



COMMONWEALTH of VIRGINIA

Office of the Governor

John M. Bennett
Secretary of Finance

P.O. Box 1475
Richmond, Virginia 23218

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MEMORANDUM

TO: The Honorable Mark R. Warner

THROUGH: The Honorable William H. Leighty

FROM: John M. Bennett

SUBJECT: September Revenue Data

September is the first month that revenue collections have been affected by the enactment of House Bill 5018, which was effective September 1. This month's report reflects the change in the recordation tax, as well as cigarette tax collections now being deposited in the Virginia Health Care Fund. The sales tax increase, which was also effective September 1, will be reflected for the first time in October collections.

Total general fund revenue collections grew 12.0 percent in September. Strong collections in individual income and estate taxes drove the increase. About 1.3 percent of September's increase was due to the change in the recordation tax rate. Another 1.0 percent is explained by unusual collections in estate taxes. The timing of required withholding payments was also a factor.

Through the first quarter of the fiscal year, revenues have grown 10.5 percent above the same period last year, well ahead of the annual estimate of 4.5 percent growth. The July - September quarter this year included two more deposit days than the first quarter of last year. Those additional deposit days explain about 1.5 percentage points of the growth rate for the quarter.

National Economic Indicators

Current economic indicators suggest that the national recovery will continue, although the soft patch experienced earlier in the year has dampened growth.

- Payroll employment in September increased by 96,000 jobs nationally -- significantly weaker than expected. August payroll gains were also revised downward from 144,000 to 128,000 jobs. U.S. Department of Labor analysts concluded that the September hurricanes did not have a material effect on the month's employment results. Relatively modest employment growth continues to constrain overall economic growth nationally.

- Initial claims for unemployment fell by 37,000 to 335,000 in the last week of September. Increasing claims in areas

affected by the hurricanes were offset by declines elsewhere in the nation. An upward revision to the previous week's claims - largely due to effects of the hurricanes - pushed the four-week average up to 349,000.

- Real GDP growth for the April - June quarter was revised upward from its original estimate of 2.8 percent to a 3.3 percent annualized rate.

- Consumer spending was flat in August, with a large decline in durable goods spending -- particularly cars - offsetting modest gains in purchases of nondurable goods and services.

- The Institute of Supply Management index fell half a point to 58.5 in September, indicating the pace of the manufacturing expansion is slowing.

- The Conference Board's index of leading indicators fell for the third consecutive month in August, although the recent declines have not reversed a general upward trend. Over the six months ending in August, the leading index grew 0.7 percent, with six out of the ten components advancing. The slowing growth rate in the index suggests economic growth will continue, but remain below trend.

- The Conference Board's index of consumer confidence fell 1.9 points to 96.8 in September, its second consecutive decline. The present situation component, particularly the assessment of the job market, accounted for most of the decline.

- As expected, the Federal Reserve raised the federal funds rate target 25 basis points to 1.75 percent at its September meeting. The Federal Reserve has raised interest rates 75 basis points in three months, although the current rate is still low by historical standards. The following statement summarized current economic conditions: "After moderating earlier this year partly in response to the substantial rise in energy prices, output growth appears to have regained some traction, and labor market conditions have improved modestly."

Virginia Economy

In Virginia, payroll employment grew by 2.2 percent in August compared to the same month last year. Northern Virginia payrolls grew by 3.1 percent, while Richmond-Petersburg employment increased 1.5 percent. The slowest job growth was in the Western Region, with a 0.7 percent gain. All regions in the Commonwealth have posted consecutive gains for the last six months.

The Virginia Leading Economic Index increased 0.3 percent in August following an increase of 0.7 percent in July. This represents the first back-to-back gain since January. Similar to last month, the Virginia-based components of the index - automobile registrations, building permits, and initial unemployment claims - all improved. The U.S. Leading Index was the only detractor from the index.

September Revenue Collections

September is a significant month for general fund revenue collections. Estimated payments are due in individual income tax, corporate income, and insurance premiums, in addition to normal monthly collections in other sources.

Total general fund revenues grew 12.0 percent in September, driven by strong growth in both withholding and nonwithholding taxes. Sales tax collections were also healthy in September, although they have moderated significantly from their pace in the fourth quarter of fiscal year 2004. Unusually strong collections in estate taxes, the increase in recordation taxes, and the timing of withholding payments were also factors.

Year-to-date growth through the first quarter of the fiscal year is 10.5 percent, well ahead of the estimate of 4.5 percent. Some of the apparent strength of first quarter collections is explained by two additional deposits days and the September increase in recordation taxes.

Individual Income Tax Withholding (62% of general fund revenues): Collections of payroll withholding taxes grew 12.0 percent in September. Some of the strength in payroll withholding is an artifact of September's calendar, which

contained five Wednesdays. Electronic filing has made Wednesday the most significant collections day of the week for payroll withholding.

October collections - with four Wednesdays - will balance out the calendar to some degree when it is compared to last October, which had five Wednesdays.

Year-to-date withholding growth is 10.1 percent, well ahead of the 4.6 percent growth required to meet the annual forecast. The two additional deposit days mentioned earlier are overstating year-to-date growth. Adjusting for calendar effects, year-to-date withholding is tracking closer to 6.7 percent.

Individual Income Tax Nonwithholding (12% of general fund revenues): The first estimated payment of fiscal year 2005 was due in September. Collections of individual nonwithholding were up 15.0 percent in September, with about 10,000 (7 percent) more filers. Year-to-date collections in this source are up 19.2 percent, well ahead of the estimate of 6.9 percent growth.

Individual Income Tax Refunds: September is typically a slow month for issuing refunds. Fiscal year-to-date, \$87.8 million in refunds have been issued compared with \$86.4 million in the same period last year. Growth of 1.6 percent trails the annual estimate of 3.8 percent.

Sales Tax (22% of general fund revenues): Collections of sales and use taxes grew 7.1 percent in September. As the income effects of the refinancing boom and large federal income tax refunds have waned, sales tax collections have moderated from the double-digit increases seen in the fourth quarter of fiscal year 2004. Steady growth in employment and wages and salaries have sustained consumer spending and therefore sales tax collections are at more typical levels.

Year-to-date sales tax collections are 7.3 percent above the same period last year - ahead of the economics-based increase of 2.4 percent needed to attain the base forecast.

Corporate Income Tax (3% of general fund revenues): The first estimated payment for corporate income taxes was due in September. Collections in this source declined 3.0 percent in September compared to last September. It is unclear whether this month's weakness in corporate income taxes is a sign that the growth in corporate profits has peaked.

Corporate income tax collections grew 8.1 percent in the first quarter, after growing 27.1 percent in the fourth quarter of fiscal year 2004.

Insurance Premiums Tax (3% of general fund revenues): The first significant payment for taxes on the gross receipts of insurance companies was also due in September. Collections in this source grew 8.4 percent over September of last year. Year-to-date collections are 10.4 percent above the same period last year, slightly ahead of the annual estimate of 8.5 percent growth.

Other Revenue Sources

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

	Year-to-Date	Required to Meet Estimate
ABC Taxes (1.1% GF revenues)	-2.6%	-8.7%
Public Service Corporations (0.7% GF revenues)	8.1%	-0.7%
Interest Income (0.7% GF revenues)	-9.2%	30.9%

All Other Revenue: All other revenue grew 48.8 percent in September. Two factors affected growth in this source. Collections in the largest component of all other revenue - wills, suits, deeds and contract fees - jumped 55.2 percent as

the increase in the recordation tax rate became effective September 1. Of the \$43.3 million collected in this source, \$39.6 million was recordation tax receipts. Adjusting for the rate increase, receipts actually declined by about two percent as refinancing activity dropped to more normal levels. Also boosting growth in all other revenue, the settlement of several large estates in September resulted in the largest monthly collections ever in this source - \$30.3 million, compared with \$16.5 million in September of last year. Collections in Fines, Forfeitures and Fees, and the Auto Rental Tax (Other Taxes) also boosted all other revenue. Year-to-date, collections of all other revenue are 12.1 percent above the same period last year - ahead of the estimate of a 13.1 percent decline.

Lottery Revenues: In September, Lottery net income increased 14.5 percent over last year due to higher sales in scratch and Pick 4 products. On a year-to-date basis, growth of 7.4 percent is well above the annual revenue estimate of a 3.2 percent decline.

Summary

September's revenue collections reflect the change in recordation tax rates, and the deposit of cigarette tax collections to the Virginia Health Care Fund, both of which became effective on September 1.

Total general fund revenue collections grew 12.0 percent in September. Strong collections in individual income and estate taxes drove the increase. Collections in sales and use taxes were also healthy.

Some of September's revenue growth is explained by unusual events. About 1.3 percent of September's increase was due to the change in the recordation tax rate. Another 1.0 percent is explained by unusual collections in estate taxes. And, September withholding collections were bolstered by a fifth Wednesday in the month, which brought with it an additional withholding electronic funds transfer.

Through the first quarter of the fiscal year, revenues have grown 10.5 percent above the same period last year, well ahead of the annual estimate of 4.5 percent growth. The July - September quarter this year included two more deposit days than the first quarter of last year. Those additional deposit days explain about 1.5 percentage points of the growth rate for the quarter.

The fall revenue forecasting process has begun. The Governor's Advisory Board of Economists will meet in October to assess the outlook for the Virginia economy over the next two biennia. This forecast will serve as the basis for the revised revenue forecast to be released by the Governor in December.