



COMMONWEALTH of VIRGINIA

Office of the Governor

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Secretary of Finance

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March 13, 2007

MEMORANDUM

TO: The Honorable Timothy M. Kaine
THROUGH: The Honorable William H. Leighty
FROM: Jody M. Wagner
SUBJECT: February 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. General fund revenues are projected to grow 6.5 percent in fiscal year 2007.

February is not typically a significant month for revenue collections, although it is the beginning of the individual income tax filing season. Total general fund revenue collections grew 5.0 percent in February compared to February 2006. On a year-to-date basis, revenues grew 4.1 percent over the same period last year.

Two factors are distorting growth – the end of the Accelerated Sales Tax Program in fiscal year 2006 and the controlled production at TAX due to implementation of new systems, which slowed processing of individual and corporate refunds during the first half of last year. Adjusting for these factors, revenues grew 4.6 percent through the first eight months of fiscal year 2007, behind the adjusted forecast of 5.4 percent annual growth.

National Economic Indicators

Most national indicators continue to depict a slowly expanding economy.

- The revised estimate of fourth quarter real GDP growth was 2.2 percent, down from 3.5 percent in the advance estimate.
- Employers added a modest 97,000 jobs to payrolls in February. December and January gains, however, were revised up by a total of 55,000 jobs. In a separate report, the unemployment rate fell slightly from 4.6 to 4.5 percent.
- Initial claims for unemployment fell from 338,000 to 328,000 during the week ending March 3. Although the number of initial unemployment claims fell by 10,000 from the prior week, the four-week moving average rose from 335,000 to 339,000 and is consistent with a healthy labor market.

- The Consumer Price Index increased 0.2 percent in January, following a flat November and a 0.4 percent increase in December. Core inflation, excluding food and energy, has increased 2.7 percent over the last year.
- The Institute of Supply Management index rebounded to 52.3 in February (up from 49.3 in January), indicating the manufacturing sector is expanding.
- The Conference Board's index of leading indicators rose 0.1 percent to 138.5 in January, following a 0.6 percent increase in December. Growth in the index is consistent with a slowly growing economy.
- The Conference Board's index of consumer confidence rose from 110.2 to 112.5 in January, its highest level since August 2001 and its fourth consecutive monthly gain. Improvement in the current assessment drove the gain.

Virginia Economy

The Virginia Employment Commission has released re-benchmarked employment data for calendar years 2005 and 2006. The revised data indicate that Virginia payroll employment increased 1.7 percent during calendar year 2006, equaling the rate of growth previously reported. Statewide, employment grew 1.2 percent in January. Northern Virginia posted job growth of 1.8 percent in January. Jobs grew by 1.4 percent in Hampton Roads, 2.0 percent in Richmond-Petersburg, and 2.1 percent in the western MSAs. The unemployment rate rose from 2.7 percent to 3.2 percent in January.

The Virginia leading index rose 0.2 percent in January, its second consecutive monthly increase. Rising auto registrations and declining initial unemployment claims drove the increase. Building permits posted a slight decline. The regional indices increased in four of the state's eleven metropolitan areas in January: Northern Virginia, Richmond, Hampton Roads, and Blacksburg. The leading index was unchanged in Roanoke and fell in the remaining MSAs.

February Revenue Collections

February is not typically a significant month for revenue collections, although it is the beginning of the individual income tax filing season. Total general fund revenue collections grew 5.0 percent in February compared to February 2006. On a year-to-date basis, revenues grew 4.1 percent over the same period last year.

Individual Income Tax Withholding (54% of general fund revenues): Collections of payroll withholding taxes grew 4.5 percent in February compared to February 2006. Year-to-date withholding growth is 6.4 percent, ahead of the projected annual growth rate of 5.7 percent.

Individual Income Tax Nonwithholding (18% of general fund revenues): February is not typically a significant month for nonwithholding collections. A total of \$58.3 million was collected in February, compared with \$48.1 million in February of last year.

To date, about 40 percent of the nonwithholding forecast has been collected, and collections during this period are 8.9 percent above the same period last year, which is below the projected annual growth of 10.2 percent. The majority of the remaining collections in this source will occur in April and May, with both final payments for tax year 2006 and estimated payments for the current year due May 1.

Individual Income Tax Refunds: In the latter half of 2005, the transition to a new computer system required TAX to process a limited number of tax returns in the fall, resulting in few refunds for that period. With the new system in place, TAX returned to a normal schedule for processing this year. Through February, \$618.1 million in refunds has been issued compared with \$450.0 million in the same period last year. For the filing season beginning January 1, about 873,000 refunds have been issued, compared with 803,000 issued in the same period last year.

Sales Tax (20% of general fund revenues): Collections of sales and use taxes, reflecting January sales, grew 12.4 percent in February. February receipts include post holiday sales and gift card purchases, and complete the holiday

shopping season. Based on collections for December, January, and February, reflecting taxable sales for November through January, sales during the holiday season grew 5.3 percent over last year, ahead of the projected increase of 3.0 percent.

Year-to-date growth in sales and use taxes of 12.4 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 3.7 percent through February, compared with the forecast of 4.1 percent adjusted growth needed to meet the annual estimate.

Corporate Income Tax (6% of general fund revenues): As with individual nonwithholding, February is not a significant month for corporate income tax collections. Corporate income tax collections were \$11.5 million in February 2007, compared with \$17.7 million in February of last year. Year-to-date collections are down 10.3 percent compared to the same period last year, which trails behind the annual projected growth of 3.4 percent.

Wills, Suits, Deeds, Contracts (4% of general fund revenues): Wills, suits, deeds, and contracts – mainly recordation tax collections fell 1.0 percent in February as the housing market continued to slow. Year-to-date collections in this source declined 18.6 percent from last year, close to the estimate of a 20.2 percent decline.

Other Revenue Sources

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

	Year-to-Date	Annual Estimate
Insurance Premiums Taxes (3% GF revenues)	-8.4%	2.9%
ABC Taxes (1.0% GF revenues)	4.3%	3.6%
Interest Income (0.6% GF revenues)*	59.8%	101.0%

All Other Revenue: Receipts in All Other Revenue fell 31.8 percent in February -- \$21.2 million compared with \$31.0 million in February of last year. Most of the decline was in inheritance, gift, and estate taxes. For the fiscal year-to-date, collections of All Other Revenue are 3.0 percent below the same period in fiscal year 2006, lagging the annual estimate of 3.4 percent growth.

Lottery Revenues: Net income of \$36.1 million in February was 18.8 percent below February of last year due to significant prize expenses for the month. Net income was lower because of higher prize payouts in Pick 3 and Pick 4, each game having a significant prize expense for the month due to the drawing of popular numbers during February. Year-to-date, net income fell 9.6 percent, slightly better than the forecast of a 10.7 percent decline.

Summary

February is not typically a significant month for revenue collections, although it is the beginning of the individual income tax filing season. Total general fund revenue collections grew 5.0 percent in February compared to February 2006. On a year-to-date basis, revenues grew 4.1 percent over the same period last year, lagging the annual estimate of 6.5 percent growth.

Two factors are distorting growth – the end of the Accelerated Sales Tax Program in fiscal year 2006 and the controlled production at TAX due to implementation of new systems, which slowed processing of individual and corporate refunds during the first half of last year. Adjusting for these factors, revenues grew 4.6 percent through the first eight months of fiscal year 2007, which is below the adjusted forecast of 5.4 percent growth.

Although total general fund collections are currently trailing the annual estimate, the forecast anticipates much of the fiscal year 2007 growth will occur in the fourth quarter. April and May are the next significant collections months for corporate and individual estimated and final payments, after which we will have a much clearer picture of fiscal year 2007 revenues.