

The Executive Revenue Estimate for the 23 Biennium

Presentation to the Revenue Interim Committee

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

NOVEMBER 19, 2020



Setting Expectations for the Budget Process

The task at hand - What are reasonable expectations for total general fund revenue for next three years?

- General Fund Revenue sources tend to display a portfolio effect within and between years, albeit the larger revenue sources do in fact have greater influence on overall revenue collections.
- Smaller individual estimate errors tend to cancel out.
- Variation tends to be in larger tax types.
- Error rates in one year may cancel-out or further exacerbate an error rate in a subsequent year. This is true for individual tax types as well as overall general fund revenue.
- Our collective task is not to predict economic variables (i.e. GDP, unemployment, etc.), but to synthesize that information and formulate its incidence on GF revenue via underlying assumptions in our various revenue models.
- These estimates will be used as half the equation for complying with the Constitutional requirement of the legislature appropriating and the Governor signing a budget next year.



Economic Information Changing Rapidly

The Good News

- Rapid recovery in overall employment
- Rapid decline in unemployment rates
- Federal aid efforts have appeared to have “plugged the gap”, at least partially and temporarily
- Vaccine results are positive and earlier than expected

The Not So Good News

- Q4 forecasts have been recently downgraded
- Risk of double-dip recession increasing
- The true long term economic impacts of COVID-19 are unknown



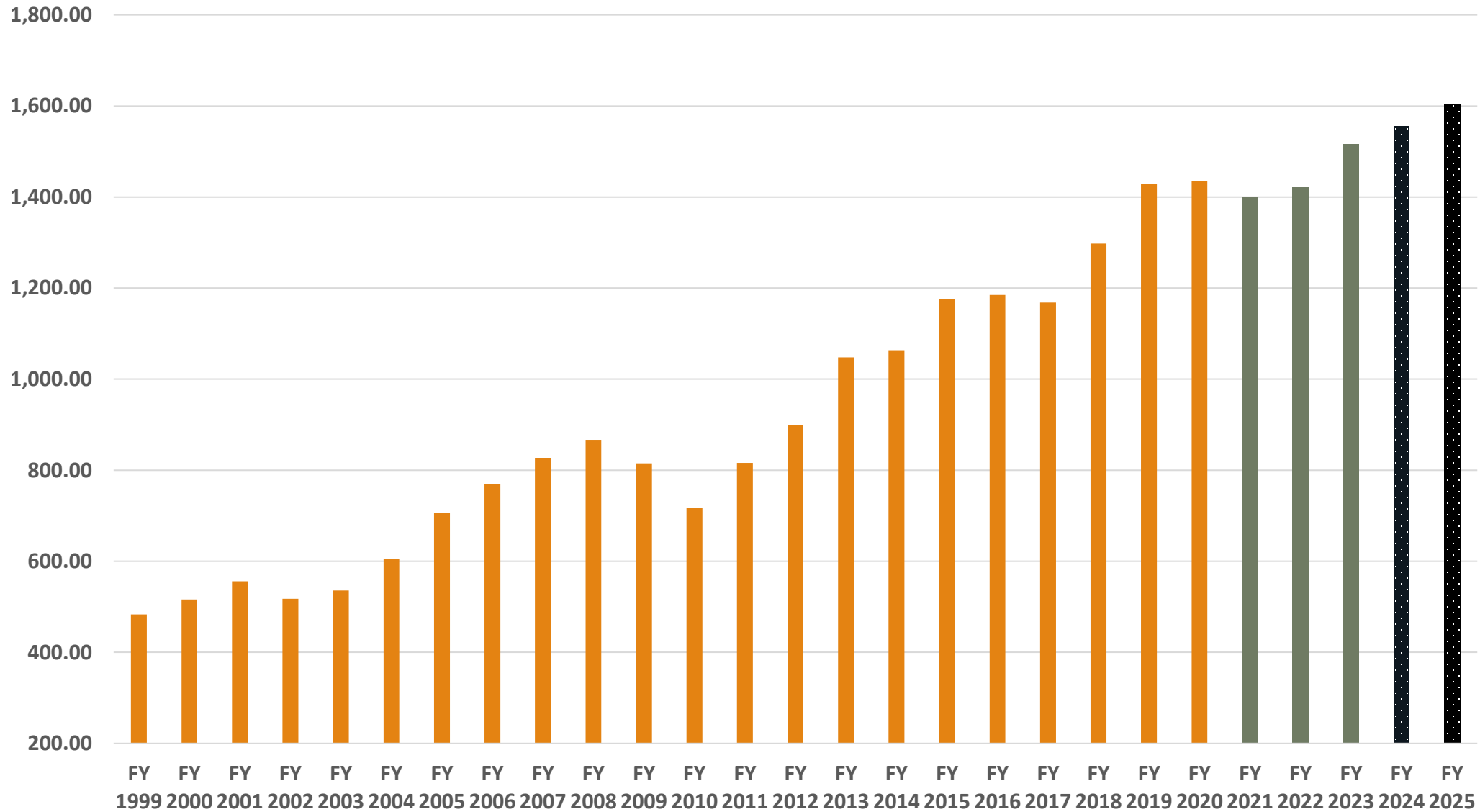
Comparison of Revenue Estimates

LFD and OBPP Estimates remain close, statistically speaking, but the margins have significant ramifications from a “building a budget” perspective

General Fund Revenue Estimate Overview & Comparison									
(\$ Millions)									
Revenue Source	Actual	LFD			OBPP			3-Year	3-Year
	FY 2020	FY 2021	FY 2022	FY 2023	FY 2021	FY 2022	FY 2023	\$ Diff.	% Diff.
Total General Fund	\$2,533.321	\$2,503.316	\$2,571.778	\$2,681.749	\$2,439.626	\$2,519.958	\$2,629.264	\$167.996	2.2%



Personal Income Tax (Millions \$) - Recent History



As goes Personal Income Tax, So goes General Fund Revenue

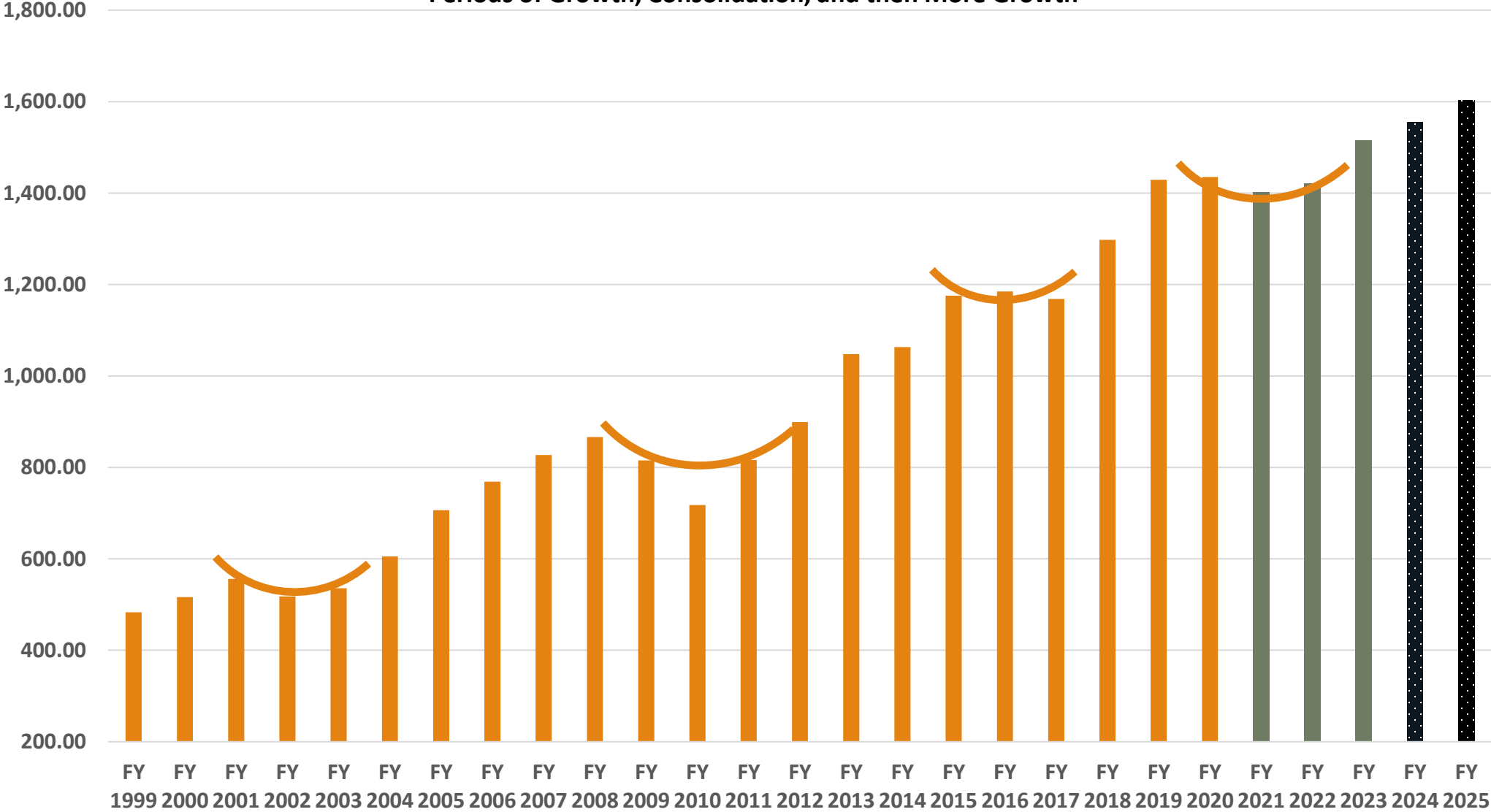
PIT Cup and Handle Phenomena –

- Recent periodic evidence of growth, consolidation and give-back, and growth again
- Typically happens over a 3-to-5-year period
- Exacerbated by larger scale or worldwide events (i.e. Great Recession)
- Income tax collections tend to grow faster than economic activity when growth is above trend and slow more rapidly when growth is below trend.
- Even before pandemic, history would suggest we were likely due for a consolidation period during the current forecast period.
- Pandemic makes it even more likely and reasonable to assume as much.



Personal Income Tax (Millions \$) - Recent History

Periods of Growth, Consolidation, and then More Growth



Wage Withholding an Early Indicator and Reliable Speed Gauge for Revenue Collections

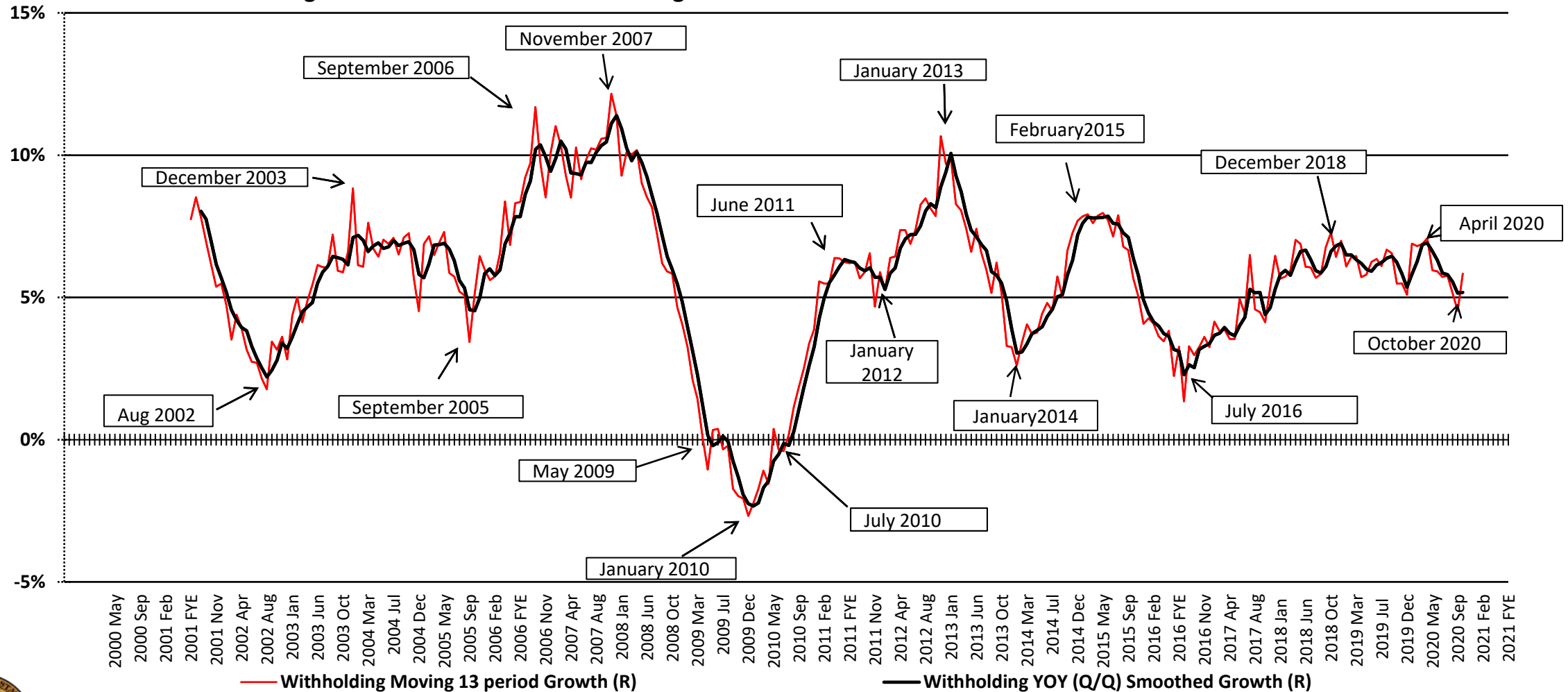
- Withholding is largest single component of General Fund revenue
- Best real-time indicator of collections
- Predictor of future tax liability
- Typically not subject to wild swings over short periods of time...
- ...But, small swings, directional trend, and comparable level to prior years matter and can have a tremendous impact on revenue collections – both positive and negative – over the course of a three-year estimate.



Wage Withholding – Which way does the line go next...and by how much?

Current YTD Wage Withholding growth is 2.3%, providing likely drag to the 13-month line moving forward.

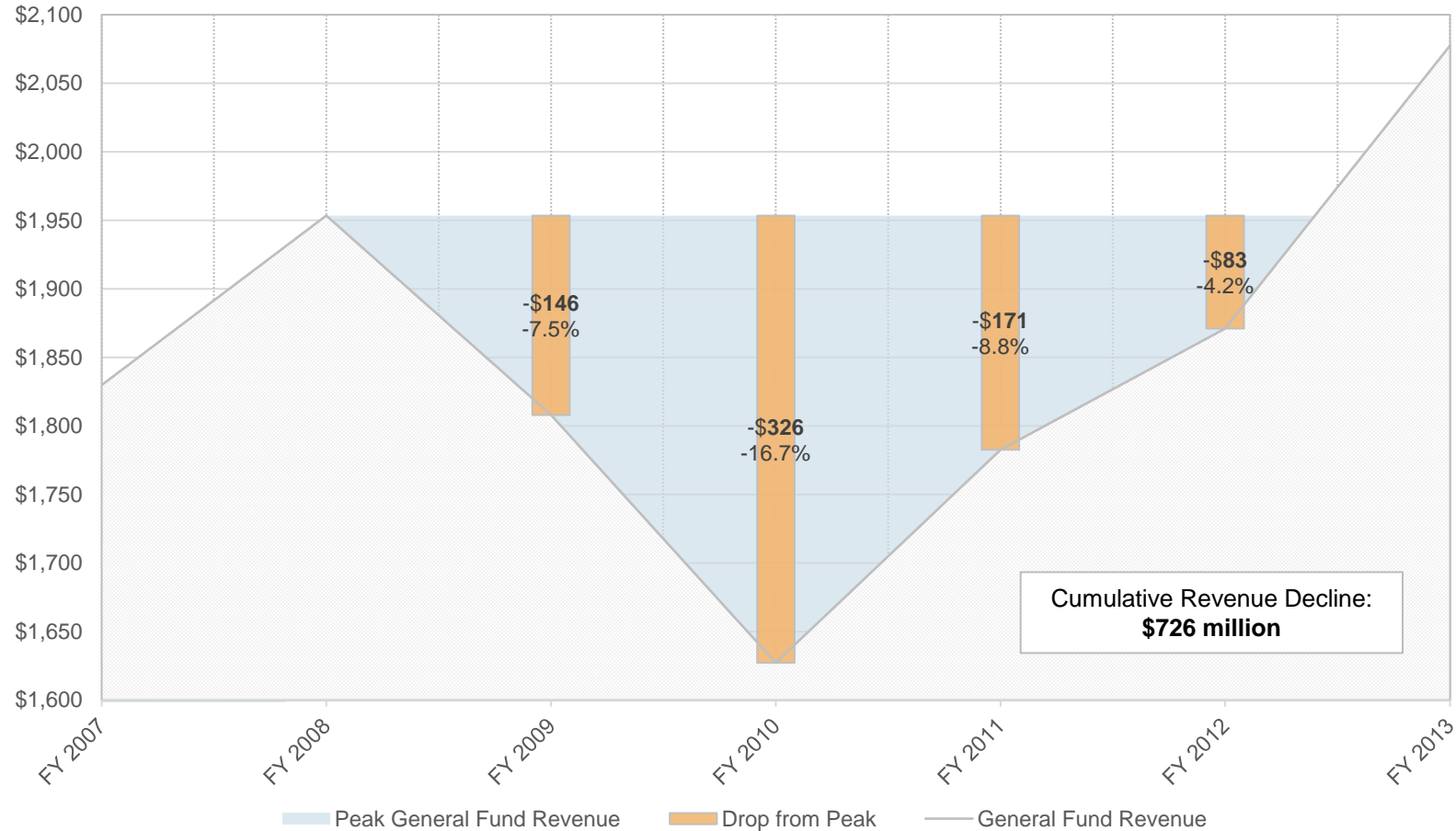
Moving Fiscal Year Income Tax Withholding Annual Growth Rates FY 2002 - FY 2021



Economic Downturns & General Fund Revenue

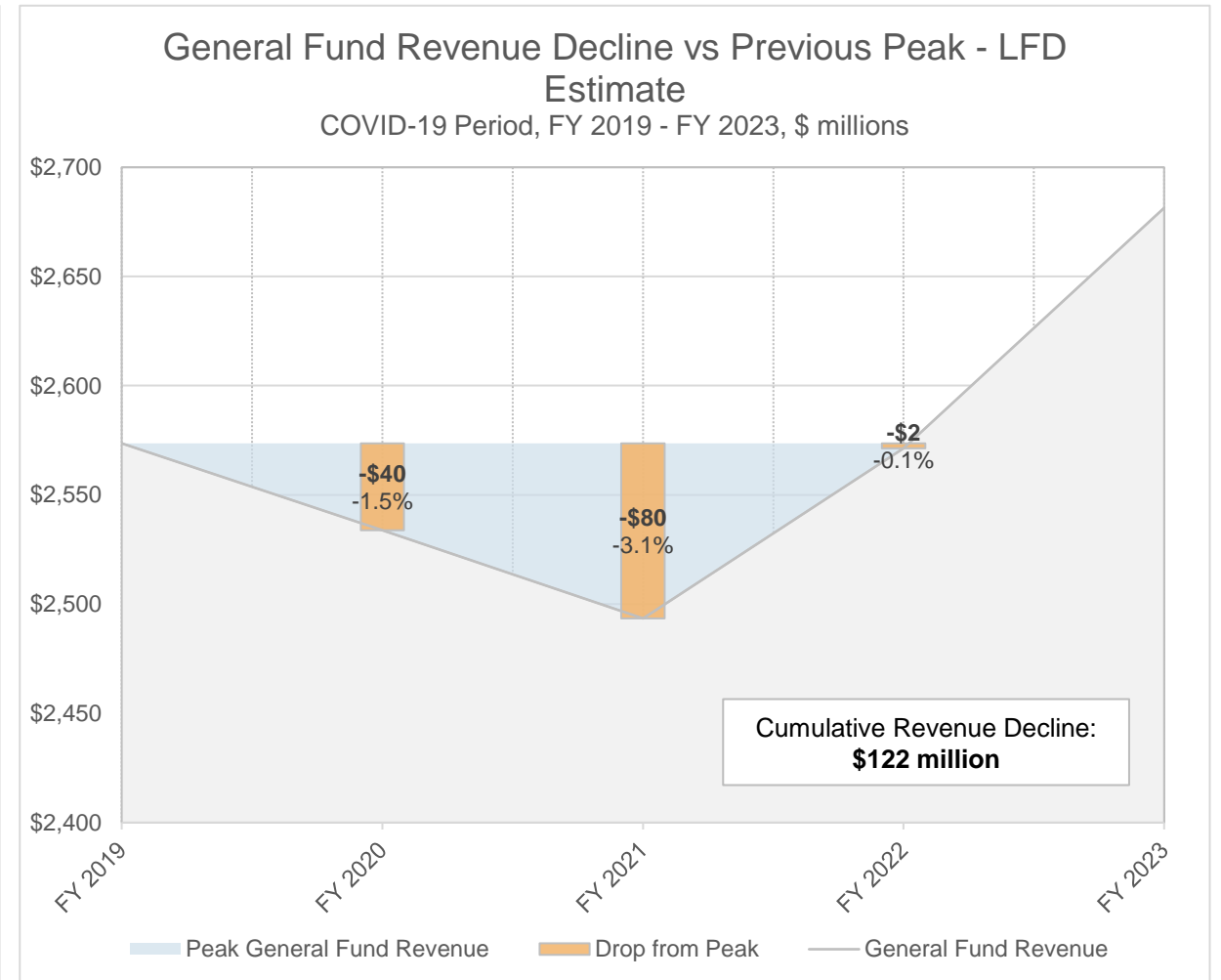
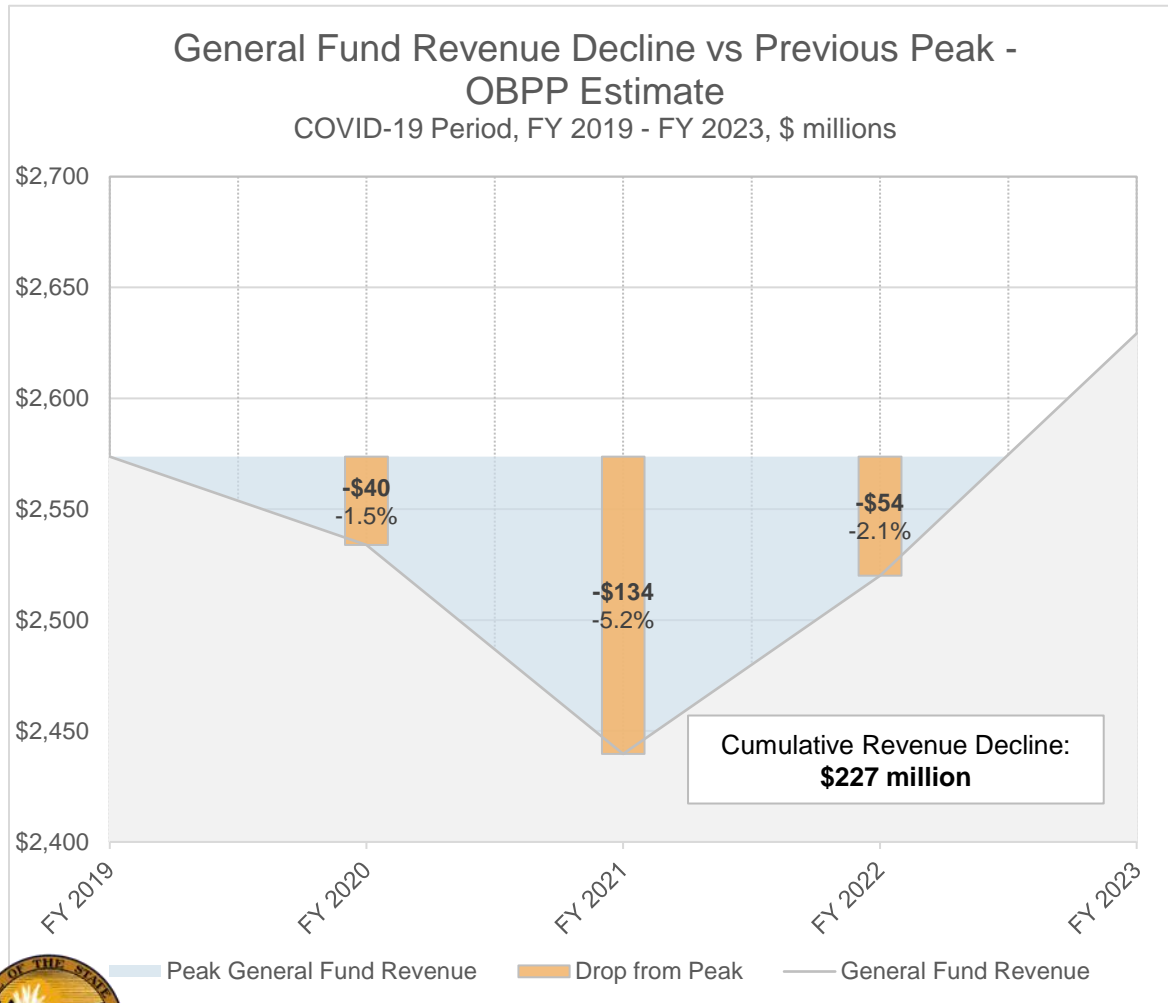
A look at the Great Recession

General Fund Revenue Decline vs Previous Peak
Great Recession Period, FY 2007 - FY 2013, \$ million



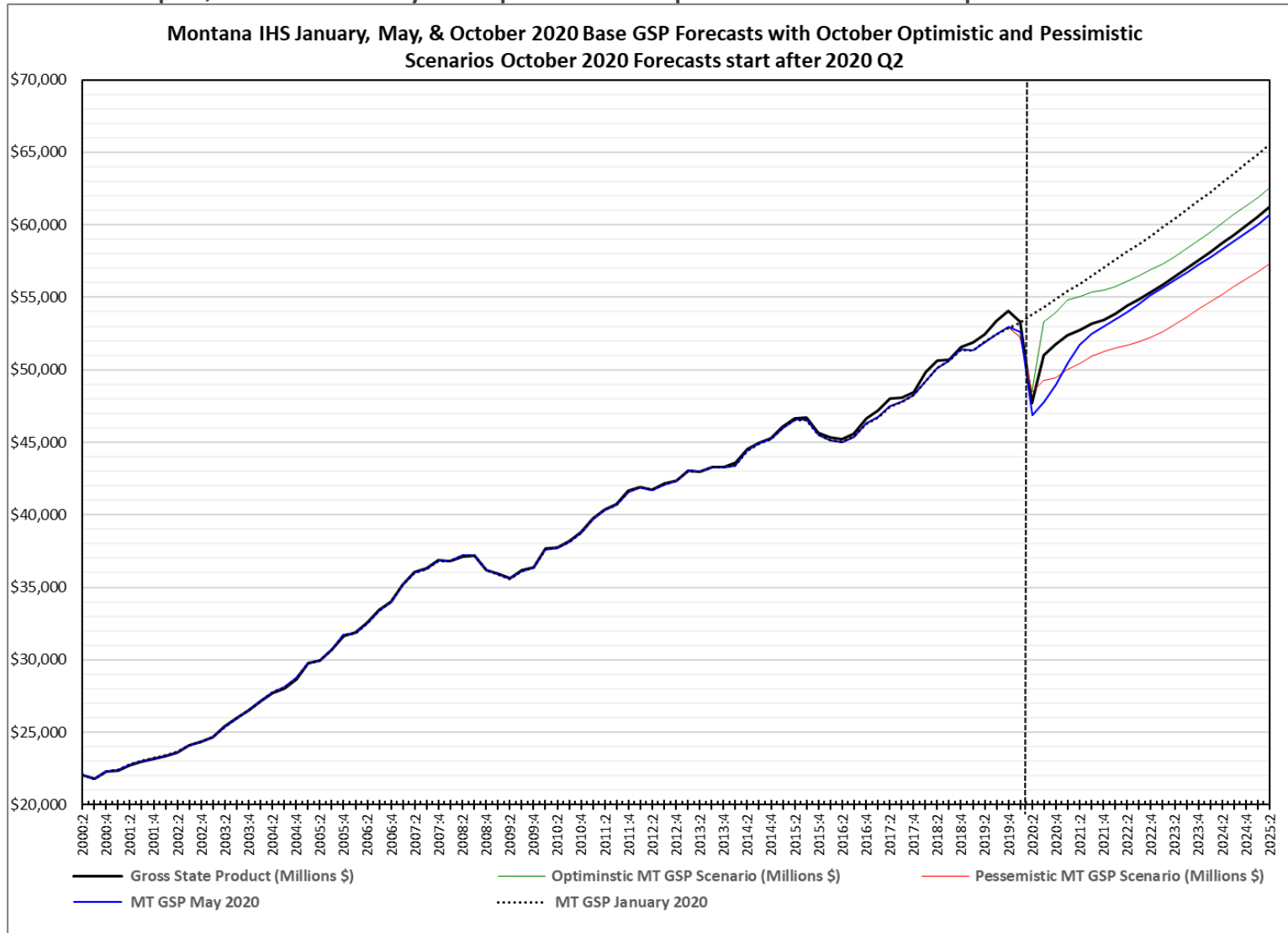
Economic Downturns & General Fund Revenue

COVID-19 and Projections for the 2023 Biennium



The Montana Economy has been through a rapid and intense shock

While recovery has been rapid, the economy is expected to operate at less than previous trend's level for an extended period



Specific Considerations by Tax Type

Individual Income Tax

- Pandemic support has complicated forecasting as most federal transfers are not directly taxable in Montana (EIP, PPP grants, & unemployment compensation programs).
- CARES Act tax changes allow for the offset of positive net business income generated by non-corporate entities with other individual losses. These entities may use TY 2020 losses to recover taxes paid in prior years. However, expenses funded with CARES Act grants cannot be used to offset other net income.
- Wages and business income have both been supplemented by direct (and indirect) federal transfers.
- CY 2020 Withholding and Wage Bill reports are likely being supported by the various programs. 60% of PPP funds are targeted at employment maintenance.
- Income tax collections tend to grow faster than economic activity when growth is above trend and slow more rapidly when growth is below trend.



Specific Considerations by Tax Type

Corporation Income Tax

- The CARES Act granted favorable Net Operating Loss (NOL) treatment for TY 2020 losses, allowing for the recovery of taxes paid in prior years. SB 550 (2017) capped such claw backs to \$500,000 per year.
- Unused NOLs will be carried forward and offset future tax liabilities.
- IHS Markit forecasts a rapid plunge (Q2) and recovery (Q3) in corporate profits – followed by corporate profit growth. How this shock will swing corporation tax collections is more uncertain than “usual”.

Property Tax

- The relative geographical distribution of accumulated housing price appreciation and the distributing of industrial property shifts local tax valuations and local mill rates.
- Because of the pandemic commercial class 4 property valuations may shift differently than residential and industrial property



Specific Considerations by Tax Type

Vehicles

- Great Recession effects on annual light vehicle continue to dissipate
- Revenue from old registrations and permanent registrations is lower
- New vehicle sales recover from sharp decline in fourth quarter of FY 2020
- Pandemic still poses a risk to large purchases like motor vehicles

Video Gaming

- COVID-19 pandemic caused temporary closure of casinos in fourth quarter of FY 2020
- Revenue declined in FY 2020 as a result
- Video gaming expenditures recover in FY 2021 and rise in each year of biennium

Insurance Premium

- Long-term health impacts of COVID-19 may impact healthcare costs, and insurance premium rates
- Federal changes to the Affordable Care Act could change the taxable premium in Montana



Specific Considerations by Tax Type

Interest Rates

- The federal funds rate was lowered to near zero to cushion to the economy during the pandemic
- This benchmark short-term rate is expected to stay close to zero during the forecast period
- Long-term interest rates fell steadily as the economic outlook deteriorated and remain low
- Rapid deployment of a COVID-19 vaccine will influence the path of long-term interest rates
- Interest earnings in the State's various trust funds are forecast to move down during the biennium
- Earnings on investments in the Treasury Cash Account responded quickly to the free fall in the federal funds rate and other benchmark short-term rates
- TCA earnings aren't expected to rebound during the biennium

Accommodation Tax

- The downturn was severe, but Montana may have been less adversely affected than the nation.
- Timing of accommodation return data complicates forecast modeling - December data will be helpful
- Montana may not benefit as much from the initial travel recovery as we lose last summer's comparative advantage, until air travel and international travel recovers



Specific Considerations by Tax Type

Oil and Gas

- Steep drop in oil prices late in FY 2020 as demand evaporated with pandemic-induced shutdowns
- Drilling halted
- Oil production fell quickly as some wells were shutdown
- Oil prices have recovered and are forecast to exhibit stability through FY 2023
- Some shutdown production comes back online and limited drilling resumes in the Bakken formation
- Oil production falls in FY 2021 and FY 2022 and ticks up in FY 2023
- Weakness in global oil demand does not support significant price growth

Coal

- Colstrip Units 1 and 2 are no longer operational
- Expect permanent production loss from adjacent Rosebud mine
- Continuing competition from natural gas dims the outlook for domestic coal demand
- Montana is active in the international market but faces strong competition
- Back taxes are owed by two of Montana's major coal producers
- Tough economics for coal industry may make it difficult for payment of these taxes



Questions to Consider

Risk Management

- COVID impacts on revenue for the next three years... and beyond?
- Fund Balance Considerations
- More fund balance = ability to take more risk and vice versa

Longer Term Impacts

- Have limited damage and helped support household economic activity, but remember it's OTO
- While damage has been mitigated , in part, economic impacts have not been distributed uniformly throughout the economy.
- It is still unclear what the long-lasting effects of the crisis have been and what “losses” will appear moving forward (i.e. who goes out of business, etc.)?
- Changes to labor mobility (relocation and remote work) and future impacts?



Looking Forward

Relative growth comparisons will have to be done carefully in FY 2021

Last year's shifted due dates will complicate comparisons in April, June, July, and October 2021.

- The flow of Montana information will be choppy.
- Employment and unemployment figures will be available next week, and in December, and then not until March. Estimated payment shifts could become apparent as soon as December. April final payments and April and June estimates payments may appear artificially high as April and June estimated payments were received in July 2020.
- Refund processing will begin in earnest in mid-March
- Pass-through entity tax filings are due in mid- March
- April 15th income tax payment season will begin, growth will appear robust, but may be artificial given last years due dates.



Thank you for the opportunity to speak with you today!

Our staff is available for questions and discussion

