



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: October Revenue Data

Monthly revenue collections for October fell 2.3 percent below collections for last October. The biggest reason for the comparative decline is collection anomalies in last October's collections. Last October, about \$15 million of nonwithholding collections and \$20 million of corporate income tax payments were pushed into October from September, due to mail disruptions following the anthrax scare. Those anomalies made last October a strong collections month. When September and October are grouped together, collections for both sources are more in line with the interim forecast.

On a year-to-date basis, total general fund revenue collections through the first four months of the fiscal year are 0.3 percent above collections for the same period last year, somewhat behind the annual forecast of 0.8 percent growth.

National Economic Indicators

Current economic indicators suggest that the nation's economic recovery is stalled.

- Real GDP grew 3.1 percent in the third quarter, predicated largely on increased auto sales. Most gains posted early in the quarter were lost near the end.
- Total personal income grew 0.4 percent in September, a slight improvement from 0.3 percent in August and flat growth in July. Although consumption expenditures fell 0.4 percent in September, two months of solid gains in wages and salaries, along with positive growth in proprietors' income and dividend income, suggest the longer-term outlook for consumer spending is somewhat brighter.
- The consumer price index rose 0.2 percent in September, and inflation remains stable.
- Labor market conditions remained weak in October. Payroll employment fell by 5,000 jobs, the second month of contraction, after four monthly gains. Manufacturing employment continued to shrink - posting losses of 49,000 jobs. The unemployment rate rose slightly to 5.7 percent.

- The Conference Board's index of leading indicators continues to depict a faltering economy. The index fell for the fourth consecutive month in September, with five of the ten components declining. Although the broad-based decline is evidence of continued weakness, the decline has been moderate, which suggests the recovery will continue its slow, uneven pace.

- After a brief recovery earlier in the year, the manufacturing sector is again contracting. The Institute of Supply Management index (formerly the NAPM) dropped to 48.5 percent in October, the second consecutive month below the break-even 50.0 percent level, and the fourth month without any improvement.

- Consumer confidence dropped sharply in October for the fifth month in a row. The Conference Board's index of consumer confidence posted its largest decline since September 2001, and the lowest level since November 1993.

- Given that most of the economic data over the past two months have been flat to negative, the Federal Open Market Committee cut interest rates by 50 basis points and adopted a neutral bias at its November 6 meeting.

Virginia Economy

Economic indicators continue to depict a weak recovery in Virginia. Payroll employment fell 0.4 percent in October from a year ago, after a 0.7 percent decline in September. In Northern Virginia, October employment declined by 0.1 percent.

The Virginia Leading Index rose by a strong 1.1 percent in September -- its third consecutive increase -- suggesting a reduced likelihood of a double-dip recession late this year. Four of the five indicators posted increases, led by a sharp rise in auto registrations. All regional indices increased in September, also driven by auto registrations. Northern Virginia showed the largest gain (1.0 percent). Charlottesville showed the smallest gain (.03 percent).

October Revenue Collections

Revenue collections fell 2.3 percent from October of last year, primarily due to distortion in collections which occurred last October. Last year, disrupted mail delivery in September caused about \$35 million in payments to arrive in October, making year over year comparisons misleading. On a year-to-date basis, revenue growth is 0.3 percent through October, below the estimate of 0.8 percent.

Individual Income Tax Withholding (62% of general fund revenues): Collections in withholding fell 3.4 percent below October of last year. Year-to-date withholding growth through October is 1.1 percent -- well below the annual estimate of 3.5 percent growth.

Some of the low withholding growth is due to changes in collections patterns. During the 2002 session, language was adopted allowing the Commonwealth to treat Electronic Funds Transfer (EFT) payments with a July 1 notification as if they had a July 1 postmark. Because June 30 fell on a weekend, some withholding collections therefore fell into FY 2002, rather than FY 2003. If an adjustment is made for the notification of EFT payments that occur on July 1 of each year, year-to-date withholding collections would have increased 2.5 percent - still below the 3.5 percent forecast but not as much. Year-to-date collections patterns for withholding will be somewhat distorted until the end of the fiscal year.

Individual Income Tax Refunds: October is typically a slow month for issuing refunds. The total amount of refunds issued in October was \$32.8 million compared with \$27.2 million last year. Through October, \$152 million in refunds have been issued compared to \$202 million issued during the same time period last year.

Individual Income Tax Nonwithholding (12% of general fund revenues): Nonwithholding collections fell 27.1 percent from October of last year. The first individual estimated payments for fiscal year 2003 were due in September. Last year, about \$15 million of estimated payments were received in October because of delays in certified mail. This distorts both September and October collections. Taken together, September and October estimated payments were 2.9 percent below the same period last year. Year-to-date, collections in nonwithholding are down 6.7 percent - ahead of the forecast of an 11.6 percent decline.

Sales Tax (22% of general fund revenues): Collections of sales tax grew 6.4 percent from October of last year. Adjusting for the accelerated sales tax payments, collections in this source increased about 3.0 percent through October, slightly ahead of the forecast of 2.7 percent growth. It is unclear what the impact of the sniper attacks will have on receipts next month, although the growth rate for sales tax will likely decline.

Insurance Premiums Tax (3% of general fund revenues): Through October, collections of insurance premiums tax were 41.2 percent ahead of last year. Refunds typically issued in October will be issued in November this year. Just as nonwithholding and corporate collections in September and October were viewed together, it will be necessary to view this source over the September, October, and November timeframe, in order to better assess collections.

Other Revenue Sources

October was not a significant month for a number of other revenue sources. The following list provides data on other key taxes:

	Year-to-Date	Required to Meet Estimate
Corporate Income Taxes (3.0% GF revenues)	-0.8%	-7.7%
ABC Taxes (1.1% GF revenues)	2.6%	1.2%
Interest Income (1.0% GF revenues)	-25.1%	-70.1%
Public Service Corporations (.9% GF revenues)	39.3%	8.2%

All Other Revenue. Revenue from all other sources grew 1.8 percent in October from last year. Wills, suits, deeds and contract fees (primarily recordation taxes) drove the increase, with collections of \$25.4 million in October compared with \$17.8 million last year. On a year-to-date basis, collections of all other revenue were 23.0 percent above the same period last year, well ahead of the annual forecast of 13.3 percent growth.

Lottery Revenues. In October, lottery net income grew 10.0 percent more than last year on nearly flat sales growth as lower prize payouts - "Luck of the Draw" - favored the Commonwealth. On a year-to-date basis, growth of 15.6 percent is significantly above the amount needed to meet the current revenue estimate.

Summary

Total year-to-date collections are 0.3 percent above collections for the same period last year, somewhat below the annual estimate of 0.8 percent growth. The decline of 2.3 percent in total revenues in October was largely due to payroll withholding and disruptions in last year's collections, which pushed some September receipts into October.

The fall revenue forecasting process is underway. The Governor's Advisory Board of Economists met in October to review the economic forecast over the next biennium. The Governor's Advisory Council on Revenue Estimates will meet this month to review the economic forecast and preliminary general fund revenue estimates. This forecast will serve as the basis for the revised revenue forecast, which will be released on December 20.