



COMMONWEALTH of VIRGINIA

Office of the Governor

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MEMORANDUM

TO: The Honorable Timothy M. Kaine
THROUGH: The Honorable William H. Leighty
FROM: Jody M. Wagner
SUBJECT: **December 2006 Revenue Data**

This month's revenue letter incorporates the revised general fund revenue forecast on which the introduced budget is based. It reflects the deliberations of the Governor's Advisory Board of Economists and the Advisory Council on Revenue Estimates. With the revisions, projected growth in general fund revenue for fiscal year 2007 is now 6.5 percent.

As you know, December and January are significant months for revenue collections. Growth can be distorted during this time of year due to several timing issues. In December, in addition to normal monthly collections of withholding and holiday sales taxes, quarterly estimated payments are due from most corporations and some fourth quarter nonwithholding payments from individuals are received. In addition, some withholding payments can be delayed by a larger volume of mail over the holidays, pushing some December payments into January. The bulk of sales tax collections from the holiday shopping season will be received in January. Finally, this December had one less deposit day than last year, but January will have one more day than last January. Due to all these factors, the months of December and January must be analyzed together to form an accurate assessment of revenue growth.

December revenue collections fell 2.6 percent from December of last year. On a year-to-date basis, total revenue has grown 4.2 percent, below the annual forecast of 6.5 percent. Adjusting total revenue for the effects of repealing the Accelerated Sales Tax program, growth is 2.0 percent through the first half of the fiscal year, behind the adjusted annual estimate of 5.4 percent growth.

National Economic Indicators

Most indicators suggest national economic growth has slowed, dampened by the impact of higher interest rates and the housing market.

- Real GDP grew 2.0 percent in the third quarter – down from the 2.6 percent pace in the second quarter and 5.6 percent in the first quarter.

The labor market is healthy -- payroll employment grew by 167,000 jobs in December, much stronger than expected. November gains were revised up from 132,000 to 154,000. In a separate report, the unemployment rate was unchanged at 4.5 percent.

- Initial claims for unemployment rose from 319,000 to 329,000 during the last week of December. The four-week moving average rose from 316,000 to 317,500. The initial claims report is consistent with a healthy labor market.
- Lower energy prices have led to lower inflation. The Consumer Price Index was unchanged at 201.7 percent in November, following declines of 0.5 percent in September and October. Core CPI, excluding food and energy, was also flat in November and was at 2.6 percent for the year.
- The Institute of Supply Management index rose from 49.5 to 51.4 in December. Although a reading above 50.0 suggests the sector is expanding, growth in this sector has slowed.
- The Conference Board's index of leading indicators rose 0.1 percent in November, its third consecutive increase. Growth in the index is consistent with a slowly growing economy.
- The Conference Board's index of consumer confidence reached an eight-month high in December, rising from 105.3 to 109.0. Both the present conditions and expectations components increased.
- At its December meeting, the Federal Reserve left the federal funds rate unchanged at 5.25 percent, where it has remained since June. It cited substantial cooling of the housing market. In its statement, the Federal Reserve indicated that the economy is likely "to expand at a moderate pace on balance over coming quarters."

Virginia Economy

In Virginia, payroll employment grew 1.4 percent in November. Growth in Northern Virginia remained well above the rest of the state, with a 2.8 percent gain. Jobs in Hampton Roads grew by 1.7 percent, followed by Richmond-Petersburg with 0.9 percent growth and the western MSAs with 0.7 percent growth. The unemployment rate rose slightly from 2.7 percent to 2.8 percent in November.

December Revenue Collections

General fund revenues fell 2.6 percent in December 2006 from December 2005. Through the first half of the fiscal year, total revenue has grown 4.2 percent, below the annual forecast of 6.5 percent. Adjusting total revenue for the effects of repealing the Accelerated Sales Tax program, growth is 2.0 percent through December 2006, behind the adjusted annual estimate of 5.4 percent growth.

Individual Income Tax Withholding (54% of general fund revenues): Collections of payroll withholding taxes grew only 1.2 percent in December. One less deposit day than December of last year contributed to the slow growth. Year-to-date withholding growth is 4.9 percent, lagging the projected annual growth rate of 5.7 percent.

Individual Income Tax Nonwithholding (18% of general fund revenues): Collections of nonwithholding fell 4.3 percent for the month. Year-to-date, collections in this source are 10.5 percent above the same period last year, tracking closely to the annual estimate of 10.2 percent.

December growth in nonwithholding can be distorted by the timing of payments. Taxpayers have until January 15 to submit their fourth estimated payment for tax year 2006, and January collections in this source are typically much higher than December collections.

In addition, monthly growth patterns in prior years have shown large swings between December and January. Strong growth in December is often followed by marked weakness in January and vice versa. A clearer assessment of

collections will be possible at the end of January, when all quarterly payments have been received.

Individual Income Tax Refunds: In December 2005, the transition to a new computer system required TAX to process a limited number of tax returns, resulting in few refunds in the fall. In December 2006, with the new system in place, TAX returned to a normal level of processing. Through December 2006, \$220.0 million in refunds has been issued compared with \$113.0 million in the same period last year.

Sales Tax (20% of general fund revenues): Collections of sales and use taxes, reflecting November sales, grew 5.6 percent in December 2006. As with individual nonwithholding, January receipts are needed to more accurately assess growth in this source because a large part of holiday sales tax collections will be received in January.

Year-to-date growth in sales and use taxes of 15.4 percent is inflated due to the repeal of the Accelerated Sales Tax program. Adjusting for the repeal of this program, growth in this source was 3.1 percent through December, compared with the 4.1 percent growth necessary to meet the annual estimate.

Corporate Income Tax (6% of general fund revenues): Collections of corporate income tax fell 21.4 percent in December. This is overstated since TAX did not issue many refunds last year because of controlled production, while this year, refund activity returned to more typical levels.

On a year-to-date basis, collections of corporate income tax have fallen 5.1 percent, well below the annual estimate of 3.4 percent growth.

Wills, Suits, Deeds, Contracts (4% of general fund revenues): Wills, suits, deeds, and contracts -- mainly recordation tax collections -- fell 15.8 percent in December as the housing market continued to slow. Year-to-date collections in this source have fallen 21.1 percent from last year.

Other Revenue Sources

The following list provides data on December collections for other revenue sources:

	Year-to-Date	Annual Estimate
Insurance Premiums Taxes (3% GF revenues)	-4.4%	2.9%
ABC Taxes (1.0% GF revenues)	4.6%	3.6%
Interest Income (0.6% GF revenues)*	83.1%	101.0%

All Other Revenue: Receipts in All Other Revenue fell 16.1 percent in December -- \$27.0 million compared with \$32.2 million in December of last year. Most of the decline was in inheritance, gift, and estate taxes. For the fiscal year, collections of All Other Revenue are 1.4 percent above fiscal year 2006, but behind the annual estimate of 3.4 percent growth.

Lottery Revenues: Net income of \$41.1 million in December was 1.4 percent below December of last year, due to a decline in sales across all online games. The largest decline in sales occurred in the jackpot games category as a result of lower advertised jackpots. Year-to-date, net income fell 6.7 percent, slightly better than the forecast of a 10.7 percent decline.

Summary

December revenue collections fell 2.6 percent from December of last year. On a year-to-date basis, total revenue has grown 4.2 percent, behind the annual forecast of 6.5 percent. Adjusting total revenue for the effects of repealing the Accelerated Sales Tax program, growth is 2.0 percent through the first half of the fiscal year, behind the adjusted annual estimate of 5.4 percent growth.

The timing of payments in December and January can significantly distort growth rates. Individual estimated payments

are due January 15, and the bulk of sales taxes from the holiday shopping season will be received in January. In addition, corporate payments from retailers will be received in January. December and January receipts must be considered together to get a clearer picture of revenue growth.