



# COMMONWEALTH of VIRGINIA

## Office of the Governor

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November 13 , 2006

### MEMORANDUM

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

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

General fund revenues grew 0.6 percent in October 2006 compared to October of last year. Solid gains in individual income taxes offset weaknesses in most other sources. Monthly growth is understated, since refunds in both individual and corporate income taxes were limited last year as TAX implemented its new accounting system. This year, processing has returned to a normal level. In addition, refunds of insurance premiums taxes were issued in October this year compared to November last year.

On a year-to-date basis, total revenue grew 5.9 percent, which is ahead of the annual forecast of 4.2 percent. Adjusting total revenue for the effects of repealing the Accelerated Sales Tax program, growth is 2.4 percent through October, which is behind the adjusted annual estimate of 3.1 percent growth.

### **National Economic Indicators**

National economic growth has slowed, dampened by the impact of higher interest rates and a slower housing market.

- Real GDP grew 1.6 percent in the third quarter of the calendar year – substantially down from the 2.6 percent pace in the second quarter and 5.6 percent in the first quarter.
- Payroll employment grew by 92,000 jobs in October – much weaker than expected. Upward revisions to August and September job gains, however, added 139,000 jobs to payrolls. That brings average monthly gains for the last three months to 157,000, which is consistent with a growing economy. In a separate report, the unemployment rate fell slightly from 4.6 to 4.4 percent.
- Initial claims for unemployment rose from 309,000 to 327,000 during the last week of October. The four-week moving average rose from 306,000 to 311,000. The initial claims report is consistent with a healthy labor market.

- A substantial drop in energy prices drove the Consumer Price Index down 0.5 percent in October, following a 0.2 percent increase in August. Core inflation (excluding food and energy) rose 0.2 percent for the third consecutive month, which is down from the 0.3 percent increases seen earlier in the year.
- The Institute of Supply Management index fell from 52.9 to 51.2 in October. This is the lowest reading since June of 2003, but remains in the range indicating industry expansion.
- The Conference Board's index of leading indicators rose 0.1 percent in September, representing the first increase in three months.
- The Conference Board's index of consumer confidence was essentially flat in October, slipping slightly from 105.9 to 105.4, and remains in the relatively high range seen prior to Hurricane Katrina.
- The Federal Reserve left the federal funds rate unchanged at 5.25 percent at its October meeting, as it did in August and September. It cited moderating growth partly due to the cooling housing market. In its statement, the Federal Reserve indicated that, "Going forward, the economy seems likely to expand at a moderate pace."

## Virginia Economy

In Virginia, payroll employment grew 1.4 percent in September. Growth in Northern Virginia remained well above the rest of the state with a 2.7 percent gain. Jobs in Hampton Roads grew by 1.6 percent, followed by the western MSAs with 1.3 percent growth. Employment fell 0.1 percent in the Richmond-Petersburg area. The unemployment rate declined from 3.2 percent to 3.1 percent in September.

The Virginia leading index fell 0.4 percent in September resulting in the fourth decline in the last five months. All three components of the index contributed to the decline. Building permits and auto registrations fell, and initial claims for unemployment rose slightly.

## October Revenue Collections

General fund revenues grew 0.6 percent in October 2006 compared to October of last year. Solid gains in individual income taxes offset weaknesses in most other sources. Monthly growth is somewhat understated, since refunds in both individual and corporate income taxes were limited last year as TAX implemented its new accounting system. This year, processing has returned to a normal level. In addition, refunds of insurance premiums taxes were issued in October this year compared to November last year.

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**Individual Income Tax Withholding (55% of general fund revenues):** With an additional deposit day compared to the same month last year, collections of payroll withholding taxes grew 7.5 percent in October. Year-to-date withholding growth is 4.9 percent, lagging the projected annual growth rate of 5.3 percent.

**Individual Income Tax Nonwithholding (16% of general fund revenues):** October is typically a slow month for nonwithholding collections. Collections of nonwithholding were \$90.8 million compared to \$70.6 million last October. Year-to-date, collections in this source are 9.2 percent above the same period last year staying well ahead of the annual estimate of a 1.7 percent decline.

**Individual Income Tax Refunds:** Last year, the transition to a new computer system required TAX to process a limited number of tax returns, resulting in few refunds in August and September. This year, with the new system in place, TAX returned to a normal level of processing. Through October, \$158.9 million in refunds has been issued compared with \$82.0 million in the same period last year.

**Sales Tax (20% of general fund revenues):** Collections of sales and use taxes, reflecting September sales, grew 4.5 percent in October.

Year-to-date growth in sales and use taxes of 23.5 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 3.9 percent through October, compared with the 6.3 percent growth necessary to meet the annual estimate.

**Corporate Income Tax (5% of general fund revenues):** October corporate income tax collections include estimated payments from corporations with a February through January fiscal year, including many retailers. Collections of corporate income tax fell 25.1 percent in October. This is overstated since TAX did not issue many refunds in October last year because of controlled production. This year, refund activity has returned to more typical levels.

On a year-to-date basis, corporate income tax collections grew 10.9 percent, which is well ahead of the estimate of a 9.6 percent decline.

**Wills, Suits, Deeds, Contracts (4% of general fund revenues):** Wills, suits, deeds, and contracts – mainly recordation tax collections – fell 16.9 percent in October as the housing market continued to slow. Year-to-date collections in this source have fallen 23.8 percent from 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)	-31.6%	11.4%
ABC Taxes (1.0% GF revenues)	2.2%	1.3%
Interest Income (0.6% GF revenues)*	122.4%	87.8%

*\*Approximately 60% of the interest for the current quarter is due to nongeneral funds and will be transferred in October.*

\*Interest Income for the July-September quarter attributable to nongeneral funds was transferred this month resulting in negative interest income for the month of October.

**All Other Revenue:** Receipts in All Other Revenue rose 13.4 percent in October -- \$39.5 million compared with \$34.8 million in October of last year. Most of the increase was in inheritance, gift, and estate taxes. For the fiscal year, collections of All Other Revenue are 8.1 percent above fiscal year 2006, which is ahead of the annual estimate of 0.7 percent growth.

**Lottery Revenues:** Net income of \$34.2 million in October was 4.0 percent above October of last year, due to lower prize expenses for the month. The jackpot games category experienced a decline in sales, with the largest decline occurring in Mega Millions sales as a result of lower advertised jackpots. Year-to-date, net income fell 3.1 percent, slightly ahead of the forecast of a 6.3 percent decline.

The Lottery will continue to evaluate the impact of the North Carolina Education Lottery on sales and revenue forecasts for the current biennium, and will update the official forecast in conjunction with the overall state re-forecasting process in the fall of 2006.

## Summary

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The fall revenue forecasting process is underway. The Governor's Advisory Board of Economists met in October to assess the outlook for the Virginia economy and to review the economic forecast prepared by TAX staff. That economic forecast was used to generate a preliminary revenue forecast, which will be reviewed by the Governor's Advisory Council on Revenue Estimates. The Council, comprised of business and legislative leaders, will meet in November to consider this preliminary revenue forecast. This forecast will serve as the basis for the final forecast to be released in December with the Executive Budget.

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