

# **Governor McDonnell's Proposed Amendments to the 2012-2014 Budget**

## **Economic Outlook & Revenue Forecast**

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

*December 17, 2012*



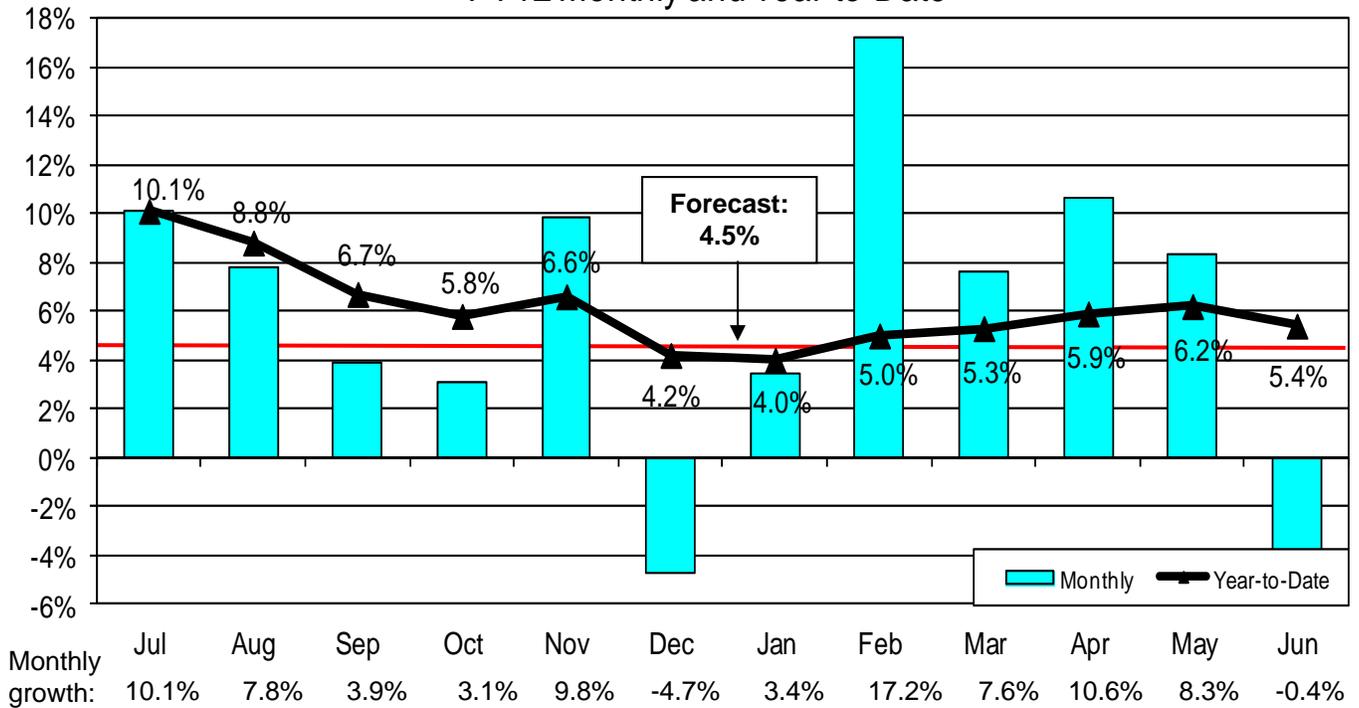
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## ***Outline...***

- Fiscal Year 2012 Year-in-Review
- U.S. and Virginia Economic Outlook
- December Revenue Forecast
- November Revenue Collections
- Next Steps

# Total General Fund Revenue Collections Exceeded The Forecast In All But Two Months...

Growth in Total General Fund Revenue Collections  
FY12 Monthly and Year-to-Date



- Total general fund revenue collections exceeded the forecast by \$123.1 million in fiscal year 2012, a forecast variance of 0.8 percent.
- Total general fund revenue collections rose 5.4 percent, ahead of the revised annual forecast of 4.5 percent growth.
  - Adjusting for the accelerated sales tax (AST) program, total revenues grew 5.4 percent, ahead of the economic-base forecast of 4.7 percent growth.

# ***Fiscal Year 2012 Revenues And Transfers Finished \$129.2 Million (0.8 Percent) Above Forecast...***

## **Summary of Fiscal Year 2012 Revenue Collections (millions of dollars)**

<u>Major Source</u>	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>		<u>% Growth Over FY11</u>	
			<u>Dollars</u>	<u>Percent</u>	<u>Forecast</u>	<u>Actual</u>
Withholding	\$ 10,006.0	\$ 10,039.7	\$ 33.7	0.3 %	3.8 %	4.2 %
Nonwithholding	2,452.2	2,357.9	(94.3)	(3.8)	12.6	8.2
Refunds	(1,931.8)	(1,784.7)	147.1	(7.6)	3.3	(4.5)
Net Individual	10,526.4	10,612.8	86.4	0.8	5.9	6.7
Sales	3,066.0	3,121.5	55.5	1.8	1.8	3.6
Corporate	827.8	859.9	32.1	3.9	0.7	4.6
Wills (Recordation)	322.9	322.1	(0.8)	(0.3)	10.8	10.5
Insurance	287.3	252.9	(34.4)	(12.0)	2.0	(10.2)
All Other Revenue	693.2	677.4	(15.8)	(2.3)	0.7	(1.6)
<b>Total Revenues</b>	<b>\$ 15,723.6</b>	<b>\$ 15,846.7</b>	<b>\$ 123.1</b>	<b>0.8 %</b>	<b>4.5 %</b>	<b>5.4 %</b>
ABC Profits	55.0	63.8	8.8	16.0	8.9	26.3
Sales Tax (0.25%)	216.1	214.1	(2.0)	(0.9)	5.9	4.9
Transfers	224.1	223.4	(0.7)	(0.3)	42.2	41.8
<b>Total Transfers</b>	<b>\$ 495.2</b>	<b>\$ 501.3</b>	<b>\$ 6.1</b>	<b>1.2 %</b>	<b>20.2 %</b>	<b>21.6 %</b>
<b>Total General Fund</b>	<b>\$ 16,218.8</b>	<b>\$ 16,348.0</b>	<b>\$ 129.2</b>	<b>0.8 %</b>	<b>5.0 %</b>	<b>5.8 %</b>

- Total revenues are back to fiscal year 2008 levels.
- With the revenue surplus, total revenue growth in fiscal year 2013 only needs to be 2.9 percent to meet the official forecast.

# **All Surplus Dollars Are Either Reserved, Committed or Assigned...**

## **General Fund - Budgetary (Cash) Basis (Unaudited) Fiscal Year 2012 (millions of dollars)**

<b>Assets</b>		
Cash, Cash Equivalents, and Investments	\$ 1,700.3	
Cash and Travel Advances	1.8	
Total Assets		<u>\$ 1,702.1</u>
<b>Liabilities and Fund Equity</b>		
Liabilities:		
Due to Other Funds	13.2	
Deposits Pending Distribution	5.5	
Total Liabilities	\$ 18.7	
Fund Equity:		
Reserved Fund Balance:		
Revenue Stabilization Reserve Fund	303.6	
Revenue Stabilization Reserve 2013	132.7	
Revenue Stabilization Reserve 2014	244.6	
Lottery Proceeds Fund	12.2	
Water Supply Assistance Grant Fund	14.3	
Total Reserved Fund Balance	707.4	
Commitments and Assignments:		
Reapp. 2010 Unexpended Bal. for Cap Outlay	7.0	
Central Capital Planning Fund	2.0	
Communication Sales and Use Tax	40.3	
3% Bonus for State Employees	77.2	
Natural Disaster Sum Sufficient	29.9	
Amount Required by Chapter 3	376.4	
Amt. Required for Mandatory Reapp.	98.0	
AST for Transportation Trust Fund	20.9	
Fed. Portion of Va. Power Rebate/Internal Service Fund	2.1	
Virginia WQIF - Part A	12.3	
Virginia WQIF - Part B	4.6	
Discretionary Reappropriations	41.8	
Federal Action Contingency Trust Fund	30.0	
Select NGF Balances	233.5	
Total Committed and Assigned Fund Balance	976.0	
Total Fund Equity	<u>\$ 1,683.4</u>	
Total Liabilities and Fund Balance		<u>\$ 1,702.1</u>

## ***Recent National and State Economic Indicators Continue to Show a Slowly Improving Economy...***

- Real GDP grew 2.7 percent in the third quarter of 2012, up from 1.3 percent in the second quarter and 2.0 percent in the first quarter.
- Payroll employment grew by 146,000 jobs in November, but September and October were revised down by a total of 49,000 jobs.
- The unemployment rate fell in November from 7.9 percent to 7.7 percent, the lowest rate since December 2008.
  - However, the decrease resulted from a decline in the labor force, possibly due to Hurricane Sandy.
- Payroll employment in Virginia grew 0.8 percent in October.
  - Employment increased 1.7 percent in Northern Virginia, 0.6 percent in Hampton Roads and 0.4 percent in Richmond-Petersburg.
- The unemployment rate in Virginia fell slightly in October from 5.6 percent to 5.4 percent, 0.6 percentage point below the October 2011 rate.
- During the week ending December 1, initial claims for unemployment fell by 25,000 to 370,000. This was the third consecutive weekly decrease following the post Hurricane Sandy increase of 90,000. The four-week moving average increased from 406,000 to 408,000 since it incorporates the large increase after the hurricane.
- The Conference Board's index of leading indicators rose 0.2 percent in October, its second consecutive monthly increase. The rise in the index is consistent with a continuing recovery.

## ***Recent National and State Economic Indicators Continue to Show a Slowly Improving Economy (continued)...***

- The Conference Board's index of consumer confidence rose 0.6 point in October to 73.7, its highest level since February 2008. This was the third consecutive monthly increase.
- Conditions in the manufacturing sector weakened in November, as the Institute of Supply Management index fell from 51.7 to 49.5. This is the fourth month since May that the index has fallen below the expansionary threshold of 50.0.
- The CPI rose 0.1 percent in October from the previous month and stands 2.2 percent above October of last year.
  - Core inflation (excluding food and energy prices) rose 0.2 percent, and has increased 2.0 percent from October 2011.
- According to RealtyTrac, U.S. foreclosure activity for October declined 19 percent from October 2011.
  - One in every 706 U.S. housing units received a foreclosure notice in October.
  - In Virginia, one in every 1,802 households received a foreclosure notice.
- The U.S. personal savings rate increased from 3.3 percent in September to 3.4 percent in October.
- The Federal Reserve announced at its October meeting that it will keep its purchases of mortgage-backed securities unchanged at \$40 billion per month and will keep the federal funds rate target unchanged at 0.0 to 0.25 percent.

***Global Insight's October U.S. Standard forecast is less optimistic about fiscal year 2013 due to the "window of uncertainty", but momentum builds afterwards....***

- Real GDP growth of 1.4 percent in the 3rd quarter (2.7 percent actual) and 1.6 percent in the 4th quarter of 2012.
  - Growth in fiscal year 2013 is projected to be 1.7 percent versus 1.8 percent in the official forecast.
  - Growth in fiscal year 2014 is projected to be 2.3 percent versus 3.2 percent in the official forecast.
- The biggest domestic risk is the fiscal cliff; however, Global Insight does not believe it will occur. Instead, they expect:
  - The lame-duck Congress will postpone the year-end fiscal cliff for a few months.
  - The new Congress and President will put together a new package of spending cuts and tax increases that will start in January 2014. (Specifically, they assume cuts in Medicare, Medicaid, Social Security and non-defense discretionary spending, and income tax increases.)
  - The Bush tax cuts will be extended for 2013.
- The biggest external risks are a deeper Eurozone recession and a harder landing in China.

# ***The Fall 2012 Consensus Forecasting Process...***

- The Joint Advisory Board of Economists (JABE) met in October.
  - Members were presented the September Standard economic outlook, a conservative forecast that had Virginia growing slower than the nation in fiscal years 2013 and 2014.
  - Members were split on the appropriate outlook for Virginia given the risk of the fiscal cliff:
    - Six members supported the Standard outlook, arguing that it was better to wait until there was more data available to adjust the forecast.
    - Seven supported the Standard minus, arguing that the forecast should be lowered given Virginia's dependence on the federal government.
    - Two supported the Pessimistic alternative, arguing that it was best to budget for the worst case scenario, even if they didn't believe it would happen.
  - An adjustment to the forecast was made to reflect the views of the Standard minus outlook.
- The Governor's Advisory Council on Revenue Estimates (GACRE) met in November.
  - Members evaluated JABE recommendations, revenue collections through October, and the associated revenue forecasts for the 2012-14 biennium.
  - Of the nine members who provided a recommendation, seven supported the standard minus forecast and two supported the standard.
  - Members of the General Assembly who provided a recommendation had similar beliefs: 10 supported the standard minus and one supported the standard.

## ***Following the GACRE meeting, Global Insight's U.S. November Forecast was incorporated into our models...***

- The Global Insight U.S. November 2012 standard economic forecast is essentially unchanged from the October forecast presented to GACRE.
  - Real GDP is at 1.9 percent for fiscal year 2013 as compared to 1.7 percent in the October forecast. Fiscal year 2014 is unchanged.
- As a result, the November 2012 Post-GACRE Virginia economic outlook is still a Standard Minus forecast.

### **Key Virginia Economic Indicators**

Official, October (Post-JABE) and November (Post-GACRE) Standard Forecasts  
Annual Percent Change

	11	12	13	14
<b>Employment</b>				
Official (Budget)	1.2	1.2	1.0	1.8
Oct 2012 (Post-JABE)	1.0	1.6	1.0	1.3
Nov 2012 (Post-GACRE)			1.2	1.4
<b>Personal Income</b>				
Official (Budget)	5.0	3.9	3.5	4.0
Oct 2012 (Post-JABE)	5.6	4.0	3.4	4.0
Nov 2012 (Post-GACRE)			3.4	4.1
<b>Wages &amp; Salaries</b>				
Official (Budget)	3.5	3.3	3.7	4.2
Oct 2012 (Post-JABE)	3.6	2.6	3.5	3.8
Nov 2012 (Post-GACRE)			3.7	3.9
<b>Average Wage</b>				
Official (Budget)	2.3	2.1	2.6	2.4
Oct 2012 (Post-JABE)	2.5	1.0	2.5	2.4
Nov 2012 (Post-GACRE)			2.5	2.5

# ***Fiscal Year 2013 Year-to-Date Revenue Collections Through November Are In Line with the Annual Estimates...***

## **November Year-to-Date Collections and Fiscal Year 2013 Forecasts**

(annual percent change)

<u>Major Source</u>	As a % of Total <u>Revenues</u>	Nov YTD <u>Actual</u>	Annual <u>Estimate</u>	Dec. <u>Estimate</u>	Dec-June Req'd <u>to Meet Dec Est.</u>
Withholding	63.7 %	1.5 %	3.5 %	3.3 %	4.4 %
Nonwithholding	15.0	7.1	3.6	6.8	6.7
Refunds	<u>(11.8)</u>	<u>(8.6)</u>	<u>7.8</u>	<u>0.4</u>	<u>1.5</u>
Net Individual	66.9	2.5	2.8	4.5	5.8
Sales	19.7	5.5	2.8	4.1	3.3
Corporate	5.4	(1.3)	3.0	(4.5)	(5.5)
Wills (Recordation)	2.0	16.3	0.3	4.5	(3.5)
Insurance	1.8	0.0	16.1	1.1	1.1
All Other Revenue	4.2	0.0	2.1	(2.2)	(3.4)
<b>Total</b>	<b>100.0 %</b>	<b>3.2 %</b>	<b>2.9 %</b>	<b>3.6 %</b>	<b>3.8 %</b>

Sales (x AST)	2.4 %	1.7 %	3.2 %	3.7 %
Total (x AST)	2.6 %	2.7 %	3.4 %	3.9 %

- In November, total revenues fell 3.3 percent.
  - This was mainly a result of November having one less Tuesday and Wednesday (when approximately 60 percent of weekly payroll withholding payments are received) than last year.
- Total revenues grew 3.2 percent through November, ahead of the official estimate of 2.9 percent.
  - Adjusting for AST, total revenues grew 2.6 percent, slightly behind the economic-base forecast of 2.7 percent growth.

## ***The December Revenue Forecast Has Been Revised Upward From the Official Forecast ...***

- Total general fund revenues have been increased by \$98.8 million over the 2012-14 biennium, with \$103.4 million coming from fiscal year 2013.
- The largest revenue source, payroll withholding, is virtually unchanged.
  - This source is 63 percent of total general fund revenues.
- Refunds contribute \$266 million over the biennium to the increase. In fiscal years 2013 and 2014, refunds are expected to be similar to fiscal year 2012 levels, instead of growing substantially as expected in the official forecast.
- Individual nonwithholding contributes \$130.5 million over the biennium to the increase. Growth is expected to be 6.8 percent in fiscal year 2013 and 4.4 percent in fiscal year 2014 compared to the official forecast of 3.6 percent and 5.2 percent.
  - Revenue model showing stronger growth due to:
    - 1) 1st quarter payments were up 4.1 percent;
    - 2) Higher growth of dividends, interest and rent in the November forecast than in the official; and
    - 3) Improvement in the S&P 500 yearly performance.
  - Also accounts for possibility that expiring capital gains tax rates have pulled nonwithholding activity into tax year 2012.

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

- Corporate, on the other hand, contributes \$132.5 million less over the biennium. In fiscal year 2013, collections are expected to fall 4.5 percent instead of increase 3.0 percent, as projected in the official forecast.
  - There was widespread weakness in the first estimated payment by large payers and as a result, first quarter payments were down 11.8 percent.
- Collections of insurance premiums also are expected to fall, contributing \$71.8 million less over the biennium.
  - Fiscal year 2012 collections came in 12.0 percent below expectations, lowering the base, as the commercial real estate market and lower business and housing valuations likely dampened growth. None of these are expected to significantly improve in fiscal year 2013.
- In the December forecast, total general fund revenues and transfers have been increased by \$111.0 million in fiscal year 2013 and \$6.6 million in fiscal year 2014.
  - Total biennium increase of \$117.6 million in total revenues and transfers.
- Revenues are expected to increase 3.6 percent in fiscal year 2013 and 3.8 percent in fiscal year 2014 compared with the official forecast of 2.9 percent and 4.5 percent growth.
  - Adjusted for the accelerated sales tax program, total revenues are projected to increase 3.4 percent in fiscal year 2013.

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

## **Decomposition of the December Revenue Forecast**

Fiscal Years 2013 and 2014

(millions of dollars)

	FY13	FY14	2012-14 Biennium
<u>Official Revenue Forecast</u>	\$16,313.1	\$17,041.7	\$33,354.8
Total Revenue Growth: Official	2.9%	4.5%	
PLUS			
<u>GACRE Revenue Forecast</u>	\$109.6	\$101.3	\$210.9
Total Revenue Growth: GACRE	3.6%	4.4%	
<u>Post GACRE Adjustments</u>			
Nonwithholding	<u>0.0</u>	<u>(25.0)</u>	<u>(25.0)</u>
Total	0.0	(25.0)	(25.0)
Total Revenue Growth: Post GACRE	3.6%	4.2%	
<u>Policy Adjustments</u>			
Earned Income Tax Credit (conformity)	(7.0)	0.0	(7.0)
Sale of Property	(0.5)	(9.5)	(10.0)
Interest Income Adjustment	0.0	(3.8)	(3.8)
Accelerated Sales Tax (Additional Relief)	0.0	(20.8)	(20.8)
Transportation Sales Tax Change	0.0	(48.1)	(48.1)
<u>Minor</u>	<u>1.3</u>	<u>1.3</u>	<u>2.6</u>
Total	(6.2)	(80.9)	(87.1)
<b>Total General Fund Revenues</b>	<b>\$ 16,416.5</b>	<b>\$ 17,037.1</b>	<b>\$ 33,453.6</b>
<b>Total Revenue Growth: December</b>	<b>3.6%</b>	<b>3.8%</b>	

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

## **Summary of the December General Fund Revenue Forecast Fiscal Years 2013 and 2014 (millions of dollars)**

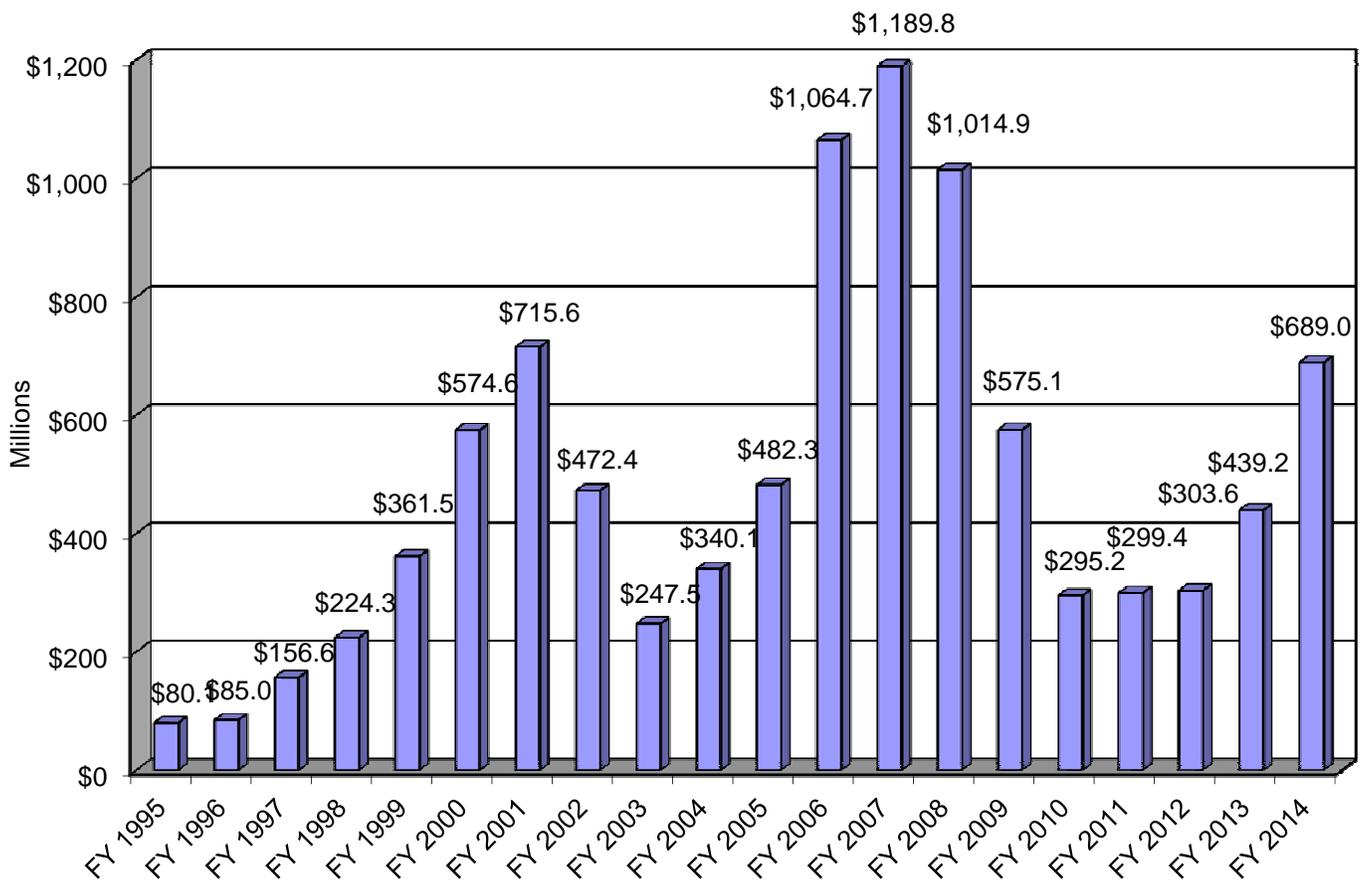
Major Source	Fiscal Year 2013			Fiscal Year 2014		
	Official*	December	\$ Change	Official*	December	\$ Change
Withholding	\$ 10,391.5	\$ 10,366.3	\$ (25.2)	\$ 10,843.9	\$ 10,809.8	\$ (34.1)
Nonwithholding	2,443.6	2,517.4	73.8	2,571.4	2,628.1	56.7
Refunds	<u>(1,923.8)</u>	<u>(1,791.3)</u>	<u>132.5</u>	<u>(1,960.6)</u>	<u>(1,827.1)</u>	<u>133.5</u>
Net Individual	\$ 10,911.3	\$ 11,092.4	\$ 181.1	\$ 11,454.7	\$ 11,610.8	\$ 156.1
Sales	\$ 3,207.9	\$ 3,248.8	\$ 40.9	\$ 3,331.5	\$ 3,303.5	\$ (28.0)
Corporate	886.0	820.9	(65.1)	907.2	839.8	(67.4)
Wills (Recordation)	322.9	336.5	13.6	322.9	336.5	13.6
Insurance	293.6	255.6	(38.0)	307.5	273.7	(33.8)
All Other Revenue	<u>691.4</u>	<u>662.3</u>	<u>(29.1)</u>	<u>717.9</u>	<u>672.8</u>	<u>(45.1)</u>
<b>Total Revenues</b>	<b>\$ 16,313.1</b>	<b>\$ 16,416.5</b>	<b>\$ 103.4</b>	<b>\$ 17,041.7</b>	<b>\$ 17,037.1</b>	<b>\$ (4.6)</b>
Percent Change for FY	2.9 %	3.6 %		4.5 %	3.8 %	(0.7)
ABC Profits	\$ 56.3	\$ 64.6	\$ 8.3	\$ 56.3	\$ 65.5	\$ 9.2
Sales Tax (0.25%)	226.1	222.8	(3.3)	235.0	230.4	(4.6)
Transfers	<u>115.4</u>	<u>118.0</u>	<u>2.6</u>	<u>122.8</u>	<u>129.4</u>	<u>6.6</u>
<b>Total Transfers</b>	<b>\$ 397.8</b>	<b>\$ 405.4</b>	<b>\$ 7.6</b>	<b>\$ 414.1</b>	<b>\$ 425.3</b>	<b>\$ 11.2</b>
<b>Total General Fund</b>	<b>\$ 16,710.9</b>	<b>\$ 16,821.9</b>	<b>\$ 111.0</b>	<b>\$ 17,455.8</b>	<b>\$ 17,462.4</b>	<b>\$ 6.6</b>

2012-14 Biennium	Official	December	\$ Change
Total Revenues	\$ 33,354.8	\$ 33,453.6	\$ 98.8
Total Transfers	<u>811.9</u>	<u>830.7</u>	<u>18.8</u>
<b>Total General Fund</b>	<b>\$ 34,166.7</b>	<b>\$ 34,284.3</b>	<b>\$ 117.6</b>

\* Chapter 3 Forecast

# ***Mandatory Deposits into the Revenue Stabilization Fund Will Double the Size of the Fund by the End of Fiscal Year 2014 Reaching \$689.0 Million ...***

**Revenue Stabilization Fund -- June 30 Balance**  
 FY 1995-2012 Actual and FY 2013-2014 Forecast  
 (millions of dollars)



- Mandatory deposits of \$132.7 million in fiscal year 2013 and \$244.6 in fiscal year 2014 are required.

## ***Next Steps In The Revenue Forecasting Process...***

- The mid-session review will incorporate the latest economic and revenue data.
  - Global Insight’s 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 17: 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**

This presentation and the appendix data listed below are available at the Secretary of Finance website ([www.finance.virginia.gov](http://www.finance.virginia.gov)).

U.S. Economic Indicators

Virginia Economic Indicators

General Fund Forecast for FY 2013 through FY 2020

Commonwealth Transportation Fund Forecast, FY 2013-2018

Virginia Health Care Fund Forecast, FY 2013 through 2020

GACRE November Standard Revenue Forecast

GACRE November Pessimistic Alternative Revenue Forecast

Growth in General Fund Revenues, FY 1961 through FY 2014

Nongeneral Fund Forecast for FY 2013 through FY 2018

November 2012 Revenue Report