



COMMONWEALTH of VIRGINIA

Office of the Governor

Jody M. Wagner
Secretary of Finance

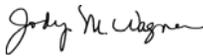
P.O. Box 1475
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January 14, 2008

MEMORANDUM

TO: The Honorable Timothy M. Kaine

THROUGH: The Honorable Wayne M. Turnage

FROM: Jody M. Wagner 

SUBJECT: December Revenue Data

This month's revenue letter incorporates the revised general fund revenue forecast on which the introduced Fiscal Year 2008-10 biennial budget and the amendments to the Fiscal Year 2008 budget are based. The forecast is based upon recommendations of both the Governor's Advisory Board of Economists and Governor's Advisory Council on Revenue Estimates. With the revisions, projected growth in general fund revenue for fiscal year 2008 is now 3.3 percent.

December and January are significant months for revenue collections. Growth can be distorted during this period due to several timing issues. In December, in addition to normal monthly collections of withholding and some holiday sales taxes, quarterly estimated payments are due from most corporations and some fourth quarter nonwithholding payments from individuals are received. In addition, some withholding payments can be delayed by a larger volume of mail over the holidays, pushing some December payments into January. Finally, the bulk of sales tax collections from the holiday shopping season will be received in January. As is always the case, due to all these factors, the months of December and January must be analyzed together to form an accurate assessment of revenue growth.

General fund revenues grew 1.8 percent in December 2007 compared to December 2006. On a year-to-date basis, revenues grew 3.2 percent over the same period last year, close to the annual forecast of 3.3 percent. Individual withholding is tracking its forecast and sales tax collections are running slightly ahead. Individual nonwithholding, corporate, and recordation tax collections are trailing their respective forecasts.

National Economic Indicators

Recent indicators suggest the national economic expansion continues to slow, as the housing shock and credit crunch remain influential. Amid growing uncertainty surrounding the economy, Moody's Economy.com estimates the probability of a recession at 50 percent, while Global Insight assigns a 40 percent probability.

- Real GDP grew 4.9 percent in the third quarter, ahead of second quarter growth of 3.8 percent, and equal to consensus expectations. Real GDP growth is expected to weaken over this and the next two quarters.
- The job market weakened significantly in December. Payroll employment grew by only 18,000 jobs in December, following a gain of 115,000 in November. Monthly gains averaged 97,000 for the fourth quarter and are consistent with moderate growth. Gains in professional and business services, health care, and leisure and hospitality jobs offset declines in construction, manufacturing, and retail trade. In a separate report, the unemployment rate rose from 4.7 to 5.0 percent.
- Initial claims for unemployment dropped by 21,000 to 336,000 during the week ending December 29. The four-week moving average decreased from 344,500 to 343,750; however, it is only slightly below its post-Katrina high.
- The Consumer Price Index jumped 0.8 percent in November, driven by rising energy prices. Core inflation, excluding food and energy, increased 0.3 percent in November, resulting in growth of 2.3 percent over the last year.
- The manufacturing sector contracted in December. The Institute of Supply Management index fell from 50.8 to 47.7, its sixth consecutive decline and its lowest level since 2003.
- The Conference Board's index of leading indicators is consistent with significantly slowing growth. The index fell 0.4 percent to 136.3 in December, the third decline in the last four months. The index is at its lowest level since Hurricane Katrina. Generally, a negative reading for six to nine months is indicative of a recession.
- The Conference Board's index of consumer confidence rose slightly from 87.8 to 88.6 in December. The increase follows four consecutive declines, and the index remains at a very low level. A rising expectations component offset the decline in the current conditions component.
- At its December 11 meeting, the Federal Reserve lowered the federal funds rate by 25 basis points to 4.25 percent. The committee stated, "Economic growth is slowing, reflecting the intensification of the housing correction and some softening in business and consumer spending. Moreover, strains in financial markets have increased in recent weeks." They also noted that recent developments have increased the uncertainty regarding future economic growth.

Virginia Economy

In Virginia, payroll employment grew 1.7 percent in November. Jobs grew by 2.0 percent in Hampton Roads, 1.6 percent in Northern Virginia, and 2.1 percent in the western MSAs.

Employment was flat in Richmond-Petersburg. The unemployment rate rose slightly, from 2.9 percent to 3.0 percent in November.

The Virginia leading index fell 0.4 percent in November, its fourth consecutive decline. All three components of the index contributed to the drop in November. The regional indices fell in nine of the state's eleven metropolitan areas in November. Only Blacksburg and Lynchburg showed an increase.

December Revenue Collections

General fund revenues grew 1.8 percent in December 2007 compared to December 2006. On a year-to-date basis, revenues grew 3.2 percent over the same period last year, close to the annual forecast of 3.3 percent.

Individual Income Tax Withholding (56% of general fund revenues): Collections of payroll withholding taxes grew 8.1 percent in December. Year-to-date withholding growth is 5.6 percent, equal to the projected annual growth rate.

Individual Income Tax Nonwithholding (19% of general fund revenues): Collections of nonwithholding in December 2007 fell 21.4 percent from December 2006. Year-to-date, collections in this source are 5.3 percent above the same period last year, lagging the estimate of a 10.0 percent increase.

December and January are significant months for collections in this source, and growth can be distorted by the timing of payments. Taxpayers have until January 15 to submit their fourth estimated payment for tax year 2007. Although January collections in this source are typically much higher than December collections, monthly growth patterns in prior years have shown large swings between December and January. Strong growth in December is often followed by marked weakness in January and vice versa. A clearer assessment of growth in this source will be possible at the end of January, when all quarterly payments have been received.

Individual Income Tax Refunds: TAX issued \$43.5 million in individual refunds in December 2007, compared with \$20.9 million in December 2006. Year to date, refunds are 3.4 percent ahead of the same period last year, trailing the annual forecast of a 7.7 percent increase.

Net Individual Income Tax (65% of general fund revenues): Year-to-date net individual income tax growth is 5.6 percent, below the projected annual growth rate of 6.5 percent, due to the lagging collections of nonwithholding taxes.

Sales Tax (19% of general fund revenues): Collections of sales and use taxes, reflecting November sales, grew 16.0 percent in December. Monthly growth is probably overstated since the Thanksgiving holiday in 2007 occurred at the earliest possible time on the calendar, allowing for an entire week of holiday sales to occur in November. The last time this occurred was in 2001 when a 14.1 percent increase in November sales was followed by a 8.7 percent decline in December. On a

year-to-date basis, collections of sales and use taxes have increased 4.9 percent, ahead of the forecasted growth rate of 2.8 percent. As with individual nonwithholding, January receipts are needed to more accurately assess growth in this source because a large part of holiday sales tax collections will be received in January.

Corporate Income Tax (5% of general fund revenues): Collections in corporate income taxes fell 21.1 percent in December. On a year-to-date basis, corporate income tax collections have fallen 24.9 percent from the same period last year, behind expectations of a 15.0 percent decline. Lower corporate payments and a substantial increase in refund activity contributed to the decline. Corporate payments have fallen 11.0 percent over the same period last year, while refunds have increased by 82.4 percent.

Wills, Suits, Deeds, Contracts (3% of general fund revenues): Wills, suits, deeds, and contracts – mainly recordation tax collections – fell 26.9 percent in December as the housing market continued to slow. On a year-to-date basis, collections in this source declined 17.3 percent from last year, compared with the estimate of a 10.7 percent annual decline.

Insurance Premiums (3% of general fund revenues): Year-to-date collections of the tax on insurance premiums are 9.3 percent ahead of the same period last year, ahead of the forecast of 4.8 percent annual growth.

Other Revenue Sources

The following list provides data on December collections for other revenue sources. The growth rate for interest income is overstated, since approximately 65 percent of the interest for the current quarter is due to nongeneral funds and will be transferred in January.

	<u>Year-to-Date</u>	<u>Annual Estimate</u>
Interest Income (1.1% GF revenues)	27.6%	-0.6%
ABC Taxes (1% GF revenues)	2.3%	5.0%

All Other Revenue: Receipts in All Other Revenue grew 25.1 percent in December – \$38.7 million compared with \$30.9 million in December 2006. Most of the increase was in inheritance, gift, and estate taxes -- \$16.5 million compared with \$6.1 million in December 2006. For the fiscal year-to-date, collections of All Other Revenue are 8.1 percent ahead of the same period in fiscal year 2007, ahead of the annual estimate of a 5.5 percent decline.

Lottery Revenues: Net income totaled \$86.2 million in December 2007 or \$10.8 million more than December 2006. December 2007 was 0.2 percent ahead of December 2006 as statistically higher-

than-expected prize payouts offset the increase in sales. Year-to-date, net income is up 12.7 percent compared to the annual forecast of a 3.7 percent increase. Comparisons to last year are affected because products currently offered (Fast Play Bingo, additional daily games' drawings) were not offered or included in sales and net income results from last year. In addition, jackpot sales were significantly depressed last year because of unusually low advertised jackpots.

Summary

General fund revenues grew 1.8 percent in December 2007 compared to December 2006. On a fiscal year-to-date basis, revenues grew 3.2 percent over the same period last year, close to the annual forecast of 3.3 percent. Individual withholding is tracking its forecast and sales tax collections are running slightly ahead. Individual nonwithholding, corporate, and recordation tax collections are trailing their respective forecasts.

The timing of payments in December and January can significantly distort growth rates. Individual estimated payments are due January 15, and the bulk of sales taxes from the holiday shopping season will be received in January. December and January receipts must be considered together to get a clearer picture of revenue growth.

Revenue collections through December were the weakest since December of 2002 and raise the importance of January's collections in assessing the annual revenue forecast. Not only will individual nonwithholding and sales tax receipts be clearer; payroll withholding, corporate, and recordation tax payments will also provide the final data point to incorporate into a midsession revenue forecast. Given that national economic news has become markedly more negative since the forecast was prepared in November, we will incorporate the latest economic data into the midsession revenue forecast. The midsession revenue forecast process will be completed as promptly as possible after the January revenue report is released on February 15, 2008.