



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: January Revenue Data

January is a significant month for revenue collections. Individual estimated payments, sales taxes on December sales, and corporate income tax payments from large retailers are due this month. Total general fund revenue collections grew 2.8 percent in January. Through January, revenues grew 4.0 percent on an unadjusted basis 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 seven months of fiscal year 2007, behind the adjusted forecast of 5.4 percent annual growth.

National Economic Indicators

Most national indicators depict an economy that continues to grow.

- Real GDP grew 3.5 percent in the fourth quarter of 2006 – up from 2.0 percent in the third quarter. For calendar year 2006, real GDP grew 3.4 percent.
- Employers added 111,000 jobs to payrolls in January, which was fewer than expected. December gains were revised up by 29,000 jobs to 206,000. In a separate report, the unemployment rate increased slightly from 4.5 to 4.6 percent.
- Initial claims for unemployment rose from 308,000 to 311,000 during the week ending February 3. The four-week moving average rose from 305,000 to 308,000. The initial claims report is consistent with a healthy labor market.
- The Consumer Price Index increased 0.5 percent in December, following a flat November and declines of 0.5 percent in both September and October. Core CPI, excluding food and energy, grew 0.2 percent in December and remained at 2.6 percent for the year. Amid volatile energy prices, underlying inflation appears to be stabilizing.
- The Institute of Supply Management index fell from 51.4 to 49.3 in January. A reading below 50.0 suggests the

sector is contracting.

- The Conference Board's index of leading indicators rose 0.3 percent in December. Growth in the index is consistent with a slowly growing economy.
- The Conference Board's index of consumer confidence rose from 110.0 to 110.3 in January, its highest level since May 2002. Improvement in the current assessment of labor market conditions drove the gain, while the expectations component declined.
- The Federal Reserve left the federal funds rate unchanged at 5.25 percent at its January meeting, where it has remained since June 2006. In its statement, the Federal Reserve indicated that the economy is likely "to expand at a moderate pace over coming quarters."

Virginia Economy

In Virginia, payroll employment grew 1.5 percent in December. Growth in Northern Virginia remained well above the rest of the state, with a 2.6 percent gain. Jobs in Hampton Roads grew by 2.1 percent, followed by Richmond-Petersburg and the western MSAs with 0.9 percent growth. The unemployment rate fell slightly from 2.8 percent to 2.7 percent in December.

Following three consecutive months of decline, the Virginia leading index rose 0.8 percent in December. Rising auto registrations and declining initial unemployment claims drove the increase. Building permits posted a slight decline. The regional indices increased in eight of the state's eleven metropolitan areas in December. The leading index was unchanged in Blacksburg and fell in Bristol and Harrisonburg.

January Revenue Collections

Total general fund revenue collections grew 2.8 percent in January. On a year-to-date basis, total revenue grew 4.0 percent, below the annual forecast of 6.5 percent on an unadjusted basis. Adjusting total revenue for the effects of repealing the Accelerated Sales Tax program and controlled production at TAX due to the implementation of new systems, growth is 4.6 percent through January, 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 an exceptionally strong 16.6 percent in January. An extra deposit day compared with January of last year, along with a timing issue of deposits by a few of the largest withholding filers in the state, overstated growth. Payments from these filers were received this year in January, while last year they were received in February. Adjusting for this anomaly, monthly growth was 8.2 percent. Unadjusted year-to-date withholding growth is 6.7 percent, ahead of the projected annual growth rate of 5.7 percent.

Individual Income Tax Nonwithholding (18% of general fund revenues): Collections of nonwithholding grew 5.0 percent for the month. While year-to-date collections in this source are 8.3 percent above the same period last year, they still lag behind the annual estimate of 10.2 percent growth.

The final calendar year 2006 estimated payment was due January 15. The two-month total (December – January) of receipts shows that estimated payments increased by 2.4 percent, behind the annual forecast of 5.0 percent growth.

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. With the new system in place, TAX returned to a normal schedule for processing this year. Through January, \$299.3 million in refunds has been issued compared with \$148.8 million in the same period last year.

Sales Tax (20% of general fund revenues): Collections of sales and use taxes, reflecting December sales, grew 1.0 percent in January. Based on collections for December and January, reflecting November and December taxable sales, sales during the holiday shopping season grew 2.9 percent over last year, close to the projected increase of 3.0 percent. February receipts, which will include post-holiday sales and gift card purchases, will provide a more complete picture of the holiday season.

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 2.7 percent through January, compared with the 4.1 percent adjusted growth needed to meet the annual estimate.

Corporate Income Tax (6% of general fund revenues): Through the first seven months of the fiscal year, collections of corporate income tax fell 9.5 percent, well below the annual estimate of 3.4 percent growth. The decline is misleading, however, since controlled production due to system changes delayed refunds last year and, this year, refunds are being processed on a normal schedule. Adjusting for last year's delay, net corporate income tax payments grew 7.6 percent.

Wills, Suits, Deeds, Contracts (4% of general fund revenues): Wills, suits, deeds, and contracts -- mainly recordation tax collections -- fell 14.8 percent in January as the housing market continued to slow. Year-to-date collections in this source declined 20.3 percent from last year, close to the estimate of a 20.2 percent decline.

Other Revenue Sources

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

	Year-to-Date	Annual Estimate
Insurance Premiums Taxes (3% GF revenues)	-7.7%	2.9%
ABC Taxes (1.0% GF revenues)	4.2%	3.6%
Interest Income (0.6% GF revenues)*	70.0%	101.0%

All Other Revenue: Receipts in All Other Revenue fell 3.9 percent in January -- \$52.0 million compared with \$54.2 million in January of last year. Most of the decline was in inheritance, gift, and estate taxes. For the fiscal year, collections of All Other Revenue were 0.4 percent above fiscal year 2006, but behind the annual estimate of 3.4 percent growth.

Lottery Revenues: Net income of \$30.3 million in January was 16.6 percent below January 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 quad and triple numbers during January. Year-to-date, net income fell 8.1 percent, slightly better than the forecast of a 10.7 percent decline.

Summary

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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 seven 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. Individual nonwithholding payments were weaker than expected in the December-January timeframe. Using historical collection patterns as a guide, receipts are barely within the bounds of what is required to attain the annual forecast. April and May are the next significant collections months for corporate and individual estimated and final payments.