



COMMONWEALTH of VIRGINIA

Office of the Governor

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MEMORANDUM

TO: The Honorable Mark R. Warner

THROUGH: The Honorable William H. Leighty

FROM: John M. Bennett

SUBJECT: February Revenue Data

February marked the second consecutive month where monthly revenue collections were essentially flat. February collections increased 0.5 percent above a very weak February last year, when revenues declined 11 percent. Year-to-date, total general fund revenue collections through February are 2.0 percent ahead of collections for the same period last year.

Withholding and sales tax collections, which make up more than 80 percent of total general fund revenue collections, improved slightly in February. However, these two sources continue to trail the growth required to meet the official estimate, with four months remaining.

National Economic Indicators

Current economic indicators suggest that the national economy has stalled. The uncertainty created by the situation in Iraq seems to be clouding business decisions, and many firms are deferring investments. Although the economy seems fundamentally sound, lack of business and consumer confidence continues to limit economic growth.

- The February labor market report is the most discouraging piece of economic news released in recent months. Payroll employment declined by 308,000 jobs in February -- the largest decline since November 2001. The Bureau of Labor Statistics reported that about 150,000 reservists were called to active duty in mid-February, but the extent to which that affected the employment figures is unknown. Once on active duty, reservists are no longer included in payroll employment totals.

There is further evidence that the labor market is deteriorating -- initial claims for unemployment increased the first week of March to 430,000, the third consecutive week of increases. The four-week average is now above 400,000, which is normally consistent with a contracting labor market.

- The Conference Board's index of consumer confidence fell nearly 15 points in February to 64.0, the lowest level since October 1993 and the largest monthly drop since September 2001. Both the assessment of current conditions and

expectations of future conditions fell sharply.

- After signs of reviving over the last two months, manufacturing activity slumped in February. The Institute of Supply Management index fell to 50.5 percent - very close to the break-even point.
- The Conference Board's index of leading indicators slightly dipped in January after three straight monthly increases. The index has grown only 0.2 percent over the last six months, indicating economic growth should remain weak, at best.
- Total personal income continued its steady growth in January, the sixth consecutive month of 0.3 percent growth. Several special factors, however, contributed to the increase. Cost of living adjustments to federal transfer payments and pay raises for federal employees boosted growth. Total wages and salaries grew a meager 0.1 percent. That increase was driven by pay increases for federal employees. Private sector wage payments fell slightly.
- Real GDP growth for the fourth quarter of 2002 was revised up to 1.4 percent - better than the 0.7 percent initially reported, but still very weak.

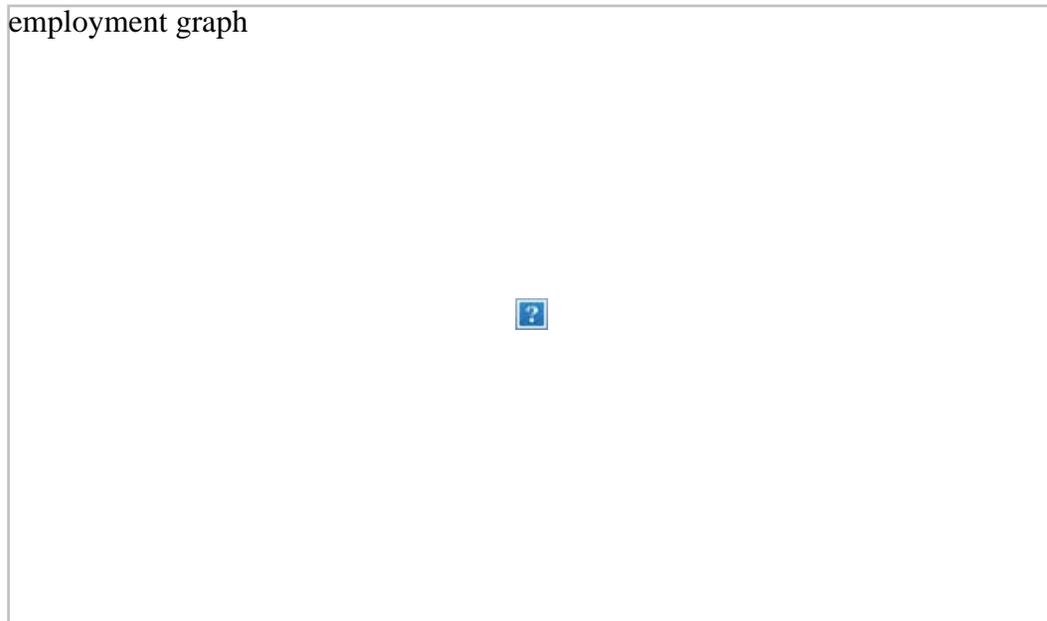
Virginia Economy

Employment data for the nation and for Virginia have recently been revised by the federal government, and a new set of employment categories is now in place. The revision reflects more careful analysis of recent employment trends, and also establishes a new system for tracking employment sectors. Although the new system provides employment data which will ultimately be more useful, December 2002 results are the latest available.

The graph on the following page includes the Bureau of Labor Statistics re-benchmark of employment data as well as its conversion from the Standard Industrial Classification system (SIC) to the North American Industry Classification System (NAICS).

As the graph highlights, job losses after the September 2001 terrorist attack were slightly greater than initially reported. This revision mirrors the weak payroll withholding collections which occurred during that time. The overall revisions are relatively small, and both data series show consecutive months of negative employment growth beginning in August 2001. However, the new NAICS data show that Virginia employment grew last October and November, before declining again in December. The December decline is consistent with a stalled national economy, where falling consumer confidence and the economic uncertainty created by the pending war with Iraq are key factors.

employment graph



February Revenue Collections

Revenue collections grew about \$3.1 million (0.5 percent) above collections for last February, which was also a very

weak month. On a year-to-date basis through February, total revenues are 2.0 percent above last year - still ahead of the required annual estimate of 1.0 percent growth but regressing back toward that rate.

Individual Income Tax Withholding (62% of general fund revenues): Collections in withholding grew by 3.2 percent from February of last year. Year-to-date withholding growth through February is 2.3 percent - trailing the annual estimate of 2.7 percent growth. In order to make the Fiscal Year 2003 individual income tax withholding forecast, collections must average 3.5 percent over the remaining four months of the fiscal year.

Individual Income Tax Refunds: Refunds this month were \$221.0 million - about \$15.8 million above February of last year. For the filing season beginning January 1, 755,000 refunds have been issued, while 750,000 were issued over the same period last year. The average refund amount is up about nine percent compared with last year.

On a fiscal year basis, total refunds are running 10.2 percent ahead of last year, meaning more has been refunded thus far this fiscal year than last. The revenue forecast assumes that refunds will grow 9.2 percent.

Individual Income Tax Nonwithholding (12% of general fund revenues): February is not a significant month for nonwithholding receipts. Through February, year-to-date collections are 3.8 percent below collections for the same period last year - ahead of the forecast of a 13.2 percent decline. The next significant month for nonwithholding collections will be May.

Sales Tax (22% of general fund revenues): Collections of sales tax grew by 3.3 percent from February of last year. Adjusting for the accelerated sales tax payments, year-to-date collections in this source increased about 1.8 percent through February, still well below the forecast of 2.7 percent growth.

Other Revenue Sources

The following list provides data on February collections of other key revenues:

	Year-to-Date	Required to Meet Estimate
Corporate Income Tax	27.6%	3.8%
Insurance Premiums Tax (3% GF revenues)	13.0%	5.3%
ABC Taxes (1.1% GF revenues)	4.6%	0.0%
Public Service Corporations (0.9% GF revenues)	25.3%	8.2%
Interest Income (0.7% GF revenues)	-27.2%	-28.3%

All Other Revenue. Revenue from all other sources was flat in February. Strong growth in collections of wills, suits, deeds and contract fees (primarily recordation taxes) and fines, forfeitures and fees offset declines in other sources. On a year-to-date basis, collections of all other revenue were 21.4 percent above the same period last year, somewhat ahead of the annual forecast of 16.2 percent growth.

Lottery Revenues. In February, Lottery net income grew 4.3 percent more than last year on a 0.1 percent increase in sales due to lower prize payouts. On a year-to-date basis, growth of 9.0 percent is significantly above the amount needed to meet the current revenue estimate.

Both sales and net income growth rates are currently above the levels needed to meet their respective annual forecasts. However, the final quarter of this fiscal year is not forecast to be as profitable as last year's final quarter because last year included a record-setting \$331 million Mega Millions jackpot. On a year-to-date tracking basis, net income is about \$7 million above forecast, with four months remaining in the year.

Summary

For the second consecutive month, February revenue collections were essentially flat -- increasing by 0.5 percent above a very weak February last year, when revenues declined 11 percent. Total general fund revenue collections through February are 2.0 percent above collections for the same period last year, ahead of the annual estimate of 1.0 percent growth. All of the excess revenue growth to date is in minor revenue sources. The two largest sources -- withholding and sales tax collections -- continue to trail the growth rates required to meet their forecast targets.

The economic outlook which underpins the revenue forecast anticipated that the last third of this fiscal year would be one in which the Iraqi situation would have been resolved and the national economy would begin an earnest recovery. A key to attaining the annual revenue forecast is for withholding and sales tax collections to gain ground on their respective annual forecasts over the next four months.