
State of Wisconsin
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Dated January 24, 2020

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Attached is a report from the Legislative Fiscal Bureau, dated January 23, 2020. This report contains General Fund tax collection projections and estimated General Fund condition statement for fiscal years 2019-20 and 2020-21.

The State of Wisconsin is providing this Additional/Voluntary Filing with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access system. This Additional/Voluntary Filing is also available on the State of Wisconsin Capital Finance Office web site and State of Wisconsin investor relations web site at:

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The undersigned represents that he is the Capital Finance Director, State of Wisconsin Capital Finance Office, which is the office of the State of Wisconsin responsible for providing additional/voluntary filings, annual reports, and Event Filings pursuant to the State's Master Agreement on Continuing Disclosure (Amended and Restated March 1, 2019), and is authorized to distribute this information publicly

/S/ DAVID R. ERDMAN

David R. Erdman, Capital Finance Director
State of Wisconsin Capital Finance Office
Wisconsin Department of Administration
101 East Wilson Street, FLR 10
Madison, WI 53703
Phone: (608) 267-0374
Fax: (608) 266-7645

E-mail: DOACapitalFinanceOffice@wisconsin.gov

Websites: doa.wi.us/capitalfinance
wisconsinbonds.com

Legislative Fiscal Bureau

Robert Wm. Lang, Director

One East Main, Suite 301 • Madison, WI 53703
Email: Fiscal.Bureau@legis.wisconsin.gov
Telephone: (608) 266-3847 • Fax: (608) 267-6873



State of Wisconsin

January 23, 2020

Senator Alberta Darling, Senate Chair
Representative John Nygren, Assembly Chair
Joint Committee on Finance
State Capitol
Madison, WI 53702

Dear Senator Darling and Representative Nygren:

In January of each year, this office conducts a review of the status of the state's general fund and presents its findings to the Legislature. In the even numbered years, this analysis includes an examination of economic forecasts and tax collection and expenditure data of the current fiscal year, and projections for each year of the current biennium. We have now completed that review.

Based upon our analysis, we project the closing, net general fund balance at the end of this biennium (June 30, 2021) to be \$620.2 million. This is \$451.9 million above the balance that was projected at the time of enactment of the 2019-21 biennial budget, as modified to incorporate the 2018-19 ending balance (2019-20 opening balance) as shown in the Annual Fiscal Report for 2018-19.

The \$451.9 million is the net result of: (1) an increase of \$818.2 million in estimated tax collections; (2) an increase of \$20.0 million in departmental revenues (non-tax receipts deposited into the general fund); (3) a decrease of \$22.8 million in net appropriations; and (4) a transfer of \$409.1 million to the budget stabilization fund.

Of the \$20.0 million of increased departmental revenues, \$14.0 million is due to higher interest earnings because of larger general fund balances. The majority (\$15.4 million) of the \$22.8 million net appropriation reduction is due to estimates of the amounts necessary to fund general fund debt service.

Under s. 16.518(3) the statutes, if actual tax collections exceed the amounts estimated in the state's biennial budget act, one-half of such excess is deposited into the budget stabilization fund. Under the estimates of this analysis, tax collections are projected to exceed the 2019 Act 9 estimate by \$378.6 million in 2019-20 and \$439.5 million in 2020-21. Thus, one-half of those amounts, \$189.3 million in 2019-20 and \$219.8 million in 2020-21 would transfer to the budget stabilization

fund.

With the transfers identified above, it is estimated that the amounts in the budget stabilization fund will total \$845 million at the end of 2019-20 and \$1,080 million at the end of 2020-21.

The following table reflects the 2019-21 general fund condition statement, which incorporates our revenue and expenditure projections.

TABLE 1
2019-21 General Fund Condition Statement

	<u>2019-20</u>	<u>2020-21</u>
Revenues		
Opening Balance, July 1	\$1,086,869,000	\$1,147,651,800
Taxes	17,699,100,000	18,077,500,000
Departmental Revenues		
Tribal Gaming Revenues	24,605,300	25,787,300
Other	<u>535,923,000</u>	<u>553,706,200</u>
Total Available	\$19,346,497,300	\$19,804,645,300
Appropriations and Reserves		
Gross Appropriations	\$18,386,956,800	\$19,201,818,000
Sum Sufficient Reestimates	-13,717,000	-11,667,600
Transfers to:		
Transportation Fund	43,301,100	44,095,000
Budget Stabilization Fund	189,330,800	219,756,000
Compensation Reserves	13,351,800	94,545,400
Less Lapses	<u>-420,378,000</u>	<u>-449,147,600</u>
Net Appropriations	\$18,198,845,500	\$19,099,399,200
Balances		
Gross Balance	\$1,147,651,800	\$705,246,100
Less Required Statutory Balance	<u>-80,000,000</u>	<u>-85,000,000</u>
Net Balance, June 30	\$1,067,651,800	\$620,246,100

Table 1 incorporates the fiscal effect of all bills enacted to date in the current legislative session (through 2019 Act 75). It does not reflect the impact of any enrolled bills that have not yet been enacted or bills that are pending before the Legislature.

There are two items that are not reflected in Table 1 which should be noted. First, the status of the budget for the medical assistance program could ultimately have a bearing on the biennium-ending general fund balance. In its most recent quarterly estimate of the MA budget (December 30, 2019), the Department of Health Services estimates that benefit expenditures will exceed

available GPR appropriations for the program by \$39.8 million. While the Department has some ability to delay or reduce expenditures in the program to stay within the budget, an MA budget deficit may also require the Legislature to take action to address the shortfall, including by increasing GPR appropriations. The Department's estimate, however, should be considered preliminary, since it is based on enrollment and expenditure data from just the first few months of the fiscal biennium. The amount of the projected GPR deficit is equal to 0.6% of the biennial total funding for the program, and deviations from expenditure estimates of this magnitude, either above or below, are not uncommon.

The second item regards state expenditures related to the electronics and information technology manufacturing (EITM) zone refundable credits for the Hon Hai Precision Industry Co., Ltd (Foxconn) development. 2019 Act 9 estimated the refundable credits at \$0 in 2019-20 and \$212.0 million in 2020-21. Under the EITM zone tax credit program, the Wisconsin Economic Development Corporation (WEDC) certified three Wisconsin corporations that are affiliated with Foxconn as eligible to claim a payroll tax credit over 15 years for up to an aggregate amount of \$1.50 billion and a capital expenditure credit over seven years for up to an aggregate amount of \$1.35 billion. The Act 9 estimate assumed that Foxconn would have sufficient payroll and capital expenditures by the end of the 2019 calendar year to receive the \$212 million of refundable credits that would be paid in the 2020-21 fiscal year. Based upon reports of the project's progress to date, and assumptions regarding payroll and capital expenditures, preliminary estimates suggest that it is likely that the credits paid to Foxconn in 2020-21 will be in the range of \$50 million to \$75 million, rather than the amounts contained in Act 9.

Before claiming EITM zone tax credits from the Department of Revenue, the Foxconn entities must receive a verification letter from WEDC. Before issuing such a letter, WEDC must first review Foxconn's annual report and a verification report from a nationally recognized certified public accountant. Pursuant to the contract, the Foxconn entities' next scheduled report is due on April 1, 2020, after which the accountant would have up to 45 days to complete its review before WEDC begins the verification process to calculate the amount of credits the Foxconn entities are eligible to claim. Further, upon receiving a verification letter from WEDC, the Foxconn entities would have up to 14 days to object to the calculation of tax credits. Given these steps, the amount of the credit to be paid in 2020-21 will likely not be known until after the end of this fiscal year.

Review of the National Economy in 2019

This office prepared revenue estimates for the 2019-21 biennium in January, 2019, based on the January, 2019, IHS Markit forecast for the U.S. economy. The forecast predicted real gross domestic product (GDP) growth of 2.5% in 2019 and 2.0% in 2020. IHS Markit forecast that consumer spending would continue to propel economic growth, supported by wage growth resulting from a strong labor market and modest productivity growth. The trade deficit, on the other hand, was expected to be a drag on economic growth due to an appreciating U.S. dollar and trade policy uncertainty.

The January, 2019, IHS Markit forecast was based on the following assumptions. First, the forecast assumed that the level of tariffs in 2018 would be maintained in 2019 and 2020 for solar panels, washing machines, steel, aluminum, and Chinese goods (10% tariff on \$200 billion of Chinese imports). Second, IHS Markit expected that the Federal Reserve would raise the target

range for the federal funds rate by 25 basis points in both May and October, 2019, and in June 2020, to bring the upper end of the range to 3.25%. Third, the real, broad, trade-weighted growth of foreign GDP was assumed to slow from 3.1% in 2017 to 2.7% in 2018, then average 2.4% through 2022. Fourth, the price of Brent crude oil was projected to fall from \$71 per barrel in 2018 to \$65 in 2019, before rising to \$73 in 2022. Finally, the impact of the federal government shutdown was not reflected in the forecast, which assumed that a shutdown would be avoided, or be brief in duration, and thus have a modest impact on the overall economy.

The optimistic forecast scenario was that faster productivity growth coupled with a lower than previously expected natural rate of unemployment (that is, the rate of unemployment consistent with stable inflation) would allow for continued economic growth and gains in employment and wages without triggering inflation or increases in the federal funds rate by the Federal Reserve. The downside risk was that a broad loss in confidence due to falling real estate and financial markets, combined with a growing aversion to risk, would lead to drops in a wide range of investment and consumer spending categories, cumulating in a recession in 2020.

In May, this office reviewed additional tax collection data and IHS Markit's May economic forecast and revised our revenue estimates upward, primarily based on stronger than expected individual income tax and corporate income/franchise tax collections through April, 2019. Tax planning following the federal Tax Cuts and Jobs Act of 2017 (TCJA) likely caused a one-time acceleration of deductible expenses and added volatility to collections patterns. Individual income taxpayers who, in prior years, made estimated payments in December in order to increase their deduction for state and local taxes (SALT), delayed those payments to April in response to the federal limit for the SALT deduction. In addition, corporate income/franchise tax collections in 2019 grew by 70% compared to the same period through April in the prior year. This was caused in part by tax planning following TCJA, but also state implementation of the entity-level tax authorized under 2017 Act 368. The new entity-level tax resulted in increased tax payments from S corporations, partnerships, and limited liability companies, which had been previously recorded under the individual income tax, to be reflected under the corporate income/franchise tax as a retroactive payment for 2018 taxes. The entity-level tax enables individuals to pay state income taxes through their business, rather than via their individual returns, thereby avoiding the federal SALT deduction limit for individuals.

Finally, the May revisions also incorporated IHS Markit's May, 2019, forecast for the U.S. economy. Real GDP growth had been slightly increased from the January estimates to 2.7% in 2019, 2.1% in 2020, and 1.8% in 2021. Growth in labor productivity was revised upwards in 2019, as output per hour in the nonfarm business sector grew by 3.6% in the first quarter. On the other hand, growth in business fixed investment in nonresidential structures was revised downward to reflect anticipated increases in the long-term interest rates. Otherwise, the key assumptions were largely the same as in IHS Markit's January, 2019, forecast, except that: (a) the Brent crude oil price was forecast to remain higher at \$72 per barrel in 2019 and then decrease to \$67 in 2020 and 2021; (b) the federal funds rate was forecast to rise to 2.75% in December (rather than 3.25%) and remain at that level; and (c) the federal government shutdown persisted for 35 days, the longest in U.S. history. The primary upside and downside risks to the forecast remained the same as the January, 2019, forecast.

Many of the assumptions used in the May, 2019, forecast turned out to be inaccurate. First, trade policy diverged substantially, with the level of tariffs increasing as the trade war with China intensified. In May, the previous 10% tariff on \$200 billion worth of Chinese imports increased to 25%. In September, additional tariffs of 15% were levied on another \$112 billion worth of Chinese imports. As a result, more than two-thirds of consumer goods imported from China were subject to tariffs. In retaliation, in September, China imposed 5% to 10% tariffs on one-third of goods imported from America. A temporary trade truce in December allowed for negotiations regarding a "Phase 1" trade deal which requires the U.S. to suspend the 15% tariff, previously scheduled to be levied on \$160 billion of Chinese goods on December 15, and to reduce the 15% tariff that was imposed in September to 7.5%. Under the deal, China would reduce its retaliatory tariffs, increase purchases of U.S. goods by \$200 billion over the next two years, and potentially address other issues, such as requiring American companies to share technology with Chinese joint ventures in exchange for market access and enforcement of intellectual property protections.

Second, IHS Markit had anticipated that the Federal Reserve would increase the federal funds rate. However, the Open Market Committee actually voted to cut the rate target three times in 2019 to a stated range of 1.50% to 1.75%. Third, real, broad, trade-weighted foreign GDP grew slowly in 2019, as anticipated, but slower than previously forecast (1.5% compared to the 2.0% forecast). Fourth, according to the U.S. Energy Information Administration (EIA), after dropping from \$81 per barrel in October, 2018, to \$57 per barrel in December, 2018, the Brent crude oil price was expected to recover to \$71 per barrel by May, 2019, before again falling to \$60 per barrel by October and increasing to \$67 per barrel in December.

Overall, the national economy grew slightly less than forecast in May, 2019. IHS Markit estimates real growth in U.S. GDP in 2019 at 2.3%, which is 0.4 percentage points lower than previously estimated. National real GDP has now grown in 23 consecutive quarters, and in 39 of the 42 quarters since the 2008-2009 recession. The current economic expansion has lasted more than 10 years, which is the longest period of economic expansion in U.S. history.

As anticipated, consumer spending was the primary driver of the economy, contributing 1.8 percentage points to real GDP growth. Consumer spending was supported by three main factors in 2019. First, as forecast, equities and financial assets held by households rebounded strongly in 2019 (growing 23.1% and 12.0%, respectively) after declining significantly in the fourth quarter of 2018 (-47.5% and -21.0%, respectively). Second, similar to the May forecast, the unemployment rate for the year averaged only 3.7% as employers added an estimated 2.3 million jobs. Since October, 2010, there have now been 111 consecutive months of seasonally-adjusted job gains. Third, due to the strong employment market and modest nonfarm productivity growth in 2019 (1.6%), growth in wages and salaries (4.9%) and personal income (4.6%) exceeded the May forecast.

Nominal residential fixed investment grew in 2019 by more than forecast in May (1.2% rather than 0.5%). After growing by 0.4% in the first quarter of 2019, nominal residential fixed investment contracted by 0.3% in the second quarter, but growth recovered in the second half of the year to 1.1% in the third quarter and 2.7% in the fourth quarter. In particular, single family construction in 2019 rebounded after April, as permits for construction increased by 135,000 annualized units. IHS Markit estimates that growth in housing starts (1.9%) and sales of new

homes (11.7%) in 2019 led to the most annual new housing starts and sales of new homes since 2007.

Growth in real GDP was also supported by government spending (0.4 percentage points). Federal, state, and local government purchases grew by 2.2% in 2019, slightly more than forecast in May. Notably, the federal budget deficit grew by less than the May forecast to \$984 billion for the federal fiscal year through the end of September. In the current forecast, it is anticipated that the federal budget deficit for the fiscal year through September, 2020, will exceed \$1.1 trillion.

As described above, the employment market, low inflation, low interest rates, and productivity growth suggests that GDP growth would increase above the baseline forecast. Nevertheless, growth is estimated to have been lower in 2019 compared to the May forecast. This is due to several factors. First, real net exports detracted from real GDP growth (-0.2 percentage points) by more than forecast in May, 2019. Real net exports improved in the first quarter by 4.0%, likely due to importers shifting their purchases into the fourth quarter of 2018 in order to avoid the imposition of new tariffs and trade barriers in 2019. However, dollar appreciation, tariff and nontariff retaliation by trade partners, and slower economic growth by trading partners in the remainder of the year contributed to a decrease in real net exports of 5.7% overall in 2019, rather than an increase of 0.2% under the May forecast.

Second, real nonresidential fixed investment grew by less than anticipated (2.3%) compared to the May forecast (3.6%) and contributed only 0.3 percentage points to real GDP growth (rather than 0.5 percentage points). Trade policy likely disrupted investment plans, and IHS Markit estimates that trade policy uncertainty reduced business fixed investment by \$100 billion in 2019. Further, oil and natural gas prices declined significantly by the end of the year, causing a slowdown in mining and petroleum related investment (-8.1%) compared to growth expected in the May forecast (6.6%). Various other factors also temporarily contributed to lower industrial output and investment in equipment than anticipated in 2019, including the six-week strike at General Motors in September and October and a reduction in aircraft investment (-32.4%) after Boeing's 737 MAX was grounded by the Federal Aviation Administration and overseas regulators beginning in March after two deadly crashes.

National Economic Forecast

Under the January, 2020, forecast, IHS Markit predicts moderate GDP growth, gains in wages and productivity, low unemployment, and low inflation. Real GDP growth is forecast to slow, but to continue growing at 2.1% in 2020 and 2021. In the short term, IHS Markit expects consumer spending and nonresidential fixed investment, bolstered by strong labor markets, increased spending for hiring on the 2020 decennial census, increased automobile production following the end of the GM strike, and the expectation that 737 MAX shipments will resume next year, to drive moderate growth. Afterwards, below-trend growth is expected for several years as the tight labor market moderates, and the stimulative effects of TCJA, increased expenditures under federal budget bills (Bipartisan Budget Act of 2019 (BBA19) and two federal appropriation acts passed in 2020), and low interest rates fade.

The new forecast is based on the following key assumptions. First, trade policy remains the

same going forward as under the Phase 1 trade deal with China, except that the promised \$200 billion increase in purchases of U.S. goods by China is unrealistic and will not occur in the short term. Second, the Federal Reserve will maintain the current federal funds rate until June, 2021, when the rate increases a quarter point to a range of 1.75% to 2.0%, with an additional quarter point rate increase in the latter half of 2021. Third, the growth of real, broad, trade-weighted foreign GDP, which slowed from 3.2% (year over year) in 2017 to 1.6% in 2019, gradually rises to 2.4% by 2025. Fourth, the average price of Brent crude oil is projected to fall from \$64 per barrel in 2019 to \$58 in 2020 and \$52 in 2021. Finally, IHS Markit expects federal discretionary spending to maintain the expenditure limits set by BBA19 and the federal appropriation acts. The personal income tax provisions of TCJA are expected to be extended after 2025.

The forecast is summarized in Table 2, which reflects IHS Markit's January, 2020, baseline outlook. Selected baseline projections are presented in more detail below, with alternative optimistic and pessimistic scenarios discussed thereafter.

TABLE 2
Summary of National Economic Indicators
IHS Markit Baseline Forecast, January, 2020
(\$ in Billions)

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Nominal Gross Domestic Product	\$20,580.2	\$21,429.9	\$22,308.9	\$23,306.7
Percent Change	5.4%	4.1%	4.1%	4.5%
Real Gross Domestic Product	\$18,638.2	\$19,069.5	\$19,461.0	\$19,866.3
Percent Change	2.9%	2.3%	2.1%	2.1%
Consumer Prices (Percent Change)	2.4%	1.8%	1.8%	1.7%
Personal Income	\$17,819.2	\$18,630.0	\$19,350.2	\$20,209.0
Percent Change	5.6%	4.6%	3.9%	4.4%
Nominal Personal Consumption Expenditures	\$13,998.7	\$14,570.3	\$15,231.0	\$15,917.9
Percent Change	5.2%	4.1%	4.5%	4.5%
Economic Profits	\$2,074.6	\$2,070.4	\$2,136.6	\$2,247.4
Percent Change	3.4%	-0.2%	3.2%	5.2%
Unemployment Rate	3.9%	3.7%	3.5%	3.5%
Total Nonfarm Payrolls (Millions)	149.1	151.4	153.3	154.4
Percent Change	1.7%	1.6%	1.2%	0.8%
Light Vehicle Sales (Millions of Units)	17.21	16.95	16.68	16.53
Percent Change	0.5%	-1.5%	-1.6%	-0.9%
Sales of New and Existing Homes (Millions of Units)	5.956	6.021	6.253	6.183
Percent Change	-3.1%	1.1%	3.9%	-1.1%
Housing Starts (Millions of Units)	1.250	1.273	1.312	1.286
Percent Change	3.4%	1.9%	3.0%	-1.9%

Employment. According to the Department of Workforce Development, the unemployment rate in Wisconsin fell to an all-time low of 2.8% in April, 2019, before increasing to 3.3% by November. Nationally, unemployment fell to a 50-year low of 3.5% by November of 2019. Further, the U-6 unemployment rate, which includes underemployed and marginally attached workers, fell to 6.7% in December, the lowest rate on record since the Bureau of Labor Statistics began tracking in 1994. IHS Markit forecasts that the employment market will remain strong, while growing at a slower rate, with total nonfarm payrolls expanding 1.2% in 2020 and 0.8% in 2021. The national unemployment rate is expected to fall slightly further than expected in May, from an average of 3.7% in 2019 to 3.5% in 2020 and 2021, before increasing to an average of 3.8% in 2022. For comparison, the U.S. Congressional Budget Office estimates that the long-term natural rate of unemployment is 4.5%. The labor force participation rate for adults under 65 is projected to continue increasing from 72.6% in 2019 to 73.2% in 2021.

According to the federal Bureau of Labor Statistics, in September, 2019, there were 7.0 million job openings compared to 5.8 million unemployed persons. Thus, available workers are likely to remain scarcer than job openings in 2020. This may be especially true in the short term due to a temporary boost from hiring for the 2020 Spring census canvass.

Personal Income. Personal income grew more than expected at 4.6% in 2019, but is forecast to grow at 3.9% in 2020 and 4.4% in 2021, a slower rate than forecast in May. Growth in personal income reflects the strong employment market and growth in wages and salary disbursements (4.3% in 2020 and 2021). Growth in 2020 is estimated lower in part due to farm proprietor income, which grew 16.7% in 2019, but is forecast to decline by 42.3% in 2020 before rebounding to 92.0% growth in 2021. IHS Markit estimates that real disposable income, which grew by 3.0% in 2019, will grow by 2.2% in 2020 and 2.6% in 2021. IHS Markit expects growth in household financial assets to moderate from 12.0% in 2019 to 5.2% in 2020 and 3.8% in 2021, with growth in household holdings of equities decreasing from 23.1% in 2019 to 7.8% in 2020 and 3.2% in 2021. Partly as a result, growth in real household net worth improved compared to the May forecast, but is still expected to slow from 8.9% in 2019 to 2.5% in 2020 and 1.0% in 2021.

Personal Consumption. IHS Markit estimates that nominal personal consumption expenditures (PCE) grew in line with the May forecast at 4.1% in 2019 and are expected to grow by 4.5% in 2020 and 2021, at lower rates than the May forecast. Sales of consumer items generally subject to the state sales tax (such as most durable goods, clothing, restaurant meals, accommodations, and certain services) grew by an estimated 3.8% in 2019 and are forecast to grow by 4.3% in 2020 and by 3.6% in 2021. Spending on gasoline and other energy goods is estimated to have declined by 3.0% in 2019, after growing by 13.5% in 2018, and is forecast to further decline by 3.8% in 2020, and 5.4% in 2021.

Sales of light vehicles, the largest component of sales tax collections, declined 1.5% in 2019 and are forecast to continue to decline by 1.6% in 2020 and 0.9% in 2021, similar to the May forecast. Nevertheless, the nominal dollar value of sales of new vehicles and leased vehicles is forecast to increase by 1.6% in 2020 and 4.1% in 2021. This is because purchases of light trucks (including sport utility vehicles, vans, and pickup trucks), which comprised 72.2% of the number of light vehicle sales in 2019, are forecast to continue to grow (2.7% in 2019, 0.8% in 2020, and 0.3% in 2021) and thus comprise 74.0% of sales in 2020 and 74.8% in 2021. Because light trucks

are generally more expensive than cars, the average price of a new vehicle is expected to increase from \$34,000 in 2018 to \$35,100 in 2019, \$36,600 in 2020, and \$38,400 in 2021. Thus, even though car sales are forecast to continue to decline at a steep rate (-11.0% in 2019, -8.0% in 2020, and -4.1% in 2021), the value of consumer and business purchases of new vehicles is forecast to grow.

International Trade. According to the Monthly Treasury Statements of Receipts and Outlays of the United States Government, custom duties on imports were \$70.8 billion in federal fiscal year 2019. However, the effect of tariffs on import prices was blunted as the real trade-weighted value of the dollar appreciated 3.5% compared with major currency trading partners in 2019. The appreciating dollar, combined with slowing global growth as measured by a broad index of trading partners (1.5%) and the grounding of Boeing's 737 MAX aircraft, weighed on exports. Overall, IHS Markit estimates that net exports declined by 1.5% in 2019, as imports of goods and services decreased by 0.1% while exports of goods and services decreased by 0.4%.

After net exports declined 10.9% in both 2017 and 2018 and by 1.5% in 2019, IHS Markit forecasts that net exports will rebound and grow by 1.7% in 2020 and by 4.0% in 2021 for several reasons. First, recent developments suggest that trade policy may become less disruptive to investment than the previous year. Congress recently approved the United States-Mexico-Canada trade agreement, which will update the North American Free Trade Agreement in 2020 once ratified by Canada. Further, the Phase 1 trade deal may lead to improved trade relations with China. Second, deliveries of Boeing's MAX 737 are expected to resume next year, boosting exports. Finally, IHS Markit forecasts that annual net U.S. exports of petroleum will be positive in 2020 and continue to grow thereafter. Notably, the EIA estimates that in September exports of crude oil and petroleum products exceeded imports by 89,000 barrels per day, which is the first time the U.S. was a net exporter of crude oil and petroleum products since EIA began collecting monthly survey data in 1973. According to the EIA, the U.S. is now the world's largest producer of crude oil and petroleum products, although it remains a net importer of crude oil because refineries import crude oil and export petroleum products.

Consumer Prices. The consumer price index (CPI) has averaged 1.8% growth over the last decade. It had been expected that wage gains from record-low unemployment would begin to provide upward pressure on prices due to higher demand and employer costs. However, as forecasted in May, the CPI increased by only 1.8% in 2019, as low energy prices and dollar appreciation trimmed import costs. For comparison, core CPI (which excludes food and energy prices) increased 2.2%, while energy prices decreased 2.1%. IHS Markit forecasts that the CPI will continue to increase moderately, although at a lower rate than the May forecast, by 1.8% in 2020 and by 1.7% in 2021, as low oil prices and a strong dollar are expected to continue reducing growth in energy and import prices. Core inflation is expected to remain relatively flat at 1.9% in 2020 and 2.1% in 2021.

Monetary Policy. IHS Markit's baseline forecast assumes that the Federal Reserve will maintain the federal funds rate at a range of 1.50% to 1.75% until mid-2021, when GDP growth and the tight labor market are expected to pressure core inflation above the Federal Reserve's two percent target. IHS Markit anticipates that in June, 2021, the Federal Reserve will begin to raise the target range for the federal funds rate, eventually to a range of 2.50% to 2.75% by 2024. It is

estimated that the average commitment rate for a 30-year, conventional, fixed mortgage will continue to increase from 3.94% in 2019 to 4.00% in 2020 and 4.29% in 2021. For comparison, the average annual yield on the 10-year U.S. treasury note is expected to increase from an estimated 2.14% in 2019 to 2.21% in 2020 and 2.68% in 2021.

Housing. IHS Markit does not expect residential investment to meaningfully contribute to GDP growth over the next few years and has revised its housing indicators lower, compared to the May forecast. Based in part on a shift to building smaller, more affordable homes, IHS Markit estimates that the average price for new single-family homes declined by 0.5% in 2019 and will moderately grow by 0.6% in 2020 and 2021. Similarly, the median price of new single-family homes declined by 1.1% in 2019, and is estimated to grow by 2.3% in 2020 and by 0.6% in 2021. For comparison, as a result from low mortgage prices and low inventories, the price for the average existing single-family home is estimated to have grown by 3.3% in 2019, and is forecast to grow by 3.5% in 2020 and by 1.6% in 2021. As prices for new homes are expected to remain flat, and hence reduce profit margins for home builders, it is estimated that real (inflation adjusted) residential investment declined by 1.7% in 2019, and will grow by 1.6% in 2020, and will decline again by 1.2% in 2021.

Despite low mortgage costs, sales of new and existing homes are not forecast to recover to their pre-recession levels in the near term (8.4 million sales in 2005 compared to only 6.0 million in 2019, 6.3 million in 2020, and 6.2 million in 2021).

Business Investment. IHS Markit estimates that growth in nominal nonresidential fixed investment peaked in 2018 at 7.8%, partly as a result of the stimulative effect of TCJA, and slowed in 2019 by more than forecast in May, to 3.5%. IHS Markit forecasts that growth in nominal nonresidential fixed investment will continue to slow to 2.5% in 2020, lower than the May forecast, before growth increases to 4.0% in 2021. Growth in 2019 was led by investment in intellectual property products (8.8%), particularly in research and development (9.0%) and software (9.5%). However, IHS Markit forecasts that growth in investment in intellectual property products will decline to 6.3% in 2020 and to 5.2% in 2021, as investment in software (6.3% in 2020 and 1.5% in 2021) slows. Growth in nominal investment in equipment slowed to 1.9% in 2019, and is forecast to increase to 2.0% in 2020 and 3.0% in 2021. The resumption of Boeing deliveries after April is expected to boost investment in aircraft equipment in 2020 (44.2%) after declining steeply in 2019 (-32.4%). However, the boost to investment is expected to dissipate after aircraft deliveries catch up and the stimulative effects of federal fiscal policy wane throughout 2020. Nominal investment in nonresidential structures is expected to decline by 1.3% in 2019 and 2.4% in 2020, and then grow by 3.9% in 2021. In particular, investment in structures for mining and petroleum (-14.7% in 2020 and -7.8% in 2021) and power and communications (-3.9% in 2020 and 0.2% in 2021) are expected to decline over the forecast period as oil and energy prices remain low.

Corporate Profits. Corporate before-tax book profits grew by just 0.2% in 2019, which is much less than the 7.1% growth forecast in May, 2019. IHS Markit now forecasts growth of 3.8% in 2020, and 5.7% in 2021. Economic profits, which are adjusted for inventory valuation and capital consumption at current cost (and thus are not affected by federal tax laws), declined by 0.2% in 2019, and are forecast to increase by 3.2% in 2020 and by 5.2% in 2021. Both measures for corporate profits now show lower growth rates in 2019, but higher growth rates in 2020 and

2021, compared to the May forecast.

The forecast reflects that TCJA reduced the federal statutory corporate tax rate from 35% to 21%, extended 100% bonus depreciation through 2022 (followed by a three-year phase-out period), and provided additional tax deductions for certain pass-through business income through 2025. The 2020 forecast assumes that the effective federal corporate tax rate for all industries dropped from 21.5% in 2015 to 10.3% in 2019 and is expected to continue to decline to 10.0% in 2020 and 9.6% in 2021.

Fiscal Policy. The federal budget deficit is expected to grow from \$984.4 billion in federal fiscal year 2019 to \$1,145.2 billion in 2020 and \$1,177.4 billion in 2021, primarily caused by tax reductions enacted under TCJA and spending increases under BBA19 and the federal appropriation acts. Overall, federal, state, and local government fiscal policies are estimated to have contributed 0.38 percentage points to real GDP growth in 2019. This is expected to decrease to 0.32 percentage points in 2020 and 0.14 percentage points in 2021 as the stimulative effects from TCJA and BBA19 dissipate, although these policies are expected to remain higher contributors to real GDP growth than anticipated in May.

Alternative Scenarios. IHS Markit's 2020 forecast also includes an optimistic scenario and a pessimistic scenario. Under the optimistic scenario, IHS Markit assigns a 10% probability that strong productivity growth and less inflation will yield GDP growth 0.9 percentage points higher in each year than predicted in the baseline forecast. The key assumptions are that a lower than estimated long-run natural rate of unemployment (4.0%) keeps core PCE inflation below its baseline level while faster productivity growth at 2.8% (one percentage point above the baseline forecast) from 2020 to 2030 allows wages to grow more quickly without triggering inflation. Growth in the rest of the world increases due to faster productivity gains, although more slowly than in the U.S. In response to better income and job prospects, consumers increase their spending. The Federal Reserve accelerates its first rate increase to early 2021, after which it gradually increases the federal funds rate up to a target range of 3.25% to 3.50% by 2024. Household formation accelerates due to improved employment and household finances, spurring a rise in housing starts.

Under the pessimistic scenario, to which IHS Markit assigns a 25% probability, a broad-based loss of confidence and risk aversion cause a three-quarter recession starting in the fourth quarter of 2020. In this scenario, rising real-estate prices and mortgage rates slow housing demand and construction. Declining consumer confidence sets off a deep drop in asset values and broad-based declines in business fixed investment. The declining stock and housing markets cause negative wealth effects which, along with employment declines, cause households to curtail their spending. Unemployment spikes to 5.8% in the fourth quarter of 2021, and GDP declines 2.0% over the three-quarter recession on an annualized basis. The recovery after the recession is expected to be weak, in part, due to lack of capacity by the federal government or the Federal Reserve to use fiscal or monetary policy to offset the effects of the recession.

General Fund Taxes

Table 3 shows general fund tax revenue estimates for 2019-20 and 2020-21. In total, these

amounts are \$818.2 million greater than the previous estimates. The percentage difference is 2.3%. The majority of the excess revenue is from increased projections for corporate income/franchise tax revenues, which are \$329.5 million higher in 2019-20 and \$299.6 million higher in 2020-21 (77% of the total increase). Estimated collections for individual income taxes and sales and use taxes have also been increased, offset partly by downward adjustments in most of the other taxes.

TABLE 3
Projected General Fund Tax Revenues
(Millions)

	2018-19 <u>Actual</u>	<u>Previous Estimates</u>		<u>Revised Estimates</u> <u>January, 2020</u>	
		<u>2019-20</u>	<u>2020-21</u>	<u>2019-20</u>	<u>2020-21</u>
Individual Income	\$8,994.1	\$8,923.1	\$9,142.0	\$8,950.0	\$9,235.0
General Sales and Use	5,695.5	5,877.3	5,960.5	5,930.0	6,010.0
Corporate Income/Franchise	1,338.1	1,165.5	1,205.4	1,495.0	1,505.0
Public Utility	364.9	366.0	364.0	358.0	362.0
Excise					
Cigarette	514.3	515.0	507.0	512.0	497.0
Tobacco Products	85.5	90.0	94.0	90.0	92.0
Vapor Products	N/A	2.3	3.2	2.3	3.2
Liquor and Wine	53.6	55.0	56.0	55.0	56.0
Beer	8.5	8.9	8.9	8.3	8.3
Insurance Company	194.4	203.0	211.0	201.0	209.0
Miscellaneous Taxes	<u>92.5</u>	<u>97.5</u>	<u>102.7</u>	<u>97.5</u>	<u>100.0</u>
Total	\$17,341.4	\$17,303.6	\$17,654.8	\$17,699.1	\$18,077.5
Change from Prior Year		-\$37.8	\$351.1	\$357.7	\$378.4
Percent Change		-0.2%	2.0%	2.1%	2.1%

The new estimates are based on the most recent national economic forecast and tax collections data through December. They reflect all state and federal law changes enacted, to-date, that impacted state tax collections.

Individual Income Tax. After totaling \$8,994.1 million in 2018-19, state individual income tax collections are estimated at \$8,950.0 million in 2019-20 and \$9,235.0 million in 2020-21. On a year-to-year basis, these estimates represent a decrease of 0.5% in 2019-20 and an increase of 3.2% in 2020-21. Relative to the previous figures, the current estimates are \$26.9 million higher in the first year and \$93.0 million higher in the second year.

Based on preliminary collection information through December, 2019, individual income tax revenues for the current fiscal year are 3.4% higher than such revenues through the same period in 2018-19. However, revenues are expected to decrease at a rate of 3.5% over the next six months largely due to law changes enacted in the two preceding years. These law changes affect collections in both years and are discussed below.

Provisions in 2017 Wisconsin Act 368, enacted in the December, 2018, extraordinary legislative session, permit pass-through entities to elect to be taxed at the entity level, thereby shifting state tax revenues from the individual income tax to the corporate income/franchise tax. Subchapter S corporations could make the election beginning in tax year 2018, and partnerships, including limited liability corporations filing as partnerships, could make the election beginning in tax year 2019. Such elections are expected to reduce estimated payments and final payments and increase tax refunds in both years. The entity-level tax is described in further detail under the corporate income/franchise tax section.

Provisions in 2019 Wisconsin Acts 9 and 10, enacted in July, 2019, reduce marginal tax rates for the individual income tax beginning in tax year 2019. Currently, the state individual income tax has four tax brackets with unique marginal tax rates specified for each bracket. Act 9 lowered the marginal tax rate for the second tax bracket from 5.84% to 5.21% for tax year 2019 and thereafter. Act 10 modified an existing statutory provision requiring an income tax reduction conditioned on certain sales and use tax changes. As modified, the statute now requires the tax rates for the two bottom individual income tax brackets to be reduced for tax year 2019 based on the amount of additional sales and use tax attributable to remote sellers for the 12-month period from October 1, 2018, to September 30, 2019, as determined by DOR. For tax years 2020 and thereafter, reductions to the same two rates will be based on the amount of additional sales and use tax attributable to remote sellers and marketplace providers during the 12-month period from October 1, 2019, to September 30, 2020, as determined by DOR. For tax year 2019, the marginal tax rates for the two bottom tax brackets have been reduced from 4.00% to 3.86% and from 5.21% to 5.04%, based on DOR's estimate of sales and use tax collections for the initial 12-month period. For tax years 2020 and thereafter, the two rates are estimated at 3.79% and 4.96%, respectively, but these amounts will likely change after DOR estimates the additional sales and use tax collections during the second 12-month period ending in 2020. The DOR determinations are subject to legislative oversight. The provisions of Acts 9 and 10 are estimated to reduce individual income tax collections by \$246.2 million in 2019-20 and \$271.9 million in 2020-21, largely in the form of increased tax refunds.

General Sales and Use Tax. State sales and use tax revenues totaled \$5,695.5 million in 2018-19, \$45.5 million above the estimated amount, representing growth of 4.5% relative to the prior year. Sales tax collections through December, 2019, are 4.1% higher than the same period in the prior year. Sales tax revenues are estimated at \$5,930.0 million in 2019-20 and \$6,010.0 million in 2020-21, constituting annual growth of 4.1% in 2019-20 and 1.3% in 2020-21. The lower estimated annual growth in 2020-21 reflects the repeal, effective July 1, 2020, of the state's imposition of sales tax on internet access services (estimated at \$166 million), pursuant to 2017 Act 59. This reduction is partly offset by additional revenues estimated from the 2019 Act 10 provision that requires marketplace providers to collect and remit sales tax. These estimates represent revenue increases relative to the prior estimates of \$52.7 million in 2019-20 and \$49.5 million in 2020-21. The increased estimates are primarily based on higher sales tax growth in 2018-19 than previously estimated, and on slightly stronger year-to-date sales tax collections growth than previously anticipated.

Corporate Income/Franchise Tax. Corporate income/franchise taxes were \$1,338.1 million in 2018-19, which grew 49.7% above the previous year. Corporate tax revenues are

projected to be \$1,495.0 million in 2019-20 and \$1,505.0 million in 2020-21, reflecting growth of 11.7% in 2019-20 and 0.7% in 2020-21. The new estimates are higher than the previous estimates for 2019-20 and 2020-21 by 28.3% and 24.9%, respectively. The new estimates reflect year-to-date corporate tax collections, which have grown by over 65% compared to the same period through December of last year.

Several factors contributed to unprecedented growth in corporate income/franchise tax collections in 2018-2019 and the first half of 2019-20, which are anticipated to moderate in 2020. First, the pass-through election to file under the entity-level tax caused an estimated \$193.8 million increase in collections in 2018-19, accounting for 21.7 percentage points of growth in collections compared to 2017-18. As discussed above, pursuant to 2017 Act 368, S corporations, partnerships, and limited liability companies may elect to be taxed at the entity level beginning in tax year 2019, (except that S corporations can make the election beginning in tax year 2018). DOR records these payments under the corporate tax, rather than the individual income tax. As such, these payments reduce individual income tax collections and contribute to substantially higher growth in corporate income/franchise tax collections because the payments would otherwise be made by individual shareholders, partners, and members for tax owed on the income passed through by the entity on their individual returns. If such an election is made, it is likely that the election to pay at the entity level will actually increase the amount of state taxes owed by the taxpayer because: (a) the corporate income/franchise tax rate of 7.9% is higher than the graduated rates for individual income tax brackets in 2019 of 3.86%, 5.04%, 6.27%, or 7.65%; (b) tax credits cannot be claimed by the entity (except for the credit for taxes paid to another state); and (c) the entity cannot claim a net operating loss from another year. Nevertheless, it may be advantageous to make the election because income taxed at the entity level for state tax purposes may be a deductible business expense for federal tax purposes (where under TCJA, beginning in tax year 2018, the federal income tax itemized deduction for state and local taxes is limited to no more than \$10,000 per year for individuals).

Overall, the May forecast expected payments from pass-through entities under the corporate tax to decrease in 2019-20. Because Act 368 was enacted in December, 2018, S corporations remitted entity level tax payments for tax year 2018 in March, 2019 (the last month to do so without incurring interest charges). Thus, in addition to receiving estimated payments from pass-through entities for the first half of 2019, collections for 2018-19 were enhanced by a one-time payment of \$124.4 million owed by S corporations for tax year 2018. Due to the short amount of time to file and the safe harbor from interest charges, it was expected that pass-through entities would overpay the 2018 entity-level tax owed and later normalize their payments by either seeking refunds or remitting lower estimated payments throughout 2019-20. However, based on collections data, it now appears that in 2019-20 refunds are lower than previously estimated and that entity-level estimated tax payments are higher than previously estimated.

Second, corporate audit payments in 2019-20 increased by \$74.4 million compared with the same period through December in 2018-19. This accounts for 5.3 percentage points of growth in estimated 2019-20 collections compared to actual collections in 2018-19. According to DOR, the sharp increase in corporate audit payments reflects activity from prior years and is unlikely to repeat.

Third, collections increased significantly in 2018-19 following the federal adoption of TCJA and the state enactment of 2017 Act 231, which updated state law to account for some, but not all, of the changes in federal law. As discussed above, TCJA lowered the federal tax rate paid by corporations from 35% to 21%, providing an incentive to organize and file as a corporation. Although the estimated fiscal impact of Act 231 was accounted for in the May estimates, the ancillary effects on increased state collections following TCJA have continued. For comparison, according to IHS Markit, overall state and local taxes on corporate income increased by 11.3% in 2018-19 and will increase again by 9.6% in 2019-20, with growth moderating to 4.8% in 2020-21. It is likely growth in collections will similarly moderate in Wisconsin as the impact fades from the one-time and ongoing effects of these law changes.

Public Utility Taxes. Revenues from public utility taxes totaled \$364.9 million in 2018-19 and are estimated at \$358.0 million in 2019-20 and \$362.0 million in 2020-21. These amounts represent a decrease of 1.9% in 2019-20 and an increase of 1.1% in 2020-21. Compared to the previous estimates, these amounts are lower by \$8.0 million in 2019-20 and \$2.0 million in 2020-21. Private light, heat, and power companies are the largest taxpayer group, comprising 63% of estimated public utility tax revenues for the 2019-21 biennium. Collections from these companies totaled \$231.5 million in 2018-19 and are estimated to decrease to \$226.7 million in 2019-20 (-2.1%) and increase to \$228.7 million in 2020-21 (0.9%). The decrease in 2019-20 reflects, in part, fewer kilowatt hours of electricity consumed in 2019 than in 2018. Revenues from 2019 comprise the basis for these companies' license fees due in May, 2020. Electricity and natural gas sales are influenced by economic conditions for commercial and industrial customers and by weather for residential customers.

Excise Taxes. General fund excise taxes are imposed on cigarettes, liquor (including wine and hard cider), other tobacco products, vapor products, and beer. Total excise tax revenues in 2018-19 were \$661.9 million, of which \$514.3 million (77.7%) was attributable to the excise tax on cigarettes. Total excise tax collections in 2018-19 represented a decrease of 2.7% from the prior fiscal year, largely due to a decrease in cigarette tax collections of 4.6% from the prior year. Total excise tax revenues are estimated at \$667.6 million in 2019-20 and \$656.5 million in 2020-21. Compared to the previous estimates, these amounts are \$3.6 million lower in 2019-20 and \$12.6 million lower in 2020-21. These estimates account for the recent federal provision to prohibit sales of cigarettes and tobacco products to individuals under the age of 21, which is expected to decrease state excise tax revenues beginning in 2020-21. Estimated excise tax revenues in 2019-20 are 0.9% higher than actual collections in 2018-19, partially because of the tax on vapor products that took effect on October 1, 2019.

Cigarette tax revenues are estimated at \$512.0 million in 2019-20, and \$497.0 million in 2020-21, and are lower than the previous estimates by \$3.0 million in 2019-20 and \$10.0 million in 2020-21. The reduction is primarily due to an ongoing trend of declining cigarette consumption, evidenced by annual cigarette revenue declines of 4.5% in 2017-18 and 4.6% in 2018-19. The reestimate for cigarette tax revenues in 2019-20 represents an approximate annual decline of 0.4%, which is a smaller reduction than the annual average decline of 2.5% over the last four fiscal years. Illinois implemented a cigarette tax increase of \$1 per pack, effective July 1, 2019, which brought its tax rate to \$2.98 per pack (higher than Wisconsin's rate of \$2.52 per pack). It is assumed that this tax increase has contributed to higher year-to-date tax collections than previously expected

because consumers living near the state border likely shifted their purchases of cigarettes to Wisconsin in response to the Illinois tax rate increase.

Insurance Premiums Taxes. Insurance premiums taxes were \$194.4 million in 2018-19, which is \$0.6 million less than estimated. Revenues are projected to increase to \$201.0 million in 2019-20, and \$209.0 million in 2020-21. These estimates reflect projected year-over-year growth of 3.4%, and 4.0%, respectively, and are \$2.0 million lower than previous estimates for each year. The estimates are based on growth of 3.1% in year-to-date insurance premiums tax collections, historic collections growth trends, and projected growth in consumer spending on insurance.

Miscellaneous Taxes. Miscellaneous taxes include the real estate transfer fee, municipal and circuit court-related fees, and a small amount from the occupational tax on coal. Miscellaneous tax revenues were \$92.5 million in 2018-19, of which 83.7% was generated from the real estate transfer fee. These revenues are estimated at \$97.5 million in 2019-20 and \$100.0 million in 2020-21, which is \$2.7 million lower than the previous estimate in 2020-21. The decrease in 2020-21 reflects lowered growth for the housing sector, relative to the May forecast.

This office will continue to monitor state revenues and expenditures and new economic forecasts, and notify you and your colleagues of any further adjustments that may be necessary.

Sincerely,

A handwritten signature in black ink, appearing to read "Bob", written in a cursive style.

Robert Wm. Lang
Director

RWL/lb

cc: Members, Wisconsin Legislature