Minnesota's Economic Outlook for 2013 and Beyond

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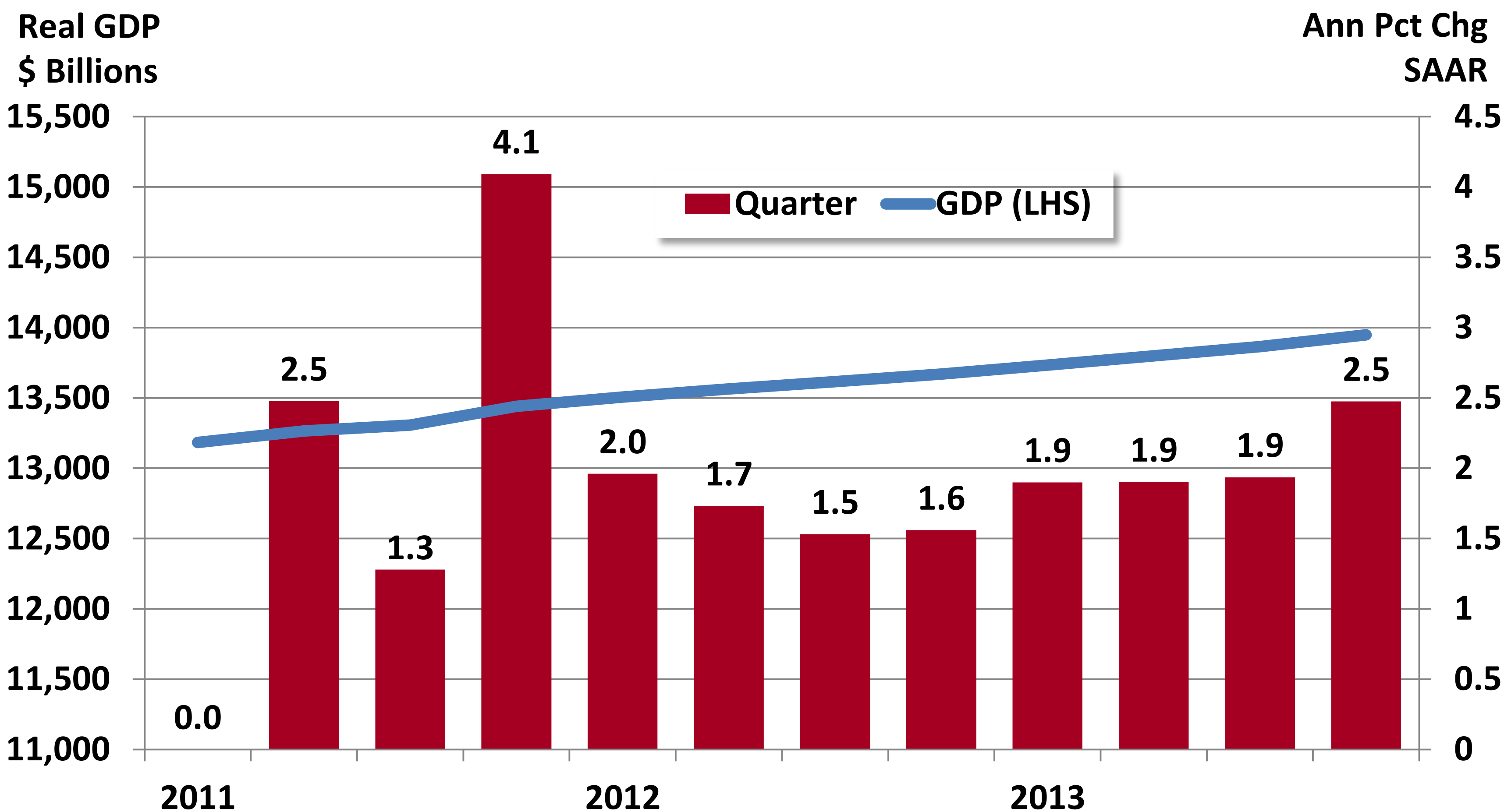
FY 2014-15 Budget Planning

($ in millions)	FY 2012-13	FY 2014-15	$ Difference	% Change
Forecast Revenues	$33,867	$35,861	$1,994	5.9%
Projected Spending	34,088	36,903	2,815	8.3%
Difference	$(221)	$(1,042)		
Inflation	---	*1,059*	---	---

Key planning assumptions:

- Tax revenue growth – Grow $2.7 billion (8.6 percent)
- Non-tax revenues – Decline $0.7 billion (-27.7 percent)
- K-12 expenditures - Increase $1.2 billion (Impact of school shifts)
- Health and human services spending – Increase $0.7 billion (6.7 percent)
- Debt service – Increase $0.9 billion (Impact of tobacco bonds)
- Other spending areas – Essentially flat
- $2.4 billion in school shifts remain to be repaid

More of the Same – Slow Growth Forecast for U.S. in 2012 and 2013



Growth Expected to Continue Through 2013

- 2012 real GDP growth expected to be 2.2 percent; 2013, 1.8 percent
- Inflation not a problem -- 2012 CPI, 2.0%
- Oil prices relatively flat through 2014
- Light vehicle sales at 14.2 million units by end of 2012
- Housing starts—750K in 2012, 1M in 2013

Favorable Interest Rate Environment Expected Through 2014

- **No fed funds increase until 2015**
- **10 year Treasury goes from 2 percent to 4+ percent by 2015**
- **30 year mortgage will creep up slowly in 2013 and 2014**
- **QE III will have little impact**

Why We Are Not Going Into a Recession

- Oil prices have not increased
- Housing starts are increasing
- Auto sales are growing
- Consumer confidence is increasing
- No supply chain problems
- Sovereign debt problems less disruptive
- The “great recession” is one year further in the past

Why We Might Go Into a Recession in 2013

- Economic growth remains sub-par
  – Consumer spending recovery is not robust
  – Jobs growth continues to disappoint
  – Capital equipment spending slowing
  – Export growth decelerating
- European sovereign debt crisis
- The federal fiscal cliff

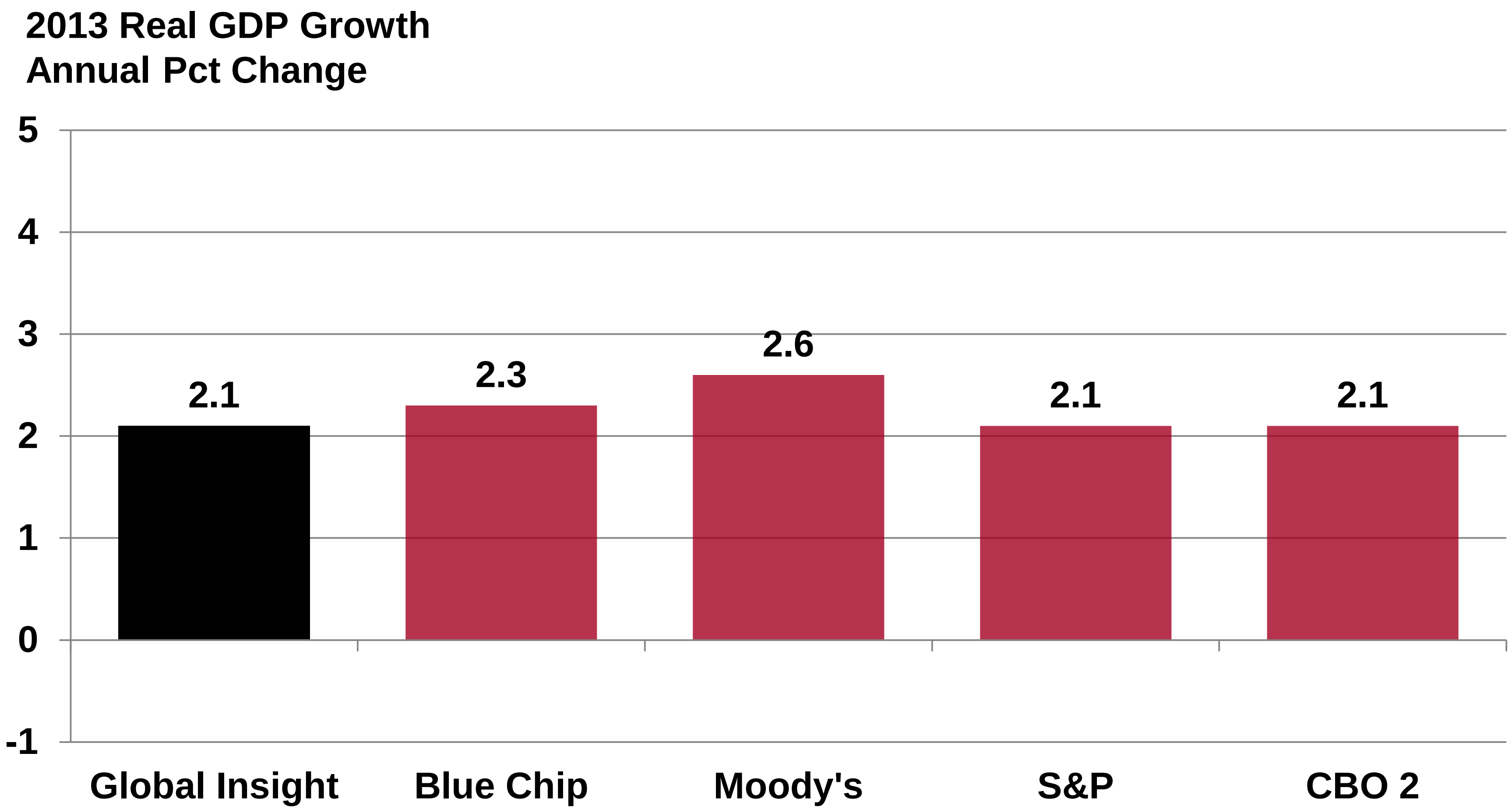
What to Watch Over the Next Eight Months

- Unemployment rate / jobs
- Consumer sentiment / consumer spending
- Oil prices
- European sovereign debt
- U.S. fiscal policy decisions

The Eurozone's Problems Are Still Very Serious

- Europe is in a recession
- European and American capital markets are linked
- Decline in Euro affects the demand for U.S. produced goods and services
- But, much of the losses associated with Greek debt have already been absorbed
- Further financial problems in Spain or Italy remain a concern

2013 Forecasts Assume a Grand Bargain Avoids the Fiscal Cliff



The Fiscal Cliff Is More than the Expiration of the Bush Tax Cuts

- **Payroll tax cut expires ------------ $110B**
- **Bush tax cut expires -------------- 160B**
- **AMT Indexing expires ------------ 125B**
- **Other changing tax provisions -- 146B**

Total tax increases $541B

Scheduled spending cuts $144B

- **TOTAL (*Fiscal Drag*) $685B**

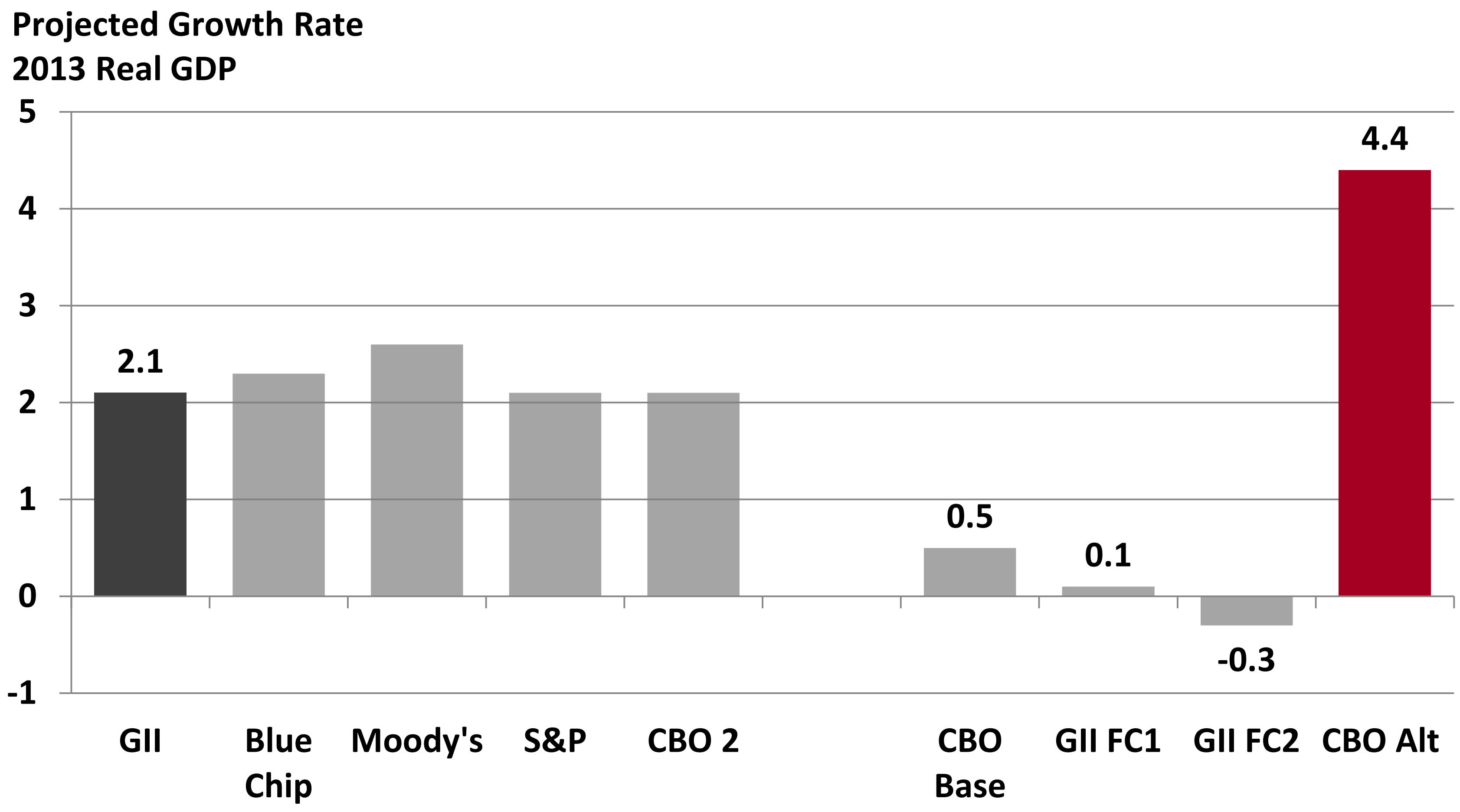
How the Fiscal Cliff Slows the Economy

- **A combination of higher taxes and lower government spending reduces household income**
- **Households balance their budgets by drawing down their savings and by cutting back on their spending**
- **Growth in consumer spending slows, reducing the economy’s overall growth rate**

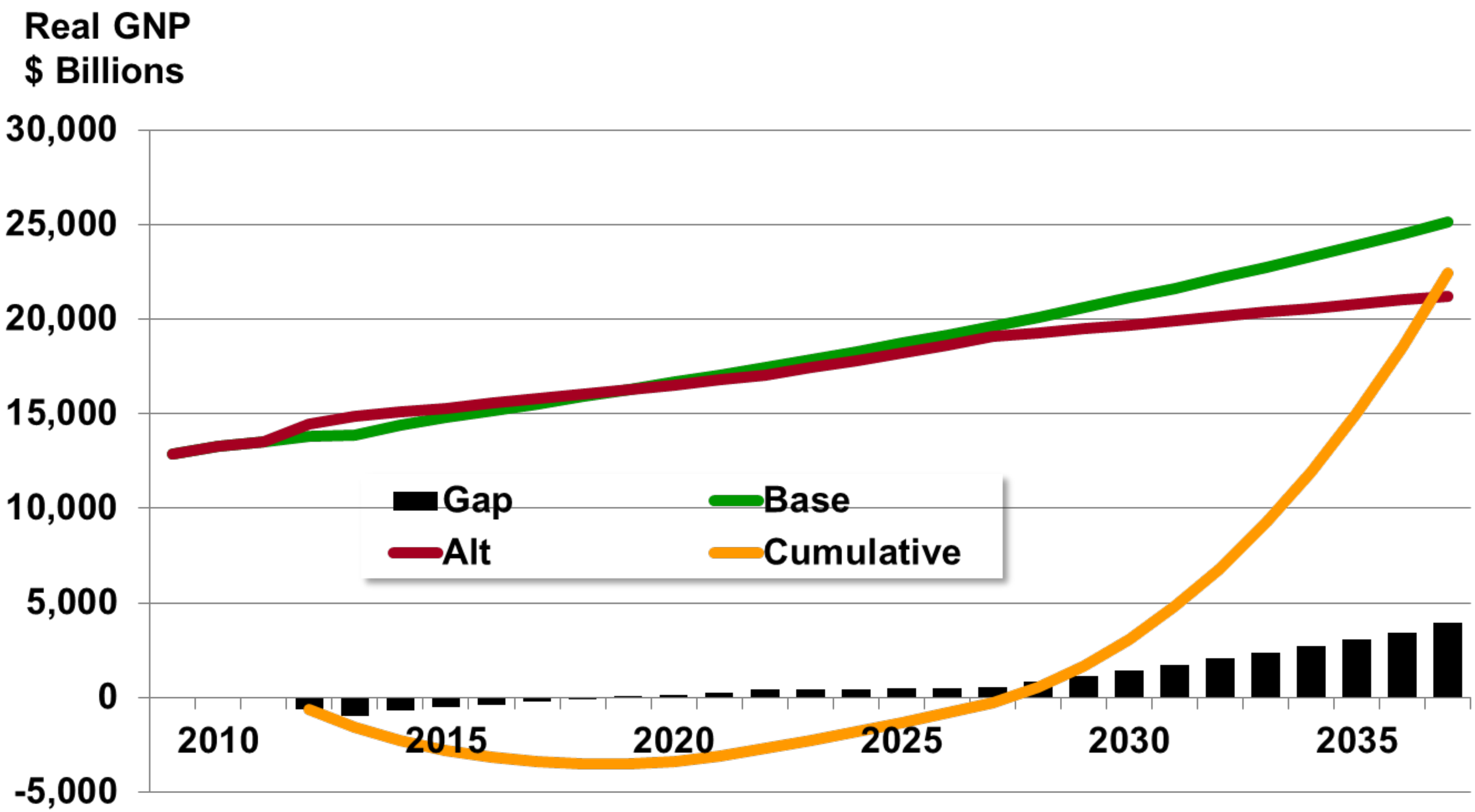
The Simple Arithmetic of the Fiscal Cliff

• **2012 Real GDP**		**$13,580 B**
Growth @ 3.5%	475	
Fiscal Drag	-685	
Savings Drawdown	228	
Net	18	
• **2013 Real GDP**		**$13,598 B**
Annual Growth Rate		0.1%

The Short Term GDP Growth Rate Would Increase Under Current Policy



Long Term GNP Growth Is Noticeably Greater in CBO's Baseline Scenario

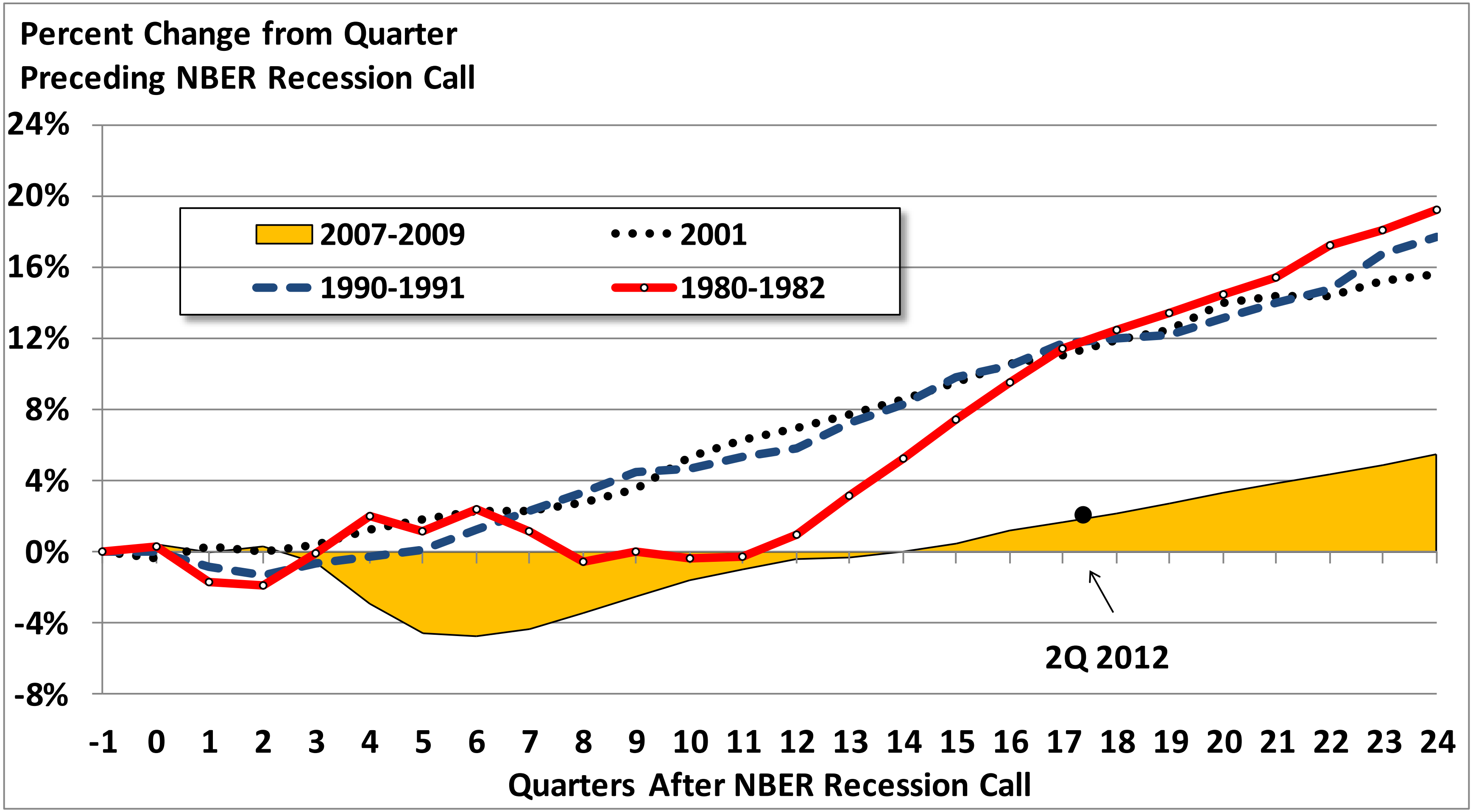


Recent Economic and Demographic Events Have Changed the Outlook for as Far as We Can See

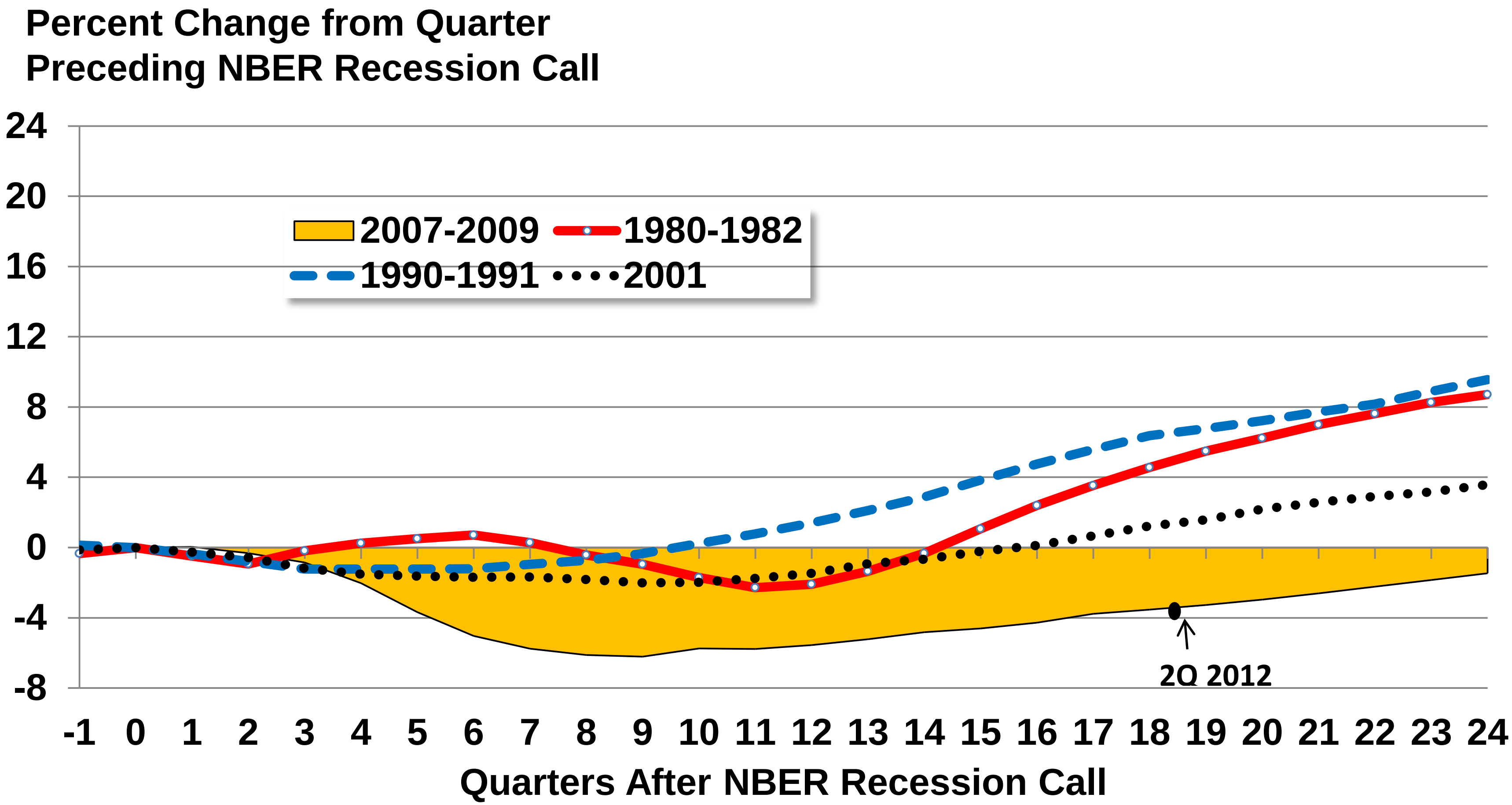
We Are Headed to a New Normal

- The Great Recession is over and the economy is growing -- but we will not return to where we once were
- We are moving to a New Normal
- The U.S. is not alone -- it is happening globally
- Those who recognize this and adapt first will be most successful
- The next four years will be critical

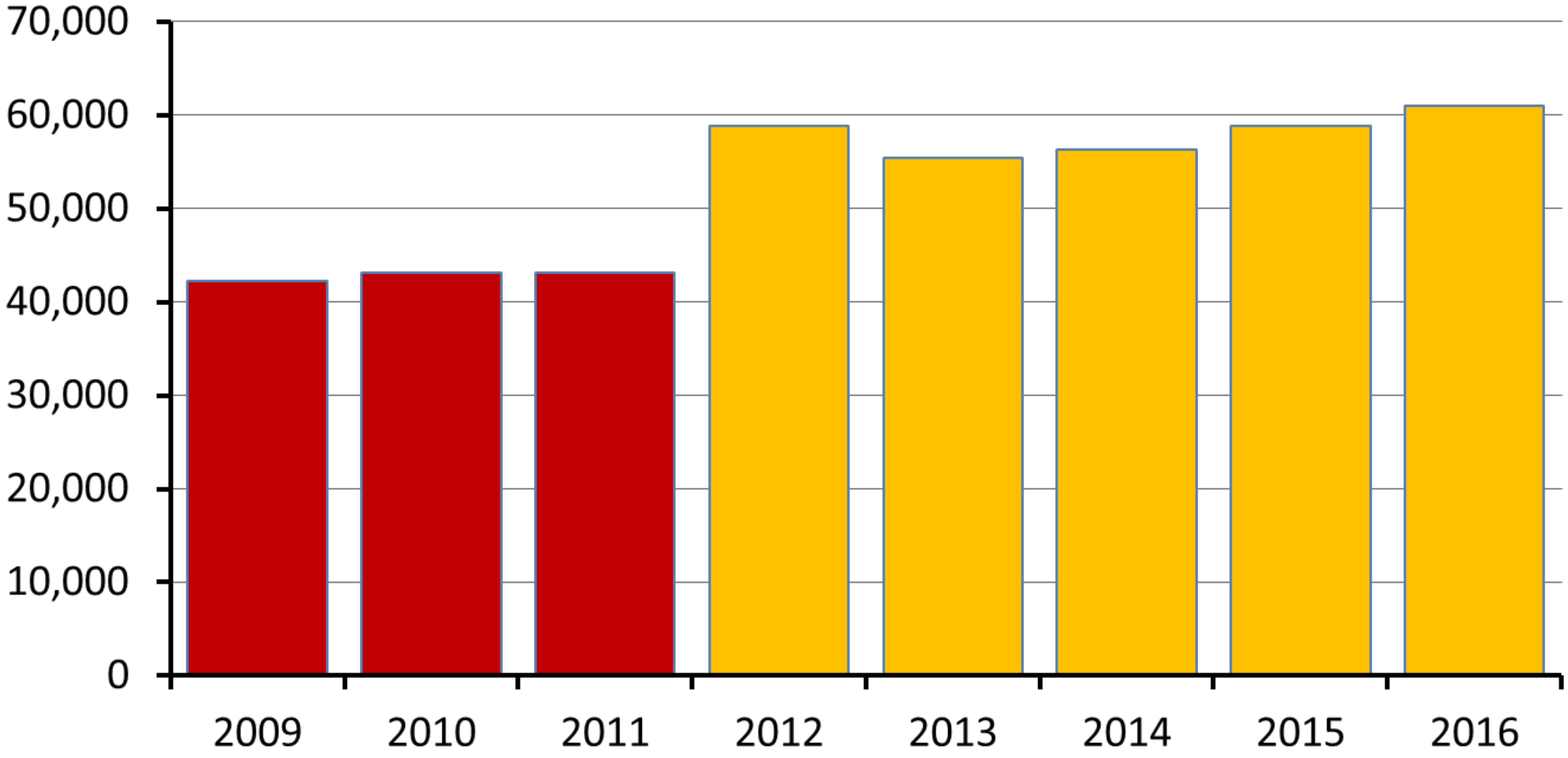
This Recovery Has Been Slower Than Those in the Past



U.S. Payroll Employment Fell More Than 5 Percent in the Great Recession

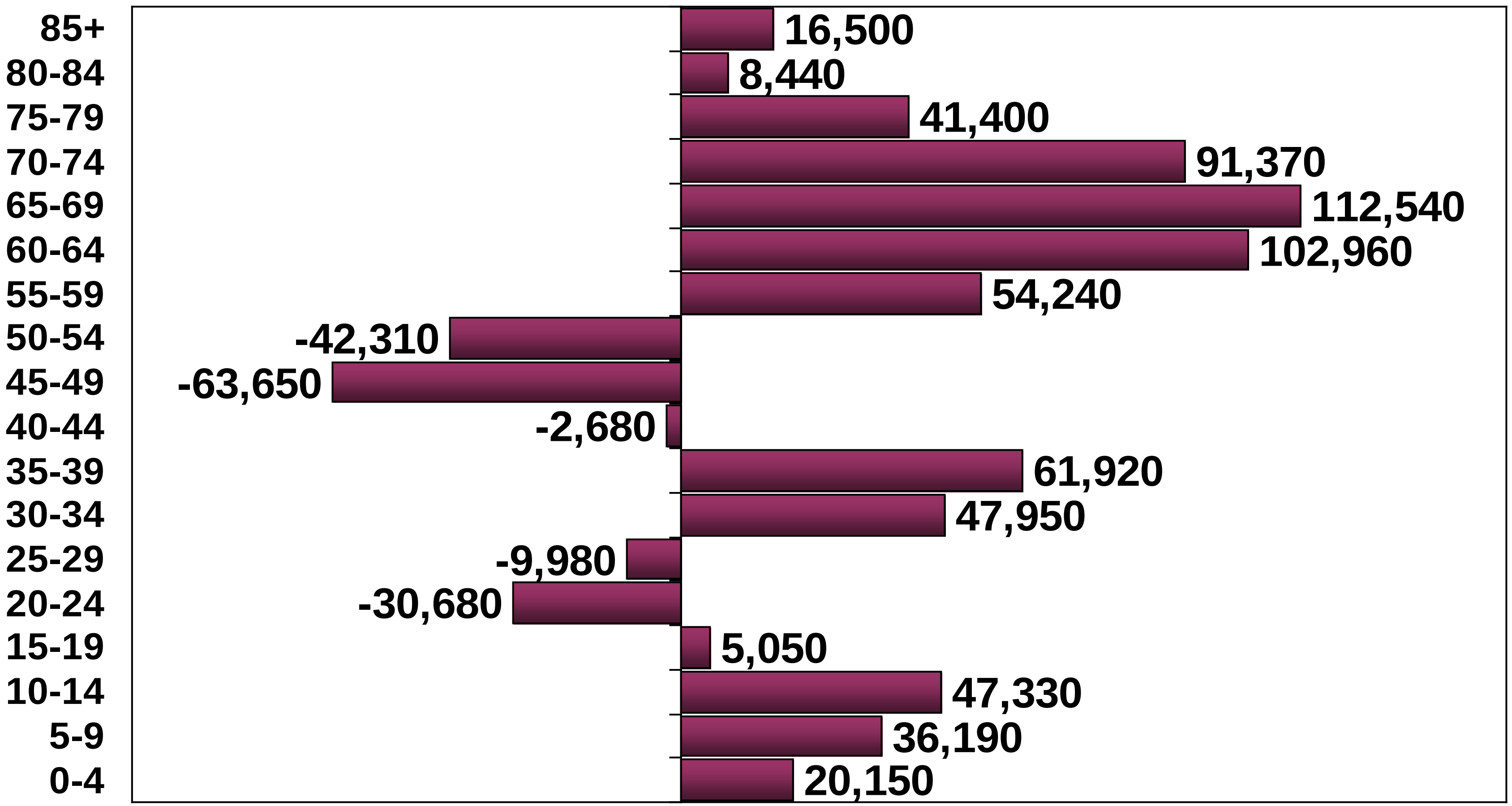


The Number Of Minnesotans Turning Age 65 Is Increasing Sharply This Year



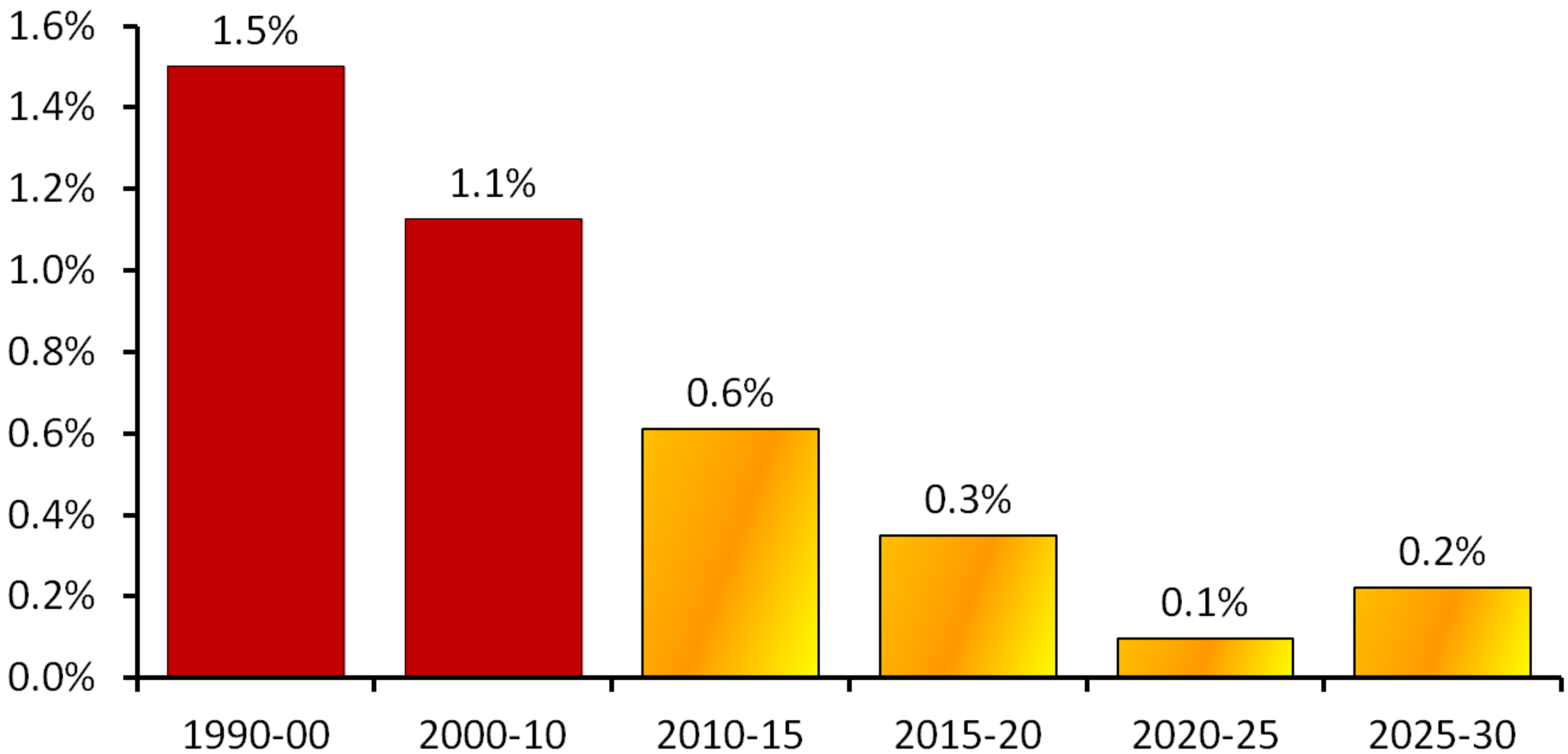
Census ACS and counts and Mn State Demographer forecasts, the 2012 increase is 36%

From 2010 to 2020, Minnesota Will See Large Increases Age 60s and 70s



Source: Minnesota State Demographic Center, rev 2007
Numbers are rounded

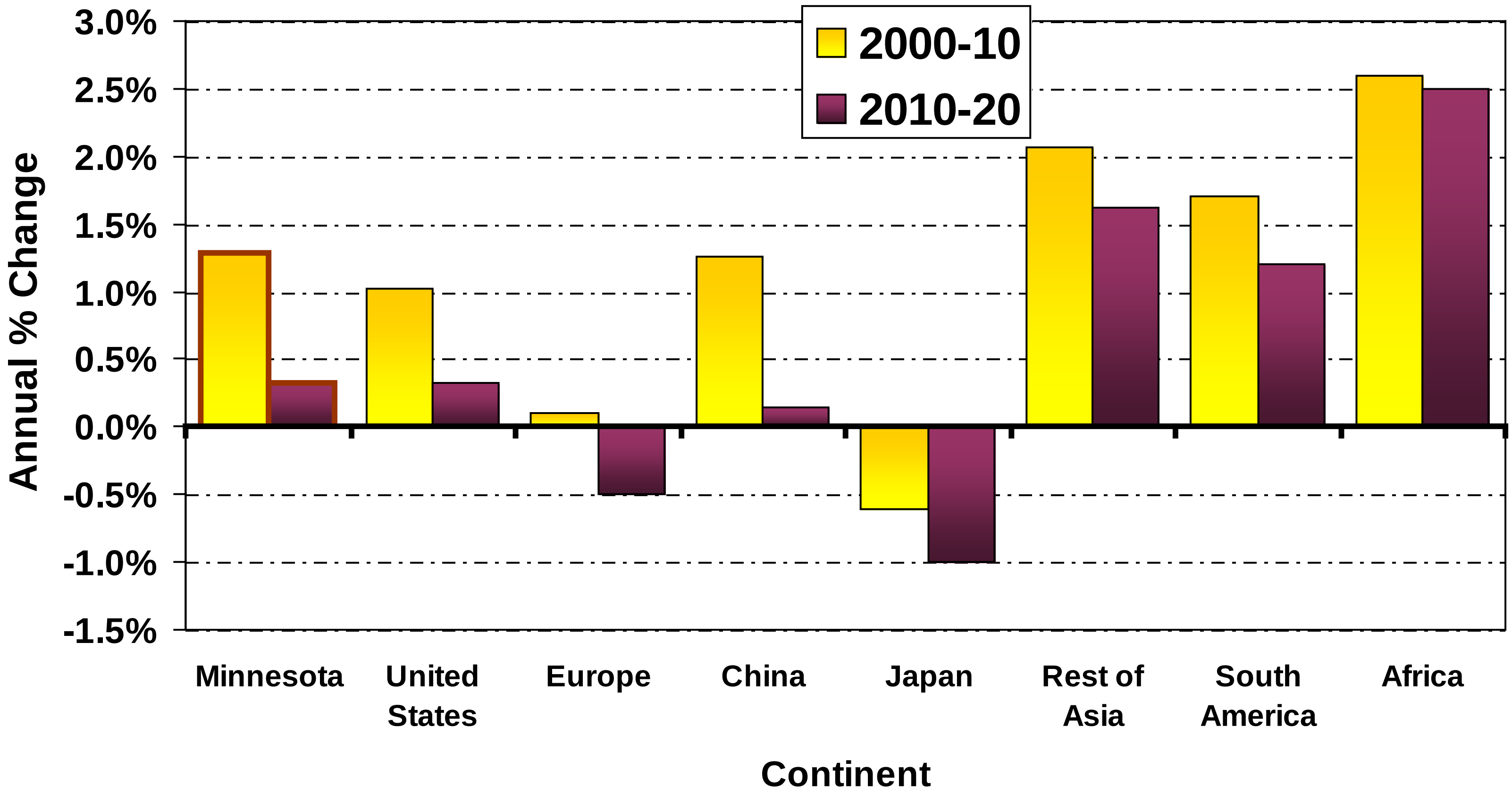
Annual Percent Change Minnesota Total Labor Force



Minnesota State Demographer forecast, revised January 2012

World Labor Force Growth Slowing

Projected Change In Working Age Population (15-64)



U.S. Census Bureau

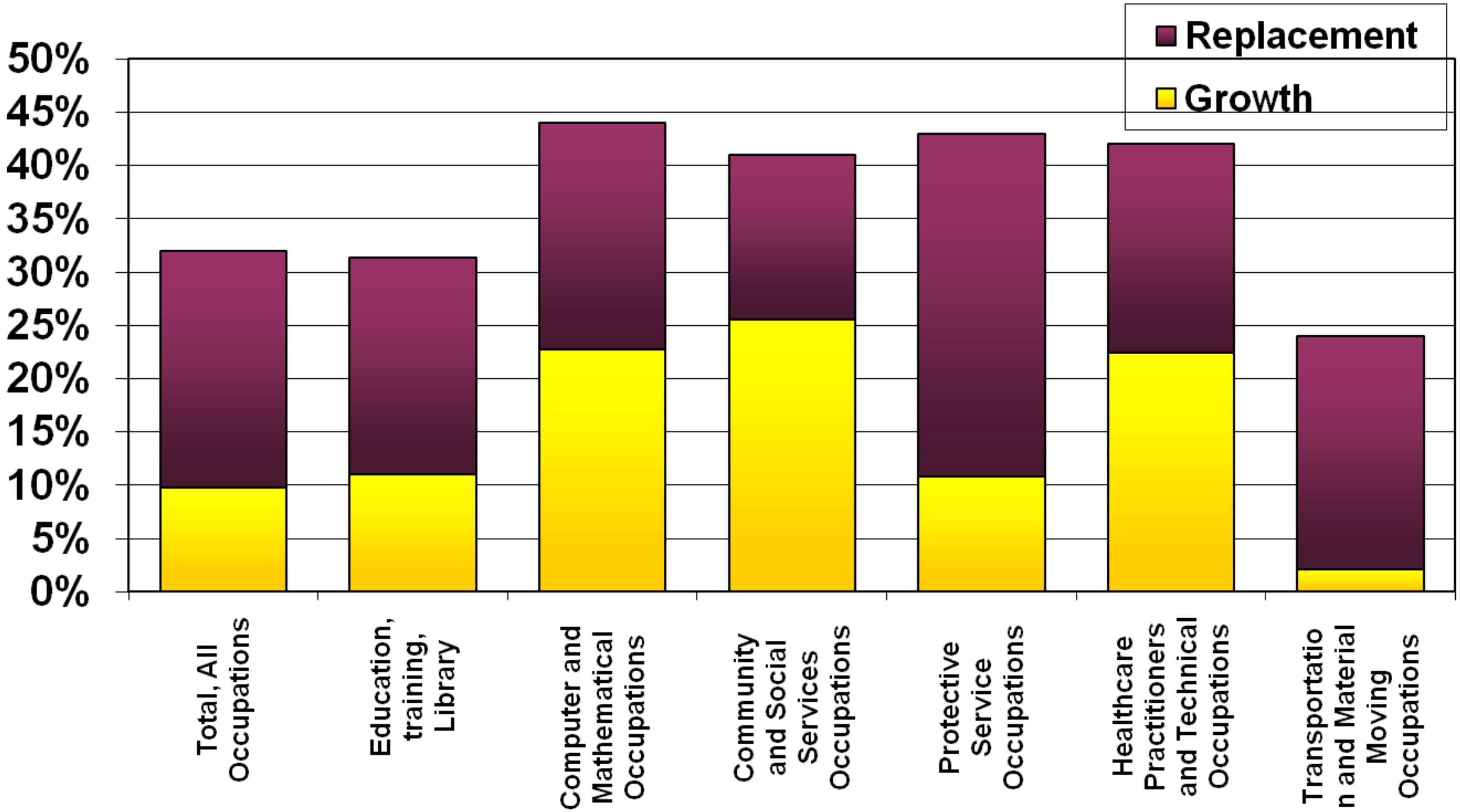
The Old Normal
+ The Great Recession
+ Long Run Demographic Changes
= The New Normal

The "New Normal" Probably Means

- Higher interest rates
- Labor and talent will be the scarce resources
- Slower economic growth
- A single-minded focus on productivity
- Increasing numbers of retirees
- A more diverse population
- More uncertainty about the future

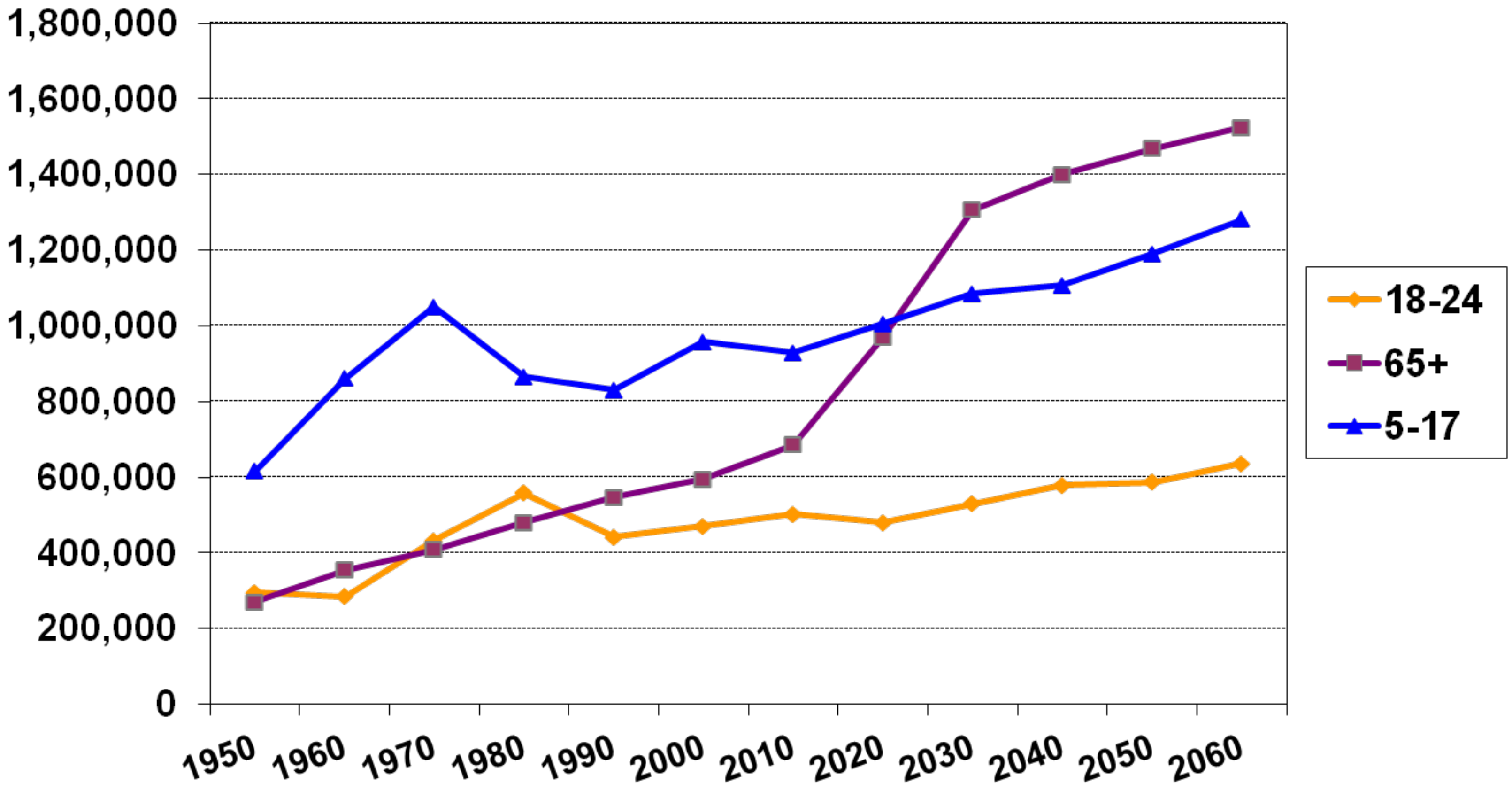
For Many Occupations, Replacements Will Outnumber New Job Growth

Projected Openings In Minnesota Occupations 2006-16



DEED projections. Percent of 2006 level

Budget Pressures Will Change
More 65+ Than School Age by 2020



Census counts & State Demographer projection, revised Jan 2012

Economic Facts of Life

Standard of Living depends on output per resident

Output = Output per Hour * Hours Worked

If the ratio of workers to residents declines productivity will need to increase if we are to maintain our current living standard

Productivity Is Not Just Producing at a Lower Cost

Increasing Productivity Also Means

- Making things better

  (improved quality)
- Making better things

  (innovation, new products)

Focusing Just On Expenditure Cuts May Be Short Sighted

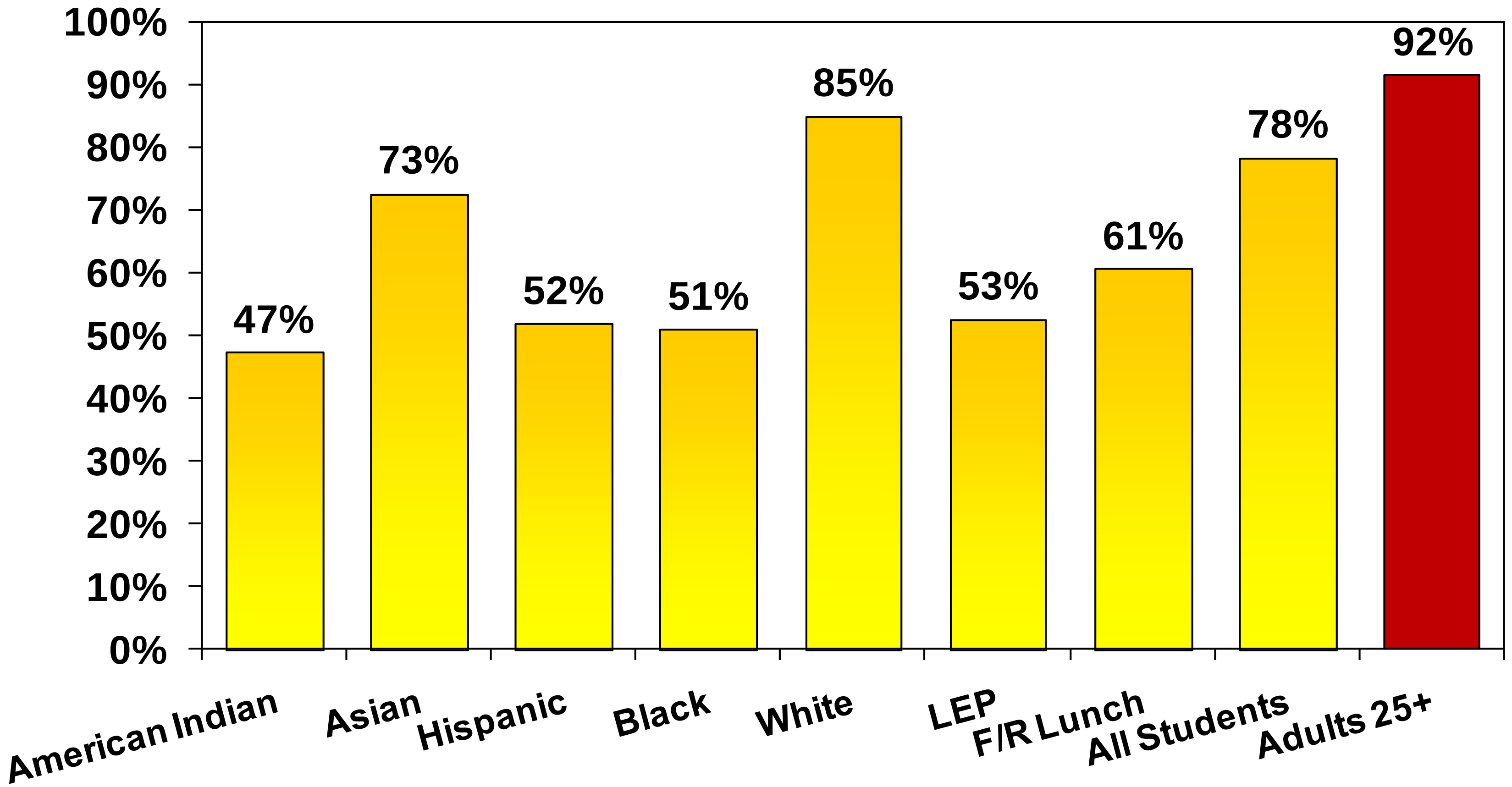
Long term cost saving may require investments which increase short term expenditures

The Fiscal Catch-22

- If we don’t make the necessary public investments in human capital, research and infrastructure, then we won’t have the productivity gains needed to provide the resources to make those investments in the future

Education Achievement Gaps Are Large

Minnesota High School Graduation Ratio



2009-10 Mn Dept of Education 5 year graduation rate.
Percent of 9th graders who graduate within 5 years. ACS 2009

Minnesota Has Been Very Successful

Especially For A Cold Weather State at the End of the Road

- Our economic growth rate has exceeded the national average
- Our population growth rate leads the frost belt
- We rank with the leaders on many social and economic indicators
- Education has been a key contributor to the state's success

Minnesota's Current Success Is Due to Decisions Made 50+ Years Ago

- **Far sighted private sector and public sector decision makers established the foundation for growth in Minnesota's economy**
- **Dealing with challenges brought by the baby boom was a key to our success**
- **Wise investments were made**

How will Minnesotan's 50 years from now view our generation's stewardship?

“I skate to where the puck will be, not to where it has been.”

Wayne Gretzky

Famous Canadian Philosopher