



COMMONWEALTH of VIRGINIA

Office of the Governor

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September 12, 2002

MEMORANDUM

TO: The Honorable Mark R. Warner

THROUGH: The Honorable William H. Leighty

FROM: John M. Bennett

SUBJECT: August Revenue Data

This month's revenue report reflects the August 19 revised forecast prepared with the recommendations of the Advisory Board of Economists and the Advisory Council on Revenue Estimates. The revised revenue forecast projects revenue growth of 0.8 percent -- \$524 million below the amount included in the biennial budget for FY 2003.

August revenue collections fell 1.7 percent below collections for August of last year. On a year-to-date basis, total general fund revenue collections through August (including Tobacco Master Settlement revenues) are 5.0 percent below collections for the same period last year, trailing the forecast of 0.8 percent growth. Timing effects of the sales tax acceleration in June and one less deposit day this month compared with August of last year contributed to the decline.

National Economic Indicators

Most recent economic indicators suggest the nation remains in a sluggish recovery, and economic indicators are giving conflicting signals.

- The labor market showed unexpected strength in August, although job creation remains modest. U.S. payrolls expanded by 39,000 jobs in August, and July's gain of 6,000 was revised upward to 67,000.
- Second quarter real GDP grew 1.1 percent, down from 5.0 percent in the first quarter, with business investment in software and equipment rising for the first time in almost two years.
- Personal income growth was flat in July, the weakest growth since November of last year. The lack of growth resulted from a drop in wages and salaries, a sign that labor markets remain weak.
- The Conference Board's index of leading indicators fell in July, with six of the ten components declining. Along with the downward revision to June's index, the fall in the index suggests the recovery remains weak.
- The expansion in the manufacturing sector appears to be weakening. The Institute of Supply Management index (formerly the NAPM) remained at 50.5 percent in both July and August. Readings above 50 percent indicate that manufacturing activity is expanding, suggesting the sector has essentially experienced two months of no growth.
- The Federal Reserve Board held the federal funds rate target unchanged at 1.75 percent at its meeting on August

13, but adopted a bias toward future easing, citing soft demand resulting from the weak stock market.

- Inflation remains almost nonexistent. The consumer price index rose only 0.1 percent in July -- the same as in June.
- Finally, consumer confidence fell sharply in August, following a substantial drop in July. The Conference Board's index fell to its lowest level since November of last year.

The Virginia Economy

In Virginia, job growth continues to lag that of the nation. Employment in Virginia dropped by 0.8 percent in July compared with July of last year -- the twelfth consecutive month of year-over-year declines. In Northern Virginia, July employment declined by 1.2 percent. July jobless claims also rose and the length of the manufacturing workweek was unchanged, reflecting weak labor market conditions.

The Virginia Leading Index rose by 0.7 percent in July, the largest increase since January. A sharp rise in auto registrations and building permits drove the increase.

August Revenue Collections

August revenue collections consist primarily of individual income tax withholding and sales tax receipts. Collections in both sources were distorted by timing factors. August revenue collections declined 1.7 percent from August of last year.

Individual Income Tax Withholding (58% of general fund revenues): With one less deposit day in August, withholding collections dropped 2.5 percent below collections for last August. Year-to-date growth is -0.6 percent, well below the estimate of 3.5 percent growth. September will have one more deposit day than last September, so the first meaningful assessment of withholding collections will occur then.

Individual Income Tax Refunds: In August, the Department of Taxation issued \$32.2 million less in refunds than was issued last August. For FY 2003 to date, \$88.0 million in refunds have been issued, compared with \$138.0 million in the same period last year. This represents a decline of 36.2 percent in refunds thus far in FY 2003.

Individual Income Tax Nonwithholding (14% of general fund revenues): Because the first individual estimated payment of fiscal year 2003 is not due until September, there is little activity in this source. Year-to-date collections of nonwithholding payments are 4.3 percent below last year.

Sales Tax (21% of general fund revenues): Sales tax collections for August are down 11.9 percent from last year. On a year-to-date basis, collections declined by 32.0 percent. With last June's accelerated collections of sales tax, sales taxes typically due in July were paid in June. Many of the dealers used over-payments from June to reduce their August liability. Adjusting for these credits, sales tax receipts are about flat for this fiscal year.

Other Revenue Sources

August was not a significant month for a number of other revenue sources, such as corporate income tax and insurance premiums. The following list provides data on other key taxes:

	Year-to-Date	Required to Meet Estimate
Corporate (2.7% GF revenues)	-25.0%	-7.7%
Insurance Premiums (2.6% GF revenues)	212.6%	4.5%
ABC Taxes (1.1% GF revenues)	3.5%	1.2%
Interest Income (1.0% GF revenues)	-30.8%	-70.1%

Public Service Corporations (.9% GF revenues)	34.3%	8.2%
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All Other Revenue. Revenue from all other sources dropped 1.8 percent in August from last year. On a year-to-date basis, however, collections are 12.6 percent above the same period last year. Collections of wills, suits, deeds and contract fees (mainly recordation taxes), and estate taxes are primarily responsible for the growth. Without recordation and estate taxes, the "all other revenue" category slightly trails the estimate for this year.

Lottery Revenues. The forecast for Lottery revenues was not updated with the August forecast revision. Year-to-date percent increases and growth rates required to meet the forecast are therefore distorted.

In August, lottery net income fell 7.2 percent below last August's income. August sales were \$6.6 million lower than last year, when the Big Game jackpot rolled to \$115 million. On a year-to-date basis, growth of 15.8 percent is significantly above the required growth rate of -10.5 percent. Sales for the first two months of fiscal year 2003 are \$181.3 million, \$7.1 million ahead of last year's pace.

Summary

Revenue growth for the first two months of fiscal year 2003 has been soft, consistent with the tentative economic recovery underway. Total year-to-date collections are 5.0 percent below collections for the same period last year. Without the distortion caused by accelerated sales tax payments and income tax refunds, total collections would essentially be flat for the fiscal year to date. September receipts will provide the first meaningful look at FY 2003 revenues. In addition to withholding and sales taxes, estimated payments are due in all major taxes.

The fall revenue forecasting process has begun. The Governor's Advisory Board of Economists will meet in October as the first step in assessing the strength of the Virginia economy over the next biennium. This forecast will serve as the basis for the revised revenue forecast, which will be released on December 20.