LFD ANALYSIS
SPENDING REDUCTIONS PROPOSAL
2011 BIENNIUM

Part 2 – General Fund Revenue Estimates

A Report Prepared for the

Legislative Finance Committee

By the

Legislative Fiscal Division

February 26, 2010

Legislative Fiscal Division

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GENERAL FUND REVENUE ESTIMATES

Purpose of Section

17-7-140, MCA, provides a procedure to be implemented by the Governor in the event of a general fund budget deficit. In the event of a budget deficit, the Governor is required to reduce spending in an amount sufficient to bring the projected ending fund balance for the year to at least 1 percent of all general fund appropriations for the biennium. On January 29th, the Governor's Budget Director initiated preliminary action to implement spending reductions by submitting general fund revenue estimates to the Revenue and Transportation Committee (RTIC) and requiring agencies to submit proposals for spending reductions. On February 16th as required by statute, the Budget Director submitted a list of budget reduction recommendations to both the Governor and the Legislative Fiscal Analyst. The executive is required to allow the RTIC and Legislative Finance Committee (LFC) 20 days to provide responses to the revenue estimates and the proposed reductions, respectively, before the Governor takes final action.

The purpose of this section is to summarize the general fund revenue estimates as projected by the executive and by your Legislative Fiscal Division (LFD) staff and the differences. As discussed in this section, there are a number of dynamic economic conditions that may change the final outcome of revenue projections for the 2011 biennium. Of primary concern is the uncertainty of individual and corporation income taxes, which have shown a significant downward trend.

Legislative Role

The final assessment of the budget deficit projection and the required spending reductions is determined by the Governor, but statute requires specific communication with the Legislative Branch and an opportunity for legislative input prior to making the final directive. The LFC must be afforded the opportunity to comment on planned spending reductions and the RTIC must be afforded the opportunity to comment on the revenue estimates used to determine the deficit. The statutory requirement for legislative interaction and input is summarized as follows:

- Agencies must submit their assessment of spending reductions to the Legislative Fiscal Analyst (LFA) at the same time they are submitted to the Office of Budget and Program Planning (this submission occurred on January 29th).
- The Governor's Budget Director shall provide a copy of his recommendations to the LFA at the same time they are submitted to the Governor (this occurred on February 16th).
- The LFC has 20 days from the time the planned reductions are submitted to the LFA to meet and make recommendations to the Governor (scheduled for March 4th).
- The LFA must provide a copy of his review of the proposed spending reductions to the budget director at least 5 days before the LFC meeting (scheduled for delivery on February 26th).
- The Governor's Budget Director must notify the RTIC of the estimated amount of the general fund revenue shortfall below the revenue estimate established in the revenue estimating resolution for the affected biennium (this occurred January 29th).
- The RTIC has 20 days from notification of the revenue shortfall to provide the Budget Director with any recommendations concerning the revenue estimates (occurred on February 19th).
- The budget director must consider the recommendations of the RTIC prior to certifying a projected general fund deficit.
- The Governor must consider the recommendations of the LFC prior to directing spending reductions.

It should be noted that action taken by the RTIC at the February meeting was in an advisory capacity only and does not change the revenue estimates as adopted by the 61st Legislature.

Implementation

As discussed above, the actual certification of a budget shortfall and the implementation of spending reductions cannot occur until after the opportunity is afforded for legislative input from the prescribed interim committees. This means the reductions cannot occur until after March 4th when the committees have concluded their assessment. Since the spending reductions are for FY 2010 and FY 2011, it is anticipated the certification and directive to reduce spending will be made as soon as possible after the March 4th LFC meeting.

GENERAL FUND REVENUE DIFFERENCES

Since adjournment of the 2009 legislative session, state general fund revenues have shown continued signs of weakness as compared to the amount adopted by the legislature in HJ 2. In July 2009, the Legislative Fiscal Division (LFD) began to issue monthly reports that provided the legislature with data on general fund revenue monthly collections and other economic information. Each report showed further erosion in year to date general fund revenue collections. The latest report, produced on February 8, 2010, is included in Appendix B: General Fund Revenue Update February 2010 of this report.

The revenue projections of the legislative fiscal staff are $349.9 million, or 9.7 percent below the estimates of HJR 2 for the 2011 biennium, while the estimates prepared by the Office of Budget and Program Planning (OBPP) are $274.9 million, or 7.6 percent, lower. A summary of the projection differences is seen below in Figure 1, where the differences of the four major revenue sources: individual income tax, corporation income tax, oil and gas production tax, and vehicle fees/taxes, are highlighted.

Figure 1

General Fund Revenue Estimate Comparison
By Significant Revenue Categories (Millions)

Category	LFD FY 2010	Exec. FY 2010	Difference FY 2010	LFD FY 2011	Exec. FY 2011	Difference FY 2011	LFD Biennium	Exec. Biennium	Difference Biennium
Individual Income Tax	$722.2	$750.7	($28.5)	$757.7	$758.8	($1.1)	$1,479.9	$1,509.5	($29.6)
Corporation Income Tax	57.4	93.0	(35.6)	68.6	79.2	(10.6)	126.0	172.2	(46.2)
Oil & Gas Production Tax	88.3	82.9	5.4	94.7	85.3	9.4	183.0	168.2	14.8
Vehicle Fees/Taxes	103.2	109.1	(5.9)	102.5	110.3	(7.8)	205.7	219.4	(13.7)
Remaining Sources	619.7	616.1	3.6	638.1	642.0	(3.9)	1,257.8	1,258.1	(0.3)
Totals	**$1,590.8**	**$1,651.8**	**($61.0)**	**$1,661.6**	**$1,675.6**	**($14.0)**	**$3,252.4**	**$3,327.4**	**($75.0)**

Over the biennium, the estimates of LFD and OBPP vary by $75.0 million. The greatest difference is seen in FY 2010, when the LFD projects total revenues will be $61.0 million less than OBPP. The biggest projection difference is in the corporation income tax, where the LFD projects collections in FY 2010 of $57.4 million, while OBPP projects collections to be $93.0 million. Over the 2011 biennium, the LFD projection for this source is $46.2 million less than OBPP, which suggests that the LFD is more optimistic about the collections in FY 2011. In the projections for the largest source of general fund revenue, the individual income tax, the LFD also projects significantly less revenue in FY 2010 than OBPP, a difference of $28.5 million. The difference of the projection for individual income tax in FY 2011 shows the LFD projection is $1.1 million less than OBPP. As mentioned above, over the biennium, the difference between the two sets of projections is $75.0 million, or about a 2.3 percent total general fund difference. The revised projections of both the LFD and OBPP for all the revenue sources is seen on page 16 of this report.

The next section will provide information about the HJR 2 estimates adopted by the 61st Legislature. Included is HJ2 as introduced, the impacts of legislation on the revenue estimates, the changes to the estimates that were made by the legislature, and finally the resulting HJR 2 estimates.

HOUSE JOINT RESOLUTION 2

During November 2009, prior to the convening of the 61st Legislature, the Revenue and Transportation Interim Committee (RTIC) formally adopted economic assumptions and the associated revenue estimates for fiscal years 2009, 2010 and 2011. This process is in accordance with 5-5-227, MCA, which states that these estimates "constitute the legislature's current revenue estimates until amended or until final adoption of the estimates by both houses." The actions taken by the RTIC were incorporated into HJR 2 and were introduced at the beginning of the Sixty-first Legislature. During the legislative process, the legislature amended certain assumptions that had been initially recommended by the RTIC in HJR 2. Figure 2 shows the total general fund impact of the changed assumptions by the House and Senate. For the three-year period, fiscal 2009 through 2011, total general fund revenue estimates were decreased by $292.6 million from the recommendations of the RTIC.

Figure 2

Revenue Estimate Adjustments by the 61st Legislature
General Fund In Millions

Revenue Issue	Fiscal 2009	Fiscal 2010	Fiscal 2011	3-Year Total
Revenue and Transportation Committee	**$1,915.651**	**$1,873.585**	**$1,941.532**	**$5,730.768**
House Taxation Committee Adjustments	(42.607)	(119.024)	(130.986)	(292.617)
Senate Taxation Committee Adjustments	0.000	0.000	0.000	0.000
Revised HJR2 Revenue Estimates	**$1,873.044**	**$1,754.561**	**$1,810.546**	**$5,438.151**

Figure 3 shows the amended current law general fund estimates by revenue category as contained in HJR 2. Actual fiscal 2008 collections are shown, along with projections for fiscal years 2009 through 2011.

Figure 3

House Joint Resolution 2
General Fund Revenue Estimates
In Millions

	Source of Revenue	Percent of 2008	Actual Fiscal 2008	Estimated Fiscal 2009	Estimated Fiscal 2010	Estimated Fiscal 2011	Estimated Fiscal 08-09	Estimated Fiscal 10-11	Cumulative % of Total
1	Individual Income Tax	44.36%	$866.659	$852.615	$838.750	$850.014	$1,719.274	$1,688.764	47.37%
2	Property Tax	10.50%	205.044	214.615	221.919	225.719	419.659	447.638	59.93%
3	Corporation Income Tax	8.21%	160.342	157.284	115.638	121.382	317.626	237.020	66.57%
4	Vehicle Tax	4.79%	93.493	93.493	92.247	90.093	186.986	182.340	71.69%
5	Common School Interest and Income	0.00%	-	-	-	-	-	-	71.69%
6	Insurance Tax & License Fees	3.28%	64.004	49.878	47.880	50.353	113.882	98.233	74.44%
7	Coal Trust Interest	1.48%	28.855	29.312	28.574	28.288	58.167	56.862	76.04%
8	US Mineral Royalty	1.86%	36.389	24.885	27.796	30.418	61.274	58.214	77.67%
9	All Other Revenue	1.97%	38.434	65.415	32.126	32.831	103.849	64.957	79.49%
10	Tobacco Settlement	0.19%	3.808	3.956	4.007	4.071	7.764	8.078	79.72%
11	Telecommunications Excise Tax	1.14%	22.350	21.597	21.672	21.761	43.947	43.433	80.94%
12	Video Gambling Tax	3.23%	63.134	66.554	69.003	71.973	129.688	140.976	84.89%
13	Treasury Cash Account Interest	1.58%	30.783	16.507	7.967	15.905	47.290	23.872	85.56%
14	Estate Tax	0.01%	0.122	0.113	0.029	0.005	0.235	0.034	85.56%
15	Oil & Natural Gas Production Tax	7.68%	149.994	94.769	66.930	82.423	244.762	149.353	89.75%
16	Motor Vehicle Fee	0.97%	18.995	18.926	19.672	19.481	37.921	39.153	90.85%
17	Public Institution Reimbursements	0.78%	15.335	13.658	14.412	14.675	28.993	29.087	91.67%
18	Lodging Facility Use Tax	0.69%	13.390	13.109	13.376	13.926	26.499	27.302	92.43%
19	Coal Severance Tax	0.61%	11.894	12.410	12.183	12.959	24.304	25.142	93.14%
20	Liquor Excise & License Tax	0.76%	14.925	15.787	16.558	17.609	30.712	34.167	94.10%
21	Cigarette Tax	1.84%	36.004	34.564	32.984	33.053	70.568	66.037	95.95%
22	Investment License Fee	0.33%	6.514	6.127	6.210	6.825	12.641	13.035	96.31%
23	Lottery Profits	0.56%	11.029	10.275	10.906	11.453	21.304	22.359	96.94%
24	Liquor Profits	0.45%	8.775	8.651	8.837	9.194	17.426	18.031	97.45%
25	Nursing Facilities Fee	0.29%	5.610	5.318	5.213	5.109	10.928	10.322	97.74%
26	Foreign Capital Depository Tax	0.00%	-	-	-	-	-	-	97.74%
27	Electrical Energy Tax	0.27%	5.179	4.707	4.717	4.727	9.886	9.444	98.00%
28	Metalliferous Mines Tax	0.55%	10.774	6.777	3.248	3.279	17.551	6.527	98.18%
29	Highway Patrol Fines	0.21%	4.049	4.052	4.055	4.058	8.101	8.113	98.41%
30	Public Contractors Tax	0.26%	5.063	4.058	4.322	4.357	9.121	8.679	98.66%
31	Wholesale Energy Tax	0.20%	3.856	3.870	3.931	3.993	7.726	7.924	98.88%
32	Tobacco Tax	0.24%	4.699	4.710	4.738	4.796	9.409	9.534	99.15%
33	Driver's License Fee	0.20%	3.866	4.667	3.920	4.739	8.533	8.659	99.39%
34	Rental Car Sales Tax	0.16%	3.157	3.118	3.182	3.313	6.275	6.495	99.57%
35	Railroad Car Tax	0.11%	2.064	2.166	2.295	2.336	4.230	4.631	99.70%
36	Wine Tax	0.09%	1.829	1.942	2.043	2.146	3.771	4.189	99.82%
37	Beer Tax	0.16%	3.124	3.160	3.221	3.282	6.284	6.503	100.00%
38	Telephone License Tax	0.00%	-	-	-	-	-	-	100.00%
39	Long Range Bond Excess	0.00%	-	-	-	-	-	-	100.00%
	Total General Fund	100.00%	$1,953.540	$1,873.044	$1,754.561	$1,810.546	$3,826.584	$3,565.107	100.00%

REVENUE IMPACTS OF OTHER LEGISLATION

Revenue Impacts of Other Legislation

Figure 4 shows the revenue impacts of legislation enacted by the 61st Legislature. If more than one bill were enacted that impact a certain revenue source, the cumulative impact of the bills is shown for each revenue source.

Figure 4

Revenue Legislation Impacts of 61st Legislature
Total General Fund
In Millions

	Source of Revenue	Estimated Fiscal 2009	Estimated Fiscal 2010	Estimated Fiscal 2011	Estimated Fiscal 08-09	Estimated Fiscal 10-11	Estimated 09,10,11
1	Individual Income Tax	$0.000	$1.513	$2.732	$0.000	$4.245	$4.245
2	Property Tax	-	6.934	6.529	-	13.463	13.463
3	Corporation Income Tax	-	-	(0.011)	-	(0.011)	(0.011)
4	Vehicle Tax	-	-	-	-	-	-
5	Common School Interest and Income	-	-	-	-	-	-
6	Insurance Tax & License Fees	-	10.882	11.445	-	22.327	22.327
7	Coal Trust Interest	-	-	-	-	-	-
8	US Mineral Royalty	-	-	-	-	-	-
9	All Other Revenue	(29.565)	3.121	2.361	(29.565)	5.482	(24.083)
10	Tobacco Settlement	-	-	-	-	-	-
11	Telecommunications Excise Tax	-	-	-	-	-	-
12	Video Gambling Tax	-	-	-	-	-	-
13	Treasury Cash Account Interest	-	-	-	-	-	-
14	Estate Tax	-	-	-	-	-	-
15	Oil & Natural Gas Production Tax	-	-	-	-	-	-
16	Motor Vehicle Fee	-	(1.702)	(2.269)	-	(3.971)	(3.971)
17	Public Institution Reimbursements	1.124	1.635	0.355	1.124	1.990	3.114
18	Lodging Facility Use Tax	-	-	-	-	-	-
19	Coal Severance Tax	-	(1.337)	(1.400)	-	(2.737)	(2.737)
20	Liquor Excise & License Tax	-	0.023	0.032	-	0.055	0.055
21	Cigarette Tax	-	(0.977)	(0.987)	-	(1.964)	(1.964)
22	Investment License Fee	-	-	-	-	-	-
23	Lottery Profits	-	0.063	0.064	-	0.127	0.127
24	Liquor Profits	-	(1.798)	(0.045)	-	(1.843)	(1.843)
25	Nursing Facilities Fee	-	-	-	-	-	-
26	Foreign Capital Depository Tax	-	-	-	-	-	-
27	Electrical Energy Tax	-	-	-	-	-	-
28	Metalliferous Mines Tax	-	-	-	-	-	-
29	Highway Patrol Fines	-	-	-	-	-	-
30	Public Contractors Tax	-	-	-	-	-	-
31	Wholesale Energy Tax	-	-	-	-	-	-
32	Tobacco Tax	-	-	-	-	-	-
33	Driver's License Fee	-	-	-	-	-	-
34	Rental Car Sales Tax	-	-	-	-	-	-
35	Railroad Car Tax	-	-	-	-	-	-
36	Wine Tax	-	-	-	-	-	-
37	Beer Tax	-	(0.003)	(0.004)	-	(0.007)	(0.007)
38	Telephone License Tax	-	-	-	-	-	-
39	Long Range Bond Excess	-	-	-	-	-	-
	Total General Fund	($28.441)	$18.354	$18.802	($28.441)	$37.156	$8.715

Figure 5 shows the revised general fund revenue estimates by source which is the sum of HJR 2 estimates and all enacted legislation impacts.

Figure 5

House Joint Resolution 2 Plus Legislation Impacts
General Fund Revenue Estimates
In Millions

	Source of Revenue	Percent of 2008	Actual Fiscal 2008	Estimated Fiscal 2009	Estimated Fiscal 2010	Estimated Fiscal 2011	Estimated Fiscal 08-09	Estimated Fiscal 10-11	Cumulative % of Total
1	Individual Income Tax	44.36%	$866.659	$852.615	$840.263	$852.746	$1,719.274	$1,693.009	47.00%
2	Property Tax	10.50%	205.044	214.615	228.853	232.248	419.659	461.101	59.80%
3	Corporation Income Tax	8.21%	160.342	157.284	115.638	121.371	317.626	237.009	66.38%
4	Vehicle Tax	4.79%	93.493	93.493	92.247	90.093	186.986	182.340	71.44%
5	Common School Interest and Income	0.00%	-	-	-	-	-	-	71.44%
6	Insurance Tax & License Fees	3.28%	64.004	49.878	58.762	61.798	113.882	120.560	74.79%
7	Coal Trust Interest	1.48%	28.855	29.312	28.574	28.288	58.167	56.862	76.37%
8	US Mineral Royalty	1.86%	36.389	24.885	27.796	30.418	61.274	58.214	77.98%
9	All Other Revenue	1.97%	38.434	35.850	35.247	35.192	74.284	70.439	79.94%
10	Tobacco Settlement	0.19%	3.808	3.956	4.007	4.071	7.764	8.078	80.16%
11	Telecommunications Excise Tax	1.14%	22.350	21.597	21.672	21.761	43.947	43.433	81.37%
12	Video Gambling Tax	3.23%	63.134	66.554	69.003	71.973	129.688	140.976	85.28%
13	Treasury Cash Account Interest	1.58%	30.783	16.507	7.967	15.905	47.290	23.872	85.94%
14	Estate Tax	0.01%	0.122	0.113	0.029	0.005	0.235	0.034	85.94%
15	Oil & Natural Gas Production Tax	7.68%	149.994	94.769	66.930	82.423	244.762	149.353	90.09%
16	Motor Vehicle Fee	0.97%	18.995	18.926	17.970	17.212	37.921	35.182	91.07%
17	Public Institution Reimbursements	0.78%	15.335	14.782	16.047	15.030	30.117	31.077	91.93%
18	Lodging Facility Use Tax	0.69%	13.390	13.109	13.376	13.926	26.499	27.302	92.69%
19	Coal Severance Tax	0.61%	11.894	12.410	10.846	11.559	24.304	22.405	93.31%
20	Liquor Excise & License Tax	0.76%	14.925	15.787	16.581	17.641	30.712	34.222	94.26%
21	Cigarette Tax	1.84%	36.004	34.564	32.007	32.066	70.568	64.073	96.04%
22	Investment License Fee	0.33%	6.514	6.127	6.210	6.825	12.641	13.035	96.40%
23	Lottery Profits	0.56%	11.029	10.275	10.969	11.517	21.304	22.486	97.02%
24	Liquor Profits	0.45%	8.775	8.651	7.039	9.149	17.426	16.188	97.47%
25	Nursing Facilities Fee	0.29%	5.610	5.318	5.213	5.109	10.928	10.322	97.76%
26	Foreign Capital Depository Tax	0.00%	-	-	-	-	-	-	97.76%
27	Electrical Energy Tax	0.27%	5.179	4.707	4.717	4.727	9.886	9.444	98.02%
28	Metalliferous Mines Tax	0.55%	10.774	6.777	3.248	3.279	17.551	6.527	98.20%
29	Highway Patrol Fines	0.21%	4.049	4.052	4.055	4.058	8.101	8.113	98.43%
30	Public Contractors Tax	0.26%	5.063	4.058	4.322	4.357	9.121	8.679	98.67%
31	Wholesale Energy Tax	0.20%	3.856	3.870	3.931	3.993	7.726	7.924	98.89%
32	Tobacco Tax	0.24%	4.699	4.710	4.738	4.796	9.409	9.534	99.15%
33	Driver's License Fee	0.20%	3.866	4.667	3.920	4.739	8.533	8.659	99.39%
34	Rental Car Sales Tax	0.16%	3.157	3.118	3.182	3.313	6.275	6.495	99.57%
35	Railroad Car Tax	0.11%	2.064	2.166	2.295	2.336	4.230	4.631	99.70%
36	Wine Tax	0.09%	1.829	1.942	2.043	2.146	3.771	4.189	99.82%
37	Beer Tax	0.16%	3.124	3.160	3.218	3.278	6.284	6.496	100.00%
38	Telephone License Tax	0.00%	-	-	-	-	-	-	100.00%
39	Long Range Bond Excess	0.00%	-	-	-	-	-	-	100.00%
	Total General Fund	100.00%	$1,953.540	$1,844.603	$1,772.915	$1,829.348	$3,798.143	$3,602.263	100.00%

ECONOMIC OVERVIEW

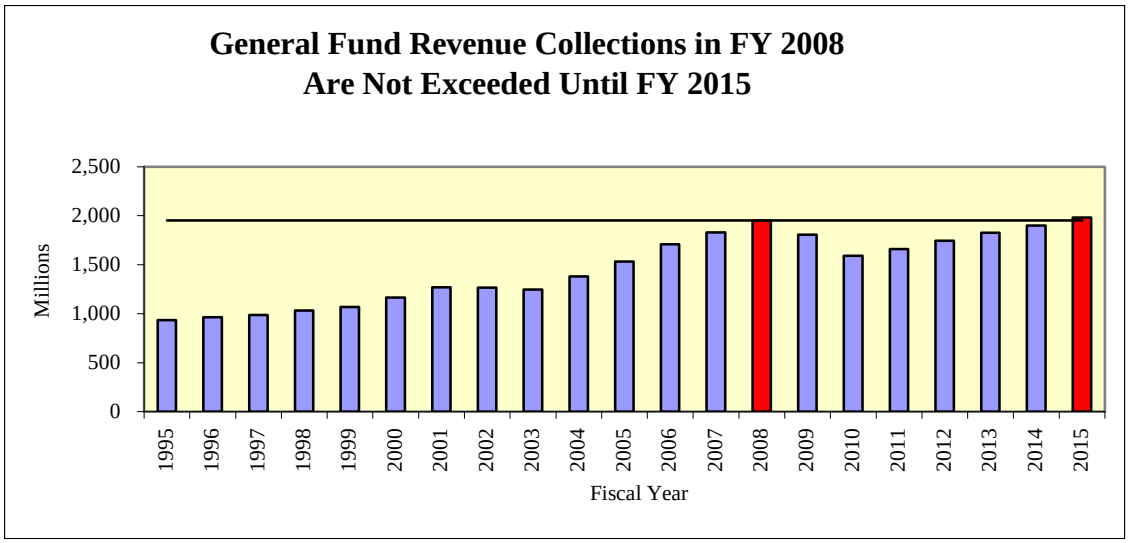
The general outlook for the US and Montana's economy for the next 3 years is for modest improvement as the nation recovers from the "Great Recession". Montana's economy and state revenues are affected by national conditions beyond its control including prices for oil and natural gas, coal and metals. Interest rates, global commodity demand, capital gains, and profits of national corporations are major drivers that determine a large portion of the state's general fund revenues. These and many other economic indicators are used to forecast revenue for the fiscal period 2011 – 2013. Revenues are forecast to increase from FY 2010 levels during the fiscal period of 2011 through 2013.

Many economic indicators have changed as rapidly as the economic climate worldwide. In April, the 61st Legislature adopted economic assumptions and accompanying revenue estimates that appeared to be reasonable at the time. Since then, state revenues have deteriorated further and the LFD revenue staff has updated the revenue estimates based on changes to year to date revenue collections as well as key economic indicators. These indicators are: wages and salaries, long and short-term interest rates, commodity prices, and corporate profits. More details are included in Appendix A: Major Economic Assumptions.

REVENUE ASSUMPTIONS

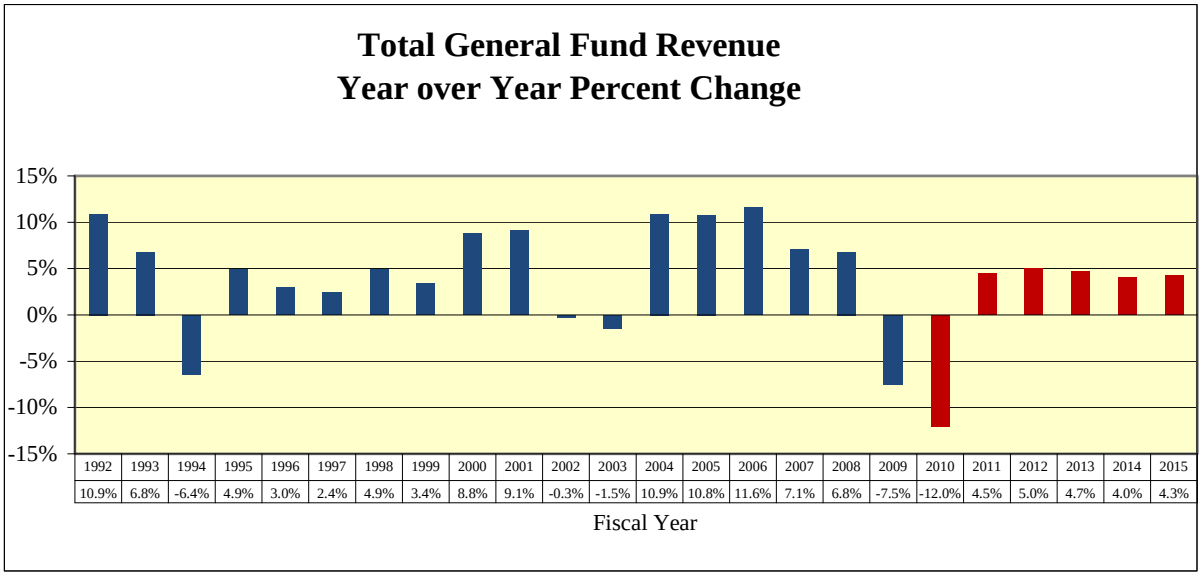
Major revenue contributors to the state general fund (and interrelated state special funds) are experiencing significant declines from FY 2008 levels. These declines are expected to continue through FY 2010 before increasing, but will still be below the FY 2008 level by FY 2013. As shown in Figure 6, general fund revenue collections peaked in FY 2008, but have declined significantly in FY 2009 and FY 2010. General fund revenues are expected to begin a recovery in FY 2011, but are not expected to reach FY 2008 levels until FY 2015.

Figure 6



The economic conditions that have prevailed since late 2008 in the state, nation, and world economies have caused state revenues to plummet from the FY 2008 amounts.

Figure 7



As shown in Figure 7, general fund revenues declined by 7.5 percent in FY 2009 and are projected to decline an additional 12.0 percent in FY 2010. Such unprecedented back to back declines have not occurred for over four decades. The only period when two consecutive years of decline occurred was in FY 2002 and 2003, but at a modest 0.3 and 1.5 percent, respectively. Such unprecedented declines also complicate the accurate prediction of future revenues and hence, complicate the budgeting process faced by the next legislature.

As shown in Figure 7, general fund revenues are expected to increase beginning in FY 2011, but at a more modest rate than observed from FY 2004 through FY 2008. These estimates are based on the IHS Global Insight (IHS) economic forecasts previously discussed. The economic forecasts as prepared by IHS reflect an economic recovery that will be slow and gradual throughout the forecast period.

THE LFD GENERAL FUND REVENUE OUTLOOK

The LFD general fund revenue estimates for the five major revenue sources are shown in Figure 8. The economic forecasts as prepared by IHS have been incorporated into these estimates when appropriate. Revised estimates for FY 2010 and FY 2011 are shown as well as estimates for FY 2012 and FY 2013. The revised estimates for the 2011 biennium are $349.9 million less than the HJ 2 estimates prepared by the 61st Legislature.

Figure 8

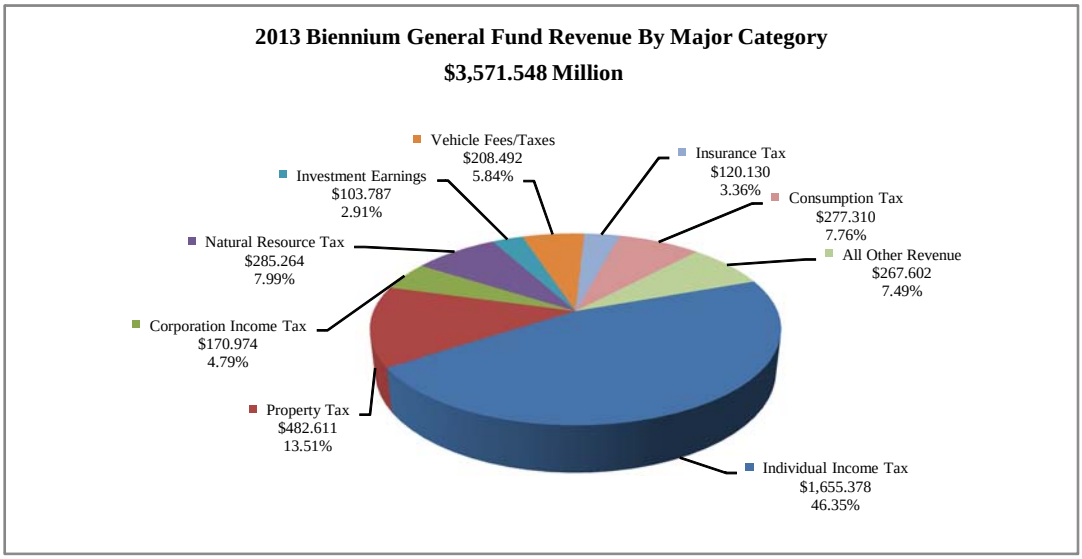
LFD Revised Revenue Estimate Recommendations - General Fund
Figures in Millions

	Actual FY 2009	Estimated FY 2010	Estimated FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium	Biennial $ Change	Biennial % Change
Individual Income Tax	$815.138	$722.166	$757.707	$801.321	$854.057	$1,479.873	$1,655.378	$175.505	11.86%
Property Tax	217.042	225.611	232.042	239.082	243.529	457.653	482.611	24.958	5.45%
Corporation Income Tax	166.355	57.392	68.630	79.868	91.106	126.022	170.974	44.952	35.67%
Vehicle Tax and Fees	104.678	103.211	102.473	103.778	104.734	205.684	208.512	2.828	1.37%
Oil and Gas Production Tax	100.491	88.269	94.726	95.174	91.84	182.995	187.014	4.019	2.20%
Remaining Sources	404.264	394.182	406.007	425.686	441.373	800.189	867.059	66.870	8.36%
Total	$1,807.968	$1,590.831	$1,661.585	$1,744.909	$1,826.639	$3,252.416	$3,571.548	$319.132	9.81%

Figure 9 shows the LFD revenue estimates for the 2013 biennium by the major revenue components. As shown, individual and corporation income taxes account for over 51 percent of the total anticipated revenues while property and vehicle taxes account for over 19.0 percent of the anticipated income. All together, individual,

corporation, property, vehicle, and natural resource taxes contributed 75.7 percent to the total estimated revenues in the 2013 biennium.

Figure 9



LFD Forecast for Major General Fund Revenue Sources

This section presents the details on five of the major general fund revenue sources that comprise 75.4 percent of the total general fund revenue for the 2011 biennium and 75.7 percent for the 2013 biennium. The LFD has revised assumptions for all of these sources in addition to all remaining sources.

ESTIMATES OF MAJOR TAX TYPES

Individual Income Tax

Background

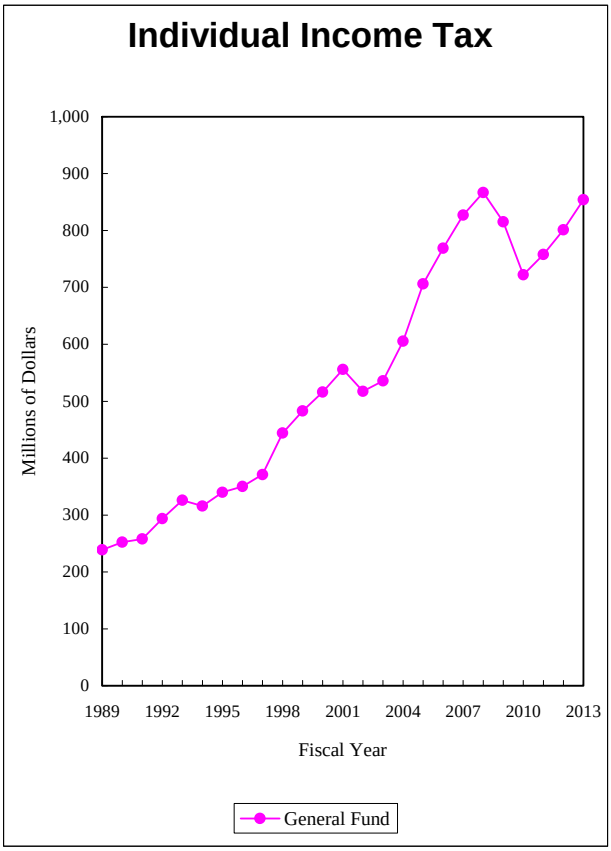
The tax is levied against taxable income, which is defined as Montana personal income adjusted for exemptions and deductions. Once tax liability is determined, the amount of tax due is computed by subtracting allowable credits. Tax rates vary from 1.0 to 6.9 percent, depending on the level of taxable income. Tax brackets, personal exemption amounts, and the standard deduction are adjusted by the rate of inflation in each year. SB 407, enacted by the 2003 legislature, created a new capital gains income tax credit. As a result, the tax rate on capital gains income is less than the tax rate on ordinary income by 1 percent in tax years 2005 and 2006, and by 2 percent in tax year 2007 and beyond. This source has contributed the following percentages of total general fund revenue:

FY 2004 – 43.82%	FY 2007 – 45.04%
FY 2005 – 46.13%	FY 2008 – 44.17%
FY 2006 – 45.01%	FY 2009 – 45.1%

Revenue Forecast

Figure 10

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1987	173.262483	Not App.
A	1988	219.241292	26.54%
A	1989	238.963596	9.00%
A	1990	252.230465	5.55%
A	1991	258.216424	2.37%
A	1992	293.564151	13.69%
A	1993	326.187735	11.11%
A	1994	315.677433	-3.22%
A	1995	339.939156	7.69%
A	1996	350.161013	3.01%
A	1997	371.275410	6.03%
A	1998	444.160729	19.63%
A	1999	483.031571	8.75%
A	2000	516.261912	6.88%
A	2001	556.014554	7.70%
A	2002	517.567691	-6.91%
A	2003	535.830664	3.53%
A	2004	605.348420	12.97%
A	2005	706.234579	16.67%
A	2006	768.922343	8.88%
A	2007	827.145498	7.57%
A	2008	866.659000	4.78%
A	2009	815.138193	-5.94%
F	2010	722.166077	-11.41%
F	2011	757.706858	4.92%
F	2012	801.320648	5.76%
F	2013	854.056658	6.58%



Individual income tax is expected to experience two years in a row of negative growth. Receipts in FY 2009 fell nearly 6 percent and are expected to fall another 11.4 percent in FY 2010. Positive growth of around 5.75 percent per year is expected between FY 2010 and FY 2013.

Montana wage growth in calendar 2009 was a negative 1.8 percent, and is expected by IHS to be 3 percent in FY 2010, 3.6 percent in FY 2011, and around 4.4 percent thereafter. Wage growth averaged 5.8 percent between calendar 1991 and calendar 2008.

Montana Employment is also expected by IHS to be below long-term historical trends though calendar 2013. Employment fell in calendar 2009 by 1.6 percent. It is expected to be flat in calendar 2010, grow 1.1 percent in calendar 2011 and average around 2.2 percent thereafter. The long-term average rate of growth in employment between 1991 and 2008 was 2.3 percent.

Montana interest income, dividend income, business income, and rents, royalties and partnership income are all expected to be down in calendar 2009, but resume growth in 2010 and thereafter.

Montana capital gains are forecast by the LFD to decline by 22.5 percent in calendar 2009, after declining nearly 36 percent in calendar 2008. Capital gains are forecast to be flat in calendar 2010, and then resume growth of 7.1 percent in calendar 2011, 6.4 percent in calendar 2012, and 5.5 percent in calendar 2013. The level of

capital gains achieved in calendar 2007, a peak of nearly $2.1 billion, will not be achieved in the forecast horizon under consideration in this report.

Property Tax

Background

Montana law requires counties to levy a county equalization levy of 55 mills, a state equalization levy of 40 mills, and 6 mills for the university system against all taxable value in each county. A mill levy of 1.5 mills is also applied against all property in the five counties with a vocational technology (vo-tech) college. Taxable value is defined as the market value of statutorily defined property times a statutory tax rate. Property valued at market value includes personal property, utility property, railroad and airline property, and mineral net and gross proceeds. The assessed value of residential and commercial real estate is the market value phased in over the reappraisal cycle. Agricultural land and timberland are valued on a productivity basis and their values are also phased in over the reappraisal cycle. The most recent reappraisal cycle took effect January 1, 2009. Beginning January 1, 2009, a new reappraisal of residential and commercial property, agricultural land and timberland became available. The new reappraised values will be phased in over the next six years, FY 2010 through FY 2015. Unless changed by the legislature, the tax rates and exemptions will be constant at the levels for FY 2009.

In addition to the tax on property, this revenue component includes collections from "non-levy" sources that are distributed on the basis of mills levied by taxing jurisdictions. These non-levy sources include the state share of coal gross proceeds taxes, federal forest revenues, and other smaller revenue sources.

This source also includes the state's share of protested taxes paid by centrally assessed companies. Should the state fail in defense of the taxation of these companies, the protested taxes must be returned to the taxpayer.

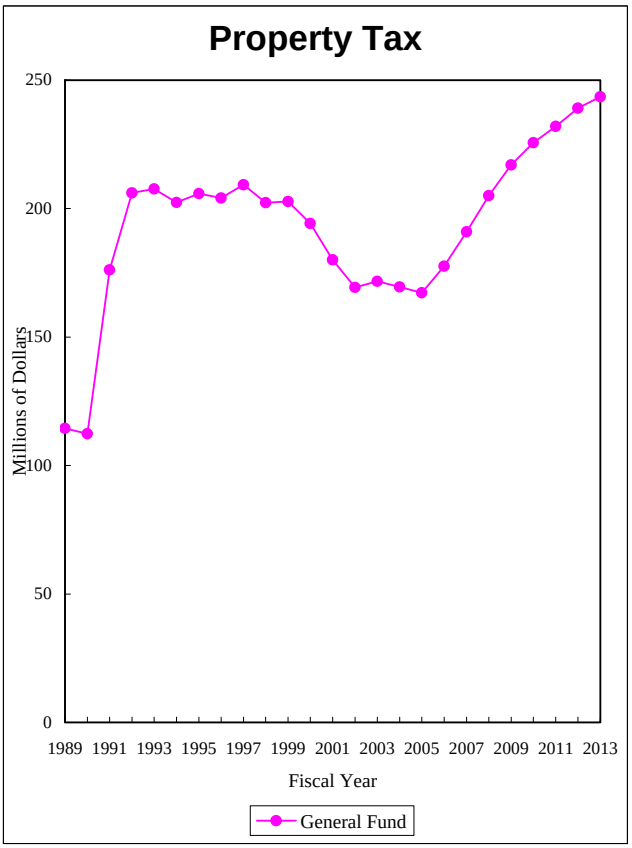
This source has contributed the following percentages of total general fund revenue:

FY 2004 – 12.27 %	FY 2007 – 10.74%
FY 2005 – 10.93%	FY 2008 – 11.53%
FY 2006 – 10.4%	FY 2009 – 12.0

Revenue Forecast

Figure 11

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1987	128.225413	Not App.
A	1988	111.111138	-13.35%
A	1989	114.444609	3.00%
A	1990	112.374543	-1.81%
A	1991	176.154583	56.76%
A	1992	206.138029	17.02%
A	1993	207.646372	0.73%
A	1994	202.381945	-2.54%
A	1995	205.842671	1.71%
A	1996	204.082588	-0.86%
A	1997	209.284365	2.55%
A	1998	202.350380	-3.31%
A	1999	202.774979	0.21%
A	2000	194.196158	-4.23%
A	2001	180.050247	-7.28%
A	2002	169.339388	-5.95%
A	2003	171.679862	1.38%
A	2004	169.530994	-1.25%
A	2005	167.270350	-1.33%
A	2006	177.639199	6.20%
A	2007	190.981939	7.51%
A	2008	205.043751	7.36%
A	2009	217.042057	5.85%
F	2010	225.611140	3.95%
F	2011	232.042083	2.85%
F	2012	239.082160	3.03%
F	2013	243.529435	1.86%



The LFD expects property tax to grow slower in FY 2010 through FY 2013 than it has in the most recent 5-year period due to the slowing economy, less homebuilding, and a slow business climate. The average rate of growth in property tax between FY 2006 and FY 2009 was 6.9 percent annually. It is expected that the rate of growth between FY 2009 and FY 2012 will be close to 3 percent annually, and only 1.9 percent in FY 2013 because the formula for the distribution of federal forest receipts under the Secure Rural Schools and Communities Act is expected to revert to the old formula based on actual production. As a result, the 55 mills will receive nearly $3 million less in federal forest receipts in FY 2013 than currently.

Slow growth was revealed in fiscal 2010 taxable value data compared with the prior year. Taxable values for commercial real estate improvements fell 10.9 percent, although commercial land continued to grow. In addition, taxable value of business equipment rose only by 0.5 percent in FY 2010 compared to increases of near 5 percent in the previous 4 years. The only tax class with extraordinary growth is class 14 – wind generation – although its' taxable value is still small compared to other classes.

Corporation Income Tax

Background

The corporation income tax is a license fee levied against a corporation's net income earned in Montana. The corporation income tax is imposed on corporations that, for reasons of jurisdiction, are not taxable under a license tax. Factors that affect corporation income tax receipts include tax credits and the audit efforts by the Department of Revenue. As with individual income tax, all tax liability is adjusted for allowable credits. The

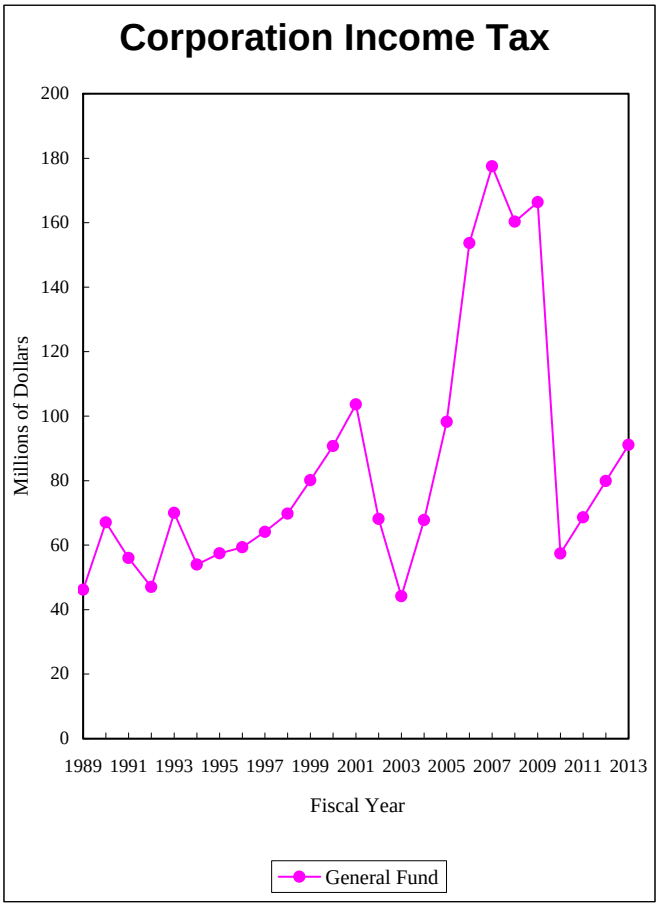
tax rate is 6.75 percent, except for corporations making a "water's edge" election (see 15-31-322, MCA), who pay a 7.0 percent tax on their net income. This source has contributed the following percentages of total general fund revenue:

FY 2004 - 4.90%	FY 2007 - 9.67%
FY 2005 - 6.42%	FY 2008 - 8.17%
FY 2006 - 9.00%	FY 2009 - 9.20%

Revenue Forecast

Figure 12

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1987	27.371125	Not App.
A	1988	37.584806	37.32%
A	1989	46.152627	22.80%
A	1990	67.087905	45.36%
A	1991	56.006784	-16.52%
A	1992	47.027797	-16.03%
A	1993	70.003987	48.86%
A	1994	53.996713	-22.87%
A	1995	57.425136	6.35%
A	1996	59.336677	3.33%
A	1997	64.078549	7.99%
A	1998	69.724680	8.81%
A	1999	80.142416	14.94%
A	2000	90.682672	13.15%
A	2001	103.670487	14.32%
A	2002	68.173253	-34.24%
A	2003	44.137518	-35.26%
A	2004	67.722940	53.44%
A	2005	98.213716	45.02%
A	2006	153.675068	56.47%
A	2007	177.503707	15.51%
A	2008	160.341786	-9.67%
A	2009	166.354514	3.75%
F	2010	57.392307	-65.50%
F	2011	68.630075	19.58%
F	2012	79.867842	16.37%
F	2013	91.105610	14.07%



Montana corporation tax collections lag the changes of national corporate profitability. National corporation profitability declined from a high of $1.6 billion in 2006 to $1.3 billion in 2008, and calculations of the Bureau of Economic Analysis do not indicate a significant change in 2009, as of the third quarter of 2009. Montana corporation tax collections started to decline in FY 2009, and have not shown any sign of improvement through the month of February. The collections through year to date February have not been so low since FY 2003, when the tax source exhibited the effects of the 2001 recession. The LFD expects that corporation tax collections will not improve through the remainder of 2010 and the result is a significant decline of 65.5 percent of tax collections, between FY 2009 and FY 2010. The projections further assume no growth in tax liability in FY 2011. However, FY 2011 does include a reduction in anticipated refunds which should coincide with a reduction in the amount of net operating losses carried back by corporations. Future collections are expected to grow at a rate similar to a one year lagged national corporation profits as projected by IHS, which mirrors the expected improvement of national corporation profitability.

Vehicle Tax

Background

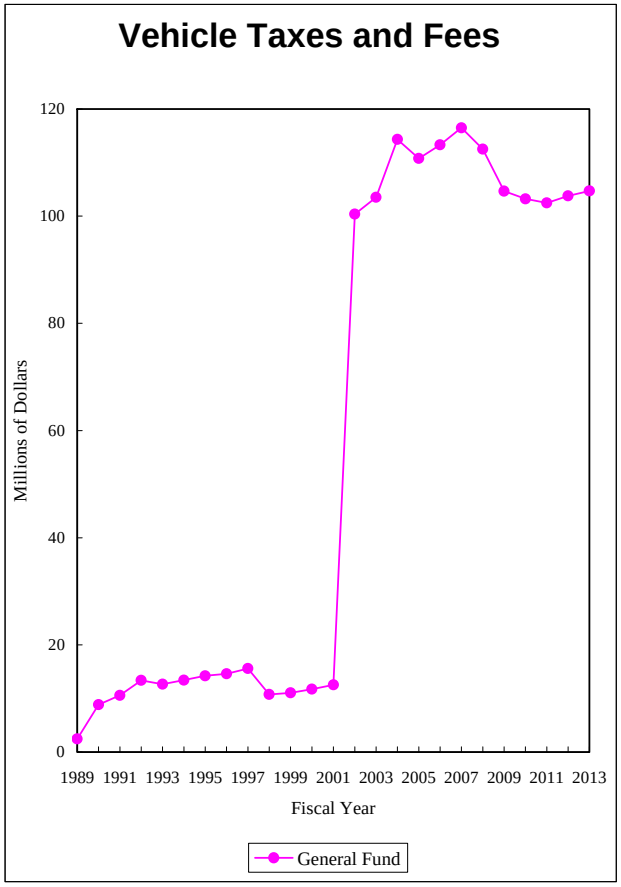
Light vehicles, motorcycles and quadricycles, snowmobiles, buses, trucks, and truck tractors having a manufacturer's rated capacity of more than 1 ton, motor homes, and certain trailers and travel trailers are taxed under a fee schedule that varies by age and weight. The fee for light vehicles is $195 for ages between zero and four years, $65 for vehicles between five and ten years of age, and $6 for vehicles over ten years old. Owners of vehicles greater than ten years old may pay $87.50 (plus other applicable fees) for a permanent registration. The fee schedule for trucks varies by age and weight capacity. The fees-in-lieu-of-tax on motorcycles and quadricycles, trailers and travel trailers, snowmobiles, watercraft, off-highway vehicles are one-time payments, except upon change of ownership. SB 508 enacted by the 2009 Legislature earmarked revenue that had previously been deposited to the general ($4.0 million in the 2011 biennium) to fund a new online vehicle insurance verification system. This source has contributed the following percentages of total general fund revenue:

FY 2004 – 6.05%	FY 2007 – 5.51%
FY 2005 – 5.23%	FY 2008 – 5.26%
FY 2006 – 5.39%	FY 2009 – 5.79%

Revenue Forecast

Figure 13

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1987	2.608426	Not App.
A	1988	2.255149	-13.54%
A	1989	2.471472	9.59%
A	1990	8.869602	258.88%
A	1991	10.582218	19.31%
A	1992	13.378654	26.43%
A	1993	12.670105	-5.30%
A	1994	13.424539	5.95%
A	1995	14.238226	6.06%
A	1996	14.605759	2.58%
A	1997	15.588374	6.73%
A	1998	10.778306	-30.86%
A	1999	11.053035	2.55%
A	2000	11.715716	6.00%
A	2001	12.548251	7.11%
A	2002	100.398624	700.10%
A	2003	103.537563	3.13%
A	2004	114.330455	10.42%
A	2005	110.771948	-3.11%
A	2006	113.292384	2.28%
A	2007	116.471506	2.81%
A	2008	112.487931	-3.42%
A	2009	104.678282	-6.94%
F	2010	103.211470	-1.40%
F	2011	102.472839	-0.72%
F	2012	103.778354	1.27%
F	2013	104.713832	0.90%



Revenue from vehicle taxes and fees is expected to follow its continuing decline (from FY 2007) through FY 2011, but recovers each year of the 2013 biennium. Problems with the Department of Justice's MERLIN system and the lack of accurate data continue to be detrimental in estimating this source. With the assistance of department staff, a base for FY 2010 was estimated and adjusted by a growth rate of national vehicle stock. Adjustments were also made to reflect revenue decreases by SB 508 enacted by the 2009 Legislature to establish an online vehicle insurance verification system.

Oil and Natural Gas Production Tax

Background

The oil and natural gas production tax is imposed on the production of petroleum and natural gas in the state. Gross taxable value of oil and natural gas production is based on the type of well and type of production.

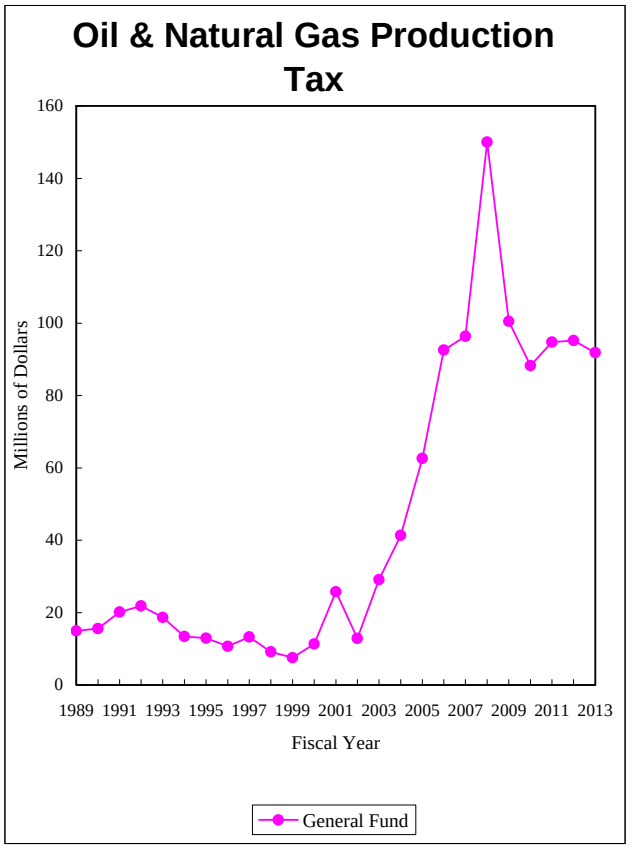
The oil and natural gas production tax has numerous tax rates depending on several factors. These factors include whether the oil or gas is produced from a stripper well, a stripper incentive well, from a well initially drilled before 1999 or after, from a well newly drilled within the last year or 18 months, and whether the interest being taxed is the working interest or the royalty interest. The Board of Oil and Gas Conservation imposes an additional privilege and license (P & L) tax on all oil and natural gas tax rates. Starting October 2006 as set by the Board, the P&L tax rate is 0.09 percent. Based on this rate, HB 758 enacted by the 2005 legislature allows an additional tax rate of 0.17 percent to generate revenue for local impacts for local governments. The two taxes may not exceed 0.3 percent. This source has contributed the following percentages of total general fund revenue:

FY 2004 – 2.99%	FY 2007 – 5.25%
FY 2005 – 4.09%	FY 2008 – 7.64%
FY 2006 – 5.42%	FY 2009 – 5.6%

Revenue Forecast

Figure 14

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1987	13.254877	Not App.
A	1988	17.975582	35.61%
A	1989	14.959251	-16.78%
A	1990	15.567426	4.07%
A	1991	20.163269	29.52%
A	1992	21.822893	8.23%
A	1993	18.676586	-14.42%
A	1994	13.403408	-28.23%
A	1995	12.963887	-3.28%
A	1996	10.665986	-17.73%
A	1997	13.283093	24.54%
A	1998	9.120152	-31.34%
A	1999	7.505617	-17.70%
A	2000	11.362741	51.39%
A	2001	25.791723	126.99%
A	2002	12.902439	-49.97%
A	2003	29.086038	125.43%
A	2004	41.323718	42.07%
A	2005	62.625939	51.55%
A	2006	92.562800	47.80%
A	2007	96.334992	4.08%
A	2008	149.993826	55.70%
A	2009	100.490971	-33.00%
F	2010	88.269324	-12.16%
F	2011	94.725580	7.31%
F	2012	95.173864	0.47%
F	2013	91.839762	-3.50%



The LFD expects oil and gas revenues to decline sharply in FY 2010 from FY 2009 due to reductions in production, even though prices are projected to increase throughout the year. Since FY 2009 was the second highest year of revenue collections due to an average yearly price of $59.55 per barrel, the decline seen in FY 2010 is accentuated. Revenues increase in FY 2011 and FY 2012 as increasing prices more than offset declining oil production and additional wells fade off the tax holiday. Revenues again decrease in FY 2013 as declining oil production outpaces increasing prices. Declining production is primarily the result of the Bakken oil formation in Montana beginning to show signs of increasing depletion. IHS prices are adjusted by historical ratios to derive Montana prices.

All Remaining General Fund Revenue

The remaining general fund revenue sources constitute 24.6 percent of the 2011 biennium total and 24.3 percent of the 2013 biennium total.

Revenue Comparison

General fund revenues are expected to be lower than initially projected by the 61st Legislature in HJR 2. The revenue projections of the legislative fiscal staff are $349.9 million, or 9.7 percent below the estimates of HJR 2 for the 2011 biennium, while the estimates prepared by the executive are $274.9 million, or 7.6 percent, lower. A full comparison of the revised projections by source is seen in Figure 15 on the following page.

Figure15

General Fund Revenue Estimates - LFD versus Executive Comparison
(in millions)

Source	Actual	HJR 2 Estimates			LFD Estimates			Executive Estimates			LFD to Executive					
											FY 2010		FY 2011		2011 Bien	
	FY 2009	FY 2010	FY 2011	2011 Bien	FY 2010	FY 2011	2011 Bien	FY 2010	FY 2011	2011 Bien	Difference	% Change	Difference	% Change	Difference	% Change
Individual Income Tax	815.138	840.263	852.746	1,693.009	722.166	757.707	1,479.873	750.730	758.750	1,509.480	28.564	4.0%	1.043	0.1%	29.607	2.0%
Property Tax	217.042	228.853	232.248	461.101	225.611	232.042	457.653	222.870	231.110	453.980	(2.741)	-1.2%	(0.932)	-0.4%	(3.673)	-0.8%
Corporation Tax	166.355	115.638	121.371	237.009	57.392	68.630	126.022	93.000	79.200	172.200	35.608	62.0%	10.570	15.4%	46.178	36.6%
Vehicle	104.678	110.217	107.305	217.522	103.211	102.473	205.684	109.140	110.340	219.480	5.929	5.7%	7.867	7.7%	13.796	6.7%
Oil Severance Tax	100.491	66.930	82.423	149.353	88.269	94.726	182.995	82.920	85.270	168.190	(5.349)	-6.1%	(9.456)	-10.0%	(14.805)	-8.1%
Video Gaming Tax	62.458	69.003	71.973	140.976	57.461	60.898	118.359	55.040	65.430	120.470	(2.421)	-4.2%	4.532	7.4%	2.111	1.8%
Insurance Tax	50.038	58.762	61.798	120.560	56.120	57.698	113.818	59.200	60.830	120.030	3.080	5.5%	3.132	5.4%	6.212	5.5%
Coal Trust Interest Earnings	26.958	28.574	28.288	56.862	26.278	26.894	53.172	27.710	27.930	55.640	1.432	5.4%	1.036	3.9%	2.468	4.6%
All Other Revenue	31.923	35.276	35.197	70.473	32.907	31.342	64.249	32.570	36.050	68.620	(0.337)	-1.0%	4.708	15.0%	4.371	6.8%
U.S. Mineral Leasing	31.573	27.796	30.418	58.214	26.353	27.881	54.234	20.800	20.830	41.630	(5.553)	-21.1%	(7.051)	-25.3%	(12.604)	-23.2%
Cigarette Tax	34.320	32.007	32.066	64.073	32.688	31.973	64.661	33.300	33.210	66.510	0.612	1.9%	1.237	3.9%	1.849	2.9%
TCA Interest Earnings	15.507	7.967	15.905	23.872	3.459	9.459	12.918	4.430	6.110	10.540	0.971	28.1%	(3.349)	-35.4%	(2.378)	-18.4%
Retail Telecom Excise Tax	22.250	21.672	21.761	43.433	22.335	22.419	44.754	22.040	22.230	44.270	(0.295)	-1.3%	(0.189)	-0.8%	(0.484)	-1.1%
Liquor Excise Tax	12.651	16.581	17.641	34.222	16.570	17.502	34.072	16.460	17.520	33.980	(0.110)	-0.7%	0.018	0.1%	(0.092)	-0.3%
Institution Reimbursements	14.101	16.047	15.030	31.077	14.702	13.670	28.372	16.050	15.030	31.080	1.348	9.2%	1.360	9.9%	2.708	9.5%
Lodging Facilities Sales Tax	12.477	13.376	13.926	27.302	12.041	12.741	24.782	13.430	14.270	27.700	1.389	11.5%	1.529	12.0%	2.918	11.8%
Coal Severance Tax	13.028	10.846	11.559	22.405	12.338	12.572	24.910	11.290	11.230	22.520	(1.048)	-8.5%	(1.342)	-10.7%	(2.390)	-9.6%
Liquor Profits	7.250	7.039	9.149	16.188	9.028	9.536	18.564	9.100	9.300	18.400	0.072	0.8%	(0.236)	-2.5%	(0.164)	-0.9%
Lottery Profits	10.136	10.969	11.517	22.486	10.154	10.173	20.327	11.520	12.290	23.810	1.366	13.5%	2.117	20.8%	3.483	17.1%
Investment Licenses	6.461	6.210	6.825	13.035	6.273	6.699	12.972	6.170	6.400	12.570	(0.103)	-1.6%	(0.299)	-4.5%	(0.402)	-3.1%
Public Contractor's Tax	5.930	4.322	4.357	8.679	6.800	5.416	12.216	4.660	3.930	8.590	(2.140)	-31.5%	(1.486)	-27.4%	(3.626)	-29.7%
Tobacco Tax	4.990	4.738	4.796	9.534	5.283	5.575	10.858	4.690	4.720	9.410	(0.593)	-11.2%	(0.855)	-15.3%	(1.448)	-13.3%
Electrical Energy Tax	4.825	4.717	4.727	9.444	5.053	5.168	10.221	4.580	4.670	9.250	(0.473)	-9.4%	(0.498)	-9.6%	(0.971)	-9.5%
Metal Mines Tax	5.993	3.248	3.279	6.527	6.231	6.231	12.462	7.020	6.600	13.620	0.789	12.7%	0.369	5.9%	1.158	9.3%
Nursing Facilities Fee	5.469	5.213	5.109	10.322	5.409	5.319	10.728	5.490	5.410	10.900	0.081	1.5%	0.091	1.7%	0.172	1.6%
Wholesale Energy Trans Tax	3.865	3.931	3.993	7.924	3.953	4.038	7.991	3.740	3.820	7.560	(0.213)	-5.4%	(0.218)	-5.4%	(0.431)	-5.4%
Highway Patrol Fines	4.180	4.055	4.058	8.113	4.204	4.228	8.432	4.230	4.260	8.490	0.026	0.6%	0.032	0.8%	0.058	0.7%
Tobacco Settlement	4.128	4.007	4.071	8.078	4.011	4.069	8.080	4.010	4.070	8.080	(0.001)	0.0%	0.001	0.0%	0.000	0.0%
Rental Car Sales Tax	2.904	3.182	3.313	6.495	2.803	2.978	5.781	2.990	3.180	6.170	0.187	6.7%	0.202	6.8%	0.389	6.7%
Drivers License Fee	3.478	3.920	4.739	8.659	3.894	3.504	7.398	4.780	3.590	8.370	0.886	22.8%	0.086	2.5%	0.972	13.1%
Beer Tax	3.115	3.218	3.278	6.496	3.185	3.238	6.423	3.190	3.260	6.450	0.005	0.2%	0.022	0.7%	0.027	0.4%
Wine Tax	1.936	2.043	2.146	4.189	2.041	2.143	4.184	2.040	2.150	4.190	(0.001)	0.0%	0.007	0.3%	0.006	0.1%
Railroad Car Tax	2.099	2.295	2.336	4.631	2.608	2.643	5.251	2.610	2.590	5.200	0.002	0.1%	(0.053)	-2.0%	(0.051)	-1.0%
	1,807.968	1,772.915	1,829.348	3,602.263	1,590.831	1,661.585	3,252.416	1,651.800	1,675.580	3,327.380	60.969	3.8%	13.995	0.8%	74.964	2.3%

APPENDIX A

MAJOR ECONOMIC ASSUMPTIONS

The LFD revenue staff has changed applicable economic assumptions to reflect the most current data available. These assumptions are based on the latest economic forecasts (January 2010) prepared by Global Insight (IHS) – a national economic forecasting company. Following are the major economic assumptions used by the LFD for the preparation of the revenue estimates contained in this document.

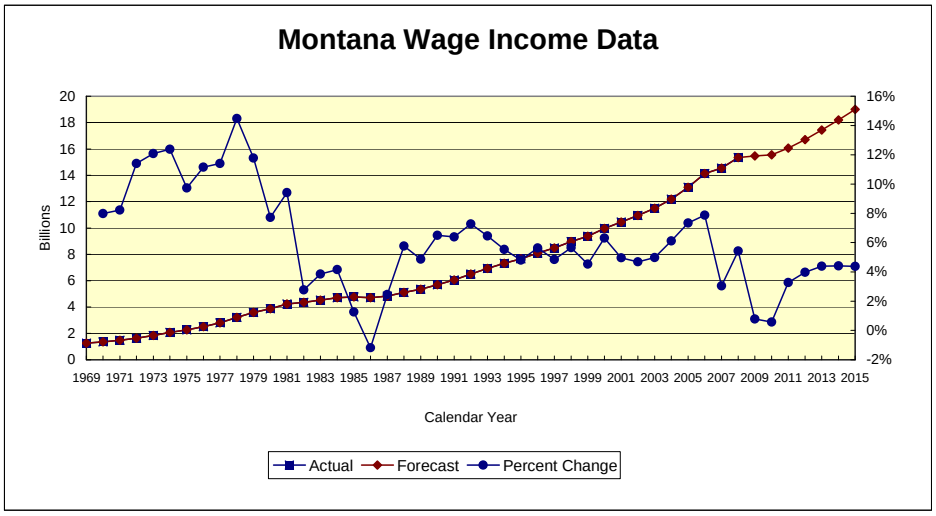
Economic Indicators

The four major economic assumptions used to forecast the state's general fund revenue for FY 2011 – FY 2013 are discussed in detail below. These four are: income, interest rates, corporation indicators, and energy prices.

Income

Montana's income, as measured by gross state product (GSP), is estimated to have been $36,186 million in 2009. GSP is projected to grow by 3 percent, in real terms, between 2009 and 2015. This rate of growth, as obtained from the most recent IHS projections, equals expectations for the growth of the gross national product over the same period. Service industries, including professional, business, educational, health, and financial services, are the principal source of income to Montana and currently account for 40 percent of GSP. Since 2000, service sectors have grown in relative importance, from 39 percent of GSP in 2000, and are expected to remain constant in the upcoming biennium, growing only as fast as the Montana economy as a whole. Other industrial groups important to the state's overall income are agriculture, mining, and construction - 17 percent GSP; and governmental activities - 15 percent GSP.

Figure 1



Income as related to state taxes is primarily driven by wages and salaries. The average annual growth in Montana wages and salaries has been 5.7 percent between 1991 and 2008. Wage growth exceeding this average occurred in the early nineties and again in the years of 2004-2006. In both these periods inflation was relatively high, i.e. greater than 2.5 percent, and employment growth was relatively high.

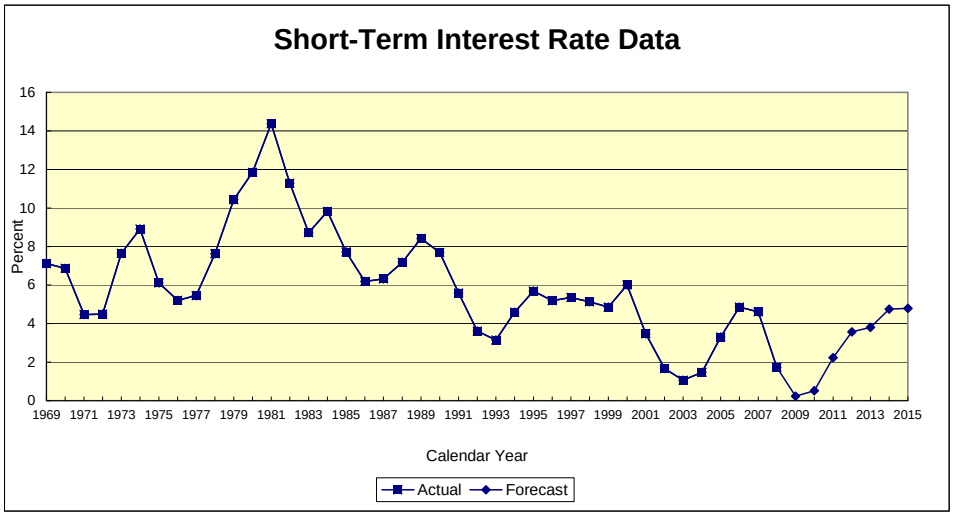
Wage and salary growth, as seen in Figure 1, is expected to be reduced from previously high growth periods. In the most recent IHS Montana-specific forecast, wages for calendar 2008 through 2015 are expected to grow at an annual rate of 3.1 percent. Growth rates for calendar years 2009 and 2010 are expected to be less than 1 percent, increasing to 4.4 percent in calendar year 2015.

Interest Rates

Interest rates have been highly volatile over the past few years. To a large degree, interest rates are controlled by the Federal Open Market Committee (FOMC). The FOMC can control interest rates by targeting the federal funds rate (the rate banks charge each other for short-term loans to meet reserve requirements) for increases or decreases. With the events of September 11, 2001 and the recession that followed, FOMC reduced interest rates. In 2004, with fears of inflation, the FOMC reversed course, causing interest rates to rise. Beginning in 2007, the FOMC reduced interest rates in hopes of spurring economic growth and providing liquidity to the stalled financial sector.

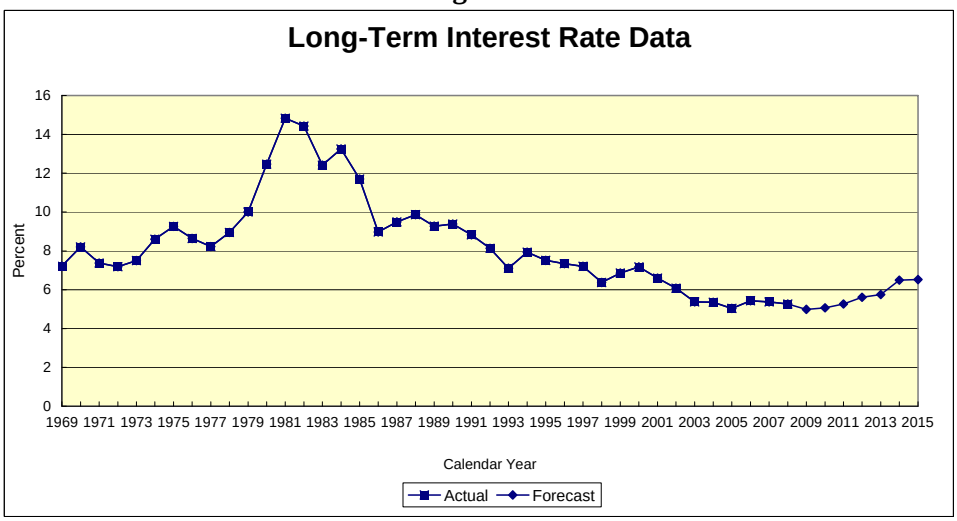
A large portion of Montana's revenues is derived from investment earnings from trust accounts and daily invested cash. Interest rates also affect the amount of investment income that is reported on individual income tax returns. As such, interest rates are a significant assumption when estimating future state revenues, and are fundamental in understanding the climate in which consumers and businesses are likely to make investments and large purchases. While low interest rates produce less revenue for Montana's trust and interest holdings, higher income tax earnings might be expected as construction and sales activities increase.

Figure 2



Two types of interest rates, long and short-term, are estimated and used in determining future revenues. Both rates are an average across a selection of investment instruments. The forecast rates are obtained from IHS. Interest rates have been at historically low levels since the beginning of the Great Recession and are expected to stay at very low levels through the next two years. As calculated by the LFD for forecasting purposes and shown in Figure 2, short-term interest rates are expected to be 0.5 percent in FY 2010, increasing to 4.8 percent by FY 2015. Long-term rates are expected to remain near 5.0 percent through FY 2011 and increase to 6.5 percent in FY 2015, as shown in Figure 18.

Figure 3

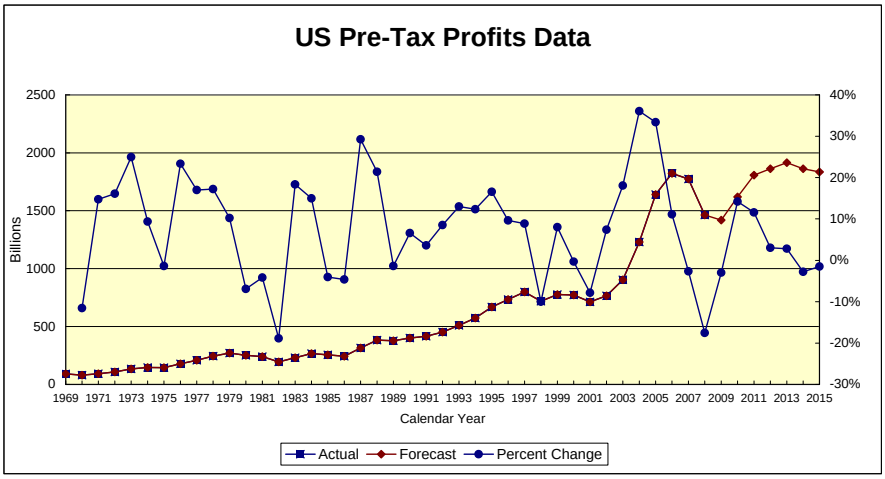


Corporation Indicators

The profitability of corporate America is an important factor in estimating revenues. Corporate profitability affects both corporation license tax and individual income tax estimates. When corporations are profitable nationally, there is

an expectation that corporations will be profitable in Montana. Additionally, greater corporate profitability is largely responsible for the amount of dividends corporations pay to stockholders as well as the value of equity investments.

Figure 4

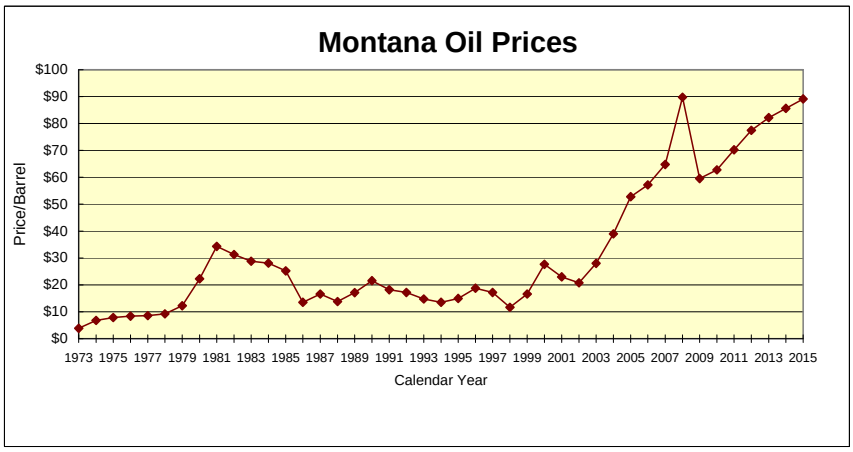


During the most recent years, the reduction of corporate profits has resulted in lower corporate license tax collections. According to IHS, between 1990 and 1997, US corporate pre-tax profits increased by an annual average of 10.3 percent. However, from 1997 through 2001, profits decreased by an average of 3.0 percent, the greatest decrease of 8.9 percent occurring in 1997. In 2004 and 2005, corporate profitability increased by 36.1 percent and 33.4 percent respectively. That trend has not continued, and with the nation in recession, corporate profits have declined substantially. In the most recent estimates provided by IHS, profits are expected to have declined by 3.0 percent in 2009 and rebound by 14.2 percent in 2010. As shown in Figure 4, corporate profits are expected to resume a slow rate of growth through 2013, followed by another period of negative growth through 2015.

Energy Prices

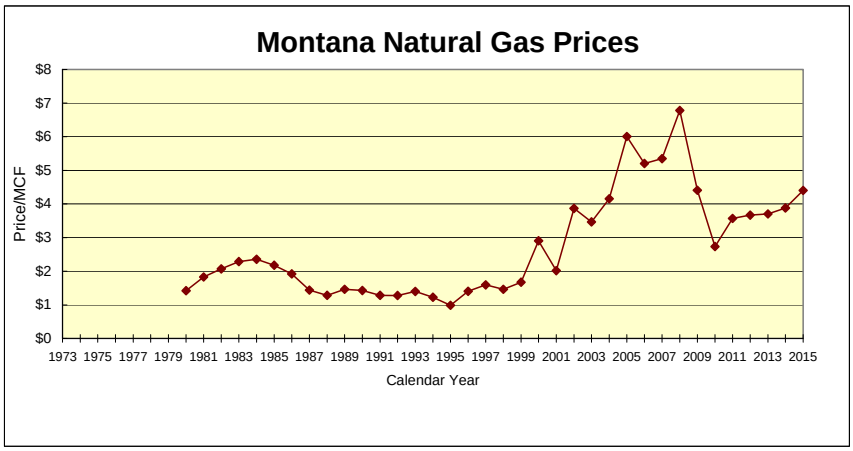
Energy prices have been volatile over the past decade. Changes in both supply and demand combine to cause dramatic price variations. For example, oil prices have varied between $12.87 per barrel in the fourth quarter of 1998 and $123.78 per barrel in the fourth quarter of 2008. In 2008, oil prices soared as demand outstripped supply, but as the world economy entered recession, prices began to decline. In recent months, the price of oil has increased and now is reported to be near $80.00 per barrel.

Figure 5



In the most recent IHS forecasts, West Texas Intermediate (WTI) oil prices are expected to average $61.76 in calendar 2009, and then increase to $68.13 in calendar 2010. WTI prices are expected to continue a slow rate of increase to $94.20 by 2015. While Montana wellhead prices are considerably lower than the WTI price, Montana prices are expected to follow a similar trend.

Figure 6

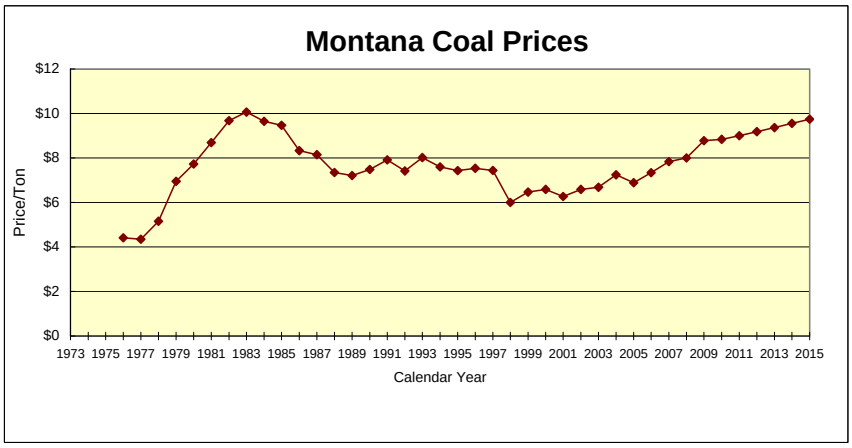


Natural gas prices at the wellhead in the US averaged $4.00 per MCF in calendar 2001 and increased to $6.22 by calendar 2007. IHS has determined that average wellhead natural gas prices fell to $3.56 in calendar 2009. Natural gas prices are not expected to increase to the highs experienced in 2007 ($7.86) in the foreseeable future, but prices are expected to resume a slow rate of increase and reach $5.92 in 2015. While Montana wellhead prices are usually lower than the US average wellhead price, Montana prices are expected to follow a similar trend.

Western U.S. coal production, which has grown steadily since 1970, is expected to continue to increase through 2015. Strong growth, combined with limited improvement in coal mining productivity, are expected to result in minemouth price increases of 1.8 percent annually from 2009 through 2015.

Between the years of 1998 and 2006, the Montana price for coal remained relatively constant. But according to recent tax return data, coal prices have started to rise. The Montana coal price is expected to increase slowly through 2015.

Figure 7



APPENDIX B

GENERAL FUND REVENUE UPDATE FEBRUARY 2010

THE BOTTOM LINE

Total general fund revenue collections through January are showing further weakness when compared to the revenue estimates used by the 61st Legislature for FY 2010. As shown in Figure 1, total general fund revenues are now estimated to be $349.9 million less than anticipated by the 61st Legislature. The potential shortfall from vehicle fees/taxes is based on information received from the Department of Justice (DOJ) extracted from their new automated system (MERLIN). The vehicle fee/tax collections data shown on the Statewide Budgeting and Human Resource system (SABHRS) continue to show a substantial reduction when compared to FY 2009 collections.

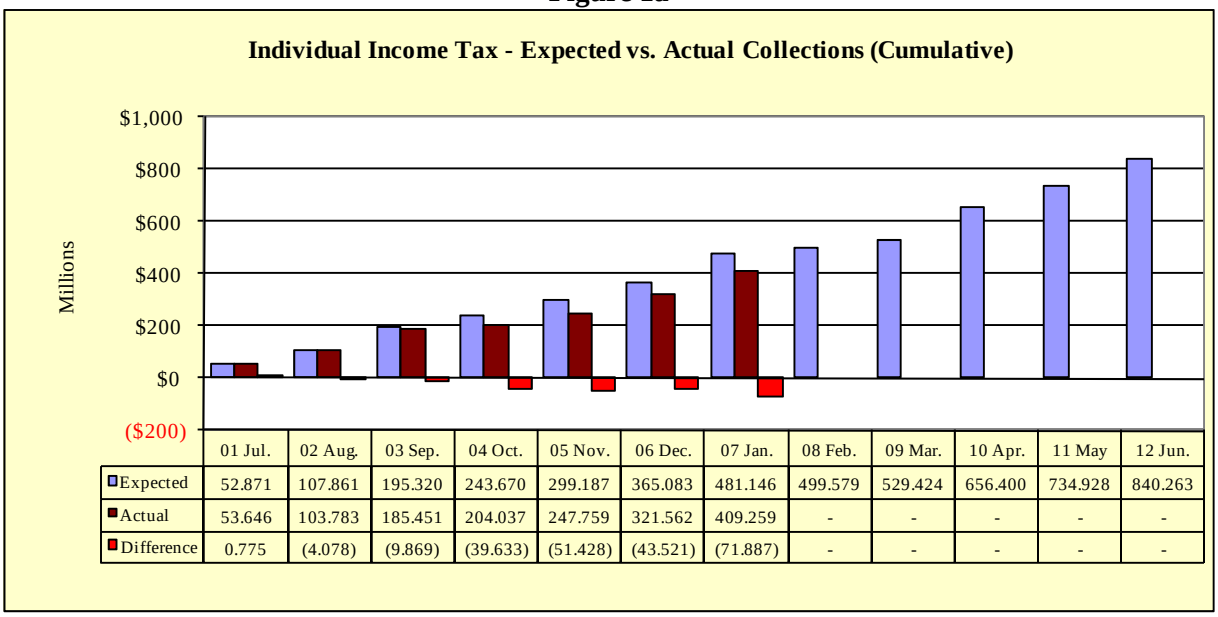
Figure 1

Estimated Revenue Changes From HJ 2 (Millions)

Category	FY 2010	FY 2011	Biennium
Individual Income Tax	($118.1)	($95.0)	($213.1)
Corporation Income Tax	(58.2)	(52.7)	(110.9)
Oil & Gas Production Tax	21.3	12.3	33.6
TCA Interest	(4.5)	(6.4)	(10.9)
Video Gaming Tax	(11.5)	(11.1)	(22.6)
Vehicle Fees/Taxes	(7.0)	(4.8)	(11.8)
Remaining Sources	(4.1)	(10.1)	(14.2)
Current Estimate	**($182.1)**	**($167.8)**	**($349.9)**
January Estimate	($137.8)	($132.7)	($270.5)
Change From January Estimate	**($44.3)**	**($35.1)**	**($79.4)**

Figure 1a shows individual income tax collections through January (cumulative) versus the HJ 2 annual revenue estimate allocated by month. As shown in Figure 1a, individual income tax collections are not keeping pace with the HJ 2 estimate and are lagging the estimate more each month. The difference shown for December in Figure 23a, however, did show a small improvement from previous months. This was because November's difference "spiked" due to an unusual large refund that reduced collections significantly. Based on these trends, individual income tax collections could be below the HJ 2 estimate by $118 million for FY 2010.

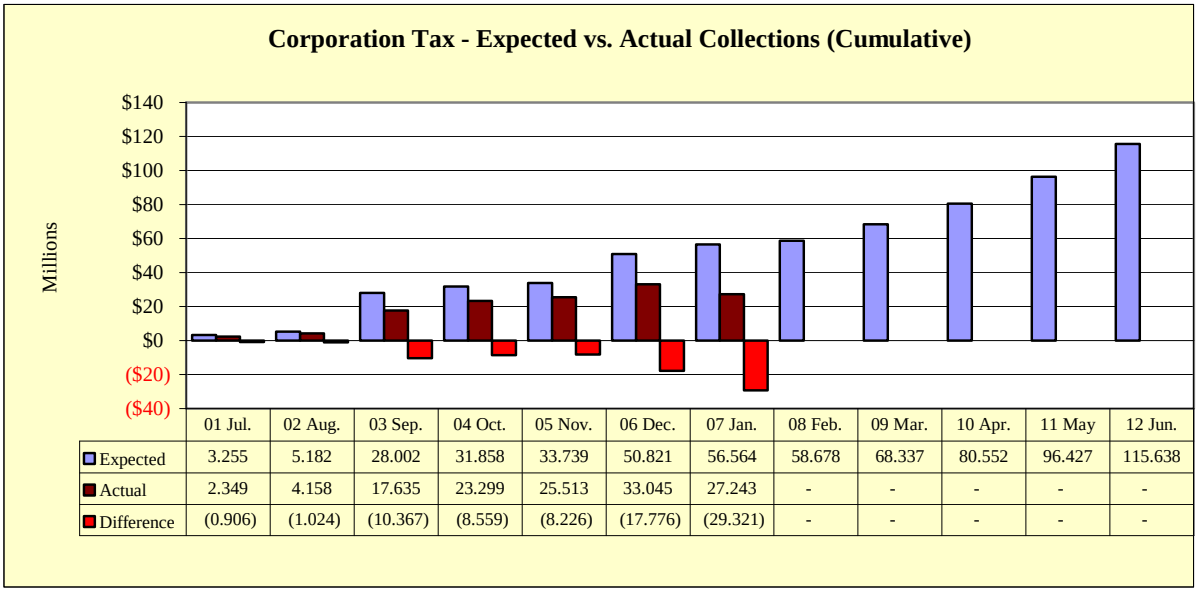
Figure 1a



	01 Jul.	02 Aug.	03 Sep.	04 Oct.	05 Nov.	06 Dec.	07 Jan.	08 Feb.	09 Mar.	10 Apr.	11 May	12 Jun.
Expected	52.871	107.861	195.320	243.670	299.187	365.083	481.146	499.579	529.424	656.400	734.928	840.263
Actual	53.646	103.783	185.451	204.037	247.759	321.562	409.259	-	-	-	-	-
Difference	0.775	(4.078)	(9.869)	(39.633)	(51.428)	(43.521)	(71.887)	-	-	-	-	-

Figure 2 shows corporation income tax collections through January (cumulative) versus the HJ 2 annual revenue estimate allocated by month. As shown in Figure 2, corporation income tax collections are not keeping pace with the HJ 2 estimate and have deteriorated further by the end of January. Based on these trends, corporation income tax collections could be below the HJ 2 estimate by $58 million for FY 2010.

Figure 2



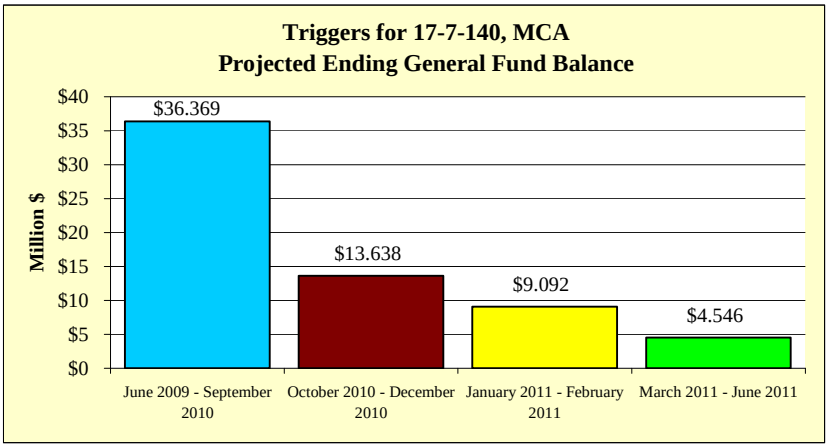
	01 Jul.	02 Aug.	03 Sep.	04 Oct.	05 Nov.	06 Dec.	07 Jan.	08 Feb.	09 Mar.	10 Apr.	11 May	12 Jun.
Expected	3.255	5.182	28.002	31.858	33.739	50.821	56.564	58.678	68.337	80.552	96.427	115.638
Actual	2.349	4.158	17.635	23.299	25.513	33.045	27.243	-	-	-	-	-
Difference	(0.906)	(1.024)	(10.367)	(8.559)	(8.226)	(17.776)	(29.321)	-	-	-	-	-

When the potential shortfall from individual and corporation income taxes, TCA interest earnings, video gaming taxes, vehicle fees/taxes, and the remaining sources is combined with the potential excess from oil and gas production taxes, total general fund revenues could be below the HJ 2 revenue estimate for FY 2010 by $182.1 million. Using these trends combined with recent economic and tax return data, FY 2011 general fund revenues could also be below the HJ 2 revenue estimate by $167.8 million. Combined, the total general fund 2011 biennium revenue shortfall could be $349.9 million or about 9.7 percent of the HJ 2 revenue estimates.

The 61st Legislature adopted a policy to maintain a higher general fund ending fund balance for the 2011 biennium ($282.4 million) in the event of revenue shortfalls. The potential shortfalls discussed above would decrease this projected balance to negative $62.5 million. This projected balance includes the additional $5.0 million received in the FY 2009 ending balance but does not include any supplemental appropriations. Staff is currently researching the need for supplemental appropriations.

Per 17-7-140, MCA, the statutory ending fund balance "floor" is computed to be $36.4 million. As specified in this statute, "the chief budget officer of the state (Governor) shall ensure that the expenditure of appropriations does not exceed available revenue." If the projected general fund deficit (as computed by the executive) falls below the budget "floor", the executive is required to submit proposed spending reductions to the Legislative Finance Committee (LFC) for their review and potential alternative recommendations. After review of all recommendations, the Governor determines the final reductions in agency spending. Figure 2a shows the phased-in trigger points for the projected general fund budget deficit. The statute was designed to require a lower ending fund balance as you approach the end of the biennium.

Figure 2a



The projected balance of negative $62.5 million is $98.9 million below the statutory trigger amount of $36.4 million. However, a projection by the Legislative Fiscal Division (LFD) is not required in statute because the "projected general fund deficit" is determined by the executive. As specified in a January 29th letter to Senator Gillian, chairperson of the Revenue and Transportation Interim Committee (RTIC), the executive has projected a general fund balance of $5.6 million, $30.8 million below the statutory trigger amount. The RTIC is scheduled to discuss the general fund revenue estimates on February 18th and the Legislative Finance Committee (LFC) is scheduled to discuss the proposed executive budget reductions on March 4th.

As discussed in previous general fund revenue reports, the revenue collection trends have progressively worsened the past several months. It is important to note that as monthly collections continue to lag the HJ 2 estimates, growth in subsequent months will need to be much greater to achieve the legislature's estimates. It also should be noted that as revenues fall below expectations, the structural imbalance (difference between on-going revenues and on-going expenditures) widens thereby creating a significant budget challenge for the 2011 Legislature.

GENERAL FUND REVENUE UPDATE

FISCAL 2010 REVENUE COLLECTIONS

Based on information recorded on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts through January for FY 2010 were $791.9 million as shown in Figure 25. This compares to $1,026.8 million collected through January for FY 2009. This is a decline in collections from FY 2009 of $235.0 million or a 22.9 percent decrease.

Total general fund collections as estimated by the legislature for FY 2010 were expected to be $35.1 million (1.9 percent) below the FY 2009 actual collections. These estimates were used by the 61st Legislature and contained in the adjusted HJ 2 (revenue estimate resolution plus impacts of enacted legislation). Most of this reduction was expected from corporate income tax, oil and gas production tax, and TCA (treasury cash account) investment earnings. Corporation income tax collections were expected to decline because of the impacts of the economic recession on corporate profits. Oil and gas production collections were expected to decline because of significantly reduced commodity prices and reduced production levels. TCA investments earnings were expected to decline because of the historical low level for short-term interest rates. Individual income tax, the largest general fund revenue source, was expected to increase as the effects of the economic recession were expected to subside by the end of FY 2010.

Figure 3 shows revenue collection and estimate data by major revenue category. The last three columns in the figure compare collections from each revenue source to the estimate contained in HJ 2. For example, corporation income tax (10th line) shows a negative $66.5 million in the "Difference" column. This means collections through January of this year are $66.5 million less than the amount received through January of FY 2009 for a negative 71.0 percent difference shown in the "% Change" column. The legislature assumed collections would be down by 30.5 percent shown in the last column. This means collections are lagging the legislative estimate and will need to accelerate in subsequent months to be on track with the HJ 2 estimate.

Figure 3

General Fund Revenue Monitoring Report

Revenue Source	Actual Fiscal 2009	HJ2 Estimate * Fiscal 2010	Through 1/31/09	Through 2/8/10	Difference	% Change	HJ2 Estimate % Change
GF0100 Drivers License Fee	3,478,285	3,920,000	1,486,094.76	2,121,188.52	635,093.76	42.74%	12.70%
GF0200 Insurance Tax	50,038,468	58,762,000	14,110,211.35	23,859,301.82	9,749,090.47	69.09%	17.43%
GF0300 Investment Licenses	6,461,446	6,210,000	5,207,366.80	5,217,258.04	9,891.24	0.19%	-3.89%
GF0400 Vehicle License Fee	89,334,878	92,247,000	45,200,579.00	32,536,723.42	(12,663,855.58)	**-28.02%**	3.26%
GF0500 Vehicle Registration Fee	15,344,744	17,970,000	8,202,762.80	5,239,748.89	(2,963,013.91)	**-36.12%**	17.11%
GF0600 Nursing Facilities Fee	5,468,766	5,213,000	1,924,646.22	1,984,978.20	60,331.98	3.13%	-4.68%
GF0700 Beer Tax	3,114,729	3,218,000	1,647,564.42	1,621,153.34	(26,411.08)	**-1.60%**	3.32%
GF0800 Cigarette Tax	34,320,412	32,007,000	19,818,032.24	18,552,709.86	(1,265,322.38)	-6.38%	-6.74%
GF0900 Coal Severance Tax	13,028,228	10,846,000	5,596,594.99	6,008,878.77	412,283.78	7.37%	-16.75%
GF1000 Corporation Tax	166,354,514	115,638,000	93,785,752.25	27,243,332.56	(66,542,419.69)	**-70.95%**	-30.49%
GF1100 Electrical Energy Tax	4,824,659	4,717,000	1,648,606.18	1,220,218.98	(428,387.20)	**-25.98%**	-2.23%
GF1150 Wholesale Energy Trans Tax	3,864,771	3,931,000	1,501,731.34	1,462,446.10	(39,285.24)	**-2.62%**	1.71%
GF1200 Railroad Car Tax	2,099,454	2,295,000	1,574,554.79	1,977,026.66	402,471.87	25.56%	9.31%
GF1300 Individual Income Tax	815,138,193	840,263,000	526,260,865.31	409,258,642.24	(117,002,223.07)	**-22.23%**	3.08%
GF1400 Inheritance Tax	217,097	29,000	107,885.06	47,486.95	(60,398.11)	-55.98%	-86.64%
GF1500 Metal Mines Tax	5,992,923	3,248,000	(0.01)	2,899.99	2,900.00	**-29000000.65%**	-45.80%
GF1700 Oil Severance Tax	100,490,971	66,930,000	44,535,368.05	21,314,801.54	(23,220,566.51)	**-52.14%**	-33.40%
GF1800 Public Contractor's Tax	5,929,999	4,322,000	3,839,207.10	5,236,458.45	1,397,251.35	36.39%	-27.12%
GF1850 Rental Car Sales Tax	2,904,340	3,182,000	1,452,338.66	1,480,427.25	28,088.59	**1.93%**	9.56%
GFxxxx Property Tax	217,042,057	228,853,000	114,739,052.20	123,374,537.00	8,635,484.80	7.53%	5.44%
GF2150 Lodging Facilities Sales Tax	12,477,461	13,376,000	5,823,051.29	5,815,572.08	(7,479.21)	**-0.13%**	7.20%
GF2200 Telephone Tax	-	-	-	-	-		
GF2250 Retail Telecom Excise Tax	22,250,383	21,672,000	5,788,012.69	5,528,852.08	(259,160.61)	**-4.48%**	-2.60%
GF2300 Tobacco Tax	4,990,497	4,738,000	2,379,240.25	2,784,933.32	405,693.07	17.05%	-5.06%
GF2400 Video Gaming Tax	62,458,106	69,003,000	47,053,337.60	27,481,710.94	(19,571,626.66)	**-41.59%**	10.48%
GF2500 Wine Tax	1,936,052	2,043,000	1,046,434.40	1,038,492.19	(7,942.21)	**-0.76%**	5.52%
GF2600 Institution Reimbursements	14,100,804	16,047,000	6,972,379.55	8,920,672.08	1,948,292.53	27.94%	13.80%
GF2650 Highway Patrol Fines	4,179,882	4,055,000	2,108,202.32	2,222,991.90	114,789.58	5.44%	-2.99%
GF2700 TCA Interest Earnings	15,506,889	7,967,000	10,487,043.40	1,551,896.01	(8,935,147.39)	**-85.20%**	-48.62%
GF2900 Liquor Excise Tax	12,650,902	16,581,000	8,268,719.38	5,466,805.25	(2,801,914.13)	**-33.89%**	31.07%
GF3000 Liquor Profits	7,250,000	7,039,000	-	-	-		-2.91%
GF3100 Coal Trust Interest Earnings	26,958,378	28,574,000	10,984,120.10	11,268,340.31	284,220.21	**2.59%**	5.99%
GF3300 Lottery Profits	10,136,213	10,969,000	2,743,202.00	2,794,584.00	51,382.00	**1.87%**	8.22%
GF3450 Tobacco Settlement	4,127,609	4,007,000	-	-	-		-2.92%
GF3500 U.S. Mineral Leasing	31,573,364	27,796,000	16,552,667.97	13,036,796.74	(3,515,871.23)	**-21.24%**	-11.96%
GF3600 All Other Revenue	31,922,159	35,247,000	13,995,198.44	14,198,558.83	203,360.39	**1.45%**	10.42%
Grand Total	1,807,967,633	1,772,915,000	1,026,840,822.90	791,870,424.31	(234,970,398.59)	**-22.88%**	-1.94%

* Plus impacts of enacted legislation

DISCUSSION OF SELECTED SOURCES FOR FISCAL 2010 AND FISCAL 2011

The following section of the report addresses some of the key general fund revenue sources that were monitored closely during the regular session. These sources are individual income tax, corporation income tax, treasury cash account (TCA) interest earnings, and oil and gas production tax. These sources were chosen because of their vulnerability to the economic recession and the discussion these sources received during the past legislative session. This section of the report also includes a discussion on sources that are showing very unusual collection patterns. These sources are insurance taxes, vehicle fees/taxes, liquor excise taxes, and video gaming taxes. As discussed in the September report, cigarette taxes and US mineral leasing revenues were lagging the HJ 2 estimate because of an accrual and revenue deposit timing issues, respectively. These issues have been resolved and the revenues are now more comparable to historical patterns.

Individual Income Tax

Based on January accounting data, net individual income tax collections for FY 2010 (gross collections less refunds) were 22.2 percent below net collections for FY 2009 or a decrease of $117.0 million. The 61st Legislature assumed that revenues would increase by 3.1 percent from the FY 2009 amount or an increase of $25.1 million. This increase was anticipated because the effects of the economic recession were expected to subside by the end of FY 2010.

Figure 4 shows the accounting details through January of individual income tax collections for FY 2010 compared to the same period for FY 2009. Since withholding tax collections are a proxy of total wage growth, the negative 3.1 percent growth from last year indicates total wages have declined from the level observed a year ago. Withholding payments for mineral royalties have declined by $5.3 million or 46.8 percent. This decline was anticipated because of the significant reduction in Montana's wellhead oil price.

Figure 4

Individual Income Tax Comparison

Revenue Code & Description	Through 1/31/2009 Fiscal 2009	Through 1/31/2010 Fiscal 2010	Difference	Percent Change
510101 Withholding Tax	365,400,636.39	354,017,686.25	(11,382,950.14)	-3.12%
510482 Mineral Royalty WH Tax	11,284,045.09	5,999,134.64	(5,284,910.45)	-46.84%
510102 Estimated Tax	177,402,743.66	114,804,808.96	(62,597,934.70)	-35.29%
510103 Current Year I/T	13,404,496.28	5,985,444.94	(7,419,051.34)	-55.35%
510105 Income Tax - Audit Collections	14,697,649.00	17,231,166.00	2,533,517.00	17.24%
510106 Income Tax Refunds	(55,928,705.11)	30,582,373.62	86,511,078.73	-154.68%
Income Tax Refunds Adjustment	0.00	(119,361,972.17)	(119,361,972.17)	
Totals	$526,260,865.31	$409,258,642.24	($117,002,223.07)	-22.23%
Percent of Actual/Estimated	60.72%	48.71%		

Estimated payments, due October 15th and January 15th, were $62.6 million (35.3 percent) below last year. During the last two quarters of FY 2009, estimated payments declined by 14.5 and 33.6 percent, respectively. Review of the first and second quarter FY 2010 payments shows a continuation of this trend. With a substantial drop in the equity markets during late 2008 and early 2009, historical low interest rates, and reductions in corporate profitability, it is not surprising to observe a significant reduction in estimated payments. Estimated payments and current year payments are a good indicator of how taxpayers' non-wage components of income are changing relative to economic conditions.

Figure 4a shows year over year change in estimated payments from FY 2008 to FY 2010. As shown, estimated payments have dropped off significantly when compared to the two previous years. The next payment, due on April 15th, will provide insight on whether taxpayers expect their non-wage income to be better in calendar 2010 as compared to calendar 2009.

Figure 4a

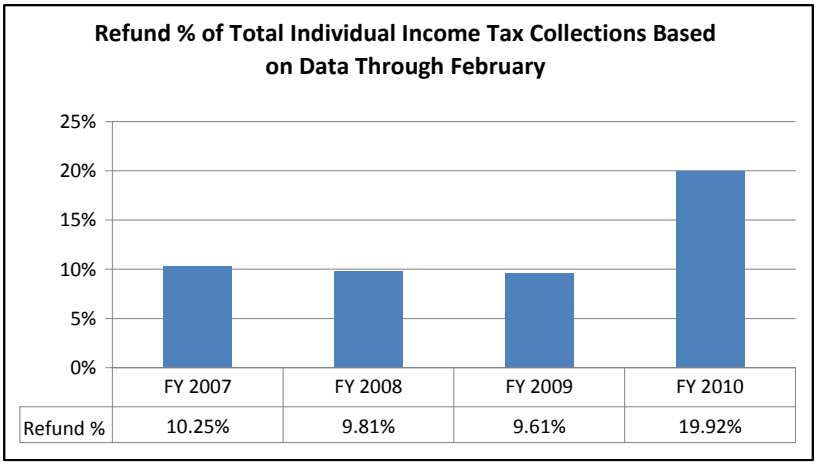
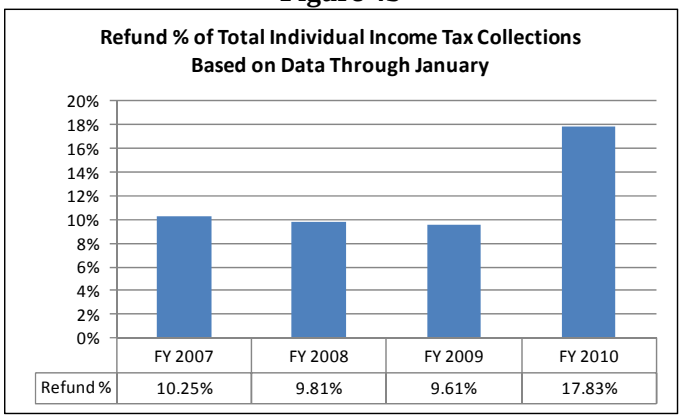


Figure 4a shows two lines for individual income tax refunds. Because of a legislative audit recommendation, the DOR processed a refund payable adjustment in October that was previously recorded during the fiscal year-end adjustment period. By including the adjustment amount in Figure 4, total collections between fiscal years continue to be an "apples to apples" comparison. Without the refund adjustment amount, refunds through January would have shown a positive $30.6 million, an amount not comparable to the negative $55.9 million shown for FY 2009. This refund adjustment will be shown in subsequent months to maintain comparability with last year.

Since October 15th was the due date for tax returns that were extended beyond the April 15th due date, refunds issued by the end of January are an indication of under or overpayment of taxes during FY 2009 plus the trends for this tax season. As stated in previous reports, if refunds during this period were unusually high, this would indicate taxpayers overpaid during FY 2009 thereby inflating actual receipts for FY 2009. Conversely, if refunds were unusually low, taxpayers underpaid during FY 2009 which would mean FY 2009 receipts were understated. As of the end of January, refunds (the two refund lines combined) were $88.8 million or $32.9 million (58.7 percent) above the same period for FY 2009. This suggests that taxpayers overpaid their taxes during FY 2009 thereby overstating FY 2009 total collections. This is an unfavorable trend for FY 2010 since overpayments in FY 2009 means the income base is lower than originally assumed by the legislature. If the income base is lower, then growth from FY 2009 to FY 2010 needs to be stronger in order to achieve the HJ 2 estimate. Figure 4b shows refunds as a percent of total individual income tax collections. As shown, the refund percent has increase significantly from previous years. It should be noted, however, that some of this increase could be due to economic conditions as well as taxpayers utilizing electronic filing. It is too early in the refund cycle to determine whether this may explain the increase.

Figure 4b



When all of the accounting categories are added together, total individual income tax collections through January are $117.0 million below FY 2009 amounts. Since total FY 2010 collections were estimated to be $25.1 million above FY 2009 amounts, the HJ 2 individual income tax estimate for FY 2010 is too optimistic. Based on seven months of accounting information and tax return data for calendar 2008, individual income tax revenues could be below the HJ 2 estimate by $118 million in FY 2010 and $95 million in FY 2011.

Corporation Income Tax

Based on January accounting data, net corporation income tax collections for FY 2010 (gross collections less refunds) were 71.0 percent below net collections for FY 2009 or a decrease of $66.5 million (Figure 5). The 61st Legislature assumed that revenues would decrease by 30.5 percent from the FY 2009 amount or a decrease of $50.7 million. This decrease was anticipated because of the effects the economic recession on corporate profitability for both state and national corporations.

As pointed out in the September report, part of the strength in FY 2009 collections was explained by the auditing efforts of the DOR and the resulting unusual high audit collections. Total audit collections were $31.0 million in FY 2009 compared to $16.9 million in FY 2008. When audit collections are removed from FY 2008 and 2009 totals, then the trend for the remaining collections are a negative 5.7 percent, a decline rate greater than estimated in HJ 2 for FY 2009. The good news is that audit collections in FY 2010 continue to be strong, $7.6 million. This amount represents 28 percent of total corporation income tax collections through January but is $6.6 million less than received through January of FY 2009. A large audit payment was received in January 2009.

Estimated payments, due October 15th and December 15th, were $35.6 million (49.6 percent) below last year. Further review of tax payment detail by corporation provides some additional insight to estimated payments. Similar to individual income tax, estimated payments for the last two quarters of FY 2009 declined by 34.9 and 41.3 percent, respectively. Review of the first seven months of FY 2010 payments shows a continuation of this trend. With announced job layoffs, business closures and/or cutbacks, significant consumer spending reductions, and construction plummeting, it is not surprising to observe a significant reduction in estimated payments.

Figure 5

Corporation Income Tax Comparison

Revenue Code & Description	Through 1/31/2009 Fiscal 2009	Through 01/31/2010 Fiscal 2010	Difference	Percent Change
510501 Corporation Tax	19,543,431.48	5,803,321.75	(13,740,109.73)	-70.31%
510505 Corporation Tax Estimated Paym	71,730,544.33	36,148,399.13	(35,582,145.20)	-49.61%
510502 Corporation Tax Refunds	(11,734,805.56)	(19,509,421.67)	(7,774,616.11)	66.25%
510503 Corporation Tax-Audit Collect.	14,246,582.00	7,628,790.00	(6,617,792.00)	-46.45%
Corporation Tax Refunds Adjustment	0.00	(2,827,756.65)	(2,827,756.65)	
Totals	$93,785,752.25	$27,243,332.56	($66,542,419.69)	-70.95%
Percent of Actual/Estimated	58.49%	23.56%		

Figure 5a shows year over year change in estimated payments from FY 2008 to FY 2010. As shown, estimated payments have dropped off significantly when compared to the two previous years. The next payment, due on April 15th, will provide insight on whether corporations expect their profits to be better in calendar 2010 as compared to calendar 2009.

Figure 5a

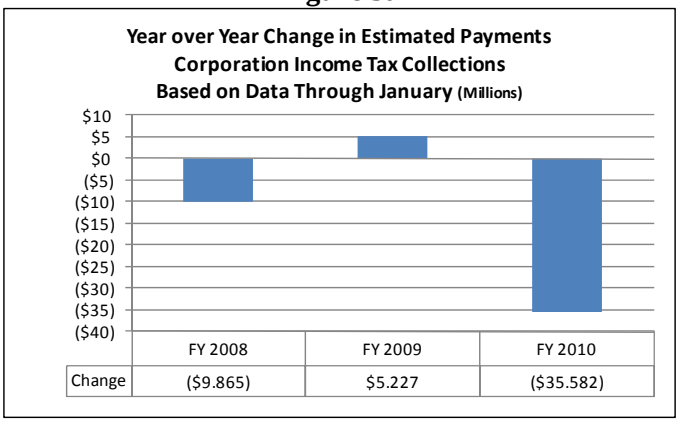
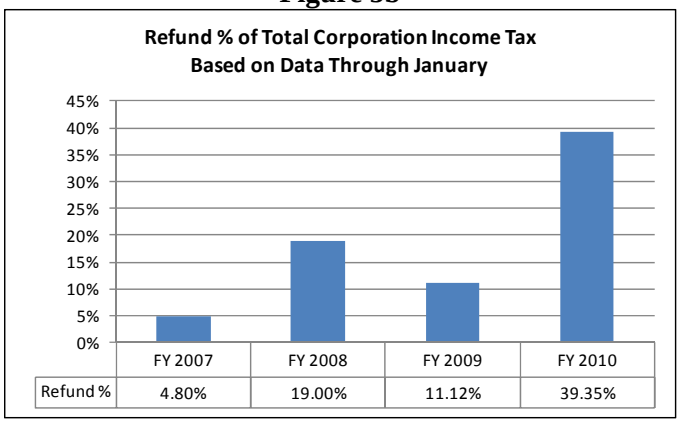


Figure 5 shows two lines for corporation income tax refunds. Because of a legislative audit recommendation, the DOR processed a refund payable adjustment in October that was previously recorded during the fiscal year-end adjustment period. By including the adjustment amount in Figure 5, total collections between fiscal years continue to be an "apples to apples" comparison. Without the refund adjustment amount, refunds through January would have shown a negative $19.5 million instead of a negative $22.3 million (the two refund amounts added together). By showing the refund adjustment, total refunds have increased by 90.3 percent compared to last year. This suggests that corporate taxpayers may have overpaid their taxes during FY 2009 thereby overstating FY 2009 total collections. Figure 5b shows refunds as a percent of total corporation income tax collections. As shown, the refund percent has increased significantly from previous years.

Figure 5b



When all of the accounting categories are added together, total corporation income tax collections through January are $66.5 million or 71.0 percent below FY 2009. Since total FY 2010 collections were estimated to be $50.7 million (30.5 percent) below FY 2009 amounts, the HJ 2 corporation income tax estimate for FY 2010 is too optimistic. Based on seven months of accounting information and tax payment data by corporation, corporation income tax revenues could be below the HJ 2 estimate by $58 million in FY 2010 and $53 million in FY 2011.

Treasury Cash Account (TCA) Interest Earnings

Based on January accounting data, TCA interest earnings for FY 2010 were 85.2 percent below collections for FY 2009 or a decrease of $8.9 million. The 61st Legislature assumed that revenues would decrease by 48.6 percent from the FY 2009 amount or a decrease of $7.5 million. This decrease was anticipated because of the reduced rate of return anticipated for short-term securities.

For FY 2009, collections from this source were below estimate by $1.0 million or 6.1 percent. This trend appears to be much worse in FY 2010 as collections are down 85.2 percent when Januarys' collections of FY 2009 are compared to the same period of FY 2010. Since TCA interest earnings are based on cash available for investment and the rate of return for short-term securities, reduced earnings are primarily due to reduced short-term interest rates. Figure 6 shows the average monthly rate of return received on the short-term investment pool (STIP) as published by the Board of Investments since November 2007. Short-term rates have plummeted from 4.9 percent in November 2007 to 0.24 percent in January 2010.

Figure 6

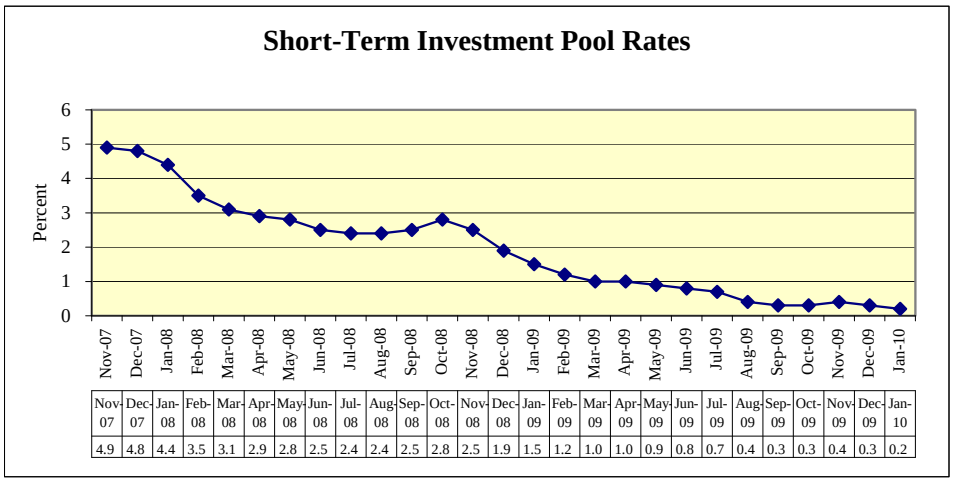
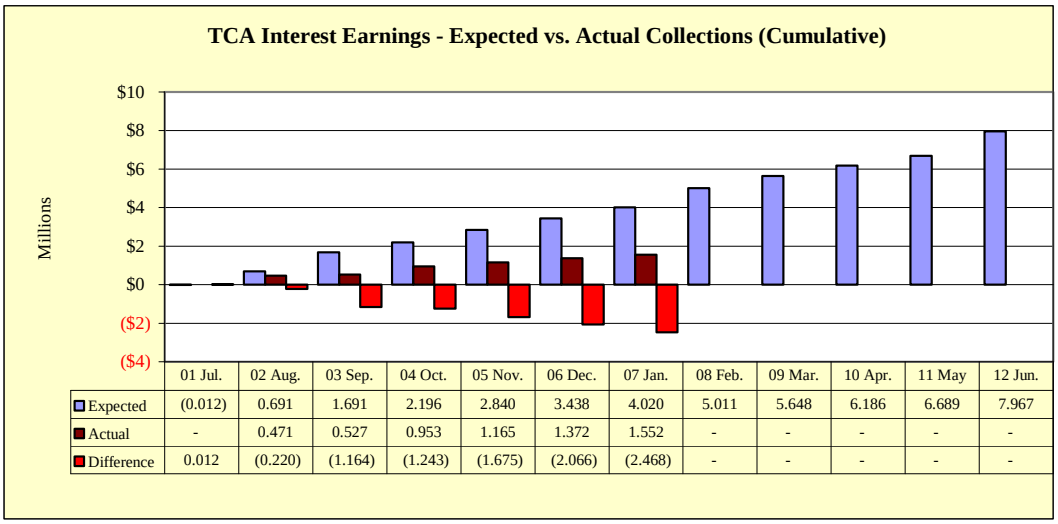


Figure 6a shows TCA interest earnings through January (cumulative) versus the HJ 2 annual revenue estimate llocated by month. As shown in Figure 6a, TCA interest earnings are not keeping pace with the HJ 2 estimate and are lagging the estimate more each month. Based on these trends, TCA interest earnings could be below the HJ 2 estimate by $4.5 million for FY 2010 and $6.4 million in FY 2011.

Figure 6a



	01 Jul.	02 Aug.	03 Sep.	04 Oct.	05 Nov.	06 Dec.	07 Jan.	08 Feb.	09 Mar.	10 Apr.	11 May	12 Jun.
Expected	(0.012)	0.691	1.691	2.196	2.840	3.438	4.020	5.011	5.648	6.186	6.689	7.967
Actual	-	0.471	0.527	0.953	1.165	1.372	1.552	-	-	-	-	-
Difference	0.012	(0.220)	(1.164)	(1.243)	(1.675)	(2.066)	(2.468)	-	-	-	-	-

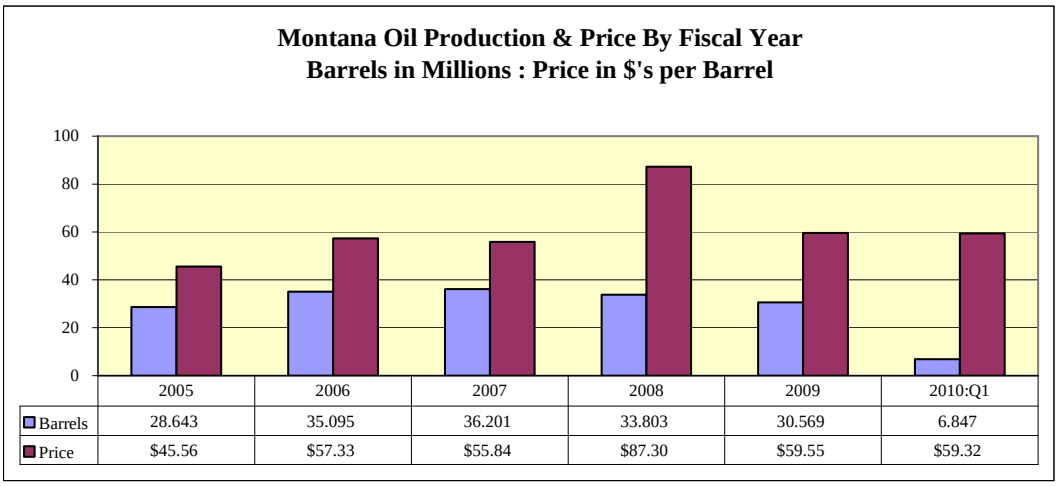
Oil and Gas Production Tax

Oil and natural gas production taxes are one of the major sources of revenue that could exceed the HJ 2 estimate. As shown in Figure 3 (page 8 Appendix), oil and gas production tax collections through January FY 2010 are below FY 2009 collections by $23.2 million. This was expected because oil and gas prices were significantly higher for the first quarter of FY 2009 versus FY 2010. The most recent tax return data as filed with the DOR provide information on production and wellhead prices for FY 2009 and the first quarter of FY 2010. As shown in Figure 7, oil production in Montana was 30.6 million barrels at an average price of $59.55 per barrel for FY 2009. The estimates contained in HJ 2 were for production to be 30.1 million barrels at an average price of $54.36 per barrel.

As shown in Figure 7, total oil production for the first quarter of FY 2010 was 6.8 million barrels. If production continues at this rate for the remaining three quarters, FY 2010 production would be 27.4 million barrels. The estimated production contained in HJ 2 is 27.5 million barrels for FY 2010.

Using the production estimate contained in HJ 2 for FY 2010 (27.5 million barrels) and a price assumption of $62.73 per barrel (approximate current price), general fund oil production tax revenue in FY 2010 would exceed the HJ 2 estimate by approximately $29 million. General fund natural gas production tax, on the other hand, could be below the HJ 2 estimate by as much as $8 million. Natural gas production and prices are currently well below the HJ 2 assumptions for FY 2010. When combined, oil and natural gas production revenue could be $21 million above the HJ 2 estimate for FY 2010 and $12 million for FY 2011.

Figure 7



Unusual Collection Patterns

As shown in Figure 3, several sources of revenue are showing unusual collection patterns other than those sources previously discussed. Some of the larger sources are insurance taxes, vehicle fees/taxes, liquor excise taxes, and video gaming taxes.

Insurance Taxes

The insurance tax collection variation is due to the timing of deposits this year versus previous years. Historically, the first estimated payment for insurance taxes is deposited either in October or November. As shown in Figure 8, the first estimated payment for FY 2007 was recorded in October while the first payment was recorded in November for FY 2008 and FY 2009. This fiscal year, the first estimated payment was deposited in September. In addition, the second estimated payment for FY 2010 was recorded in December. Historically, this payment was deposited in January or in February as was the case in FY 2009.

Figure 8

Insurance Tax Collections

Month	Actual FY 2007	Actual FY 2008	Actual FY 2009	Actual FY 2010
01 Jul.	-	-	-	85,036.88
02 Aug.	17,351.87	142,074.46	(66,186.21)	426,556.78
03 Sep.	706,428.30	523,190.61	10,629.00	***11,448,689.03***
04 Oct.	***11,847,042.80***	(64.05)	72,949.25	30,688.53
05 Nov.	551,560.59	***13,221,557.58***	***14,049,612.52***	292,115.31
06 Dec.	429,657.82	236,967.83	22,597.79	***11,305,965.43***
07 Jan.	**12,305,424.58**	**8,153,338.01**	20,609.00	*270,249.86*
08 Feb.	4,763.50	109,654.50	**9,529,622.13**	*301,391.85*
Total	**$25,862,229.46**	**$22,386,718.94**	**$23,639,833.48**	**$24,160,693.67**

It should be noted that collections shown for FY 2010 reflect the reduced insurance tax deposits to the general fund because of the passage of Initiative 155 and the subsequent modification of statute in HB 676 by the 61st Legislature. Initiative 155 allocated 33 percent of the insurance tax to the Healthy Montana Kids account. HB 676, enacted after Initiative 155, reduced the insurance tax distribution to the Healthy Montana Kids account from 33 percent to 16.67 percent and allocated the difference to the general fund. This legislation was effective July 1, 2009, and the section changing the percentage distribution of insurance taxes terminates June 30, 2013.

Vehicle Fees/Taxes

During September, our office contacted the Department of Justice (DOJ) regarding vehicle fees/taxes. At that time, DOJ personnel indicated that the interface between MERLIN (the new DOJ vehicle system) and SABHRS was not totally working correctly. DOJ personnel assured LFD staff that by the end of October, general fund collections for motor vehicle fees/taxes would be adjusted to reflect correct collections to date. Near the end of October, DOJ staff contacted our office to inform us of further unresolved issues and that the correcting adjustments would not be completed by the end of October. On December 31st, the DOJ staff informed our office that the department had successfully processed the accounting transaction backlog except for approximately $2.5 million in uncleared

collections. The DOJ staff indicated that collections through December 2009 should be comparable to December 2008 collections.

As shown in Figure 9, total vehicle fees/taxes as recorded on SABHRS are $15.6 million below last years amount as of the end of January. The DOJ, however, has provided our office with information extracted from the MERLIN system that shows a comparison between fiscal years including payments that are due from counties but have not been received. This data indicate that collections are down from FY 2009 amounts by about 0.4 percent after five months of collections activity (through November). Based on this trend, revenue from this source could be below the HJ 2 estimate by $7.0 million in FY 2010 and $4.8 million in FY 2011.

Figure 9

Vehicle Fee/Tax Collections and Estimates

Revenue Category	Actual FY 2009	HJ 2 Estimate FY 2010	Through Jan. FY 2009	Through Jan. FY 2010	Change
GF0400 Vehicle License Fee	89,334,878	92,247,000	45,200,579	32,536,723	(12,663,856)
GF0500 Vehicle Registration Fee	15,344,744	17,970,000	8,202,763	5,239,749	(2,963,014)
Total Vehicle Fees/Taxes	**$104,679,622**	**$110,217,000**	**$53,403,342**	**$37,776,472**	**($15,626,869)**

Liquor Excise Taxes

Liquor excise tax collections through January 2009 are not comparable to the same period of 2008. This is because of an accounting procedure change implemented by the DOR due to an audit recommendation by the Legislative Auditor. Our office requested the Legislative Audit Division (LAD) to review the procedures implemented by the department to determine whether these changes conform to appropriate accounting principles. LAD has reviewed these procedures and has discussed their findings with DOR personnel. At this time, liquor excise tax collections are expected to lag last year's collections until fiscal year end when collections should be more comparable between fiscal years.

Video Gaming Taxes

The video gaming tax collection variation is due to the timing of deposits this year versus previous years and also a decline in machine play. Historically, the first payment for video gaming taxes is deposited in July and/or August as shown in Figure 10. The revenue accrual reversal (shown as negative) should occur in October per state accounting policy. Figure 10 shows the accrual reversal did not occur until November in FY 2008 and not until January in FY 2010. The accrual reversal did not occur until February in FY 2009.

Figure 10

Video Gaming Tax Collections

Month	Actual FY 2008	Actual FY 2009	Actual FY 2010
01 Jul.	6,723,404.94	15,982,192.05	15,334,630.29
02 Aug.	8,642,589.97	8,339.34	7,678.82
03 Sep.	24,045.75	56,439.70	75,826.60
04 Oct.	14,726,602.92	15,793,382.36	14,543,265.35
05 Nov.	(14,182,034.95)	(39,493.32)	409,568.80
06 Dec.	15,602.75	88,608.80	(15,198,697.62)
07 Jan.	15,345,436.50	15,163,868.67	12,309,438.70
Total	**$31,295,647.88**	**$47,053,337.60**	**$27,481,710.94**

As mentioned in previous reports, a decrease in collections was noted during the legislative session but it was premature to assess the trend until further collection activity was received. For FY 2009, collections from this source were below estimate by $4.1 million or 6.2 percent. This downturn trend has continued into FY 2010. After adjusting for the deposit anomalies discussed above, video gaming tax collections are lagging the FY 2010 HJ 2 estimate by $11.5 million or 16.7 percent. A similar trend is expected in FY 2011 with an additional shortfall of $11.1 million. Since video gaming tax revenues are based on gross income (defined as net of payouts), reduced tax revenues are due to less machine play. This would indicate that individuals have less to spend (economic recession impacts) or are choosing to spend their disposable income on other items or to increase savings. The additional factor that has impacted video gaming tax collections is the passage of the smoking ban which went into effect on October 1, 2009.

In conclusion, unusual collection patterns can skew total general fund revenues when comparisons are made from month to month. All of these anomalies have been considered when determining the anticipated revenue shortfall shown in Figure 1. Our office will continue to monitor these issues further as well as any new issues before the next report in early March.

SUMMARY

Total general fund revenue collections through January for FY 2010 are below the same period of FY 2009 by $235.0 million or 22.9 percent. The 61st Legislature assumed revenue would decline by only 1.9 percent from FY 2009 to FY 2010 or $35.1 million. This means that total future collections must improve by a net $200 million in subsequent months to be on track with the HJ 2 estimate for FY 2010.

The focus of this analysis was on individual income tax, corporation income tax, TCA interest earnings, oil and gas production tax, and sources with unusual collection patterns. Since individual income tax is the predominate source of revenue in the general fund account, a small percentage change in this source can have a significant impact on total general fund revenues. As detailed in the report, however, accounting data for seven months of the fiscal year combined with new economic and tax return data show that individual and corporation income tax revenues, TCA interest earnings, video gaming taxes, vehicle fees/taxes, and all remaining sources could be below the HJ 2 estimate by $203.4 million for FY 2010 and an additional $180.1 million for FY 2011. Conversely, oil and gas production tax revenue could exceed the HJ 2 estimate by as much as $33.6 million for the biennium if prices exceed $62.73 per barrel and production does not fall below the HJ 2 estimate.

The previous reports indicated that collections were lagging expectations and that the lag in collections would have to be "made up" in subsequent months in order to achieve the HJ 2 estimated level. Collections through January have not improved and are worse than indicated in previous reports. It should be noted, however, that unusual collection patterns for the sources discussed previously can skew the total general fund collections from month to month. These unusual collection patterns have been accounted for in the summary information shown in Figure 1 on page 1. Your staff will continue to research each of these issues and any other issues before the next report is issued in early March. That report will highlight collections through the end of February.

Attachment 1 and 2 are pages first added to the monthly updates on general fund revenue collections in November. Attachment 1 shows a variety of important economic and revenue indicators for Montana. For example, if you are interested in price and production statistics for Montana's natural resource industry, this document shows oil, coal, and natural gas data for the last completed two years. For each statistic shown, the data source, measurement unit, whether the information is by calendar or fiscal year, an amount for 2008 and 2009, change amount, and percentage change is provided. The purpose of this information is to provide the reader with some relevant data on Montana's economic climate.

Attachment 2 shows a summary of the general fund cash balance flow by month, current year revenue collections and disbursements by month, and cumulative current year revenue collections and disbursements by month. These summaries provide an insight to the fluctuations in cash balances as well as the variances between monthly revenues and disbursements. Particular attention should be given to the first figure in attachment 2. The beginning cash balance for FY 2010 was $446.4 million. This balance has declined by $113.0 million to $333.4 million after the first seven months of FY 2010. Ending fund balance is always the focal point in budget deliberations but it takes cash to pay for the services provided by state government. The cash balance is a key number to watch in subsequent monthly updates.

The third figure on attachment 2 shows cumulative revenues and expenditures by month for FY 2010. This figure indicates that revenues are being collected at a slower rate than the expenditures for state services. The reason this can occur is because of the large carry forward cash balance from FY 2009.

Attachment 3 is a "forecast flash" on the US economy as prepared by IHS Global Insight (GI). This article is an assessment by GI on what they are expecting for the US economy in the months ahead. As you may recall, GI is the national economic forecasting firm the state contracts with to provide economic forecasts.

Attachment 1 – Economic & Revenue Indicators

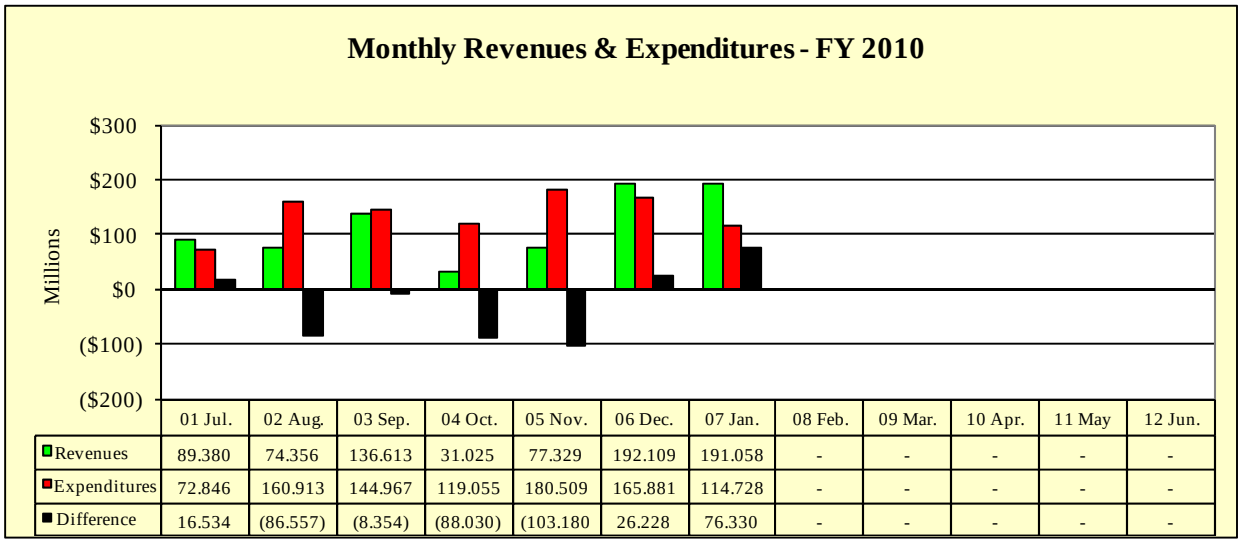
Group	Statistic	Source*	Unit	Year Type	2008	2009	Change Amount	Percent Change
General Economy Indicators								
	MT Wage and Salary Income ($Q:_{1-3}$ to $Q:_{1-3}$)	BEA	Dollars	Calendar	$15,575,000,000	$15,294,000,000	($281,000,000)	-1.80%
	MT Non-Farm Employment ($Q:_{1-4}$ to $Q:_{1-4}$)	DOL	Count	Calendar	446,475	438,742	(7,733)	-1.73%
	US Consumer Price Index ($Q:_{1-4}$ to $Q:_{1-4}$)	DOL	Index	Calendar	214.5	215.3	0.8	0.37%
	MT Housing Starts (SAAR) ($Q:_{1-4}$ to $Q:_{1-4}$)	IHS	Count	Calendar	2,280	1,470	(810)	-35.53%
	MT Existing Home Sales ($Q:_{1-4}$ to $Q:_{1-4}$)	IHS	Count	Calendar	19,800	20,830	1,030	5.20%
	MT Agricultural Cash Receipts (2007 to 2008)	BEA	Dollars	Calendar	$2,646,477,000	$3,063,104,000	$416,627,000	15.74%
	MT Statewide Taxable Values (2009 to 2010)	DOR	Dollars	Fiscal	$2,137,780,356	$2,192,158,238	$54,377,882	2.54%
	MT Short-Term Investment Pool (STIP) Rate	BOI	Percent	Fiscal	4.49%	1.74%	-2.75%	-61.25%
	MT Trust Funds Bond Pool Rate	LFD	Percent	Fiscal	5.57%	5.54%	-0.03%	-0.54%
Natural Resources								
	Montana Oil Production (Taxable)	DOR	Barrels	Fiscal	33,803,342	30,568,615	(3,234,727)	-9.57%
	Montana Oil Wellhead Price	DOR	$'s/Barrel	Fiscal	$87.30	$59.55	($27.75)	-31.79%
	Montana Coal Production (Taxable)	DOR	Tons	Fiscal	37,404,304	35,807,130	(1,597,174)	-4.27%
	Montana Coal Price (Contract Price)	DOR	$'s/Ton	Fiscal	$8.13	$8.78	$0.64	7.89%
	Montana Natural Gas Production (Taxable)	DOR	MCF's	Fiscal	119,472,119	109,552,438	(9,919,681)	-8.30%
	Montana Natural Gas Wellhead Price	DOR	$'s/MCF	Fiscal	$6.54	$4.41	($2.13)	-32.59%
Consumption								
	Cigarettes Sold (Taxable)	DOR	Packs	Fiscal	50,306,100	48,146,775	(2,159,325)	-4.29%
	Other Tobacco Products (Value)	DOR	Dollars	Fiscal	$5,509,256	$6,305,395	$796,140	14.45%
	Other Tobacco Products (Roll)	DOR	Ounces	Fiscal	2,674,010	2,631,623	(42,387)	-1.59%
	Other Tobacco Products (Moist)	DOR	Ounces	Fiscal	8,777,115	8,989,006	211,892	2.41%
	Lottery Ticket Sales	SABHRS	Dollars	Fiscal	$43,821,752	$43,826,879	$5,127	0.01%
	Video Gaming Net Income	Computed	Dollars	Fiscal	$420,893,335	$416,387,371	($4,505,963)	-1.07%
	Liquor Sales	DOR	Dollars	Fiscal	$86,480,196	$89,781,906	$3,301,710	3.82%
	Beer Produced/Imported	DOR	Barrels	Fiscal	973,346	990,269	16,923	1.74%
	Wine Imports	DOR	Liters	Fiscal	10,010,357	10,600,521	590,164	5.90%
	Rental Vehicle Sales (Taxable)	DOR	Dollars	Fiscal	$82,195,538	$75,931,032	($6,264,506)	-7.62%
	Lodging Facility Sales (Taxable)	DOR	Dollars	Fiscal	$465,744,417	$442,405,546	($23,338,871)	-5.01%
	Gasoline Gallons (Taxable)	DOT	Gallons	Fiscal	495,175,969	483,073,024	(12,102,945)	-2.44%
	Diesel Gallons (Taxable)	DOT	Gallons	Fiscal	266,624,089	249,174,745	(17,449,344)	-6.54%

Source *

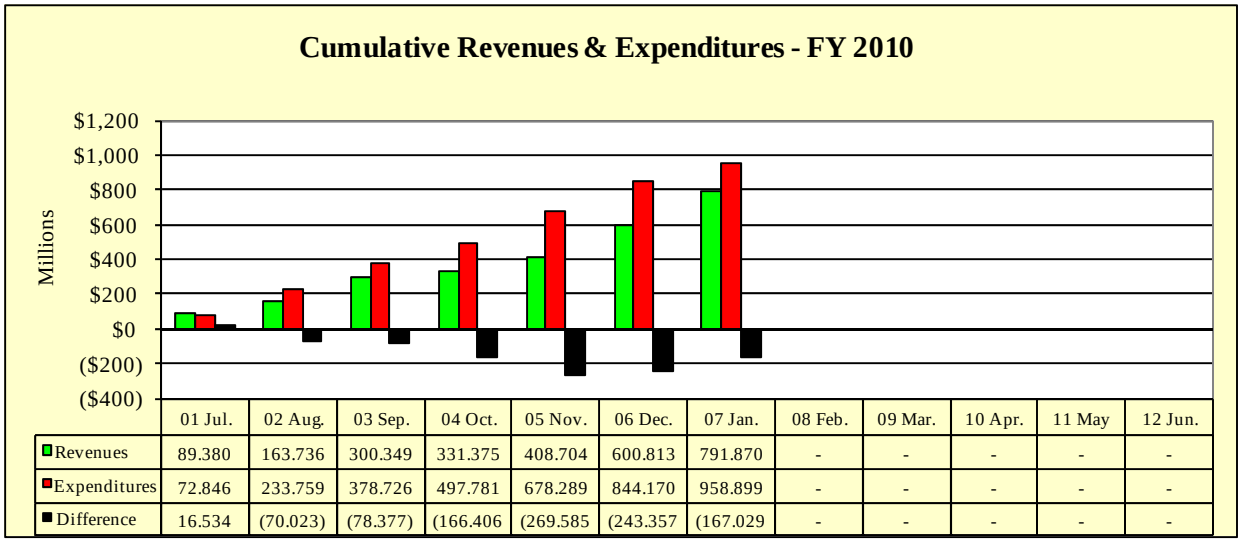
BEA - US Department of Commerce, Bureau of Economic Analysis
DOL - Montana Department of Labor and Industry
IHS - IHS Global Insight
BOI - Board of Investments
LFD - Legislative Fiscal Division
DOR - Montana Department of Revenue
SABHRS - Statewide Accounting, Budgeting, Human Resource System
Computed - Computed using collections and tax rate
DOT - Montana Department of Transportation

Attachment 2

General Fund Cash Balance By Month - FY 2010		
Period	Cash In Bank Change	Cash In Bank Cumulative
Beginning	446,407,475.56	446,407,475.56
07/30/09	(6,614,483.38)	439,792,992.18
08/31/09	(74,152,696.93)	365,640,295.25
09/30/09	(41,150,783.45)	324,489,511.80
10/31/09	5,562,359.78	330,051,871.58
11/30/09	(92,094,829.66)	237,957,041.92
12/31/09	6,989,272.24	244,946,314.16
01/31/10	88,502,097.97	333,448,412.13



	01 Jul.	02 Aug.	03 Sep.	04 Oct.	05 Nov.	06 Dec.	07 Jan.	08 Feb.	09 Mar.	10 Apr.	11 May	12 Jun.
Revenues	89.380	74.356	136.613	31.025	77.329	192.109	191.058	-	-	-	-	-
Expenditures	72.846	160.913	144.967	119.055	180.509	165.881	114.728	-	-	-	-	-
Difference	16.534	(86.557)	(8.354)	(88.030)	(103.180	26.228	76.330	-	-	-	-	-



	01 Jul.	02 Aug.	03 Sep.	04 Oct.	05 Nov.	06 Dec.	07 Jan.	08 Feb.	09 Mar.	10 Apr.	11 May	12 Jun.
Revenues	89.380	163.736	300.349	331.375	408.704	600.813	791.870	-	-	-	-	-
Expenditures	72.846	233.759	378.726	497.781	678.289	844.170	958.899	-	-	-	-	-
Difference	16.534	(70.023)	(78.377)	(166.406	(269.585	(243.357	(167.029	-	-	-	-	-

Attachment 3

U.S. Economy

This information was last updated on Mon 08 Feb 2010, 4:37 PM EST (21:37 GMT)

Forecast Flash: First Take

Markets Wobble, But Recovery Continues

Financial markets have been hit by an attack of nerves, partly related to fiscal woes on the Eurozone periphery, but the incoming data have been pointing to a continuing, if moderate, recovery in the U.S. economy. The pace of growth may not be even—it has been better for manufacturing than services, better for large businesses than small businesses, and was faster in the fourth quarter than we will see going forward—but it is recovery nonetheless.

A Strong Exit from 2009. The U.S. economy finished 2009 on a very strong note. Fourth-quarter growth came in at 5.7%, although more than 3 percentage points of it came from a dramatic slowing in the rate of inventory decumulation. But final sales growth also improved, from 1.5% to 2.2%. There was positive evidence in strong export growth and a revival in business equipment spending. There is more help to come from the inventory cycle in coming quarters, but not another 3-percentage-point bump. We still expect the credit-constrained recovery to prove a subpar one, and anticipate that GDP growth will ease to 3.0% in the first quarter. But for 2010 overall, we now expect 3.0% growth, better than last month's 2.6% projection.

Jobs Return in 2010… Cost-slashing has been so severe that we expect firms will need to rehire sooner after this recession than after the 2001 one. The latest evidence suggests that private hiring is on the verge of turning positive. Government hiring for the Census will give a further, albeit temporary, boost to employment in the second quarter. The overall pace of hiring is likely to be modest, though—around 800,000 jobs added over the course of 2010, a small dent in the 8.4-million-job hole created by the recession.

…Helping the Consumer. The improvement in the jobs market will give consumers some extra help. This will allow them to increase spending while maintaining a higher saving rate. Consumption fell 0.6% in 2009, but we expect a 2.4% increase in 2010.

Housing Recovery Likely to Be Bumpy. The path ahead for housing will likely be bumpy; existing home sales hit a brick wall in December, after the original expiry date for the first-time homebuyers' tax credit. And we are not convinced that house prices have yet hit bottom. But housing starts should rise markedly during 2010, since at present production levels, the backlog of unsold new homes is declining quickly.

Mixed Business Spending Outlook. Among the most encouraging news in the fourth-quarter GDP report was the 13.3% increase in business equipment and software spending. High-tech equipment and vehicles were the big gainers. Capital goods orders are also beginning to turn around more convincingly. With utilization so low, capacity expansion is not needed, but businesses are flush with cash, and we expect increased spending on replacement investment to pull equipment purchases higher in 2010. Nonresidential construction, however, is still dropping. Spending on buildings fell at more than a 30% annual rate in the fourth quarter, and we see further declines (but of diminishing severity) through the end of 2010.

Foreign Trade Revival Continues. Both exports and imports jumped at strong double-digit annualized rates in the fourth quarter, for the second time in a row. Surprisingly, exports outpaced imports, so that trade was a positive contributor to GDP growth. With the U.S. inventory cycle turning so quickly, we would have expected imports to bounce up more than exports; we now expect to see that pattern emerge during the first quarter.

Inflation Threat Not Immediate, So the Fed Can Wait. Recent inflation indications continue to show core inflation very quiet, and commodity prices have eased a little. Wage inflation in the private sector is still negligible. We continue to expect no change in interest rates from the Federal Reserve until the end of the third quarter of 2010.

by Nigel Gault

A Quick Look at the Numbers

(Annual rates)

	Quarterly				Annual				
	09:4	10:1	10:2	10:3	2009	2010	2011	2012	2013
Real GDP (Percent change)	5.7	3.0	2.4	2.4	-2.4	3.0	2.8	3.7	3.2
Federal Funds Rate (Percent)	0.12	0.12	0.13	0.18	0.16	0.24	1.70	3.34	3.55
Ten-Year Treasury Yield (Percent)	3.46	3.71	3.77	3.84	3.26	3.80	4.03	4.54	4.72
Oil Prices, WTI (Dollars/barrel)	76	74	69	72	62	72	78	83	87
Consumer Price Index (% change y/y)	1.5	2.6	2.2	1.7	-0.3	1.9	1.7	2.0	1.9
Housing Starts (Millions)	0.55	0.60	0.69	0.79	0.55	0.75	1.27	1.61	1.73
Consumer Sentiment (Univ. of Michigan)	70	73	75	74	66	74	76	79	82
Unemployment Rate (Percent)	10.0	9.9	9.9	10.0	9.3	9.9	9.3	8.3	7.5