November 2005 Economic Forecast

Minnesota Department of Finance

November 2005

Highlights

$701 Million Balance Projected for FY 2006-07, Statutes Require Entire Balance be Used for School Shift Buyback

General fund revenues for the 2006-07 biennium are now forecast to be $31.280 billion, $694 million (2.3 percent) more than end-of-session estimates. After adjusting for increases in spending and other changes, a $701 million balance remains. Current law requires this balance be used to reverse the education accounting shifts enacted in 2002 and 2003. With this action the school aid payment shift is fully bought back and more than three-quarters of the school property tax recognition shift is reversed.

$337 Million Balance in Tax Relief Account after FY 2005 Closing

As reported previously, FY 2005 revenues exceeded the forecast by $298 million. Expenditure savings, transfers, and dedicated revenues added another $39 million to the ending balance. Under current law any balance at the end of the biennium is deposited in the tax relief account.

Little Change in Economic Outlook

Global Insight's November baseline is very similar to February's. Higher energy prices, further interest rate hikes, and Hurricanes Katrina and Rita have produced only modest changes in the national economic outlook. In November's baseline forecast the 2006-07 biennium ends with real GDP at almost the same level as forecast in February. Real GDP growth rates of 3.5 percent for fiscal 2006 and 3.2 percent for fiscal 2007 are now projected. Inflation is expected to be slightly higher than previously forecast for the current biennium. The forecast now calls for CPI growth of 3.5 percent in FY 2006 and 1.5 percent in FY 2007.

FY 2008-09 Financial Outlook Improves

Planning estimates for FY 2008-09 revenues are $551 million higher than end-of-session projections, while expenditure estimates are $45 million lower. As a result, projected balances for FY 2008 and FY 2009 have increased. The balances are now roughly equal to the cost of inflation and the loss of revenues from a potential constitutional amendment that would dedicate all general fund motor vehicle sales tax revenue to transportation.

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Budget Summary

$701 Million Balance Projected for Current Biennium

Minnesota's financial outlook for FY 2006-07 has improved slightly since the end of the 2005 legislative sessions. A forecast balance of $701 million is now expected, up $689 million from the $12 million balance projected for the adopted budget.

A modestly higher revenue forecast increases expected revenues by $661 million. Dedicated revenues and transfers add $33 million to end-of-session estimates. The combination of higher spending, monies carried forward from FY 2005, and a change in reserves provides a small offset to the revenue increase.

FY 2006-07 Forecast Changes

($ in millions)

Ending Balance - Enacted Budget	**$12**
Balance From FY 2005	390
Taxes, Other Revenues	661
Transfers, Dedicated, Other	33
Increase in Spending	(78)
Tax Relief Account	(317)
Subtotal - Forecast Changes	**689**
Forecast Balance before Allocation	**$701**

Under current law the projected balance for FY 2006-07 is automatically used to reverse education accounting shifts enacted in 2002 and 2003. The forecast balance of $701 million is allocated as follows:

$370.4 million to complete the buyback of the remaining portion of the school aid payment shift, returning school aids to a 90-10 payment schedule.

$330.7 million for a partial buyback of the property tax recognition shift, reducing the recognition percentage from 48.6 to 10.8 percent.

Monies allocated to this purpose will be paid to school districts in FY 2006, beginning with the December 2005 payments. Buying back the remaining portion of the property tax recognition shift would cost an additional $94 million.

FY 2005 Books Closed, $337 Million Deposited to Tax Relief Account

The state has closed the books on fiscal year 2005 and the 2004-05 biennium. A positive revenue variance and slightly lower spending combined to yield an ending balance of $337 million. Under current law, the balance at the end of the biennium is transferred to the tax relief account. This account is treated as a reserve.

FY 2005, Changes from End-of-Session

($ millions)

	End-of-Session	Actual	Change
Beginning Balance	**$1,268**	**$1,268**	**$0**
Non-Dedicated Revenue	13,952	14,250	298
Transfers, Other Revenue	378	403	25
Total Resources	**15,598**	**15,921**	**323**
Expenditures	**14,595**	**14,528**	**(67)**
Reserves			
Appropriations Carried Forward	0	53	53
Budget & Cash Reserves	1,003	1,003	0
Tax Relief Account	*0*	*337*	*337*
Ending Balance	**$0**	**$0**	**$0**

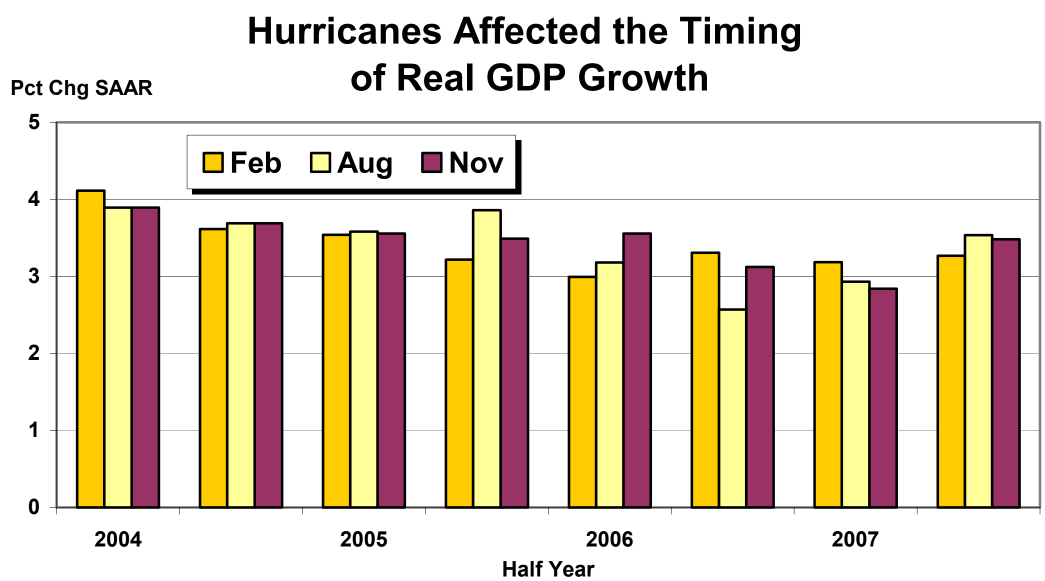
General fund resources for fiscal 2005 totaled $14.653 billion, $323 million (2.2 percent), more than February's forecast. As reported in October's *Economic Update*, net non-dedicated revenues were $298 million (2.1 percent) more than forecast. The remainder of the additional resources came from transfers from other funds and dedicated revenues.

Actual spending in fiscal 2005 was $14.528 billion, $67 million (0.5 percent) below estimates at the end of the 2005 legislative sessions. While spending was lower, $53 million of the unspent funds were authorized to carry forward to FY 2006, leaving a net reduction of $14 million. The savings come from slightly lower costs in K-12 education, human services, and property tax aid and credit programs.

U.S. Economy Expected to Show Strong Growth in Early 2006

Hurricanes Katrina and Rita could have produced a serious economic slowdown had the U.S. economy been weaker last summer. The combination of unusually severe local losses and a major disruption of energy production and processing in the affected Gulf Coast region created a substantial drag on economic output. But the national economy had so much momentum when Katrina struck that it appears there will be only a temporary slowing in what otherwise would have been a year of extremely strong growth.

Most economists believe real economic growth in the current quarter will drop to around 3.0 percent, the slowest real GDP growth in nearly 3 years. Real growth of 3.0 percent is still strong though when compared to average real growth rates observed prior to the late 1990s. Forecasters expect a substantial rebound in the first half of 2006 as reconstruction activity along the Gulf accelerates and businesses temporarily closed due to hurricane damage once again operate at normal levels. The energy situation, interest rates, and consumer spending are all major uncertainties, but the snap-back from the production losses caused by the sister storms is expected to overcome those potential negatives. By mid-summer forecasters expect the economy to be back on its pre-Katrina path, although with a slightly higher inflation outlook.



The outlook in November's baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, is very similar to the consensus. GII expects real GDP growth rates of 3.6 percent in 2005, 3.4 percent in 2006 and 3.1 percent in 2007. The Blue Chip Panel calls for real growth rates of 3.5 percent, 3.3 percent, and 3.2 percent. GII expects the over all inflation rate to slow slightly as oil prices stabilize and then begin to decline in late 2006. CPI inflation is expected to average 2.6 percent in calendar year 2006 and 1.5 percent in 2007. Core inflation, the CPI without its more volatile food and energy components, is expected to increase by 2.4 percent in 2006 and 2.5 percent in 2007.

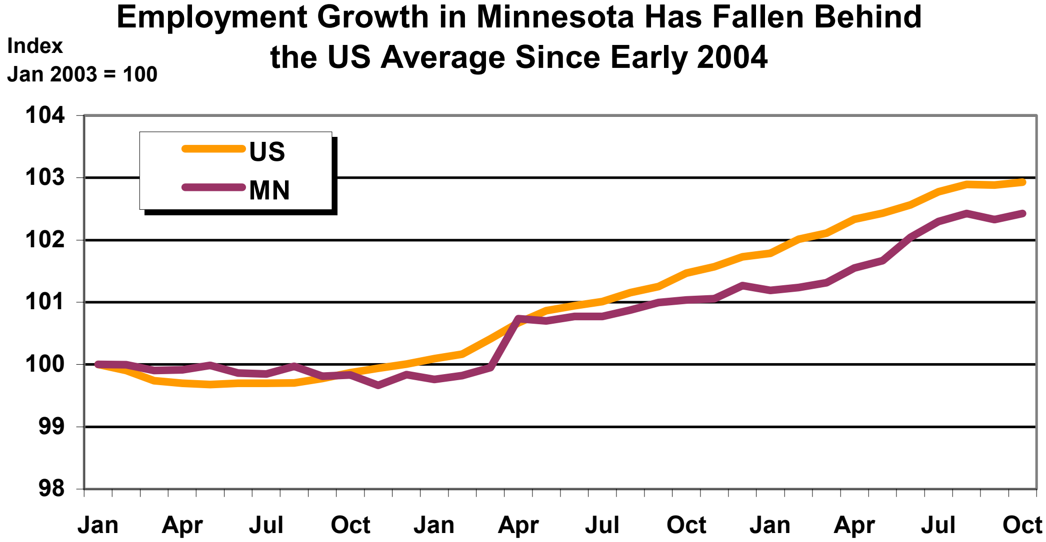
Global Insight assigns a probability of 55 percent to their November baseline forecast. A more pessimistic forecast, which does not include a recession but only slower growth, is assigned a 25 percent probability, and a more optimistic scenario is assigned a probability of 20 percent. In February the baseline scenario was assigned a 60 percent probability and the two alternatives 20 percent each. The change in the probabilities reflects a slight increase in the downside risk for the economy as it emerges from the energy sector problems created by Hurricanes Katrina and Rita.

Minnesota's Economy Is Growing, But Not as Fast as the U.S. Averages

Minnesotans have grown used to seeing their state among the leaders in economic performance. An example is the state's unemployment rate, now 3.7 percent, well under the U.S average of 5.1 percent. Lately though we have begun to lag in job growth. This forecast projects that Minnesota's job and income growth will continue at a slower pace than the national averages over the remainder of this biennium. Minnesota employment is projected to increase by 1.6 percent between now and the close of fiscal 2007; Global Insight projects U.S. employment growth of 2.5 percent.

Part of the reason for this less than cheery outlook is simply arithmetic. Employment and economic activity fell dramatically along the Gulf Coast in the wake of the hurricanes, and those local, storm-related losses pulled the national averages down as well. That made states like Minnesota which were largely unaffected by Katrina and Rita temporarily look stronger in comparison to the national numbers. Now, as Gulf Coast economies begin to return to more normal levels of activity, growth rates in states unaffected by the hurricanes will appear comparatively weaker than the national averages.

Employment Growth in Minnesota Has Fallen Behind the US Average Since Early 2004



Unfortunately though, there appears to be more going on than simple arithmetic. Beginning with the start of the recession in 2001, payroll employment growth in Minnesota has been weaker than the national average. This is not just a recession phenomenon. Since January 2003, well after the economy started to grow again, employment in Minnesota has grown by 2.4 percent. Over that same time U.S. payroll employment grew 2.9 percent. Based on growth in withholding receipts Minnesota's wage growth in 2005 also appears to be below the national averages.

Manufacturing employment has fallen, but manufacturing layoffs do not explain Minnesota's sub-par performance. Manufacturing employment has not fallen as fast in Minnesota as it did elsewhere in the nation. Since February 2001 manufacturing employment in Minnesota is down 11.7 percent. Nationally manufacturing employment is down 16.5 percent.

Some of the reasons for Minnesota's slower than average growth in non-manufacturing jobs are obvious. Minnesota is home to a major air carrier and the airline transportation sector has been very weak since 2001. State and local government employment growth has also been well behind the national average as Minnesota struggled to deal with the budget problems created by the 2001 recession. Retail employment growth also has been weaker than the national averages.

The employment growth rates used in this forecast are slightly less than those used in February's revenue forecast. Payroll employment is now expected to increase by about 56,000 jobs between now and the end of fiscal 2007, an average of about 9,000 jobs per quarter. Manufacturing employment is projected to continue its slow upward climb, increasing by about 3,000 jobs over the forecast horizon.

Revenue Forecast for 2006-07 Biennium Up $694 Million

General fund resources for the 2006-07 biennium are now projected to total $31.280 billion, $694 million (2.3 percent) more than end-of-session estimates. Forecasts for the individual income tax, the sales tax, the corporate franchise tax, and other taxes each were raised by more than $100 million.

Forecast Revenues, FY 2006-07

($ in millions)

	End of Session	Nov Forecast	$ Change	% Change
Individual Income	$13,559	$13,747	$188	1.4
Sales	8,943	9,116	173	1.9
Corporate	1,516	1,681	165	10.9
Motor Vehicle Sales	531	523	-8	-1.5
Statewide Levy	1,291	1,290	-1	-0.1
Subtotal	25,840	26,538	518	2.0
Other Taxes	2,352	2,489	137	5.8
Non-Tax Revenue	1,491	1,498	7	0.5
Dedicated, Transfers	903	936	33	3.7
Total Revenues	**$30,586**	**$31,280**	**$694**	**2.3**

Consistent with the small changes in the economic outlook, percentage changes in revenues were small. The individual income tax and sales tax forecasts were up 1.4 percent and 1.9 percent respectively. The large change in other revenues reflects a one-time event that will not affect future revenues.

Prospective corporate tax receipts showed the largest percentage increase, up 10.9 percent from February's estimates. There, a combination of stronger than projected receipts and a major revision to Global Insight's corporate profit forecast more than offset the reduction in revenues expected due to the Hutchinson Technology court decision. The Department of Revenue estimates the Hutchinson decision will reduce state corporate tax receipts by $232 million in the current biennium and an additional $150 million in the 2008-09 biennium.

Individual income tax liability for tax year 2004 is now estimated to have been $165 million more than projected in February. Preliminary indications are that capital gains realizations increased by more than 50 percent during that year. Some of those realizations were assumed to be borrowed from the future and capital gains growth rates in tax years 2005 through 2007 were reduced from those assumed in February. The income, sales, and corporate tax forecasts include more than $147 million in expected revenue from compliance initiatives enacted in the 2005 legislative session.

Forecast Spending Increased Slightly Before Shift Buyback

General fund spending for the biennium is forecast to be $30.652 billion, up $78 million (0.3 percent), from end-of-session estimates. Funding the education shift buyback adds $701 million, increasing total spending to $31.353 billion, 2.5 percent above end-of-session estimates.

The $78 million increase in forecast spending included $53 million of unspent appropriations carried forward from FY 2005. Since this is balanced by an equal amount of resources carried forward from FY 2005, the underlying forecast change in spending reduces FY 2006-07 balances by only $25 million.

Forecast Spending, FY 2006-07
($ in millions)

	End of Session	Nov Forecast	$ Change	% Change
K-12 Education	$12,578	$12,596	$18	0.1
Higher Education	2,761	2,761	0	0.0
Property Tax Aids & Credits	2,984	3,039	55	1.8
Health & Human Services	8,264	8,216	(48)	(0.6)
Debt Service	781	776	(5)	(0.6)
All Other	3,206	3,264	58	1.8
Forecast Total	**$30,574**	**$30,652**	**$78**	**(0.3)**
Education Shift Buyback	***0***	***701***	***701***	**---**
Revised Total	**$30,574**	**$31,353**	**$779**	**2.5**

The small change in spending comes from three areas. K-12 education estimates increased $18 million, reflecting a lower rate of decline in pupil units. Property tax aid and credit estimates increased $55 million, due primarily to increased interest costs from the Hutchinson Technology decision. Those increases were offset by health and human services spending which fell by $48 million, driven largely by reductions in average costs for Medical Assistance Families and Children Basic Care and enrollments in MA Long-Term Care Waivers.

The $701 million education shift buyback increases spending in 2006-07. Of the total, $697 million will be paid out through K-12 education aid payments, increasing K-12 spending to $13.293 billion. The remaining $4 million will be paid to school districts through related property tax aids and credits, increasing spending that portion of the budget to $3.043 billion. These revised spending totals are used in comparative tables throughout the remainder of this forecast document.

Planning Estimates for FY 2008-09 Improve

Projected revenue planning estimates for FY 2008-09 are now $551 million higher than end-of-session estimates, while expenditures are $44 million lower. Changes from end-of-session levels reflect the increases in FY 2006-07 revenues and savings in health and human services programs continuing into the next biennium. Planning estimates for FY 2008-09 continue to show a positive balance between current law revenues and expenditures.

It is important, however, to realize the limitations of current-law planning estimates. The current forecast highlights the sensitivity of out-year planning estimates to even small percentage changes in forecast revenues. Projected balances also are likely to be affected by potential budget actions in the 2006 legislative session, cost pressures from inflation and other factors.

As required by current law, expenditure projections for the next biennium do not include any adjustment for inflation. Estimated inflation at 1.7 and 2.2 percent for FY 2008 and FY 2009 respectively would add $271 million and $640 million, a total of $911 million to the current law spending projections.

Additionally, a proposed constitutional amendment on the 2006 ballot would dedicate remaining general fund motor vehicle sales tax revenues to transportation. If passed, this would reduce projected revenues by $60 million in FY 2008 and $125 million in FY 2009.

These issues must be recognized when analyzing any changes in the current biennium's budget, as well as in preliminary planning for the FY 2008-09 budget.

FY 2008-09 Planning Estimates

($ in millions)

	FY 2008	FY 2009
Revenues	$16,305	$17,151
Spending	15,972	16,249
Difference	**333**	**902**
Inflation	*(271)*	*(640)*
Constitutional Amendment	*(60)*	*(125)*
Balance	**$2**	**$137**

A complete version of this 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

November's forecast provides the first comprehensive review of Minnesota's financial outlook for FY 2006-07 since the close of the 2005 Special Legislative Session. It is the first of four forecasts that will occur during the biennium. This forecast provides revised revenue and expenditure estimates for the current biennium based on the most recent information about the national and state economic outlook, and caseload, enrollment, and cost projections. Actual closing data for fiscal year 2005 revenues and expenditures are also included in this report as are updates of the revenue and expenditure planning estimates for the FY 2008-09 biennium.

The revised revenue estimates reflect the changes in the national economic outlook that have occurred since February's forecast. That forecast was the basis for the FY 2006-07 enacted budget. This forecast also incorporates additional revenue collection experience. For example, state individual income tax receipts now builds from a preliminary estimate of tax year 2004 liability.

Revenue estimates for the remainder of the current biennium are based on econometric forecasts of the U.S and Minnesota economy. The revenue forecast is prepared based on a national economic forecast provided by Global Insights Inc. (GII). GII's national forecast, was reviewed by Minnesota's Council of Economic Advisors. The council's comments are found in the "Economic Summary." The "Economic Outlook" which follows provides a more comprehensive overview of the current outlook for the U.S. and Minnesota economies.

Revenue projections for FY 2008-09 are obtained from less complex models. As in past years, the economic growth assumptions used to develop the revenue planning estimates have been updated. Calendar year 2008 economic growth rates are now taken from the GII November baseline scenario. Planning estimates should not be interpreted as explicit forecasts, but rather as a guide to indicate whether proposed actions will create financial problems in future years.

Expenditure estimates in most areas are shown at the level of the appropriations made for FY 2006-07 by the 2005 legislature, plus any authorized spending carried forward from prior years. Entitlement programs--such as K-12 general education, intergovernmental aids, health care, and family support--are forecast based on expected changes in eligibility, enrollment, and average costs.

Wage and price inflation is included in the revenue estimates, which are based on current law tax rates. It is not included in projected current law expenditures for FY 2008-09. Estimated inflation during the period is 1.7 and 2.2 percent for FY 2008 and FY 2009 respectively.

Economic Summary

Economic forecasts typically are accompanied by several paragraphs describing what could go wrong. During the past few years those concerns have been almost entirely longer-term items. Now, things are different. It is not that the longer-term concerns have gone away. They have not. Nor is it that short-term economic indicators are flashing warning signs. For the most part they continue to indicate that the economy is on track for good growth for at least the next 12 months. What has changed is that the economy now faces several legitimate short-term concerns, items that are likely to slow economic growth in the current quarter, and could potentially contribute to weaker real GDP growth in 2006. Reasonable estimates for GDP growth rates over the next year are in a wider range than we have grown accustomed to over the past few years.

An uncertain short-term energy outlook is one source of forecaster concern. The problem goes beyond the higher gasoline prices caused by strong global demand over the past two years. There also are questions about how consumer spending will fare when households find themselves faced with the substantially higher winter heating bills that will soon be on the way. And, economists also can only speculate about how much of the increase in energy prices will be passed on to consumers in the prices of non-energy goods and services.

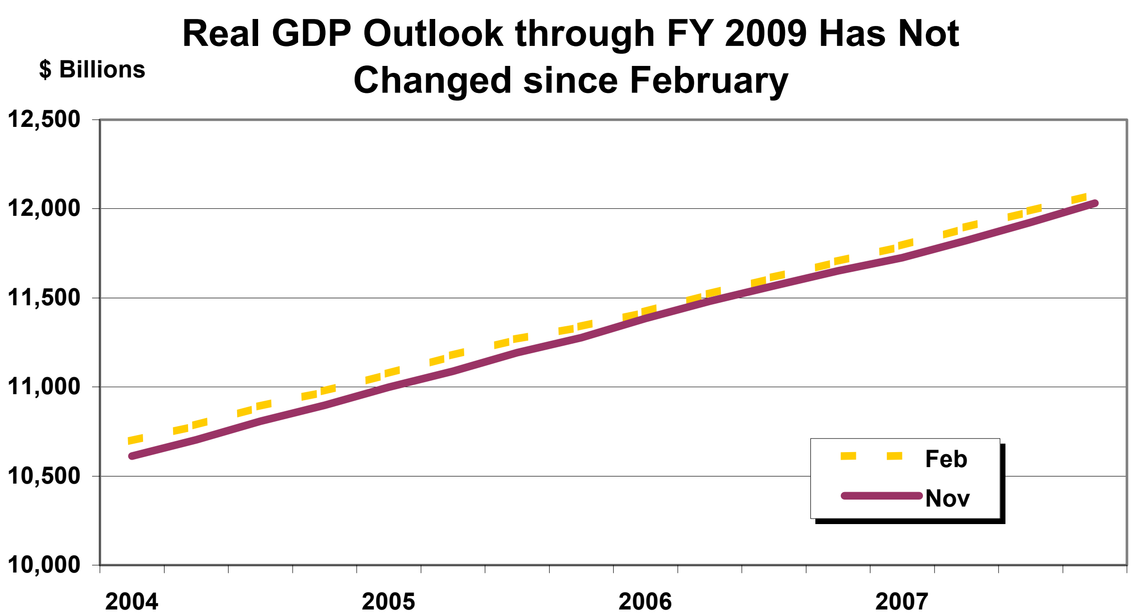
The demand driven energy price increases seen earlier this year have been exacerbated by supply shocks associated with Hurricanes Katrina and Rita. Those storms damaged crucial Gulf Coast energy infrastructure, including the undersea pipelines that bring the oil and natural gas onshore from the drilling platform. In mid-November, more than 45 days after Hurricane Rita, 40 percent of Gulf natural gas production and 45 percent of oil production in the Gulf remained shut-in. In 2004, following Hurricane Ivan, less than 10 percent of Gulf production was shut in after 45 days.

There are no solid estimates of when the oil and natural gas production that is currently shut in will again be back on line. That uncertainty, coupled with the vagaries of winter weather leaves the possibility that a further spike in natural gas prices could occur right in the middle of the winter heating season. Such a price shock would further reduce household discretionary income and hold consumer spending growth below trend through mid-summer.

The energy sector is not the only source of short-term uncertainty. The housing price outlook has grown fuzzier as mortgage interest rates begin to creep up. The interest rate outlook, particularly for longer term credits and home mortgages, has also grown more uncertain. And, there also are questions about the amount and timing of federal assistance for the rebuilding of the storm damaged Gulf Coast communities.

To further add to forecasters' uncertainty the monthly national economic data series used by most economists to shape their current forecasts have become less useful for the short term. Currently changes in the key national economic statistics are more likely to reflect the massive economic disruption and dislocation caused by Hurricanes Katrina and Rita, not underlying national economic trends. Analysts are doing their best to separate "Katrina specific" effects from those describing the strength of the economy beyond the Gulf Coast, but it is likely to be several months before forecasters regain full confidence that changes in the national data reveal more than simply the size of local hurricane induced losses and the recovery from those losses.

November's Baseline forecast from Global Insight, Minnesota's national economic consultant, projects a middle path for the economy over the next 18 months. They expect real GDP growth to slow slightly during the fourth quarter of 2005, but that will be followed by strong growth in early 2006 as the Gulf Coast starts recovering. GII's forecast calls for real GDP growth rates of 3.6 percent in 2005, 3.4 percent in 2006, and 3.1 percent in 2007. The GII baseline is almost identical to the Blue Chip Consensus forecast. The Blue Chip panel expects growth to proceed at an annual rate of 3.5 percent in 2005 and 3.3 percent in 2006.



Global Insight believes that the high energy prices currently in place will not cause inflation to accelerate in 2006 and 2007. They forecast the CPI growth rate to reach 3.4 percent in 2005, then fall back to 2.6 percent in 2006 and 1.5 percent in 2007 as oil prices first stabilize, then gradually move back to $50 per barrel. Their inflation outlook is a little more optimistic than the Blue Chip consensus, which calls for CPI growth of 3.4 percent in 2005 and 3.1 percent in 2006. Global Insight also detects some signs that longer-term inflationary pressures are beginning to emerge. Their forecast for the core CPI (the CPI after netting out the effects of food and energy price changes) shows that measure of inflation continuing at an annual rate of 2.5 percent through 2007.

GII assigns a probability of 55 percent to their baseline forecast, 5 percent less than in February. Their more pessimistic scenario containing more inflation and slower growth, but no recession is now assigned a 25 percent probability, up 5 percent from February. A more optimistic scenario in which everything goes right and productivity growth continues very strong continues to receive a 20 percent probability.

Members of Minnesota's Council of Economic Advisors agreed that Global Insight's baseline forecast was consistent with the consensus short term outlook for the U.S. economy. While the forecasts of some Council members were more optimistic than the GII baseline, and others less optimistic there were no substantial disagreements with Global Insights outlook for the next 18 months. Most Council members also agreed that the short term forecast was more likely to be too optimistic than too pessimistic.

Council members remain optimistic about the short-term outlook, however, with most believing that the first quarter of 2006 will be particularly strong as the recovery in the Gulf Coast economies is reflected in the national income statistics. There were differences of opinion over the extent to which higher interest rates would slow the national economy later in 2006 and early 2007, but all were comfortable with the GII baseline forecast for economic growth..

Department of Finance economists noted that national economic growth will not translate directly into economic activity in Minnesota. Job growth in the state has lagged that in the rest of the nation since early 2004, even though manufacturing employment has declined at a slower rate than it has on average elsewhere in the nation. Since national job growth in 2006 will reflect the return to work of individuals temporarily unemployed along the Gulf Coast plus the local construction boom in communities in the path of the hurricanes, payroll employment in Minnesota is unlikely to grow as fast as the national averages. Finance Department economists also noted that much of the lift to the economy projected in early 2006 will reflect re-building and the return to normal levels of business activity along the storm damaged Gulf Coast. That activity will add to national economic output, but it is unlikely to have a significant effect on employment or incomes in Minnesota.

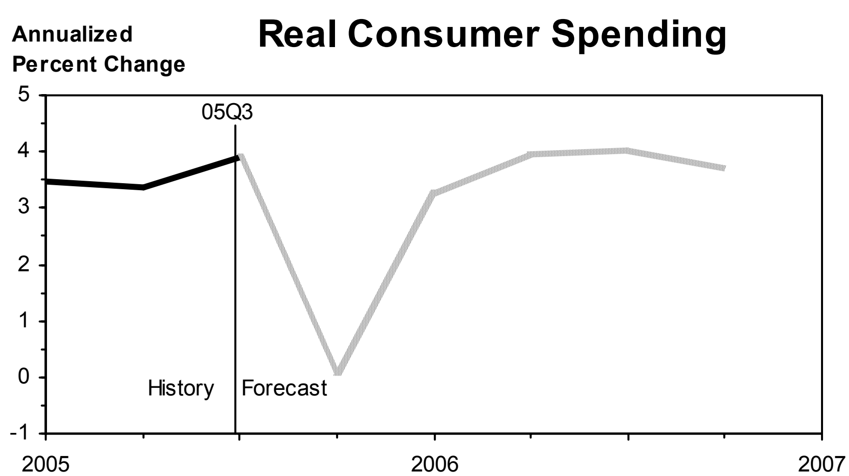
Council members continue to stress the importance of re-building reserves when economic times are good. While the Council recognized the value of risk management tools such as the cash flow account and buying back expenditure shifts the Council continues to believe that a budget reserve of 5 percent of biennial expenditures is the appropriate level of reserves for Minnesota's general fund. The Council also again noted 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 may face in future biennia.

ECONOMIC OUTLOOK

Devastating hurricanes, memories of three dollar gasoline, a surge in inflation, winter heating bills, talk of a housing bubble, and Dr. Greenspan's imminent retirement have cast clouds over the economy's near term outlook. Reflecting the unease, consumer sentiment plunged close to recession levels in September and October. But Global Insight believes the funk will only cause a temporary lull in household spending. While a rebound could be hampered by a cooling housing market and burdensome credit card debt, that seems unlikely. Recent reports suggest the economy is already shaking off last fall’s bad news.

Third quarter real GDP growth was a robust 3.8 percent, and non-auto retail sales have been surprisingly strong. In addition, hurricane reconstruction is gradually getting underway and business investment outlays are expected to accelerate. So, unless something else goes wrong, forecasters expect the economy will overcome the drag from higher winter heating bills and imports of expensive oil. Christmas retail sales should be all right though probably not as good as last year.

While the economy is expected to continue growing, the question is how fast. There are now several new risks. A cooling housing market and high debt levels will leave consumers less able to deal with any future weakness in the job market or purchasing power. Accelerating inflation accompanied by higher interest rates is another concern. Short-term inflation could be contained by receding energy prices if it does not take too much longer to reopen shut-in oil and gas wells. But even if that goes well, oil field repair and hurricane reconstruction will use up the economy's remaining spare capacity, increasing long-term inflationary pressure. And there will be upward pressure on interest rates in financial markets made more volatile by concern over tight energy supplies, by inflation fears, by the need to finance a growing federal budget deficit, by the potential for a precipitous decline in the dollar, and by uncertainty over the policies and skills of Dr. Greenspan's successor.



Consumer sentiment plunged to recession levels in September and October. But Global Insight believes the funk will cause only a temporary lull in consumer spending growth. Prospects for a rebound as forecast seem to be improving because consumer sentiment is now showing signs of recovery.

Will A Cooling Housing Market Crimp Consumer Spending?

While sales and starts remain strong, the Federal Reserve Beige Book and media reports note the housing market is cooling, raising concerns about the consumer. Households have long been content to let the real estate market do their saving for them, but over the past few years use of home equity loans and cash-out refinancing has put a growing and significant amount of liquidity in consumers' hands. A research paper by Dr. Greenspan and a colleague indicates this came to 7 percent of personal disposable income or some $600 billion in 2004. It appears that about one-half was spent.

Consumers' use of cash from home equity suggests slower growth in housing values could crimp household spending. Global Insight takes a sanguine view, forecasting only a modest cooling with 2006 still expected to be a very good year for housing starts, second only to the stellar years 2004 and 2005.

Rising Inflation Expectations?

September saw the largest monthly jump in CPI inflation in 25 years. Analysts attribute almost all of that to hurricane-induced higher energy prices. Prior to the hurricanes, energy prices had risen steadily for about two years, but there was very little spillover into other prices.

Though not likely at this time, September's spike could accelerate the spillover. Consumer inflation which ran at a 5.1 percent annual rate in the third quarter may persist long enough to raise expectations for future non-energy prices. If that happens, people would adapt by changing their behavior. Consumers would demand wage increases to preserve their purchasing power, and firms would work harder to pass on cost increases. Unless the Federal Reserve tightens severely, inflation would almost surely spill over into wages, producer prices, and consumer prices in a self-sustaining spiral reminiscent of the 1970's.

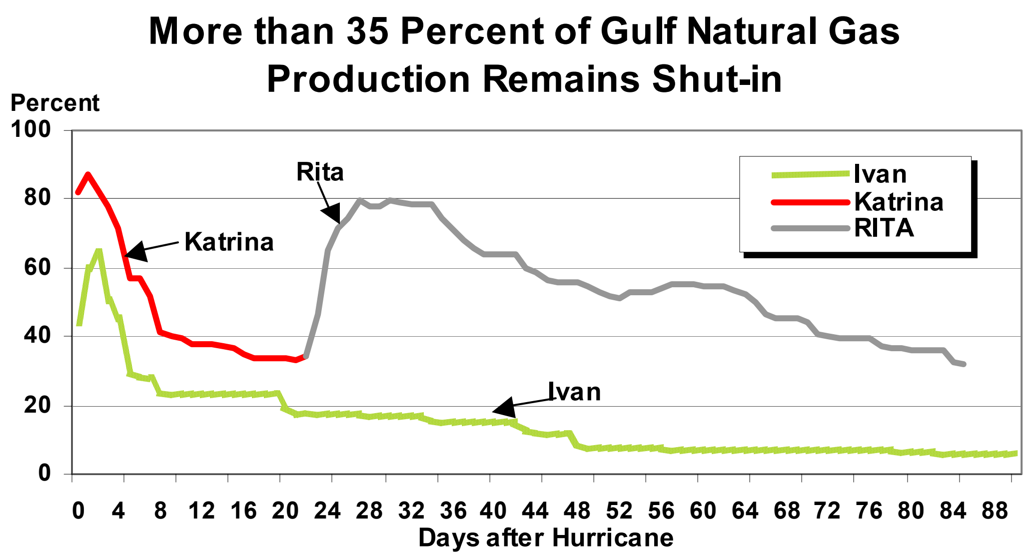
In Global Insight's November baseline, receding energy prices lower inflation before expectations change very much. The only lasting damage will be a slightly higher outlook for price increases in non-energy and non-food items, or core inflation, reflecting the small amount of spillover from energy that has time to occur.

Before the hurricanes, core inflation seemed stable at about 2.0 percent and the Federal Reserve was gradually raising interest rates in hopes of preserving the status quo. Many analysts think core inflation in the neighborhood of 2.0-2.5 percent is the maximum the Fed will tolerate without significantly larger rate increases than those of the past 17 months. Global Insight's baseline forecast is at the upper end of this range.

Consumption

Consumer sentiment plunged in September and October but has since shown signs of recovering. Fortunately, spending does not always follow sentiment and apparently it has not done so this time. There has been a slump in auto sales, partly as payback for very successful incentives last summer, but non-auto retail sales have been surprisingly strong.

Consumers will soon be tested by this winter's surging home heating bills. Those will come as shock to many, a very big shock if the winter is especially cold. While gasoline prices are lower, natural gas and heating oil have not retreated very much. Natural gas is in tight supply because many Gulf wells are still shut in and weeks of production were lost from those that have reopened. Unlike gasoline, lost gas production cannot be made up by imports. Europe has gasoline for sale, but the same is not true for diesel and heating oil, so those also are in tight supply. Global Insight estimates home heating bills will average some 60 percent above year-ago levels in the first three months of 2006, potentially a problem for many households.



Consumers will soon be tested by high home heating bills. Natural gas is in tight supply because many Gulf wells remain shut in after hurricane Rita. Damage done by Rita has greatly slowed reopening the wells.

For years, the saving rate declined because consumer spending increased faster than income. In many cases savings could not make up the difference. So, households ran up credit card debt and let rising home values do their saving for them. More recently they have begun dipping heavily into home equity, a development that may indicate coming changes in behavior. If rising interest rates force consumers to rely less on equity, Global Insight assumes they will resume saving more out of their incomes. Finance Department economists think consumers will do that only as a last resort but, if they do pull back, economic growth could slow significantly.

Many analysts have interpreted the declining saving rate and rising use of home equity to mean that household budgets have become tight and are getting tighter. Global Insight believes many households are stretched to the limit. The November baseline incorporates a good though not stellar Christmas retail season assuming a mild reaction to higher heating costs.

Investment

Analysts disagree over whether current home prices reflect a speculative bubble. The problem is that there is no consensus on how to distinguish price increases driven by speculation from those driven by market forces. Global Insight’s view is that a widespread collapse in home values is unlikely as long as income growth and interest rates remain near November’s baseline. A pessimistic scenario, given a 25 percent probability, has a 20 percent decline in house prices in 2007 in response to sharply higher interest rates, rising unemployment, and a consumer spending slowdown.

Business firms are holding large amounts of cash, profits are strong, spare capacity is becoming scarce, and inventories are tight. So, firms have means and incentive to invest in new equipment, more space, and additional inventories. November’s Global Insight baseline anticipates a double-digit increase in equipment spending in 2006 led by computer and software purchases. A similar increase in spending for structures is also expected, boosted by oil drilling and repairs to hurricane damaged oil rigs and platforms. And, inventories are expected to surge at a 32 percent annual rate. As a result, business investment leads the economy, growing faster than real GDP and real consumption through the entire three-year forecast horizon.

Government

Global Insight assumes the federal government will spend some $110 billion for hurricane relief and reconstruction over the next three to four years. As a result, the federal unified budget deficit is expected to grow to $365 billion in fiscal 2006 and then steadily declines through 2008. In pre-Katrina baseline scenarios, the deficit declined in 2006.

The large budget deficit will be a source of inflationary pressure because the economy is already producing at close to capacity. At 5.1 percent, the unemployment rate has descended close to the lowest level considered sustainable without inflationary increases in wages as employers compete for scarce workers.

International

Higher imported oil prices and rising merchandise imports from China will contribute to a widening trade deficit in 2006. Some, but not enough, relief will come from modest gains in exports to Europe and Japan. Consequently, the current account deficit will increase about 12 percent in 2006, an improvement over 2005's 21 percent, but downward pressure on the dollar will persist. In the November baseline, the dollar falls gradually and the deficit begins slowly shrinking in 2007 assuming among other things that crude oil slips below $50 per barrel after averaging almost $60 in 2006.

Exports to China seem a significant opportunity for long-term improvement in the trade deficit. Last summer, as a long-awaited and much sought diplomatic concession to the U.S., China agreed to abandon its currency's fixed link to the dollar. China now has a foreign exchange market in Shanghai and the yuan is linked to a basket of currencies including the dollar. However, the yuan is currently allowed to move only 0.3 percent per day against the dollar. The *Wall Street Journal* speculates that a freely floating yuan may be five years away. Economists generally believe that given China's trade surplus, the value of the yuan would rise as much as 40 percent if markets were allowed to determine its value.

Inflation

Last September and October, consumer and producer inflation spiked upward, driven by hurricane-induced increases in energy prices. Forecasters are watching closely to see how quickly inflation tapers off. Ideally, and in Global Insight's baseline, annualized consumer inflation will settle back down to 2.6 percent or less in 2006.

Before the hurricanes, the data were indicating a drift toward higher inflation. For more than two years, real GDP had grown faster than the 3.25 percent rate generally considered sustainable without accelerating inflation. Energy prices had been rising steadily, building materials were in tight supply with prices rising, the unemployment rate was declining, and there were reports of shortages of a few kinds of skilled workers.

Now, the key question is whether consumers and business firms will regard the recent burst of inflation as an event not likely to be soon repeated. Or, will they consider it the beginning of a new round of price increases? For many individuals and firms a one-time event can be absorbed without permanent behavioral changes. For example, households can temporarily save less and firms can look for one more way to cut costs. On the other hand, if a steady stream of price increases is expected people will pressure employers for permanent compensating wage increases while firms will work harder to pass on higher costs. And, everyone who expects accelerating inflation will be more willing to accept higher prices from others.

Global Insight believes a few indicators will play a central role in determining expectations. Consumers will watch gasoline prices and heating bills. Firms will watch productivity. Higher productivity lowers unit costs, offsetting energy price increases. Productivity gains have slowed from 3.8 percent in 2003 to an estimated 2.7 percent in 2005, so further significant deterioration could put more pressure on firms to pass on cost increases. Unfortunately, Global Insight's baseline productivity forecast is for 2.3 percent in 2006 and only 1.9 percent in 2007.

Monetary

The Federal Reserve has raised short-term interest rates 12 times since June 2004, and most observers expect more tightening during the next few months. In their November baseline, Global Insight assumes short-term rates currently at 4.0 percent will be increased to 4.75 percent by early next year. Long-term rates will also rise as financial markets react to growing inflation risk.

Long-term prospects for monetary policy are somewhat uncertain because Dr. Greenspan is retiring as Chairman of the Federal Reserve Board on January 31. As his replacement, the Senate will almost certainly confirm Dr. Ben Bernanke, a highly regarded academic economist who has been a Federal Reserve Board member with Dr. Greenspan and, recently, Chairman of the President's Council of Economic Advisors. If tradition prevails, the Board will then elect Dr. Bernanke to head the rate-setting Open Market Committee.

The *Wall Street Journal* reports that while the change has the potential to unsettle financial markets and investors, Dr. Bernanke seems a safe choice. His monetary policy is likely to resemble Dr. Greenspan's emphasis on low inflation and pragmatic analysis. It also seems likely that Dr. Bernanke will continue efforts begun years ago to make the Fed's objectives more transparent. He may begin by proposing an inflation target. But, a *Business Week* article indicates that seems unlikely because it is very difficult to devise a credible targeting policy which leaves enough flexibility to deal with a domestic or international crisis.

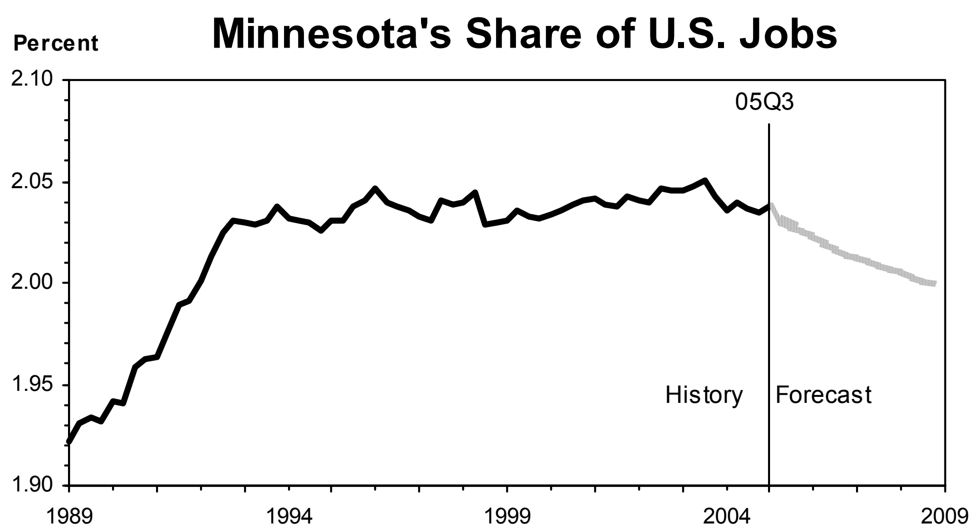
A workable target would not mean Dr. Greenspan's shoes are filled. Not only is he arguably the most successful Fed Chairman ever, *The Economist* indicates that in his 18-year tenure Dr. Greenspan's position has become more personalized than any of his predecessors. And though there has been occasional controversy, it is clear that Dr. Greenspan has the confidence of the financial markets, and that he has been very effective at forging a consensus on the Open Market Committee. For a while, Dr. Bernanke is not likely to command the same respect.

Successful handling of a crisis could make a big difference. The only question is when one will occur. Dr. Bernanke will face a domestic economy which, as *The Economist* points out, seems to be a crisis in the making. The U.S. economy is dominated by unsustainable federal budget and current account deficits, uncertain energy supplies, a drift toward higher inflation, and a potential housing price bubble. But unlike the past, Dr. Bernanke and the Open Market Committee will be less able deal with domestic or international crises without coordinating with other central bankers in an increasingly global economy. As *Business Week* points out, economic interdependence is shrinking the role of the Fed both here and abroad.

MINNESOTA OUTLOOK

Minnesota's economy has performed well enough to keep income and sales tax collections very close to February's forecast. However, as forecast in February, jobs market data in 2005 continue to indicate a mixed performance. Minnesota's share of U.S. jobs has continued to slip. Monthly jobs growth has occasionally reversed on a seasonally adjusted basis, often a characteristic of a weak expansion. A drift toward slower growth is indicated by the decline in job vacancies noted in the Minnesota Department of Employment and Economic Development's Job Vacancy Report. And, continuing unemployment claims seem stuck at last year's levels.

Minnesota's share of U.S. jobs was slipping long before the hurricanes arrived. Hurricane relief and reconstruction will directly boost the economies of the Gulf States, but not Minnesota's. That is an additional reason to believe the state's economy will continue to lag behind its national counterpart. Virtually all the hurricane's Minnesota impacts will be small. Repairs and rebuilding will boost U.S. growth in 2006, but except for a few firms furnishing specific products or services needed for reconstruction, the positive state impacts will trickle down through the U.S. economy. Except for higher energy costs, the same is true for most of the negative impacts. For example, there are a number of firms reporting sharply higher prices for petroleum based chemical products. Any acceleration in U.S. inflation and resulting higher interest rates would be directly felt here, but at this time that is only a modest risk.



As indicated by its share of U.S. jobs, Minnesota's economy is underperforming its national counterpart. Other jobs market data also indicate a weak expansion. Finance Department economists have no reason to believe that will not continue.

Minnesota's Job Share Continues To Slip

As noted one year ago, Minnesota's share of U.S. jobs began declining in 2004. That has continued largely as forecast. The decline is widespread among industries. Natural resources and mining, construction, transportation and warehousing, information, leisure and hospitality, professional and business services, other services, and state and local government are showing some slippage.

Such a broadbased shift is likely to have multiple causes. For some industries there seems to be at least a partial explanation. Increasing oil and gas drilling helps explain natural resources and mining. Difficult times in the airline industry must be a contributing factor in transportation and warehousing. And tight budgets are a likely explanation for state and local government.

The others seem to have no specific explanation though some generalizations are possible. In some industries, unobserved competitive forces could be at work. In others, demographics may be involved. In 2001, Minnesota population growth slowed abruptly. That change should eventually have observable impacts in the trade sector and possibly elsewhere.

A Revised Outlook

Minnesota's employment and wage forecasts have been revised based on GII's November baseline and experience since February. The revisions are small. Expected employment and wage income growth for 2006 and 2007 are slightly less than forecast in February. Changes to the U.S. outlook are also small, though on the upside.

Minnesota And U.S. Economic Outlook

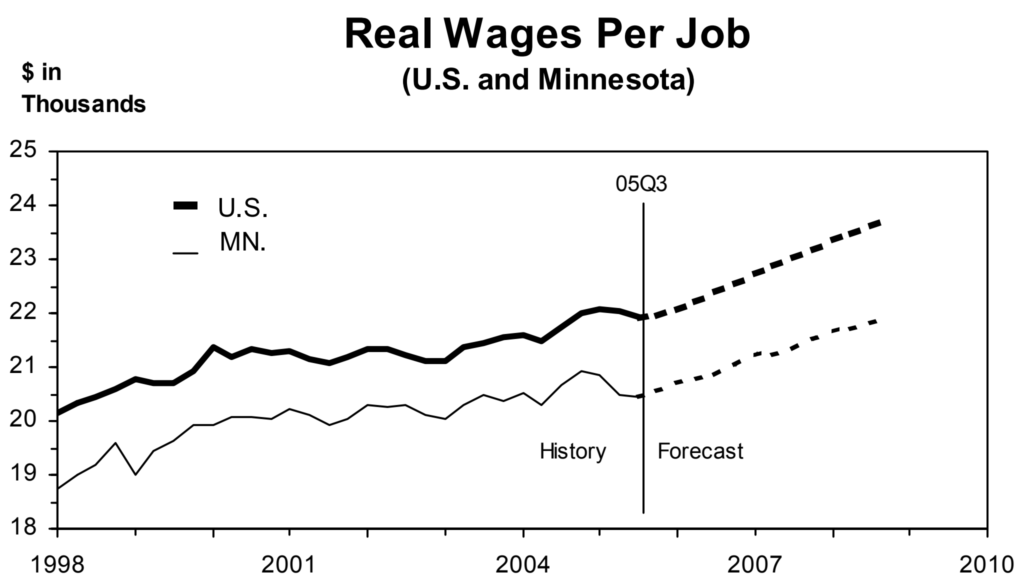
(Calendar Year Percent Changes)

	2004	2005	2006	2007	2008
Non-Farm Employment					
Minnesota					
February 2005	0.7	1.1	1.3	1.2	NA
November 2005	0.7	1.3	1.0	1.0	0.9
United States					
February 2005	1.1	1.7	1.4	1.1	NA
November 2005	1.1	1.6	1.6	1.4	1.3
Wage and Salary Income					
Minnesota					
February 2005	4.1	5.4	5.0	5.1	NA
November 2005	4.9	4.5	4.9	4.8	5.0
United States					
February 2005	4.7	5.5	5.5	5.6	NA
November 2005	5.4	6.5	5.7	5.9	5.9

Some Critical Assumptions

For the November forecast to hold, Minnesota must now be adding some 3,000 jobs a month on a seasonally adjusted basis. The data indicate that is happening, but the outlook is guarded because continuing unemployment claims remain at last year's levels and at last report job vacancies were declining. The jobs outlook assumes rising energy prices and higher prices for petroleum-based raw materials will not further exacerbate employer caution and just-in-time hiring practices.

In addition to more jobs, the outlook assumes real or inflation adjusted wage income per job will rise steadily. Ordinarily that can happen only with productivity improvements which economists are largely unable to predict. The consensus, shared by Global Insight, is that productivity gains will continue, though slowing from the experience of the past few years. Finance Department economists are unaware of any credible industry productivity forecasts which could be used to validate projections for real wage growth in specific Minnesota industries.



The outlook assumes real or inflation adjusted wages per job will rise steadily. Ordinarily, that happens only with productivity improvements which are hard to predict. Rising real wages per job are a critical factor in personal income tax revenue growth.

Other assumptions must also be met. Local government and higher education budgets must gradually ease enough to permit modest increases in public employment. Finally, the current slowdown in mortgage refinancing and the cooling housing market must not cause significant employment declines in financial services and in construction. Though expected to slow, housing starts must remain strong enough to sustain current levels of construction employment until a rebound in commercial construction gets underway.

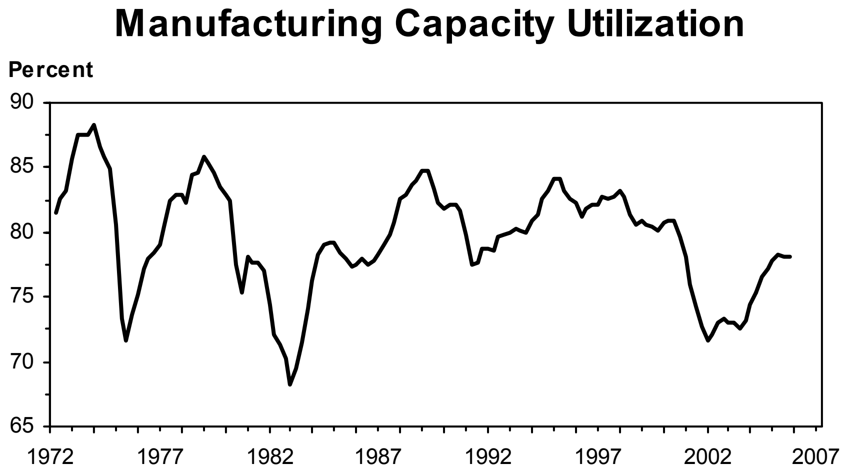
Housing Market Softens

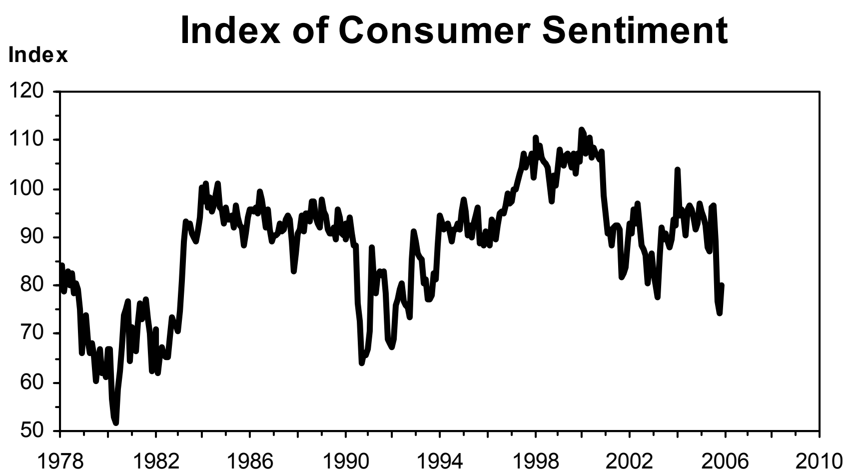
Like its national counterpart, Minnesota's housing market is softening in response to higher interest rates. Homes are staying on the market longer, Twin Cities building permits issued during 2005 are at their lowest level in several years, and more sellers are reducing their prices to meet buyer's offers. A St. Paul *Pioneer Press* article indicates some real estate professionals expect the Twin Cities area median price of some $230,000 will remain the same through early 2006.

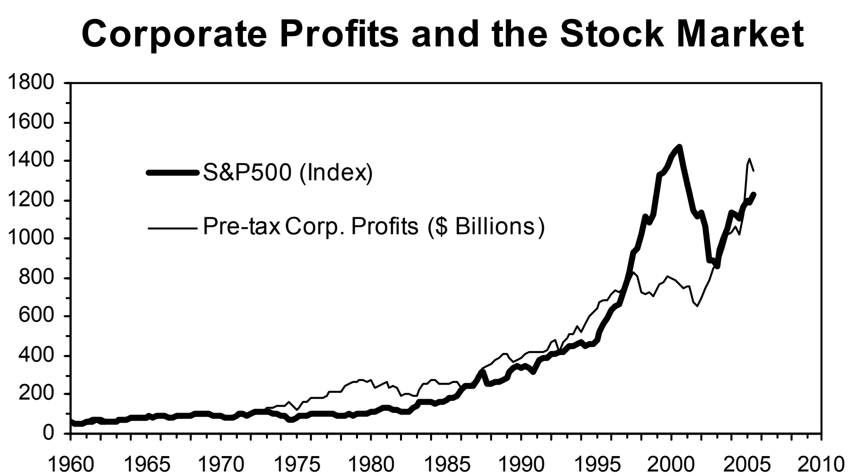
Commercial Real Estate Market Slowly Improving

Last summer's United Properties report indicates that the Twin Cities area industrial vacancy rate was 13 percent in 2005's first half, its lowest level since 2000 and down from 15.5 percent at the end of 2004. Real estate analysts believe that once the vacancy rate reaches 10 percent rental rates will begin rising. At that point, speculative construction should begin once again after a long hiatus. Normally, industrial construction begins first, followed in 12-18 months by offices. But, unlike the past, this rebound could be slowed by lack of much available land within the I-494/694 beltway. Land outside the beltway often lacks suitable infrastructure.

Selected National Economic Indicators







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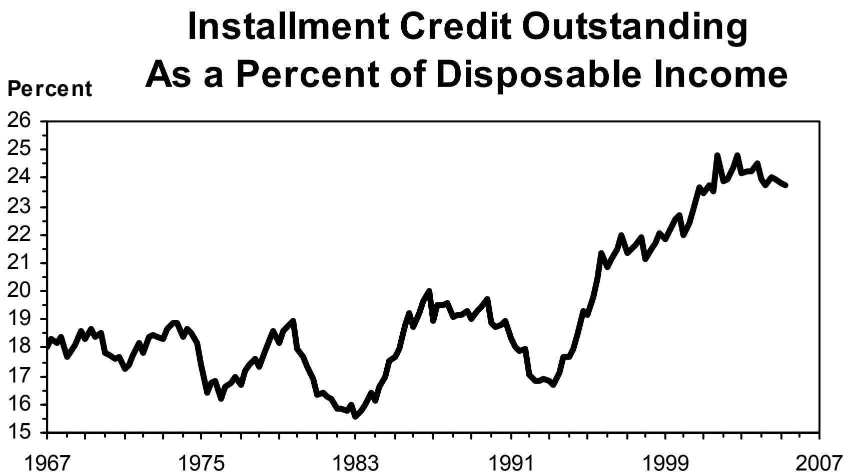

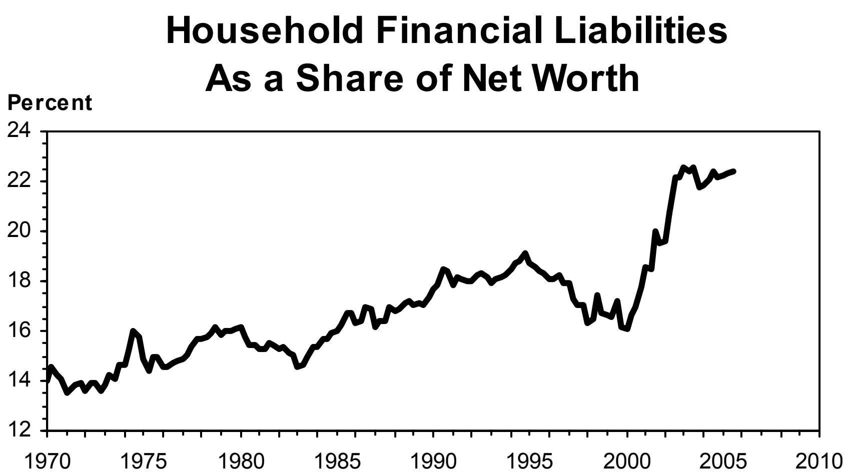

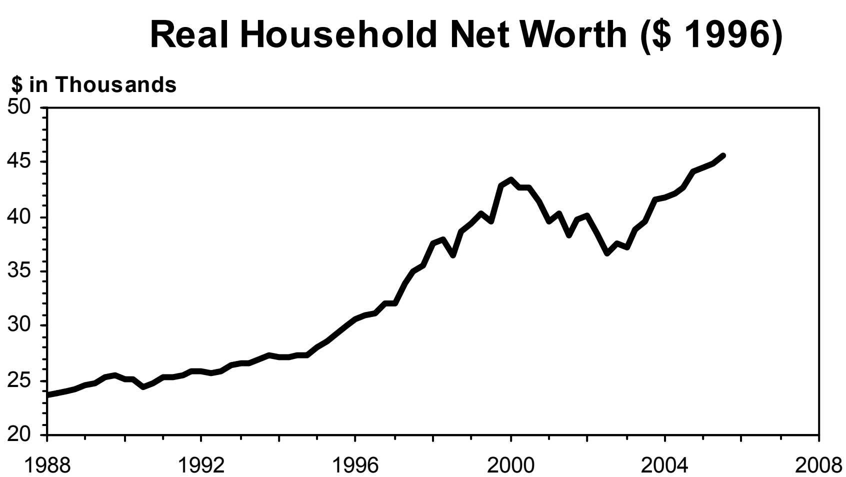

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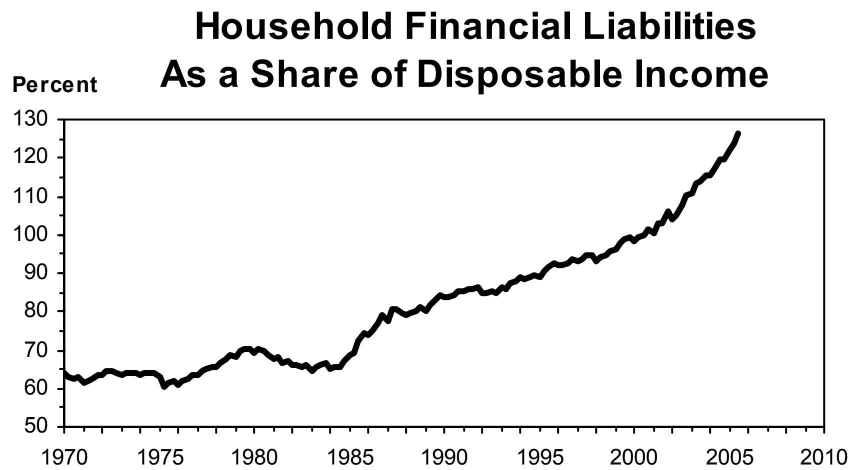

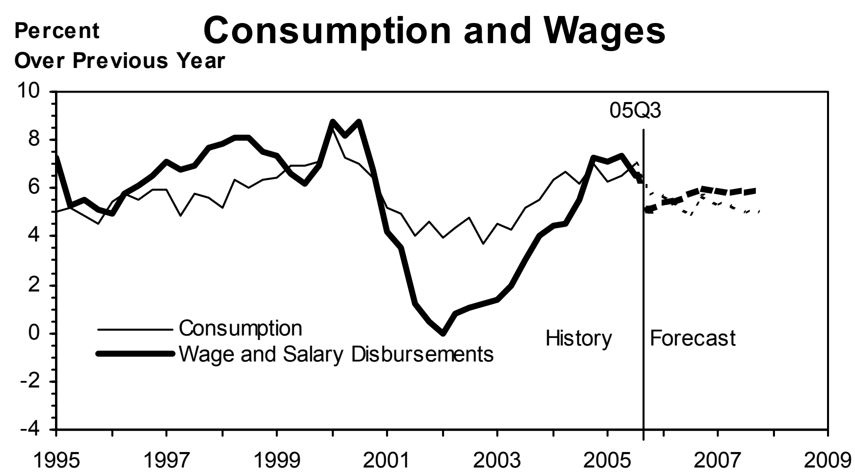

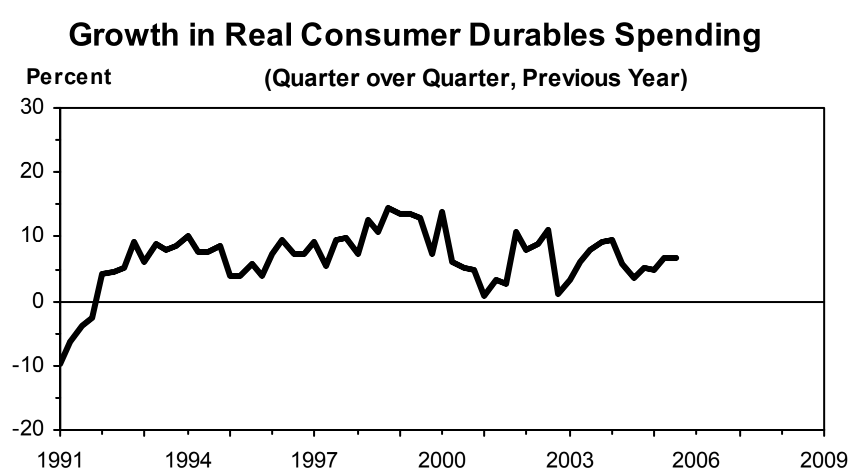

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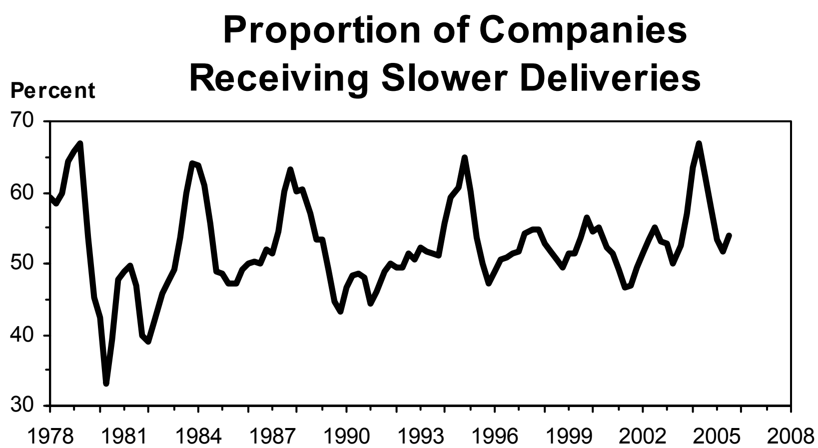

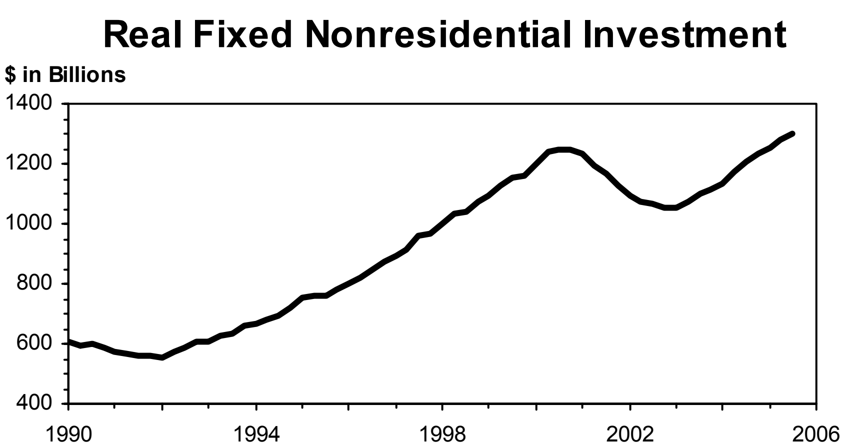

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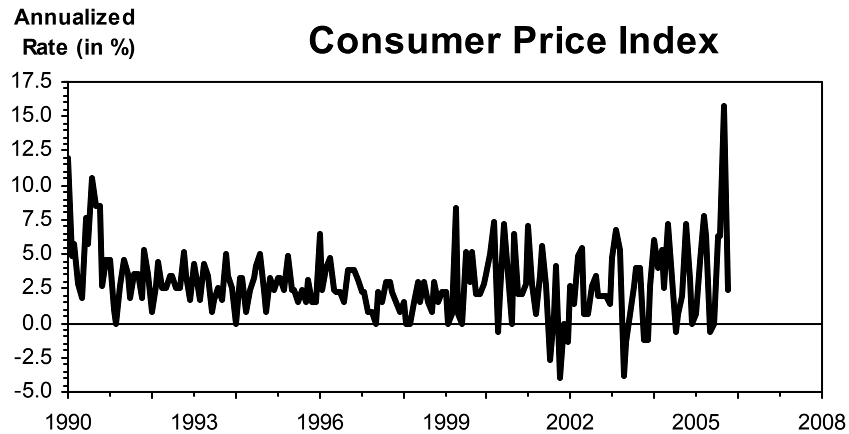

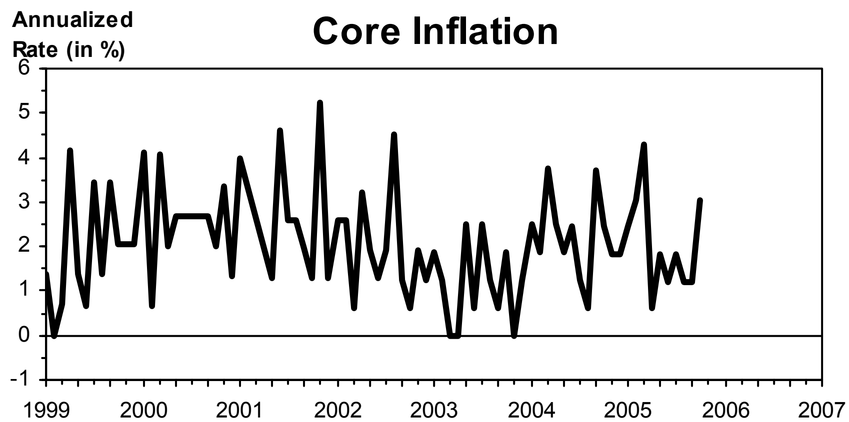

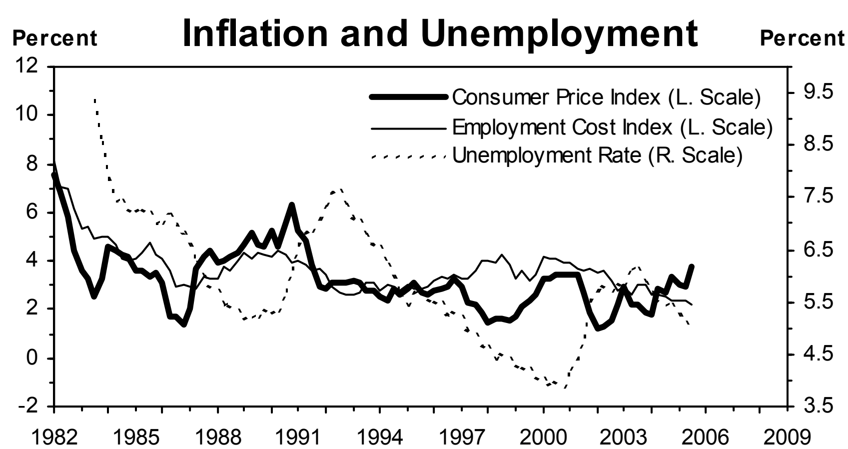

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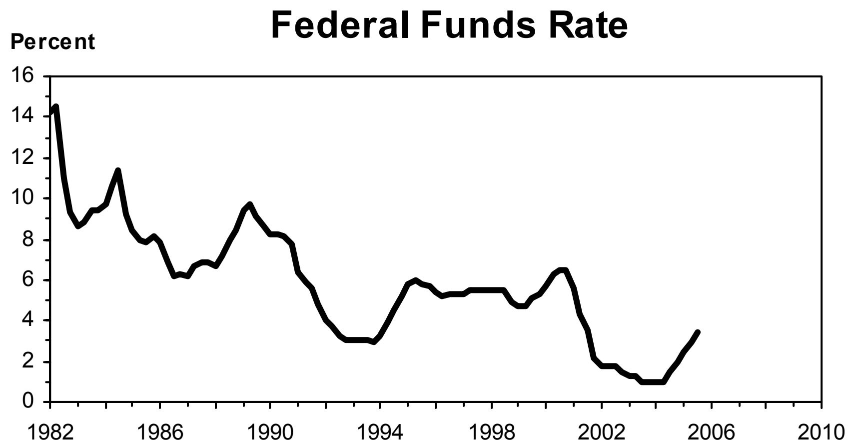
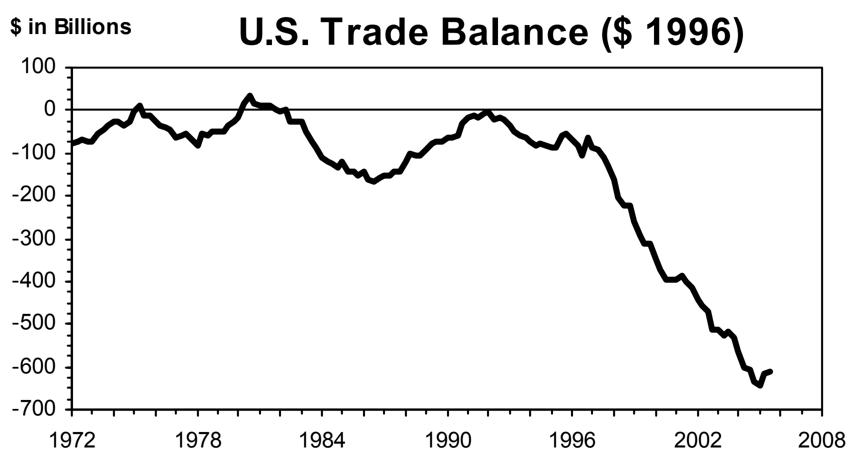




FY 2005 Year End Summary

FY 2005 Ended on a Positive Note, $337 Million Deposited to Tax Relief Account

In August 2005, the books were officially closed for the fiscal year ending June 30, 2005. FY 2005 ended with a general fund balance of $337 million. Under current law, this balance was transferred to the tax relief account. The budget reserve account balance is $653 million and the cash flow account is $350 million. The table below shows final FY 2005 activity compared to estimates made at the end of the 2005 legislative session.

FY 2005 Closing

($ in millions)

	End of Session	FY 2005 Close	Difference
Beginning Balance	**$1,268**	**$1,268**	**$0**
Non-Dedicated Revenue	13,952	14,250	298
Transfers, Other Resources	378	403	25
Total Resources	**15,598**	**15,921**	**323**
Expenditures	**14,595**	**14,528**	**(67)**
Balance Before Reserves	**1,003**	**1,393**	**390**
Cash Flow Account	350	350	0
Budget Reserve	653	653	0
Tax Relief Account	0	337	337
Appropriations Carried Forward	0	53	53
Budgetary Balance	**$0**	**$0**	**$0**

Final FY 2005 Revenues Up $323 Million

Total current general fund resources for fiscal 2005 totaled $14.653 billion, $323 million (2.2 percent), more than February's forecast. Net non-dedicated revenues were $298 million (2.1 percent) more than forecast. The remainder of the additional revenues came from larger than projected transfers from other funds, dedicated revenues and prior year adjustments. For the 2004-05 biennium current resources totaled $29.153 billion.

Receipts from the individual income tax in fiscal 2005 were $165 million more than forecast and corporate income tax receipts were $97 million more than projected in February. Almost all the additional income tax revenue came from higher than projected final payments for tax year 2004. Payments accompanying tax year 2004 returns, including payments accompany extensions, were $199 million more than anticipated.

That gain was partially offset by individual income tax refunds which were $35 million more than forecast. Withholding for fiscal 2005 was $14 million below February's estimate. As with the individual income tax much of the additional corporate tax revenue reflects economic activity in 2004. Corporate tax refunds in fiscal 2005 were $45 million less than projected and final payments accompanying 2004 tax returns were $18 million more than forecast. Gross sales tax receipts continued to track the forecast closely through the end of the fiscal year.

Other resources, including transfers from other funds, were $25 million greater than end of session estimates.

FY 2005 Spending Was $67 Million Below Forecast

FY 2005 expenditures were $67 million (0.5 percent) below end of session estimates. However, carry forward authority allowing agencies to carry unspent FY 2005 appropriations into the next fiscal year totaled $53 million. $31 million was carried forward under specific legal authorities that allow selective appropriation to carry forward beyond the end of the biennium. The balance, $22 million, was carried forward under special authority enacted in 2005 that allowed state agencies to carry forward unspent operating funds. Since these funds will now show as spending in FY 2006, the net effective change in spending was a decrease of only $14 million. There were no significant increases or decreases in major spending areas. Net of appropriations carried forward, K-12 education was $1.3 million below estimates, health and human services $3.6 million lower, and property tax aids and credits $6.3 million below prior estimates.

Reserves

The cash flow and budget reserve accounts did not change from end of session. Based on current law (Minnesota Statutes 16A.1522, Subd. 4), the $337 million available balance at the end of the fiscal year was deposited into the tax relief account. The tax relief account is treated as a general fund reserve and cannot be accessed without legislative action.

However, the amount in the tax relief account was reduced from $337 million in FY 2005 to $317 million in FY 2006. This decrease occurs as a result of a $20 million appropriation made from the tax relief account in anticipation of the additional year-end revenues. The appropriation was made in the 2005 session as part of the local government aid funding for FY 2006.

FY 2006-07 Budget Summary
FY 2008-09 Planning Estimates

Projected Balance of $701 Million Forecast for FY 2006-07

Forecast revenues for the current biennium have been increased by $661 million, while estimated transfers, dedicated revenues and other resources are $33 million above end-of-session projections. Forecast spending for the biennium increased $78 million. However, that includes $53 million of appropriations carried forward from FY 2005. The $12 million balance left at the end of the 2005 legislative session is now projected to be $701 million balance by June 30, 2007.

FY 2006-07 Budget (before allocation)

($ in millions)

	End of Session	November Forecast	Difference
Beginning Balance	**$1,003**	**$1,393**	**$390**
Revenues	29,683	30,344	661
Other Resources	903	936	33
Expenditures	30,574	30,652	78
Balance before Reserves	1,015	2,021	1,006
Reserves	1,003	1,320	317
Balance	**$12**	**$701**	**$689**

A $518 million increase in forecast receipts from the state's five major tax sources and a projected $92 million increase in the estate tax accounts for almost all of the $694 million improvement in Minnesota's revenue outlook. Increases in the individual income tax and sales tax were small, 1.4 percent and 1.9 percent respectively. The forecast for corporate tax receipts increased by nearly 11 percent from end-of-session estimates despite the impact of the Hutchinson Technology decision which the Department of Revenue has indicated will reduce net corporate income tax receipts by $232 million in the current biennium.

The increase in spending was small, $78 million, of which $53 million came from appropriations carried forward from FY 2005. The remaining, $25 million is from slightly higher spending in K-12 education and property tax aids and credits, offset by reductions in the forecast for human services programs and projected general fund debt service costs.

$701 Million Forecast Balance Used to Buy Down Remaining School Shifts

Under current law any forecast balance in the biennium must be used to continue to reverse education shifts enacted in 2002 and 2003 as part of the solution to state budget problems. A total of $268 million was directed to the buybacks in the November 2004 and February 2005 forecasts.

The current forecast balance of $701 million is allocated as follows:

$697 million to K-12 payments to return to a 90-10 payment schedule and begin partial buyback of the property tax recognition shift.

$4 million to property tax aid and credit programs paid to school districts to return to a 90-10 payment schedule.

Nearly all of these funds will be paid out to school districts before June 30, 2006 as existing payment schedules will be modified for the balance of the fiscal year 2006.

FY 2008-09 Planning Estimates Improve Slightly

Planning estimates for current law revenues and expenditures for FY 2008-09 are presented to help decision-makers identify longer-term impacts of current budget decisions. The November forecast updates the FY 2008-09 planning estimates from those prepared at the end of the 2005 legislative session.

FY 2008-09 Planning Estimates

($ in millions)

	End of Session	November Forecast	Difference
Beginning Balance	**$1,015**	**$1,320**	**$305**
Revenues	32,176	32,668	492
Other Resources	728	787	59
Current Law Spending	32,265	32,221	(45)
Balance Before Reserves	**1,654**	**2,554**	**900**
Reserves	1,003	1,320	317
Budgetary Balance	**$651**	**$1,234**	**$583**

Revenue planning estimates are now based on the Global Insight's November baseline forecast. Expenditure estimates assume that current laws and policies are updated for caseload, enrollment, and other forecast variables in major program areas.

About three-quarters of the gain in major revenues in FY 2006-07 carries forward to FY 2008-09, while net projected spending is slightly lower. The $45 million reduction in projected spending is largely accounted for by $61 million reduction in projected human services spending offset by minor increases in other areas.

Positive Projected Balances For FY 2008-09 Highlight Other Budget Planning Issues

Current law projections for the next biennium do not include any adjustment for inflation expected during the period. Inflation, based on the consumer price index forecast is expected to be 1.7 percent in FY 2008 and 2.2 percent in, FY 2009. If spending were uniformly adjusted for inflation, this would add about $911 million to the amounts shown, $271 million to FY 2008 spending and $640 million to FY 2009.

The current law forecast also does not include the potential effect of a constitutional amendment that will be on the 2006 ballot. The proposed amendment would phase-in complete dedication of the remaining general fund portion of motor vehicle sales taxes over six years beginning in FY 2008. If enacted, this would reduce projected general fund revenues by $185 million in the next biennium - $60 million in FY 2008, and $125 million in FY 2009.

FY 2008-09 Revenue-Expenditure Balance

($ in millions)

	End of Session		November Forecast	
	FY 2008	**FY 2009**	**FY 2008**	**FY 2009**
Revenues	$16,065	$16,840	$16,305	$17,151
Spending	15,962	16,304	15,972	16,249
Balance	**$103**	**$536**	**$333**	**$902**
Estimated Inflation	*(319)*	*(692)*	*(271)*	*(640)*
Const. Amendment	*(60)*	*(124)*	*(60)*	*(125)*
Balance (Deficit)	**$(276)**	**$(280)**	**$2**	**$137**

These planning estimates do not reflect potential Governor's recommendations or legislative actions in the 2006 legislative session that may affect the budget. Since the forecast is based on current law, any projected balances shown for FY 2008-09 assume that the tax relief account, budget reserve and cash flow accounts remain at current levels.

Revenue Forecast
FY 2006-07

Current general fund resources for the 2006-07 biennium are now expected to total $31.280 billion, up $694 million (2.3 percent) from February's forecast after adjusting for legislative action. Projected receipts from the five major taxes are $518 million above levels projected in February. Other tax and non-tax revenues including dedicated revenues and transfers and prior year adjustments are $176 million more than February's forecast.

Revenues FY 2006-07
($ in millions)

	FY2004-05	FY2006	FY2007	FY2006-07
Individual Income	$12,051	$6,685	$7,063	$13,747
Sales	8,340	4,473	4,643	9,116
Corporate	1,554	875	806	1,681
Motor Vehicle Sales	534	254	269	523
Statewide Levy	1,210	630	660	1,290
Five Major	23,689	12,917	13,441	26,357
Other Revenue	3,513	1,913	1,728	3,641
Tobacco	344	173	172	345
Net Non-dedicated	27,546	15,003	15,341	30,344
Other Resources	1,607	462	474	936
Current Resources	**$29,153**	**$15,465**	**$15,815**	**$31,280**

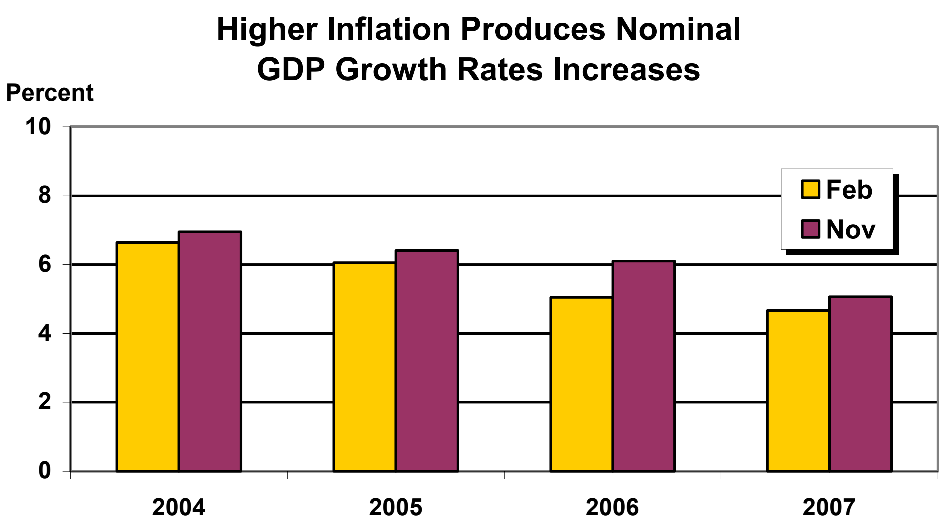
Projected receipts from the individual income tax, the corporate income tax, the sales tax, and the estate tax all grew by more than $100 million. The combined increase in receipts from those four taxes accounted for more than 90 percent of the additional revenue now forecast for the current biennium. The individual income tax and sales tax changes were small, increases of 1.4 percent and 1.9 percent respectively. Projected corporate income tax and estate tax receipts grew by more substantial percentages. The forecast for corporate tax receipts increased by nearly 11 percent, while projected estate tax receipts are now projected to be 60 percent above February's estimates due to receipt of a very large estate tax payment.

For the 2006-07 biennium total current resources are now projected to be $2.127 billion (7.3 percent) above state receipts in the 2004-05 biennium.

Changes in Economic Assumptions

The Global Insight baseline forecast has changed only slightly since February. Prior to Hurricanes Katrina, Rita, and Wilma economic output in the last half of calendar 2005 was expected to be well above the level forecast at the start of the year. The hurricanes have tempered the outlook slightly for the very short term. In early 2006, however, those reductions are more than offset by the economic stimulus expected once Gulf Coast reconstruction gets fully underway. The November baseline forecast calls for real (inflation adjusted) GDP growth rates of 3.4 percent in calendar 2006 and 3.1 percent in calendar 2007. On average those growth rates are slightly more optimistic than the 3.1 percent and 3.2 percent growth rates called for in Global Insight's February baseline.

When current dollar, or nominal GDP growth rates are examined, however, the differences in forecast are more substantial. Global Insight believes that the higher energy prices currently being observed will be partially incorporated in the prices of other products, and that will lead to a modestly larger, economy wide increase in prices. Nominal GDP growth rates of 6.1 per cent for 2006 and 5.1 percent for 2007 are now being projected, up significantly from the 5.1 percent and 4.7 percent growth rates used in the February forecast. The outlook for before tax corporate profits was also raised.



Individual Income Tax

Individual income tax receipts for the 2006-07 biennium are now forecast to total $13.747 billion, up $188 million (1.4 percent) from end-of-session estimates. FY 2006 collections through the month of October were very close to forecast. The income tax variance during the first four months of this fiscal year was $3.8 million, or less than 0.2 percent.

Fiscal 2005 closed with a positive variance of $165 million for the individual income tax. Payments accompanying tax year 2004 returns and payments with extensions were

$199 million more than projected in February. Those additional receipts were partially offset by payment of $35 million more in refunds. The combination of higher final payments and higher refunds leaves tax year 2004 individual income tax liability $164 million above the level projected in February. When 2004 base liability is adjusted to reflect current receipts, that adjustment to tax year 2004 liability explains almost all of the forecast increase in the individual income tax.

Tax year 2004 information is still not fully complete. Some extension returns remained to be processed at the time the forecast was prepared and a small number of filers with special extensions will submit their returns between mid-November and the end of calendar 2005. As in the past the additional liability from those returns was estimated and added to the base liability for the year. That estimate will be replaced in February's forecast with the actual tax year 2004 liability.

Currently information on the sources of the additional tax liability observed for tax year 2004 is limited. More detailed Minnesota specific information will be available in January after a sample of Minnesota tax returns becomes available. The results from that sample and final estimated liability for 2004 will be used to calibrate the House Income Tax Simulation (HITS) model for February's forecast.

For this forecast the HITS model was calibrated to produce an estimated 2004 liability consistent with the higher receipts already observed. Preliminary information from U.S. returns and conversations with other states indicated that capital gains receipts had grown much more rapidly than forecast. February's forecast called for tax year 2004 capital gains realizations to be 20 percent above 2003's levels, and grow by nearly 65 percent by tax year 2007. Now it appears that tax year 2004 capital gains realizations were about 50 percent greater than in tax year 2003. That substantial increase occurred even though capital loss carry forwards available to offset tax year 2004 gains were at record levels.

Assuming that capital gains realizations in tax year 2004 grew by 50 percent was not sufficient to bring projected tax year 2004 liability to levels consistent with current receipts. Additional, slight (1.0 percentage point), increases in the growth rates for wages, proprietors' incomes and pensions were also necessary to bring HITS model results to the level indicated by current receipts.

As in prior Novembers this forecast marks the first use of a version of the HITS model that uses a new sample and has been updated to include any income tax law changes. This year the new sample causes the model to under forecast tax year 2003 by $43 million. Model generated liabilities were increased by that amount as an off-model adjustment for tax years 2004 and beyond.

The wage growth rate for tax year 2005 was set to be consistent with withholding tax receipts received through October. That wage growth rate is less than historical growth rates and below the projected U.S. average for the current year. Employment in Minnesota has grown more slowly than the national average over the past 18 months, but that relative underperformance is not sufficient to fully explain the difference between

Minnesota wage growth rate and the national averages. Possible explanations for those differences include a change in the pattern of receipt of bonus and option income, a change in the long term relationship between wages as reported for federal statistical purposes and withholding payments, or possible downward revision in U.S. wages.

February's forecast assumed capital gains realizations in Minnesota would grow by 20 percent in tax year 2004, and then increase at an annual rate of 11 per cent in tax years 2005 through 2007. Preliminary reports now indicate that capital gains realizations increased by about 50 percent in 2004. When that preliminary data is used in the capital gains model along with current flow of funds data on household equity holdings slower growth rates for tax years 2005 through 2007 are projected. Capital gains are now forecast to increase at a 5 percent annual rate through 2007. If that growth rate holds true realizations in 2007 will be 75 percent greater than in 2003. They will still, however, be nearly 15 percent below the record level of gains recorded in tax year 2000.

Charitable deductions for tax year 2005 are estimated to have grown at an annual rate of 6.2 percent over the level observed for tax year 2003. Charitable giving for tsunami and hurricane related relief plus changes in tax law affecting 2005 giving may have produced an even larger increase in tax year 2005 contributions than is in this forecast. Fourth quarter estimated tax payments will be monitored for signs that charitable contributions grew faster than projected, or possible downward revision in U.S. wages.

Compliance activity is projected to produce $74 million in additional income tax receipts during the current biennium. The $31 million projected to be collected from voluntary compliance from filers who made use of "abusive" tax shelter is expected to be received during December, January and February, and those actual receipts will be included in February's forecast. The revenue gain from all other individual income tax compliance activity has been assumed to follow a straight-line path beginning at the start of calendar 2006.

Sales Tax

Net sales tax receipts for the 2006-07 biennium are projected to reach $9.116 billion, $173 million more than end-of-session estimates. Gross sales tax receipts were up $180 million while projected sales tax refunds increased by $7 million. Additional tax compliance revenue of $37 million is included in the gross revenue estimates. Net sales tax receipts, including compliance revenue, are now expected to be 9.3 percent greater than in the 2004-05 biennium. The positive variance of $31 million in net sales tax receipts through October is included in the new forecast for fiscal 2006.

Since sales tax receipts have been very close to forecast since February, and slightly stronger than forecast in the last quarter no adjustment was made to receipts elasticities used in February to convert growth in the sales tax base to growth in sales tax revenues. This forecast uses an elasticity of 0.85 for the current quarter, through the second quarter of 2006, 0.90 through the remainder of 2006, and .95 for 2007 and beyond. This forecast also adjusted the factors allocating national sales growth to Minnesota to reflect what appears to be a distortion in the projected growth rates in wages and personal income between Minnesota and the U.S. Growth rates applied to measures of Minnesota income used in the sales tax model to allocate sales to Minnesota were raised by 0.5 percentage points in 2005 and beyond to reduce any potential distortion that might occure.

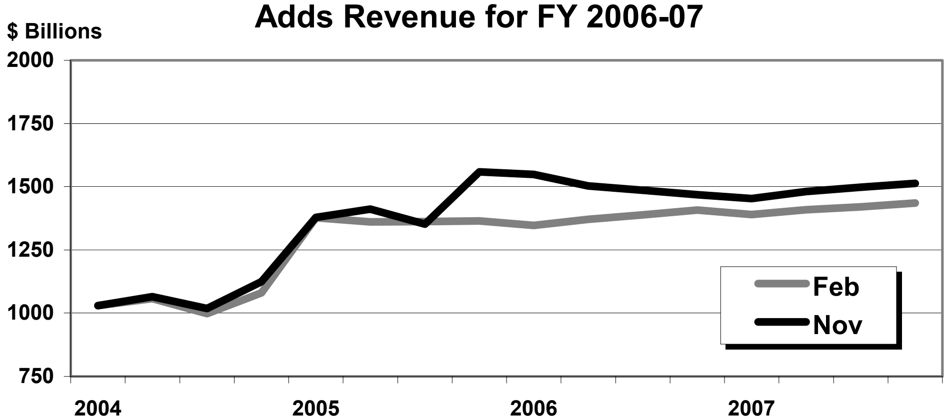
Projected sales tax losses to e-commerce and catalog sales were assumed to grow at an annual rate of 13 percent.

Corporate Franchise Tax

Corporate tax revenues for the 2006-07 tax year are forecast to total $1.681 billion, $165 million (10.9 percent) more than end-of-session estimates. The current forecast includes the Department of Revenue's projections of the revenue loss associated with the Hutchinson Technology decision. Those projections indicate that Hutchinson related refunds in the 2006-07 biennium will be $102 million and that the Hutchinson decision will allow firms to reduce settle-up payments by $130 million.

Through October fiscal year 2006 corporate tax receipts were $99 million (43 percent) above levels forecast in February. That positive variance has been included in this forecast. Global Insight's corporate profits outlook also has improved dramatically since February. In fiscal 2006 corporate profits are now expected to be 21 percent above the levels called for in the February baseline. Much of that surge in the corporate profits forecast came following Hurricane's Katrina and Rita. Corporate profits estimates in the national income accounts are frequently subject to major revisions.

Large Increase in Corporate Profits Forecast Adds Revenue for FY 2006-07

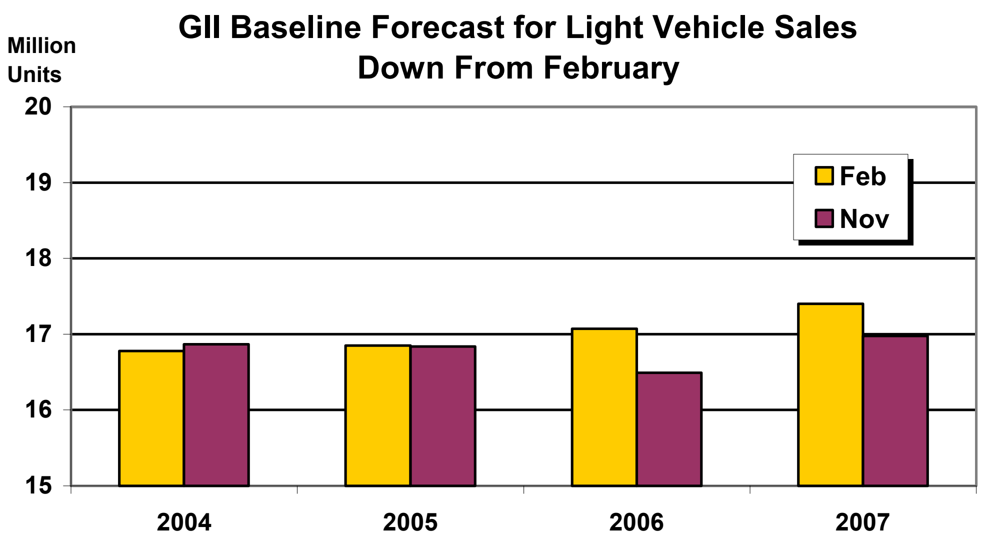


Additional corporate compliance revenue totaling $36 million is included in this forecast. The $26 million expected to be recovered from corporations who made use of abusive tax shelters is projected to be received in December and January, and the actual amount received will be included in February's forecast. The remaining increase in compliance revenue has been spread evenly through the last 18 months of the biennium.

Receipts from Minnesota's corporate franchise tax have been extremely volatile through the years. The large court decision and major compliance initiatives added to the sizeable increase in the corporate profits forecast further increases the margin of error on this component of the state's revenue forecast.

Motor Vehicle Sales Tax

Minnesota's sales tax on motor vehicles is now projected to yield $523 million, $7 million (1.5 percent), less than end-of-session estimates. Global Insight's forecast for growth in motor vehicle sales in 2006 and 2007 has been reduced by about 500 thousand units for both 2006 and 2007, reflecting in part sales taken from the future by the industry's summer 2005 incentive program. Through October motor vehicle sales tax collections were $2 million (2.2 percent) above February's forecast for fiscal 2006, and those revenues were incorporated into the forecast.



Other

Other tax and non-tax revenues including the statewide property tax levy are expected to total $5.277 billion, up $142 million from February's estimate. A large estate tax payment accounted for much of that variance. Through October fiscal 2006 estate tax receipts totaled $150 million, $122 million more than at a comparable time last year and $77 million more than was collected during the entire 2005 fiscal year. Changes to the forecast for the deed and mortgage taxes added $39 million to the biennial forecast. Changes to other revenue sources were generally small and offsetting.

Revenue Planning Estimates
FY 2008-09

The November 2005 revenue planning estimates for the 2008-09 biennium show general fund current resources totaling $33.456 billion, an increase of $2.176 billion (6.9 percent), over the forecast for 2006-07 biennial revenues. Net non-dedicated revenues reach $32.668 billion, $2.324 billion more than is forecast for 2006-07. Receipts from the five major taxes grow by 9.4 percent from the level forecast for the 2006-07 biennium. Projected individual income tax receipts are up 13.3 percent, projected sales taxes by 5.7 percent. November's revenue planning estimates for fiscal 2008-09 current resources exceed February's projections by $551 million or 1.7 percent. As in the FY 2006-07 forecast the individual income tax, the corporate franchise tax, and the sales tax were the sources of almost all additional revenue.

Revenues FY 2008-09
($ in millions)

	FY2006-07	FY2008	FY2009	FY2008-09
Individual Income	$13,747	$7,484	$8,025	$15,509
Sales	9,116	4,769	4,974	9,744
Corporate	1,681	785	836	1,621
Motor Vehicle Sales	523	279	289	568
Statewide Property Tax	1,296	685	705	1,390
Five Major Taxes	26,357	14,002	14,830	28,832
Other Revenue	3,641	1,739	1,761	3,500
Tobacco Settlement	345	169	167	336
Net Non-dedicated	30,344	15,910	16,758	32,668
Other Resources	936	395	392	787
Current Resources	**$31,280**	**$16,305**	**$17,151**	**$33,456**

No one can forecast the path of the economy five years into the future. The baseline revenue planning estimates presented above 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 means that any change in the base level of revenues for fiscal 2007 will change 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 nineteen months, or should some item of portfolio income such as capital gains fall well below forecast 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 projections of items such as capital gains realizations are accurate, these planning estimates are likely to slightly understate actual receipts.

But, the GII baseline forecast includes strong growth with no recession over the entire four year forecast horizon, and that scenario could be overly optimistic. 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. 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 4 years.

Since November 2002 the Finance Department has based its revenue planning estimates on the Global Insight's baseline forecast. The revenue planning estimates for fiscal 2008 and 2009 were prepared consistent with the GII baseline forecast for calendar 2008 and 2009. GII's projected real GDP growth rates of 3.4 percent for 2008 and 3.1 percent for 2009 and nominal GDP growth of 5.6 percent and 5.5 percent respectively are consistent with those of the Blue Chip Consensus. GII's real GDP growth rate is also consistent with that used by the CBO in its August budget update. CBO's nominal GDP growth rate is slightly less than GII's at 5.1 percent for both 2008 and 2009.

GII expects the CPI to increase at an annual rate of 2.0 percent in calendar 2008 and 2.2 percent in calendar 2009. Those rates are lower than the Blue Chip rate of 2.5 percent for those years. CBO projections assume CPI growth to average 2.2 percent in 2008 and 2009. When viewed on a fiscal year basis Global Insight is now projecting CPI growth of 1.7 percent in fiscal 2008 and 2.2 percent in fiscal 2009 and price increases at those rates are implicitly included in the revenue planning estimates for the 2008-09 biennium.

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.

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. Those receipts were then reduced by amounts consistent with the Department of Revenues estimates of the corporate tax revenue that will be lost due to the Hutchinson decision. 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 non-tax revenues were prepared by extrapolating existing trends.

Expenditure Forecast
FY 2006-2009

Actual, Forecast and Projected Spending, FY 2004-2009

Actual spending for the biennium that ended June 30, 2005 totaled $28.128 billion. The forecast for the current biennium now totals $31.353 billion, a $779 million increase from end-of-session estimates. Accounting for most of the increase is $701 million allocated for school shift buybacks, as well as $53 million of authorized appropriations carried forward from FY 2005. Projected spending for FY 2008-09 is expected to reach $32.221 billion, excluding the impact of estimated inflation, largely unchanged from prior projections.

Actual & Estimated Spending
($ in millions)

	Biennial Budget Period				
	2004-05	**2006-07**	**Change**	**2008-09**	**Change**
K-12 Education	$12,037	$12,596	$559	$12,808	$212
School Shift Buyback	--------	697	nm	58	nm
Property Tax Aids & Credits	2,800	3,043	243	3,131	88
Higher Education	2,490	2,761	271	2,791	30
Health & Human Svcs.	7,250	8,216	966	9,261	1,045
Envir., Ag, & Econ. Dev.	728	691	(37)	673	(18)
Transportation	157	208	51	221	13
Public Safety	1,445	1,688	243	1,713	25
State Government	562	603	41	587	(15)
Debt Service	589	776	187	907	131
Other	11	0	(11)	0	0
Est. Cancellations	0	(23)	(23)	(20)	3
Subtotal	28,069	31,257	3,188	32,131	874
Dedicated Expenditures	59	96	37	89	(6)
Total	**$28,128**	**$31,353**	**$3,225**	**$32,221**	**$868**

FY 2006-07 spending of $31.353 billion represents a $3.225 billion (11.4 percent) increase over the last biennium. The increases shown for major areas largely reflect budget increases approved in the 2005 legislative sessions. Spending estimates for FY 2006-07 and FY 2008-09 were not materially changed in the current forecast.

Projected spending for FY 2008-09 now totals total $32.221 billion, $868 million over FY 2006-07 levels. The planning estimates do not include the cost of general inflationary increases.

The 2.8 percent biennial change in FY 2008-09 spending is driven by the two largest areas of the budget, K-12 education and health and human services. Spending for K-12 education will decrease from FY 2006-07 to 2008-09 due to $697 million in one-time spending in FY 2006 for the school shift buybacks. Without this, education aids would grow $212 million (1.7 percent). Although pupil units continue to decline, the two-year cost of the FY 2007 formula increase drives the growth between biennia. Health and human services continues to show the highest growth of any spending area, accounting for over $1 billion (12.7 percent) growth from FY 2006-07 to FY 2008-09. Projected current law increases are expected to continue to be determined by moderate enrollment pressures, cost and utilization increases, and changing demographics in human services programs.

Forecast Changes: FY 2006-07 Spending Up $78 Million, $779 Million After Shift Buybacks

Forecast expenditures for FY 2006-07 show little net change from end-of-session estimates. Spending increased $78 million, or 0.3 percent. This net increase, however, included $53 million that represents authorized spending moved forward to FY 2006 when the books were closed for FY 2005 in August.

Forecast Change in FY 2006-07 Spending

($ in millions)

	End of Session FY 2006-07	November FY 2006-07	Forecast Change
K-12 Education	$12,578	$12,596	$18
School Shift Buyback	---	697	697
Property Tax Aids & Credits	2,984	3,043	59
Higher Education	2,761	2,761	0
Health & Human Svcs.	8,264	8,216	(48)
Envir., Ag, & Econ. Dev.	680	691	11
Transportation	205	208	3
Public Safety	1,685	1,688	3
State Government	584	603	19
Debt Service	781	776	(5)
Estimated Cancellations	(23)	(23)	0
Subtotal	30,500	31,257	757
Dedicated Expenditures	74	96	22
Total	**$30,574**	**$31,353**	**$779**

Three areas accounted for most of the change in forecast spending. K-12 education estimates increased $18 million, human services spending decreased $48 million, and property tax aids and credits increased $55 million when comparing end-of-session estimates to this forecast.

Underlying expenditure changes are augmented by the statutory allocation of the general fund forecast balance. This added $701 million to total spending, all of which is used to further reduce education accounting shifts enacted in 2002 and 2003. The amount of the education shift buyback is reflected in two areas: K-12 education payments were increased $697 million, while payments to school districts under the property tax aid and credit programs increase $4 million.

Change in FY 2008-09 Projected Spending is Minimal

Compared to end-of-session estimates, projected spending for FY 2008-09 shows little change. Projected spending has decreased a total of $45 million, 0.1 percent, from earlier estimates. Savings from lower pupil units in K-12 Education in FY 2006-07 continue through the planning estimates, as do modest forecast savings for health and human services.

Forecast Changes: FY 2008-09 Expenditure Projections

($ in millions)

	End of Session FY 2008-09	November FY 2008-09	Forecast Difference
K-12 Education	$12,863	$12,808	$(55)
School Shift Buyback	----	58	58
Property Tax Aids & Credits	3,123	3,131	7
Higher Education	2,791	2,791	0
Health & Human Svcs.	9,322	9,261	(61)
Envir., Ag, & Econ. Dev.	672	673	1
Transportation	221	221	0
Public Safety	1,722	1,713	(9)
State Government	586	587	1
Debt Service	909	907	(2)
Estimated Cancellations	(20)	(20)	0
Subtotal	32,191	32,131	(60)
Dedicated Expenditures	74	89	15
Total	**$32,265**	**$32,220**	**$(45)**

Similar to the major spending areas, little change in outlook is expected for other drivers of spending in the planning estimates. Continued growth in projected spending for public safety moderates slightly as estimates of future prison populations are slightly reduced.

Hurricane Katrina Effects on Forecasted Expenditures

State and local agencies, numerous non-profit organizations and others pitched in to help when Minnesota was asked to prepare to accept up to 5,000 Hurricane Katrina survivors within a matter of days. Although the actual number of survivors who have relocated to the state is far fewer, agencies have incurred costs in preparing for and serving those persons. Limited reimbursement of some costs may be available through FEMA and other federal programs, but details of those arrangements have yet to be worked out in Washington. Education and human services expenditure forecasts include the impact of Katrina survivors in those programs.

Like many other states, schools in Minnesota received K-12 students displaced by Hurricane Katrina. A survey of school districts by the Minnesota Department of Education indicated that 273 Katrina students (as measured by Average Daily Membership) are enrolled in Minnesota schools this year. The Department expects enrollment will decline to 143 students in FY 2007 and beyond as some families choose to return to affected areas. The November 2005 Education Finance forecast was adjusted to account for this change in enrollment. Most of the financial cost associated with these students will occur in Basic Education aid where Katrina-related increases are estimated to be $2.3 million in FY 2006-07 and $1.6 million in FY 2008-09. Compensatory aid is also projected to increase by approximately $800,000 in each biennium. Since detailed information about these students in not available, it is difficult to estimate the full impact of their arrival.

The Health and Human Services forecast includes estimates of Hurricane Katrina survivors in Medical Assistance (MA), General Assistance Medical Care (GAMC), General Assistance (GA) and the Minnesota Family Investment Program (MFIP). Estimates are based on experience to date and assume that additional survivors will participate in these health care and cash assistance programs over the coming months. The forecast includes approximately 750 Medical Assistance enrollees; 300 GAMC enrollees; 200 GA enrollees and 300 MFIP participants during the FY 2006-07 biennium, with a smaller number continuing in each of these programs during the FY 2008-09 biennium. Based on average monthly cost projections, this adds roughly $12.3 million to the forecast in FY 2006-07 and roughly $5 million in FY 2008-09.

K-12 Education Forecast Up $715 Million for FY 2006-07, Reflects Shift Buybacks

Education Finance, the largest category of state general fund spending, consists of aid programs for K-12 education, special education, early childhood and family education, charter schools, nonpublic pupil programs, and desegregation programs.

K-12 aids can be divided into two major funding streams: 1) general education, the primary source of basic operating funds for schools, and 2) categorical aid tied to specific activities or categories of funding.

For the current biennium, Education Finance spending is estimated to be $13.293 billion, a $714.8 million increase from end-of-session estimates. This forecast includes $701 million to buy back education accounting shifts as required by M.S. 16A.152. An increase of $696.8 million will be paid out through K-12 education aids. The remaining $4 million will be paid out as education-related property tax aids and credits. Of the $701 million allocated for this purpose, $370.4 million completes the buyback of the School Aid Payment Shift and $330.7 million reverses nearly three-quarters of the Property Tax Recognition Shift. The aid payment percentage is now 90 percent in the current year and 10 percent in the following year. The property tax recognition percentage decreases from 48.6 percent to 10.8 percent.

Over 80 percent of K-12 aid ($11.2 billion in FY 2006-07) is distributed to schools through the General Education program, and most of the forecast change is also in this program. While there are several factors that account for this change, the most significant is pupil estimates. Although pupil counts are projected to decrease on an annual basis, the rate of decline is occurring at a more modest pace than was anticipated at the end-of-session. Public enrollment as measured by Average Daily Membership (ADM) is now projected to fall from 825,941 in FY 2006 to 820,080 in FY 2009.

Reporting of actual student data by school districts is the primary driver of ADM changes since the end-of-session. Other factors contributing to the change include recent information on increases in children born in Minnesota, expansion of online learning options and a modest number of Hurricane Katrina students.

General Education

Spending for General Education in FY 2006-07 is now estimated to increase by $674.2 million when compared to earlier estimates. This represents an overall change of 6.4 percent. Of this amount, $647.5 million is related to shift buy backs and the balance is the result of forecast adjustments to General Education appropriations. Basic Education is up $11.1 million (0.1 percent) due to higher pupil counts. Extended Time, which is used by school districts to offer extended day, week or year programs, is now projected to be $10.3 million (12.6 percent) higher than earlier estimates. Compensatory and Limited English Proficiency (LEP) remain virtually unchanged since end-of session. Compensatory is down $2 million (0.4 percent) and LEP is down $915,000 (2.8 percent).

Interest in the state's new alternative teacher compensation program, QComp, has been strong. Unlike most other components of General Education, basic QComp has a capped appropriation. Therefore, only downward forecast adjustments of the basic component are possible. In FY 2006-07, QComp is down $2 million (2.4 percent), primarily due to the short application period for school districts to sign up in FY 2006.

Although 73.8 percent of new operating referendums proposed to voters were approved in the November 2005 election, fewer school districts sought an operating referendum this year than was anticipated at the end-of-session. This results in levies being $37.9 million (4.1 percent) lower than earlier estimates. However, since the mix of districts qualifying for equalization changed, Referendum Equalization aid is up $2.4 million (1.2 percent) in FY 2006-07.

Investment earnings from the Permanent School Fund are projected to be up $5.7 million (15.2 percent) in FY 2006-07 as dividends and interest rates rise. This increase provides a direct offset to the state's General Fund obligation for Education Finance.

Categorical Aids

Spending for Categorical Aids in FY 2006-07 is now estimated to increase by $39.5 million when compared to earlier estimates. This represents an overall change of 2.0 percent. Net forecast adjustments for Categorical Aids are down $9.8 million for the biennium. This decrease in appropriations is offset by $49.3 million in shift buy backs. The majority of Categorical Aids show only minor forecast changes from end-of-session estimates. A few programs show more significant changes, including Charter School Lease Aid, Charter School Startup Aid, School Lunch, and Debt Service Equalization. Overall, charter school enrollment is continuing to grow. However, the delay in some charter school openings coupled with fewer than anticipated charter school applications being approved has resulted in a $4.6 million (8.2 percent) downward adjustment for Charter School Lease Aid, and a $1.1 million (24.0 percent) decrease in Charter School Startup Aid from end-of-session. School Lunch is up $1.6 million (8.9 percent) from end-of-session due to higher projected participation. The continued growth in districts' adjusted net tax capacity along with fewer than anticipated bond referenda drive Debt Service Equalization down $5 million (10 percent) from end-of-session.

FY 2008-09 Education Finance Appropriations Up $3.3 Million

Education Finance spending in the next biennium is now expected to be $12.9 billion, an increase of $3.3 million from end-of session projections. Buy backs of the School Aid Payment Shift and Property Tax Recognition Shift total $58.2 million in FY 2008-09, which is partially offset by a $54.9 million downward adjustment in the forecast. The vast majority of this forecast change is due to the fact that end-of-session General Education estimates were slightly overstated because they were based on an extrapolation of aggregate statewide information. The November 2005 forecast uses detailed district-by-district data, which provides a more accurate estimate of future spending.

General Education

General Education appropriations are projected to increase by $18.9 million from earlier estimates. This represents an overall change of 0.2 percent. Shift buy backs total $57.7 million in FY 2008-09, which is offset by downward forecast adjustments of $38.9 million. Forecast increases of $19.1 million (0.2 percent) in Basic Education, $12.9 million (16 percent) in Extended Time, and $5 million (3.4 percent) in Referendum Equalization are partially offset by changes in other areas. Compensatory is down $3.4 million (0.7 percent), LEP is down $995,000 (1.9 percent), QComp is down $346,000 (0.3 percent), and Permanent School Fund investment earnings are up $6.8 million (17.5 percent). The balance of the change in General Education is primarily due to differences between the appropriations established at end-of-session using estimated statewide totals versus those established using more accurate district level calculations of aid and levies.

Categorical Aids

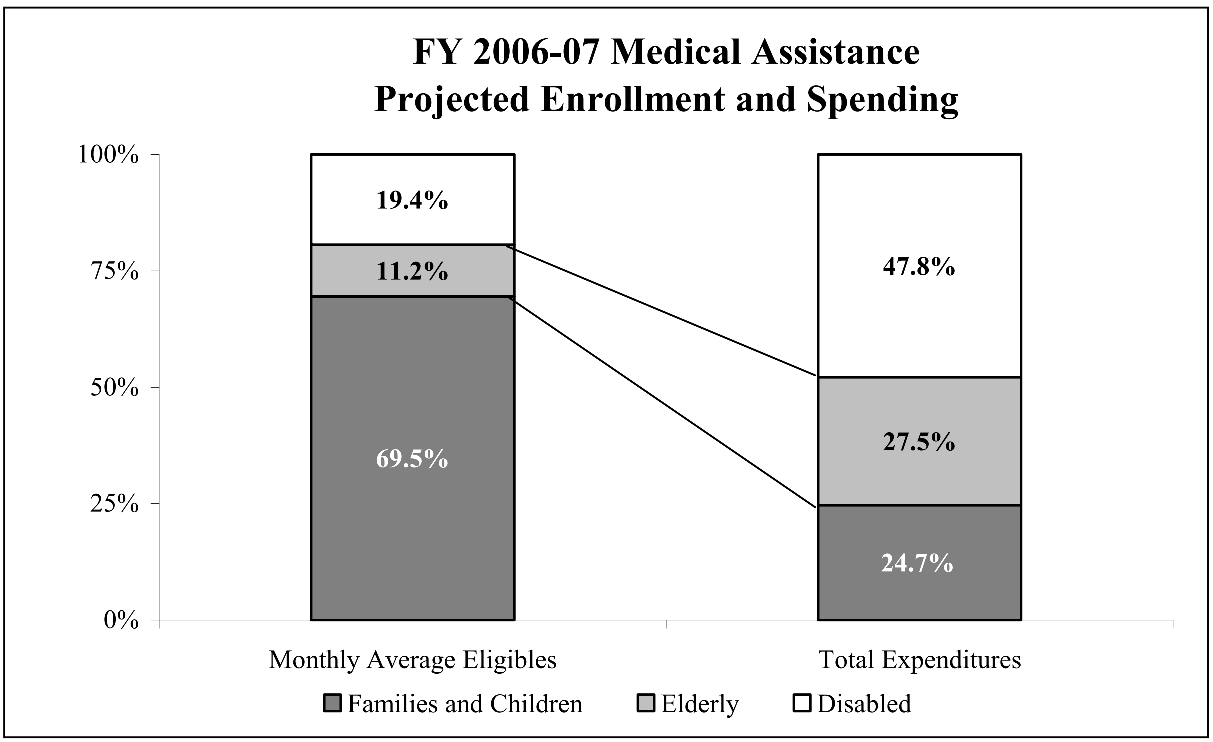
Categorical Aids are estimated to decrease by $15.6 million in FY 2008-09 when compared to earlier estimates. This represents an overall change of 0.9 percent. Forecast adjustments for Categorical Aids are down $16.0 million for the biennium. This decrease in appropriations is partially offset by $400,000 in shift buy backs. The forecast changes from end-of-session in categorical programs for FY 2008-09 are much the same as the changes for FY 2006-07. Most programs show only minor changes with a few programs showing more significant changes. Charter School Lease Aid, Charter School Start-Up Aid, and Debt Service Equalization continue the trend of lower projections compared to previous estimates. Charter School Lease Aid is down $13.1 million (16.3 percent) and Charter School Startup Aid is down $3.7 million (53.3 percent) from end-of-session. Debt Service Equalization is $6.4 million (14.3 percent) lower than end-of-session estimates. School Lunch is estimated to increase $1.7 million (9.2 percent) from end-of-session due to higher than anticipated participation. State aid for Integration Revenue is up $4.9 million (4.4 percent) from end-of-session due to increasing enrollment in integration program districts, and the addition of some new integration districts.

Medical Assistance Program Trends and Projections: 2002-2009

Medical Assistance provides basic health and long-term care to low-income families, senior citizens and people with disabilities. In 2006-07, Minnesota will spend an estimated $11.0 billion on this program (including county, state and federal funds) to purchase care for approximately 354,000 low-income parents and children, 57,000 elderly and 97,000 people with disabilities. Minnesota receives a fifty percent federal match on most MA expenditures. Medical Assistance faces significant fiscal challenges in the coming years, due to rising health care costs, reductions in employer-provided health insurance, demographic trends and likely reductions in federal funding.

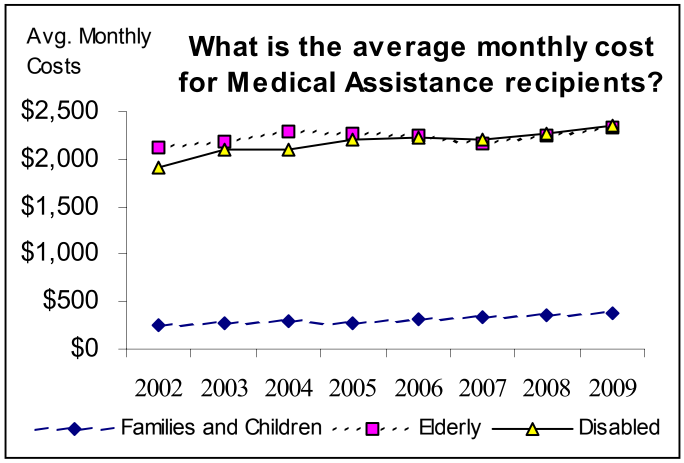
Most Medical Assistance enrollees are low-income parents and children; however, most MA spending pays for services for the elderly and disabled. In FY 2006-07, low-income parents and children will compose roughly 70 percent of the MA population, but account for only 25 percent of MA spending. Alternatively, elderly and disabled beneficiaries will represent 30 percent of MA enrollment, but account for 75 percent of program spending. Minnesota's enrollment and spending trends are similar to those of virtually all other states.

Enrollment of parents and children is sensitive to labor market conditions, such as rates of unemployment and the prevalence of employer-provided health insurance coverage. Elderly and disabled enrollment, however, will continue to increase regardless of economic circumstances as baby boomers age and people live longer. Medical Assistance faces a future in which its most expensive participants are likely to grow as a share of enrollment.



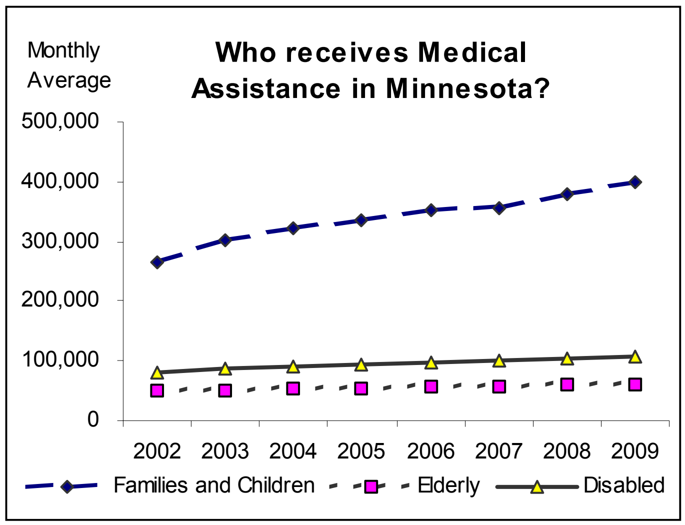
Low Income Families:

Minnesota will spend an estimated $2.6 billion on MA for families and children in FY 2006-07. Expenditures for this population are expected to grow at an average annual rate of 11.5 percent from FY 2006 to FY 2009. Both average cost growth and enrollment growth will contribute significantly to this spending increase.



Elderly:

Total expenditures are expected to exceed $3.0 billion in the current biennium and, on average, increase 4.4 percent annually over the next four years. Sixty percent of elderly recipients will receive long-term care services in addition to basic care services, comprising approximately 65 percent of total expenditures. Average annual enrollment growth of three percent is primarily contributing to the increase. While the elderly's average cost is significantly higher than for the families and children population, the average annual change is a modest 1.3 percent.



Individuals with Disabilities:

The disabled population alone accounts for almost half of all Medical Assistance spending. For FY 2006-07, total expenditures are expected to be $5.3 billion. Over the current and subsequent biennia, total expenditures are projected to increase an average of 5.9 percent per year. Similar to the elderly population, the increase is primarily due to enrollment, which is estimated to increase 4.0 percent annually from FY 2006 to FY 2009. The average monthly cost of $2,219 in FY2006-07 is expected to increase at an average annual rate of 1.8 percent.

AVERAGE ANNUAL CHANGE 2006-2009

	Families and Children	Elderly	Disabled
Enrollment	4.5%	3.0%	4.0%
Average Cost	6.7%	1.3%	1.8%
Total Cost	11.5%	4.4%	5.9%

Health and Human Services Spending $48 Million Lower in FY 2006-07, $61 Million Lower in FY 08-09

Total Health and Human Services spending is projected to total $8.2 billion in FY 2006-07 and $9.3 billion in FY 2008-09. This is a reduction of $48.4 million (0.6 percent) in the current biennium and $61.1 million (0.7 percent) in the subsequent biennium from end-of-session estimates. Two factors explain a significant amount of the lower estimates: reductions in Medical Assistance (MA) Families and Children Basic Care average cost and MA Long-Term Care Waiver caseloads. Higher projections of General Assistance Medical Care enrollment partially offset the overall reductions in both biennia.

Basic Health Care

Basic Health Care pays for acute health care services such as physician visits, prescription drugs and hospitalizations that are covered under MA Elderly and Disabled Basic Care, MA Families and Children Basic Care, and General Assistance Medical Care. Basic Health Care expenditures are projected to reach $3.5 billion in FY 2006-07 and $4.1 billion in FY 2008-09, down 0.5 percent and up 0.8 percent respectively from end-of-session estimates.

MA Elderly and Disabled Basic Care expenditure projections are essentially unchanged in FY 2006-07 and up $67.7 million (3.3 percent) in FY 2008-09 compared with end-of-session estimates. Elderly and disabled caseload growth projections are modestly lower. These changes are offset by higher costs for the disabled population, attributable mostly to higher utilization of community-based mental health services. Average costs are slightly higher for Elderly Basic Care as well.

The Elderly and Disabled Basic Care forecast also includes several key new assumptions related to Medicare's new prescription drug benefit: first, it reduces the number of monthly "clawback" payments to the federal government in FY 2006; second, it increases the amount of each monthly clawback payments based on new information about state costs; and third, it assumes greater savings in other pharmacy costs the state will still incur when the Medicare drug benefit is implemented. The forecast still assumes that, on net, the state will experience small gains, especially in the short term, because of this new benefit.

Families and Children Basic Care expenditures are down $64.1 million (4.9 percent) in FY 2006-07 and down $81.8 million (4.8 percent) in FY 2008-09, due to significant decreases in forecast average payments. Projected enrollment growth for this population is also slightly lower than previous estimates.

General Assistance Medical Care (GAMC) expenditures are up $49.9 million (9.7 percent) in FY 2006-07 and $46.4 million (12.3 percent) in FY 2008-09. This is primarily due to higher enrollment projections compared with end-of-session estimates. A technical correction related to the shift of GAMC enrollees to MinnesotaCare also accounts for some of the FY 2006-07 increase. Finally, average monthly cost projections are higher compared to earlier estimates.

Continuing Care Grants

Continuing Care Grants provides long-term care services for individuals with chronic health needs in institutions, such as nursing facilities and intermediate care facilities, and in-home and community-based settings. Two activities within the Continuing Care Grants comprise the vast majority of spending within the program: MA Long-Term Care Waivers and MA Long-Term Care Facilities. Overall, Continuing Care Grants expenditures are expected to be $3.1 billion for the FY 2006-07 biennium, down $40.9 million (1.3 percent) from end-of-session estimates.

MA Long-Term Care Waiver expenditures are down $27.7 million (1.6 percent) in FY 2006-07, primarily due to lower than expected caseloads in three waiver programs: Elderly Waiver (EW), Community Alternative for Disabled Individuals (CADI), and Traumatic Brain Injury (TBI). These reductions are partially offset by higher recipient average cost within the Developmentally Disabled (DD) waiver.

Projected spending in MA Long-Term Facilities is down $29.6 million (2.9 percent) in FY 2006-07 due to lower nursing facility caseloads and average cost estimates. These reductions are partly offset by a revised estimate of the proportion of intermediate care facilities for the mentally retarded subject to a county share.

FY 2008-09 expenditures for Continuing Care Grants are now expected to be $3.4 billion, a $91.9 million (2.6 percent) decrease from end-of session estimates. The change is almost entirely due to the effect of the lower caseloads within MA Long-Term Care Waivers. Like FY 2006-07, an increase in DD waiver average cost partially offsets the overall reductions.

Children and Economic Assistance Grants

Children and Economic Assistance Grants provide a variety of supports to low-income families and individuals. These programs include cash, food support, child care, housing assistance, and job training services. These expenditures are now forecast to reach $787.0 million in FY 2006-07 and $928.3 million in FY 2008-09, up $4.9 million (0.6 percent) and down $1.5 million (0.2 percent) respectively from end-of-session estimates.

MFIP/Diversionary Work Program general fund expenditures are expected to total $71.2 million in FY 2006-07 and $103.0 million in FY 2008-09, up 5.4 percent and down 0.1 percent respectively. Lower estimates are due to lower caseload projections and are somewhat mitigated by slightly higher forecast average grant payments. MFIP/Transition Year child care assistance is now expected to reach $87.3 million in general fund expenditures in FY 2006-07 and $121.6 million in FY 2008-09, down 1.4 percent and 2.4 percent compared with earlier estimates. This change is also related to lower caseload projections. Both programs forecast lower enrollment due to improved economic projections.

Group Residential Housing (GRH) expenditures are down $10.6 million (5.8 percent) in FY 2006-07 and $8.3 million (4.0 percent) in FY 2008-09 due to lower average costs for the non-elderly, non-disabled segment of the caseload.

General Assistance (GA) expenditures increased $6.1 million (9.8 percent) in the current biennium and $7.6 million (12.1 percent) in FY 2008-09 due to increased caseloads. Estimates of future caseloads have been revised upward based on recent program experience.

Tax Aid and Credit Programs Increase $59 Million in FY 2006-07, $7 Million in 2008-09

Tax aid and credit programs are now expected to total $3.043 billion for the FY 2006-07 biennium, $59 million higher than end-of-session estimates. However, this net increase is marked by a change not related to local aid or credit spending. The forecast includes $61 million in additional tax refund interest. Of this change, $58 million reflects expected payments during FY 2006-07 related to the Hutchison Technology court decision. Similarly, $28 million is anticipated in refund and interest costs for FY 2008-09 that accounts for most of a total $37 million increase in projected refunds and interest.

As a result of the school shift buybacks associated with this forecast, estimates for aid and credit programs' payment to school districts increased $4 million in FY 2006. This increase reflects that cost of returning the market value homestead credit and other property tax aid and credit payments to school districts to a 90-10 schedule.

Partially offsetting these increases are reductions in estimates for the Aid to Police and Fire payments. Forecasted payments have been reduced by $7 million in FY 2006-07, $30 million in FY 2008-09. Change to the proportions of the insurance gross premiums tax allocated to Police and Fire Aid that will be phased in over the next three years act to reduce forecast growth from previous estimates.

No significant forecast changes occur in the property tax refund or local aid and credit programs. Minor increases in forecast property tax refunds, are largely offset by similarly small reductions in expected payments to counties for market value homestead credits.

Debt Service Costs Reduced for FY 2006-07 and FY 2008-09

The debt service forecast for the current biennium is now $776 million, $5 million lower than end of session estimates. $163.6 million of outstanding bonds were refinanced reducing general fund debt service by just over $16 million. This savings was $4 million higher than previous forecast. The remaining $1 million of the forecast reduction is the result of the amount of premiums paid on new bonds sold, selling more bonds than had been estimated, as well as interest earned on cash balances in the debt service fund and the bond proceeds fund.

Projected debt service for the 2008-09 biennium is $907 million down over $2 million from the end-of-session estimates. The forecast assumes future capital budgets of $560 million in each even numbered legislative session and $135 million in each odd numbered legislative session.

All Other Spending Largely Unchanged, Down $7 Million

The remaining categories of state spending total $5.951 billion for the current biennium. This amount represents 19 percent of total general fund spending. Higher Education accounts for 8.8 percent, all other agencies and functions 10.2 percent. While a relatively small percentage of the total budget, these areas include a broad range of agencies, programs and services. The breadth of activities includes: natural resources and environmental programs; trade, economic development, and agriculture programs; housing programs; the state prisons, public safety activities and courts; state regulatory and licensing activities; a portion of general fund financed transit and transportation-related funding; state funding for the arts, the Minnesota Zoo and Historical Society – as well as general state administration including tax collection, accounting and financial management, and human resources functions and legislative and constitutional offices.

Other Spending, FY 2006-07

($ in millions)

	End of Session	Nov. Fcst	Change
Higher Education	$2,761	$2,761	$0
Envir., Ag, & Econ. Dev.	680	691	11
Transportation	205	208	3
Public Safety	1,685	1,688	3
State Government	584	603	19
Total	**$5,915**	**$5,951**	**$36**

Funding for these areas are primarily set as fixed amounts by legislative appropriations. Changes in estimates associated with the forecast largely reflect amounts carried forward from FY 2005, transfers between agencies, or other technical adjustments, as well as a limited number of smaller open appropriations. The differences shown from end-of-session estimates are almost exclusively appropriations carried forward from FY 2005. Generally, these are not significant changes related to the forecast and have little or no effect on the general fund projected balance.

Other Spending, FY 2008-09

($ in millions)

	End of Session	Nov. Fcst	Change
Higher Education	$2,791	$2,791	$0
Envir., Ag, & Econ. Dev.	672	673	1
Transportation	221	221	0
Public Safety	1,722	1,713	(9)
State Government	586	587	1
Total	**$5,992**	**$5,985**	**$(7)**

The planning estimates for FY 2008-09 also remain largely unchanged. One exception is the estimates for the Department of Corrections for the next biennium. Correctional programs have decreased $9.5 million from end-of-session estimates due to smaller numbers of new prison commitments, including those for methamphetamine offenders, than previously anticipated. Although the prison population continues to increase, it is now projected to do so at a slower rate than previously forecast. By the end of FY 2007, the Department of Corrections projects 9,118 offenders in prison, down from 9,835 offenders projected last year for the same time. By the end of FY 2009, the projection is for 9,653 offenders, down from 10,502.

For other agencies, FY 2008-09 current law planning estimates generally represent the FY 2007 level of appropriations extended into the following two fiscal years. Adjustments are made only to remove one-time appropriations or to annualize the costs of programs only partially reflected in FY 2007. These adjustments are identified and made as part of the legislative and executive branch tracking of out-year costs when the budget is enacted.

Alternative Forecast Comparison

Real GDP (Annual Rates)

	05 III	05IV	06I	06II	06III	06IV	05A	06A	07A
GII Baseline (11-05)	3.8	3.0	3.9	3.4	3.1	2.9	3.6	3.4	3.1
Blue Chip (11-05)	3.8	3.0	3.5	3.4	3.2	3.1	3.5	3.3	NA
Economy.Com (11-05)	3.8	2.9	4.2	4.2	3.8	3.0	3.6	3.7	NA
American Financial (11-05)	3.8	3.7	3.0	2.4	3.7	3.8	3.6	3.3	NA
UBS (11-05)	3.8	3.0	3.6	2.8	2.5	2.5	3.6	3.1	2.5
Standard & Poors (11-05)	3.8	3.0	3.6	3.4	NA	NA	3.6	3.3	3.0

Consumer Price Index (Annual Rates)

	05 III	05IV	06I	06II	06III	06IV	05A	06A	07A
GII Baseline (11-05)	5.1	3.2	2.4	1.2	1.2	1.3	3.4	2.6	1.5
Blue Chip (11-05)	5.1	4.0	2.5	2.3	2.3	2.3	3.4	3.1	NA
Economy.Com (11-05)	5.1	3.2	2.8	2.6	2.8	NA	3.4	3.2	NA
American Financial (11-05)	5.1	3.5	1.5	2.4	2.8	2.9	3.8*	2.4*	NA
UBS (11-05)	5.1	4.9	2.8	2.3	2.6	2.6	3.5	3.5	2.5
Standard & Poors (11-05)	5.1	3.2	2.4	1.2	NA	NA	3.4	2.6	1.4

* 4Q/4Q

Forecast Comparisons

Real Economic Growth
(Annual Percent Change in Real GDP)

	2004	2005	2006	2007	2008	2009
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 04GII 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
Nov 05 GII Baseline	1.6	3.6	3.4	3.1	3.4	3.1

Inflation

(Annual Percent Change in CPI-U)

	2004	2005	2006	2007	2008	2009
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 04GII 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
Nov 05 GII Baseline	2.7	3.4	2.6	1.5	2.0	2.2

(1) 10 year trend from 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	0.8	2.6	5.5	6.5	5.7	5.9
Minnesota	3.2	1.4	2.5	4.9	4.5	4.9	4.8
Implied Annual Wage							
United States	2.3	1.9	2.9	4.3	4.8	4.1	4.4
Minnesota	3.0	2.4	2.6	4.2	3.2	3.9	3.8
Non-Farm Employment							
United States	0.3	-1.1	-0.3	1.1	1.6	1.6	1.4
Minnesota	0.2	-1.0	-0.1	0.7	1.3	1.0	1.0
Personal Income							
United States	3.5	1.8	3.2	5.9	5.7	6.5	5.9
Minnesota	2.8	2.5	3.1	6.3	4.2	5.6	5.3

Comparison of Actual and Estimated
Non-Restricted Revenues - October YTD, Fiscal Year 2006
($ in Thousands)

	Forecast Revenues	Actual Revenues	Variance Act-Fcst
Individual Income Tax			
Withholding	1,739,966	1,735,168	(4,797)
Declarations	256,768	266,246	9,478
Miscellaneous	91,871	97,843	5,972
Gross	2,088,605	2,099,257	10,652
Refund	48,372	55,190	6,818
Net	2,040,233	2,044,068	3,834
Corporate & Bank Excise			
Declarations	201,200	305,379	104,179
Miscellaneous	48,927	44,573	(4,354)
Gross	250,127	349,953	99,826
Refund	17,500	18,111	611
Net	232,627	331,842	99,215
Sales Tax			
Gross	1,390,968	1,411,480	20,512
Refunds	65,121	54,934	(10,187)
Net	1,325,848	1,356,546	30,699
Motor Vehicle Sales Tax	90,280	92,292	2,012
Other Revenues:			
Estate	28,667	150,541	121,874
Liquor/Wine/Beer	19,867	20,089	222
Cigarette/Tobacco/Cont Sub	64,061	68,900	4,839
Deed and Mortgage	76,781	98,856	22,076
Insurance Gross Earnings	62,600	61,124	(1,476)
Lawful Gambling	16,029	13,467	(2,562)
Health Care Surcharge	67,063	67,037	(26)
Other Taxes	444	301	(144)
state wide property tax	90	291	201
dhs rtc Collections	17,038	17,957	919
Income Tax Reciprocity	0	0	0
Investment Income	5,000	12,875	7,875
Tobacco Settlement	0	0	0
Departmental Earnings	109,350	112,874	3,524
Fines and Surcharges	27,697	27,339	(358)
Lottery Revenues	10,462	9,414	(1,048)
Revenues yet to be allocated	0	452	452
Residual revenues	17,508	9,582	(7,926)
Sales Tax Rebates (all years)	0	(3)	(3)
County Nursing Home Pub Hosp	10,264	4,264	(6,000)
			0
Other Subtotal	**532,921**	**675,362**	**142,441**
Other Refunds	**10,487**	**6,662**	**(3,825)**
Other Net	**522,434**	**668,700**	**146,266**
Total Gross	**4,352,901**	**4,628,344**	**275,443**
Total Refunds	**141,479**	**134,897**	**(6,582)**
Total Net	**4,211,422**	**4,493,447**	**282,026**

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	160690		
*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
*November 2005 Baseline	137.386	140.039	147.263	153.310	161.799	170.983
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	1043690	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
*November 2005 Baseline	96.925	99.371	104.225	108.959	114.328	119.824
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
November 2005 Baseline	30.012	29.451	30.825	31.190	33.432	36.204
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	12.083
February 2005 Baseline	11.120	11.747	12.681	13.507	14309	15.156
November 2005 Baseline	10.448	11.218	12.213	13.161	14.037	14.956

** Wages reflect ES202 Data as adjusted by D.O.F.*

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		
Percent	0.4%	2.2%	5.1%	3.1%		
February 2004 Baseline	61.425	63.011	67.636	70.481		
Percent	0.0%	2.6%	7.3%	4.2%		
November 2004 Baseline	61.092	62.542	66.848	71.014	73.521	75.447
Percent	-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
Percent	-1.0%	2.2%	6.8%	6.4%	4.4%	3.0%
November 2005 Baseline	61.286	62.605	66.460	70.850	74.979	77.651
Percent				6.6%	5.83%	3.6%
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
November 2005 Baseline	10.626	10.952	11.775	12.456	12.849	12.265
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
November 2005 Baseline	9.921	9.777	10.639	11.906	12.862	13.935
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
November 2003 Baselin5	8.841	9.198	10.200	10.995	11.868	11.939

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	184.34	194.76	204.77
November 2005 Baseline*	164.44	169.50	177.36	188.44	196.70	207.71
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
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
November 2005 Baseline	8.621	8.887	8.989	9.185	8.925	9.340
CORPORATE FRANCHISE TAX	**Calendar Year**					
U.S. Corporate Pre-Tax Profits						
November 2001 Control	685.7	761.2				
February 2002 Control	722.1	761.2				
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**	1,019.7**	1,010.9**
February 2005 Baseline	755.8	690.9	810.3	945.5**	971.8**	965.8**
November 2005 Baseline	755.8	689.5	853.5	1,016.9**	1,137.8**	1,299.8**

* Bureau of Economic Analysis Concept

** Finance Dept Estimate

FY 2004-05 Biennium
General Fund
($ in thousands)

	FY 2004	FY 2005	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	1,268,455	368,922
Current Resources:			
Tax Revenues	12,520,041	13,508,327	26,028,368
Non-Tax Revenues	775,448	741,801	1,517,249
Dedicated Revenue	19,929	47,791	67,720
Transfers In	1,143,977	338,178	1,482,155
Prior Year Adjustments	39,897	17,180	57,077
Subtotal-Current Resources	14,499,292	14,653,277	29,152,569
Total Resources Available	**14,868,214**	**15,921,732**	**29,521,491**
Actual & Estimated Spending			
K-12 Education	5,715,303	6,321,829	12,037,132
Property Tax Aids & Credits	1,438,722	1,361,709	2,800,431
Higher Education	1,235,604	1,254,481	2,490,085
Health & Human Services	3,511,023	3,738,617	7,249,640
Environment, Agriculture & Economic Dev	365,952	362,071	728,023
Transportation	77,623	79,880	157,503
Public Safety	682,531	762,315	1,444,846
State Government	265,617	295,925	561,542
Debt Service	265,706	323,453	589,159
Deficiencies/Other	5,892	5,243	11,135
Subtotal Expenditures & Transfers	**13,563,973**	**14,505,523**	**28,069,496**
Dedicated Expenditures	35,786	23,123	58,909
Total Expenditures & Transfers	**13,599,759**	**14,528,646**	**28,128,405**
Balance Before Reserves	**1,268,455**	**1,393,086**	**1,393,086**
Cash Flow Account	0	350,000	350,000
Budget Reserve	403,677	653,000	653,000
Tax Relief Account	0	336,716	336,716
Appropriations Carried Forward	183,613	53,370	53,370
Budgetary Balance	**681,165**	**0**	**0**

FY 2005 General Fund Closing
Compared to End of 2005 Session
($ in thousands)

	7-05 Enacted FY 2005	Closing FY 2005	Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	1,268,455	1,268,455	0
Current Resources:			
Tax Revenues	13,249,452	13,508,327	258,875
Non-Tax Revenues	702,909	741,801	38,892
Dedicated Revenue	38,385	47,791	9,406
Transfers In	314,187	338,178	23,991
Prior Year Adjustments	25,000	17,180	(7,820)
Subtotal-Current Resources	14,329,933	14,653,277	323,344
Total Resources Available	**15,598,388**	**15,921,732**	**323,344**
Actual & Estimated Spending			
K-12 Education	6,329,193	6,321,829	(7,364)
Property Tax Aids & Credits	1,368,053	1,361,709	(6,344)
Higher Education	1,306,098	1,254,481	(51,617)
Health & Human Services	3,750,536	3,738,617	(11,919)
Environment, Agriculture & Economic Dev	373,349	362,071	(11,278)
Transportation	81,098	79,880	(1,218)
Public Safety	767,145	762,315	(4,830)
State Government	319,185	295,925	(23,260)
Debt Service	323,346	323,453	107
Deficiencies/Other	0	5,243	5,243
Estimated Cancellations	(61,000)	0	61,000
Subtotal Expenditures & Transfers	**14,557,003**	**14,505,523**	**(51,480)**
Dedicated Expenditures	38,385	23,123	(15,262)
Total Expenditures & Transfers	**14,595,388**	**14,528,646**	**(66,742)**
Balance Before Reserves	**1,003,000**	**1,393,086**	**390,086**
Cash Flow Account	350,000	350,000	0
Budget Reserve	653,000	653,000	0
Tax Relief Account	0	336,716	336,716
Appropriations Carried Forward	0	53,370	53,370
Budgetary Balance	**0**	**0**	**0**

FY 2006-07 Current Biennium Forecast Comparison
November 2005 vs End-of-Session (Before Statutory Allocations)
($ in thousands)

	7-05 Enacted FY 2006-07	11-05 Fcst FY 2006-07	Fcst vs Enacted FY 2006-07
Actual & Estimated Resources			
Balance Forward From Prior Year	1,003,000	1,393,086	390,086
Current Resources:			
Tax Revenues	28,191,936	28,846,263	654,327
Non-Tax Revenues	1,491,197	1,497,739	6,542
Dedicated Revenue	74,065	124,777	50,712
Transfers In	758,899	761,076	2,177
Prior Year Adjustments	70,000	50,000	(20,000)
Subtotal-Current Resources	30,586,097	31,279,855	693,758
Total Resources Available	**31,589,097**	**32,672,941**	**1,083,844**
Actual & Estimated Spending			
K-12 Education	12,578,190	12,595,877	17,687
K-12 Shift Buyback	0	0	0
Property Tax Aids & Credits	2,983,735	3,039,131	55,396
Higher Education	2,761,000	2,761,485	485
Health & Human Services	8,264,447	8,216,010	(48,437)
Environment, Agriculture & Economic Dev	680,253	691,135	10,882
Transportation	205,187	208,333	3,146
Public Safety	1,685,033	1,687,820	2,787
State Government	583,651	602,944	19,293
Debt Service	781,146	775,831	(5,315)
Estimated Cancellations	(22,500)	(22,500)	0
Subtotal Expenditures & Transfers	**30,500,142**	**30,556,066**	**55,924**
Dedicated Expenditures	74,065	95,693	21,628
Total Expenditures & Transfers	**30,574,207**	**30,651,759**	**77,552**
Balance Before Reserves	**1,014,890**	**2,021,182**	**1,006,292**
Cash Flow Account	350,000	350,000	0
Budget Reserve	653,000	653,000	0
Tax Relief Account	0	316,716	316,716
Budgetary Balance	**11,890**	**701,466**	**689,576**

FY 2006-07 General Fund Budget
November 2005 Forecast
($ in thousands)

	FY 2006	FY 2007	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	1,393,086	1,161,538	1,393,086
Current Resources:			
Tax Revenues	14,235,505	14,610,758	28,846,263
Non-Tax Revenues	767,857	729,882	1,497,739
Dedicated Revenue	62,469	62,308	124,777
Transfers In	374,212	386,864	761,076
Prior Year Adjustments	25,000	25,000	50,000
Subtotal-Current Resources	15,465,043	15,814,812	31,279,855
Total Resources Available	**16,858,129**	**16,976,350**	**32,672,941**
Actual & Estimated Spending			
K-12 Education	6,195,978	6,400,273	12,596,251
K-12 Shift Buyback *	620,958	75,828	696,786
Subtotal K-12 Education	6,816,936	6,476,101	13,293,037
Property Tax Aids & Credits	1,492,438	1,550,999	3,043,437
Higher Education	1,365,985	1,395,500	2,761,485
Health & Human Services	4,016,850	4,199,160	8,216,010
Environment, Agriculture & Economic Dev	358,732	332,403	691,135
Transportation	105,112	103,221	208,333
Public Safety	837,809	850,011	1,687,820
State Government	307,107	295,837	602,944
Debt Service	352,337	423,494	775,831
Estimated Cancellations	(7,500)	(15,000)	(22,500)
Subtotal Expenditures & Transfers	**15,645,806**	**15,611,726**	**31,257,532**
Dedicated Expenditures	50,785	44,908	95,693
Total Expenditures & Transfers	**15,696,591**	**15,656,634**	**31,353,225**
Balance Before Reserves	**1,161,538**	**1,319,716**	**1,319,716**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Tax Relief Account	316,716	316,716	316,716
Budgetary Balance	**(158,178)**	**0**	**0**

* $701 million education shift buyback includes $697 million in K-12 payments and $4 million in property tax credits paid to school districts.

FY 2006-07 Biennial Comparison
November 2005 Forecast vs End of 2005 Session
($ in thousands)

	7-05 Enacted FY 2006-07	11-05 Fcst FY 2006-07	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,003,000	1,393,086	390,086	38.9%
Current Resources:				
Tax Revenues	28,191,936	28,846,263	654,327	2.3%
Non-Tax Revenues	1,491,197	1,497,739	6,542	0.4%
Dedicated Revenue	74,065	124,777	50,712	68.5%
Transfers In	758,899	761,076	2,177	0.3%
Prior Year Adjustments	70,000	50,000	(20,000)	-28.6%
Subtotal-Current Resources	30,586,097	31,279,855	693,758	2.3%
Total Resources Available	**31,589,097**	**32,672,941**	**1,083,844**	**3.4%**
Actual & Estimated Spending				
K-12 Education	12,578,190	12,596,251	18,061	
K-12 Shift Buyback *	0	696,786	696,786	
Subtotal K-12 Education	12,578,190	13,293,037	714,847	5.7%
Property Tax Aids & Credits	2,983,735	3,043,437	59,702	2.0%
Higher Education	2,761,000	2,761,485	485	0.0%
Health & Human Services	8,264,447	8,216,010	(48,437)	-0.6%
Environment, Agriculture & Economic Dev	680,253	691,135	10,882	1.6%
Transportation	205,187	208,333	3,146	1.5%
Public Safety	1,685,033	1,687,820	2,787	0.2%
State Government	583,651	602,944	19,293	3.3%
Debt Service	781,146	775,831	(5,315)	-0.7%
Estimated Cancellations	(22,500)	(22,500)	0	0.0%
Subtotal Expenditures & Transfers	**30,500,142**	**31,257,532**	**757,390**	**2.5%**
Dedicated Expenditures	74,065	95,693	21,628	29.2%
Total Expenditures & Transfers	**30,574,207**	**31,353,225**	**779,018**	**2.5%**
Balance Before Reserves	**1,014,890**	**1,319,716**	**304,826**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Tax Relief Account	0	316,716	316,716	
Budgetary Balance	**11,890**	**0**	**(11,890)**	

* $701 million education shift buyback includes $697 million in K-12 payments and $4 million in property tax credits paid to school districts.

FY 2008-09 Planning Estimates Comparison
November 2005 Forecast vs End of 2005 Session
($ in thousands)

	7-05 Plng Est FY 2008-09	11-05 Plng Est FY 2008-09	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,014,890	1,319,716	304,826	30.0%
Current Resources:				
Tax Revenues	30,726,960	31,218,804	491,844	1.6%
Non-Tax Revenues	1,449,330	1,449,352	22	0.0%
Dedicated Revenue	74,065	124,109	50,044	67.6%
Transfers In	604,260	613,249	8,989	1.5%
Prior Year Adjustments	50,000	50,000	0	0.0%
Subtotal-Current Resources	32,904,615	33,455,514	550,899	1.7%
Total Resources Available	**33,919,505**	**34,775,230**	**855,725**	**2.5%**
Actual & Estimated Spending				
K-12 Education	12,863,119	12,807,982	(55,137)	
K-12 Shift Buyback	0	58,451	58,451	
Subtotal K-12 Education	12,863,119	12,866,433	3,314	0.0%
Property Tax Aids & Credits	3,123,193	3,130,602	7,409	0.2%
Higher Education	2,791,000	2,791,000	0	0.0%
Health & Human Services	9,322,560	9,261,519	(61,041)	-0.7%
Environment, Agriculture & Economic Dev	672,028	673,298	1,270	0.2%
Transportation	221,442	221,442	0	0.0%
Public Safety	1,722,251	1,712,704	(9,547)	-0.6%
State Government	586,195	587,452	1,257	0.2%
Debt Service	909,687	907,226	(2,461)	-0.3%
Estimated Cancellations	(20,000)	(20,000)	0	0.0%
Subtotal Expenditures & Transfers	**32,191,475**	**32,131,676**	**(59,799)**	**-0.2%**
Dedicated Expenditures	74,065	89,309	15,244	20.6%
Total Expenditures & Transfers	**32,265,540**	**32,220,985**	**(44,555)**	**-0.1%**
Balance Before Reserves	**1,653,965**	**2,554,245**	**900,280**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Tax Relief Account	0	316,716	316,716	
Budgetary Balance	**650,965**	**1,234,529**	**583,564**	

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

	Closing FY 2004-05	11-05 Fcst FY 2006-07	11-05 Plng Est FY 2008-09
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	1,393,086	1,319,716
Current Resources:			
Tax Revenues	26,028,368	28,846,263	31,218,804
Non-Tax Revenues	1,517,249	1,497,739	1,449,352
Dedicated Revenue	67,720	124,777	124,109
Transfers In	1,482,155	761,076	613,249
Prior Year Adjustments	57,077	50,000	50,000
Subtotal-Current Resources	29,152,569	31,279,855	33,455,514
Total Resources Available	**29,521,491**	**32,672,941**	**34,775,230**
Actual & Estimated Spending			
K-12 Education	12,037,132	12,596,251	12,807,982
K-12 Shift Buyback *	0	696,786	58,451
Subtotal K-12 Education	12,037,132	13,293,037	12,866,433
Property Tax Aids & Credits	2,800,431	3,043,437	3,130,602
Higher Education	2,490,085	2,761,485	2,791,000
Health & Human Services	7,249,640	8,216,010	9,261,519
Environment, Agriculture & Economic Dev	728,023	691,135	673,298
Transportation	157,503	208,333	221,442
Public Safety	1,444,846	1,687,820	1,712,704
State Government	561,542	602,944	587,452
Debt Service	589,159	775,831	907,226
Deficiencies/Other	11,135	0	0
Estimated Cancellations	0	(22,500)	(20,000)
Subtotal Expenditures & Transfers	**28,069,496**	**31,257,532**	**32,131,676**
Dedicated Expenditures	58,909	95,693	89,309
Total Expenditures & Transfers	**28,128,405**	**31,353,225**	**32,220,985**
Balance Before Reserves	**1,393,086**	**1,319,716**	**2,554,245**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Tax Relief Account	336,716	316,716	316,716
Appropriations Carried Forward	53,370	0	0
Budgetary Balance	**0**	**0**	**1,234,529**

* $701 million education shift buyback includes $697 million in K-12 payments and $4 million in property tax credits paid to school districts.