

January 11, 2002

MEMORANDUM

TO: The Honorable James S. Gilmore, III

THROUGH: The Honorable John A. Mahone

FROM: John W. Forbes

SUBJECT: December Revenue Data

This month's revenue report displays the revised forecast, released with your budget on December 19, in the first column and the required growth rates in the last column.

Revenue collections through the first half of fiscal year 2002 just kept pace with year-ago levels, as the effects of the recession continue to be felt in Virginia. Fiscal year 2002's growth is the lowest rate for the first half of the fiscal year since fiscal year 1990. December's receipts were unexpectedly soft, declining by 3.0 percent, as slumping withholding collections and the declines in corporate income tax payments continued.

The nation's payrolls declined by 124,000 jobs in December and the unemployment rate rose to 5.8 percent. The Index of Leading Economic Indicators rose 0.5 percent in November, the second consecutive monthly increase. Consumer confidence rose in December for the first increase since June and is approaching pre-September levels. Personal income fell for the third consecutive month in November and real income growth is at its weakest rate since early 1992. The Federal Reserve lowered the federal funds rate by 25 basis points at its December meeting to 1.75 percent. The real funds rate is now zero and is at a 40-year low.

In Virginia, job growth continues to weaken, increasing by only 0.5 percent in November compared with last year. The November unemployment rate was 3.6 percent -- the highest rate since September 1997.

Individual Income Taxes

Net individual income tax collections dropped in December, declining by 3.5 percent over last year. For the first half of the fiscal year, collections grew at 0.6 percent, significantly ahead of the revised annual forecast of a 0.2 percent decline.

Withholding: Withholding collections fell by 1.0 percent compared to last December, due to purely economic factors. Year-to-date growth of 3.1 percent is 1.8 percentage points behind the revised estimate of 4.9 percent growth. This revenue source is the most current indicator of the economic health of the Commonwealth. As employment growth in Virginia weakens, so too will withholding collections. Although job growth has slipped over 2 percentage points since the first quarter of 2001, payroll withholding receipts have slowed much more dramatically as not only job creation slowed, but hours worked and pay rate increases have slowed considerably. Since the first quarter of 2001, payroll withholding growth has slowed by over 7 percent -- from 9.6 percent growth in the first quarter to 2.5 percent in the quarter ending December.

Nonwithholding: Nonwithholding receipts for December declined by 4.6 percent. Although the Department of Taxation received six percent more checks this December, the average check size fell by close to eight percent. Since the final individual estimated payment for taxable year 2000 is not due until January 15, 2002, it is not reasonable to assess nonwithholding receipts until

all payments are received by the end of January. On a year-to-date basis, the 1.3 percent decline is running ahead of the revised forecast of a 6.8 percent decline.

Refunds: Refunds this month were \$28.5 million compared with \$16.2 million in December of last year. Through the first half of the fiscal year, refunds are 37.1 percent ahead of last year's pace, exceeding the revised forecast of 23.6 percent.

Sales

December sales tax collections, which represent November activity, increased by 14.1 percent. December's performance, however, is attributable solely to timing of receipts compared with last December. Last December, monthly growth fell by 6.3 percent and January receipts increased by 14.6 percent as the first few days of January had a significant amount of certified mail sales tax receipts. Year-to-date growth in this source stands at 1.5 percent.

Nationally, initial reports indicate that the 2001 holiday shopping season will post only meager gains. Retail sales around the nation fell by 0.5 percent in November, indicating a lack of momentum into December. In Virginia, January sales tax collections should contain the bulk of holiday sales receipts and provide a clearer snapshot of the holiday shopping season.

Corporate Income Tax

Corporate receipts declined further in December, falling by 29.5 percent. December receipts include the final quarterly estimated payment of the tax year along with corporate extension returns for the prior tax year. Estimated payments were flat and corporate refunds increased by 14.3 percent. The year-to-date decline of 24.5 percent is well behind the annual forecast of a 1.7 percent decrease.

Public Service Corporations

December's estimated payments represent the final month when current monthly consumption tax receipts will be compared with last year's quarterly public service gross receipts payments. For the year, receipts are down 37.5 percent compared with the revised forecast of 2.2 percent growth. Despite the gap between actual and estimated growth six months into the fiscal year, this source is tracking close to attaining its forecast.

Insurance Company Premiums

December collections of insurance company premiums, which represent the second quarterly payment from insurance companies, increased by 7.7 percent over last year. Year-to-date growth of 11.9 percent is ahead of the revised forecast of 7.4 percent growth.

Interest

During December, interest income fell by 50.5 percent over last year (\$9.8 million versus \$19.9 million) mainly due to the timing of maturities. The year-to-date decline of 21.7 percent is ahead of the revised forecast of a 36.2 percent decline.

ABC Taxes

ABC taxes (Beer and Beverage excise only) increased by 1.5 percent in December over last year. Year-to-date growth of 1.6 percent is slightly behind the revised forecast of 2.3 percent growth.

Lottery Revenues

Lottery net income was \$30.6 million, \$8.1 million or 36.1 percent higher than December last year, mainly due to higher Scratch sales and lower than expected prize payouts. On a year-to-date basis, Lottery net income is up 7.8 percent, well ahead of the required annual growth rate of a 1.9 percent decline.

All Other Revenue

Revenue from all other sources fell by 0.8 percent in December. December's decline was due to collections of the volatile inheritance, gift and estate taxes (down 31.5 percent). Wills, suits, deeds and contract fees, however, continued to post solid gains, growing by 43.4 percent as low interest rates sustain refinancing activity. On a year-to-date basis, all other revenue is up 12.5 percent, well ahead of the revised forecast of a 9.7 percent decline.

Summary

Revenue collections through the first half of fiscal year 2002 were weak. The lack of revenue growth in December was caused by declining payroll withholding receipts and a continued decline in corporate income tax payments. While the decline in December's receipts is not encouraging, January's receipts will be necessary to provide a more in-depth assessment of year-to-date revenues. The bulk of the holiday shopping sales tax receipts and individual estimated tax payments, due January 15, will be collected in January

January's total collections are expected to decline as they will be compared to last January's growth of 24.0 percent, the second highest monthly growth rate in the last thirteen years. This strong growth rate was mainly due to large amounts of December receipts rolling into January from sales tax, payroll withholding, and individual estimated payments.