

Governor McDonnell's Proposed Amendments to the 2010-2012 Budget

Economic Outlook & Revenue Forecast

*A Briefing for the Senate Finance,
House Finance, and House Appropriations
Committees*

December 17, 2010



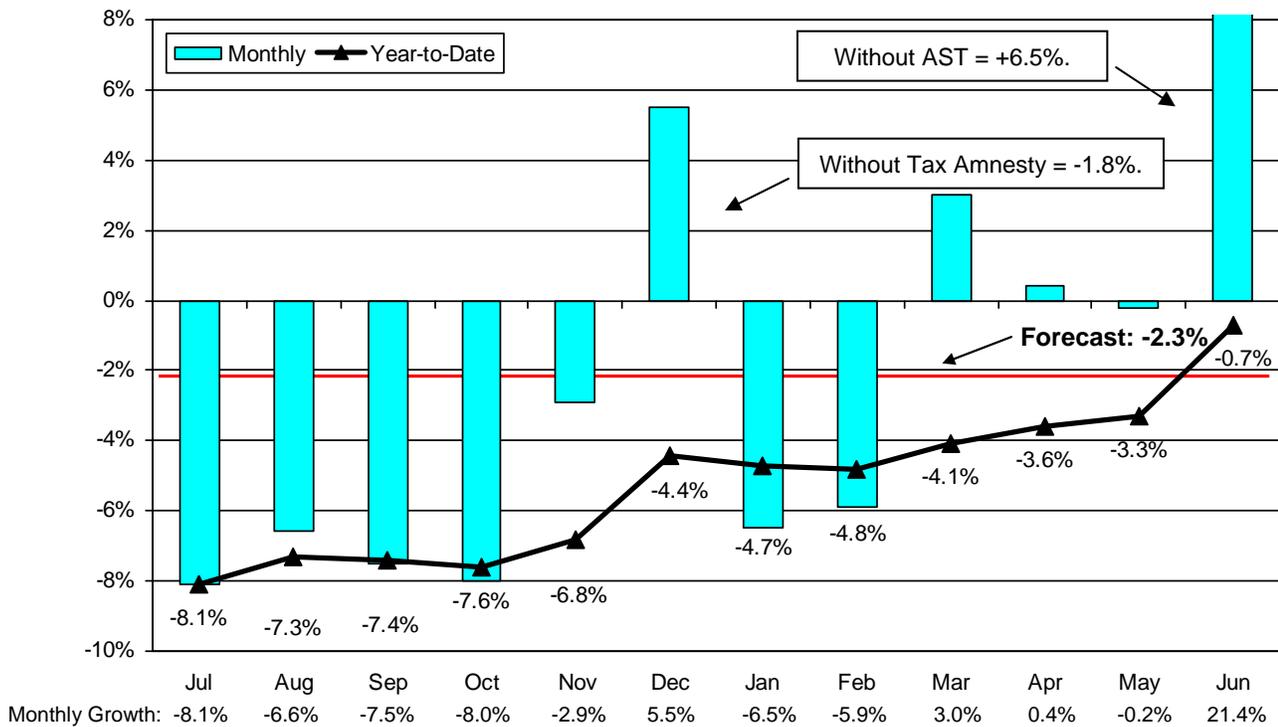
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Outline...

- Fiscal Year 2010 Year-in-Review
- U.S. and Virginia Economic Outlook
- December Revenue Forecast
- November Revenue Collections
- Next Steps

Total General Fund Revenue Collections Improved Markedly Over The Last One-Third Of Fiscal Year 2010...

Growth in Total General Fund Revenue Collections FY10 Monthly and Year-to-Date



- After declining for the first eight months of fiscal year 2010, total general fund revenues increased three of the last four months of the year.
 - The March increase broke a streak of 19 consecutive monthly declines dating back to August 2008.

Fiscal Year 2010 Revenues and Transfers Finished \$228.5 Million (1.6 Percent) Above Forecast...

Summary of Fiscal Year 2010 Revenue Collections (millions of dollars)

<u>Major Source</u>	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>		<u>Annual Growth</u>
			<u>Dollars</u>	<u>Percent</u>	
Withholding	\$ 9,153.4	\$ 9,176.2	\$ 22.8	0.2 %	0.4 %
Nonwithholding	1,813.2	1,906.8	93.6	5.2	(17.5)
Refunds	<u>(2,006.5)</u>	<u>(1,994.7)</u>	<u>11.8</u>	<u>(0.6)</u>	<u>1.4</u>
Net Individual	8,960.1	9,088.3	128.2	1.4	(4.1)
Sales	3,043.0	3,082.5	39.5	1.3	6.2
Corporate	730.7	806.5	75.8	10.4	24.4
Wills (Recordation)	299.0	290.2	(8.8)	(2.9)	(7.7)
Insurance	242.5	261.9	19.4	8.0	2.7
All Other Revenue	<u>713.3</u>	<u>690.2</u>	<u>(23.2)</u>	<u>(3.2)</u>	<u>(3.2)</u>
Total Revenues	\$ 13,988.6	\$ 14,219.5	\$ 230.9	1.7 %	(0.7) %
ABC Profits	42.2	50.0	7.8	18.4	13.3
Sales Tax (0.25%)	204.5	209.4	4.9	2.4	(1.9)
Transfers	<u>322.9</u>	<u>307.8</u>	<u>(15.1)</u>	<u>(4.7)</u>	<u>106.6</u>
Total Transfers	\$ 569.6	\$ 567.2	\$ (2.4)	(0.4) %	39.5 %
Total General Fund	\$ 14,558.2	\$ 14,786.7	\$ 228.5	1.6 %	0.4 %

- Total revenues declined in two consecutive years for the first time in 50 years.
 - The only other years in which revenues fell were fiscal year 1991 and fiscal year 2002.

The Fiscal Year 2010 General Fund Surplus Was Already Dedicated...

	\$ in Millions
Revenue Surplus:	<u>\$228.5</u>
Uses:	
Three percent bonus to state employees	82.2
Water Quality Fund	36.5
Accelerated Sales Tax for Transportation Trust Fund	27.7
Additional Sales Tax to K-12	18.7
Natural Disaster Authorizations (sum-sufficient)	13.2
Federal Portion of Dominion Resources Refund	1.2
Total Designations	<u>179.5</u>
Remaining Balance:	49.0
To Transportation Trust Fund (2/3)	32.7
To Nonrecurring Expenditures (1/3)	<u>16.3</u>
Unallocated Surplus:	\$0.0

Recent National and State Economic Indicators Suggest the Weak Economic Expansion is Continuing...

- According to the second estimate, real GDP grew 2.5 percent at an annualized rate in the third quarter of 2010, following second-quarter growth of 1.7 percent.
 - This marked the fifth consecutive quarter of growth since the recession officially ended in June 2009.
- Payroll employment rose by 39,000 jobs in November, with private payrolls adding only 50,000 jobs, the lowest amount since January 2010.
 - The labor market remains weak and improvement is expected to be slow and uneven.
- The national unemployment rate rose to 9.8 percent in November, the highest rate since April 2010.
- In Virginia, employers added jobs for the fourth consecutive month in October. Payroll employment in the Commonwealth grew 0.9 percent in October from October of last year.
 - Compared with October of last year, Northern Virginia posted a gain of 0.4 percent, Hampton Roads grew 1.4 percent, and Richmond-Petersburg fell 0.5 percent.
- The unemployment rate in Virginia remained unchanged at 6.5 percent in October, well below the peak of 7.8 percent in February and the lowest rate since November 2009.

Recent National and State Economic Indicators Suggest the Weak Economic Expansion is Continuing (continued)...

- Initial claims for unemployment fell by 17,000 to 421,000 during the week ending December 4. The four-week moving average fell from 432,000 to 428,000.
 - The initial claims data are consistent with a job market that is showing modest improvement.
- According to RealtyTrac, the number of foreclosure filings nationwide were unchanged in October from a year ago, with one in every 389 households receiving a foreclosure notice.
 - Activity may slow in the future as major lenders have temporarily halted foreclosure proceedings as a review of possible abuses is initiated.
- In Virginia, one in every 577 households received a foreclosure notice in October.
- The U.S. personal savings rate rose to 5.7 percent in October.
 - The rate has been above 5 percent for two years.
 - From October 1998 to October 2008 the savings rate was only above 5 percent in one month, May 2008.

Recent National and State Economic Indicators Suggest the Weak Economic Expansion is Continuing (continued)...

- The expansion in the manufacturing sector held up in November. The Institute of Supply Management index fell from 56.9 to 56.6 in November.
 - This month's report signals a continuation of the recovery that began 16 months ago.
- The Conference Board's index of leading indicators rose 0.5 percent in October, after increasing 0.5 percent in September and 0.1 percent in August, consistent with improving growth.
- The Conference Board's index of consumer confidence rose from 49.9 to 54.1 in November, its highest level since June.
 - The index remains at a very low level, suggesting consumer spending is not likely to accelerate.
- Inflation remains low – the CPI increased 0.2 percent in October from the previous month.
 - Core inflation (excluding food and energy prices) remained flat in October for the third consecutive month and stands 1.2 percent above October of last year.
- The Federal Reserve announced at its November meeting that it will keep the federal funds rate target unchanged at 0.0 to 0.25 percent. In addition, quantitative easing will be expanded by purchasing long-term treasury securities.

Global Insight's October U.S. Standard Forecast – “More Of The Same”...

- Global Insight believes the economic recovery has lost momentum, but does not expect a double-dip recession.
- “The inventory building and fiscal stimulus boosts to growth are waning, so the economy is falling back on whatever underlying strength there is in private final demand, which is limited because households and businesses remain cautious.”
- Global Insight expects real GDP growth to average 1.7 percent over the rest of the year and then pick up in the first and second quarters of 2011.
- The forecast assumes that the Fed will implement more quantitative easing in November and then will begin to raise interest rates in 2012.
- The standard forecast also assumes that emergency unemployment insurance benefits will be extended into 2011; “Making Work Pay” income tax cuts will be extended for one year; and all of the Bush tax cuts will be extended temporarily.

The Fall 2010 Consensus Forecasting Process...

- The Joint Advisory Board of Economists (JABE) met in October.
 - Members assessed recent economic developments and evaluated the revised economic outlook for the current biennium – the September standard economic outlook, which was somewhat weaker than the official economic forecast.
 - JABE members were about evenly split, with half supporting the standard outlook and half choosing standard minus.
 - The October standard outlook was adjusted to incorporate comments of the JABE – specifically for slower employment growth in fiscal year 2011.
- The Governor's Advisory Council on Revenue Estimates (GACRE) met in November.
 - Members evaluated JABE recommendations, revenue collections through October, and the associated revenue forecast.
 - While a few members were more optimistic and a few were more pessimistic, the body overwhelming supported the standard minus forecast suggested by the JABE as reasonable.
 - Members of the General Assembly who attended the meeting expressed pessimism and suggested caution.

The October 2010 Virginia Economic Outlook For The Current Biennium Is Slightly Weaker Than The Official Forecast Used In The Current Budget...

- Consistent with the revised national outlook and consensus of the JABE and GACRE, growth projections for Virginia have been reduced.

Key Virginia Economic Indicators

Official and October Forecasts

Annual Percent Change

	Fiscal Year		
	10	11	12
Employment			
Official (Oct '09)	(2.6)	1.1	2.1
Oct '10 Standard	(2.1)	0.7	2.0
Personal Income			
Official (Oct '09)	1.3	3.0	3.7
Oct '10 Standard	1.0	2.8	3.6
Wages & Salaries			
Official (Oct '09)	0.1	3.0	3.7
Oct '10 Standard	0.3	2.6	4.7
Average Wage			
Official (Oct '09)	2.8	1.9	1.6
Oct '10 Standard	2.5	1.8	2.6

The Official forecast for FY10 is Global Insight's October 2009 U.S. pessimistic alternative scenario. The Official forecast for FY11-12 is Global Insight's October 2009 U.S. standard forecast.

- Virginia is projected to outperform the nation in terms of employment and wage growth over the next two fiscal years.

The Revised Revenue Forecast Reflects The Latest Economic Outlook, GACRE Advice And Positive Revenue Trends...

- The economic outlook, while slightly weaker in fiscal year 2011, is coming off a slightly higher base year of fiscal year 2010.
 - In terms of wages and salary growth, fiscal year 2012 is stronger, albeit still a mild recovery.
- GACRE advice confirmed recommendations from JABE to use a slightly less optimistic outlook.
 - Global Insights October 2010 economic outlook is one of the most conservative.
 - Their economic outlook is in the bottom one-third of forecasters in the Blue Chip Consensus Forecast.
- Current revenue collections from payroll withholding and sales tax have exceeded revenue model results.
 - This “money-in-the-bank” revenues have been included in the revised revenue forecast.

Fiscal Year 2011 Year-to-Date Revenue Collections Through November Continue a Trend of Positive Revenue Reports...

November Year-to-Date Collections and FY 2011 Forecasts (annual percent change)

Major Source	As a % of Total Revenues	Percent Growth over Prior Year				
		Nov YTD Actual	Official Estimate	December Estimate	Dec-Jun Req'd Meet Nov Est.	Dec-Jun Last Year
Withholding	64.4 %	5.4 %	2.4 %	3.4 %	2.2 %	2.8 %
Nonwithholding	14.5	(4.7)	11.0	10.9	15.2	(15.9)
Refunds	(13.2)	(13.8)	(3.5)	(3.6)	(2.0)	(2.2)
Net Individual	65.7	5.7	5.5	6.5	7.1	(1.7)
Sales	19.8	(9.7)	(6.5)	(2.2)	2.5	15.4
Corporate	5.4	(8.6)	(1.7)	(3.1)	(1.1)	26.9
Wills (Recordation)	2.2	(2.9)	8.2	(5.6)	(7.8)	(11.2)
Insurance	1.9	NA	4.8	6.0	6.0	2.7
All Other Revenue	5.0	0.5	6.3	(0.3)	(0.7)	7.1
Total	100.0 %	1.3 %	2.6 %	3.5 %	4.9 %	3.6 %

Sales x AST *	5.6 %	0.8 %	5.5 %	5.4 %	1.7 %
Total x AST *	4.7 %	4.2 %	5.2 %	5.5 %	0.9 %

* Adjusted for the accelerated sales tax program in fiscal year 2010.

- Adjusting for the accelerated sales tax program in June 2010, total revenues grew 4.7 percent through November, slightly ahead of the official estimate of 4.2 percent.
- Adjusted for AST, total revenues have increased on a year-over-year basis in seven out of the last eight months.
 - Withholding: 7 consecutive monthly increases
 - Sales Tax: 8 consecutive monthly increases

The December Revenue Forecast Has Been Revised Upward From The Official Forecast...

- Withholding and sales tax drive the upward revision to total revenues for the next two years.
 - Basis for change:
 - 1) Both withholding and sales exceeded their respective forecasts in fiscal year 2010, raising the revenue base, and;
 - 2) Year-to-date collections for fiscal year 2011 through November maintained the positive trend dating back to March of 2010.
 - These factors more than offset the slightly weaker economic outlook.
- For both withholding and sales, revised annual growth for fiscal year 2011 is below year-to-date growth. If conditions deteriorate, the December forecast can still be achieved.
- For most other sources, revisions are minor, with reductions attributable to the continued weakness in housing and longer term concerns regarding financial markets and non-wage income.

The December Revenue Forecast Has Been Revised Upward From The Official Forecast (continued)...

- In the December forecast, total general fund revenues and transfers have been increased by \$146.9 million in fiscal year 2011 and \$190.1 million in fiscal year 2012.
 - Total biennium increase of \$337.0 million in total revenues and transfers.
- Revenues are expected to increase 3.5 percent in fiscal year 2011 compared with the official forecast of 2.6 percent growth.
 - Adjusted for the accelerated sales tax program in June 2010, total revenues are projected to increase 5.2 percent compared with the official forecast of 4.2 percent growth.
 - In the second year following a recession, total general fund revenue growth typically averages 11.2 percent. The projected annual percent increase for fiscal year 2011 is consistent with the economic forecast of a “half-speed” recovery.
- Total revenues are expected to increase 5.0 percent in fiscal year 2012, slightly ahead of the 4.9 percent increase contained in the official forecast.

The December General Fund Revenue Forecast Includes Policy Adjustments and Economic Development Incentives...

Decomposition of the December Revenue Forecast

Fiscal Years 2011 and 2012

(millions of dollars)

	FY11	FY12	11-12 Biennium
<u>Base Revenue Forecast</u>			
GACRE Forecast	133.9	128.3	262.2
Post-GACRE Adjustments:			
Withholding	41.0	42.0	83.0
Sales Tax	21.0	36.0	57.0
<u>Sales Tax (0.25% Transfer)</u>	<u>1.6</u>	<u>2.8</u>	<u>4.4</u>
Total	197.5	209.1	406.6
<u>Policy Adjustments</u>			
Advance Virginia Tax Conformity to 12/31/10			
Corporate	(19.2)	(8.2)	(27.4)
Individual (EITC)	(6.2)	-	(6.2)
<u>Data Centers Sales Tax Exemption</u>	<u>(3.3)</u>	<u>(7.0)</u>	<u>(10.3)</u>
Total	(28.7)	(15.2)	(43.9)
<u>Economic Development Incentives</u>			
Virginia Port Tax Incentive	-	(5.0)	(5.0)
Virginia Winery and Vineyard Development Tax Credit	-	(0.3)	(0.3)
<u>Refundable Research and Development Tax Credit</u>	<u>-</u>	<u>(5.0)</u>	<u>(5.0)</u>
Total	-	(10.3)	(10.3)
<u>Technical Budget Adjustments</u>			
Interest from Nongeneral Fund Accounts (§3-3.03A.)	(25.0)	(25.0)	(50.0)
Miscellaneous Revenue Adjustments	(1.5)	(1.8)	(3.3)
<u>Transfers Per Appropriations Act</u>	<u>4.6</u>	<u>33.2</u>	<u>37.8</u>
Total	(21.9)	6.4	(15.5)
December Forecast Revision	146.9	190.1	337.0

The December Revenue Forecast Has Been Revised Upward From The Official Forecast (continued)...

Summary of the December General Fund Revenue Forecast Fiscal Years 2011 and 2012 (millions of dollars)

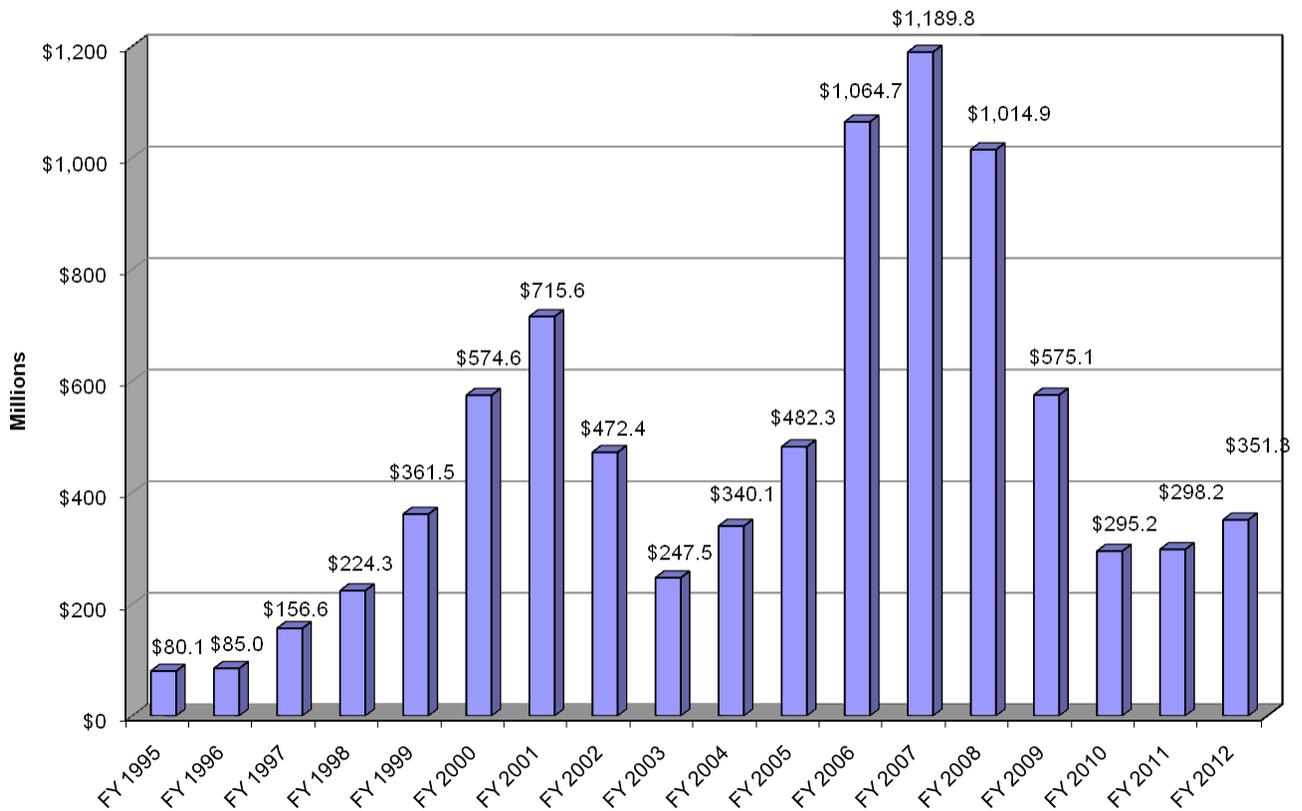
Major Source	Fiscal Year 2011			Fiscal Year 2012		
	Official *	December	\$ Change	Official *	December	\$ Change
Withholding	\$ 9,394.5	\$ 9,489.8	\$ 95.3	\$ 9,700.7	\$ 9,871.0	\$ 170.3
Nonwithholding	2,117.3	2,114.0	(3.3)	2,282.9	2,224.1	(58.8)
Refunds	(1,924.1)	(1,922.0)	2.1	(1,847.1)	(1,877.0)	(29.9)
Net Individual	\$ 9,587.7	\$ 9,681.8	\$ 94.1	\$ 10,136.5	\$ 10,218.1	\$ 81.6
Sales	\$ 2,880.8	\$ 3,014.6	\$ 133.8	\$ 2,974.2	\$ 3,115.5	\$ 141.3
Corporate	792.8	781.5	(11.3)	838.4	824.1	(14.3)
Wills (Recordation)	314.0	274.0	(40.0)	314.0	294.1	(19.9)
Insurance	274.4	277.7	3.3	291.4	289.6	(1.8)
All Other Revenue	733.8	687.8	(46.0)	748.6	710.8	(37.8)
Total Revenues	\$ 14,583.5	\$ 14,717.4	\$ 133.9	\$ 15,303.1	\$ 15,452.2	\$ 149.1
Percent Change for FY	2.6 %	3.5 %		4.9 %	5.0 %	
ABC Profits	\$ 46.2	\$ 46.2	\$ 0.0	\$ 49.3	\$ 47.8	\$ (1.5)
Sales Tax (0.25%)	208.9	217.3	8.4	215.8	225.1	9.3
Transfers	159.3	163.9	4.6	179.8	213.0	33.2
Total Transfers	\$ 414.4	\$ 427.4	\$ 13.0	\$ 444.9	\$ 485.9	\$ 41.0
Total General Fund	\$ 14,997.9	\$ 15,144.8	\$ 146.9	\$ 15,748.0	\$ 15,938.1	\$ 190.1

2010-12 Biennium	<u>Official</u>	<u>December</u>	<u>\$ Change</u>
Total Revenues	\$ 29,886.6	\$ 30,169.6	\$ 283.0
Total Transfers	859.3	913.3	54.0
Total General Fund	\$ 30,745.9	\$ 31,082.9	\$ 337.0

* Chapter 874 Forecast

The Projected Balance In The Revenue Stabilization Fund Will Be \$351.3 Million After The Proposed \$50 Million Deposit In Fiscal Year 2012...

Revenue Stabilization Fund -- June 30 Balance
 FY 1995-2010 Actual and FY 2011-2012 Forecast
 (millions of dollars)



Next Steps In The Revenue Forecasting Process...

- The mid-session review will incorporate the latest economic and revenue data.
 - Global Insight January U.S. economic outlook.
 - Impact of federal legislation, including extension of tax cuts and unemployment compensation.
 - Retail holiday sales.
 - Key additional revenue data will be available.
 - December 15: Due date for the fourth quarter corporate estimated income tax payment.
 - January 15: Due date for the fourth quarter individual estimated income tax payment.
 - Retail sales tax collections reflecting the main holiday shopping season.

APPENDIX

U.S. Economic Indicators

Virginia Economic Indicators

General Fund Forecast for FY 2011 through FY 2018

Commonwealth Transportation Fund Forecast, FY 2011-2016

Virginia Health Care Fund Forecast, FY 2011 through 2018

GACRE November Standard Revenue Forecast

GACRE November Alternative Revenue Forecast

Growth in General Fund Revenues, FY 1961 through FY 2012

Nongeneral Fund Forecast for FY 2011 through FY 2016

November 2010 Revenue Report