



COMMONWEALTH of VIRGINIA

Office of the Governor

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MEMORANDUM

TO: The Honorable Timothy M. Kaine
THROUGH: The Honorable Wayne M. Turnage
FROM: Jody M. Wagner
SUBJECT: **September Revenue Data**

September completes the first quarter of the fiscal year and is a significant month for revenue collections. Estimated payments from individuals, corporations, and insurance premiums are all due in September, along with regular monthly collections in withholding, sales, and other sources.

Total general fund revenue collections for the first quarter of fiscal year 2008 were close to the annual forecast. Revenues grew 4.0 percent in September compared to September 2006. On a year-to-date basis, revenues grew 3.6 percent over the same period last year, slightly ahead of the annual forecast of 3.0 percent. Sluggish growth in individual withholding is being offset by continued strength in nonwithholding collections and a substantial drop in refunds. Collections of corporate income tax and sales and use tax are close to their annual forecasts.

National Economic Indicators

Recent indicators suggest the national economy slowed over the summer as effects from the slowdown in the housing market continued to drag on growth. Turmoil in the subprime mortgage market escalated in August, deepening the uncertainty concerning the future path of the economy.

- Second quarter GDP growth was revised down from 4.0 percent in the preliminary estimate to 3.8 percent in the final estimate.
- The labor market is slightly healthier than previously reported. Payroll employment rose by 110,000 jobs in September. In addition, the August decline of 4,000 jobs was revised to a gain of 89,000. In a separate report, the unemployment rate rose from 4.6 to 4.7 percent.
- Initial claims for unemployment rose by 16,000 to 317,000 during the last week of September. The four-week moving average rose slightly, from 312,250 to 312,750. Initial claims activity is consistent with an expanding job market.
- Inflation pressures continue to ease. The Consumer Price Index fell 0.1 percent in August, following increases of

just 0.1 percent in July and 0.2 percent in June. Energy prices fell for the third consecutive month. Core inflation, excluding food and energy, increased 0.2 percent in August, resulting in growth of 2.1 percent over the last year.

- Although the manufacturing sector is expanding, growth slowed in September. The Institute of Supply Management index fell from 52.9 to 52.0, its third consecutive decline.
- The Conference Board's index of leading indicators fell 0.6 percent to 137.8 in August, the largest decline since the 0.8 percent drop following Katrina in September 2005. The weakness was broad-based – eight of the ten components declined. Lower stock prices, higher initial jobless claims, a decline in building permits, and lower consumer expectations were the most significant drags on growth.
- The Conference Board's index of consumer confidence fell from 105.6 to 99.8 in September, its second consecutive drop and a 22-month low. Both the current situation and expectations components dropped sharply, led by weak assessments of the current job market.
- At its September meeting, the Federal Reserve lowered the federal funds rate by 50 basis points to 4.75, the first cut since 2003. The committee noted that “economic growth was moderate during the first half of the year, but the tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth more generally.”

Virginia Economy

In Virginia, payroll employment grew 1.7 percent in August. Jobs grew by 1.6 percent in Hampton Roads, 1.5 percent in Northern Virginia, 1.3 percent in Richmond-Petersburg, and 2.4 percent in the western MSAs. The unemployment rate was flat at 3.1 percent in August.

The Virginia leading index fell 0.2 percent in August, the second decline in nine months. A substantial drop in building permits and falling auto registrations offset an improvement in initial claims for unemployment. The regional indices increased in five of the state's eleven metropolitan areas in August. The indices in Blacksburg, Lynchburg, Charlottesville, Harrisonburg, and Danville increased for the month. Northern Virginia, Hampton Roads, Richmond, Bristol, and Winchester experienced slight declines, while Roanoke was unchanged.

September Revenue Collections

Total general fund revenue collections for the first quarter of fiscal year 2008 were close to the annual forecast. Revenues grew 4.0 percent in September compared to September 2006. On a year-to-date basis, revenues grew 3.6 percent over the same period last year, slightly ahead of the annual forecast of 3.0 percent. Growth in individual withholding remains sluggish, while nonwithholding collections continue to exceed expectations. Collections of corporate income tax and sales and use tax are close to their annual forecasts.

Individual Income Tax Withholding (57% of general fund revenues): With one less deposit day than September of last year, collections of payroll withholding taxes grew 4.8 percent in September. Year-to-date withholding growth is 4.7 percent, lagging the projected annual growth rate of 6.0 percent.

Individual Income Tax Nonwithholding (19% of general fund revenues): The first estimated payment of fiscal year 2008 was due in September. Collections of nonwithholding were \$24.4 million ahead of September 2006, an 8.1 percent increase. Year-to-date, collections in this source are 10.7 percent above the same period last year, ahead of the estimate of a 6.6 percent increase.

Individual Income Tax Refunds: Individual refunds were down 44.2 percent in September and 24.1 percent for the quarter. Through September, \$83.6 million have been refunded compared with \$110.2 million in the same period last year.

Summary of Net Individual Income Tax (65% of general fund revenues): Year-to-date net individual income tax growth is 7.1 percent, ahead of the projected annual growth rate of 5.4 percent.

Sales Tax (20% of general fund revenues): Collections of sales and use taxes, reflecting August sales, grew 3.5

percent in September. On a year-to-date basis, collections of sales and use taxes have increased 3.1 percent, close to the estimate of a 2.8 percent increase. This is the slowest first quarter increase in sales tax collections in five years as the slowdown in the housing industry and higher energy prices continue to dampen overall demand.

Corporate Income Tax (5% of general fund revenues): The first estimated payment of fiscal year 2008 was due in September. Collections in corporate income taxes fell 8.9 percent in September. On a year-to-date basis, corporate income tax collections have fallen 13.5 percent from the first quarter of last year, close to expectations of an 18.4 percent decline. Lower corporate payments and a substantial increase in refund activity both contributed to the decline.

Wills, Suits, Deeds, Contracts (3% of general fund revenues): Wills, suits, deeds, and contracts – mainly recordation tax collections – fell 21.3 percent in September as the housing market continued to slow. First quarter collections in this source declined 13.3 percent from last year, compared with the estimate of a 9.0 percent annual decline.

Other Revenue Sources

The following list provides data on September collections for other revenue sources:

	Year-to-Date	Annual Estimate
Insurance Premiums Taxes (2% GF revenues)	15.8%	2.9%
ABC Taxes (1.0% GF revenues)	-5.7%	0.7%
Interest Income (0.9% GF revenues)*	9.5%	-2.4%

**General fund interest earnings reflect the first quarter's interest earnings from nongeneral fund balances. That will be transferred to those nongeneral fund accounts in October.*

All Other Revenue: Receipts in All Other Revenue fell 15.4 percent in September – \$34.1 million compared with \$40.3 million in September of last year. The decline was broad based across minor sources, with the largest negative contribution from inheritance, gift, and estate taxes. For the fiscal year-to-date, collections of All Other Revenue are 11.5 percent below the same period in fiscal year 2007, lagging the annual estimate of 8.7 percent growth.

Lottery Revenues: Net income totaled \$36.2 million in September or \$1.6 million more than last year. September was 4.7 percent ahead of September of last year as a decline in expenses offset a small decline in sales. Year-to-date, net income is up 22.8 percent as compared to the annual forecast of a 7.3 percent decline. 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

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The fall revenue forecasting process has begun. The Governor's Advisory Board of Economists will meet October 17 to assess the outlook for the Virginia economy over the current and next biennium. The economic outlook recommended by the Board will drive the preliminary revenue forecast developed by the Department of Taxation. The Governor's Advisory Council on Revenue Estimates, comprised of business and legislative leaders, will meet in November to consider this preliminary revenue forecast. This forecast will serve as the basis for the final forecast to be released in December with the Executive Budget.

