



COMMONWEALTH of VIRGINIA

Office of the Governor

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MEMORANDUM

TO: The Honorable Mark R. Warner

THROUGH: The Honorable William H. Leighty

FROM: John M. Bennett

SUBJECT: October Revenue Data

Total general fund revenue collections increased \$82.9 million above collections for last October - a 10.2 percent increase. Of the \$82.9 million, \$66.6 million came in payroll withholding, largely as the result of a fifth Friday payroll deposit day for the month. Last year, this Friday deposit day occurred in November. Through the first four months of this fiscal year, revenues have grown 7.9 percent over the same period last year -- ahead of the annual estimate of 4.6 percent growth.

On a related note, Tax Amnesty ended on November 3, 2003. While a final accounting will not be available until later this month, it appears that the Commonwealth will reach the \$48.8 million budgeted.

[Note: In order to more accurately compare revenue collections with the official revenue forecast, this and subsequent monthly reports will exclude from the posted total the \$32.4 million in enhanced federal Medicaid reimbursement which was deposited in July. Because the July reimbursement represented the federal share of Medicaid expenses incurred during FY 2003, accounting rules require that the payment be recorded as revenue, rather than as a budget savings, which will be the case for enhanced federal reimbursement for the remainder of FY 2004. The tables detailing revenue collections will footnote that fact each month.]

National Economic Indicators

The national economy is strengthening, with evidence that the job market is finally improving. Recent indicators, including those describing labor market conditions, depict a generally healthy economy.

- Third quarter real GDP growth advanced at the fastest rate since the first quarter of 1984, with growth of 7.2 percent. Consumption grew 6.6 percent and fixed investment posted a double-digit gain. Overall growth was broad-based, with stimulus from child care tax credits, lower federal income tax withholding, and home refinancings.

- Payroll employment rose by 126,000 jobs in October, following a revised gain of 125,000 jobs in September. Job gains of 286,000 over the last three months indicate that the labor market has begun to turn around. Driven by these gains, the

unemployment rate fell one-tenth of a percentage point in October to 6.0 percent.

- Initial claims for unemployment fell to 348,000 during the last week of October. The four-week average has been below the break-even 400,000 level for five consecutive weeks. The four-week moving average of 380,000 is its lowest since the beginning of calendar year 2001.

- The manufacturing sector continues to expand, albeit modestly. The Institute of Supply Management index advanced to 57.0 in October -- the fourth straight month above the break-even 50.0 mark.

- The Consumer Price Index rose 0.3 percent in September as energy prices posted a second straight month of strong gains. The rate of core inflation increased by just 0.1 percent, pushing the measure to 1.2 percent over the last year - very low by historical standards.

- The Conference Board's index of consumer confidence rose just over four points in October, reversing most of September's decline. The "present situation" index had a larger gain than the "expectations index," mostly due to improving labor market conditions.

- The Conference Board's index of leading indicators fell 0.2 percent in September. The index fell largely because the two components weighted most heavily - money supply and the spread between Federal Funds and 10-year Treasury notes - dropped slightly. Four of the index's ten components grew during the month, the strongest of which was industrial production.

- The Federal Reserve left interest rates unchanged at its mid-October meeting.

Virginia Economy

In Virginia, payroll employment grew 0.2 percent above September of last year, with the unemployment rate remaining steady at 3.8 percent. With 1.0 percent growth in September, Northern Virginia has now experienced nine consecutive months of job growth. Rural Virginia is also seeing some steady improvements. Outside the state's eight major metropolitan areas, job growth has been positive for the last 5 months -- rebounding from a 1.6 percent decline in total employment to an increase of 0.8 percent in September. Employment outside the eight major metropolitan areas accounts for about 17 percent of the total workforce.

The Virginia Leading Index registered flat growth in September after rising for the past four months. The leading indices for the eight major metropolitan areas were also mixed in September, with the sharpest declines in Lynchburg and Danville.

October Revenue Collections

Due principally to strong collections in payroll withholding, October revenues increased by \$82.9 million above last year - a 10.2 percent increase. Continuing strength in corporate estimated payments and recordation receipts along with lower refund activity contributed to the monthly growth. Growth through the first four months of fiscal year 2004 is 7.9 percent -- ahead of the estimate of 4.6 percent annual growth.

Individual Income Tax Withholding (62% of general fund revenues): With the additional Friday deposit day, collections in withholding grew 12.3 percent above last October. Tax data reveal that approximately \$35 million - or about one half of the monthly increase - was due to the fifth Friday deposit day. Also contributing to October's growth were payments by quarterly and monthly filers, most of whom are small businesses.

For the first time since October 2000, October collections increased, with businesses apparently gearing up for the all-important holiday shopping season. Year-to-date withholding growth is 6.6 percent - close to the 6.5 percent growth required to meet the annual estimate. Adjusting for the Friday anomaly, withholding is growing closer to 4.9 percent, below the annual estimate but stronger than at the beginning of the calendar year

Individual Income Tax Nonwithholding (12% of general fund revenues): October is typically a slow month for

nonwithholding payments. Collections in this source were \$31.9 million compared to \$34.8 million last October. Year-to-date collections are 0.4 percent ahead of collections for the same period last year - exceeding the forecast of a 4.8 percent decline.

Individual Income Tax Refunds: October is typically a slow month for issuing refunds. Through the first four months of the fiscal year, \$111.0 million in refunds have been issued, compared with \$152.4 million for the same period last year -- a decline of \$41.4 million (27.2 percent). This decline is due to faster processing during last spring's filing season and extension returns being processed with lower refund requests. This decline in the dollar amount of refunds issued accounts for about 1.4 percent of the 7.9 percent revenue growth thus far this fiscal year.

Sales Tax (22% of general fund revenues): Collections of sales and use taxes increased by 2.3 percent in October. Growth for the first four months of the fiscal year is 5.4 percent - close to the 5.3 percent growth required to meet the annual estimate. Sales in the first four months of the fiscal year have been buoyed by tax rebates, reductions in federal income tax withholding, and record levels of cash-out mortgage refinancings. Sales in the upcoming months - and especially during the holiday shopping season - will indicate more clearly the strength of sales tax collections.

Corporate Income Tax (3% of general fund revenues): October activity in corporate income tax represents payments by corporations that have a fiscal year beginning in February. These corporations have estimated payments due in October rather than September. Taken together with September's activity, the first estimated payment of the fiscal year is running about 12 percent ahead of last year's payments. Year-to-date growth for the first four months of fiscal year 2004 is 27.7 percent -- well ahead of the annual estimate of an 8.0 percent decline. The processing of returns for corporations which requested a filing extension is now underway. These returns will provide insight into the strength in corporate income tax collections.

Insurance Premiums Tax (3% of general fund revenues): Through October, collections of insurance premiums tax were 12.9 percent behind last year. Refunds issued in November last year were issued in October this year - affecting year-to-year comparisons. Adjusted for the refund anomaly, year-to-date growth is 2.5 percent, exceeding the annual estimate of 0.9 percent growth.

Other Revenue Sources

The following table provides data on October collections of other important revenue sources:

	Year-to-Date	Required to Meet Estimate
ABC Taxes (1.1% GF revenues)	8.8%	-0.5%
Public Service Corporations (0.7% GF revenues)	-14.6%	-8.2%
Interest Income (0.7% GF revenues)	-25.7%	-2.1%

All Other Revenue. Revenue from all other sources increased 20.2 percent in October, with \$65.1 million in collections compared with \$54.1 million in October of last year. Collections of wills, suits, deeds and contract fees (primarily recordation taxes) showed continued strength, and accounted for all the growth in All Other Revenue this month. Two of the last four months have included record-setting amounts of recordation receipts, due primarily to low interest rates and a high level of refinancing activity. Refinancing activity has retreated from close to 88 percent of all mortgage applications this past summer to 51 percent in October, pointing to weaker recordation tax collection in the months ahead.

On a year-to-date basis, collections of all other revenue are 17.9 percent above the same period last year - well ahead of the annual forecast of a 2.7 percent decline.

Lottery Revenues. In October, Lottery net income increased 1.7 percent over last year, as double digit growth in scratch game sale offset weak growth in daily games and jackpot sales. On a year-to-date basis, growth of 3.2 percent is above the annual revenue estimate of -1.0 percent.

Summary

Revenue collections grew 10.2 percent in October. For the first four months of the fiscal year, total general fund revenue collections are up 7.9 percent, ahead of the annual estimate of 4.6 percent growth.

Although there are clear signs that the expected economic recovery is underway, current total revenue collections are somewhat overstating the strength of the recovery. Payroll withholding and sales tax collections, which account for 84 percent of all revenues, have grown 5.0 percent through the first four months of the year. Strong growth in recordation taxes collections and corporate income tax payments, combined with fewer refunds of individual income taxes individual refunds, are buoying the growth rate above this level.

The fall revenue forecasting process is underway. The Governor's Advisory Board of Economists met in October to review the economic forecast over the next biennium. The Governor's Advisory Council on Revenue Estimates will meet this month to review the economic forecast and preliminary general fund revenue estimates. This forecast will serve as the basis for the revised revenue forecast, which will be presented in December.