

June 15, 2001

MEMORANDUM

TO: The Honorable James S. Gilmore, III

THROUGH: The Honorable M. Boyd Marcus, Jr.

FROM: John W. Forbes

SUBJECT: May Revenue Data

May's tax revenues exceeded expectations, topping last year's spectacular performance by 4 percent. Last May, the Commonwealth posted \$1.25 billion in revenues, a 27.5 percent increase over the previous May, and at the time it was thought to have set a very difficult record to beat. However, revenues for this May were \$1.30 billion, a 4 percent increase over last year. Solid collections in individual income tax offset declines in sales tax and corporate income tax collections. In addition, the Commonwealth received more revenues than expected from recordation taxes and large one-time payments from the Department of Medical Assistance Services. With only one month remaining in the fiscal year, May's strong performance pushes the Commonwealth to within just one-tenth of one percent (0.1 percent) of meeting its annual forecast of 3.8 percent.

National economic indicators were brighter than those seen in the past few months and suggest the economy could be poised for a solid second half of 2001. As expected, the first quarter GDP was revised sharply downward to 1.3 percent, confirming that the economy slowed dramatically at the beginning of the year. Payroll employment continued to decline in May, as 19,000 jobs were lost. Job losses have accelerated in the manufacturing sector, which has shed 470,000 jobs since the beginning of the year. The Index of Leading Economic Indicators rose slightly in April for the second increase in the last seven months. Stabilization in the stock market, Fed interest rate cuts, and tax cuts helped to boost consumer confidence, which increased stronger than expected in May.

The Federal Reserve Board has cut short-term interest rates five times this year, each time by 50 basis points, including two intra-meeting rate cuts. There were two reductions in January, then one each in March, April, and May. This total reduction of 250 basis points in less than five months is expected to vigorously stimulate the economy. The effect of new monetary policy, however, is not instantaneous. It usually takes six to nine months for policy actions to have a significant impact on economic activity.

In Virginia, job growth remains solid with payroll employment increasing by 2.2 percent in April from last year. The unemployment rate fell 0.2 percentage point in April to 2.2 percent. This rate is almost one-half of the nation's jobless rate.

Individual Income Taxes

Net individual income tax collections in May increased by 2.6 percent as the individual refund season peaked. On a year-to-date basis, receipts have grown 6.3 percent, equaling the annual forecast.

Withholding: Withholding collections were solid in May, increasing by 6.6 percent as stock options exercised by employees of a few large Virginia companies boosted growth by three percentage points. Year-to-date growth of 7.3 percent is 0.8 percentage points behind the annual estimate of 8.1 percent.

Nonwithholding: Nonwithholding receipts increased as expected in May, growing by 9.7 percent. Year-to-date collections in this source are up 9.1 percent, right on target with the annual estimate. Tax due payments for tax year 2000 liabilities paid in April and May have increased 13.0 percent over last year's receipts.

Refunds: The individual income tax refund processing season peaked in May with the Department of Taxation (TAX) issuing \$134.2 million of refunds. This is 77.1 percent more than in last May. Year-to-date refunds have exceeded last year's by \$137.3 million, 20.5 percent, and are tracking closely to the forecast.

Sales and Use Tax

Sales tax collections fell by 1.3 percent in May from last year. On a year-to-date basis, sales tax growth of 3.4 percent is one percentage point behind the annual forecast of 4.4 percent growth.

Since the beginning of 2001, sales tax receipts have increased 0.6 percent over the same period last year. A slowing economy, the decreased wealth effect, and higher energy prices have hampered consumer spending.

Corporate Income Tax

May collections normally consist of the first quarterly and final payments from retailers. Continuing with the year-long trend, May collections fell 81.7 percent. Highlighting the softening economy and the NASDAQ's performance last year, corporate refunds are at an all time high of \$144.4 million -- a 24 percent increase over last year. However, \$11.4 million of the refunds are related to Coalfield Employment Enhancement refunds.

Furthermore, corporate income tax payments have fallen 25 percent through the first eleven months of fiscal year 2001. The year-to-date decline of 39.5 percent lags the annual estimate of a 15.8 percent decline.

Public Service Corporations

May's receipts represent monthly consumption tax collections and the early receipt of a portion of the rolling stock tax. The year-to-date growth of 8.3 percent is well ahead of the annual forecast of a 16.1 percent decline. Year-to-date growth is expected to fall closer to the annual estimate in June as the Commonwealth will only receive consumption tax revenues of about \$7.1 million versus the second estimated payment on gross receipts of about \$25 million normally paid prior to deregulation (effective January 1, 2001).

Insurance Company Premiums

May is typically a slow month in this source. Year-to-date receipts of 6.6 percent growth are slightly ahead of the annual forecast of 3.4 percent growth.

Interest

Interest earnings were \$27.9 million in May, compared to \$24.7 million last year. Year-to-date growth of 13.0 percent is well ahead of the annual forecast of 6.1 percent growth.

ABC Taxes

ABC tax collections were 7.8 percent ahead of last May. On a year-to-date basis, collections are up 4.4 percent from fiscal year 2000, slightly ahead of the annual forecast of 4.2 percent.

Lottery Revenues

Lottery net income for the month declined 20 percent from last May, primarily due to The Big Game achieving a record jackpot of \$363 million and having 37 percent of its sales for the year that month. Year-to-date lottery net income growth is -0.9 percent, well ahead of the required annual growth rate of -2.9 percent.

All Other Revenue

Monthly revenue from all other sources increased by a strong 82.0 percent in May from a year ago. The strong monthly growth was due to a surge in miscellaneous revenue sources and various one-time payments of revenues from the Department of Medical Assistance Services. Also, the resiliency of the housing and refinancing markets continue to boost recordation tax receipts. On a year-to-date basis, collections are up 10.5 percent -- well ahead of the annual estimate of a 6.2 percent decline.

Summary

With one month left in the fiscal year, year-to-date receipts are tracking very close to the official estimate. June has historically been the largest revenue collections month in the fiscal year, as estimated payments are due in all major tax sources. For the past four years, June revenues have grown on average by 7.6 percent. To attain the official forecast of 3.8 percent, June revenue collections need to be \$1.182 billion -- \$57 million more than last year's \$1.125 billion, a 5 percent increase. Given the continued growth experienced in the fourth quarter, particularly in May, I am optimistic that we will meet or come quite close to the official forecast of 3.8 percent revenue growth.