2025 Nebraska Budget Stress Test

Prepared by the Legislative Fiscal Office

2025 Budget Stress Test Report

Summary

Neb. Rev. Stat. sec. 50-419 requires the Legislative Fiscal Analyst to prepare a budget stress test comparing estimated future revenue to and expenditure from major funds and tax types under various potential economic conditions. This report analyzes revenues to the General Fund from the major sources of taxes (sales and use, individual income tax, corporate income tax, and miscellaneous tax) in different economic scenarios, expenditures from the General Fund most directly tied to an economic downturn, and the inventory of buffers available in these scenarios. The Legislative Fiscal Office (LFO) analyzes the total General Funds at risk, to revenues and expenditures, for the four-year period of FY2025-26 to FY2028-29.

LFO finds the inventory of buffers exceed the total General Funds at risk under the two economic downturn scenarios evaluated, but only if funds that are very difficult to access are included in the inventory of buffers.

Scenarios

For purposes of determining the General Fund revenue risk in this budget stress test, LFO utilizes three scenarios from Moody's Analytics published in October of 2025: baseline, slower-trend growth, and next-cycle recession. The assumptions for the scenarios are discussed in the following sections.

Baseline

This scenario, by definition, has a 50% probability that the economy will perform better than this and a 50% probability that it will perform worse. Key national variables for this scenario are shown in the following table.

Baseline	Percentage Change				
	FY2025-26	FY2026-27	FY2027-28	FY2028-29	FY2029-30
Nominal GDP growth	4.8%	4.3%	4.2%	4.4%	4.4%
Nominal Personal Income	4.7%	4.5%	4.0%	4.1%	4.4%
Nominal Corporate Profits	7.3%	1.1%	5.7%	5.9%	4.9%
CPI	3.2%	3.3%	2.3%	1.9%	1.8%
Interest Rates	-11.4%	-12.1%	-0.1%	1.0%	-2.3%
S&P 500 growth	10.7%	-2.4%	3.1%	7.0%	7.7%

Slower-Trend Growth

This scenario is a low-performance, long-term scenario where the economic underperforms indefinitely. This scenario includes the following key assumptions:

- The federal shutdown lasts two weeks, the same as in the baseline.
- Higher tariffs and deportations of immigrants weaken the economy more than expected.
- Elevated interest rates slow credit-sensitive spending more and longer than expected.
- The Russian invasion of Ukraine and tensions between China and Taiwan persist longer than expected.

Key national variables for this scenario are shown in the following table.

Slower-Trend Growth	Percentage Change				
	FY2025-26	FY2026-27	FY2027-28	FY2028-29	FY2029-30
Nominal GDP growth	4.7%	3.5%	3.0%	3.3%	3.8%
Nominal Personal Income	4.0%	3.5%	3.0%	3.3%	4.0%
Nominal Corporate Profits	9.3%	2.0%	1.5%	2.2%	2.9%
CPI	3.1%	3.0%	2.1%	1.5%	1.6%
Interest Rates	-13.8%	-12.4%	2.3%	0.9%	-2.3%
S&P 500 growth	9.6%	-3.9%	2.3%	5.2%	6.2%

Next-Cycle Recession

This scenario assumes the Federal Reserve's tight policy response to inflation leads to recession. This scenario includes the following key assumptions:

- Inflation accelerates back to more than 4% in the fourth quarter of 2025 and the first half of 2026. There are several drivers. First, President Trump raises tariffs more than expected, increasing the cost of imported goods and inputs into production. Second, deportations of immigrants cause labor shortages. Third, oil prices rise as tensions in Ukraine and the Middle East persist and sanctions are imposed on Iranian oil.
- The peak tariff rate is more than 21%, compared with 15.1% in the baseline, and tariffs remain elevated through the end of 2028.
- The federal government shutdown lasts for two weeks, the same as in the baseline.
- Rising inflation in the fourth quarter of 2025 and the first half of 2026 causes the Fed to stop lowering the fed funds rate for several quarters during which the economy decelerates but does not decline. However, recession begins in the third quarter of 2026, causing the Fed to lower the fed funds rate.
- The recession lasts three quarters.
- The unemployment rate peaks at 6.2% in the first quarter of 2027.
- The economy returns to full employment in the first quarter of 2029.

Key national variables for this scenario are shown in the following table.

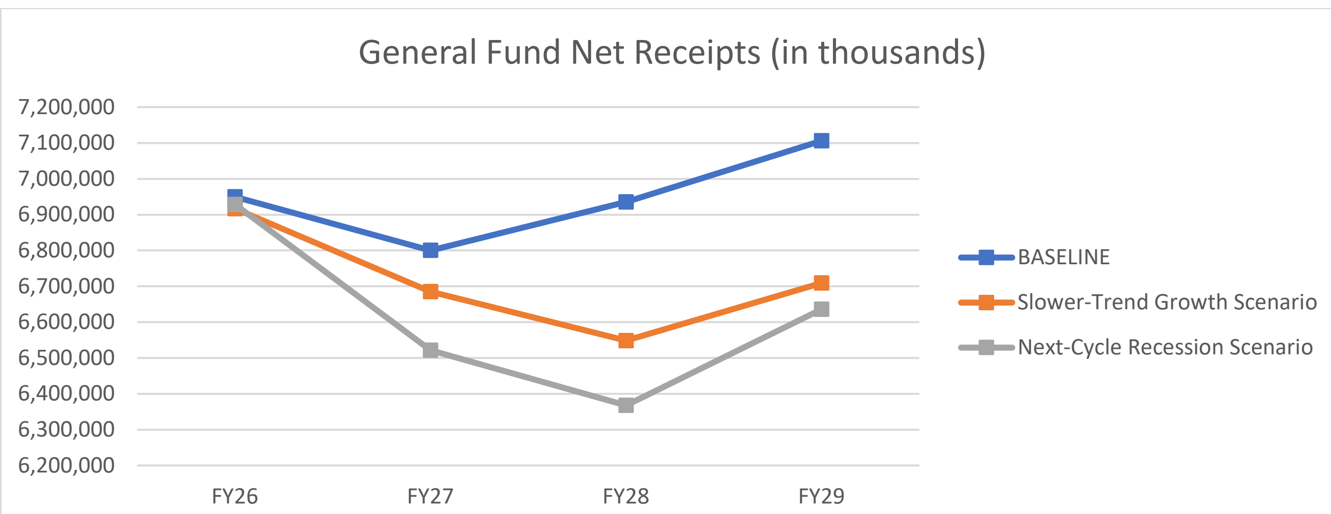
Next-Cycle Recession	Percentage Change				
	FY2025-26	FY2026-27	FY2027-28	FY2028-29	FY2029-30
Nominal GDP growth	5.0%	2.3%	3.9%	5.8%	5.1%
Nominal Personal Income	4.4%	2.1%	2.5%	4.2%	5.2%
Nominal Corporate Profits	7.8%	2.0%	4.0%	8.3%	5.4%
CPI	3.4%	3.4%	2.1%	1.9%	1.7%
Interest Rates	-4.5%	-11.8%	-6.9%	0.0%	-2.3%
S&P 500 growth	10.2%	-21.2%	6.4%	23.4%	11.8%

Revenue

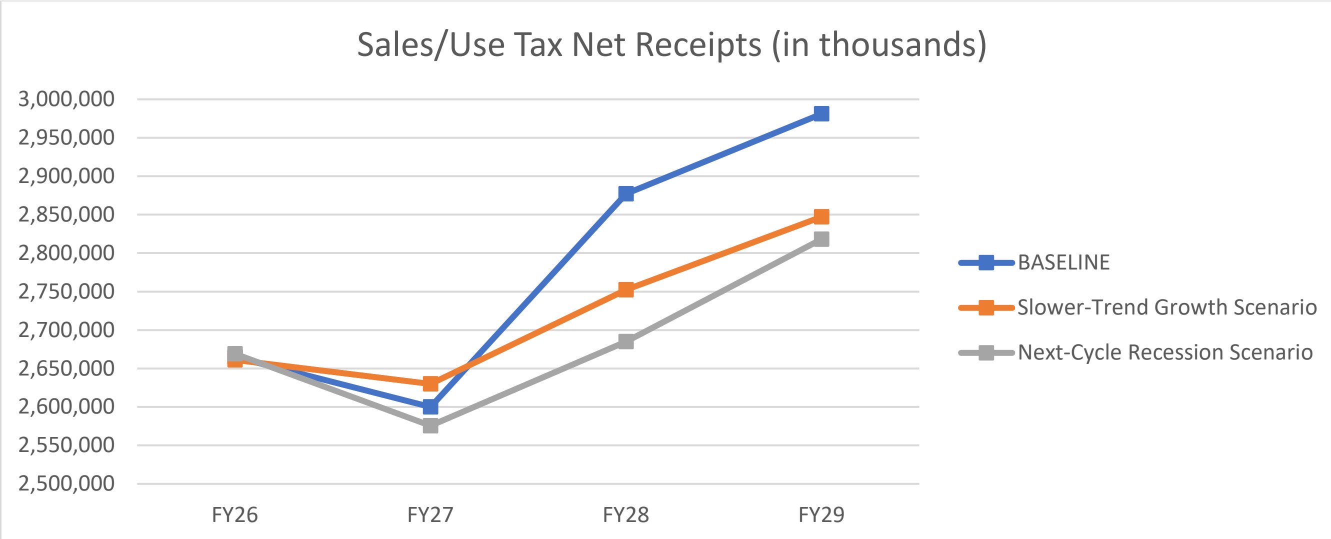
To compare the estimated revenue credited to the General Fund, the estimated General Fund revenue forecast from October 2023, set by the Nebraska Economic Forecasting Advisory Board, is utilized for FY2025-26 and FY2026-27 as the baseline forecast, and for FY2027-28 and FY2028-29, LFO estimated the baseline forecast for using Moody's baseline assumptions. LFO forecast revenue under the Slower-Trend Growth and Next-Cycle Recession scenarios for the four-year period as well, utilizing Moody's assumptions for each scenario. Revenue at risk is shown for each scenario as the difference between estimated tax collected in the baseline and estimated tax collected in each scenario. The net receipts are lower in each scenario evaluated for each fiscal year than in the baseline forecast. The cumulative revenue at risk over the four-year period is $932 million in the Slower-Trend Growth scenario and $1.337 billion in the Next-Cycle Recession scenario.

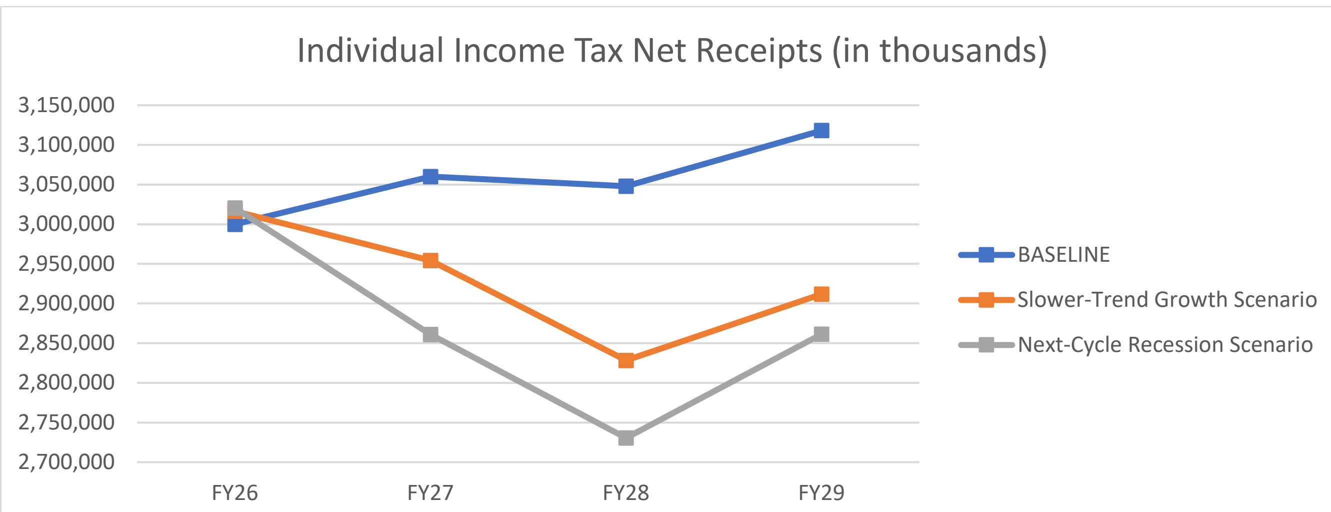
Total General Fund Revenue at Risk by Type of Tax FY2025-26 to FY2028-29 (in thousands)		
Scenario	**Slower-Trend Growth Scenario**	**Next-Cycle Recession Scenario**
Sales/Use Tax	232,408	375,061
Ind. Income Tax	515,622	752,829
Corp. Income Tax	198,932	221,313
Misc. Tax	(12,891)	(9,603)
Total	**932,071**	**1,337,600**

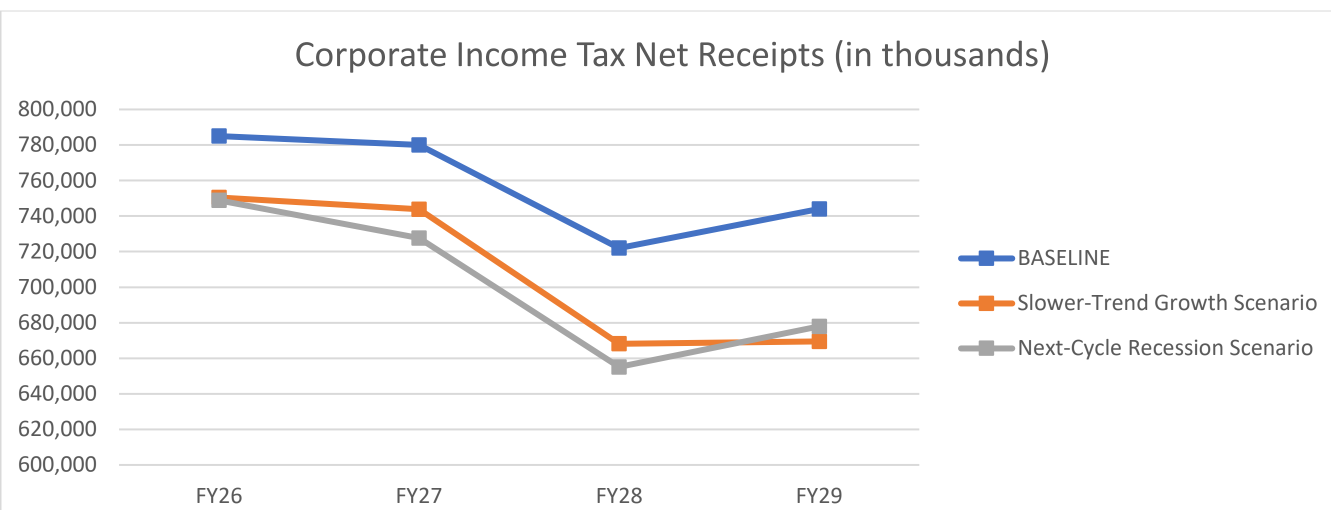
The following shows the estimated General Fund revenue by fiscal year in the three scenarios.

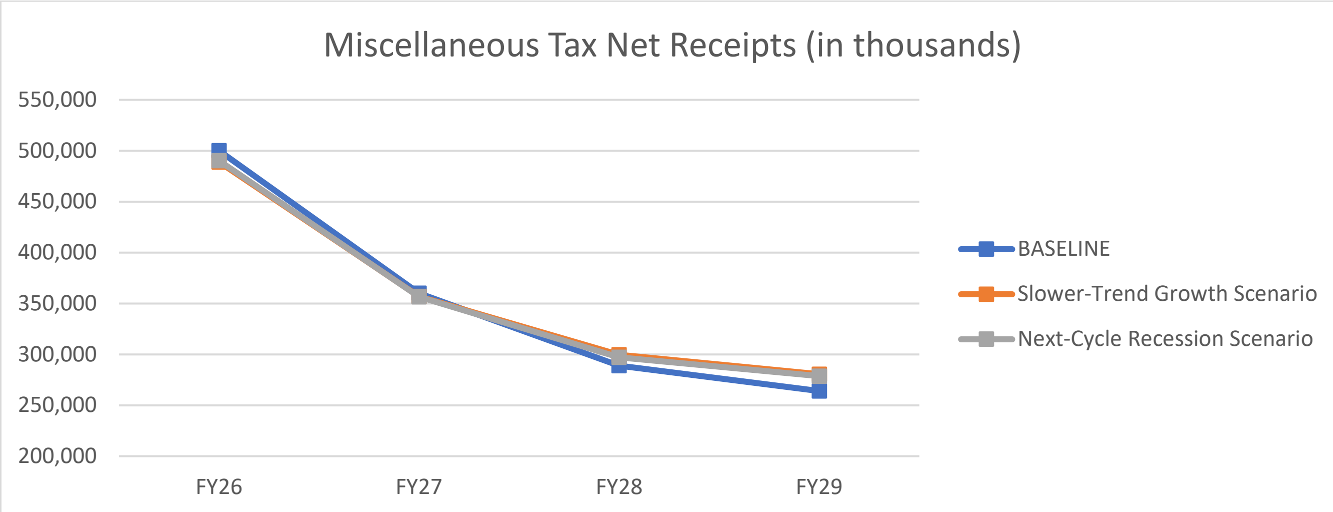


In addition to General Fund net receipts, the following charts display estimated net receipts by type of tax by fiscal year.









Expenditures

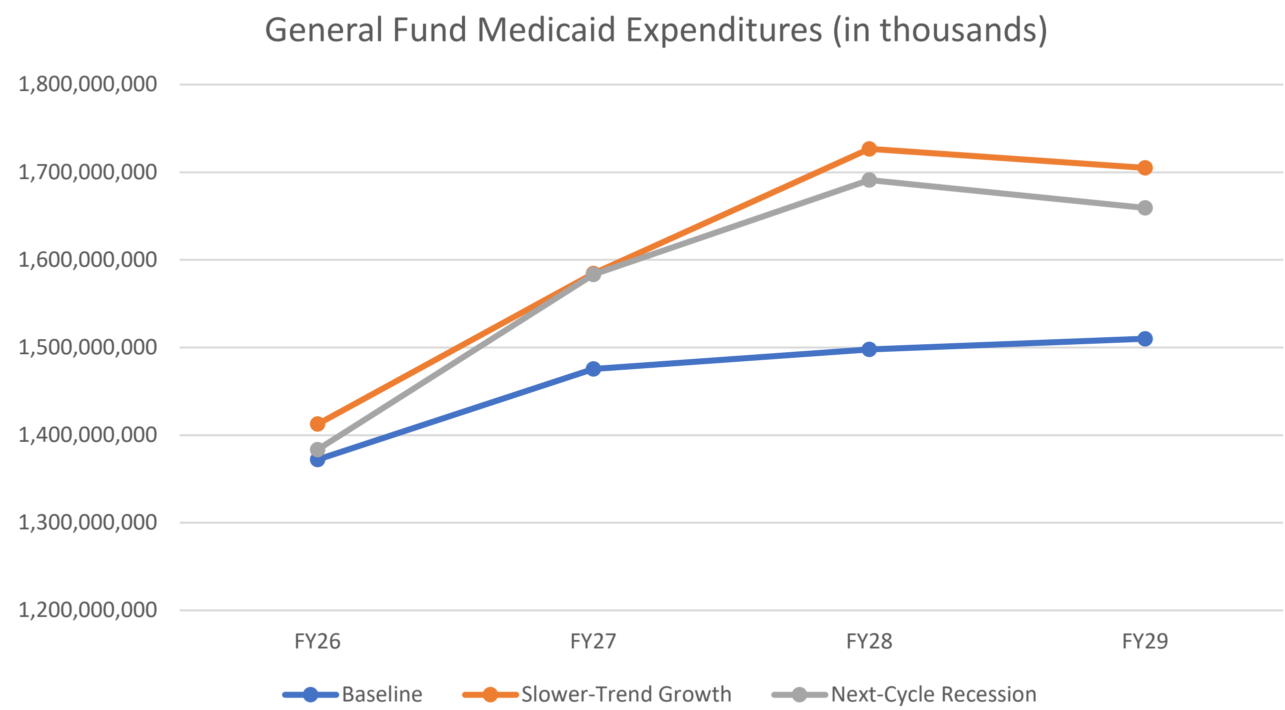
For purposes of this report, LFO focuses on the risk to state General Fund expenditures due to changes in the economic variables for each of the three scenarios previously described. In evaluating state expenditures in previous economic downturns, the expenditure displaying the most likely risk for increases directly related to those economic conditions was the Medical Assistance Program (Medicaid).

Expenditures pursuant to Medicaid are from state and federal sources. The federal portion is determined by the Federal Medical Assistance Percentage (FMAP), which is based on a state's per capita income as compared to national per capita income. The minimum FMAP by law is 50%. For purposes of this analysis, the FMAP for FY2025-26 and FY2026-27, used in all three scenarios, is calculated based on the actual federal fiscal year FMAP for Nebraska for the corresponding federal fiscal years. The calculated FMAP is 55.15% in FY2025-26 and 54.24% in FY2026-27. In the baseline scenario, the calculated FMAP of 54.20% is used in FY2027-28 and FY2028-29. In the Slower-Trend Growth and Next-Cycle Recession scenarios, the FMAP used in FY2025-26 and FY2026-27 is 50%, which is used to illustrate the compounded effect of a slowing economy and the lagged impact of a decline in the FMAP. In all scenarios, the federal contribution for Medicaid expansion enrollees is 90% and there are no anticipated changes to this percent.

For this expense, LFO forecasted Medicaid enrollment in traditional Medicaid and Medicaid expansion categories in each year based on assumptions related to each economic scenario. Historical increases were used to calculate a per-member, per-month (PMPM) rate for each enrollment category, which was then applied to the enrollment forecast to get estimated aggregate expenditures. Increased expenditures for both categories were aggregated to capture total expense risk. Total expenditures at risk over the four-year period are $573.1 million in the Slower-Trend Growth scenario and $461.8 million in the Next-Cycle Recession scenario.

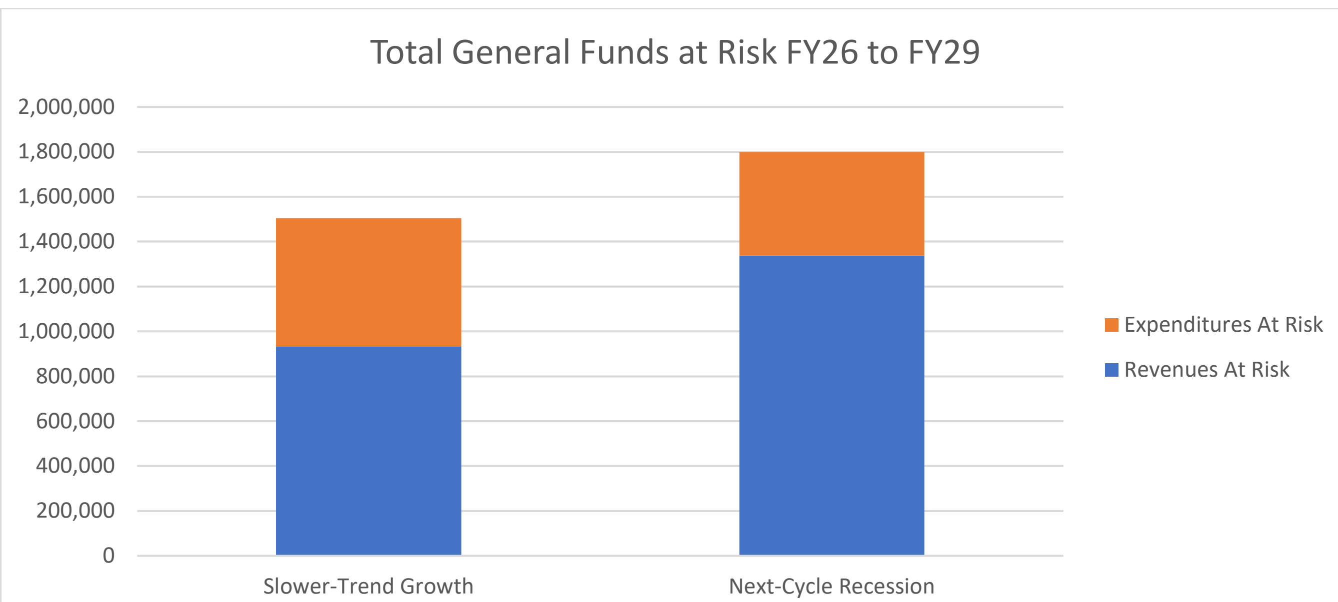
Total General Fund Expenditures at Risk FY2025-26 to FY2028-29 (in thousands)		
Scenario	**Slower-Trend Growth**	**Next-Cycle Recession**
Total	**573,102**	**461,815**

The following shows the estimated General Fund Medicaid expenditures by fiscal year in the three scenarios.



Total Funds at Risk

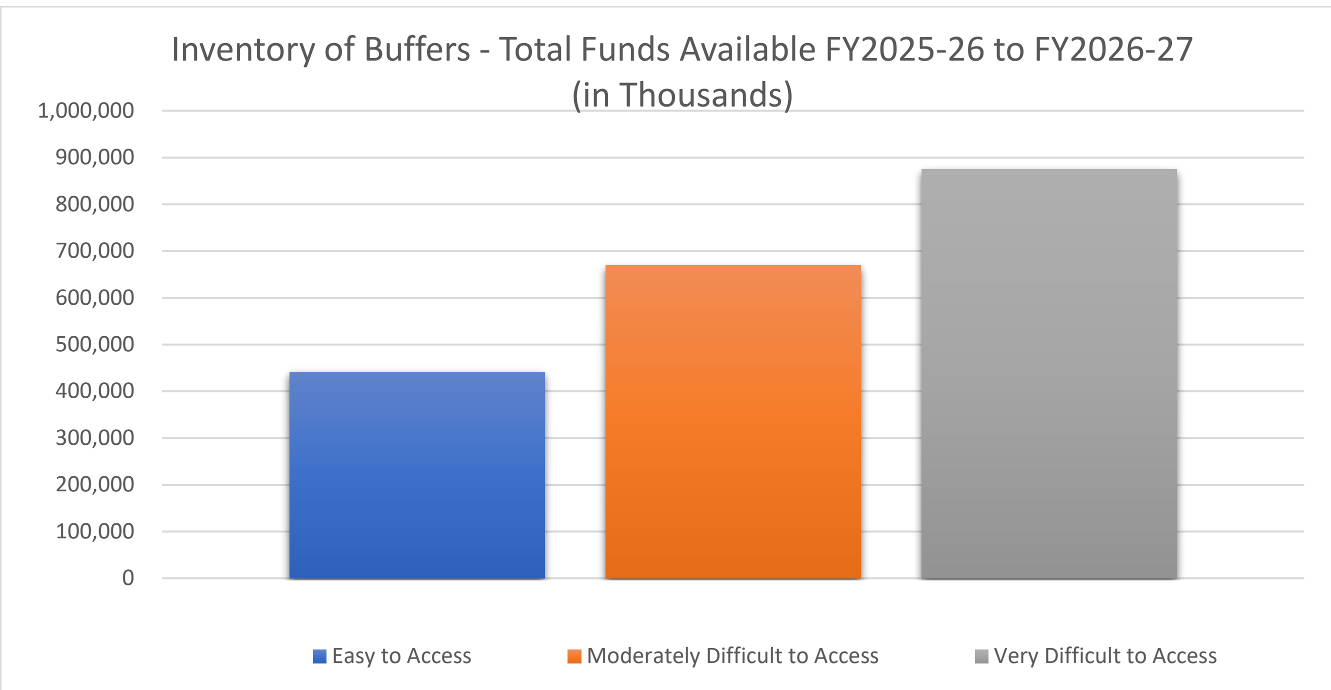
In combining the total revenue at risk and the total expenditures at risk, over the four-year period, there is estimated to be total funds at risk of $1.505 billion under the Slower-Trend Growth scenario and $1.799 billion under the Next-Cycle Recession scenario.



Inventory of Buffers

As of the November 2025 Tax Rate Review Committee Report, the General Fund is facing a deficit and has a projected unobligated balance below the minimum reserve of **$471.5** million for the FY2025-26/FY2026-27 biennium, which means that the Legislature will be required to balance the biennial budget in the upcoming 2026 session. Actions to balance the biennial budget may include utilizing some of the reserves identified in this report, thereby reducing the inventory of buffers available for an economic slowdown as contemplated in this report.

The state's Cash Reserve Fund has an unobligated balance of $569 million at the end of the four-year period. Additionally, reductions in state General Fund appropriations are contemplated, and state cash funds with unobligated balances have been used in past economic downturns to address a General Fund shortfall. LFO has analyzed these available budget reserves by ease of access over the four-year time period, and the totals are shown in the following table. It should be noted that some state funds are not included here due to limitation of access for the purpose of stabilizing the General Fund in times of economic downturn.



Easy to access funds total $441 million over the four-year period, moderately difficult to access funds total $668 million over the four-year period, and very difficult to access funds total $874 million over the four-year period. Funds in the easy or moderately difficult to access categories total $1.11 billion, which is insufficient to supplement the General Fund for the total value at risk in either scenario. The state has an estimated maximum total funds available of $1.98 billion over the four-year period in case of an economic downturn. This amount exceeds the estimated value at risk in the Slower-Trend Growth scenario by $479 million and in the Next-Cycle Recession scenario by $185 million, but would include the funds which are very difficult to access and would require significant policy changes to reduce or terminate certain state activities funded with General Funds and certain cash funds.