



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 Collections

October is not a major collections month for general fund revenue. Normal monthly collections are due in withholding, sales taxes, public service corporations, and most other sources. Estimated payments are also filed in October for corporations which use a February through January fiscal year - mainly retailers.

Total general fund revenue collections grew 7.7 percent in October. Most of the October revenue growth was due to strength in payroll withholding, some of which is due to timing of payments. Continued strength in individual nonwithholding, corporate income, and recordation taxes also contributed to the growth. Year to date, revenues have grown 12.8 percent over the same period last year.

Tax policy changes enacted over the last two sessions have been distorting growth rates over the last year - particularly in sales and recordation taxes. Beginning this month, these changes have been in effect for a full year, meaning that monthly growth rates will more fully reflect underlying economic growth. The only remaining anomaly is the additional reduction in the sales tax on food, which went into effect on July 1.

The Department of Taxation continued its conversion process to the new Integrated Revenue Management System (IRMS) in October. The conversion has slowed the processing of individual refunds through the first four months of the fiscal year. Many of the individual and corporate estimated payment vouchers also remain to be entered into the system. Therefore, much of the data necessary to more fully analyze revenue flows is still not available. IRMS is expected to be more fully functional in November and should provide much of the data necessary to provide a comprehensive revenue analysis.

This month's revenue report displays in the first column the forecast contained in Chapter 951. The last column reflects the percent annual growth required by the estimate as compared to actual fiscal year 2005 collections. These growth rates represent growth needed to meet the amounts on which the current Appropriations Acts is based, and should not be interpreted as an updated forecast. The fall forecasting process will produce a revised revenue forecast in December.

National Economic Indicators

Most recent indicators suggest the national economy was healthy leading up to the hurricanes. More recent data show that the storms temporarily disrupted but did not stall economic growth.

- Real GDP grew 3.8 percent in the third quarter, up from second-quarter growth of 3.3 percent. Hurricane Katrina's arrival late in the quarter had very little impact on third quarter GDP.
- Payroll employment increased by 56,000 jobs in October – well below most experts' expectations. September's initial estimate of a 35,000-job loss was reduced to an 8,000 loss. Thus far, about 521,000 claims have been filed for unemployment insurance due to the hurricane, although this has been offset somewhat by jobs created by rescue and clean-up efforts.
- Initial claims for unemployment fell to 323,000 during the last week of October. The four-week moving average fell to 351,000.
- Personal income statistics were distorted by the hurricanes, but growth was still evident. Personal income rose 1.7 percent in September after falling a revised 0.9 percent in August. Wage and salary income grew 0.3 percent in September.
- Manufacturing activity remains healthy. The *Institute of Supply Management* index fell slightly in October but remains relatively high at 59.1 percent.
- The Conference Board's index of consumer confidence fell another 2.5 points in October, after dropping 18 points in September. Both the present conditions and expectations components declined.
- The Conference Board's index of leading indicators fell 0.7 percent in September - the third consecutive decline. The decline was led by the sharp drop in consumer confidence and jump in initial claims which resulted from the hurricane.
- The consumer price index rose 1.2 percent in September, with a 12.0 percent increase in energy prices. Core inflation, however, rose 0.1 percent for the fifth consecutive month.
- The Federal Reserve raised the federal funds rate another quarter point to 4.00 percent at its meeting on November 1-the twelfth consecutive increase.

Virginia Economy

In Virginia, payroll employment grew by 1.2 percent in September, compared with the same month last year. In Northern Virginia, payrolls grew by 3.3 percent, followed by Richmond-Petersburg with 2.6 percent growth, the western MSAs with 2.1 percent growth, and Hampton Roads with 1.1 percent growth.

The Virginia Leading Index fell by 1.4 percent in September after rising 1.2 percent in August. Auto registrations, building permits and the U.S. leading Index all contributed to the decline. The only positive component of the index was a drop in initial unemployment claims.

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Individual Income Tax Withholding (57% of general fund revenues): Collections of payroll withholding taxes grew 9.2 percent in October. Growth was boosted by comparison to a very weak October of 2004. Last year, some payments normally received on the last day of October fell into November, producing an apparent 3.4 percent decline for the month. This October's collections therefore appear stronger than they were. Year-to-date, withholding growth has been 7.8 percent.

Individual Income Tax Nonwithholding (14% of general fund revenues): October is typically not a significant month for nonwithholding collections. This October, a small number of individuals who filed returns, based on the July-June tax year, made large payments. Collections of nonwithholding were therefore up 34.2 percent for the month. Year-to-date collections of nonwithholding are up 23.7 percent.

Individual Income Tax Refunds: In October, TAX continued implementing its new accounting system. Processing of refunds improved, but remains below full production levels. In October, TAX issued \$31.6 million in refunds, compared with \$35.4 million last year. Fiscal year-to-date, \$82.0 million in refunds have been issued, compared to \$123.2 million in the same period last year.

Sales Tax (22% of general fund revenues): This monthly report for sales and use taxes represented September sales. Collections for sales and use taxes showed no growth for the month. Rising energy prices likely contributed to the zero growth performance. Year-to-date growth through October stands at 7.1 percent.

Monthly comparisons of sales and use taxes now are based on the same tax rate, but for the remainder of this fiscal year will continue to be influenced by the reduced sales tax on food.

Corporate Income Tax (4% of general fund revenues): October corporate income tax collections include estimated payments from corporations with a February through January fiscal year, which includes many retailers.

Monthly collections grew 29.9 percent in October. Year-to-date collections have grown 63.9 percent over the same period last year.

Other Revenue Sources

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

	Year-to-Date	Required to Meet Estimate
Insurance Premiums Taxes (3% GF revenues)	-2.9%	10.7%
ABC Taxes (1.1% GF revenues)	6.1%	-0.5%
Public Service Corporations (0.7% GF revenues)	6.8%	0.3%
Interest Income (0.7% GF revenues)*	20.7%	-0.2%

**Interest income for the July-September quarter attributable to nongeneral funds was transferred in October.*

All Other Revenue: All Other Revenue fell by 1.9 percent in October. Substantial growth in the largest component of All Other Revenue - wills, suits, deeds, and contract fees - helped to offset an \$11.7 million decline in estate tax collections. Wills, suits, deeds, and contract fees (mostly recordation tax receipts) grew by 16.7 percent in October. For the fiscal year, collections of All Other Revenue are 12.7 percent above fiscal year 2006 - ahead of the annual estimate of a 15.6 percent decline.

Lottery Revenues: Lottery net profits fell 3.4 percent for the month. An increase of 5.5 percent in gross sales was offset by higher overall expenses. Through the first four months of the year, net profits are 3.3 percent ahead of the same period last year. During the fall forecasting process, the Lottery forecast will be updated to include the estimated impact of a North Carolina lottery.

Summary

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Tax policy changes enacted over the last two sessions have been distorting growth rates over the last year - particularly in sales and recordation taxes. Beginning this month, these changes have been in effect for a full year, meaning that monthly growth rates will more fully reflect underlying economic growth. The only remaining anomaly is the 1.5 percent reduction in the sales tax on food, which went into effect on July 1.

The fall revenue forecasting process has begun. The Governor's Advisory Council on Revenue Estimates (GACRE) will meet in November to assess the outlook for the Virginia economy over the current and next biennium, and to review a preliminary revenue forecast. The Council's review will lead to the revised revenue forecast on which the Executive Budget will be based.