real surprises. With things going well, most forecasters believe the expansion is safe for the near term. Sharing that view, Global Insight's February baseline outlook is for 3.5 percent real GDP growth in 2005. That is slower than last year's 4.4 percent, but still above trend, and up slightly from 3.2 percent in November.

Indications of the economy's continued strength are easy to find. Christmas retail sales were the best since 1999, consumer spending is strong, and hiring is gaining a little momentum. In addition, new claims for unemployment benefits are declining, manufacturing orders and output are rising, long term interest rates remain surprisingly low, and fourth quarter GDP data indicates firms' equipment and software spending is accelerating.

There is some upside potential in 2005. Global Insight's relatively modest expectations for business investment spending, productivity, and profits could be exceeded. With the dollar down, rising exports could sharply reduce the trade deficit. And favorable weather, increased production, and improved conservation could further reduce oil prices.

Downside risks seem longer term. Convinced the economy's momentum will carry it through 2005, most forecasters are contemplating shocks which could derail 2006. The most likely scenarios involve some combination of surging interest rates, a dollar crash, a burst of inflation, or another spike in oil prices. Other less likely possibilities include a consumer retrenchment or a sudden increase in the trade deficit following a hard landing in China.

Hiring Is Gaining A Little Momentum

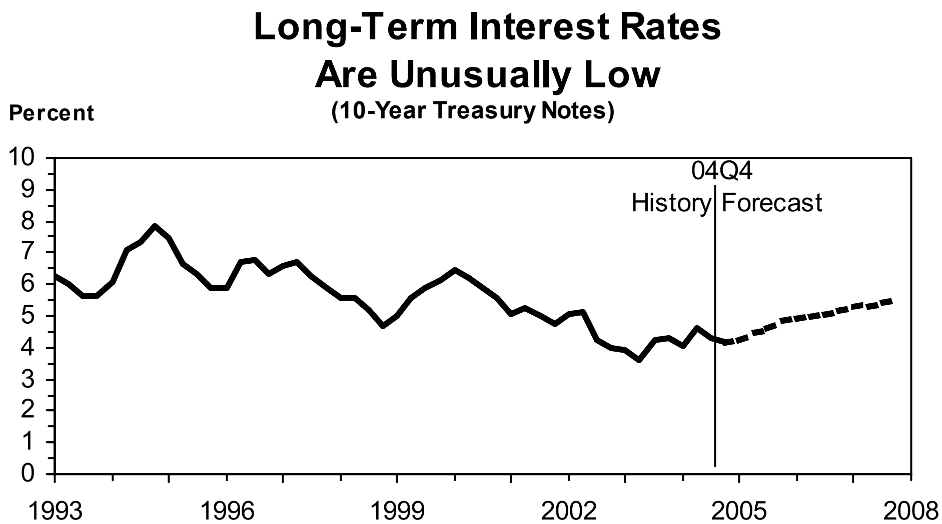
Many economists believe hiring is picking up. In 2004, payroll jobs rose significantly for the first time in 4 years. And, 2004 was the first year since 1999 that seasonally adjusted jobs increased every month. Early in the year, some gains were small and irregular, making the expansion look fragile. But then monthly increases trended up from a paltry 85,000 in July to a modest 146,000 in January, a milestone as payrolls rose above their pre-recession peak.

While Global Insight expects hiring will accelerate further in 2005, some are not so sure. *Wall Street Journal* articles indicate employers will proceed cautiously. Many are waiting for increases in demand because they are able to hire just-in-time from a still relatively large pool of unemployed workers. In addition, some firms are doing little hiring because they have unrealized productivity gains from technology investments in the late 1990's. Others are restructuring.

Offshore outsourcing is displacing some jobs, but most economists doubt it is primarily responsible for currently modest hiring. Global Insight estimates that offshoring was at most responsible for only 2 to 3 percent of U.S. job losses during the recent downturn. And looking forward, the authors of a recent *Journal of Economic Perspectives* article conclude that the growing outsourcing of services from India and other countries is not likely to have a significant impact on jobs available in the U.S.

Long Term Interest Rates Are Unusually Low

Though the Federal Reserve Bank has raised short-term interest rates, the markets have not increased long-term rates. Those remain unusually low for a 4-year old expansion. For example, the benchmark 10-year Treasury note is currently at about 4.2 percent, virtually the same as a year ago. *The Economist* quotes a Morgan Stanley economist as saying that inflation adjusted rates are some 250 basis points below their 20-year average. That, most economists believe, is remarkable since core inflation has accelerated, the dollar is falling, and the federal fiscal outlook shows large deficits for the foreseeable future.



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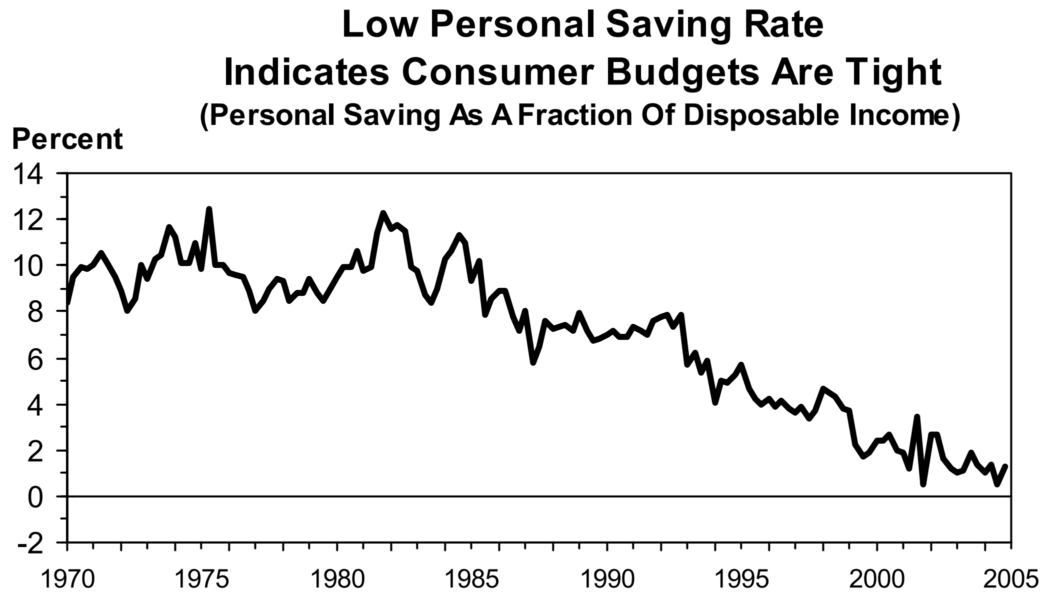
Dr. Greenspan calls current long-term rates a conundrum. Others offer multiple explanations. *Business Week* and *Wall Street Journal* articles note lack of investment opportunities overseas, prospects for strong demand for bonds by underfunded pension plans, still relatively low inflation, and Asian central bank purchases of U.S. Treasurys. The consensus is that these factors will hold rates down only temporarily. But, unless the dollar crashes or the Fed unexpectedly becomes much more hawkish on inflation, a sharp upward spike seems unlikely. In the February baseline, the 10-year Treasury rate gradually rises to 5.4 percent by mid-2007.

Low Saving Rate An Unlikely Short Term Risk If Employment Grows

A few analysts have been concerned about the historically low personal saving rate calculated using consumption and disposable income data from the National Income and Product Accounts. They suggest the low rate reflects unwarranted optimism about the future, possibly an example of Dr. Greenspan's irrational exuberance. If something brings people back to reality, the subsequent rush to cut spending in order to save more could slow the economy significantly.



The low personal saving rate indicates household cash flow is unusually tight. Consumers have yet to adjust to not having extra money from tax cuts and mortgage refinancing, making their spending especially dependent on growth in incomes from additional jobs.

That scenario is not part of most forecasters' thinking because the personal saving rate underestimates household saving. In Global Insight's view, all it indicates is that household cash flow is unusually tight because consumers have yet to adjust to not having extra money from tax cuts and mortgage refinancing. Until consumers adapt, their spending will be especially dependent on growth in incomes from additional jobs. The February baseline has the saving rate rising, but the increases will be too small to have much impact.

Consumption

After an uninspiring start, Christmas sales proved to be a pleasant surprise for most retailers. The Commerce Department reports December’s sales increase over a year earlier was the largest since 1999. And, with growth in hard-to-estimate internet sales and rising use of gift cards which are only counted as spending when redeemed, it seems Christmas was probably better than the data indicate.

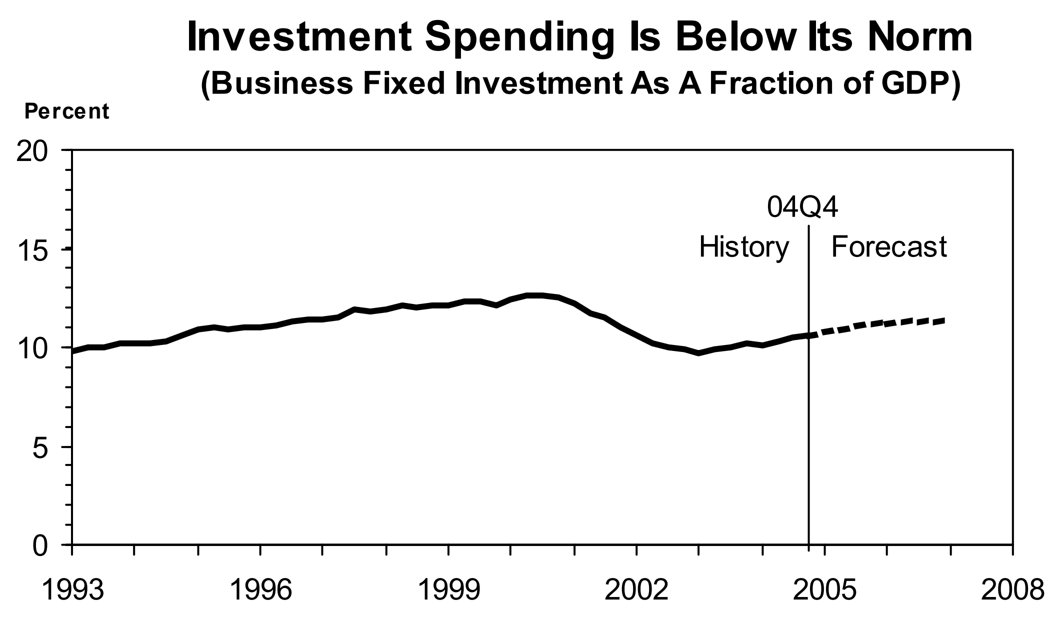
Some stores, particularly mid-sized department stores, missed out. Economists attribute that in part to slow wage growth among low-income households who are also struggling with higher energy prices. But the *Wall Street Journal* also indicates that consumer preferences are shifting away from apparel and personal merchandise and toward home goods and "intangible experiences."

Despite weak department store sales, economists are in general agreement that household spending is off to a solid start in 2005. With budgets tight, consumers appear to be responding strongly to recent jobs growth, a reassuring sign.

Investment

Global Insight expects growth in jobs and incomes will not be enough to offset rising mortgage rates. As rates rise, housing starts and sales are expected to retreat from 2004 levels. However, *Business Week* doubts rates will go high enough to precipitate a general collapse in residential prices and homebuilding. It would take an 8 percent 30-year mortgage rate to push payments on a $190,000 median-priced home above 25 percent of the typical $55,000 annual income. Given a normal spread, 8 percent mortgages would require the benchmark 10-year Treasury rate to be about 6.5 percent. That seems unlikely to happen soon since the current rate is about 4.2 percent. Global Insight has 10-year Treasury notes slowly rising to 5.4 percent by mid-2007.

As consumer spending and housing slow in 2005, business fixed investment is expected to take up some of the slack. Before it expired December 31, federal bonus depreciation seems to have shifted only a little investment spending originally planned for 2005 backward into 2004. So, Global Insight, Federal Reserve Bank of St. Louis researchers, and others expect investment growth in 2005 will be only a little less than in 2004. Some analysts note that investment spending as a fraction of GDP is below its norm in spite of firms' large cash hoard, suggesting there is potential for a better-than-forecast performance. Absent that, investment spending will not completely offset slower consumer spending, one reason why GDP growth will be slower in 2005 than it was last year.



Business investment spending is relatively low in spite of firms' large cash hoard, suggesting there is potential for a better-than-forecast performance.

Government

The February baseline makes only general assumptions about federal tax legislation and the federal budget. It assumes Congress will tinker with personal taxes so as to gradually raise federal receipts to 18.4 percent of GDP in 2008, in part by preserving some of the Alternative Minimum Tax (AMT).

On the spending side, Congress is assumed to hold federal expenditures to about 20 percent of GDP through the forecast horizon primarily by restricting discretionary spending. In the baseline, that is accomplished largely by holding the sum of Medicare, Medicaid, and defense spending at about 8 percent of GDP. That relationship prevailed in the past, though it is not necessarily a realistic assumption for the future. Global Insight also assumes less than the full amount of current budget supplementals are carried forward, making its spending projections more conservative than those from the Congressional Budget Office (CBO).

Together, the revenue and spending assumptions reduce the unified budget deficit from fiscal 2004's record $412 billion to $295 billion in 2008. In the February baseline, expenditures for Iraq and Afghanistan are treated as supplementals. Any costs for tax reform or changes to Social Security are not included because the outcome is still too uncertain.

International

Driven by a record and growing current account deficit, the dollar has been sliding downward. So far, the economy has been spared the worst possible consequences. Long-term interest rates have remained unusually low for a 4-year old expansion, in part because of significant purchases of U.S. Treasury debt by private foreign investors and by Asian central banks defending their currencies. Recently, these purchases seem to have slowed significantly, but that is not likely to be signaling a flight out of the dollar. Should foreigners bail out, their portfolios would experience enormous losses as the dollar collapsed. And the central banks probably would not participate because their countries' exports to the U.S. would decline.

But, the will to support the dollar seems to be weakening as Dr. Greenspan predicts it must. Reports in the *Wall Street Journal* and elsewhere indicate China already has or will soon shift to building up reserves in other currencies, a move needed to implement announced plans for Chinese markets to set exchange rates and interest rates. Presumably China will eventually free the yuan from its peg to the dollar, letting it float upward. Global Insight assumes the float begins sometime in 2006. That seems likely in view of China's plan to open its banking sector to foreign competition in 2007.

Monetary

Despite some observers' concern that inflationary pressure is building, the Federal Reserve has stayed on the course set out last June. Since then, short-term rates have been nudged up from 1.0 percent to 2.5 percent in 25 basis point increments. Global Insight predicts increases to 3.5 percent by early 2006.

Much information about thinking inside the Fed comes from interpretation of the minutes of Federal Open Market Committee (FOMC) meetings. Those are getting increased attention because they are released after just 3 weeks instead of a few days after a subsequent meeting. Observers believe the minutes show Dr. Greenspan and his FOMC colleagues are aware inflation could accelerate without further rate increases. However, the timing of future tightening moves will "depend on incoming data", a comment taken to mean that the "measured pace" pursued until now will be abandoned.

Inflation

According to most indicators, inflation picked up in 2004. Measured as it usually is on a year-over-year basis, the Consumer Price Index (CPI) rose 2.7 percent in 2004, up from 2.3 percent in 2003. Measured 12 months apart between December 2004 and December 2003, the CPI looked much worse, rising 3.4 percent, partly because of higher energy prices. Core inflation also edged higher. Though inflationary pressure is building, most forecasters believe it will be damped by rising interest rates.

Global Insight expects headline CPI inflation will slow in 2005 as long as there is not another spike in oil prices. The CPI was flat in December and up only slightly in January, which observers take as a sign inflation is moderating in response to lower energy prices.

A vigilant Fed and signs of moderating CPI inflation are not the only reasons forecasters believe prices are still in check. A supply side response to 2004's high commodity prices also appears to be underway. A *Wall Street Journal* article notes a shortage of oil drilling rigs in the Gulf of Mexico, suggesting increased future production. And Global Insight notes world commodity output seems to be rising, so prices of steel, primary metals, chemicals, paper, and other things are expected to stabilize or fall. Finally, labor cost increases remain modest. Most economists believe inflation cannot accelerate without rapidly escalating labor costs.

MINNESOTA OUTLOOK

Last year was the Minnesota economy's best since 2000. However, the state's expansion was not as robust as nationwide. Jobs increased by 0.7 percent, less than the 1.0 percent experienced nationally. And wage income rose 4.1 percent, compared to 4.7 percent for the U.S. Both the Minnesota and national labor markets were soft, but Minnesota's was much more volatile with seasonally adjusted monthly job gains sometimes offset by subsequent losses. By year's end, the U.S. jobs market was gaining momentum while Minnesota's languished.

Despite the unstable job market, other indicators suggest the state's modest expansion will continue. Perhaps the best sign is that in the current quarter Minnesota's income tax withholding implies wage income is on its way to increasing at least 5.5 percent from 2004’s first quarter. Other indicators are also positive, but less so. Job vacancies are flat. Initial claims for unemployment insurance are holding at a level the Minnesota Department of Employment and Economic Development (DEED) indicates is consistent with "weak and sporadic job growth" while continuing claims have improved recently. And, the Federal Reserve Bank of Minneapolis notes modest signs of growth in consumer spending, manufacturing, construction, energy, and mining, with price increases appearing in some sectors.

MINNESOTA OUTLOOK COMPARED TO THE U.S.

(Calendar Year Percent Changes)

	2003	2004	2005	2006	2007
Non-Farm Employment					
Minnesota					
November 2004	-0.1	0.8	1.0	0.9	1.1
February 2005	-0.1	0.7	1.1	1.3	1.2
United States					
November 2004	-0.3	1.0	1.7	1.2	0.8
February 2005	-0.3	1.1	1.7	1.4	1.1
Wage and Salary Income					
Minnesota					
November 2004	2.8	4.1	5.3	4.9	5.0
February 2005	2.4	4.1	5.4	5.0	5.1
United States					
November 2004	2.6	4.5	5.4	5.4	5.2
February 2005	2.6	4.7	5.5	5.5	5.6

Outlook Little Changed

Minnesota's payroll employment and wage income forecasts have been revised to be consistent with Global Insight's February baseline and to reflect recent experience. Expected 2005 employment and wage growth is little changed. For 2005, employment is forecast to increase 1.1 percent, up from 1.0 percent in November. Wage income is forecast to rise 5.4 percent, up from 5.3 percent. Global Insight forecasts U.S. employment to increase 1.7 percent, the same as in November, while wages are expected to rise 5.5 percent, up from 5.4 percent previously.

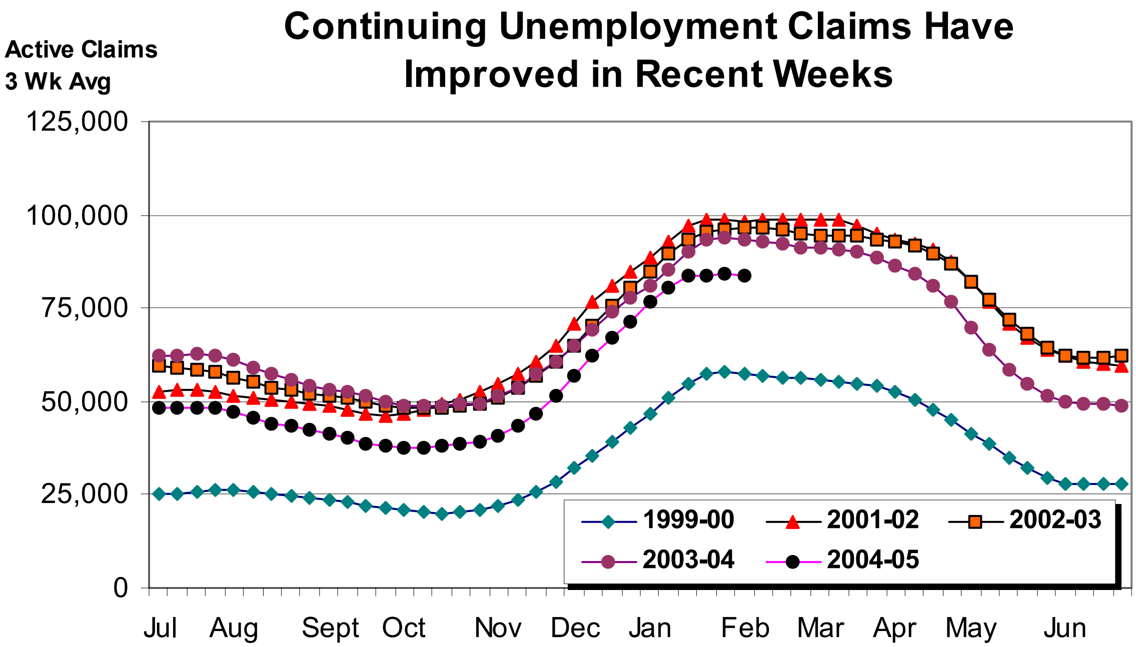
Recent experience explains much of the difference in the jobs outlook for the U.S. and Minnesota. Beginning in January 2004, the U.S. employment reports have shown monthly increases in seasonally adjusted jobs which were accelerating at year's end. Minnesota job gains have been much more erratic, with some monthly increases being reversed by subsequent losses. After growing in January 2004, employment declined in February and March, grew in April and May, and went flat in June. It then declined in July, rose in August, fell in September, grew in October, declined again in November, and showed no increase in December. That performance leads Finance Department economists to expect Minnesota's employment recovery will continue to lag behind its U.S. counterpart in 2005. While U.S. jobs reached their pre-recession peak in January 2005, Minnesota will not reach that point until sometime this spring.

Wages also appear to be lagging, though current income tax withholding indicates recent improvement. Preliminary data indicate Minnesota wage income grew 4.1 percent in 2004 while the U.S. increased 4.7 percent. The last time Minnesota wage income lagged significantly behind the U.S. was in 1998.

Employment Growth Must Begin Now

If the February outlook is to materialize, Minnesota's economy must immediately begin adding about 2,500 jobs per month on a seasonally adjusted basis. That may already be underway since continuing unemployment claims have fallen in recent weeks. The outlook indicated by the Finance Department model of the state economy assumes employer caution and just-in-time hiring will not continue to slow jobs growth.

Two other assumptions concerning jobs must also be met during the next year. First, the current slowdown in mortgage refinancing and the coming softening in housing must not cause a significant decline in financial services employment. Second, the outlook assumes local government and higher education budgets ease enough to permit modest increases in public employment beginning in 2005's third quarter.



Continuing unemployment claims have fallen in recent weeks, a sign Finance Department economists take to mean hiring is picking up. Minnesota's February outlook assumes employer caution and just-in-time hiring will not continue to slow employment growth.

Highly Concentrated Jobs Growth Poses Risks

Minnesota's February outlook shows employment growth highly concentrated in just a few industries. Health care, professional and business services, manufacturing, and construction which currently comprise some 41 percent of total employment account for 72 percent of the projected 103,500 job increase through the end of 2007.

Depending on simultaneous uninterrupted expansion in each of a handful of industries is somewhat risky. Health care has been growing steadily for years and seems the least likely to soon experience unanticipated setbacks. The other industries are another story. Professional and business services has experienced a steady loss of national share for many years and may not resume growth in the spring of 2005 as projected. Manufacturing has lost jobs recently and is exposed to strong international competition. Construction has been flat since last summer and the outlook is uncertain. Rising interest rates, a soft labor market, and a slowdown in Minnesota population growth could dampen homebuilding more than expected. A recent news article indicates one developer is concerned that there has been overbuilding in condominiums. It is also unclear when office vacancy rates will decline enough to warrant a pickup in commercial construction.

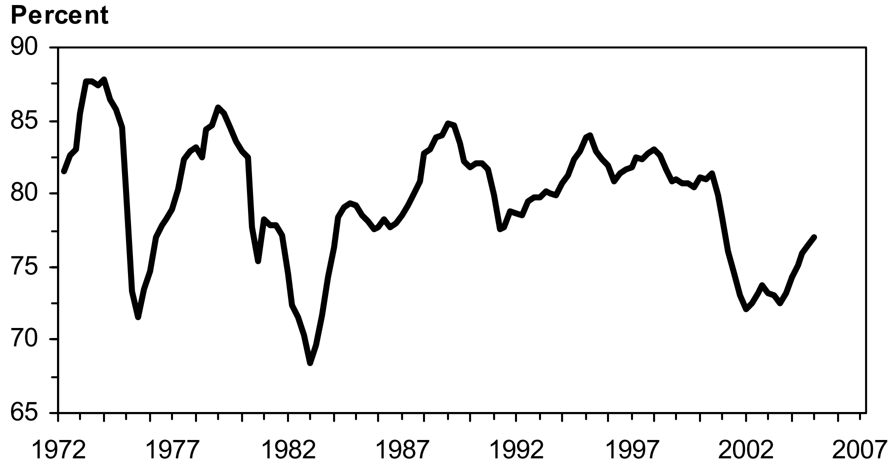
Minnesota's outlook shows employment growth highly concentrated in just a few sectors. Depending on simultaneous uninterrupted expansion in each of a handful of industries is somewhat risky.

Real Wage Incomes Must Also Rise

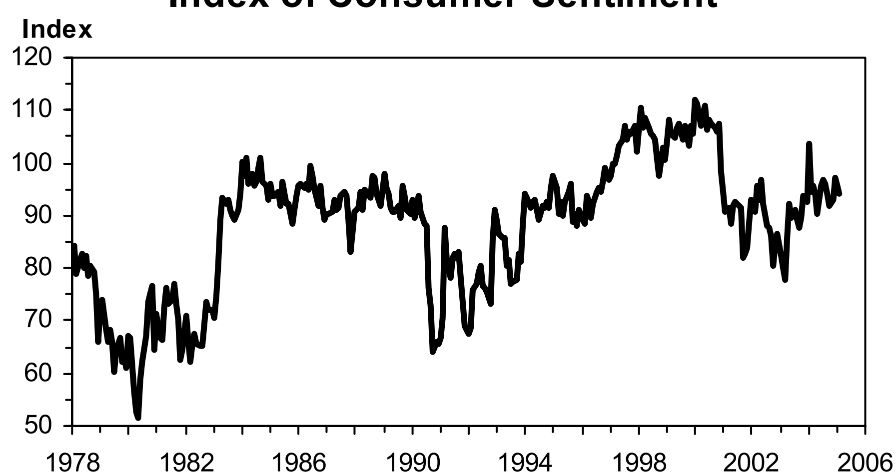
In addition to increases in employment, Minnesota's outlook also assumes real or inflation adjusted wage income per job will rise throughout the forecast horizon, with increases accelerating in some industries. Ordinarily, that can happen only with productivity improvements economists are largely unable to predict. The general consensus, shared by Global Insight, is that economy-wide productivity growth will continue, though slowing from rates experienced during the past several years. Finance Department economists are unaware of any credible industry productivity forecasts that could be used to validate projections for real wage growth in specific Minnesota industries.

Selected National Economic Indicators

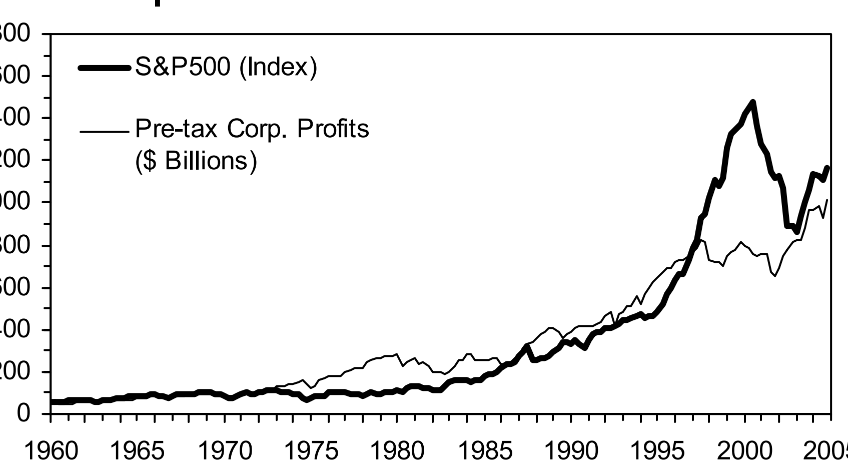
Manufacturing Capacity Utilization



Index of Consumer Sentiment

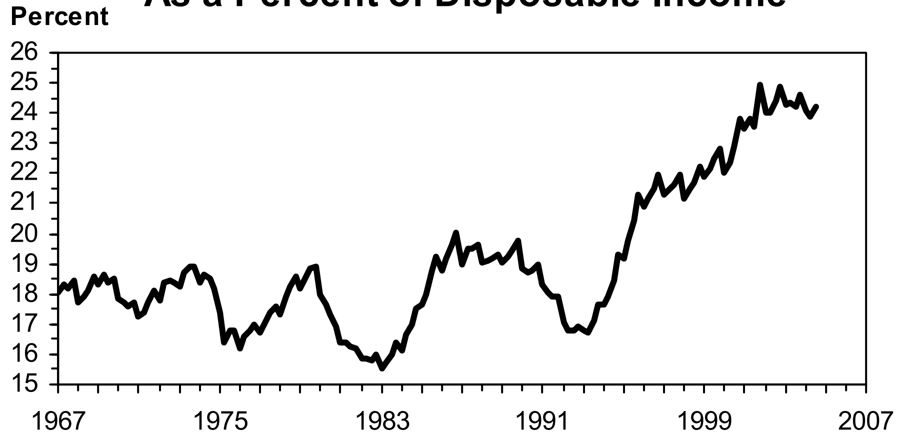


Corporate Profits and the Stock Market

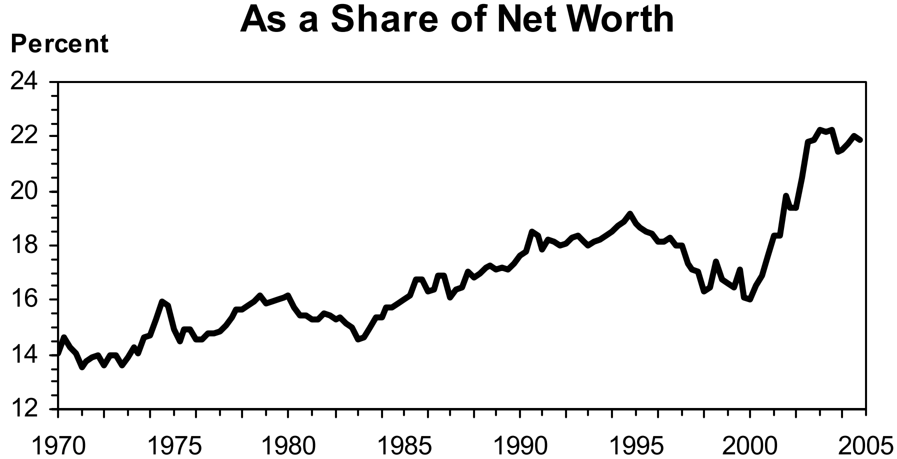


Selected National Economic Indicators

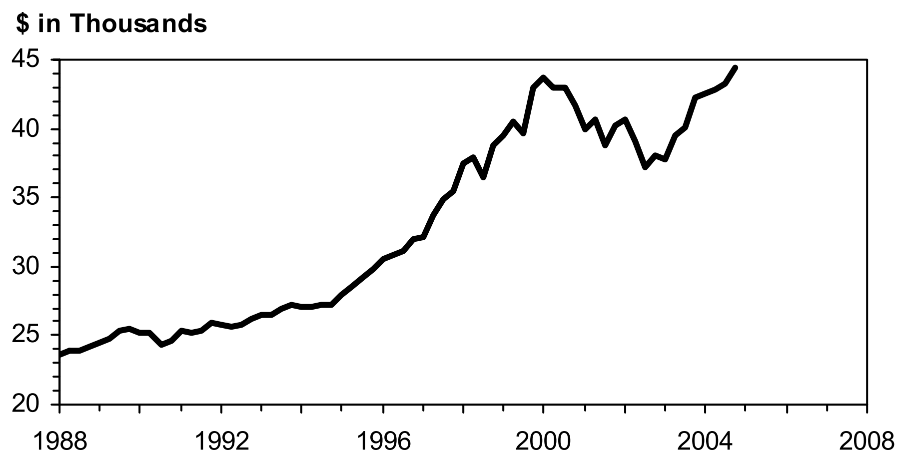
Installment Credit Outstanding As a Percent of Disposable Income



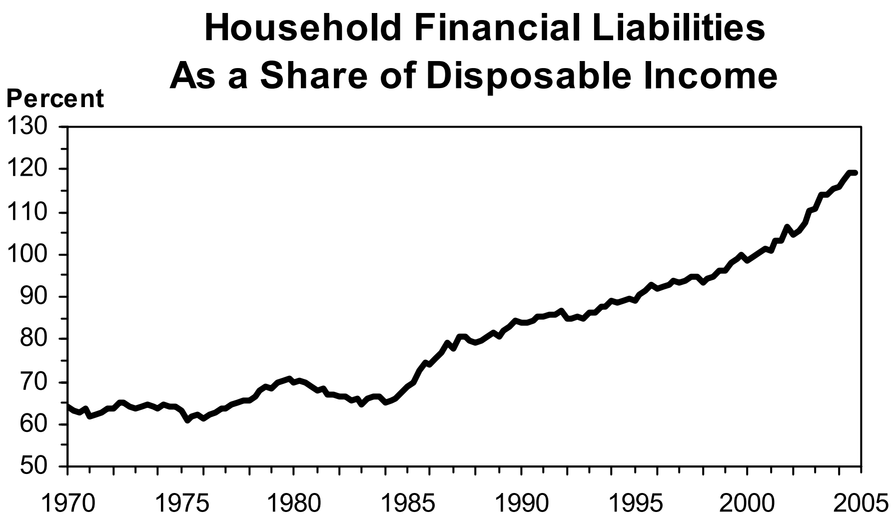
Household Financial Liabilities As a Share of Net Worth

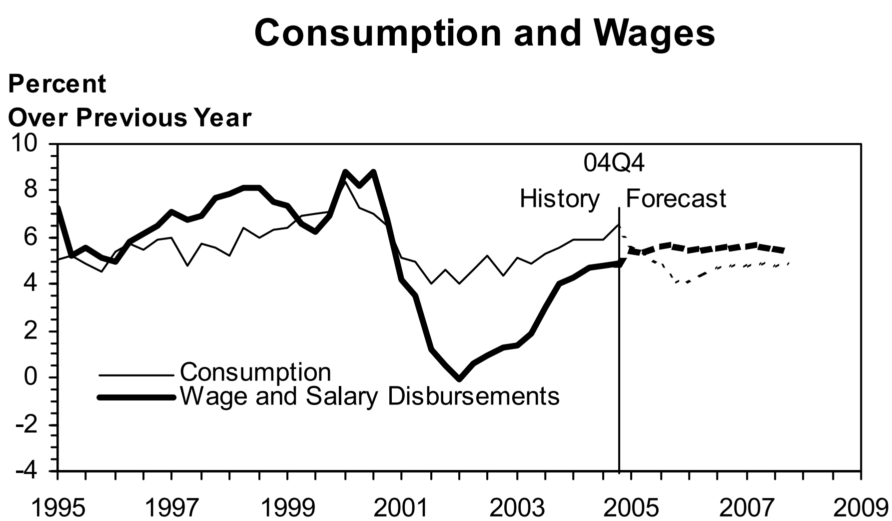


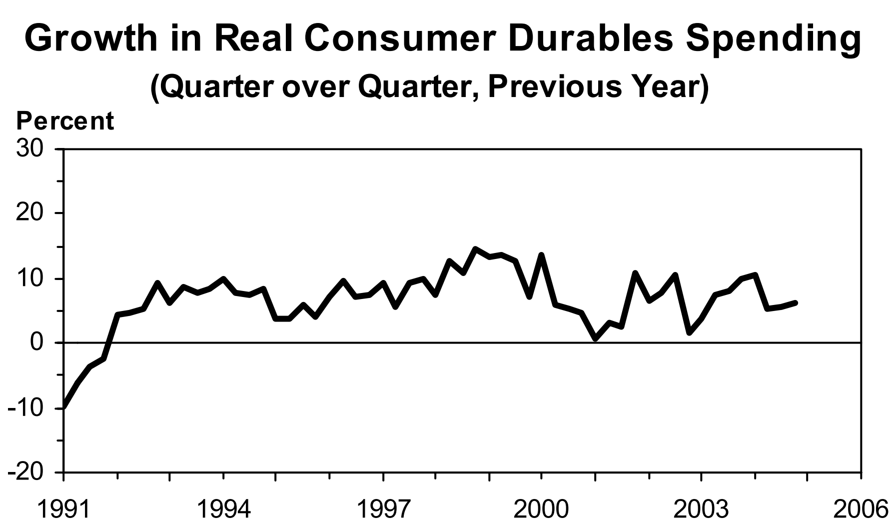
Real Household Net Worth ($1996)



Selected National Economic Indicators

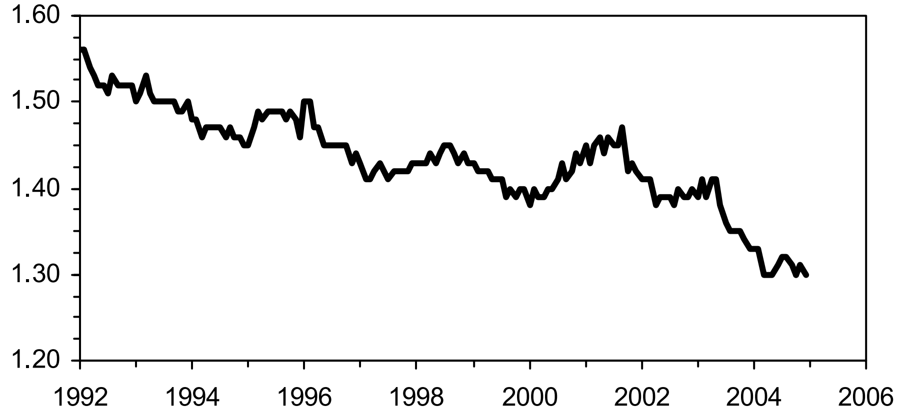






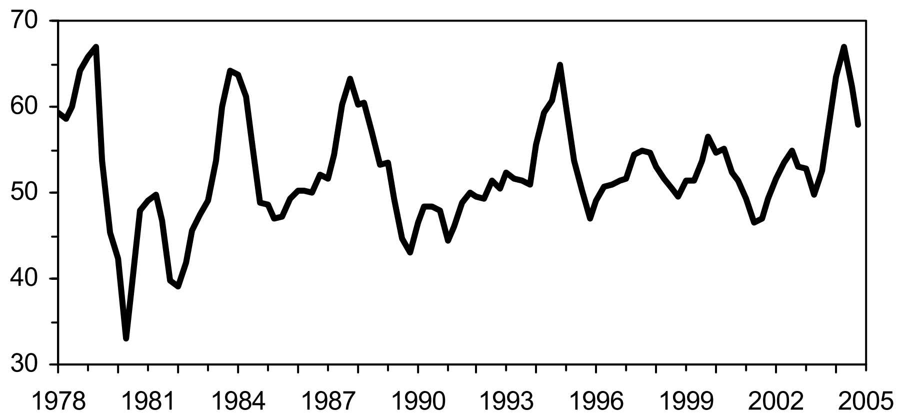
Selected National Economic Indicators

Manufacturing and Trade Inventory to Sales Ratio



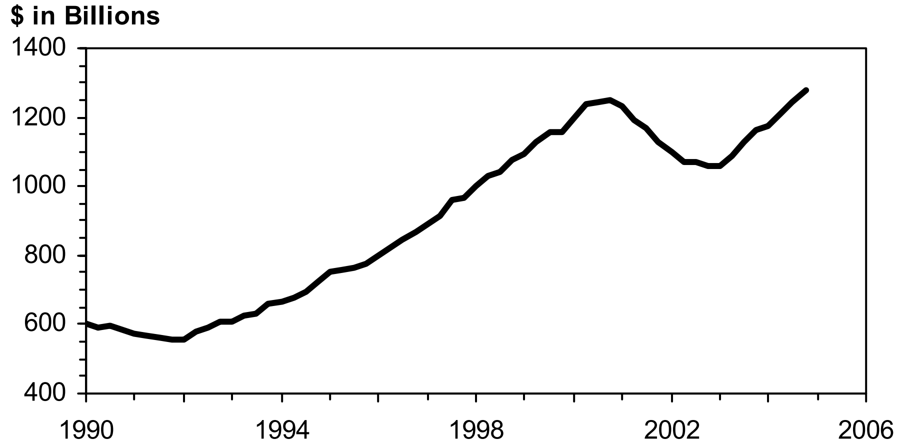
Proportion of Companies Receiving Slower Deliveries

Percent



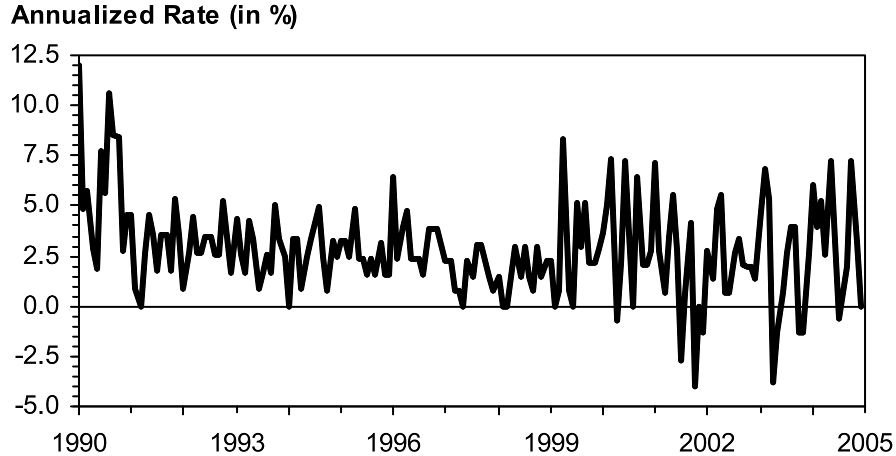
Real Fixed Nonresidential Investment

$ in Billions

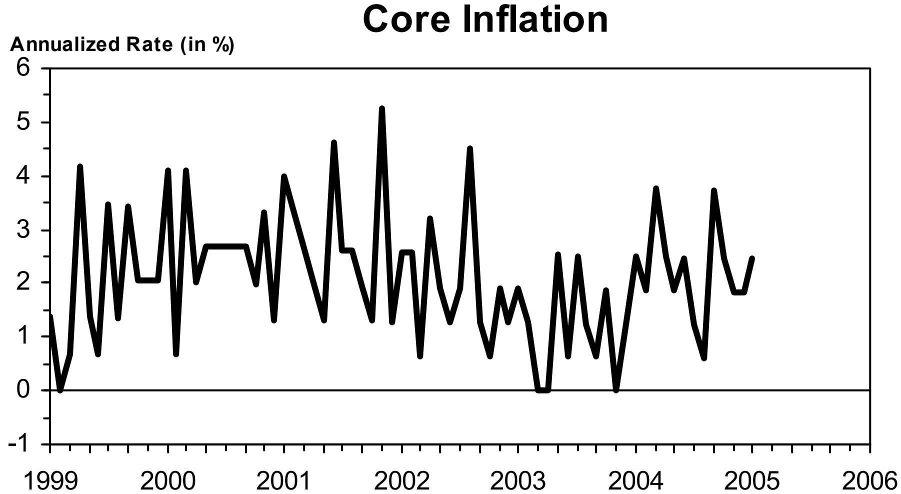


Selected National Economic Indicators

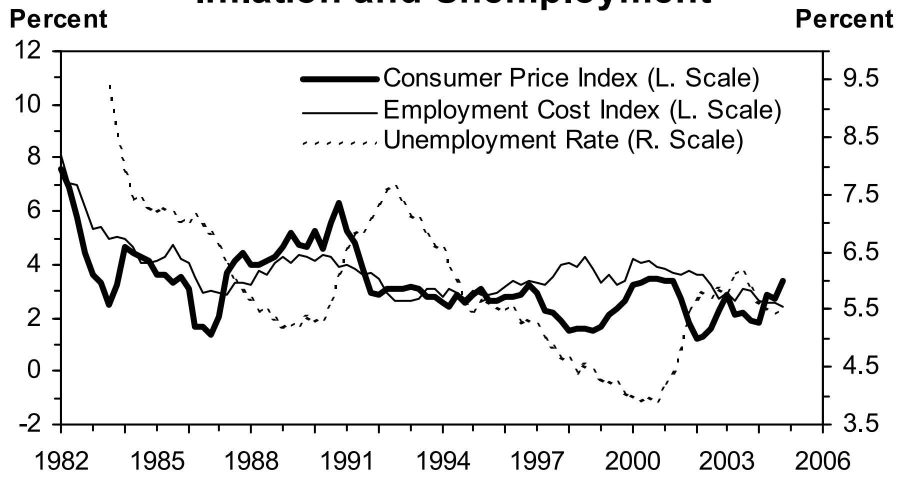
Consumer Price Index



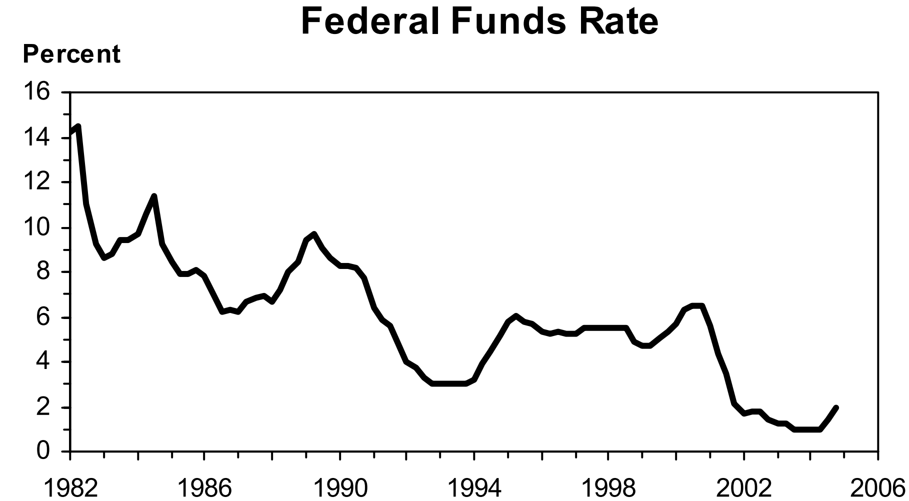
Core Inflation

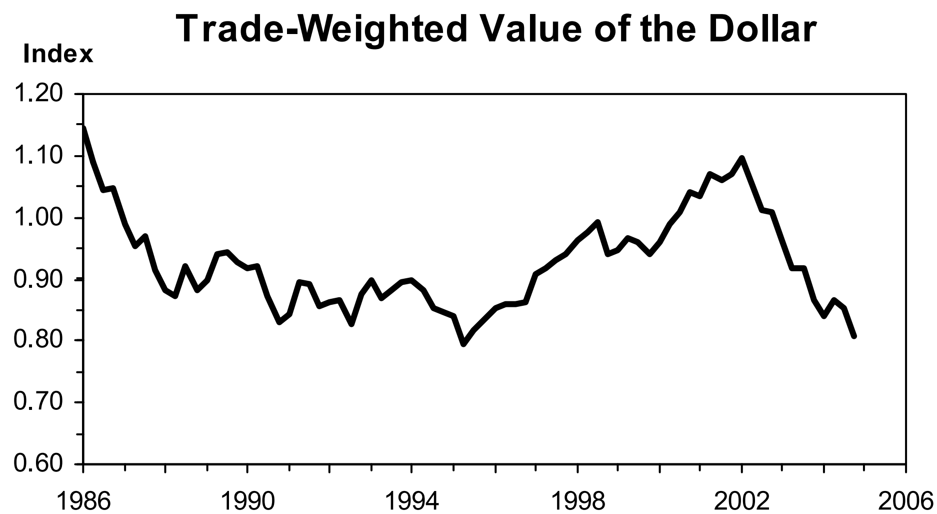


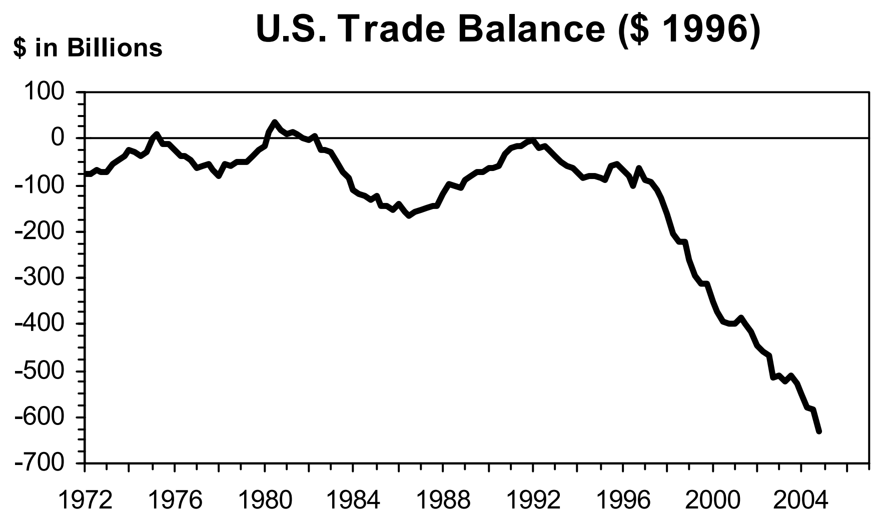
Inflation and Unemployment



Selected National Economic Indicators







FY2004-05 Budget Status

FY2005 Balance of $175 Million Allocated by Current Law

The November 2004 forecast projected a $495 million general fund balance for the end of the FY2004-05 biennium. Under current law, that entire balance was allocated to restoring the general fund cash flow account to $350 million, restoring the budget reserve to $653 million, and a partial buyback of school shifts enacted in 2002 and 2003. This left a zero ending balance.

Revised revenue and expenditure estimates now indicate a $175 million balance for FY2005. February forecast changes reflect not only revenue and expenditure forecast revisions, but also provisions from the 2005 legislative session that made supplemental appropriations for fiscal year 2005. The entire amount of this budget balance is allocated by current law to restoring general fund reserves and additional buy back of school payment shifts. After these allocations, the forecast available balance for the biennium ending June 30, 2005, is again zero.

FY2004-05 Forecast (Before Allocation)

($ in millions)

		February Changes		
	November Forecast	Legis Action	Forecast Changes	Revised Forecast
Beginning Balance	$369			$369
Revenues	28,673	6	150	28,829
Expenditures	28,039	31	(25)	28,045
Cash Flow Acct	350			350
Budget Reserve	653	(25)	0	628
Balance	**$0**	**--**	**--**	**$175**

Current Law Allocates Forecast Balance to Reserves and Shift Buybacks

The budget reserve was reduced $24.7 million by budget actions in the 2005 legislative session. As was the case in November, statutes direct that any forecast balances for the biennium be allocated first to restoring reserves to their prior levels. Any additional forecast balance must be directed to continuing to buy back K-12 school aid payment shifts.

Under this requirement the $175 million projected balance at the end of the biennium produced by the forecast changes is distributed as follows:

- $ 24.7 million to restore the Budget Reserve to $653 million
- $150 million to FY2005 Education Aid Payments

Deficiency Bill Added $31 Million to FY2005 Spending

The 2005 legislature passed a supplemental spending bill to deal with emergency items that was signed into law in early February 2005.

- $31 million was provided for current year budget shortfalls in the Board of Public Defense, Humans Services state operated services, the Department of Corrections, and several other areas.
- $6.4 million in increased revenues offset part of the new spending. $4.8 million was from a related sale of a state building, the remainder an increase in RTC collections;
- $24.7 million was taken from the general fund budget reserve to fund the remainder of the newly authorized spending. This reduced the budget reserve from $653 million to $628.3 million.

Increased Revenues and Lower Spending Contributed to Balance In FY2005

The forecast for general fund revenues has increased $157 million from November estimates, while forecast expenditures increased $6 million.

The forecast for total general fund revenues for the biennium has increased by $157 million to $28.829 billion. Of the total revenue increase, $66 million occurs in expected income tax collections, $64 million in higher corporate tax receipts and $27 million in expected higher net sales tax collections. Changes in all other tax and non-tax revenues are not significant, yielding a net increase of $1 million.

Spending for the biennium has increased by $6 million to $28.045 billion. A significant portion of the change, $31 million, is spending associated with the FY2005 deficiency bill passed in February. The remainder, a $25 million net reduction, is the result of net savings from other forecast expenditures. This forecast represents less than 0.1 percent change in projected spending for the biennium.

Revenue Forecast FY2004-05

Current general fund resources for the 2004-05 biennium are now forecast to total $28.829 billion, $157 million (0.5 percent) more than forecast in November. The forecast for net non-dedicated revenues increased by $155 million (0.6 percent) over November's projection. Current resources for the biennium are projected to exceed those in the 2002-03 biennium by $3.387 billion or 13.3 percent.

Revenue Forecast FY2004-05
$ in Millions

	FY2002-03	FY2004	FY2005	FY2004-05
Individual Income	$10,815	$5,709	$6,176	$11,885
Sales	7,710	4,101	4,226	8,327
Corporate	1,118	628	829	1,457
Motor Vehicle Sales	705	275	263	537
Statewide Levy	891	600	618	1,218
Five Major Taxes	21,239	11,313	12,117	23,424
Other Revenue	3,204	1,812	1,666	3,480
Tobacco	309	169	175	344
Net Non-dedicated	24,752	13,295	13,952	27,248
Other Resources	690	1,204	378	1,582
Current Resources	**$25,442**	**$14,499**	**$14,330**	**$28,829**

Small changes in the individual income tax forecast, the corporate income tax forecast and the sales tax forecast accounted for almost the entire increase in projected FY2005 revenues. Percentage changes for all major taxes other than the corporate income tax were small. Although corporate income tax receipts were up by a greater percentage, even that increase was within the normal range of variation in the forecast.

Much of the additional revenue has already been realized. Through January receipts were $154 million above forecast and that positive variance has been incorporated in this revenue forecast.

Individual Income Tax

Individual income tax receipts in Minnesota are forecast to total $6.176 billion in fiscal 2005, up $66 million from November's estimate. The forecast for Minnesota wage growth in tax year 2005 is almost unchanged from November as is the Minnesota employment forecast. As in November's forecast, employment in Minnesota is expected to grow more slowly than the U.S. average through the end of the biennium. Minnesota employment is now projected to be 2.695 million in the final quarter of the current biennium, up 800 jobs from November's estimate.

Withholding tax receipts were noticeably above forecast for a few days in early January, producing a positive variance of about $20 million in receipts. Except for those few days, however, withholding revenues have grown at the rate forecast in November. The timing of that small boost in withholding payments suggests the additional revenue came from year-end bonuses, not from an increase in base wages. To better reflect those higher bonuses the forecast for withholding revenues for first quarter 2005 was adjusted up by $15 million.

Through January there was also a $50 million positive variance in estimated tax payments. That variance did not provide a dollar for dollar boost to projected revenues though. November's forecast assumed a larger portion of the state taxes collected on income from non-wage sources would arrive in April as final payments and a smaller portion would be paid as estimated payments at the end of 2004 than is now forecast. Part of the revenue variance appears to be attributable to individuals increasing their fourth quarter estimated income tax payments to reflect the large one-time dividend payment made by Microsoft. The additional state tax revenue accruing because of that single payment could exceed $20 million. A portion of the observed estimated tax variance simply reflects an acceleration in the receipt of income tax revenue for tax year 2004.

Data from the Department of Revenue's sample of tax year 2003 Minnesota income tax returns was used to calibrate the income tax micro-simulation model to reach tax year 2003 liability. That information indicated that many of the "blow up" factors should be adjusted. The most significant change was for capital gains realizations. Capital gains are now believed to have grown by more than 25 percent in tax year 2003. In November a growth rate of 6 percent was used. Slower growth in wages and in partnership and proprietors incomes offset the increase in capital gains. Final liability for tax year 2003 was $12 million above November's preliminary estimate. Other technical adjustments reduced the projected revenues in tax year 2004 and 2005.

Sales Tax

Net sales tax collections for the 2004-05 biennium are now expected to reach $8.327 billion, $27 million (0.3 percent) more than forecast in November. Gross sales tax receipts were $14 million less than forecast for the months of November, December and January. But sales tax refunds were $33 million less than projected leaving a positive variance of $18 million.

Gross sales tax receipts are now projected to finish fiscal 2005 $6 million below November's estimate. Spending on both non-auto consumer durables and business capital equipment is expected to grow slightly faster than anticipated in November, but the additional growth is insufficient to fully make up the year-to-date shortfall in receipts.

The small decline in gross receipts is more than offset by a reduction in projected sales tax refund payments of $33 million. Sales tax refunds were reduced because projected refunds due under the *Sprint Spectrum L.P* decision now appear to be less than anticipated. And, the base level of refunds was reduced to adjust for sales tax refund levels being below forecast since 2001. The reduction in refunds attributable to the Sprint decision affects only fiscal 2005, but the reduction in the base level of refunds extends through the entire forecast horizon, adding to net revenues in both the 2006-07 and 2008-09 biennia.

Even though receipts were below forecast the receipts elasticity for the remainder of fiscal 2005 was left at .80. The receipts elasticity is used to convert the growth rate in the sales tax base to growth in sales tax receipts. As in November revenues lost to e-commerce and catalog sales were assumed to grow by 15 percent in 2005.

Corporate Franchise Tax

Net corporate tax receipts for the 2004-05 biennium are now estimated to total $1.457 billion, $64 million (4.6 percent) more than forecast in November. Much of that additional revenue is already on hand. Net corporate tax receipts for November, December, and January were $60 million above forecast. Refunds for tax year 2003 are currently $32 million less than forecast and estimated payments for tax year 2004, $26 million above forecast. Miscellaneous and final payments, which may be attributable to any prior tax year exceeded forecast by $3 million.

Global Insight has reduced its forecast for corporate profits growth. They are now expecting 19 percent growth in corporate profits in fiscal 2005, down from the 24 percent growth projected in November. There is little change in the level of corporate profits through the rest of the forecast horizon.

The combination of higher base receipts and a modestly weaker outlook for future corporate profits raises the forecast for corporate estimated payments by $42 million. Corporate refunds for fiscal 2005 were reduced to $116 million, down $20 million from November's estimate.

The corporate income tax continues to be the most volatile of the state's major revenue sources.

Motor Vehicle Sales Tax

The sales tax on motor vehicles is now projected to add $263 million to the general fund in fiscal 2005, $2 million less than projected in November. Motor vehicle sales tax receipts in November, December and January were $2 million less than projected and this forecast recognizes that modest decline in revenues and carries it forward through the end of the biennium. Global Insight's forecast for light vehicle sales for the remainder of the biennium is down very slightly from November.

Other Revenues

Other tax and non-tax revenues are now expected to total $5.041 billion during the current biennium, up just $1 million from November's forecast. Payments from the tobacco settlement were $7.6 million more than projected, while the mortgage and deed taxes were slightly less than November's forecast.

Expenditure Forecast
FY2004-05

Increase in Spending From Legislative Action, Largely Offset by Forecast Changes

The expenditure forecast for the current biennium now totals $28.045 billion, $6 million more than November's estimates. Action triggered by the forecast will add $150 million to the spending for FY2005 for the K-12 payment shift buy-back. With this change, total spending will be $28.195 billion.

Forecast changes include interim action that approved $31 million in FY2005 supplemental appropriations. This was largely offset by a $25 million decrease in forecast spending that resulted in the small net increase. A $5 million decrease in K-12 education, a $5 million reduction in tax penalty and interest payments, and a one-time $17 million increase in forecast cancellations accounted for the majority of the savings. There was little net change in the forecast for health and human service programs, increasing only $16 million from previous estimates largely due to FY2005 deficiency appropriations.

FY2004-05 Expenditure Forecast
Before Statutory Allocation
($ in millions)

	November	February	Difference
Estimated Spending by Area			
K-12 Education	$12,232	$12,224	$(8)
Payment Change/Prop Tax Recog.	(329)	(326)	3
Post-Secondary Education	2,542	2,542	0
Property Tax Aids & Credits	2,810	2,804	(6)
Health & Human Services	7,245	7,262	16
Environ., Agric., Econ. Dvlpmt.	739	739	0
Transportation	159	159	0
Public Safety	1,437	1,450	13
State Government	580	585	5
Debt Service	589	589	0
All Other	(39)	(56)	(17)
Subtotal	27,964	27,971	6
Dedicated Expenditures	74	74	0
Total Expenditures & Transfers	**$28,039**	**$28,045**	**$6**

Legislative Action Increased Current Year Spending

In January the Governor recommended a number of supplemental "deficiency" appropriations to resolve particular agencies' budget shortfalls in FY2005. The legislature concurred with the Governor's budget recommendations, and Laws 2005 Chapter 2 was signed into law in mid-February.

The FY2005 deficiency appropriations are displayed below by omnibus bill and agency.

FY2005 Deficiency Bill
($ in thousands)

Health & Human Services	
Dept of Human Services	$13,394
Public Safety	
Board of Public Defense	7,681
Board of Judicial Standards	199
Dept of Corrections	4,070
Dept of Public Safety	986
State Government	
Dept of Veterans Affairs	39
Dept of Administration	4,705
Total	**$31,074**

The amounts shown add to FY2005 spending. With few exceptions, the additional spending is ongoing and is carried forward into current law planning estimates for FY2006-07.

K-12 Education Spending Remains Virtually Unchanged in FY2004-05, School Aid Payment Percentage now 84.3 percent/15.7 percent

K-12 education spending in FY2004-05 is now expected to be $12.227 billion. Underlying appropriations are up $142.6 million since November due to a partial buy back of the school aid payment shift as required by M.S. 16A.152. This brings the aid payment percentage to 84.3 percent in the current year and 15.7 percent in the following year.

Health and Human Services Spending Increases $16.5 Million in FY2005

Total health and human services spending for the current biennium is expected to be $7.3 billion, a $16.5 million increase (0.2 percent) over previous estimates in November. Most of the increase is due to the deficiency appropriations that added $13.4 million in FY2005 to the Department of Human Services (DHS) budget to accommodate higher numbers of patients in forensic treatment programs. Within the forecasted programs, adjustments in

Basic Health Care grants primarily accounts for the small remaining increase in the current year.

Basic Health Care Grants

Medical Assistance (MA) Elderly and Disabled Basic Care is projected to increase $10.0 million in FY2005. The increase is largely due to an omission in payment data reported as part of the November forecast.

The increase in MA Elderly and Disabled is partially offset by decreases in MA Families and Children Basic Care and General Assistance Medical Care (GAMC), which decrease $4.1 million and $2.0 million, respectively.

Children and Economic Assistance Grants

Children and Economic Assistance Grants estimates are virtually unchanged for FY2005. There are largely offsetting changes between Minnesota Family Investment Program/Transition Year (MFIP/TY) Child Care expenditures and MFIP Grants expenditures due to maintenance-of-effort (MOE) requirements of the federal Temporary Assistance for Needy Families (TANF) block grant.

Continuing Care Grants

Estimates for Continuing Care Grants are also essentially unchanged, falling $1.1 million from November. MA Long-Term Care (LTC) Waivers decreased $7.8 million, primarily due to decreased caseloads. The decrease was almost entirely offset by small increases in MA Long-Term Care Facilities and Chemical Dependency (CD) treatment.

Property Tax Aids and Credits Spending Slightly Lower

Tax aids and credits total $2.807 billion for the current biennium, $2.8 million less than was forecast in November 2004. The largest single change is a $6.5 million reduction in expected payments of tax refund interest and penalties. This reduction is partially offset by forecast increases in market value credit payments to school districts and local governments ($3 million) and contributions to police and fire pension funds ($1 million).

All Other Spending Changes Have Little Material Impact

Since other spending areas are limited by fixed appropriations, there is little material change in the forecast for individual agencies or items. However, the forecast for estimated cancellations for FY2005 has increased by $17 million and is now projected to be $44 million. This change in the forecast for cancellations reflects appropriations in Human Services' state operated services accounts that will likely remain unspent and which will cancel under current law. An ongoing effort within DHS to restructure the delivery of mental health services to community-based settings has proceeded more slowly than originally planned. This results in the previously unplanned cancellation.

FY2006-09 Budget Outlook

This forecast for the FY2006-07 biennium describes the budget outlook if current laws and policies remain unchanged. It establishes the resources available under current law to fund state programs and is the basis of action by the Governor and legislature to approve the general fund budget for the upcoming biennium. The February 2005 forecast provides the final basis for action on the FY2006-07 budget, updating forecast estimates made in November 2004.

FY2006-07 Budget Gap Improves Slightly, Reduced to $466 from $700 million

The projected shortfall for the FY2006-07 budget is now $466 million. The forecast shortfall has decreased slightly from the $700 million projected in November, improving by $234 million. Higher forecast revenues account for all of the change. There was no net change in the expenditure forecast for FY2006-07.

FY2006-07 Biennial Budget Forecast
Change from November 2004 Estimates
($ in millions)

	November	February	Difference
Revenues	29,478	29,711	234
Expenditures	30,177	30,177	0
Projected Shortfall	**$ (700)**	**$ (466)**	**$234**

Unlike the forecast for FY2004-05, the projected $466 shortfall for FY2006-07 is not based on an enacted budget. Instead the February revenue forecast, when matched against "base level" current law spending, provides the framework for determining the budget for the next two years.

FY2006-07 forecast revenues have increased $234 million over November's estimates. Higher projected individual income tax collections, higher corporate income tax revenue, and higher expected net sales tax receipts account for a $275 million gain. Small decreases in the motor vehicle sales tax, and some other revenue sources offset a portion of the gain, decreasing the change in total tax receipts to $230 million. Minor changes in non-tax revenues, transfers and other resources added $4 million to the total revenue forecast increase.

Net spending for the FY2006-07 is unchanged. A $43 million increase from FY2005 "deficiency" appropriations extended into the next biennium is offset by savings from other forecast changes. A $44 million increase in estimated K-12 spending is more than offset by

$76 million in forecasted savings in health and human services spending, $5 million in savings from lower tax refund penalties and interest, and $4 million savings from lower debt service estimates. All other changes net to a $2 million decrease in spending, resulting in no change in total spending from that forecast in November.

For planning purposes, revenues are projected based on current tax laws and rates. Expenditure projections include provisions currently in law and are adjusted only for enrollment and caseload changes in K-12 education, higher education, human services and corrections. The expenditure forecast does not include estimated general inflation increases beyond that portion that is integrated into the health care cost components of the forecast.

FY2008-09 Planning Estimates

The planning estimates for FY2008-09 differ from the short-term forecasts for the current and FY2006-07 biennia. Projection methods are different and the longer-term estimates carry a higher degree of uncertainty and a larger range of potential error.

FY2008-09 Planning Estimates / Structural Balance

($ in millions)

	FY2008	FY2009
Projected Revenues	**$15,680**	**16,413**
Projected Spending	**15,546**	**15,843**
Difference	**$134**	**$570**

The projected revenue-expenditure gap in FY2008 and FY2009 has improved slightly from the November 2004 forecast. The structural balance between ongoing revenues and spending has increased from $40 million to $134 million for FY2008 and from $450 million to $570 million for FY2007. General fund revenue projections for FY2008-09 are $277 million higher than the November forecast, while state spending for the same period is $63 million above previous projections.

Planning estimates of current law revenues and expenditures for FY2008-09 are presented to identify longer-term impacts of proposed budget actions. Revenue planning estimates are based on an assumed long-term real GDP growth rate. Expenditure estimates assume current laws and policies adjusted for caseload, enrollment and other forecast variables in major program areas.

Since the impact of inflation is not generally reflected in the expenditure projections, it is important to recognize that changes in state spending may be significantly greater than those shown. Forecast general inflation, based on the Consumer Price Index (CPI) is expected to increase 1.5 and 1.8 percent for fiscal years 2006 and 2007, while CPI growth rates of 2.0 percent and 2.2 percent are forecast for FY2008 and 2009 respectively.

If the forecast spending were uniformly adjusted for inflation, it would add approximately $730 million to planning estimates for FY2006-07. Compounded over four years, inflation would add over $2 billion to spending estimates for FY2008-09.

Revenue Forecast FY2006-07

Total current resources for the 2006-07 biennium are forecast to be $29.711 billion, $234 million (0.8 percent), more than projected in November. Receipts from the five major taxes are forecast to total $25.622 billion, $259 million more than was anticipated in November. A slight decline is projected in other tax and non tax receipts. Current resources in the 2006-07 biennium are now projected to grow by 3 percent over FY2004-05 revenues. Revenue from the five major taxes is forecast to grow by 9.4 percent over levels in the 2004-05 biennium. Other resources fall by $1.168 billion compared to FY2004-05 levels reflecting the one time transfer of tobacco funds to the general fund done as part of the 2004-05 budget solution.

Revenue Forecast FY2006-07

($ in millions)

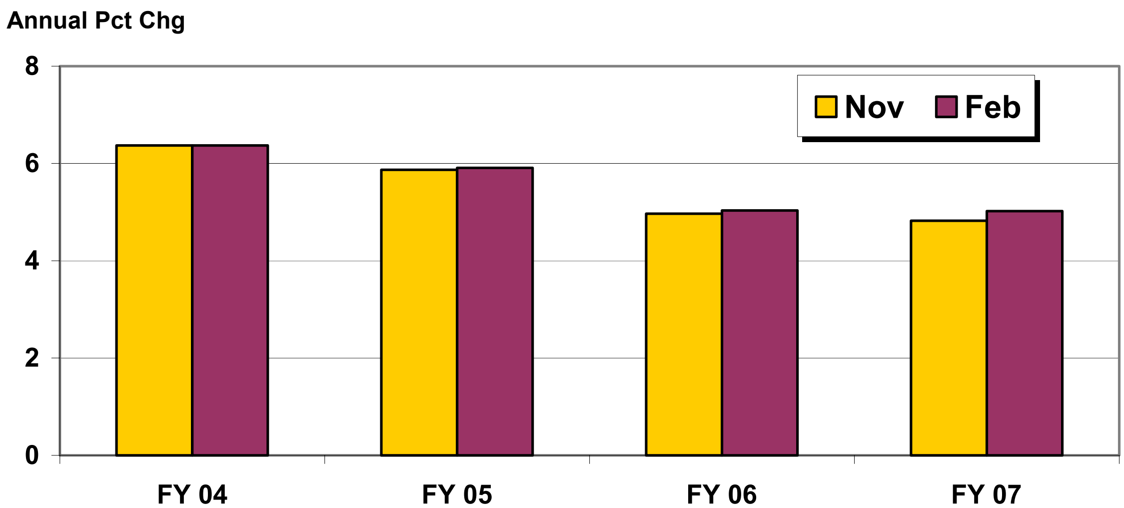
	FY2004-05	FY2006	FY2007	FY2006-07
Individual Income	$11,885	$6,528	$6,955	$13,483
Sales	8,327	4,396	4,452	8,848
Corporate	1,457	736	733	1,469
Motor Vehicle Sales	537	260	271	531
Statewide Levy	1,217	635	657	1,291
Five Major Taxes	23,424	12,555	13,067	25,622
Other Revenue	3,480	1,657	1,677	3,334
Tobacco	344	172	169	340
Net Non-dedicated	27,247	14,383	14,913	29,297
Other Resources	1,582	203	211	414
Current Resources	**$28,829**	**$14,586**	**$15,125**	**$29,711**

There were modest increases in the forecast for the individual income tax and sales tax, and a slightly larger percentage increase in the corporate income tax forecast. Changes in projected receipts from those three taxes account for all the additional revenue found in this forecast. The sales tax showed the largest dollar value change, up $115 million; the corporate income tax the largest percentage change, up 6.4 percent.

Changes in Economic Assumptions

The economic outlook has changed only slightly since November. Global Insight now forecasts real (inflation adjusted) GDP in the U.S. to grow at a 3.2 percent annual rate in FY2006 and a 3.1 percent annual rate in FY2007. In November the GII baseline called for growth rates of 3.0 percent and 3.1 percent. Nominal GDP growth rates also show no material change. In the February GII baseline, nominal GDP is projected to grow at a 5 percent annual rate in both fiscal 2006 and fiscal 2007. In November nominal GDP growth was projected at a 5 percent rate in fiscal 2006 and a 4.8 percent annual rate in fiscal 2007. The outlook for before tax corporate profits was slightly weaker than in November, while projected growth rates for sales of non-auto consumer durables and business equipment showed modest increases.

Forecast For Nominal GDP Growth Shows Almost No Change from November



Income Tax

Individual income tax receipts for the 2006-07 biennium are forecast to total $13.483 billion, $71 million (0.5 percent) more than was forecast in November. Although the higher base liability in tax year 2004 carries forward, not all of that increased liability was permanent. Since there were no major changes in growth rates the changes to projected FY2006 and FY2007 revenues are smaller than those for FY2005.

There were only minor, and offsetting, changes in projected Minnesota wage growth between November and February. Minnesota's employment growth continues to lag the U.S. average, but despite that withholding tax receipts have remained on forecast. Since there has been no significant change in the employment outlook for either the state or the nation since November, changes in projected wages and salaries are small. The $15 million off-model adjustment for apparent bonus payments observed in withholding receipts in the first days of 2005 was not carried forward to 2006 and 2007.

Capital gains were assumed to grow at an 11 percent annual rate in the 2005, 2006 and 2007 tax years. In November annual growth rates of 14 percent, 11 percent and 11 percent were used. Since the base level of capital gains revenue in tax year 2003 was larger and the capital gains growth rate in tax year 2004 greater than that used in November, capital gains realizations in FY2007 are more than 20 percent greater than projected in November.

The revenue gains attributable to the higher forecast for capital gains realizations were offset in part by lower forecasts for net rental income and partnership income. Changes in the alternative minimum tax adjustment reduced revenues by an average of $10 million in tax years 2005 through 2007. Technical adjustments to blow up factors and parameters in the micro simulation and minor changes to receipts in revenue categories included in the individual income tax but not forecast directly by the micro-simulation also reduced the forecast by modest amounts.

Sales Tax

Net sales tax receipts for the 2006-07 biennium are projected to reach $8.849 billion, $115 million (1.3 percent) more than was forecast in November. Gross sales tax receipts were up $64 million (0.7 percent) while sales tax refunds were reduced by $51 million reflecting recent refund payment history. Net sales tax receipts are now projected to be up 6.1 percent over levels projected for 2004-05. Expiration of $103 million in supplemental sales taxes on liquor and auto rentals artificially depresses the biennium to biennium growth rate. Had those taxes remained in place net sales tax receipts would have grown by 7.5 percent.

Growth in gross sales tax receipts was also slowed by a change in the revenue elasticity used to convert growth in the sales tax base to growth in sales tax revenues. To account for the negative variances in gross sales tax receipts observed since the last forecast the revenue elasticity for fiscal 2006 was reduced to an average of 0.825 from the 0.8375 used in November. For fiscal 2007 an average revenue elasticity of 0.875 was used. Projected sales tax losses to e-commerce and catalog sales were assumed to grow at an annual rate of 14.5 percent, the same as in fiscal 2005, and the same as assumed in November.

Corporate Franchise Tax

Corporate tax revenues for the 2006-07 tax year are forecast to total $1.469 billion, $89 million (6.4 percent) more than forecast in November. Stronger than anticipated corporate estimated tax receipts during the fourth quarter of 2004, and smaller than projected refunds from tax year 2003 filings are incorporated in the base and extended into the next biennium. Not all of the increased net revenue projected for fiscal 2005 was added to the base since a portion of those additional receipts reflected one-time events that were not expected to be replicated during calendar 2005 or calendar 2006. A slight reduction in Global Insight's corporate profits forecast for calendar years 2005 also lowers the base level of profits in 2006 and 2007 further limiting the increase in the forecast in those years.

Motor Vehicle Sales Tax

The sales tax on motor vehicles is now projected to yield $531 million $19 million (3.5 percent) less than previously forecast. The Global Insight forecast for growth in motor vehicle sales in the 2006 and 2007 fiscal years has been reduced since November. While the base level of sales in Minnesota was reduced to be consistent with the small shortfall currently observed in state motor vehicle sales tax collections, motor vehicle sales tax receipts in recent months have grown more slowly than would be expected from the national economic data. Should that trend continue a large reduction in FY2006-07 revenues could be necessary in November. Global Insight currently expects light vehicle sales in calendar 2006 to be slightly less than their November projection, but still in excess of 17 million.

Other Revenues

Other tax and non-tax revenues, including the statewide property tax levy are expected to total $4.965 billion, $23 million (0.5 percent) less than forecast in November. Forecasts for the mortgage and deed taxes and the insurance gross premiums tax were all reduced slightly from November's levels, consistent with current collection experience. Projected receipts from tobacco settlement were increased reflecting the slightly higher than expected payment made by the tobacco companies in December 2004. Regional Treatment Center collections are now projected to be $33 million less than was forecast in November.

Revenue Planning Estimates FY2008-09

The February 2005 revenue planning estimates for the 2008-09 biennium show general fund current resources totaling $32.093 billion, an increase of $2.382 billion (8 percent), over February's forecast for 2006-07 biennial revenues. Net non-dedicated revenues reach $31.794 billion, $2.497 billion more than is forecast for 2006-07. Receipts from the five major taxes grow by 9.4 percent. Individual income tax receipts grow by 13.4 percent from levels forecast for the 2006-07 biennium; the sales tax grows by 5.7 percent. The February planning estimates for general fund revenues exceed November's estimates by $277 million or 0.9 percent.

Revenue Forecast FY2008-09

($ in millions)

	FY2006-07	FY2008	FY2009	FY2008-09
Individual Income	$13,483	$7,394	$7,897	$15,291
Sales	8,849	4,600	4,754	9,355
Corporate	1,469	728	752	1,479
Motor Vehicle Sales	531	278	287	565
Statewide Levy	1,291	674	692	1,366
Five Major Taxes	25,622	13,674	14,382	28,056
Other Revenue	3,334	1,693	1,718	3,411
Tobacco	340	165	162	327
Net Non-dedicated	29,297	15,532	16,262	31,794
Other Resources	414	148	151	300
Current Resources	**$29,711**	**$15,680**	**$16,413**	**$32,093**

No one can forecast the path of the economy five years into the future. These baseline revenue planning estimates are not explicit forecasts, they are extrapolations of projected trends in the economy. Even small deviations from the assumed trend over five years will compound and produce sizeable changes in revenues. In addition, the way the estimates are constructed leads to any change in the base level of revenues for fiscal 2007 being reflected in the revenue planning estimates for 2008 and 2009. Other things equal, stronger than anticipated revenue growth through fiscal 2007 will carry forward and add significantly to revenues in the 2008-09 biennium. But, should the economy grow more slowly than forecast during the next three years, or should some item of portfolio income such as capital gains fall well below forecast – as it did in tax year 2001 -- the revenue outlook for the 2008-09 biennium will deteriorate.

The revenue planning estimates are only a guide to the level of future revenues. They are not a guarantee. If the economy remains as strong as GII projects through 2009, and if items such as capital gains realizations grow at their trend rate, the planning estimates are likely to slightly understate actual receipts. But, the GII baseline forecast includes strong growth with no recession over the entire five year forecast horizon, and that scenario could be overly optimistic. Actual revenues could exceed or fall short of the planning estimates by $2.0 billion or more depending on the economy's performance over the next 5 years.

Prior to 1994 the Finance Department relied on the Data Resources Incorporated (DRI) trend long forecast for the revenue planning estimate projections. In those years DRI's control forecast covered only three years, and once an additional year of the control forecast was available, growth rates from that forecast were used. In the early 1990's Finance Department economists noticed a systematic positive bias to the trend long forecast, and after consulting with its Council of Economic Advisors developed a hybrid projection methodology to neutralize the positive bias in the DRI forecast. Between 1994 and 2002 the Finance Department used those hybrid estimates when preparing the revenue planning estimates. The Finance Department continued its practice of replacing the first year of the hybrid estimate with values from the Control forecast in November of odd numbered years. That procedure limited use of the hybrid projections to forecasts for calendar years beginning more than 3 years into the future.

In November 2002 the Finance Department, after consulting with the Council of Economic Advisors, provisionally changed its procedure for computing the revenue planning estimates. The hybrid model was eliminated and estimates for national economic aggregates were taken directly from the November GII baseline forecast. GII's purchase of DRI and WEFA had necessitated a reworking of their U.S. macro model and those improvements appeared to produce a steadier and smoother growth path for the forecast in years four and five and a less abrupt transition to the long-term growth path. To reduce volatility in the planning estimates further, the Finance Department decided to adjust year four revenue growth rates consistent with the current GII baseline forecast, but to maintain year five revenue growth rates at a rate consistent with economic growth rates used for the February forecast in odd numbered years.

After reviewing this policy with the Council of Economic Advisors the Department of Finance decided to continue its use in budget planning for the 2005 legislative session. Revenue planning estimates for fiscal 2008 and 2009 were prepared consistent with the GII baseline growth rates for 2008 and 2009. The GII projected real GDP growth rates of 3.1 percent and 3.3 percent are consistent with the Blue Chip Consensus, as well as those assumed by the CBO and the Bush Administration. Nominal GDP increases of 5.3 percent and 5.5 percent are very similar to the Blue Chip Consensus of 5.4 percent and 5.3 percent, but above the CBO's estimate of 5.1 percent. The Bush Administration's forecast is the same as the Blue Chip Consensus. GII expects the CPI to increase at an annual rate of 1.9 percent in calendar 2008 and 2.1 percent in calendar 2009. Those rates are lower than the Blue Chip rate of 2.4 percent for those years. The Bush administration also assumes CPI growth of 2.4 percent in both 2008 and 2009. CBO projections assume the CPI grows by 2.2 percent in 2008 and 2009. When viewed on a fiscal year basis CPI growth of is now 2.1 percent in fiscal 2008 and 2.2 percent in fiscal 2009 is now projected and included in the revenue planning estimates.

Finance Department economists caution that because this forecast calls for strong economic growth lasting for at least 5 more years, revenue projections based on this forecast are more likely to prove to be too optimistic than too pessimistic.

As in the past, the individual income tax estimates were prepared using the House Income Tax Simulation Model. Assumed filer growth in Minnesota was consistent with average national employment growth for the years in question. All elements of income and all individual itemized deductions were assumed to grow at the growth rate of taxable personal income – the combination of wages and salaries, proprietors' incomes, dividend, interest and rents – as projected by GII in their baseline forecast. Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 2007.

As was done for the 2006-07 revenue planning estimates the complete sales tax model was used to prepare sales tax revenue planning estimates. Corporate tax receipts in Minnesota were estimated to grow at the same rate as GII's forecast of national before tax corporate profits. Minnesota's motor vehicle sales tax collections are expected to grow at the GII baseline growth rate for national consumption of motor vehicles and parts. The deed and mortgage tax was forecast based on the projected growth in the value of new and existing home sales. Planning estimates for other tax and no tax revenues were prepared by extrapolating existing trends.

Expenditure Forecast
FY2006-2009

FY2006-07 Forecast Expenditures Unchanged

Net spending for the next biennium is unchanged from the November 2004 estimates. Spending for FY2006-07 is now expected to total $30.177 billion.

FY2006-07 Budget Expenditure Estimates
($ in millions)

	November	February	Difference
Estimated Spending by Function			
K-12 Education	$12,045	$12,099	$54
Payment Change/Prop Tax Recog.	(76)	(86)	(10)
Post-Secondary Education	2,753	2,753	0
Property Tax Aids & Credits	2,966	2,961	(5)
Health & Human Services	8,684	8,632	(52)
Environ., Agric., Econ. Dvlpmt.	735	737	2
Transportation	163	163	0
Public Safety	1,569	1,587	18
State Government	563	561	(2)
Debt Service	721	716	(5)
All Other	(20)	(20)	0
Subtotal	30,103	30,103	0
Dedicated Expenditures	74	74	0
Total Spending	**$30,177**	**$30,177**	**$0**

As with FY2005, the deficiency appropriations enacted this legislative session increase "baseline" expenditures in subsequent years. The table below highlights the continuing impact of FY2005 changes and the increased spending now incorporated in FY2006-07 as a result of this enacted budget change.

FY2006-07 Effects of Chapter 2 Deficiency Bill
($ in thousands)

	2005	2006	2007
Health and Human Services			
Dept of Human Services	$13,394	$12,144	$12,144
Public Safety			
Board of Public Defense	7,681	7,681	7,681
Board of Judicial Standards	199	0	0
Dept of Corrections	4,070	1,220	1,220
Dept of Public Safety	986	276	276
State Government			
Dept of Administration	4,705	0	0
Dept of Veterans Affairs	39	39	39
Total Spending	**$31,074**	**$21,360**	**$21,360**

Excluding the impact of the FY2005 deficiency bill, only two areas of the forecast have material changes from November. K-12 education and health and human services account for nearly offsetting increases and decreases from November estimates. Changes in all other spending, including savings in forecast tax penalty and interest payments and debt service savings, resulted in $10 million net savings.

FY2008-09 Projected Spending Increases Slightly

Planning estimates for FY2008-09 project spending of $31.389 billion. This represents projected growth in spending of $1.212 billion over the current law forecast for the FY2006-07 biennium – a 4.0 percent increase.

Projected spending for FY2008-09 is $63 million higher than November estimates. K-12 education accounts for a $103 million increase, while projected spending for health and human services is $40 million lower. Changes for K-12 and human services mirror the same factors and assumptions occurring in the forecast for FY2006-07. Changes in all other spending areas are largely offsetting and have little impact on the bottom line

FY2008-09 Planning Estimates
($ in millions)

	November	February	Difference
Estimated Spending by Area			
K-12 Education	$11,856	$11,929	$73
Payment Change/Prop Tax Recog.	(84)	(54)	30
Post-Secondary Education	2,651	2,651	0
Property Tax Aids & Credits	3,035	3,020	(15)
Health & Human Services	9,983	9,943	(40)
Environ., Agric., Econ. Dvlpmt.	736	738	2
Transportation	179	179	0
Public Safety	1,612	1,630	18
State Government	558	561	3
Debt Service	746	739	(7)
All Other	(20)	(20)	0
Subtotal	31,252	31,316	64
Dedicated Expenditures	74	73	(1)
Total Spending	**$31,326**	**$31,389**	**$63**

K-12 Estimates Increase by $53.4 Million in FY 2006-07

K-12 Education spending is now expected to total $12.099 billion for the FY 2006-07 biennium, which is $53.4 million higher than forecast in November. Property tax recognition and aid payment shifts offset this increase by $9.7 million. Therefore, K-12 appropriations will only increase by $43.8 million. The appropriation increase is primarily driven by 1) increased immigration estimates related to Hmong refugees from the Wat Tham Krabok camp in Thailand, and 2) higher than anticipated free and reduced price lunch counts on October 1, 2004.

The forecast shows an increase of approximately 2,000 pupils per year over what was anticipated in November. This increase is primarily due to the fact that the proportion of Hmong refugees who are under age 21 is much higher than anticipated. Initial information from affected school districts indicates that more than 60% of the refugees are, or will soon be, eligible for K-12 education services. Higher projected pupil counts ripple through most aspects of school finance, but are most visible in the General Education and Special Education spending estimates.

The General Education program is now forecast to be $45 million higher in FY 2006-07 than in November. Within General Education, higher pupil counts drive a $17.4 million increase in Basic Education Aid and a $5 million increase in Limited English Proficiency (LEP) Aid. Compensatory Aid is now forecast to be $38.3 million higher than November estimates. Only about 3% of the increase in FY 2006 and 19% of the increase in FY 2007 is attributable to Hmong refugees. The balance of the change is due to higher free and reduced price lunch counts, which are almost 1% higher statewide than assumed in November. This change is primarily driven by more frequent review and enrollment of eligible students.

Special Education Aid is up $1.6 million in FY 2006-07 as a result of a projected increase in pupil counts. Aid for Children with Disabilities is projected to be $2.5 million lower than November estimates in FY 2006-07 largely due to clarifying the list of eligible facilities.

Nonpublic Pupil Aid is down $1.1 million from the November forecast due in part to revised rate estimates and participation figures for textbooks, health, and guidance counseling. In addition, nonpublic pupil counts are down from November, which is reflected in the decline in both Nonpublic Pupil Aid and Nonpublic Transportation Aid. Nonpublic Transportation Aid is down $1.9 million also due in part to lower than anticipated overall transportation costs.

Debt Service Equalization Aid is up $1.8 million from the November forecast due in part to more complete information on bond referendums. The projected increase is slightly offset by a decrease in FY 2006 for bond refunding and lower debt service revenue requirements.

FY 2008-09 K-12 Education Projections Also Expected to be Higher

Spending for the FY 2008-09 biennium for K-12 Education is now projected to total $11.929 billion, which is $72.9 million higher than earlier estimates. Revised property tax recognition and aid payment shift estimates add $30.4 million in additional cost to the state. Therefore, K-12 appropriations will increase by $103.3 million in FY 2008-09. This increase is primarily due to the continuation of the trends seen in the FY 2006-07 estimate, including higher pupil units and higher free and reduced price lunch counts.

General Education estimates are $99.7 million higher, with Basic Education Aid up $19.8 million and Limited English Proficiency (LEP) Aid up $5.6 million compared to November levels. Compensatory Aid is up $42.8 million from previous estimates.

Special Education is up $2 million from previous estimates due to the increase in pupil counts. Aid for Children with Disabilities is down $3.1 million in FY 2008-09 due to a clarification of eligible facilities.

The decreases projected in FY 2006-07 for Nonpublic Pupil Transportation Aid and Nonpublic Pupil Aid continue into the next biennium resulting in forecast reductions of $2.7 million and $1.3 million respectively when compared to the November forecast.

Debt Service Equalization Aid is up $6.4 million from November due to a significant increase in aid associated with anticipated passage of bond referendums in FY 2007 through FY 2009.

Health and Human Services Projections $52 Million Lower in FY2006-07

Total health and human services expenditures are now expected to be $8.6 billion, $52.2 million (0.6 percent) lower than November estimates. Basic Health Care Grants expenditures displayed the greatest change, falling $83.0 million (2.2 percent). The decline in Basic Health Care Grants is partially offset by the ongoing effects of the FY2005 deficiency bill that increased the base for DHS' state operated services by $24.3 million in FY2006-07.

Basic Health Care Grants

Despite slightly higher enrollment estimates and higher average cost per recipient, MA Families and Children Basic Care expenditures are $35.6 (2.5 percent) million less than November estimates. Over one-half of the reduction is attributable to a delay in the implementation of the HealthMatch eligibility system, coupled with a lower forecast of MinnesotaCare enrollment; both of these changes reduce the number of MinnesotaCare enrollees who had been projected to move to MA during FY2006-07. The projected costs for non-citizens are also lower due to lower managed care costs and updated estimates that reflect a higher percentage of expenditures eligible for federal financial participation.

The forecast for General Assistance Medical Care (GAMC) is $43.2 million (6.4 percent) lower than previous estimates. Most of the change in GAMC is also due to the HealthMatch delay, and a decrease in the projected number of MinnesotaCare enrollees who will eventually shift to GAMC, resulting in significantly reduced caseloads. A more favorable economic forecast also contributes to a lower GAMC caseload forecast.

Children and Economic Assistance Grants

Children and Economic Assistance Grants are now expected to be $923.9 million, $2.3 million (0.25 percent) less than November estimates. The most significant fiscal change occurs in Minnesota Family Investment Program/Transition Year (MFIP/TY) child care, where expenditures are reduced $6.8 million for the biennium. Additionally, caseload projections are lower than in November for the MFIP/DWP cash grants due to revised assumptions about the number of families who will move from DWP to MFIP. This lower caseload results in TANF reductions rather than General Fund savings.

Continuing Care Grants

Continuing Care Grants are increased $8.8 million (0.28 percent) for FY2006-07, primarily due to increases in MA Long-Term Care (LTC) Facilities and MA Long-Term Care Waivers, which grow $6.5 million and $4.0 million, respectively. Average costs in Intermediate Care Facilities for the Mentally Retarded (ICF/MR) are higher as a result of lower cost facilities closing, accounting for over two-thirds of the increase in MA LTC Facilities. The remaining increase is due to revised assumptions in determining nursing facility expenditures.

FY2008-09 Health and Human Services Projections Decrease Slightly

Total health and human services expenditures for FY2008-09 are now projected to be $9.9 billion, a $40.1 million (0.4 percent) decrease from the November forecast. The largest decrease is seen in Basic Health Care Grants, where expenditures are $46.9 (1.0 percent) less than previous estimates. The same assumptions and trends that affect GAMC in FY2006-07 continue in the subsequent biennium, as expenditures are down $62.4 million (7.0 percent). Trends within the MA Elderly and Disabled Basic Care, MA Families and Children Basic Care, and Continuing Care Grants continue as well; however, a correction in a technical error on average costs within MA Elderly and Disabled Basic Care has significant upward effects for FY2008-09.

Children and Economic Assistance Grants are being revised downward $26.4 million in FY2008-09 to account for a projected decline in MFIP caseloads and higher projections of available TANF funding.

Finally, the higher base for DHS' state operated services also results in $24.2 million in higher projected costs in FY2008-09 than had been assumed in November.

All Other Spending Areas Largely Unchanged By Forecast

The majority of programs, outside the major forecast areas highlighted above, show little net change from the levels projected in November. Estimated debt service for FY2006-07 is now $716.6 million, $4.5 million lower than forecast in November. Forecast premiums on new bonds sold contributed $2.4 million of the savings, while investment earnings on cash balances in the debt service fund provided $2.0 million in savings. Changes in property tax aids and credits forecast for FY2006-07 result in a $5 million reduction. As was the case in FY2005, the savings are attributed to a $7.5 million reduction in interest payments on tax refunds, offset by a $4 million increase in forecast aid to police and fire payments.

Alternative Forecast Comparison

Real GDP (Annual Rates)

	04III	04IV	05I	05II	05III	05IV	04A	05A	06A
GII Baseline (02-05)	4.0	3.1	3.6	3.7	3.3	2.5	4.4	3.5	3.1
Blue Chip (02-05)	4.0	3.1	3.5	3.6	3.5	3.5	4.4	3.6	3.4
Economy.Com (02-05)	4.0	3.1	3.5	3.6	3.5	3.5	4.4	3.5	NA
American Express (02-05)	4.0	3.1	4.4	3.1	3.3	3.0	4.4	3.7	3.5
UBS (02-05)	4.0	3.1	3.7	3.4	3.3	3.1	4.4	3.5	3.1
Standard & Poors (02-05)	4.0	3.1	4.0	4.2	3.4	NA	4.4	3.7	3.3

Consumer Price Index (Annual Rates)

	04III	04IV	05I	05II	05III	05IV	04A	05A	06A
GII Baseline (02-05)	1.9	3.4	1.6	0.7	1.0	2.1	2.7	2.0	1.6
Blue Chip (02-05)	1.9	3.4	2.0	2.2	2.2	2.3	2.7	2.5	2.3
Economy.Com (02-05)	1.9	3.4	1.7	NA	NA	NA	2.7	2.3	NA
American Express (02-05)	1.9	3.4	1.7	2.5	2.4	2.8	3.4	2.4*	2.9
UBS (02-05)	1.9	3.4	1.4	1.4	1.8	2.2	2.7	2.1	2.3
Standard & Poors (02-05)	1.9	3.4	1.6	0.7	1.1	NA	2.7	2.0	1.7

*4Q/4Q

Forecast Comparisons

Real Economic Growth
(Annual Percent Change in Real GDP)

	2004	2005	2006	2007	2008	2009
Feb 01 DRI Control	3.2(1)	3.2(1)				
Nov 01 DRI Control	3.8	3.2(1)				
Feb 02 DRI Control	3.9	3.2(1)				
Nov 02 GII Baseline	4.1	3.8	3.5	3.1		
Feb 03 GII Baseline	4.6	3.8	3.1	2.9		
Nov 03 GII Baseline	4.3	3.6	3.6	2.9		
Feb 04 GII Baseline	4.8	3.8	3.6	2.9		
Nov 04 GII Baseline	4.4	3.2	3.6	3.1	3.1	3.2
Feb 05 GII Baseline	4.4	3.5	3.1	3.2	3.1	3.3

Inflation
(Annual Percent Change in CPI-U)

Feb 01 DRI Control	2.4(1)	2.7(1)				
Nov 01 DRI Control	2.6	2.7(1)				
Feb 02 DRI Control	2.5	2.7(1)				
Nov 02 GII Baseline	2.4	2.3	2.2	2.1		
Feb 03 GII Baseline	1.9	2.1	2.2	2.5		
Nov 03 GII Baseline	1.4	1.9	2.0	2.5		
Feb 04 GII Baseline	1.4	1.3	1.5	2.5		
Nov 04 GII Baseline	2.7	2.2	1.3	1.7	1.9	2.1
Feb 05 GII Baseline	2.7	2.0	1.6	2.0	2.1	2.2

(1) 10 year trend Baseline DRI Early Recession (Pessim), November, 2000

Minnesota - U.S. Comparison Report

February 2005 Control

(Annual Percent Changes)

	2001	2002	2003	2004	2005	2006	2007
Wage and Salary Income							
United States	2.4	0.7	2.6	4.7	5.5	5.5	5.6
Minnesota*	3.2	1.4	2.4	4.1	5.4	5.0	5.1
Implied Annual Wage							
United States	2.0	2.0	2.8	3.3	3.8	4.1	4.5
Minnesota	3.1	2.4	2.5	3.4	4.2	3.7	3.9
Non-Farm Employment							
United States	0.3	-1.1	-0.3	1.1	1.7	1.4	1.1
Minnesota	0.2	-1.0	-0.1	0.7	1.1	1.3	1.2
Personal Income							
United States	3.5	1.8	3.2	5.4	5.0	5.3	5.5
Minnesota	3.0	2.4	3.3	6.0	5.7	4.3	4.9

* Es 202 Wages

COMPARISON OF ACTUAL AND ESTIMATED
NON-RESTRICTED REVENUES
Jan Ytd, 2005 -FY2005

($ IN THOUSANDS)

	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax			
Withholding	2,997,160	3,015,083	17,923
Declarations	635,005	684,947	49,942
Miscellaneous	122,299	128,693	6,394
Gross	3,754,464	3,828,723	74,259
Refund	118,916	123,052	4,136
Net	3,635,547	3,705,670	70,123
Corporate & Bank Excise			
Declarations	393,849	419,640	25,791
Miscellaneous	87,484	90,103	2,620
Gross	481,332	509,743	28,411
Refund	77,141	45,196	(31,945)
Net	404,191	464,547	60,356
Sales Tax			
Gross	2,514,119	2,499,905	(14,214)
Refunds	127,590	95,576	(32,014)
Net	2,386,529	2,404,329	17,799
Motor Vehicle Sales	149,477	147,638	(1,839)
Other Revenues:			
Inherit/Gift/Estate	47,888	47,896	9
Liquor/Wine/Beer	37,396	38,153	758
Cigarette/Tobacco/Cont Sub	83,021	82,771	(249)
Deed and Mortgage	164,527	158,320	(6,207)
Insurance Gross Earnings	120,031	119,891	(140)
Lawful Gambling	29,374	29,336	(38)
Health Care Surcharge	117,013	117,684	671
Other Taxes	1,533	737	(796)
state wide property tax	277,844	278,310	466
dhs rtc Collections	28,000	31,502	3,502
Income Tax Reciprocity	49,850	49,850	0
Investment Income	8,649	7,596	(1,053)
Tobacco Settlement	167,742	175,488	7,746
Departmental Earnings	159,917	160,697	780
Fines and Surcharges	47,976	43,925	(4,052)
Lottery Revenues	20,603	22,253	1,650
Revenues yet to be allocated	1,464	626	(838)
Residual revenues	31,789	37,996	6,207
Sales Tax Rebates (all years)	0	2	2
County Nursing Home Pub Hosp	17,962	17,962	0
Other Subtotal	1,412,577	1,420,995	8,418
Other Refunds	16,563	17,299	736
Other Net	1,396,015	1,403,696	7,682
Total Gross	**8,311,970**	**8,407,004**	**95,034**
Total Refunds	**340,210**	**281,124**	**(59,087)**
Total Net	**7,971,760**	**8,125,880**	**154,121**

Factors Affecting the Individual Income Tax

($ in billions)

	Calendar Year					
	2002	2003	2004	2005	2006	2007
Minnesota Non-Farm Tax Base						
February 2001 Control	152.840	162.610				
November 2001 Control	146.880	155.990				
February 2002 Baseline	145.890	153.470				
*November 2002 Baseline	140.600	145.760	154.850	164.940		
*February 2003 Baseline	140.520	144.940	153.580	163.500		
*November 2003 Baseline	142.370	146.160	152.011	160.690		
*February 2004 Baseline	142.370	146.080	152.201	160.413		
*November 2004 Baseline	138.871	142.592	149.277	156.214	163.506	171.373
*February 2005 Baseline	138.874	142.349	149.075	156.519	163.983	172.200
Minnesota Wage and Salary Income						
February 2001 Control	108.100	115.190				
November 2001 Control	102.920	109.210				
February 2002 Control	101.910	107.140				
*November 2002 Baseline	96.100	99.790	106.150	112.830		
*February 2003 Baseline	96.100	98.830	104.690	111.420		
*November 2003 Baseline	96.780	99.410	103.830	109.140		
*February 2004 Baseline	96.780	99.520	103.570	108.910		
*November 2004 Baseline	96.941	99.558	103.632	109.075	114.465	120.202
*February 2005 Baseline	96.944	99.315	103.416	108.997	114.473	120.360
Minnesota Property Income						
February 2001 Control	34.163	36.102				
November 2001 Control	33.184	35.201				
February 2002 Control	33.466	35.074				
November 2002 Baseline	33.564	34.408	36.104	39.119		
February 2003 Baseline	33.464	34.389	36.176	38.513		
November 2003 Baseline	34.509	34.946	36.045	38.041		
February 2004 Baseline	34.509	34.780	36.027	38.197		
November 2004 Baseline	30.809	31.287	32.956	33.650	34.760	36.088
February 2005 Baseline	30.809	31.287	32.978	34.014	35.200	36.744
Minnesota Proprietors' Income						
February 2001 Control	10.570	11.323				
November 2001 Control	10.779	11.586				
February 2002 Control	10.515	11.256				
November 2002 Baseline	10.936	11.761	12.297	12.996		
February 2003 Baseline	10.955	11.720	12.712	13.573		
November 2003 Baseline	11.086	11.803	12.691	13.508		
February 2004 Baseline	11.086	11.779	12.601	13.308		
November 2004 Baseline	11.120	11.747	12.689	13.489	14.281	15.083
February 2005 Baseline	11.120	11.747	12.681	13.507	14.309	15.156

** Wages reflect ES202 Data*

Factors Affecting Sales Tax, Corporate Income Tax, and Sales Tax on Motor Vehicles

($ in billions)

	Fiscal Year					
	2002	2003	2004	2005	2006	2007
SALES TAX						
Minnesota Synthetic Sales Tax Base						
November 2003 Baseline	61.647	62.976	66.185	68.232		
Pct	0.4%	2.2%	5.1%	3.1%		
February 2004 Baseline	61.425	63.011	67.636	70.481		
Pct	0.0%	2.6%	7.3%	4.2%		
November 2004 Baseline	61.092	62.542	66.848	71.014	73.521	75.447
Pct	-1.0%	2.4%	6.9%	6.2%	3.5%	2.6%
February 2005 Baseline	61.088	62.450	66.710	70.957	74.046	76.286
Pct	-1.0%	2.2%	6.8%	6.4%	4.4%	3.0%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
November 2002 Baseline	10.806	11.146	11.733	12.451		
February 2003 Baseline	10.807	11.137	11.617	12.394		
November 2003 Baseline	10.793	11.119	11.764	12.174		
February 2004 Baseline	10.717	11.118	12.106	12.685		
November 2004 Baseline	10.573	10.856	11.705	12.241	12.612	13.021
February 2005 Baseline	10.573	10.856	11.700	12.267	12.783	13.205
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
November 2002 Baseline	8.799	10.252	10.693	11.579		
February 2003 Baseline	9.795	10.082	10.624	11.577		
November 2003 Baseline	9.785	10.143	11.080	11.703		
February 2004 Baseline	10.043	10.300	11.616	12.506		
November 2004 Baseline	10.005	10.177	11.438	12.766	13.674	14.289
February 2005 Baseline	10.005	10.177	11.449	12.926	13.957	14.751
Minnesota's Proxy Share of U.S. Construction Spending						
February 2002 Control	8.345	8.420				
November 2002 Baseline	8.467	8.337	8.612	9.424		
February 2003 Baseline	8.479	8.429	8.798	9.191		
November 2003 Baseline	8.364	8.404	8.990	8.915		
February 2004 Baseline	8.691	8.864	9.814	9.970		
November 2004 Baseline	8.823	9.101	10.171	11.188	11.620	11.676
February 2005 Baseline	8.827	9.105	10.123	10.864	11.444	11.708

Factors Affecting Sales, Corporate Income And Sales Tax on Motor Vehicles

($ in billions)

	Fiscal Year					
	2002	2003	2004	2005	2006	2007
SALES TAX (Cont.)						
Minnesota's Personal Income Excluding Farm Proprietors Income						
February 2001 Control	169.03	179.41				
November 2001 Control	163.61	174.93				
February 2002 Control	165.28	173.63				
November 2002 Baseline*	166.54	173.04	181.57	192.47		
February 2003 Baseline*	166.43	172.40	181.12	192.14		
November 2003 Baseline*	166.40	172.04	178.50	187.08		
February 2004 Baseline*	166.40	172.31	178.82	187.04		
November 2004 Baseline*	164.17	168.77	176.02	185.30	194.41	204.46
February 2005 Baseline*	164.17	168.77	175.82	185.34	194.76	204.77
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
February 2001 Control	6.566	7.080				
November 2001 Control	7.007	7.484				
February 2002 Control	7.403	7.506				
November 2002 Baseline	7.493	7.353	7.568	7.361		
February 2003 Baseline	7.496	7.572	7.619	7.676		
November 2003 Baseline	7.512	7.800	7.988	8.060		
February 2004 Baseline	8.524	8.378	8.770	8.891		
November 2004 Baseline	8.514	8.856	9.025	9.095	9.132	9.594
February 2005 Baseline	8.514	8.856	9.025	9.207	9.140	9.495
CORPORATE FRANCHISE TAX		**Calendar Year**				
U.S. Corporate Profits						
February 2001 Control	1,006.3	1,066.2				
November 2001 Control	685.7	761.2				
February 2002 Control	722.1	786.0				
November 2002 Baseline	662.2	771.1	873.5	871.0		
February 2003 Baseline	650.7	753.8	859.6	857.1		
November 2003 Baseline	665.2	770.0	869.6	890.9		
February 2004 Baseline	745.0	842.9	1,016.8	997.5**		
November 2004 Baseline	755.8	690.9	810.3	949.5**	1019.7**	1010.9**
February 2005 Baseline	755.8	690.9	810.3	945.5**	971.8**	965.8**

* Wages reflect ES202 date

** Finance Dept Estimate

FY 2004-05 Biennium Forecast Comparison
February 2005 vs November 2004 (Before Statutory Allocations)
($ in thousands)

	11-04 Fcst FY 2004-05	2-05 Fcst FY 2004-05	Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	368,922	0
Current Resources:			
Tax Revenues	25,627,138	25,769,493	142,355
Non-Tax Revenues	1,465,776	1,478,357	12,581
Dedicated Revenue	58,506	58,314	(192)
Transfers In	1,456,362	1,458,164	1,802
Prior Year Adjustments	64,897	64,897	0
Subtotal-Current Resources	28,672,679	28,829,225	156,546
Total Resources Available	**29,041,601**	**29,198,147**	**156,546**
Actual & Estimated Spending			
K-12 Education	12,231,855	12,224,059	(7,796)
Property Tax Recog/Payment Change	(329,538)	(326,303)	3,235
Subtotal K-12 Education	11,902,317	11,897,756	(4,561)
Property Tax Aids & Credits	2,809,593	2,803,818	(5,775)
Higher Education	2,541,702	2,541,702	0
Health & Human Services	7,245,112	7,261,559	16,447
Environment, Agriculture & Economic Dev	739,306	739,301	(5)
Transportation	158,721	158,721	0
Public Safety	1,436,740	1,449,676	12,936
State Government	580,229	584,802	4,573
Debt Service	589,027	589,052	25
Deficiencies/Other	5,491	5,491	0
Estimated Cancellations	(44,000)	(61,000)	(17,000)
Subtotal Expenditures & Transfers	**27,964,238**	**27,970,878**	**6,640**
Dedicated Expenditures	74,363	74,171	(192)
Total Expenditures & Transfers	**28,038,601**	**28,045,049**	**6,448**
Balance Before Reserves	**1,003,000**	**1,153,098**	**150,098**
Cash Flow Account	350,000	350,000	0
Budget Reserve	653,000	628,300	(24,700)
Budgetary Balance	**0**	**174,798**	**174,798**

February 2005 General Fund Forecast
Current Biennium (After Statutory Allocations)
($ in thousands)

	Actual FY 2004	2-05 Fcst FY 2005	2-05 Fcst FY 2004-05
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	1,268,455	368,922
Current Resources:			
Tax Revenues	12,520,041	13,249,452	25,769,493
Non-Tax Revenues	775,448	702,909	1,478,357
Dedicated Revenue	19,929	38,385	58,314
Transfers In	1,143,977	314,187	1,458,164
Prior Year Adjustments	39,897	25,000	64,897
Subtotal-Current Resources	14,499,292	14,329,933	28,829,225
Total Resources Available	**14,868,214**	**15,598,388**	**29,198,147**
Actual & Estimated Spending			
K-12 Education	6,139,708	6,087,759	12,227,467
Property Tax Recog/Payment Change	(424,004)	241,434	(182,570)
Subtotal K-12 Education	5,715,704	6,329,193	12,044,897
Property Tax Aids & Credits	1,438,722	1,368,053	2,806,775
Higher Education	1,235,604	1,306,098	2,541,702
Health & Human Services	3,511,023	3,750,536	7,261,559
Environment, Agriculture & Economic Dev	365,952	373,349	739,301
Transportation	77,623	81,098	158,721
Public Safety	682,531	767,145	1,449,676
State Government	265,617	319,185	584,802
Debt Service	265,706	323,346	589,052
Deficiencies/Other	5,491	0	5,491
Estimated Cancellations	0	(61,000)	(61,000)
Subtotal Expenditures & Transfers	**13,563,973**	**14,557,003**	**28,120,976**
Dedicated Expenditures	35,786	38,385	74,171
Total Expenditures & Transfers	**13,599,759**	**14,595,388**	**28,195,147**
Balance Before Reserves	**1,268,455**	**1,003,000**	**1,003,000**
Cash Flow Account	0	350,000	350,000
Budget Reserve	403,677	653,000	653,000
Appropriations Carried Forward	183,613	0	0
Budgetary Balance	**681,165**	**0**	**0**

February 2005 General Fund Forecast
FY 2006-07 Biennium
($ in thousands)

	2-05 Fcst FY 2006	2-05 Fcst FY 2007	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	1,003,000	639,174	1,003,000
Current Resources:			
Tax Revenues	13,678,783	14,208,956	27,887,739
Non-Tax Revenues	704,659	704,359	1,409,018
Dedicated Revenue	37,113	36,952	74,065
Transfers In	140,475	149,919	290,394
Prior Year Adjustments	25,000	25,000	50,000
Subtotal-Current Resources	14,586,030	15,125,186	29,711,216
Total Resources Available	**15,589,030**	**15,764,360**	**30,714,216**
Actual & Estimated Spending			
K-12 Education	6,062,841	6,035,700	12,098,541
Property Tax Recog/Payment Change	(58,213)	(27,486)	(85,699)
Subtotal K-12 Education	6,004,628	6,008,214	12,012,842
Property Tax Aids & Credits	1,472,589	1,488,895	2,961,484
Higher Education	1,427,266	1,325,492	2,752,758
Health & Human Services	4,132,195	4,499,557	8,631,752
Environment, Agriculture & Economic Dev	368,666	368,118	736,784
Transportation	80,740	81,995	162,735
Public Safety	786,495	800,394	1,586,889
State Government	279,312	282,114	561,426
Debt Service	365,852	350,710	716,562
Estimated Cancellations	(5,000)	(15,000)	(20,000)
Subtotal Expenditures & Transfers	**14,912,743**	**15,190,489**	**30,103,232**
Dedicated Expenditures	37,113	36,952	74,065
Total Expenditures & Transfers	**14,949,856**	**15,227,441**	**30,177,297**
Balance Before Reserves	**639,174**	**536,919**	**536,919**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Budgetary Balance	**(363,826)**	**(466,081)**	**(466,081)**

FY 2006-07 Biennial Comparison
February 2005 Forecast vs November 2004 Forecast
($ in thousands)

	11-04 Fcst FY 2006-07	2-05 Fcst FY 2006-07	Feb vs Nov FY 2006-07
Actual & Estimated Resources			
Balance Forward From Prior Year	1,003,000	1,003,000	0
Current Resources:			
Tax Revenues	27,658,161	27,887,739	229,578
Non-Tax Revenues	1,405,540	1,409,018	3,478
Dedicated Revenue	74,685	74,065	(620)
Transfers In	289,151	290,394	1,243
Prior Year Adjustments	50,000	50,000	0
Subtotal-Current Resources	29,477,537	29,711,216	233,679
Total Resources Available	**30,480,537**	**30,714,216**	**233,679**
Actual & Estimated Spending			
K-12 Education	12,045,122	12,098,541	53,419
Property Tax Recog/Payment Change	(76,041)	(85,699)	(9,658)
Subtotal K-12 Education	11,969,081	12,012,842	43,761
Property Tax Aids & Credits	2,966,359	2,961,484	(4,875)
Higher Education	2,752,758	2,752,758	0
Health & Human Services	8,683,916	8,631,752	(52,164)
Environment, Agriculture & Economic Dev	735,014	736,784	1,770
Transportation	162,735	162,735	0
Public Safety	1,568,535	1,586,889	18,354
State Government	563,243	561,426	(1,817)
Debt Service	721,055	716,562	(4,493)
Deficiencies/Other	0	0	0
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal Expenditures & Transfers	**30,102,696**	**30,103,232**	**536**
Dedicated Expenditures	74,685	74,065	(620)
Total Expenditures & Transfers	**30,177,381**	**30,177,297**	**(84)**
Balance Before Reserves	**303,156**	**536,919**	**233,763**
Cash Flow Account	350,000	350,000	0
Budget Reserve	653,000	653,000	0
Budgetary Balance	**(699,844)**	**(466,081)**	**233,763**

Biennial Comparison
FY 2006-07 vs FY 2004-05
($ in thousands)

	2-05 Fcst FY 2004-05	2-05 Fcst FY 2006-07	$ Change	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	368,922	1,003,000	634,078	
Current Resources:				
Tax Revenues	25,769,493	27,887,739	2,118,246	8.2%
Non-Tax Revenues	1,478,357	1,409,018	(69,339)	-4.7%
Dedicated Revenue	58,314	74,065	15,751	27.0%
Transfers In	1,458,164	290,394	(1,167,770)	-80.1%
Prior Year Adjustments	64,897	50,000	(14,897)	-23.0%
Subtotal-Current Resources	28,829,225	29,711,216	881,991	3.1%
Total Resources Available	**29,198,147**	**30,714,216**	**1,516,069**	**5.2%**
Actual & Estimated Spending				
K-12 Education	12,227,467	12,098,541	(128,926)	
Property Tax Recog/Payment Change	(182,570)	(85,699)	96,871	
Subtotal K-12 Education	12,044,897	12,012,842	(32,055)	-0.3%
Property Tax Aids & Credits	2,806,775	2,961,484	154,709	5.5%
Higher Education	2,541,702	2,752,758	211,056	8.3%
Health & Human Services	7,261,559	8,631,752	1,370,193	18.9%
Environment, Agriculture & Economic Dev	739,301	736,784	(2,517)	-0.3%
Transportation	158,721	162,735	4,014	2.5%
Public Safety	1,449,676	1,586,889	137,213	9.5%
State Government	584,802	561,426	(23,376)	-4.0%
Debt Service	589,052	716,562	127,510	21.6%
Deficiencies/Other	5,491	0	(5,491)	-100.0%
Estimated Cancellations	(61,000)	(20,000)	41,000	-67.2%
Subtotal Expenditures & Transfers	**28,120,976**	**30,103,232**	**1,982,256**	**7.0%**
Dedicated Expenditures	74,171	74,065	(106)	-0.1%
Total Expenditures & Transfers	**28,195,147**	**30,177,297**	**1,982,150**	**7.0%**
Balance Before Reserves	**1,003,000**	**536,919**	**(466,081)**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Appropriations Carried Forward	0	0	0	
Budgetary Balance	**0**	**(466,081)**	**(466,081)**	

FY 2004-09 Planning Horizon
February 2005 General Fund Forecast
($ in thousands)

	2-05 Fcst FY 2004-05	2-05 Fcst FY 2006-07	2-05 Plng Est FY 2008-09
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	1,003,000	536,919
Current Resources:			
Tax Revenues	25,769,493	27,887,739	30,416,168
Non-Tax Revenues	1,478,357	1,409,018	1,378,071
Dedicated Revenue	58,314	74,065	73,397
Transfers In	1,458,164	290,394	175,622
Prior Year Adjustments	64,897	50,000	50,000
Subtotal-Current Resources	28,829,225	29,711,216	32,093,258
Total Resources Available	**29,198,147**	**30,714,216**	**32,630,177**
Actual & Estimated Spending			
K-12 Education	12,227,467	12,098,541	11,929,123
Property Tax Recog/Payment Change	(182,570)	(85,699)	(54,081)
Subtotal K-12 Education	12,044,897	12,012,842	11,875,042
Property Tax Aids & Credits	2,806,775	2,961,484	3,019,648
Higher Education	2,541,702	2,752,758	2,650,984
Health & Human Services	7,261,559	8,631,752	9,943,336
Environment, Agriculture & Economic Dev	739,301	736,784	737,619
Transportation	158,721	162,735	178,990
Public Safety	1,449,676	1,586,889	1,630,421
State Government	584,802	561,426	560,513
Debt Service	589,052	716,562	739,187
Deficiencies/Other	5,491	0	0
Estimated Cancellations	(61,000)	(20,000)	(20,000)
Subtotal Expenditures & Transfers	**28,120,976**	**30,103,232**	**31,315,740**
Dedicated Expenditures	74,171	74,065	73,397
Total Expenditures & Transfers	**28,195,147**	**30,177,297**	**31,389,137**
Balance Before Reserves	**1,003,000**	**536,919**	**1,241,040**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Budgetary Balance	**0**	**(466,081)**	**238,040**