



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: **September Revenue Data**

September completes the first quarter of the fiscal year and is a significant month for revenue collections. Estimated payments from individuals, corporations, and insurance premiums are all due in September, along with regular monthly collections in withholding, sales, and other sources.

General fund revenues grew 6.3 percent in September from September of last year. Adjusting for an unusually large corporate payment due to a one-time capital gain, revenue grew 4.0 percent for the month. Weakening growth in payroll withholding and sales taxes, and steep declines in collections of recordation taxes reflect the slowdown in economic growth. On a year-to-date basis, total revenue has grown 7.6 percent, ahead of the annual forecast of 4.2 percent. Adjusting total revenue for the effects of repealing the Accelerated Sales Tax program, growth is 3.0 percent through the first quarter of the fiscal year – in line with the adjusted annual estimate of 3.1 percent growth.

National Economic Indicators

Most economic indicators continue to suggest the national economy is slowing.

- Labor market indicators are somewhat mixed. Payroll employment grew by only 51,000 jobs in September -- much weaker than expected -- with job losses in manufacturing, retail trade, temporary help, and government offset by gains in financial services, and education and healthcare services. August job gains, however, were revised up from 128,000 to 188,000, bringing the three-month average to 121,000 jobs per month – consistent with an expanding labor market. In a separate report, the unemployment rate fell slightly from 4.7 to 4.6 percent.
- Initial claims for unemployment dropped from 319,000 to 302,000 during the last week of September. The four-week moving average dropped from 316,000 to 314,000. The initial claims report is consistent with a healthy labor market.
- Rising energy prices drove the Consumer Price Index up 0.2 percent in August, following a 0.4 percent increase

in July. Core inflation (excluding food and energy) rose 0.2 percent for the second consecutive month.

- Personal income grew 0.3 percent in August, constrained by a modest 0.1 percent increase in wage and salary growth. Consumer spending grew 0.1 percent. Both income and spending posted the slowest growth in nine months.
- The Institute of Supply Management index fell from 54.5 to 52.9 in September. This is the lowest reading since May of 2005, but remains in the range indicating industry expansion.
- The Conference Board's index of leading indicators fell 0.2 percent in August, with seven of the ten components declining. Declining building permits and consumer expectations were the main contributors to the decline.
- The Conference Board's index of consumer confidence rose from 100.2 to 104.5 in September, 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 September meeting, as it did in August. It cited moderating growth partly due to the cooling in the housing market. In its statement, the Federal Reserve indicated that although prices have accelerated recently, "inflation pressures seem likely to moderate over time, reflecting reduced impetus from energy prices, contained inflation expectations, and the cumulative effects of monetary policy actions and other factors restraining aggregate demand."

Virginia Economy

In Virginia, payroll employment grew 1.5 percent in August. Growth in Northern Virginia remained well above the rest of the state, with a 3.0 percent gain. Jobs in Hampton Roads grew by 1.7 percent, followed by Richmond-Petersburg and the western MSAs with 1.2 percent growth. The unemployment rate fell from 3.3 percent to 3.2 percent in August.

September Revenue Collections

General fund revenues grew 6.3 percent in September 2006 from September 2005. Adjusting for an unusually large corporate payment due to a one-time capital gain, revenue grew 4.0 percent during that period. On a year-to-date basis, total revenue has grown 7.6 percent, ahead of the annual forecast of 4.2 percent; however, adjusting for the effects of repealing the Accelerated Sales Tax program, growth was 3.0 percent through the first quarter of the fiscal year – in line with the adjusted annual estimate of 3.1 percent growth.

Individual Income Tax Withholding (55% of general fund revenues): With one less deposit day than the same month last year, collections of payroll withholding taxes grew 4.1 percent in September. Collections in this source were disappointing considering that withholding collections only grew 2.4 percent last September. Year-to-date withholding growth is 4.0 percent, lagging the projected annual growth rate of 5.3 percent. This is the slowest first quarter growth since fiscal year 2003.

Individual Income Tax Nonwithholding (16% of general fund revenues): The first estimated payment of fiscal year 2007 was due in September. Collections of nonwithholding were 8.9 percent above last September, with average check size up 8.0 percent. Year-to-date, collections in this source are 5.3 percent above the same period last year, well ahead of the 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 September, \$110.2 million in refunds has been issued compared with \$50.5 million in the same period last year.

Sales Tax (20% of general fund revenues): Collections of sales and use taxes, reflecting August sales, grew 5.0 percent in September. The sales tax holiday on school supplies, along with slowing economic activity, dampened growth in this source.

Year-to-date growth in sales and use taxes of 31.6 percent is overstated due to the repeal of the Accelerated Sales Tax program. Adjusting for the repeal of this program, growth in this source was 3.8 percent through the first quarter of the fiscal year, compared with the 6.0 percent growth necessary to meet the annual estimate.

Corporate Income Tax (5% of general fund revenues): The first estimated payment of fiscal year 2007 was due in September. Collections of corporate income tax grew 31.1 percent in September. A single company made a large payment on a one-time capital gain. Adjusting for this large payment, monthly growth in this source was 10.2 percent.

On a year-to-date basis, collections of corporate income tax have grown 20.5 percent, 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 27.1 percent in September as the housing market continued to slow. Year-to-date collections in this source have fallen 25.7 percent from last year.

Other Revenue Sources

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

	Year-to-Date	Required to Meet Estimate
Insurance Premiums Taxes (3% GF revenues)	4.5%	11.4%
ABC Taxes (1.0% GF revenues)	5.5%	1.3%
Interest Income (0.6% GF revenues)*	91.5%	87.8%

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

All Other Revenue: Receipts in All Other Revenue rose 15.2 percent in September -- \$40.3 million compared with \$35.0 million in September of last year. Most of the growth was in inheritance, gift, and estate taxes. For the fiscal year, collections of All Other Revenue were 6.5 percent above fiscal year 2006, ahead of the annual estimate of 0.7 percent growth.

Lottery Revenues: Net income of \$34.7 million in September was 8.2 percent below September of last year, due to lower sales and higher than expected prize expense rates for the month. The decline in sales occurred in the jackpot games category, with the largest decline occurring in Mega Millions sales as a result of lower advertised jackpots. Year-to-date, net income fell 5.3 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

General fund revenues grew 6.3 percent in September from September of last year. Adjusting for an unusually large corporate payment due to a one-time capital gain, revenue grew 4.0 percent for the month. Weakening growth in payroll withholding and sales taxes, and steep declines in collections of recordation taxes reflect the slowdown in economic growth. On a year-to-date basis, total revenue has grown 7.6 percent, ahead of the annual forecast of 4.2 percent. Adjusting total revenues for the effects of repealing the Accelerated Sales Tax program, growth is 3.0 percent through the first quarter of the fiscal year -- in line with the adjusted annual estimate of 3.1 percent growth.

The fall revenue forecasting process has begun. The Governor's Advisory Board of Economists will meet October 18th to assess the outlook for the Virginia economy over the current and next biennium. The economic outlook

recommended by the board will drive the preliminary revenue forecast developed by the Tax Department's forecasting staff. The Governor's Advisory Council on Revenue Estimates, 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.
