Minnesota
Department of Finance

February 2006

February 2006 Economic Forecast

Highlights

Forecast for 2006-07 Up $181 Million – $88 Million Balance Remains After Completing School Shift Buyback

General fund revenues for the 2006-07 biennium are forecast to be $31.404 billion, $124 million (0.4 percent) more than in November. General fund spending is projected to be $57 million less than previously forecast, leaving a projected surplus of $181 million. Current law requires that $93 million of the surplus be used to complete the reversal of education accounting shifts enacted in 2002 and 2003, leaving an $88 million balance.

Major Revenues Up Just $14 Million – Other Tax and Non-tax Resources Increase by $110 Million

The individual income tax, sales tax and motor vehicle sales tax forecasts were reduced by a total of $151 million (0.6 percent) from November's estimates reflecting a slightly weaker outlook for economic growth in Minnesota. That decline was offset by a $161 million increase in projected corporate tax receipts. Other taxes increased by $34 million from November. Non-tax revenues, including investment income and transfers, added $76 million to the forecast.

U.S. Economic Outlook Largely Unchanged – Strong Growth in 2006, a Modest Slowing in 2007

There have been only small changes in Global Insight's baseline forecast since November. Real GDP growth rates were reduced by 0.2 percentage points in both fiscal 2006 and 2007 and the inflation outlook was raised slightly due to an increase in the forecast for energy prices. Oil prices are now expected to remain above $60 per barrel through 2007.

FY 2008-09 Revenue Outlook Drifts Slightly Lower

Planning estimates for FY 2008-09 revenues have been reduced by $140 million from November's projections and projected spending is $2 million above the prior estimate. Projected balances for the next biennium remain roughly equal to the cost of inflation and the pending constitutional amendment.

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Budget Summary

Forecast Improves $181 Million in Current Biennium

Minnesota's budget outlook for FY 2006-07 has improved slightly since November. The forecast balance is now $181 million. After completing the buyback of school accounting shifts the available balance falls to $88 million.

The revenue forecast for the current biennium is up by $124 million. The forecast for five major taxes increased by just $14 million. Changes in forecasts for other taxes and non-tax revenue sources accounted for the majority of change in revenue. Projected spending fell by $57 million.

FY 2006-07 Forecast Changes

($ in millions)

	February Forecast	Change
Beginning Balance	$1,393	$0
Revenues	31,404	124
Spending	31,296	(57)
Reserves	1,003	0
Tax Relief Account	317	0
Forecast Balance	181	$181
School Shift Buyback	***(93)***	
Available Balance	**$88**	

$88 Million Balance Remains After Completing School Shift Buyback

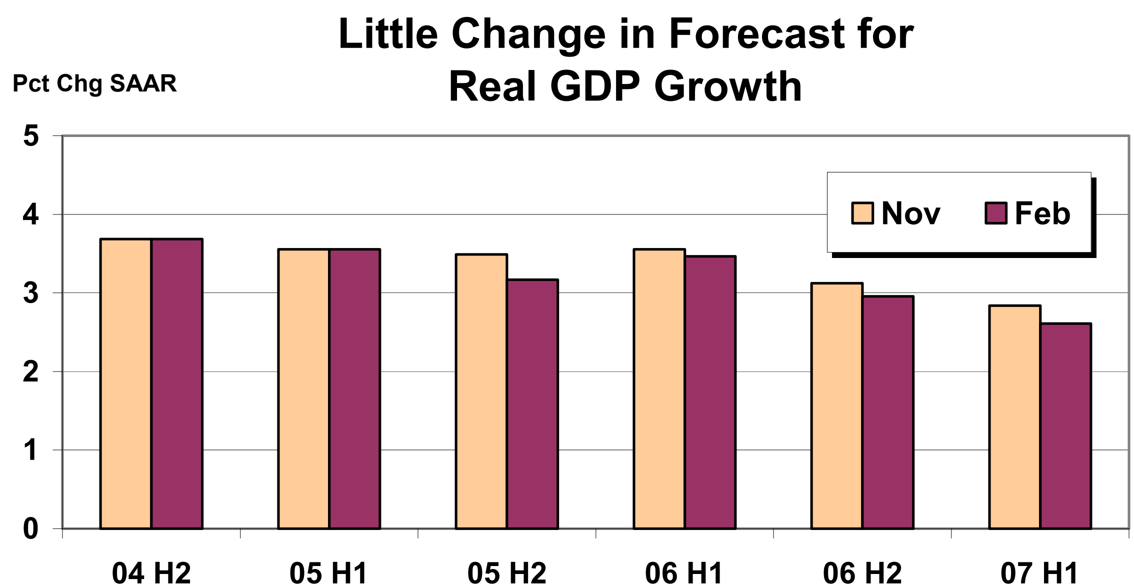
Under current law $93 million of the projected balance is used to complete the buyback of the remaining portion of the education accounting shifts enacted in 2002 and 2003. The $93 million will be added to K-12 education aids spending for the biennium, reducing the recognition percentage from 10.8 percent to zero. The additional funds will be paid to school districts in FY 2006 and FY 2007, beginning with the April 2006 payments.

After the shift buyback, an $88 million balance remains in the general fund. An additional $317 million remains in the Tax Relief Account. General fund reserves remain unchanged from the November forecast with the cash flow account at $350 million and the budget reserve at $653 million.

U.S. Economy on Track for Another Year of Strong Growth

The official statistics show the U.S. economy stumbling slightly at the end of 2005, when the advance estimate of real GDP growth fell to 1.1 percent. But, few believe those figures indicate economic problems are near. Consumer spending finished the year stronger than anticipated, and the warm winter weather has eliminated the potential drag on household spending from higher heating costs. Business investment appears to be on track, and everyone expects a substantial increase in federal spending, reversing the two percent decline posted by the government sector in the last quarter.

Most forecasters are calling for very strong real GDP growth during the first half of 2006. The economy is then expected to cool slightly in the second half of 2006, and to slow a little further in early 2007, with the consensus forecasts calling for economic growth rates near three percent through the end of the biennium. The usual caveats regarding the absence of a major geo-political event remain in effect, and there is increasing concern that inflation might be worse than projected, forcing the Fed to push interest rates substantially higher. Some also are concerned about the possible negative impacts of an untidy ending to an apparently frothy housing market. But, absent a major geo-political shock accompanied by a dramatic surge in energy prices, an economic downturn seems unlikely.



February's baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, is consistent with the consensus outlook. GII expects real GDP to grow at an annual rate of 3.5 percent during the first half of 2006, and at a 3.0 percent rate in the second half of this year. Their baseline forecast then calls for a further slowdown in early 2007 with real growth averaging 2.6 percent for the last 6 months of the 2006-07 biennium. GII's November baseline was slightly more optimistic with real growth rates of 3.6 percent and 3.1 percent in the first and second halves of 2006, followed by 2.8 percent in the first half of 2007.

GII also expects inflationary pressures to moderate as energy prices stabilize. CPI growth is projected to fall to 2.5 percent in 2006 and then to 1.8 percent 2007. Core inflation (the CPI except for food and energy), is expected to turn higher, moving to 2.3 percent in 2006 and 2.4 percent in 2007.

Minnesota Economic Outlook Calls for Good, but not Outstanding Growth in 2006-07 Biennium

Job growth in Minnesota continues to be weaker than would be expected at this point in an economic expansion. In the four years since the end of the recession, payroll employment has increased by just 2.3 percent. In the four years following the end of the 1990-91 recession, employment grew by 11 percent. Since November 2001 Minnesota's economy has added 56,000 jobs or about 14,000 per year. In the 49 months following the end of the 1990-91 recession employment in Minnesota was up by 237,000 jobs or nearly 60,000 per year.

Part of the explanation is that the U.S. economy has not added jobs at its usual pace since the end of the 2001 recession. U.S. employment has grown by just 2.7 percent since the end of the recession, only slightly faster than Minnesota. But, in the last two years, employment growth in Minnesota has fallen further behind the national averages. During the second half of 2005 Minnesota payroll employment grew at an annual rate of just 0.4 percent. U.S. payroll employment, even with the disruptions from the hurricanes along the Gulf Coast, grew nearly twice as fast.

Minnesota's population is growing slightly more slowly than the national average, but differences in population growth alone are not sufficient to explain the slower job growth. Labor force participation rates have also fallen slightly, particularly among teenagers. That suggests that there has been some consolidation in the number of jobs, with the number of hours worked remaining constant, even though fewer are employed. Those explanations help explain longer term trends, but are not satisfactory explanations of the stagnant labor market observed in the last half of 2005.

Forecasts for employment growth and wage and salary growth have again been reduced slightly, reflecting more recent economic data, and the slight weakening in the Global Insight February baseline. Payroll employment is expected to increase by 39,000 jobs between fourth quarter 2005 and the end of the biennium. In November an increase of 43,000 jobs was projected. Minnesota wages are now forecast to grow slightly faster over the remainder of the biennium than they were in November, but from a lower base level for calendar 2005. Growth rates used for both employment and wages are below the national average rates in February's Global Insight baseline.

Revenue Forecast for 2006-07 Biennium Up $124 Million

General fund resources for the current biennium are now expected to be $31.404 billion, $124 million (0.4 percent) more than November forecast estimates. Other taxes, non-tax revenues and transfers accounted for almost all of the net revenue gain. The five major taxes were up by $14 million, or less than 0.1 percent.

Forecast Revenues, FY 2006-07

($ in millions)

	November Forecast	February Forecast	$ Change	% Change
Individual Income	$13,747	$13,618	$(129)	(0.9)
Sales	9,116	9,114	(2)	0.0
Corporate	1,681	1,842	161	9.6
Motor Vehicle Sales	524	504	(20)	(3.8)
Statewide Levy	1,290	1,294	4	0.3
Subtotal	26,358	26,372	14	0.1
Other Taxes	2,489	2,523	34	1.4
Non-Tax Revenue	1,498	1,556	58	3.9
Dedicated, Transfers	935	953	18	1.9
Total Revenues	**$31,280**	**$31,404**	**$124**	**0.4**

An increase in projected corporate tax receipts more than offset declines in the individual income tax, sales tax and motor vehicle sales tax forecasts. Global Insight now expects 2006 and 2007 corporate profits to be even stronger than forecast in November. Changes in the individual income tax forecast were small. Slower than projected 2005 wage growth reduced the base level of wages carried forward to tax years 2006 and 2007. The revenue lost due to the lower wage estimate was partially offset by a slight increase in the capital gains forecast.

Other taxes, non-tax revenues, and transfers are $110 million more than November's forecast. Increases in the estate tax and mortgage tax forecasts reflected higher than estimated year-to-date receipts. Projected investment earnings, departmental earnings, the annual tobacco settlement payments and other non-dedicated revenues also were increased, due to higher than projected year-to-date receipts.

There was no material change in the forecast for the health impact fee. It reflects the current agreement between the state and plaintiffs which allows the state to continue to collect the fee. The state has agreed not to transfer those fees or any earnings on them to the general fund before the end of the biennium while the case is under appeal.

Forecast Spending Decreased $57 Million Before Shift Buyback

General fund spending for the biennium is forecast to be $31.296 billion, down $57 million (0.2 percent), from November's estimate. Buying back the remaining education aid shift, adds $93 million to K-12 education aids, increasing total spending to $31.389 billion, $36 million more than November's estimate.

Forecast Spending, FY 2006-07

($ in millions)

	November Forecast	February Forecast	$ Change	% Change
K-12 Education	$13,293	$13,281	$(12)	(0.1)
Higher Education	2,761	2,761	0	0.0
Property Tax Aids & Credits	3,043	3,033	(10)	(0.3)
Health & Human Services	8,216	8,197	(19)	(0.2)
Debt Service	776	757	(19)	(2.4)
All Other	3,264	3,267	3	0.1
Forecast Total	**31,353**	**31,296**	**(57)**	**(0.2)**
Education Shift Buyback	**--**	**93**	**93**	**--**
Revised Total	**$31,353**	**$31,389**	**$36**	**0.1**

The forecast was reduced in three areas. K-12 education estimates before the buyback, decrease nearly $12 million. Projected human services costs are $19 million lower primarily due to reductions in payments to the federal government associated with the new Medicare prescription drug benefit. Debt service estimates were lowered by $19 million, reflecting higher premiums on bonds sold.

The $93 million education shift buyback increases K-12 spending in 2006-07. This amount will be paid out through K-12 education aid payments, increasing forecast K-12 spending to $13.375 billion. This revised spending total is used in comparative tables throughout the remainder of this forecast document.

Planning Estimates for FY 2008-09 Decline Slightly

Projected revenue planning estimates for FY 2008-09 are now $140 million below November estimates, while expenditures are $2 million higher. Changes reflect small reductions in FY 2008-09 revenues and slightly higher K-12 spending. Savings in health and human services programs and debt service that continue into the next biennium partially offset the lower revenues. Current law 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. Projected balances also are likely to be affected by 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 1.9 and 2.0 percent for FY 2008 and FY 2009 respectively would add $303 million and $640 million, a total of $943 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. The loss in general fund revenue associated with passage of that amendment is now estimated to be $56 million in FY 2008 and $116 million in FY 2009.

FY 2008-09 Planning Estimates

($ in millions)

	FY 2008	FY 2009
Revenues	$16,341	$16,974
Spending	15,967	16,257
Difference	**374**	**717**
Inflation	*(303)*	*(640)*
Constitutional Amendment	*(56)*	*(116)*
Balance	**$15**	**$(39)**

A complete version of this document 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

February's forecast is the second of four forecasts that will occur during the biennium. It 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. That updated revenue and expenditure information is also used to revise the revenue and expenditure planning estimates for the 2008-09 biennium.

The revised revenue estimates reflect changes in the national economic outlook that have occurred since November. This forecast also incorporates additional revenue collection experience into the projections. For example, state sales tax collections now include receipts from the crucial Christmas shopping season. And, fourth quarter estimated tax payments as well as withholding receipts through January are available for further guidance about tax year 2005 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 Insight Inc., (GII). Minnesota's Council of Economic Advisors reviewed the GII national baseline forecast. 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 planning estimates for FY 2008-09 come from less complete models. As in the past the economic growth assumptions used to develop the revenue planning estimates are updated to be consistent with the GII February baseline scenario for the years under consideration. The revenue planning estimates should not be interpreted as explicit forecasts, but rather as a guide to indicate whether proposed actions are likely to create financial problems outside the current biennium.

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

While wage and price inflation is included in revenue estimates, it is not included in projected expenditures. The estimated inflation rate for fiscal 2008 and 2009 is now projected to be 1.9 and 2.0 percent respectively.

As with all budget forecasts this report reflects only current law. It does not reflect the Governor's budget recommendations, any potential legislative action, or the passage of any pending constitutional amendment dedicating state general fund revenues to specific uses. The forecast provides a current law framework for those discussions.

Economic Summary

Three months ago there were legitimate concerns about the short-term economic outlook. That led economist's forecasts for real GDP growth in 2006 to be spread over a wider than usual range. No one was predicting a recession, but there was a real possibility that economic growth rates would slow significantly over the next year. The spending needed to begin re-building hurricane-damaged areas of the Gulf Coast was expected to provide a significant boost the economy in the first quarter of 2006. But, consumer spending in the fourth quarter of 2005 was projected to be flat since some of the summer's historically high auto sales had likely been borrowed from the future. What was unknown was how household spending on items other than autos would fare and how long it would take before consumer spending once again was growing at its normal rate. Substantial increases in energy prices added to the uncertainty about non-auto spending as did concerns about when storm damaged oil and natural gas production facilities in the Gulf would again be on-line. And, there was the question of the weather. A colder than normal winter could further slow real consumer spending by raising household heating bills enough to reduce households' discretionary income.

Now those short-term questions have largely been answered. Consumer spending growth did slow in the fourth quarter, but non-auto spending remained healthy growing at an annual rate of 4.8 percent. Energy prices have come down since November, particularly natural gas prices. And, most important, the potential drag on consumer spending posed by higher heating costs has been largely eliminated by the warmest winter on record. While the advance estimates showed real GDP growing at just a 1.1 percent annual rate in the fourth quarter of 2005 that was because federal government spending faltered, dropping by 2.4 percent. Federal defense spending was down 13 percent, something that likely will be reversed in the next few quarters. Many forecasters believe that coming revisions will raise the fourth quarter real growth rate and projected growth rates for the first quarter of 2006 have generally been raised substantially.

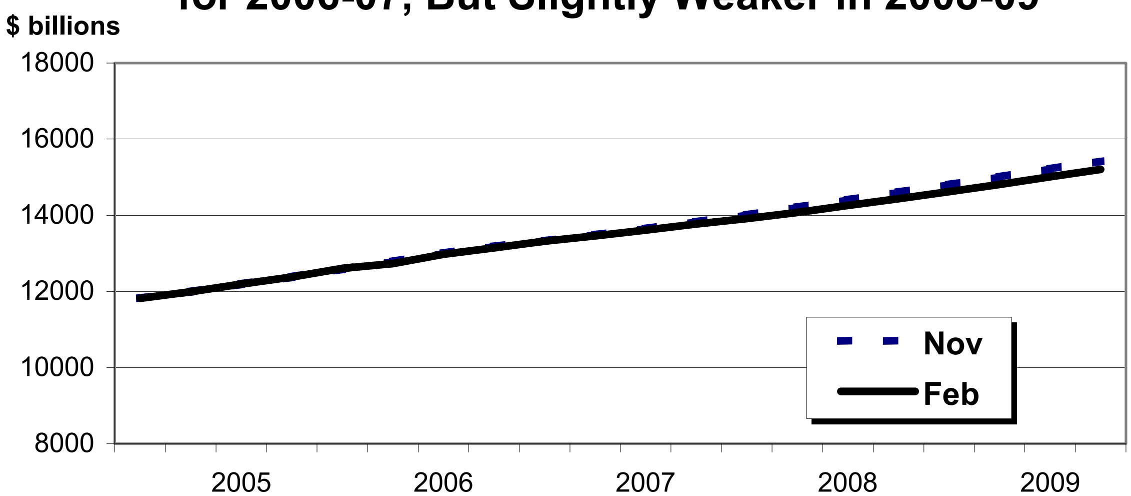
As always there are things that could go wrong. The housing market is cooling and the housing sector could become a drag on U.S. economic growth. Forecasters are also growing increasingly concerned about the inflation outlook, since the unemployment rate is falling, and average earnings have recently been growing at a 3.3 percent year-over-year pace. Oil prices remain a wild-card. Global demand for energy continues to increase and there is little spare capacity. The possibility that a geo-political event could force oil prices significantly higher, and that those higher prices could spillover into core inflation cannot be dismissed. There are also questions about the interest rate outlook. Forecasters expect another hike in the fed funds rate in March, but there is considerable difference in opinion over the expected path for longer-term rates over the next year.

February's baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, calls for a strong first quarter, followed by a modest slowdown in 2006. The economy slows further in 2007, then begins to accelerate again in both 2008 and 2009. Real GDP growth of 3.3 percent is now expected for 2006, just slightly below the 3.5 percent growth rate currently reported for 2005. In 2007 growth is slower, 2.7

percent. The GII forecast is almost identical to that of the Blue Chip consensus. The Blue Chip panel expects growth to proceed at an annual rate of 3.3 percent in 2006 and 3.1 percent in 2007.

Global Insight sees little near-term relief in oil prices. They have raised their forecast for oil prices significantly since November. West Texas Intermediate is now projected to exceed $58 at the end of 2007, $12 more than the $46 per barrel price forecast in November. CPI growth is expected to remain under control, dropping to a 2.5 percent annual rate in 2006 and a 1.8 percent annual rate in 2007. Inflation forecasts for 2006 by CBO and OMB are almost identical to GII's, but both are less optimistic for 2007, calling for 2.2 percent CPI growth. The Blue Chip Consensus is much less optimistic, calling for a 2.9 percent in 2006 and a 2.4 percent in 2007. GII expects core CPI growth (CPI less food and energy) to be slightly higher, but to remain under control as well, averaging just under 2.5 percent through the forecast horizon.

Nominal GDP Outlook Almost Unchanged for 2006-07, But Slightly Weaker in 2008-09



GII assigns a probability of 55 percent to their baseline forecast, the same as in November. A more pessimistic scenario containing higher inflation and slower growth, but no recession, is assigned a 25 percent probability. A more optimistic scenario is given 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. Council members were a little more nervous than GII about the inflation outlook over the next 18 months, but there was general agreement with the baseline forecast for real growth. Council members were split on whether the short term forecast was more likely to be too optimistic or too pessimistic.

Department of Finance economists again noted that Minnesota employment growth is not keeping up with the national averages. For 2005 it now appears that payroll employment grew about ¼ percentage point more slowly than the U.S. average. Wage growth was also below the U.S. average. Council members and Finance Department economists held an extended discussion examining possible explanations for the weakness in Minnesota employment, and whether it should be considered a short-term aberration or the sign of a potential structural problem that will extend into the future. Finance Department economists indicated that other things equal the weaker than expected wage growth during the fourth quarter of 2005 would reduce the coming forecast of individual income tax receipts. Council members agreed that the current data warranted some caution in the outlook for future employment and wage growth in Minnesota.

Council members once again stressed the importance of rebuilding reserves. Using the November forecast to buy back the school aid payment shift and a portion of the property tax recognition shift, as was required by statute was seen by the Council as a useful tool to help manage future financial risk. The Council continues to believe, however, 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 the current law requirement that the Finance Department project future expenditures without making any allowance for inflation except where specifically required by law understates the severity of potential financial problems facing the state in future biennia.

Economic Outlook

After a brief year-end slowdown, the U.S. economy is surging ahead according to most indicators. That could be too much of a good thing since there is little spare capacity and inflationary pressures are building. In addition to pressure from strong demand, supply side forces are at work. Average hourly wages are creeping upward, productivity gains are weakening, and there are more anecdotal reports of firms making price increases stick. Global Insight's February outlook is for an ideal outcome in which gradually rising interest rates and a cooling housing market provide enough drag to slow the economy to a so-called "soft landing" late this year.

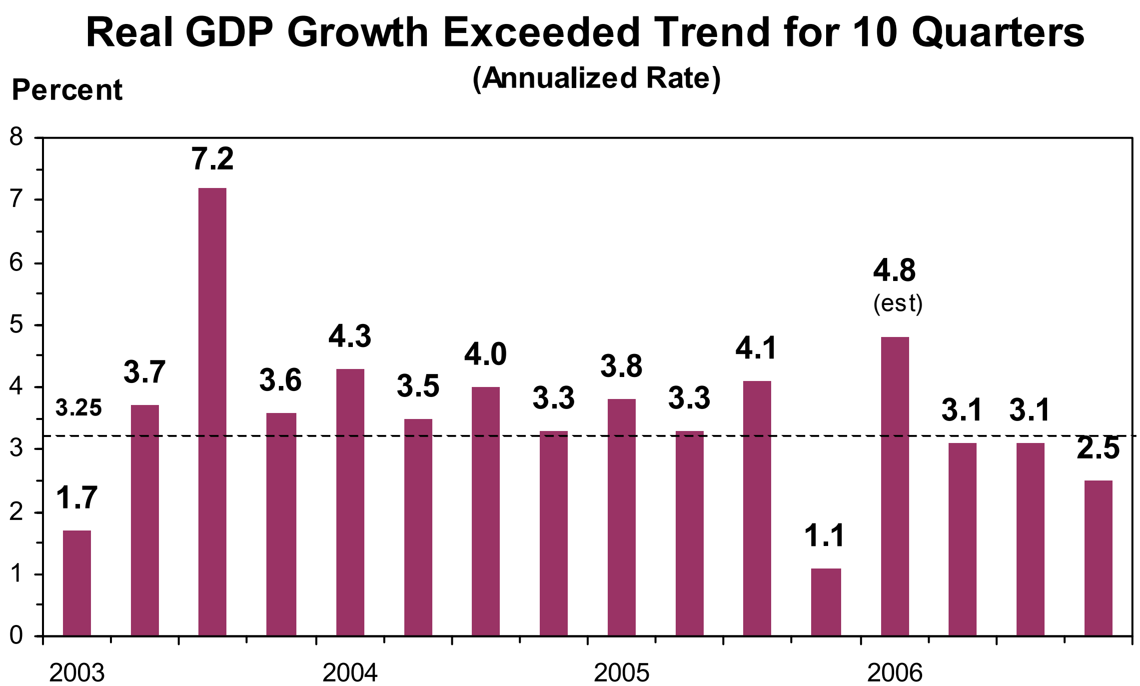
Since 2003, real GDP growth has generally exceeded the 3.25 percent annual rate economists consider sustainable without accelerating inflation. Except for the housing market, there are few signs of cooling in recent data, leading some analysts to question the effectiveness of the Federal Reserve's tightening since 2004. Third Quarter 2005 real GDP growth was a surprising 4.1 percent and would have been more but for the hurricanes, while the fourth quarter's sluggish 1.1 percent was due to one-time events. In the current quarter, Global Insight expects GDP growth to reach 4.8 percent as business investment spending picks up and consumer outlays rise.

While not expected to lead the economy in 2006, consumers hold the key to a prolonged expansion. Household spending is vulnerable to another spike in energy prices, a sharp surge in interest rates, or a sudden acceleration in core inflation. Consumers are in a poor position to absorb a sudden loss of purchasing power because they are already dealing with heavy debt loads, high energy costs, and a cooling housing market. Better than expected retail sales have convinced forecasters consumers will do their part as long as there are no surprises.

Can Inflation Be Contained?

Analysts differ as to how much additional inflation can be expected. Clearly, prices are poised to rise faster. Core inflation was 2.2 percent in 2005, up from 1.8 percent in 2004, and has accelerated a little in recent months. That is unlikely to stop soon. Even though energy prices have receded somewhat, part of past increases will still be passed on into other prices. And prices also will eventually reflect some part of wage gains which will accompany further declines in the unemployment rate. Global Insight predicts 2.3 percent core inflation in 2006, a more modest acceleration than predicted by some other forecasters.

With additional inflation already in the pipeline, the greatest risk seems to be another energy price shock which then spills over into other prices more readily than last time. If that happens, controlling inflation almost surely would require larger doses of monetary tightening than experienced recently, and the financial markets would probably be more volatile. In recent testimony before Congress, Dr. Bernanke tried to soothe the markets by keeping his interest rate options open. Absent an unfavorable shock and assuming the Federal Reserve's incremental interest rate moves of the past 20 months soon begin to have a noticeable impact, February's baseline forecast is for core inflation to peak around 2.4 percent in 2007.



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Long Term Interest Rates Remain Surprisingly Low

It appears there is still time for previous Fed tightening to work because inflation is accelerating slowly, inflation expectations do not appear to be rising very much if at all, and, while weakening, productivity growth remains strong enough to help hold down labor costs. At this time, gradually rising long term interest rates would help ensure the Fed's success because they have a stronger impact on the economy than short rates. But only the financial markets control long rates, not the Fed.

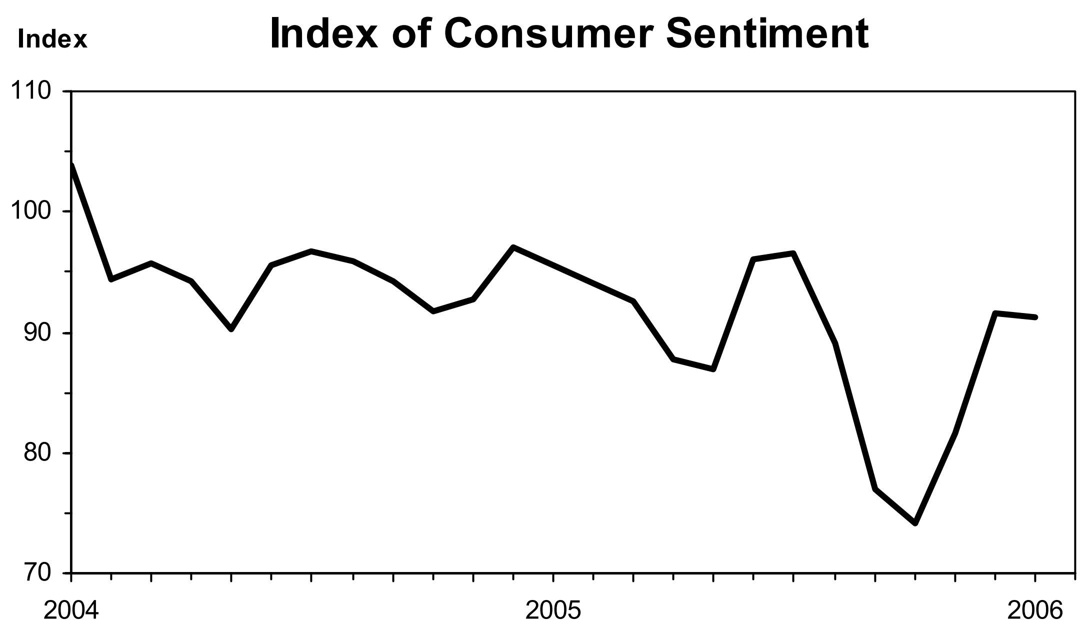
Hardly anyone believes the slightly inverted yield curve is signaling a recession. But, most observers think long term rates are unusually low for an expansion now almost 5 years old, something Dr. Greenspan called a conundrum. Many were surprised when long rates rose so little as the Fed tightened in 2005.

Explanations abound. Some economists attribute low long rates to financial market complacency about upside inflation risk. Others point out purchases of dollar denominated instruments by foreign central banks and overseas investors, a consequence of large U.S. trade deficits. But, the real lesson is long rates can surprise. In the February baseline, Global Insight is forecasting no more surprises with the benchmark 10-year Treasury rate gradually rising from 4.5 percent at the end of 2005 to about 5.0 percent by mid 2007.

Consumption

A robust labor market has helped consumer confidence recover from its post-hurricane dive. However, Global Insight predicts consumers will slow their spending a little during 2006 because of a heavy debt load, higher interest rates, and slower appreciation in house prices. Fewer housing starts will also mean less spending for household goods.

Unless something goes wrong, consumers are not likely to retrench. Real fourth quarter consumer spending grew a sluggish 1.1 percent only because of a deep slump in auto sales following last summer's especially attractive incentives. But, non-auto spending rose 4.8 percent. Auto sales have since picked up, and forecasters interpret recent retail sales results to mean consumers are not intimidated by a cooling housing market, nor were they overwhelmed by winter heating bills. Unusually warm weather in many parts of the country has helped.



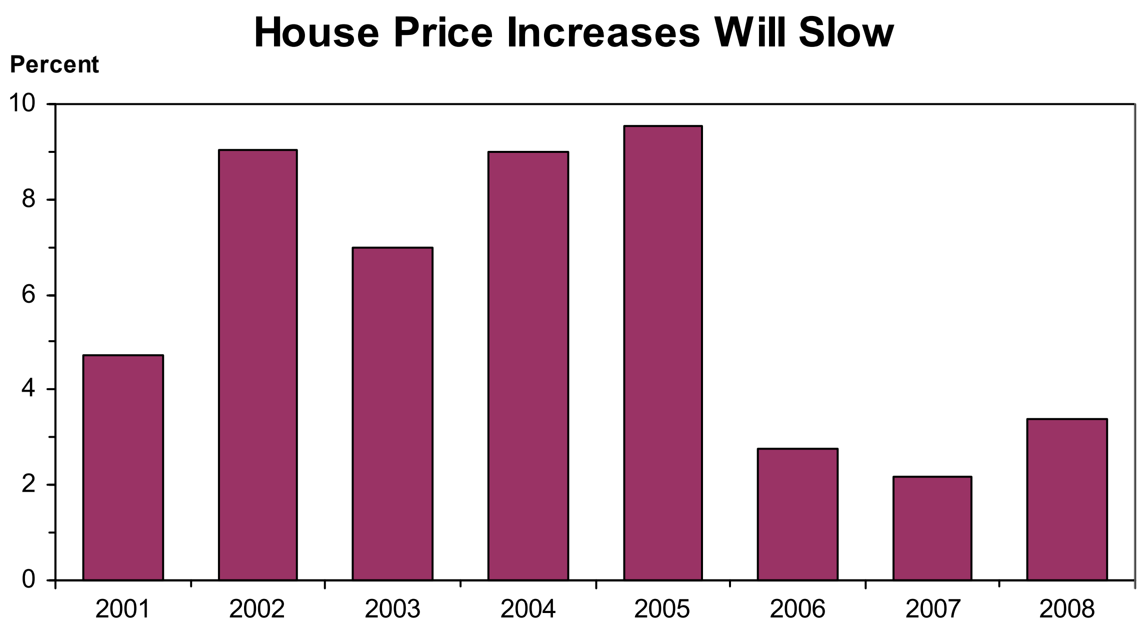
A robust labor market has helped consumer confidence recover from its post-hurricane dive.

Last quarter's sales slump demonstrated autos' importance to consumer spending. The future is somewhat clouded because the market is saturated. Global Insight notes that for some time the stock of autos has increased much faster than the driving age population, an unsustainable situation. Other analysts also point out that people are keeping their cars longer, with the age of the average auto now at a 30-year high.

Investment

In the February baseline, housing starts and home sales decline until the end of the decade. House prices, however, continue to rise, though much more slowly than in the recent past.

A few analysts and much of the media are devoting attention to the possibility of a sudden plunge in house prices. While indicating that would be one of the worst things that could happen to the economy, Global Insight is not alone in being skeptical. More likely the current slowdown in house price appreciation will continue as marginal buyers are gradually forced out of the market. In the February baseline, slowly rising mortgage rates help cool the housing market in 2006, but no widespread decline in house values is expected.



Slowly rising mortgage rates will help cool the housing market, but no widespread decline in housing values is expected.

At least some academic economists also doubt there will be a sudden, widespread plunge in house prices. Though focused on conditions prevailing at the end of 2004, a recent *Journal of Economic Perspectives* article is still worthwhile because of its in-depth analysis. After taking local economic conditions into account, the authors find there is little evidence of a bubble in most metropolitan areas. So, barring a surprising surge in mortgage rates or a severe economic downturn, a plunge in house values is unlikely. The authors note, though, that their conclusions apply only to single family homes.

As housing and consumer spending cool in 2006, business fixed investment is expected to lead the economy. Firms are cash rich, and they are expected to spend heavily, primarily on computers and communications equipment. In the February baseline, spending on structures also accelerates in 2006, but then tapers off in 2007 as hurricane repairs are completed. Despite reports of an improving office market in the *Wall Street Journal* and elsewhere, Global Insight indicates commercial construction has yet to rebound.

Government

Since last November, Global Insight has raised its estimates of the federal budget deficit over the entire forecast horizon. The change reflects appropriations for Iraq and Afghanistan, the cost of the unfunded Medicare Part D program, more hurricane relief, and higher interest rates than previously expected. There is also a lower outlook for wage income which reduces the federal revenue forecast. In the February baseline, the deficit increases to $367 billion in fiscal 2006, up from $319 billion in fiscal 2005.

With the economy producing close to capacity, the rising federal budget deficit is a source of significant near term inflationary pressure. That could make financial markets more volatile, increasing the risk of an interest rate surprise.

The deficit is forecast to decline after 2006, but so slowly the outlook is for large shortfalls throughout this decade and beyond. That view is shared by most analysts who sometimes question whether chronic, large deficits are sustainable without adverse long term consequences. A recent Congressional Budget Office (CBO) report concludes deficits reduce national saving and private sector investment, thus lowering future living standards.

Finance Department economists wish it was that easy to resolve deficit issues. The CBO view should be qualified to take into account deficits incurred at times when the economy is running close to full capacity as it is now. At full capacity, federal borrowing can crowd out private sector investment. But even if full capacity prevails, further analysis is needed, and there are no simple answers. There is the question of how much crowding out can occur when firms are as cash rich as they are now. And as CBO points out, there is the question of whether the objects of deficit spending will contribute more to future living standards than private sector investment, a particularly difficult problem since defense outlays and entitlements are a big part of the budget.

International

In 2005, the current account deficit surged as imported oil prices rose. February's baseline assumes crude oil reached its peak of some $70 per barrel late last August. Crude is now forecast to decline to about $55 by 2008, which is about $9 more than forecast last November. *Business Week* calls this the "new reality" in oil prices. Diplomatic tensions in the Middle East, civil unrest in Nigeria, and political developments in Latin America pose a significant upside risk to oil prices, and to the trade deficit.

Global Insight predicts the trade deficit will rise to a record level in 2006. Subsequently, it will shrink slowly, but a large deficit is expected to persist for the rest of the decade and beyond. Because of the deficit, the dollar is expected to resume its gradual decline once the Federal Reserve stops raising interest rates.

As long as the trade deficit exists, foreigners will accumulate dollar denominated assets, with potential long term adverse consequences. Two possibilities seem to stand out. One is that foreigners decide to sell in order to diversify. Conceivably, if one large foreign investor sells, the rest will rush to follow. A stampede to market could send the dollar into a dive, imposing large capital losses on all but the first few sellers. In the U.S., higher interest rates and more inflation would almost surely follow, potentially pushing the economy into recession.

However, a recent Federal Reserve Bank of San Francisco analysis discounts this scenario, noting that there seems to be little reason to believe foreigners would knowingly impose large capital losses on themselves. More likely they would maintain their dollar holdings while diversifying into other currencies as China is apparently now doing.

A more plausible adverse outcome is considered by economist Ronald McKinnon. In a paper sponsored by the Brookings Institution he concludes that U.S. households have found it easy to become highly leveraged because credit is cheap, financed by dollar denominated assets sold to foreigners. The resulting heavy household debt burden leaves consumers less able to deal with future weakness in purchasing power imposed by the job market or by accelerating inflation, making the U.S. economy less stable.

Inflation

Last fall's inflationary spike is tapering off much as forecasters predicted. Some part of the run-up in energy prices will still spill over into core inflation, but so far that has been less than expected. Better yet, the media report that the Michigan Survey of Consumer Sentiment indicates expected inflation is declining after rising last fall. It should be noted, however, that some financial market data does not support that conclusion.

Recent data indicate the pre-hurricane drift toward higher core inflation continues. Core consumer inflation was 2.2 percent in 2005, up from 1.8 percent in 2004. Global Insight predicts 2.3 percent in 2006 and 2.4 percent in 2007. *Business Week* reports hourly wage increases seem to be accelerating in a tightening labor market. Inflationary pressure in the labor markets will intensify if real GDP grows at above-trend rates much longer. While productivity increases will help dampen the impacts of above-trend growth, it seems the inflationary build up can be halted smoothly only if past Federal Reserve tightening ultimately proves successful.

Monetary

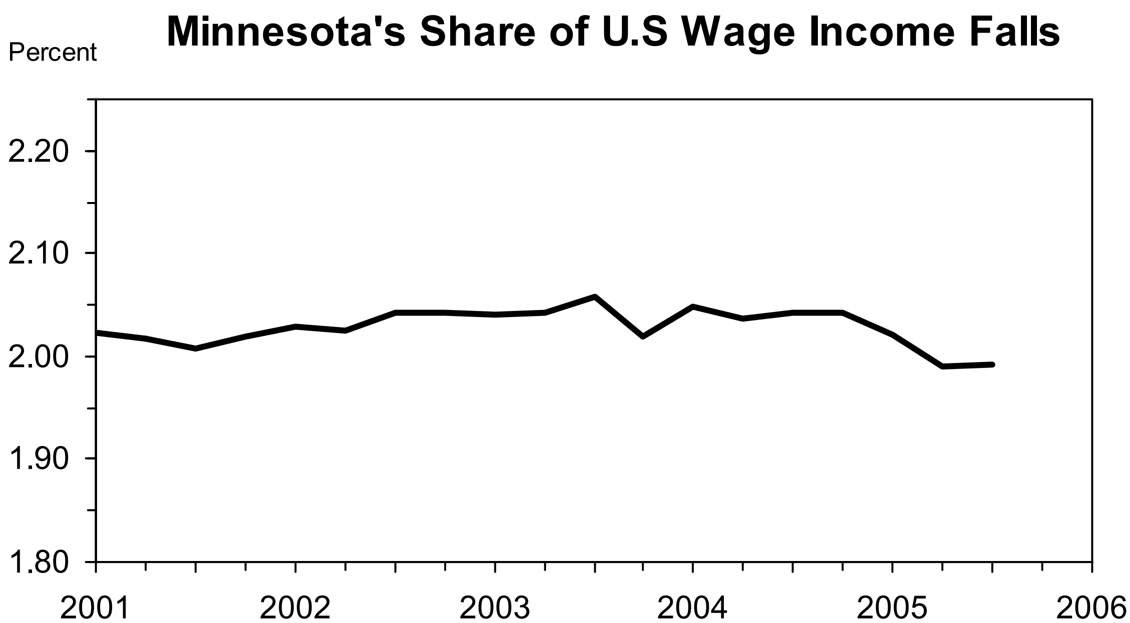
February's baseline assumes the Federal Reserve raises short-term rates to 4.75 percent at the end of March and then pauses for an indefinite period. While many observers think a pause is coming, in recent Congressional testimony Dr. Bernanke sought to soothe the financial markets by indicating he would keep an open mind while continuing to monitor developments.

Whether to pause is likely to be Dr. Bernanke's first big decision as Federal Reserve chairman. Any decision involves significant risk. Since monetary policy affects the economy with a long lag, generally thought to be about 18 months, the impact of most of the recent string of 15 quarter-point interest rate increases is yet to be observed. There could also be delayed negative effects of higher energy costs. Consequently, the economy could be already headed for a hard landing which further tightening would only make worse. But, the risks are not one-sided. If inflation expectations are rising unseen, without further tightening the current drift toward higher inflation would probably accelerate. That could be hard to bring under control without risking a recession.

Minnesota Outlook

Recent data show Minnesota's economy did not perform as well in 2005 as anticipated in the November forecast. Seasonally adjusted employment data for the last three months of 2005 show almost no growth in any major sector except health care, and December's income tax withholding collections were significantly below estimate, implying weak wage income growth. The February forecast is for Minnesta's weak expansion to continue during the first half of 2006 before accelerating.

Previous forecasts noted that Minnesota's share of total U.S. jobs is slipping downward. Preliminary data now show the state's share of total U.S. wage income declined in 2005. There is no evidence these developments will reverse in the near future, though conditions seem a little better in the current quarter. The Department of Employment and Economic Development (DEED) reports job vacancies at the end of 2005 were up from a year ago, an improvement from the previous survey taken last June. But, there was no increase in the reported median wage. And while continuing claims for unemployment insurance are down slightly in recent weeks, they are still well above prerecession levels.



Preliminary data shows Minnesota's share of U.S. wage income declined in 2005. There is no evidence this development will reverse in the near future.

Finance Department economists interpret those mixed indications to mean that 2005's weak expansion will continue for a while. But, beginning in late spring or early summer, some improvement is expected provided Global Insight's baseline forecast for the U.S. economy materializes. Much of the Minnesota outlook depends on whether the state's economy gets a boost from very strong U.S. growth in the current quarter. With Minnesota's share falling, that is not a sure thing.

Minnesota's Economy Weaker Than Expected

Employment data and new estimates of wage and salary income for 2005 now indicate the Minnesota economy's performance has been weaker than expected. The November forecast also assumed that in late 2005 jobs were growing steadily by some 3000 monthly on a seasonally adjusted basis, with several major sectors contributing. In fact, revised data show most of the late 2005 growth concentrated in health care.

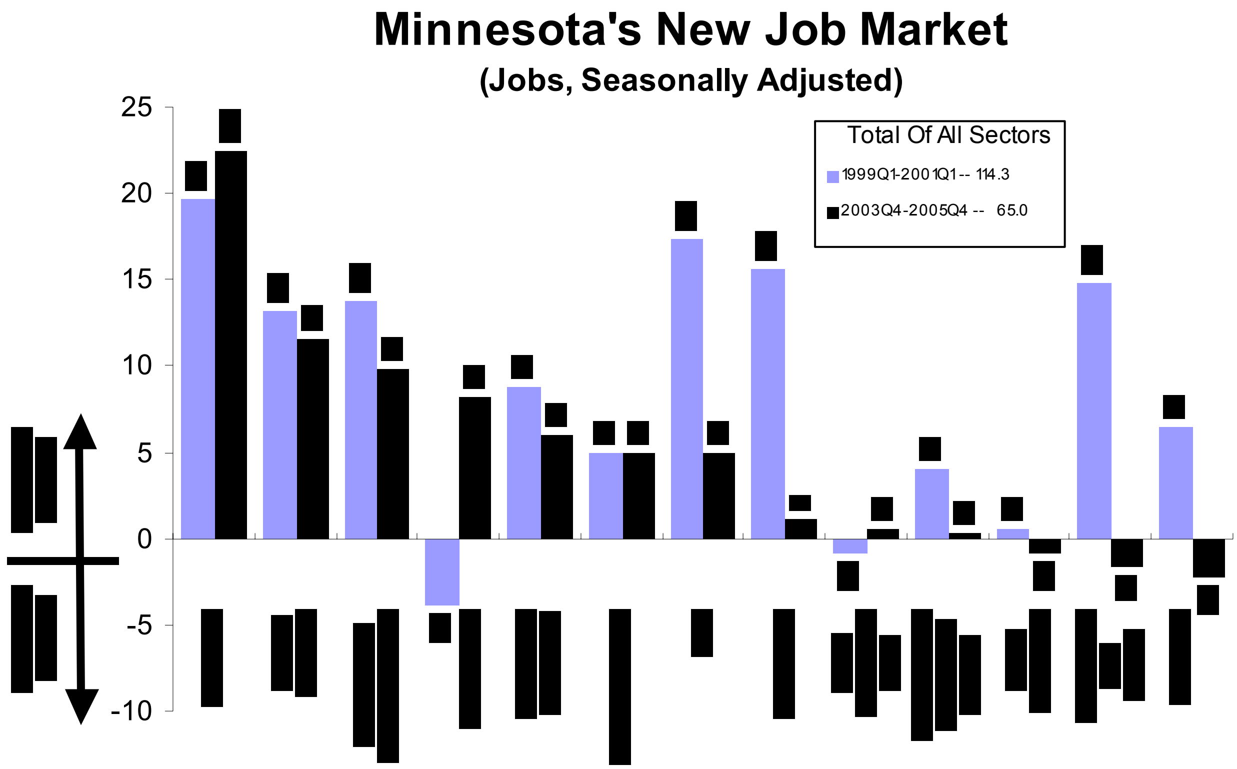
In November, 2005 wage income was forecast to grow 4.5 percent. Complete data will not be available until early summer, but there is now at least some information for all four quarters of 2005. Wage income reported to the unemployment insurance system and income tax withholding collections now indicate wages grew only 3.5 percent in 2005. Withholding collections for December imply near-zero fourth quarter growth in wage income compared to previous quarters, though there seems to be some improvement in the current quarter.

Minnesota's New Job Market

Minnesota's recent economic performance reflects the state's new job market. Now, laid off workers must often seek employment in a new industry or occupation. And new labor force participants must often work in industries or occupations they previously would not have chosen. Consequently, it seems job searches are taking longer and there are anecdotes of laid off workers going back to school or accepting jobs paying less than the ones they had.

In the new job market, during the two years ending in Fourth Quarter 2005 net job growth became concentrated in fewer industries compared to the two years ending with the beginning of the last recession in early 2001. Trade, construction, educational and other services, information, and transportation, warehousing, and utilities were not the significant contributors they once were. At the same time, health care accounted for 34 percent of total job growth, up from 17 percent previously.

Other data also suggest Minnesota's job market has changed. Historically, the state's unemployment rate averaged about 1.5 percentage points below its U.S. counterpart. In recent years that spread has narrowed to about one percentage point. In addition, continuing claims for unemployment insurance have not retreated to anywhere near pre-recession levels, and labor force participation has dropped off except for those near retirement age. Some observers suggest the decline in participation is due to difficulty finding a job while others cite employers' reluctance to offer wages high enough to draw people into the labor force.



Minnesota's recent economic performance reflects the state's new job market in which growth is concentrated in fewer industries than it was just a few years ago.

There is at least one favorable new development. During the past two years, the manufacturing sector employment grew again after losing jobs prior to the recession. Overseas trade could be a reason. Data from DEED indicate strong growth in exports of Minnesota manufactured goods. And research by the Federal Reserve Bank of St. Louis concludes the Minnesota's exports are getting a boost from the North American Free Trade Agreement (NAFTA). Surprisingly, that includes increased exports to Asia, an important and still emerging market.

A Revised Outlook

Outlooks for Minnesota's employment and wage income have been revised based on Global Insight's February baseline and information obtained since November's forecast. Expected employment growth is almost the same as in November, but wage income growth is less than previously forecast. The U.S. outlook also has been revised downward in a manner similar to Minnesota's.

Minnesota And U.S. Economic Outlook

(Calendar Year Percent Changes)

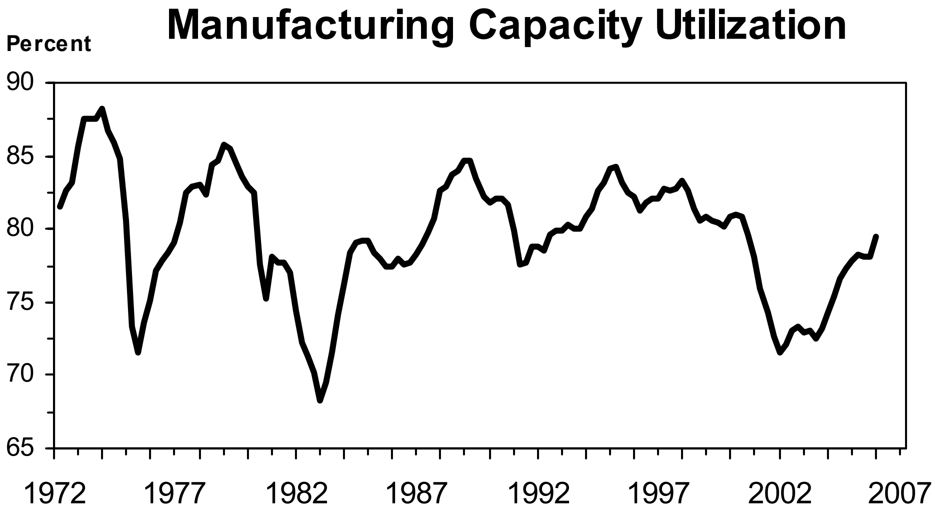
	2004	2005	2006	2007	2008
Non-Farm Employment					
Minnesota					
November 2005	0.7	1.3	1.0	1.0	0.9
February 2006	0.7	1.4	0.9	1.0	0.9
United States					
November 2005	1.1	1.6	1.6	1.4	1.3
February 2006	1.1	1.5	1.5	1.4	1.1
Wage and Salary Income					
Minnesota					
November 2005	4.9	4.5	4.9	4.8	5.0
February 2006	5.7	3.5	4.7	4.6	4.6
United States					
November 2005	5.4	6.5	5.7	5.9	5.9
February 2006	5.4	6.0	5.1	5.4	5.3

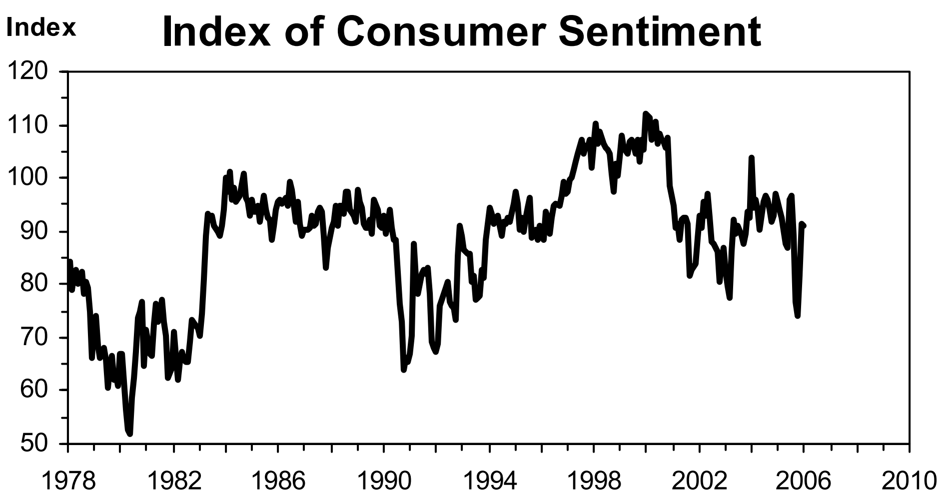
A Summary of Assumptions

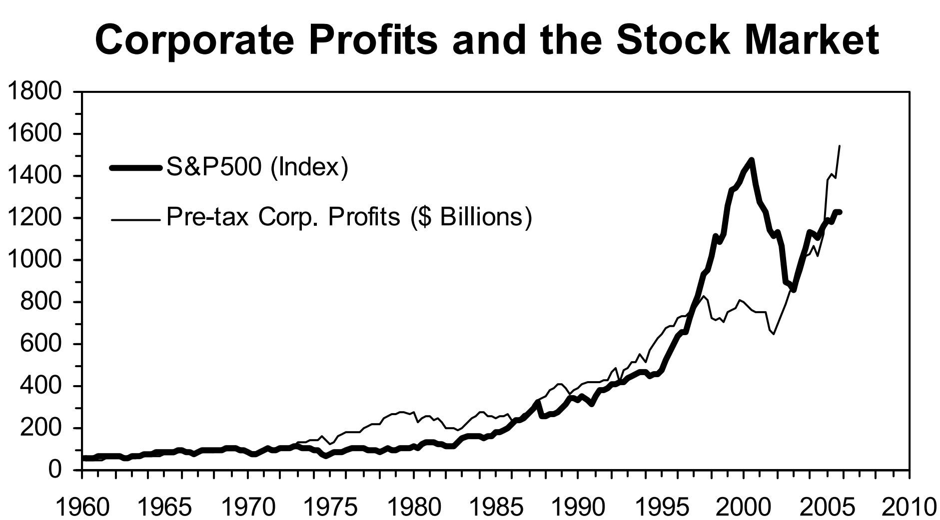
If the February forecast is to materialize, Minnesota must now be adding some 1400 jobs monthly on a seasonally adjusted basis. Future growth is expected to be concentrated much as in the recent past, with health care accounting for some 39 percent of total additional jobs over the next two years. The remainder must come in smaller increments from several sectors which, Finance Department economists note, have recently showed few if any signs of gains. It should also be noted that construction is expected to lose jobs over the next two years, a consequence of a softening housing market.

While the forecast is for a slow start in early 2006, Minnesota's economy must gather strength during the summer, with seasonally adjusted job growth rising to about 3500 monthly in the second half of 2006. As employment increases, productivity gains must continue to drive real wages per job upward.

Selected National Economic Indicators







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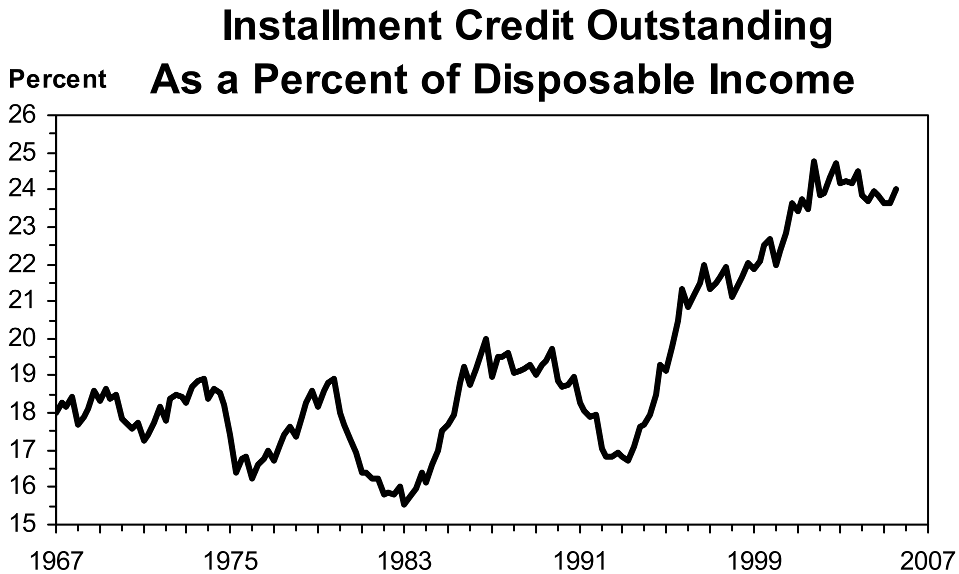

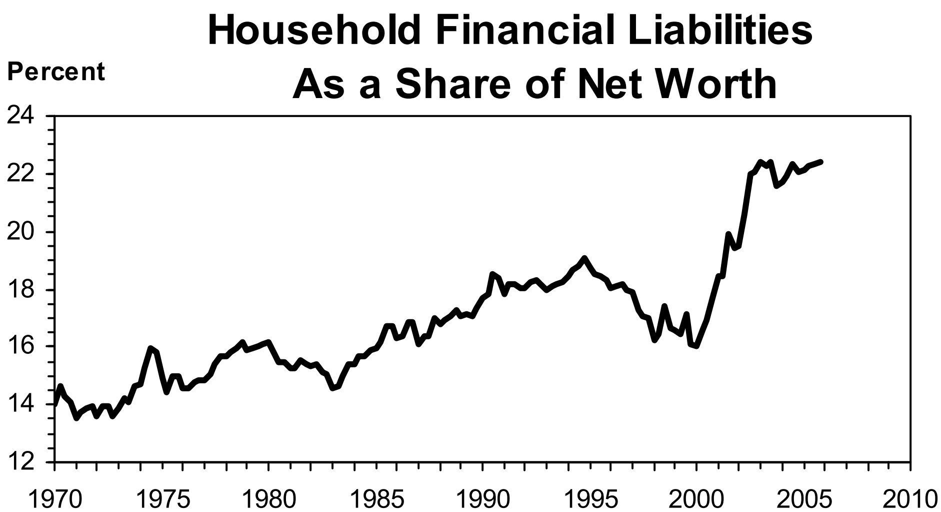

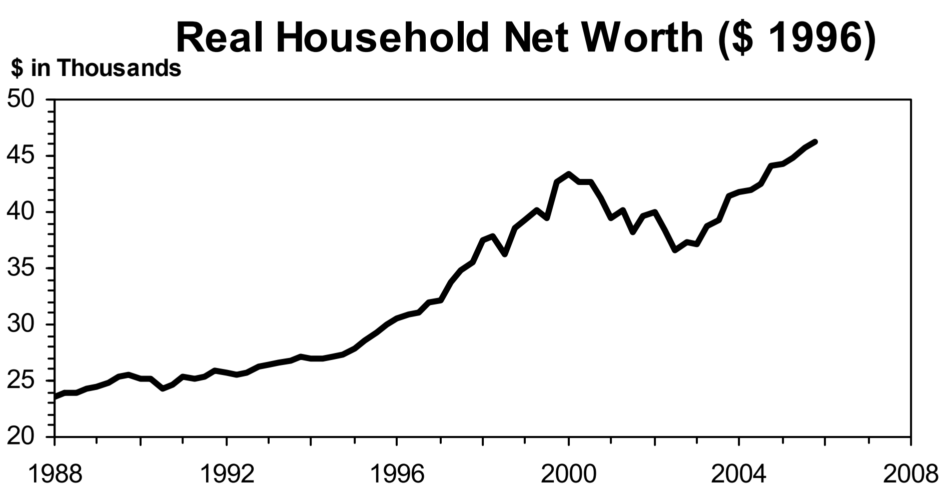

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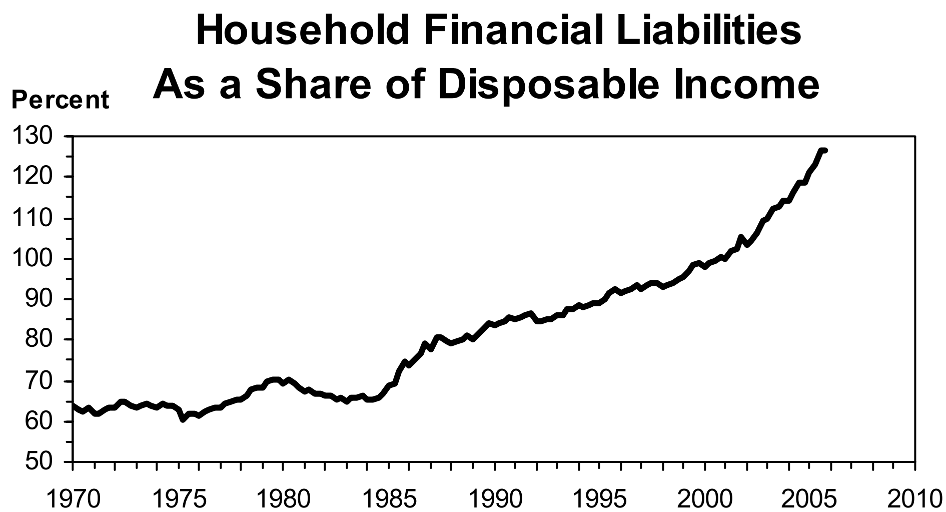

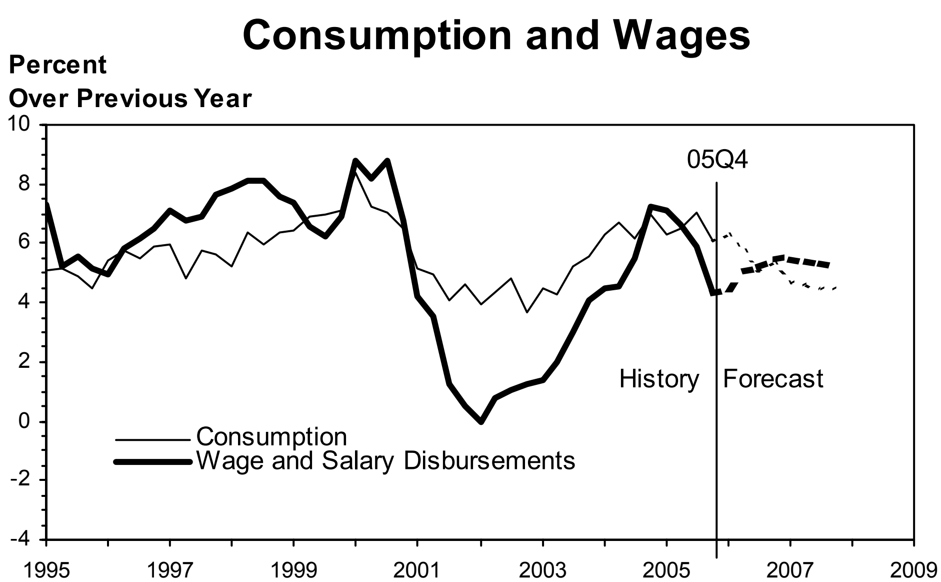

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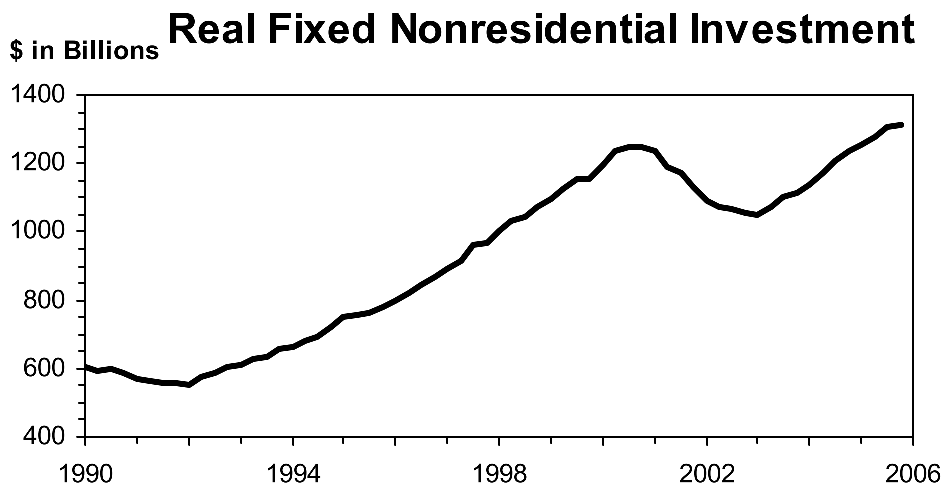

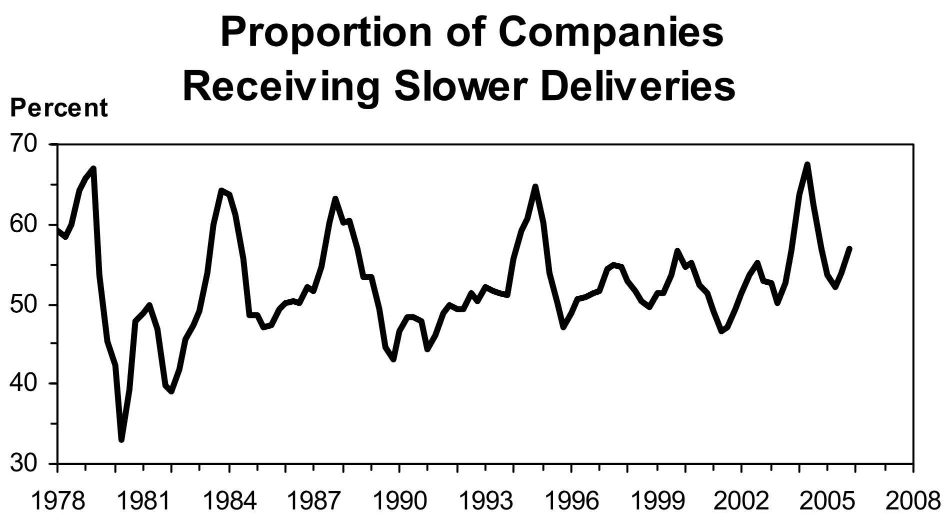

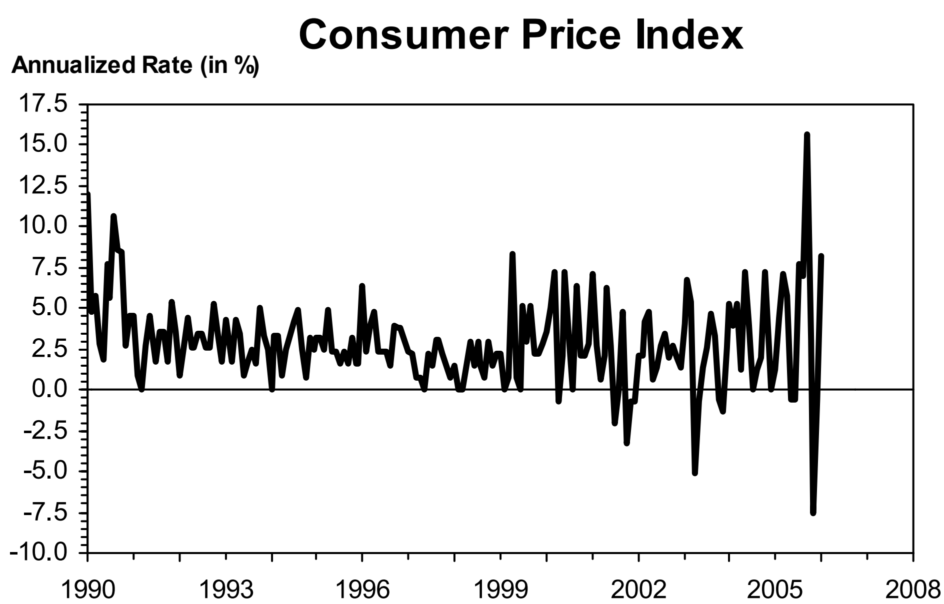

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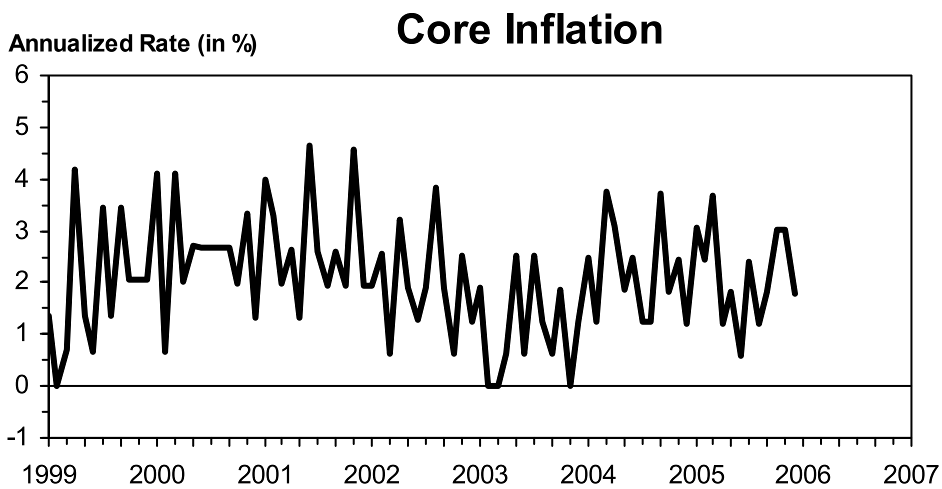

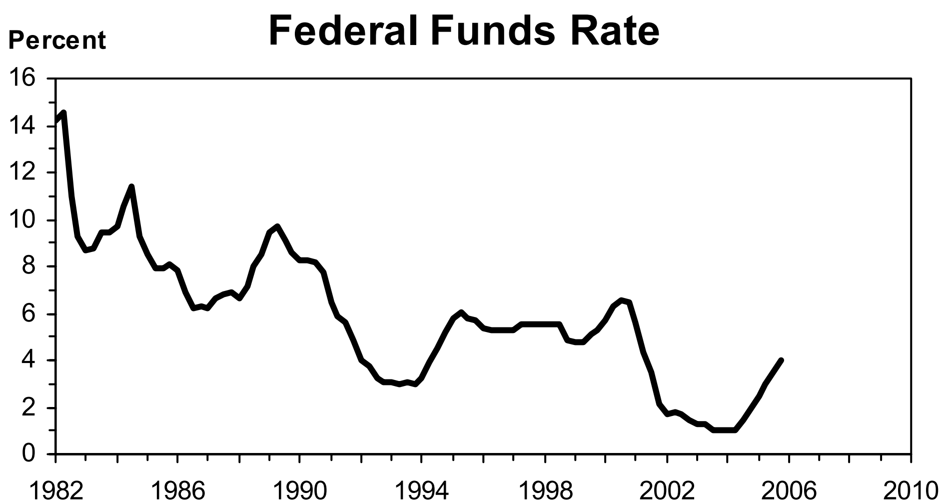

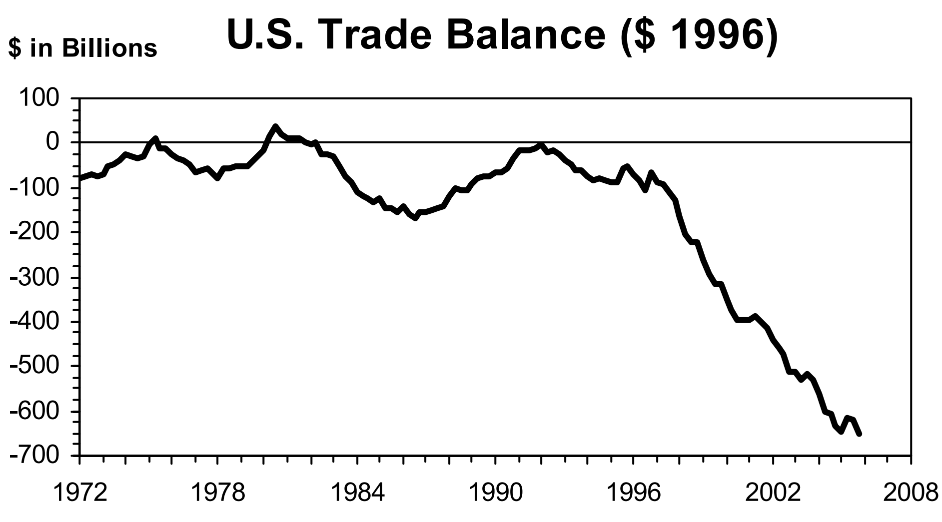

FY 2006-07 Budget Summary
FY 2008-09 Planning Estimates

$181 Million Balance Forecast for FY 2006-07, $93 Million Allocated by Current Law

Forecast revenues for the current biennium have increased $106 million, while projected transfers, dedicated revenues and other resources increased by $18 million, producing a net revenue gain of $124 million. Estimated biennial spending has fallen $57 million, resulting in a forecast balance of $181 million. Under current law any forecast balance must go to buy back any remaining portion of the K-12 property tax recognition shift. After $93 million is used for this purpose, $88 million remains as an available budgetary balance.

Comparison: FY 2006-07 Budget
($ millions)

	November Forecast	February Forecast	Change
Beginning Balance	$1,393	$1,393	$0
Non-dedicated Revenues	30,345	30,451	106
Other Resources	935	953	18
Expenditures	31,353	31,296	(57)
Balance before Reserves	1,320	1,502	182
Cash Flow Account	350	350	0
Budget Reserve	653	653	0
Tax Relief Account	317	317	0
Balance before Allocation	0	181	181
School Shift Buyback	--	*93*	*93*
Available Balance	**$0**	**$88**	**$88**

Small Changes in Revenues, FY 2006-07 Forecast up by $124 Million

Net non-dedicated revenues for the 2006-07 biennium are now forecast to be $30.451 billion, $106 million (0.3 percent) more than forecast in November, transfers and other resources added $18 million to bring total resources to $31.404 billion.

Changes in the five major revenues were generally small and offsetting. The net change was $14 million. Expected receipts from the individual income tax were $129 million below November's estimate and the sales tax $2 million less than previously forecast. The corporate income tax forecast was increased $161 million reflecting the increase in the corporate profit forecast and higher than projected receipts in the fourth quarter of 2005.

The forecast for other tax and non-tax revenues grew by $92 million. The largest changes came in higher forecasts for receipts from the mortgage taxes, the estate tax, investment income, fees, payments from the tobacco settlement, and all other non-dedicated revenues.

Forecast Spending for FY 2006-07 Slightly Lower before K-12 Shift Buyback

Forecast spending for the biennium is now expected to be $31.296 billion, $57 million (0.2 percent) less than projected in November. Lower K-12 education spending contributed $12 million of the savings in the current forecast, a reduction in health and human services estimates provided $19 million, while a $19 million reduction in debt service estimates and a $10 million reduction in projected tax aid and credit spending contributed the balance of the savings. Changes in all other spending areas were limited to small, largely offsetting items.

After allocating $93 million to complete the school shift buyback, revised spending totals $31.389 billion, $36 million above November's forecast.

Required Forecast Allocations Completed

State law (M.S. 16A,152,Subd2) requires that any general fund forecast balances must first be used to restore the state's cash flow and budget reserve accounts. Any remaining balances are then required to be used to reverse education shifts enacted in 2002 and 2003 as part of the solution to state budget problems. With this forecast, those requirements have been fully met. Statutory allocations totaling $1.439 billion were triggered by the last four positive state budget forecasts – restoring reserves to 2002 levels and completely reversing the school accounting shifts.

Forecast Date	Reserves	K-12 Shift Buyback
	($ in millions)	
November 2004		
Restore cash flow account	$350	
Restore budget reserve to $653	27	
K-12 payment change (80/20 to 81.9/18.1)		$118
February 2005		
K-12 payment change (81.9/18.1 to 84.3/17.4)		150
November 2005		
K-12 payment change (84.3/17.4 to 80/20)		370
K-12 property tax recognition 48.6 to 10.8		331
February 2006		
K-12 property tax recognition 10.8 to zero		93
Total Statutory Allocations	**$377**	**$1,062**

FY 2008-09 Planning Estimates Indicate Slightly Lower Balances

Projected revenues for FY 2008-09 have been reduced by $140 million (0.4 percent), while spending has increased $2 million from November's planning estimates. Planning estimates for the individual income tax, the sales tax and the motor vehicle sales tax were all scaled back slightly. As in the outlook for 2006-07, projected corporate tax receipts were increased slightly, as were other tax and non-tax revenues.

The total change in spending is small and the changes by major program area mirror FY 2006-07 experience. K-12 education spending is slightly above November's estimate reflecting out-year costs of the shift buyback in the current biennium. Savings in health and human services spending, and lower debt service spending in the current biennium carry forward at similar levels into the FY 2008-09 planning estimates.

The planning estimates do not reflect any Governor's recommendations or potential legislative actions in the 2006 session. Those actions will likely affect the current biennium and FY 2008-09. Since the forecast makes no assumption about possible budget actions, the planning estimates for FY 2008-09 highlights the difference between likely ongoing revenues and ongoing spending.

FY 2008-09 Revenue-Expenditure Balance

($ in millions)

	November Forecast		February Forecast	
	FY 2008	**FY 2009**	**FY 2008**	**FY 2009**
Revenues	$16,305	$17,151	$16,341	$16,974
Spending	15,972	16,249	15,967	16,257
Difference	**$333**	**$902**	**$374**	**$717**
Estimated Inflation	*(271)*	*(640)*	*(303)*	*(640)*
Const. Amendment	*(60)*	*(125)*	*(56)*	*(116)*
Balance	**$2**	**$137**	**$15**	**$(39)**

The positive balance between revenues and expenditures in the FY 2008-09 planning estimates has fallen from that forecast in November. In November, balances of $333 million in FY 2008 and $902 million for FY 2009 were projected. The comparable numbers are now $374 million in FY 2008 and $717 million in FY 2009.

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 1.9 percent in FY 2008 and 2.0 percent in FY 2009. November's baseline called for CPI growth of 1.7 and 2.2 percent. If spending were uniformly adjusted for current estimates of inflation, this would add about $943 million to the amounts shown, $303 million to FY 2008 spending and $640 million to FY 2009.

The current law planning estimates also do not include the potential effect of a constitutional amendment that will be on the 2006 ballot. The pending amendment would phase-in the complete dedication of the remaining general fund portion of motor vehicle sales taxes beginning in FY 2008. If enacted, this would reduce projected general fund revenues by $172 million in the next biennium - $56 million in FY 2008, and $116 million in FY 2009 based on the current projections of motor vehicle sales tax revenues.

Revenue Forecast
FY 2006-07

Current general fund resources for the 2006-07 biennium are now forecast to total $31.404 billion, $124 million (0.4 percent) more than in November. Net non-dedicated revenues are now projected to be $30.451 billion, $107 million (0.4 percent) more than November's estimate. Biennial receipts for Minnesota's five major taxes are now estimated to be $26.372 billion, $14 million more than the previous forecast. February's forecast for 2006-07 biennial revenues exceeds the level projected at the end of the 2005 special legislative session by $818 million or 2.7 percent. The forecast for the five major revenues has increased by $532 million, or 2.1 percent from end-of-session estimates.

Revenues FY 2006-07
($ in millions)

	FY 2004-05	FY 2006	FY 2007	FY 2006-07
Individual Income	$12,051	$6,609	$7,009	$13,618
Sales	8,340	4,468	4,646	9,114
Corporate	1,554	957	886	1,842
Motor Vehicle Sales	534	250	254	504
Statewide Levy	1,210	630	664	1,294
Five Major	23,689	12,914	13,458	26,372
Other Revenue	3,513	1,965	1,762	3,727
Tobacco	344	179	173	352
Net Non-dedicated	27,546	15,058	15,394	30,451
Other Resources	1,607	251	702	953
Current Resources	**$29,153**	**$15,309**	**$16,095**	**$31,404**

Projected individual income tax receipts have been reduced by $129 million since November but remain $59 million more than end-of-session estimates. Expected sales tax receipts are now $2 million less than November's forecast and $171 million more than end-of-session estimates.

Changes in Economic Assumptions

The Global Insight baseline forecast has not changed materially since November. Expected real GDP growth rates have been lowered by 0.2 percentage points in both fiscal 2006 and 2007, and projected nominal or current dollar growth rates reduced by 0.1 percentage points. Real GDP growth is now projected to grow at an annual average rate of 3.2 percent during the biennium. The projected nominal growth rate for the biennium is 5.8 percent. The energy price forecast has been increased significantly, particularly for 2007 and beyond, driven by GII's re-assessment of supply and demand fundamentals. GII now believes that oil prices will be at the $60 per barrel level through the end of 2007 and above $50 per barrel through 2010. The November baseline assumed that prices would drop below $50 per barrel by 2007.

Global Insight is also less optimistic about the outlook for wage growth during the biennium. GII's February baseline calls for U.S. wages to grow at an annual rate of 5.2 percent over the biennium, 0.6 percentage points less than was forecast in November. U.S. wage growth is now projected to average 5 percent in fiscal 2006 and 5.6 percent in fiscal 2007. The Minnesota economic model also yields slower wage growth than in November. February's Minnesota baseline calls for statewide wages to increase by 5.2 percent in fiscal 2006 and by 3.7 percent in fiscal 2007. The GII outlook for corporate profits has improved. February's baseline forecast of corporate profit growth is three percentage points higher than November's in both fiscal 2006 and 2007.

Individual Income Tax

Individual income tax receipts for the 2006-07 biennium are now forecast to total $13.618 billion, down $129 million from November's estimate. Slightly more than half of the reduction in revenue was due to technical matters including a lower base level liability for tax year 2004 than was used in November. A change in the proportion of liability assumed to be paid in estimated tax payments added to the forecast.

Growth rates for tax year 2004 were adjusted to be consistent with the preliminary results of the 2004 sample of state individual income tax returns. Small changes were also made to projected growth rates for most sources of income and deductions for tax years 2005 through 2007.

The most significant change in this forecast was to the tax year 2005 wage growth rate. It was reduced to 3.5 percent, one percentage point below November's estimate, to be consistent with the lower than projected withholding growth observed during the final quarter. Projected wage growth rates in tax year 2006 and 2007 were also reduced modestly to match February's slightly weaker state economic forecast. The slower wage growth in tax years 2005 through 2007 was partially offset by stronger growth in non-wage income. In November, non-wage income in 2005 was projected to grow by 9.3 percent. In this forecast non-wage income is projected to grow at an 11.6 percent rate.

Estimated tax payments for the fourth quarter of tax year 2004 were stronger than anticipated. That, combined with additional economic data and revisions in the flow of funds account led to a slight increase in the projected growth rate for capital gains in tax years 2005 and 2006. Capital gains are now projected to have grown 9 percent in tax year 2005. In tax years 2006 and 2007 capital gains are assumed to grow at annual rates of 6 percent and 5 percent respectively.

Sales Taxes

Net sales tax collections for the 2006-07 biennium are now expected to reach $9.114 billion, $2 million less than forecast in November. The forecast for gross sales tax receipts was reduced by $700,000, while expected sales tax refunds were increased by $1.4 million. The $9.2 million positive variance in year-to-date sales tax receipts through January was included in the estimate.

Global Insight's current national forecast of key variables affecting Minnesota's sales tax receipts is modestly stronger than November's baseline. That potential increase was offset by a slight reduction in Minnesota's relative share of national consumption, business purchases and construction due to slower projected growth in income and employment in Minnesota than the national forecast.

Receipts elasticities were left the same as in November as were the projected losses in sales tax receipts to e-commerce and catalog sales.

Corporate Franchise Tax

Net corporate franchise tax receipts during the 2006-07 biennium are now estimated to total $1.842 billion, $161 million (9.6 percent) more than forecast in November. Much of the increase was due to an increase in Global Insight's baseline pre-tax corporate profits forecast. January's $39 million fiscal year-to-date positive variance also added to the forecast.

Fiscal 2006 revenues were increased slightly to reflect a change in the Department of Revenue's estimate of the timing of refunds related to the Hutchinson Technology decision. While the projected total of Hutchinson related refunds remains unchanged, the amount to be paid in the current biennium has been reduced by $20 million. In addition, prospective losses in tax payments in this biennium were reduced by $3 million. Estimates of corporate tax collections also were reduced to reflect slightly lower than anticipated compliance revenue through February.

Motor Vehicle Sales Tax

The general fund's share of Minnesota's sales tax on motor vehicles is now projected to yield $504 million during the 2006-07 biennium, $20 million (3.8 percent) less than forecast in November. Global Insight's February baseline forecast for U.S. auto sales is slightly more optimistic for 2006 than was November's, but that is largely offset by a more pessimistic forecast for 2007. GII now expects light vehicle sales to average about 16.6 million in both 2006 and 2007. Motor vehicle sales volume in Minnesota is expected to grow more slowly than the national average consistent with the forecast for slower growth in state employment. The $2 million negative variance in motor vehicle sales tax receipts since November's forecast was incorporated into the forecast.

Other

Other tax and non tax revenue, including the statewide property tax levy and transfers from other funds to the general fund are expected to total $6.326 billion, $114 million (1.8 percent) more than projected in November. Projected receipts from the estate tax and the mortgage tax were each up $20 million. The investment income forecast was raised by $30 million, reflecting stronger than forecast year-to-date earnings. The forecast of other, non-dedicated revenues was increased by $31 million following an adjustment in projected timing of receipts. Fees and tobacco settlement receipts were increased by $11 million and $7 million respectively.

Minnesota continues to collect the health impact fee despite a December 20, 2005 court decision enjoining the state from enforcing the fee against distributors. On January 18, 2006, the district court stayed its order, pending resolution of an appeal to the Minnesota Supreme Court. As part of that agreement Minnesota has stipulated that it will retain any health impact fees collected, along with any earnings on those fees, in the health impact fund until the case is resolved. If state court appeals are not exhausted by the end of the current biennium the state may transfer the funds from the health impact fund to the general fund. Consistent with that agreement, the expected FY 2006 transfer of revenues from the health impact fund to the general fund was shifted to the 2007 fiscal year, reducing revenues in fiscal 2006, but increasing them in 2007 by the same amount.

Revenue Planning Estimates
FY 2008-09

The February 2006 revenue planning estimates for the 2008-09 biennium project general fund current resources to total $33.315 billion, an increase of $1.911 billion (6.1 percent), over February's forecast for 2006-07 biennial general fund revenues. Net non-dedicated revenues reach $32.520 billion, $2.069 billion more than is now forecast for 2006-07. Receipts from the five major taxes are projected to grow by 8.5 percent from the levels forecast for the 2006-07 biennium. Individual income tax receipts are up 12.1 percent and net sales tax receipts by 5.9 percent. February's general fund revenue planning estimates for the 2008-09 biennium are $140 million (0.4 percent) less than was projected in November. Estimates of future individual income tax receipts, sales tax receipts, and motor vehicle sales tax receipts were all reduced from November's level. Those revenue reductions were partially offset by a further improvement in the outlook for corporate franchise tax receipts.

Revenue FY 2008-09
$ in millions

	FY 2006-07	FY 2008	FY 2009	FY 2008-09
Individual Income	$13,618	$7,419	$7,851	$15,270
Sales	9,114	4,746	4,908	9,654
Corporate	1,842	883	874	1,757
Motor Vehicle Sales	504	258	269	527
Statewide Property Tax	1,294	692	711	1,403
Five Major Taxes	26,372	13,998	14,613	28,611
Other Revenue	3,727	1,769	1,790	3,559
Tobacco Settlement	352	175	175	350
Net Non-dedicated	30,451	15,942	16,578	32,520
Other Resources	953	399	396	795
Current Resources	**$31,404**	**$16,341**	**$16,974**	**$33,315**

No one can forecast the economy's path for 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. Consequently, even small deviations from the assumed trend over five years will compound and produce sizeable changes in revenues. In addition, the revenue planning estimates for 2008 and 2009 are sensitive to any changes in the base level of revenues for fiscal 2007. 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 sixteen months, or should some item of portfolio income such as capital gains fall well below forecast – as it did in tax year 2001 – the revenue outlook for the 2008-09 biennium will deteriorate.

These 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 three and one-half year forecast horizon, and that scenario could be overly optimistic. Actual revenues could exceed or fall short of the planning estimates by $2.0 billion or more depending on the economy's performance. When changes in portfolio income are included the difference between these planning estimates and actual receipts could be even greater.

Finance Department economists caution that because this forecast calls for strong economic growth lasting for at least 4 more years, revenue projections based on this forecast are more likely to prove to be too optimistic than too pessimistic.

Since November 2002 the Finance Department has based its revenue planning estimates on Global Insight's baseline forecasts. These revenue planning estimates for fiscal 2008 and 2009 were also prepared consistent with the GII baseline forecast. GII projects real GDP growth rates of 2.9 percent and 3.2 percent and nominal GDP growth of 5.0 percent and 5.3 percent for fiscal 2008 and fiscal 2009, respectively. The real and nominal GDP growth rates from GII are consistent with those used by the CBO in its January, 2006 Budget and Economic Outlook. GII's outlook is slightly less optimistic than that used to prepare the 2007 federal budget. OMB assumes nominal growth rates of 5.5 percent in 2008 and 5.3 percent in 2009. October's Blue Chip Consensus (the most recent available with forecasts for 2008 and 2009) was also more optimistic than the February Global Insight forecast, with projected nominal growth rates of 5.5 percent and 5.4 percent for 2008 and 2009 respectively.

GII expects the CPI to increase at an annual rate of 2.0 percent in calendar 2008 and 1.9 percent in calendar 2009. GII's expected CPI growth rates are well below those in the October Blue Chip or those assumed by the OMB. The Blue Chip Consensus calls for CPI growth of 2.5 percent in both 2008 and 2009, the OMB expects CPI growth of 2.4 percent in those years. CBO's CPI forecast of 2.2 percent growth in the CPI is closer to GII's, but still noticeably less optimistic on the inflation front. When viewed on a fiscal year basis Global Insight is now projecting CPI growth of 2.0 percent in both fiscal 2008 and fiscal 2009. 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.

Sales tax estimates were prepared using the same model as used for the FY 2006-07 forecast, except that Minnesota sales were assumed to grow at the U.S. average rate. 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 Technology decision. Hutchinson related refunds in the 2008-09 biennium are now expected to be $20 million more than projected in November reflecting a slightly longer payout period than had been assumed earlier. The total amount of Hutchinson related refunds expected to be paid out remains unchanged. Minnesota's motor vehicle sales tax collections are expected to grow at the GII baseline growth rate for national consumption of motor vehicles. 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

FY 2006-07 Spending Shows Little Change

Forecast expenditures for FY 2006-07 changed little from November. Before $93 million was added to K-12 spending to complete the school shift buyback, forecast spending showed a decrease of $57 million, or 0.2 percent. After the shift buyback spending is now expected to be $31.389 billion, 0.1 percent higher than in November.

Current Biennium Forecast Change
($ millions)

	November Forecast	February Forecast	Difference
K-12 Education	$13,293	$13,281	$(12)
School Shift Buyback	----	*93*	*93*
Property Tax Aids & Credits	3,043	3,033	(10)
Higher Education	2,761	2,761	0
Health & Human Services	8,216	8,197	(19)
Envir., Ag., and Econ. Development	691	694	3
Transportation	208	206	(2)
Public Safety	1,688	1,690	2
State Government	603	610	7
Debt Service & Borrowing	776	757	(19)
Estimated Cancellations	(22)	(22)	0
Subtotal-Major Spending Categories	31,257	31,300	43
Dedicated Expenditures	96	89	(7)
Total Expenditures & Transfers	**$31,353**	**$31,389**	**$36**

There were modest reductions in several program areas. Prior to the shift buy back, K-12 education estimates decreased $12 million with minor changes in a variety of programs offsetting a small increase in pupil units. Health and human services spending declined nearly $19 million with reductions in payments to the federal government associated with the new prescription drug benefits accounting for most of the savings. Lower debt service estimates, lower estimates of tax penalties and interest, and a reduction in forecast dedicated revenue spending account for the balance of the net reduction in forecast spending.

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FY 2008-09 Planning Estimates

There was also little change from November in the FY 2008-09 planning estimates. Projected spending for the next biennium has increased a total of $2 million. Minor decreases in estimates for K-12 education spending and health and human services spending generally reflect current forecast savings for FY 2006-07 continuing into FY 2008-09. Changes in all other spending areas are largely offsetting reflecting small savings in forecast debt service matched against small increases in open appropriation estimates in the environment and state government areas.

FY 2008-09 Planning Estimates
($ millions)

	November Forecast	February Forecast	Difference
K-12 Education	$12,867	$12,876	$9
School Shift Buyback	----	*16*	*16*
Property Tax Aids & Credits	3,131	3,139	8
Higher Education	2,791	2,791	0
Health & Human Services	9,261	9,247	(14)
Envir., Ag., and Econ. Development	673	679	6
Transportation	221	221	0
Public Safety	1,713	1,713	0
State Government	587	589	2
Debt Service & Borrowing	908	890	(18)
Estimated Cancellations	(20)	(20)	0
Subtotal	32,132	32,141	9
Dedicated Expenditures	89	82	(7)
Total Projected Spending	**$32,221**	**$32,223**	**$2**

It is important to note that the estimated impact of inflation during the FY 2008-09 biennium is *not* included in expenditure planning estimates. Inflation during the planning period is expected to be 1.9 percent in FY 2008 and 2.0 percent in FY 2009 based on GII's forecast of the consumer price index. If major expenditure categories were to be uniformly adjusted for inflation, this would add approximately $303 million to FY 2008 spending and $640 million to FY 2009 amounts.

Education Finance Forecast Up $81.8 Million in FY 2006-07 After Completing Buy Back of Property Tax Recognition Shift

For the current biennium, Education Finance spending is estimated to be $13.4 billion, an $81.8 million increase over previous estimates. Buying back the final portion of the Property Tax Recognition Shift under M.S. 16A.152 added $93.5 million to forecast expenditures, while other expenditures were $11.7 million lower than previous estimates.

Over four forecasts since November 2004, Minnesota has bought back nearly $1.1 billion in education shifts. Of this total, $638.4 million was used to return the school aid payment schedule back to 90 percent in the current year and $424.2 million was used to reduce the early property tax recognition percentage from 48.6 percent to zero.

Enrollment projections for public K-12 schools are now based on actual FY 2005 student data. Average Daily Membership (ADM) is projected to fall from 826,117 in FY 2006 to 820,289 by FY 2009. ADMs are up slightly since the November 2005 Forecast.

Aside from the impact of the Property Tax Recognition Shift buy back, spending for General Education in FY 2006-07 is now estimated to decrease by $2.5 million when compared to earlier estimates. Relatively small increases in Basic Education and Compensatory are offset by decreases in Training & Experience, Alternative Attendance, and QComp. Compensatory is up $5.7 million (1.0 percent) due to an increase in statewide average poverty concentration as measured by free and reduced price meal counts on October 1, 2005. Alternative Attendance is down $3.1 million as the Department of Education implemented changes to forecast methodology to correct for school districts' underestimating resident pupils. QComp, the state's alternative compensation program for teachers, is down $3.5 million (4.2 percent) from previous session estimates due to the short application period for school districts to sign up in FY 2006 and lower than anticipated levy equalization costs in FY 2007.

FY 2008-09 Education Finance Appropriations Up $25.5 Million

Education Finance spending in the next biennium is now expected to be $12.9 billion, an increase of $25.5 million from November projections. Of this amount, $16.6 million is related to the Property Tax Recognition Shift buyback.

General Education appropriations are projected to increase by $19 million from earlier estimates. This represents an overall change of less than 0.1 percent. The largest increase is in Compensatory, which is up $11.3 million, 2.0 percent.

Forecast decreases reflected in FY 2006-07 for Nonpublic Pupil Aid and Nonpublic Transportation Aid continue into the next biennium resulting in forecast reductions of $1.7 million and $6.9 million respectively. Integration Revenue is down $2 million in FY 2008-09 primarily due to lower than anticipated pupil units in the Minneapolis district.

Little Change in Health and Human Services Forecast, Down $19 million

Total health and human services spending for the current biennium is expected to be $8.197 billion, a $19.2 million (0.2 percent) decrease from November estimates. Total health and human services spending in FY 2008-09 is projected to reach $9.247 billion, a drop of $14.3 million (0.2 percent) compared to earlier projections.

There were a number of very small adjustments to various components of health and human services spending. Three primary changes stand out relative to November estimates.

The forecast includes a reduction in estimated payments to the federal government (often referred to as "clawback" payments) associated with Medicare's new prescription drug benefit. These estimated payments are $20.3 million lower in FY 2006-07 and $35.6 million lower in FY 2008-09 due to decreased national prescription drug inflation estimates used as part of the formula to determine payment amounts.

The forecast also includes a substantial increase in the estimated proportion of Elderly Waiver (EW) recipients whose services are purchased through managed care rather than by a fee-for-service payment system. While this movement creates little net difference in the forecast because costs are shifted from one part of the Medical Assistance (MA) budget to another, it demonstrates an emerging trend in the EW program. EW recipients increasingly choose to enroll in managed care programs that integrate Medicaid and Medicare services. This option has become increasingly attractive over the past year as enrollees became aware that one managed care option includes the new Medicare Part D prescription drug benefit as part of its integrated service package.

Finally, estimated Chemical Dependency treatment expenditures have increased significantly over November projections. Expenditures are now expected to increase $13.5 million (10.1 percent) over previous estimates for the current biennium and by $18.8 million (12.4 percent) in FY 2008-09. A substantial caseload increase accounts for the entire change.

Federal Law and Funding Changes

The Deficit Reduction Act of 2005 became law on February 8, 2006. This new law contains significant federal policy changes that will affect health and human service programs, including Temporary Assistance for Needy Families, Child Support, Child Welfare, Medicaid and the State Children's Health Insurance Program. This forecast includes no changes related to the Deficit Reduction Act (DRA), largely because the new law more directly affects counties rather than state-financed forecast programs. Also, the law calls for regulations to be issued on certain key topics. Until those regulations are issued, there is insufficient information available to change existing assumptions about what constitutes current law for those forecast programs potentially affected by DRA provisions.

Minnesota's human services delivery system relies on a partnership between the state and counties, with counties administering most programs. In some instances, counties work directly with the federal government and pay the non-federal share of program expenditures. Consequently, some of the new changes in federal law and policy will affect counties more directly than the state. For example, DRA limits the scope of activities eligible for Medicaid Targeted Case Management (TCM) funding and circumstances under which activities can receive federal match. Counties use TCM to finance services for children at risk of abuse and neglect as well as for people needing mental health treatment. Minnesota counties draw approximately $87 million in federal funds each year for these services; it is unclear how much of that funding is at risk given new restrictions on which activities may be eligible for federal financial participation.

DRA also prohibits states from drawing federal matching payments for child support incentive grants. Counties have used this funding, worth roughly $24 million per year, to operate their child support programs.

In addition, some of the broader changes in federal statute require regulatory action to specify finer details of how the new laws will be implemented. The limitations to Targeted Case Management will be more fully defined in regulation, as will changes to the Temporary Assistance for Needy Families (TANF) program.

The TANF law changes include a provision to rebase the calculation for caseload reduction credits that have allowed most states to successfully meet the law's work participation requirements for welfare recipients. On its own, this change would likely cause an adjustment to state costs, as Minnesota would need to contribute a higher proportion of program costs for failing to meet the work participation requirements. However, the regulations regarding what constitutes allowable activities for work have not yet been issued, so this forecast does not make changes in underlying assumptions about success or failure on participation rates. If Minnesota failed to meet these requirements, general fund obligations would increase by $6 million in FY 2006-07 and by $24 million in FY 2008-09.

Tax Aid and Credit Estimates Reduced $10 Million

Tax aid and credit programs are expected to total $3.034 billion, $10 million below November estimates for the current biennium. Estimates for tax refunds and penalties have been reduced $13.7 million. Specifically, claims from the Hutchinson Technology court decision are being paid out more slowly than previously projected reducing the amount of interest to be paid out on those claims in the current biennium. A small $4.4 million reduction in market value homestead credit estimates added additional savings. These decreases are partially offset by a $9.4 million increase in expected property tax refund program payments.

For FY 2008-09, tax aid and credit programs increased $8.1 million over November estimates. This net increase is primarily due to the expected payment of interest on Hutchinson decision claims being delayed from FY 2006-07. Small increases in the cost of property tax refunds in FY 2008-09 are offset by similarly sized reductions in projected market value homestead credit payments.

Projected Debt Service Costs Reduced $19 Million

Debt Service transfers for the current biennium are now expected to total $757 million, a $19 million reduction from November estimates. Expected premiums received on bonds sold account for the majority of the savings. Bidders on state bonds had bid large premiums during this period of low interest rates. The lower the interest rate, the higher the premium paid. GII's forecast of interest rates on long-term tax-exempt bonds is lower than that used in November. The lower rates are expected to increase premiums paid on bonds by $17 million. At the same time, high short-term interest rates are likely to produce higher investment earnings in the bond proceeds and debt service funds, reducing required general fund transfers by an additional $2 million.

Those factors drive a similar decline in projected debt service costs for FY 2008-09, accounting for nearly an $18 million decline in projected spending. Debt service projections assume capital budgets of $560 million in each even-year legislative session and $135 million in each odd-year session.

All Other Spending Changes Little, Net $3 Million Higher

The remaining categories of state spending total $6.028 billion for the current biennium. Funding for these areas are set as fixed amounts by legislative appropriations. Small changes in individual areas largely represent technical adjustments and updates to several small open appropriations. Several small changes occurring in the environmental and state government areas are noteworthy. Open appropriation estimates for payment in lieu of taxes (PILT) paid by the Department of Natural Resources increased slightly over $3 million. In the state government area, estimates for the open appropriation for legislators' retirement were increased nearly $5 million based on current actuarial analyses. Finally, these increases are largely offset by a $7 million reduction in estimated general fund dedicated revenue spending.

Alternative Forecast Comparison

Real GDP (Annual Rates)

	05IV	06I	06II	06III	06IV	07I	05A	06A	07A
GII Baseline (2-06)	1.1	4.8	3.1	3.1	2.5	2.4	3.5	3.3	2.7
Blue Chip (2-06)	1.1	4.1	3.4	3.1	3.0	3.1	3.5	3.3	3.1
Moody's Economy.Com (2-06)	1.1	4.7	3.9	3.7	3.3	NA	3.5	3.5	3.2
Ameriprise (2-06)	1.1	5.0	3.9	4.1	2.4	1.8	3.5	3.6	2.6
UBS (2-06)	1.1	3.6	2.8	2.5	2.5	NA	3.5	2.8	2.5
Standard & Poors (2-06)	1.1	4.8	3.1	3.1	NA	NA	3.5	3.3	2.7

Consumer Price Index (Annual Rates)

	05IV	06I	06II	06III	06IV	07I	05A	06A	07A
GII Baseline (2-06)	3.2	1.5	1.4	1.7	2.0	1.8	3.4	2.5	1.8
Blue Chip (2-06)	3.2	2.2	2.4	2.3	2.4	2.5	3.4	2.9	2.4
Moody's Economy.Com (2-06)	3.2	3.5	2.3	3.0	2.9	NA	3.4	3.4	NA
Ameriprise (2-06)	3.2	2.0	2.8	3.0	3.1	3.2	3.8*	2.7*	2.5*
UBS (2-06)	3.2	1.7	2.2	3.0	2.8	NA	3.4	3.0	2.6
Standard & Poors (2-06)	3.2	1.5	1.4	1.7	NA	NA	3.4	2.5	1.8

* 4Q/4Q

Forecast Comparisons

Real Economic Growth

(Annual Percent Change in Real GDP)

	2004	2005	2006	2007	2008	2009
Feb 02 DRI Control	3.9	3.2[1]				
Nov 02 GII Baseline	4.1	3.8	3.5	3.1		
Feb 03 GII Baseline	4.6	3.8	3.1	2.9		
Nov 03 GII Baseline	4.3	3.6	3.6	2.9		
Feb 04 GII Baseline	4.8	3.8	3.6	2.9		
Nov 04 GII Baseline	4.4	3.2	3.6	3.1	3.1	3.2
Feb 05 GII Baseline	4.4	3.5	3.1	3.2	3.1	3.3
Nov 05 GII Baseline	4.2	3.6	3.4	3.1	3.4	3.1
Feb 06 GII Baseline	4.2	3.5	3.3	2.7	2.9	3.2

Inflation

(Annual Percent Change in CPI-U)

Feb 02 DRI Control	2.5	2.7[1]				
Nov 02 GII Baseline	2.4	2.3	2.2	2.1		
Feb 03 GII Baseline	1.9	2.1	2.2	2.5		
Nov 03 GII Baseline	1.4	1.9	2.0	2.5		
Feb 04 GII Baseline	1.4	1.3	1.5	2.5		
Nov 04 GII Baseline	2.7	2.2	1.3	1.7	1.9	2.1
Feb 05 GII Baseline	2.7	2.0	1.6	2.0	2.1	2.2
Nov 05 GII Baseline	2.7	3.4	2.6	1.5	2.0	2.2
Feb 06 GII Baseline	2.7	3.4	2.5	1.8	2.0	1.9

[1] 10 year trend from DRI Early Recession (Pessim), November, 2000

Minnesota - U.S. Comparison Report

February 2006 Baseline

(Annual Percent Changes)

	2001	2002	2003	2004	2005	2006	2007
Wage and Salary Income							
United States	2.4	0.8	2.6	5.4	6.0	5.1	5.4
Minnesota	3.2	1.4	2.5	5.7	3.5	4.7	4.6
Implied Annual Wage							
United States	2.3	1.9	2.9	4.3	4.4	3.5	4.0
Minnesota	3.0	2.4	2.6	5.0	2.0	3.8	3.6
Non-Farm Employment							
United States	0.3	-1.1	-0.3	1.1	1.5	1.5	1.4
Minnesota	0.2	-1.0	-0.1	0.7	1.4	0.9	1.0
Personal Income							
United States	3.5	1.8	3.2	5.9	5.4	6.2	5.4
Minnesota	2.8	2.4	3.2	6.8	3.7	5.2	5.0

Comparison of Actual and Estimated Non-Restricted Revenues

January, 2006 - FY2006 YTD

($ in Thousands)

	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax			
Withholding	3,249,325	3,197,319	-52,006
Declarations	712,700	776,588	63,888
Miscellaneous	170,827	151,719	-19,108
Gross	4,132,853	4,125,626	-7,226
Refund	134,778	136,141	1,364
Net	3,998,075	3,989,485	-8,590
Corporate & Bank Excise			
Declarations	502,779	521,950	19,171
Miscellaneous	88,103	86,705	-1,399
Gross	590,883	608,655	17,772
Refund	77,711	56,892	-20,819
Net	513,172	551,763	38,591
Sales Tax			
Gross	2,612,024	2,615,289	3,265
Refunds	119,026	113,049	-5,977
Net	2,492,998	2,502,240	9,242
Motor Vehicle Sales Tax (gross)	144,555	142,507	-2,047
Other Revenues:			
Estate	169,088	176,948	7,860
Liquor/Wine/Beer	37,896	38,541	644
Cigarette/Tobacco/Cont Sub	93,381	92,449	-932
Deed and Mortgage	169,490	185,174	15,684
Insurance Gross Earnings	121,124	121,875	750
Lawful Gambling	28,837	25,810	-3,027
Health Care Surcharge	118,291	116,775	-1,516
Other Taxes	720	537	-183
Statewide Property Tax	277,634	283,440	5,806
DHS RTC Collections	27,449	29,929	2,479
Income Tax Reciprocity	56,802	56,802	0
Investment Income	17,583	24,827	7,244
Tobacco Settlement	173,401	179,060	5,659
Departmental Earnings	207,767	214,847	7,080
Fines and Surcharges	53,036	51,871	-1,165
Lottery Revenues	22,893	23,970	1,078
Revenues yet to be allocated	452	923	470
Residual Revenues	38,892	25,881	-13,010
Sales Tax Rebates (all years)	-3	-2	1
County Nursing Home Pub Hosp	5,962	5,962	0
Other Subtotal	**1,620,696**	**1,655,618**	**34,922**
Other Refunds	**19,164**	**13,590**	**-5,574**
Other Net	**1,601,532**	**1,642,028**	**40,496**
Total Gross	**9,101,010**	**9,147,695**	**46,685**
Total Refunds	**350,679**	**319,672**	**-31,007**
Total Net	**8,750,331**	**8,828,023**	**77,692**

Factors Affecting the Individual Income Tax

($ in billions)

	Calendar Year					
	2002	2003	2004	2005	2006	2007
Minnesota Non-Farm Tax Base						
February 2002 Baseline	145.890	153.470				
*November 2002 Baseline	140.600	145.760	154.850	164.940		
*February 2003 Baseline	140.520	144.940	153.580	163.500		
*November 2003 Baseline	142.370	146.160	152.011	160.690		
*February 2004 Baseline	142.370	146.080	152.201	160.413		
*November 2004 Baseline	138.871	142.592	149.277	156.214	163.506	171.373
*February 2005 Baseline	138.874	142.349	149.075	156.519	163.983	172.200
*November 2005 Baseline	137.386	140.039	147.263	153.310	161.799	170.983
*February 2006 Baseline	137.386	140.039	148.030	153.618	161.561	170.274
Minnesota Wage and Salary Income						
February 2002 Baseline	101.910	107.140				
*November 2002 Baseline	96.100	99.790	106.150	112.830		
*February 2003 Baseline	96.100	98.830	104.690	111.420		
*November 2003 Baseline	96.780	99.410	103.830	109.140		
*February 2004 Baseline	96.780	99.520	103.570	108.910		
*November 2004 Baseline	96.941	99.558	103.632	109.075	114.465	120.202
*February 2005 Baseline	96.944	99.315	103.416	108.997	114.473	120.360
*November 2005 Baseline	96.926	99.371	104.225	108.959	114.328	119.824
*February 2006 Baseline	96.926	99.371	104.992	108.639	113.713	118.957
Minnesota Property Income						
February 2002 Baseline	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	37.509	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
February 2006 Baseline				31.610	33.754	36.367
Minnesota Proprietors' Income						
February 2002 Baseline	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	11.776	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	14.309	15.156
November 2005 Baseline	10.448	11.218	12.213	13.161	14.037	14.956
February 2006 Baseline	10.448	11.218	12.213	13.369	14.093	14.950

** Wages reflect ES202 Data as seasonally 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						
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%
February 2005 Baseline	61.403	62.604	66.355	70.553	74.807	77.366
Percent				6.3%	6.0%	3.4%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
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	10.627	10.952	11.775	12.456	12.849	13.265
February 2006Baseline	10.627	10.952	11.775	12.447	12.993	13.247
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
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	13.647	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
February 2006Baseline	9.921	9.777	10.639	11.891	12.610	13.841
Minnesota's Proxy Share of U.S. Construction Spending						
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 2005 Baseline	8.841	9.198	10.200	10.995	11.868	11.939
February 2006 Baseline	8.839	9.198	10.200	10.996	11.714	11.729

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						
November 2001 Control	163.61	174.93				
February 2002 Control	165.28	173.63				
November 2002 Control*	166.54	173.04	181.57	192.47		
February 2003 Control*	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
February 2006 Baseline*	164.44	169.50	177.36	188.18	195.47	206.78
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
February 2002 Control	7.403	7.506				
November 2002 Control	7.493	7.353	7.568	7.361		
February 2003 Control	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
February 2006 Baseline	8.621	8.887	8.990	9.194	8.919	9.258
CORPORATE FRANCHISE TAX	**Calendar Year**					
U.S. Corporate Profits						
February 2002 Control	722.1	761.2				
November 2002 Control	662.2	771.1	873.5	871.0		
February 2003 Control	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**
February 2006 Baseline	755.8	689.5	853.3	1,016.9**	1,137.8**	1,329.9**

* Bureau of Economic Analysis Concept

** Finance Dept Estimate

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

	11-05 Fcst FY 2006-07	2-06 Fcst FY 2006-07	Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	1,393,086	1,393,086	0
Current Resources:			
Tax Revenues	28,846,263	28,894,749	48,486
Non-Tax Revenues	1,497,739	1,556,494	58,755
Dedicated Revenue	124,777	117,577	(7,200)
Transfers In	761,076	785,620	24,544
Prior Year Adjustments	50,000	50,000	0
Subtotal-Current Resources	31,279,855	31,404,440	124,585
Total Resources Available	**32,672,941**	**32,797,526**	**124,585**
Actual & Estimated Spending			
K-12 Education	13,293,037	13,281,308	(11,729)
K-12 Shift Buyback	0	0	0
Property Tax Aids & Credits	3,043,437	3,033,525	(9,912)
Higher Education	2,761,485	2,761,485	0
Health & Human Services	8,216,010	8,196,802	(19,208)
Environment, Agriculture & Economic Dev	691,135	694,170	3,035
Transportation	208,333	205,737	(2,596)
Public Safety	1,687,820	1,690,416	2,596
State Government	602,944	609,606	6,662
Debt Service	775,831	756,927	(18,904)
Estimated Cancellations	(22,500)	(22,500)	0
Subtotal Expenditures & Transfers	**31,257,532**	**31,207,476**	**(50,056)**
Dedicated Expenditures	95,693	88,493	(7,200)
Total Expenditures & Transfers	**31,353,225**	**31,295,969**	**(57,256)**
Balance Before Reserves	**1,319,716**	**1,501,557**	**181,841**
Cash Flow Account	350,000	350,000	0
Budget Reserve	653,000	653,000	0
Tax Relief Account	316,716	316,716	0
Budgetary Balance	**0**	**181,841**	**181,841**

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

	FY 2006	FY 2007	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	1,393,086	941,211	1,393,086
Current Resources:			
Tax Revenues	14,253,200	14,641,549	28,894,749
Non-Tax Revenues	804,241	752,253	1,556,494
Dedicated Revenue	58,869	58,708	117,577
Transfers In	167,294	618,326	785,620
Prior Year Adjustments	25,000	25,000	50,000
Subtotal-Current Resources	15,308,604	16,095,836	31,404,440
Total Resources Available	**16,701,690**	**17,037,047**	**32,797,526**
Actual & Estimated Spending			
K-12 Education	6,808,467	6,472,841	13,281,308
K-12 Shift Buyback	72,493	20,993	93,486
Subtotal K-12 Education	6,880,960	6,493,834	13,374,794
Property Tax Aids & Credits	1,479,828	1,553,697	3,033,525
Higher Education	1,365,985	1,395,500	2,761,485
Health & Human Services	4,027,293	4,169,509	8,196,802
Environment, Agriculture & Economic Dev	358,732	335,438	694,170
Transportation	102,516	103,221	205,737
Public Safety	840,405	850,011	1,690,416
State Government	312,628	296,978	609,606
Debt Service	352,447	404,480	756,927
Estimated Cancellations	(7,500)	(15,000)	(22,500)
Subtotal Expenditures & Transfers	**15,713,294**	**15,587,668**	**31,300,962**
Dedicated Expenditures	47,185	41,308	88,493
Total Expenditures & Transfers	**15,760,479**	**15,628,976**	**31,389,455**
Balance Before Reserves	**941,211**	**1,408,071**	**1,408,071**
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	**(378,505)**	**88,355**	**88,355**

FY 2006-07 General Fund Forecast Change
February 2006 vs November 2005
($ in thousands)

	11-05 Fcst FY 2006-07	2-06 Fcst FY 2006-07	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,393,086	1,393,086	0	0.0%
Current Resources:				
Tax Revenues	28,846,263	28,894,749	48,486	0.2%
Non-Tax Revenues	1,497,739	1,556,494	58,755	3.9%
Dedicated Revenue	124,777	117,577	(7,200)	-5.8%
Transfers In	761,076	785,620	24,544	3.2%
Prior Year Adjustments	50,000	50,000	0	0.0%
Subtotal-Current Resources	31,279,855	31,404,440	124,585	0.4%
Total Resources Available	**32,672,941**	**32,797,526**	**124,585**	**0.4%**
Actual & Estimated Spending				
K-12 Education	13,293,037	13,281,308	(11,729)	
K-12 Shift Buyback	0	93,486	93,486	
Subtotal K-12 Education	13,293,037	13,374,794	81,757	0.6%
Property Tax Aids & Credits	3,043,437	3,033,525	(9,912)	-0.3%
Higher Education	2,761,485	2,761,485	0	0.0%
Health & Human Services	8,216,010	8,196,802	(19,208)	-0.2%
Environment, Agriculture & Economic Dev	691,135	694,170	3,035	0.4%
Transportation	208,333	205,737	(2,596)	-1.2%
Public Safety	1,687,820	1,690,416	2,596	0.2%
State Government	602,944	609,606	6,662	1.1%
Debt Service	775,831	756,927	(18,904)	-2.4%
Estimated Cancellations	(22,500)	(22,500)	0	0.0%
Subtotal Expenditures & Transfers	**31,257,532**	**31,300,962**	**43,430**	**0.1%**
Dedicated Expenditures	95,693	88,493	(7,200)	-7.5%
Total Expenditures & Transfers	**31,353,225**	**31,389,455**	**36,230**	**0.1%**
Balance Before Reserves	**1,319,716**	**1,408,071**	**88,355**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Tax Relief Account	316,716	316,716	0	
Budgetary Balance	**0**	**88,355**	**88,355**	

FY 2008-09 General Fund Planning Estimates Change
February 2006 vs November 2005
($ in thousands)

	11-05 Plng Est FY 2008-09	2-06 Plng Est FY 2008-09	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,319,716	1,408,071	88,355	6.7%
Current Resources:				
Tax Revenues	31,218,804	31,012,570	(206,234)	-0.7%
Non-Tax Revenues	1,449,352	1,507,187	57,835	4.0%
Dedicated Revenue	124,109	116,909	(7,200)	-5.8%
Transfers In	613,249	628,764	15,515	2.5%
Prior Year Adjustments	50,000	50,000	0	0.0%
Subtotal-Current Resources	33,455,514	33,315,430	(140,084)	-0.4%
Total Resources Available	**34,775,230**	**34,723,501**	**(51,729)**	**-0.1%**
Actual & Estimated Spending				
K-12 Education	12,866,433	12,875,366	8,933	
K-12 Shift Buyback	0	16,555	16,555	
Subtotal K-12 Education	12,866,433	12,891,921	25,488	0.2%
Property Tax Aids & Credits	3,130,602	3,138,717	8,115	0.3%
Higher Education	2,791,000	2,791,000	0	0.0%
Health & Human Services	9,261,519	9,247,192	(14,327)	-0.2%
Environment, Agriculture & Economic Dev	673,298	679,042	5,744	0.9%
Transportation	221,442	221,442	0	0.0%
Public Safety	1,712,704	1,712,704	0	0.0%
State Government	587,452	589,760	2,308	0.4%
Debt Service	907,226	889,611	(17,615)	-1.9%
Estimated Cancellations	(20,000)	(20,000)	0	0.0%
Subtotal Expenditures & Transfers	**32,131,676**	**32,141,389**	**9,713**	**0.0%**
Dedicated Expenditures	89,309	82,109	(7,200)	-8.1%
Total Expenditures & Transfers	**32,220,985**	**32,223,498**	**2,513**	**0.0%**
Balance Before Reserves	**2,554,245**	**2,500,003**	**(54,242)**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Tax Relief Account	316,716	316,716	0	
Budgetary Balance	**1,234,529**	**1,180,287**	**(54,242)**	