GENERAL FUND REVENUE UPDATE
FISCAL 2009

A Report Prepared for the

Revenue and Transportation Interim Committee

By

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INTRODUCTION

The purpose of this report is to provide the committee with current information on general fund revenue collections through June 2009. The 2011 biennium outlook table that would be traditionally included in the report has not been updated. The reason for not showing a detailed 2011 biennium outlook table is because considerable research and analysis will be required to determine what new revenue trends observed in FY 2009 will impact revenue collections in the 2011 biennium.

During the regular legislative session, our office recommended to the 61st Legislature that the general fund revenue estimates be decreased by $292.6 million for fiscal 2009, 2010, and 2011. The House Taxation Committee adopted these recommendations and included the assumptions into HJ 2, the revenue estimating resolution. The reduced revenue was anticipated from major sources such as individual and corporation income taxes and oil and gas production taxes. The final collections for FY 2009 will not be available until the end of July when all the year-end adjustments (accruals) have been posted to the state accounting system. As explained later in this report, FY 2009 individual income tax collections are lagging estimates while corporation income tax collections are exceeding estimates. The information in this report is based on data received through the end of June 2009.

The report is organized into three main sections. The first section discusses the FY 2009 general fund revenue collections including a discussion of selected general fund revenue sources. The second section addresses key economic trends that help understand or explain why selected revenue sources fluctuate from legislative estimates. The third section is a summary of the findings.

GENERAL FUND REVENUE OUTLOOK

FISCAL 2009 REVENUE TRENDS

Based on information recorded through the end of June 2009 on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts for FY 2009 were $1.655 billion as shown in Figure 1. This compares to $1.954 billion collected for all of FY 2008. It is important to note that the collections for FY 2009 are not finalized at this time. During July 2009, there will be additional year-end adjustments (accruals) that will change the final collection amounts for FY 2009. All of these adjustments (both revenues and disbursements) should be processed by the end of July.

At this time, total general fund collections are $298.7 million below last year's amount, which represents a 15.3 percent decrease. Revenue estimates as used by the 61st Legislature and contained in adjusted HJ 2 (revenue estimate resolution plus impacts of enacted legislation) assumed collections would decline $108.9 million or 5.6 percent from fiscal 2008 to 2009. Most of this reduction was expected from insurance premium tax, individual income tax, oil and gas production tax, and TCA (treasury cash account) investment earnings. Insurance premium tax collections were expected to decline because of the passage of I 155 - Healthy Montana Kids initiative and the statutory changes adopted in HB 676 of the regular session. Individual income tax collections were expected to decline because of the economic recession impacts on wage and salary income, capital gains income, and many of the other taxable income components. Oil and gas production collections were expected to decline because of significantly reduced commodity prices and reduced production levels. TCA investments earnings were expected to decline because of the historical low level for short-term interest rates.

Figure 1 shows revenue collection and estimate data by major revenue category. The last two columns in the figure show how the collections from the revenue source are performing when compared to the estimate contained in HJ 2. For example, insurance tax (2nd line) shows a negative 19.7 percent in the "% Change" column. This means that collections through June 2009 are 19.7 percent less than collections for FY 2008. The last column shows what the legislature assumed the growth rate would be (negative 22.1 percent). Since the current growth rate through June (negative 19.7 percent) is less negative than the assumed growth rate (negative 22.1 percent), insurance tax collections are above the estimate contained in HJ 2. Obviously, this is the conclusion based on collections data through June.

However, there may be year-end adjustments (accruals) that will be processed in July that could change the final collections for FY 2009.

Figure 1

General Fund Revenue Monitoring Report							
Revenue Source	Actual Fiscal 2008	HJ2 Estimate * Fiscal 2009	Final FY 2008	Through 6/30/09	Difference	% Change	HJ2 Estimate % Change
GF0100 Drivers License Fee	3,865,872	4,667,000	3,865,871.68	3,362,183.74	(503,687.94)	**-13.03%**	20.72%
GF0200 Insurance Tax	64,003,987	49,878,000	64,003,986.80	51,416,874.39	(12,587,112.41)	-19.67%	-22.07%
GF0300 Investment Licenses	6,513,962	6,127,000	6,513,962.10	6,444,072.26	(69,889.84)	-1.07%	-5.94%
GF0400 Vehicle License Fee	93,493,069	93,493,000	93,493,069.36	68,395,769.84	(25,097,299.52)	**-26.84%**	0.00%
GF0500 Vehicle Registration Fee	18,992,762	18,926,000	18,992,761.93	12,135,110.88	(6,857,651.05)	**-36.11%**	-0.35%
GF0600 Nursing Facilities Fee	5,610,099	5,318,000	5,610,098.63	4,106,096.65	(1,504,001.98)	**-26.81%**	-5.21%
GF0700 Beer Tax	3,124,238	3,160,000	3,124,237.91	2,832,317.04	(291,920.87)	**-9.34%**	1.14%
GF0800 Cigarette Tax	36,004,249	34,564,000	36,004,249.24	33,066,660.38	(2,937,588.86)	**-8.16%**	-4.00%
GF0900 Coal Severance Tax	11,894,408	12,410,000	11,894,408.01	10,025,680.69	(1,868,727.32)	**-15.71%**	4.33%
GF1000 Corporation Tax	160,341,787	157,284,000	160,341,786.71	168,512,257.32	8,170,470.61	5.10%	-1.91%
GF1100 Electrical Energy Tax	5,179,013	4,707,000	5,179,012.86	3,696,185.44	(1,482,827.42)	**-28.63%**	-9.11%
GF1150 Wholesale Energy Trans Tax	3,856,112	3,870,000	3,856,112.47	3,001,026.59	(855,085.88)	**-22.17%**	0.36%
GF1200 Railroad Car Tax	2,063,981	2,166,000	2,063,981.21	2,099,454.00	35,472.79	**1.72%**	4.94%
GF1300 Individual Income Tax	866,658,538	852,615,000	866,658,537.89	795,071,417.97	(71,587,119.92)	**-8.26%**	-1.62%
GF1400 Inheritance Tax	122,148	113,000	122,147.66	174,859.67	52,712.01	43.15%	-7.49%
GF1500 Metal Mines Tax	10,774,242	6,777,000	10,774,241.67	2,819,873.25	(7,954,368.42)	**-73.83%**	-37.10%
GF1700 Oil Severance Tax	149,993,826	94,769,000	149,993,826.11	65,055,130.93	(84,938,695.18)	**-56.63%**	-36.82%
GF1800 Public Contractor's Tax	5,062,659	4,058,000	5,062,659.38	5,095,627.27	32,967.89	0.65%	-19.84%
GF1850 Rental Car Sales Tax	3,157,239	3,118,000	3,157,238.94	2,307,540.29	(849,698.65)	**-26.91%**	-1.24%
GFxxxx Property Tax	205,043,752	214,615,000	205,043,751.83	208,949,461.39	3,905,709.56	**1.90%**	4.67%
GF2150 Lodging Facilities Sales Tax	13,389,534	13,109,000	13,389,534.25	9,690,249.80	(3,699,284.45)	**-27.63%**	-2.10%
GF2200 Telephone Tax	-	-	-	-	-		
GF2250 Retail Telecom Excise Tax	22,350,323	21,597,000	22,350,322.51	16,543,318.94	(5,807,003.57)	**-25.98%**	-3.37%
GF2300 Tobacco Tax	4,698,888	4,710,000	4,698,888.11	4,548,601.68	(150,286.43)	**-3.20%**	0.24%
GF2400 Video Gaming Tax	63,134,000	66,554,000	63,134,000.22	47,166,360.63	(15,967,639.59)	**-25.29%**	5.42%
GF2500 Wine Tax	1,829,311	1,942,000	1,829,311.01	1,775,494.88	(53,816.13)	**-2.94%**	6.16%
GF2600 Institution Reimbursements	15,334,683	14,782,000	15,334,683.22	11,370,153.00	(3,964,530.22)	**-25.85%**	-3.60%
GF2650 Highway Patrol Fines	4,049,390	4,052,000	4,049,389.50	3,935,986.17	(113,403.33)	**-2.80%**	0.06%
GF2700 TCA Interest Earnings	30,782,748	16,507,000	30,782,748.26	15,002,238.45	(15,780,509.81)	**-51.26%**	-46.38%
GF2900 Liquor Excise Tax	14,925,057	15,787,000	14,925,057.19	11,192,446.68	(3,732,610.51)	**-25.01%**	5.78%
GF3000 Liquor Profits	8,775,000	8,651,000	8,775,000.00	-	(8,775,000.00)	**-100.00%**	-1.41%
GF3100 Coal Trust Interest Earnings	28,854,611	29,312,000	28,854,611.21	22,341,692.91	(6,512,918.30)	**-22.57%**	1.59%
GF3300 Lottery Profits	11,028,563	10,275,000	11,028,562.62	7,597,027.00	(3,431,535.62)	**-31.11%**	-6.83%
GF3450 Tobacco Settlement	3,807,570	3,956,000	3,807,570.28	4,127,609.08	320,038.80	8.41%	3.90%
GF3500 U.S. Mineral Leasing	36,388,559	24,885,000	36,388,558.69	27,240,795.07	(9,147,763.62)	-25.14%	-31.61%
GF3600 All Other Revenue	38,435,655	35,850,000	38,435,655.35	23,752,520.18	(14,683,135.17)	**-38.20%**	-6.73%
Grand Total	1,953,539,835	1,844,604,000	1,953,539,834.81	1,654,852,094.46	(298,687,740.35)	**-15.29%**	-5.58%

* plus impacts of enacted legislation

The total shown at the bottom of Figure 1 indicates that general fund revenue growth for FY 2009 (negative 15.3 percent) are below expectations since total revenues were expected to decrease by 5.6 percent from actual FY 2008 collections. As previously discussed, the amount of fiscal year-end adjustments will change the final FY 2009 total collections. The estimates shown for FY 2009 are from HJ 2 as amended during the 61st Legislature by the House Taxation Committee and adjusted for revenue legislation enacted by the regular session.

While the growth rate of negative 15.3 percent is more negative than the adjusted HJ 2 estimated rate of a negative 5.6 percent, accruals plus unusual events occurring between fiscal years can make an aggregate comparison of this type misleading. For example, if collection patterns during the past year are not similar to the current year, the computed growth rate can be skewed either positively or negatively. Unusual or one-time collections such as audit activity in either year can also distort the underlying growth rates. Both individual and corporation income tax collections can be significantly influenced by audit efforts of the Department of Revenue (DOR). The next section of the report will discuss some of the available details for the larger revenue components.

DISCUSSION OF SELECTED REVENUE SOURCES FOR FISCAL 2009

As explained in the previous section of the report, a comparison of total revenues from the previous fiscal year to the current fiscal year can be misleading. Not only can collection patterns and statutory modifications change revenue trends, but changes in general economic conditions can also skew aggregate growth trends.

Figure 2

Comparison of General Fund Revenue Sources to Adjusted HJ2 Estimates				
Revenue Source	% of 2008	Actual Fiscal 2008	HJ2 Adjusted Estimate Fiscal 2009	Estimated Chg From 2008
Individual Income Taxes	44.4%	$866,658,538	$852,615,000	($14,043,538)
Corporation Income Taxes	8.2%	160,341,787	157,284,000	(3,057,787)
Property Taxes	10.5%	205,043,752	214,615,000	9,571,248
Natural Resource Taxes & Royalties	10.7%	209,051,035	138,841,000	(70,210,035)
Vehicle Taxes	5.8%	112,485,831	112,419,000	(66,831)
All Other Revenue Sources	20.5%	399,958,892	368,830,000	(31,128,892)
Totals	100.0%	$1,953,539,835	$1,844,604,000	($108,935,835)

As shown in Figure 2, the five general fund revenue sources listed comprised almost eighty percent of the total general fund collections received in FY 2008. These sources plus the remaining categories were expected to decrease by $108.9 million in FY 2009 from FY 2008 actual collections. Included in this amount is an anticipated reduction in individual income tax revenues of $14.0 million. This decrease is expected because of the economic recession and its impact on taxable incomes of individual taxpayers. The legislature also expected corporation income tax collections to decrease by $3.1 million from the FY 2008 amount. This reduction is anticipated because of the economic recession and its impact on corporate profitability. The legislature expected property taxes to increase by $9.6 million reflecting the expected increase in statewide taxable values. The taxable value increase was not due to the impacts of reappraisal but merely a reflection of the changes in all classes of taxable property. The legislature also expected the general fund portion of natural resource taxes (oil, natural gas, coal, metals, and royalties) to decrease by $70.2 million. This decrease is predominately due to reduced commodity prices primarily for oil, natural gas and metals. Vehicle tax is expected to remain stable at the FY 2008 amount. All other revenue sources are expected to decrease by $31.1 million. Included in this lump sum amount are insurance premium tax and investment earnings. The decrease in insurance premium tax is due to the passage of I 155 – Healthy Montana Kids initiative and the statutory changes adopted in HB 676 during the regular session. Investment earnings are expected to decline because of reduced short-term interest rates.

The following section of the report addresses some of the key general fund revenue sources that were monitored closely during the regular session. These sources are insurance premium tax, individual income tax, corporation income tax, oil and gas production tax, video gaming tax, and TCA investment earnings. These sources were chosen because of their vulnerability to the economic recession and the discussion these sources received during the past legislative session.

Insurance Tax

Insurance tax revenues are $12.6 million (19.7 percent) below last year as of the end of June. This decrease is due to a revenue deposit schedule that is inconsistent with historical patterns and is further skewed by the impacts of Initiative 155. Based on information from SABHRS, the State Auditor's office deposited $13.3 million to the Montana Healthy Kids Plan account, the fund created by the passage of Initiative 155. When these deposits are combined with year to date collections through June 30, insurance tax collections are on target with the HJ 2 revenue estimate. During the session, insurance tax collections appeared to be lagging the HJ 2 revenue estimate. Since some insurance coverage may be viewed as discretionary combined with reduced new car sales and housing starts, it would be reasonable to expect insurance tax revenues to decline during an economic recession. These collection trends will be monitored closely in subsequent months.

Individual Income Tax

Based on accounting data through June 2009, individual income tax collections for FY 2009 are below estimates contained in HJ 2. Net collections (gross collections less refunds) through June 2009 were 8.3 percent below net collections through FY 2008 or a decrease of $71.6 million. The 61st Legislature assumed the growth rate to be a negative 1.6 percent from the FY 2008 amount or a decline of $14.0 million. As previously mentioned, this decline was anticipated because of the effects of the economic recession.

Since about 60 percent of total income reported on state tax returns reported for tax year 2007 was from wage and salary income, a review of this income component can provide some insight to future collection patterns. As assumed in HJ 2, the wage and salary growth rate between calendar years 2008 and 2009 was estimated to be 0.75 percent. According to the Bureau of Economic Analysis (BEA) first quarter data (shown in Figure 6) indicate growth at 1.2 percent - slightly above the assumed rate shown in HJ 2.

Figure 3 shows the accounting details of individual income tax collections through June of this year compared to the totals for FY 2008. Since withholding tax collections could be a proxy of total wage growth, the negative 3.2 percent growth from last year would indicate wages may be declining versus increasing as the BEA data would suggest. However, a withholding tax accrual of approximately $22 million will be processed by DOR during the adjustment period. With this accrued amount, withholding tax collections will probably be slightly above last year's amount by about 0.17 percent.

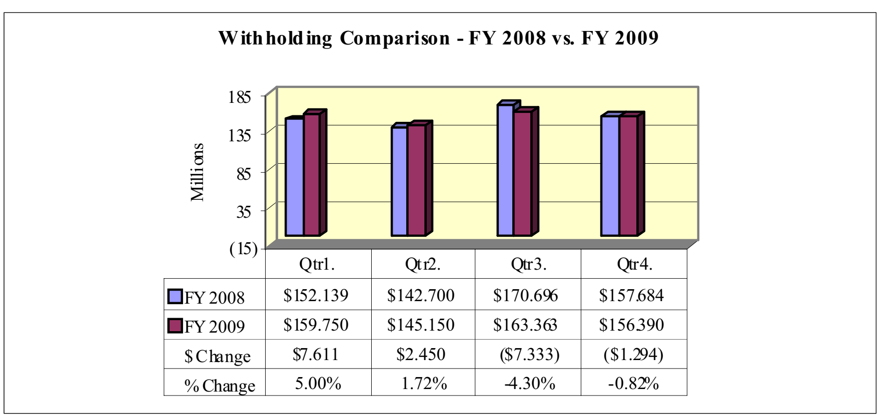
Figure 3

Individual Income Tax Comparison

Revenue Code & Description	Final Fiscal 2008	Through 6/30/2009 Fiscal 2009	Difference	Percent Change
510101 Withholding Tax	645,532,404.52	624,652,888.06	(20,879,516.46)	-3.23%
510482 Mineral Royalty WH Tax	12,426,153.25	15,186,293.87	2,760,140.62	22.21%
510102 Estimated Tax	250,705,012.40	247,228,099.03	(3,476,913.37)	-1.39%
510103 Current Year I/T	182,219,742.98	127,658,677.24	(54,561,065.74)	-29.94%
510105 Income Tax - Audit Collections	30,636,653.00	28,968,230.00	(1,668,423.00)	-5.45%
510106 Income Tax Refunds	(254,861,428.26)	(248,622,770.23)	6,238,658.03	-2.45%
Totals	$866,658,537.89	$795,071,417.97	($71,587,119.92)	-8.26%
Percent of Actual/Estimated	100.00%	93.47%		

Figure 3a shows a comparison of withholding tax collections between FY 2008 and FY 2009 by fiscal quarter. During the first quarter of FY 2009 (July through September), withholding collections were above last year by 5.0 percent. This growth rate slowed to 1.7 percent for the second quarter (October through December) and dropped below last year during the third quarter (January through March) to negative 4.3 percent. The fourth quarter (April through June) improved somewhat but was still 0.8 percent below last year. As stated above, withholding taxes can be a good indicator of the growth in wage and salary income for Montana. If the reduction observed in the third and fourth quarter of FY 2009 continues for an extended period of time, the HJ 2 assumption for wage growth of 0.75 percent from calendar 2008 to 2009 may be too optimistic. Since 60 percent of total income reported on state tax returns is from wage and salary income, even a small change in the wage growth assumption can significantly impact the revenue estimate for individual income tax collections.

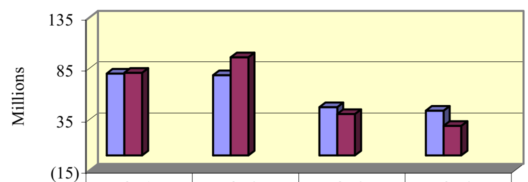
Figure 3a



Estimated payments are $3.5 million (1.4 percent) below last year. Review of this data by quarter shows good growth in estimated payments between the first and second quarters of FY 2009. The last two quarters of FY 2009, however, show an entirely different picture. As shown in Figure 3b, estimated payments as compared to FY 2008 have declined by 14.5 and 33.6 percent, respectively for the last two quarters of FY 2009.

Figure 3b

Individual Estimated Payment Comparison - FY 2008 vs. FY 2009



	Qtr1.	Qtr2.	Qtr3.	Qtr4.
FY 2008	$80.363	$78.885	$47.528	$43.929
FY 2009	$81.019	$96.384	$40.653	$29.172
$ Change	$0.656	$17.499	($6.875)	($14.757)
% Change	0.82%	22.18%	-14.47%	-33.59%

With a substantial drop in the equity markets, historical low interest rates, reductions in corporate profitability, and the beginning of a new calendar year (a new reporting period for the taxpayer), it is not surprising to observe a significant reduction in estimated payments. The trends shown in Figure 3b are consistent with our office statements during the legislative session.

When all of the accounting categories are added together (including the anticipated withholding tax accrual), total individual income tax collections could be about $49 million below FY 2008 amounts. Since FY 2009 collections were estimated to be $14.0 million below FY 2008 amounts, the HJ 2 individual income tax estimate could be overstated by $35 million for FY 2009. If this trend continues into the 2011 biennium, total individual income tax collections could be overstated by $105 million for the three-year period provided there are no unusual accrual entries.

Corporation Income Tax

Corporation income tax receipts for FY 2009 are above the estimate contained in HJ 2. Net collections (gross collections less refunds) through June 2009 were 5.1 percent or $8.2 million above the net collections for the final FY 2008 amounts. The 61st Legislature assumed the FY 2009 growth rate to be a negative 1.9 percent or $3.1 million below the FY 2008 amount. Figure 4 shows specific details of corporation income tax collections through June of this year compared to the final FY 2008 amounts.

The strength in collections can be explained by the auditing efforts of the DOR and the resulting unusual high audit collections for FY 2009. Total audit collections were $29.8 million in FY 2009 compared to $16.9 million in FY 2008. If the audit collections are removed from FY 2008 and 2009 totals, then the trend for the remaining collections are consistent with the estimated decline rate contained in HJ 2.

Figure 4

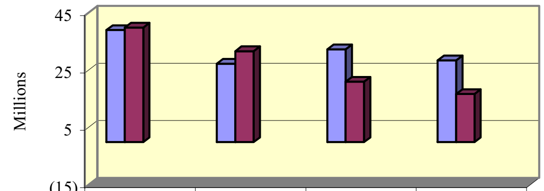
Corporation Income Tax Comparison

Revenue Code & Description	Final Fiscal 2008	Through 06/30/09 Fiscal 2009	Difference	Percent Change
510501 Corporation Tax	39,473,129.82	46,195,459.39	6,722,329.57	17.03%
510505 Corporation Tax Estimated Paym	127,433,438.78	109,585,667.24	(17,847,771.54)	-14.01%
510502 Corporation Tax Refunds	(23,439,303.89)	(17,053,615.31)	6,385,688.58	-27.24%
510503 Corporation Tax-Audit Collect.	16,874,522.00	29,784,746.00	12,910,224.00	76.51%
Totals	$160,341,786.71	$168,512,257.32	$8,170,470.61	5.10%
Percent of Actual/Estimated	100.00%	100.87%		

Further review of tax payment detail by corporation provides some additional insight to estimated payments. This data show growth in estimated payments between the first and second quarters of FY 2009. Like individual income tax estimated payments, collections for the last two quarters of FY 2009 show an entirely different picture. With announced job layoffs, business closures and/or cutbacks, significant consumer spending reductions, and construction plummeting, estimated payments have declined significantly when compared to the previous year. As shown in Figure 4a, estimated payments as compared to FY 2008 have declined by 34.9 and 41.3 percent, respectively for the last two quarters of FY 2009.

Figure 4a

Corporation Estimated Payment Comparison - FY 2008 vs. FY 2009



	Qtr1.	Qtr2.	Qtr3.	Qtr4.
FY 2008	$39.121	$27.382	$32.380	$28.550
FY 2009	$39.963	$31.768	$21.081	$16.774
$ Change	$0.842	$4.386	($11.299)	($11.776)
% Change	2.15%	16.02%	-34.89%	-41.25%

Since FY 2009 collections were estimated to be $3.1 million below FY 2008 amounts, the HJ 2 corporation income tax estimate could be understated by $11.2 million for FY 2009. Based on the decline in estimated payments for the last two quarters of FY 2009, this understatement is not expected to continue into the 2011 biennium. Total corporation income tax collections for the 2011 biennium appear to be on target with the HJ 2 estimate.

Oil and Gas Production Tax

Total oil and gas production tax collections are $84.9 million (56.6 percent) below last year as of the end of June. These collections represent economic conditions for the 3rd and 4th quarter of calendar 2008 as compared to the final FY 2008 amounts. During the year-end adjustment period, the DOR will be processing an accrual for the 1st and 2nd quarters of calendar 2009. A decrease in oil and gas production tax was not unexpected as prices have plummeted from the highs of a year ago. Montana oil prices averaged $79.54 per barrel for the first nine months of FY 2008 versus $62.50 per barrel for the first nine months of FY 2009. If Montana prices remain at the March level for April, May, and June, the average price for FY 2009 will be $57.50 per barrel. The oil price assumption contained in HJ 2 for FY 2009 is $54.36 per barrel.

Production amounts as reported on the tax returns for FY 2009 will not be available until fall after the DOR has input the information into their computer system. At this time, there is no tax return production numbers available for FY 2009. Production amounts for calendar 2008 declined by 9.5 percent from calendar 2007. This information is shown in Figure 7b as reported by the Board of Oil and Gas.

Video Gaming Tax

Video gaming taxes are $16.0 million (negative 25.3 percent) below last year as of the end of June. This decrease was noted during the session but it was premature to assess the trend until an accounting error was corrected in SABHRS. This correction was made during the month of February. Based on the corrected collection data, video gaming tax collections are lagging the HJ 2 revenue estimate. The assumption contained in HJ 2 is for revenues to increase by 5.4 percent from FY 2008 to FY 2009. During the year-end adjustment period, the Department of Justice will be processing an accrual for approximately $15.5 million. With this accrual, video gaming tax revenues could be below the HJ 2 estimate by about $4 million for FY 2009. If this trend continues into the 2011 biennium, video gaming tax collections could be overstated by $12 million for the three-year period.

TCA Interest Earnings

Treasury cash account (TCA) interest earnings are $15.8 million (negative 51.3 percent) below last year as of the end of June. An accrual will be processed by the Board of Investments during the year-end adjustment period that will reduce this difference by a small amount. The overall decrease, however, is due to the significant reduction in short-term interest rates that have occurred during FY 2009. According to the Montana Board of Investments, the short-term investment portfolio (STIP) yield averaged 0.86 percent for May 2009. The assumption contained in HJ 2 was for the TCA interest rate to average 2.0 percent for FY 2009. Information from the Board of Investments shows the average TCA rate as of the end of May at 2.1 percent.

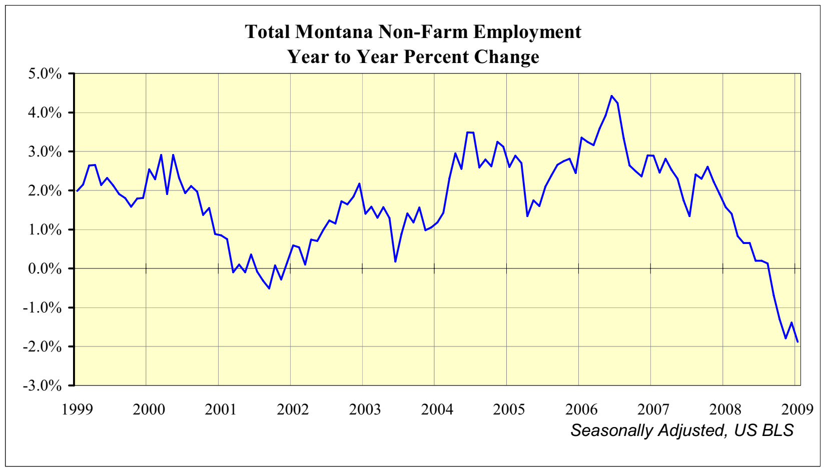
SIGNIFICANT ECONOMIC TRENDS

The Montana economy is thought to lag the economic climate of the nation. The US economy has been in a recession since December of 2007, and one year later, the state started to show signs of significant economic weakening. State government revenues are highly sensitive to factors such as Montana non-farm employment, wage and salary income, and various commodity prices such as oil, natural gas, coal, metals, livestock, and crops. Factors like corporate profitability, inflation factors, interest rates, equity markets, and federal tax changes are influenced by the national economy but have direct impacts on state revenues also. The following is a brief summary of current information that illustrates the impact of these economic factors on state revenues.

Montana Employment and Wages

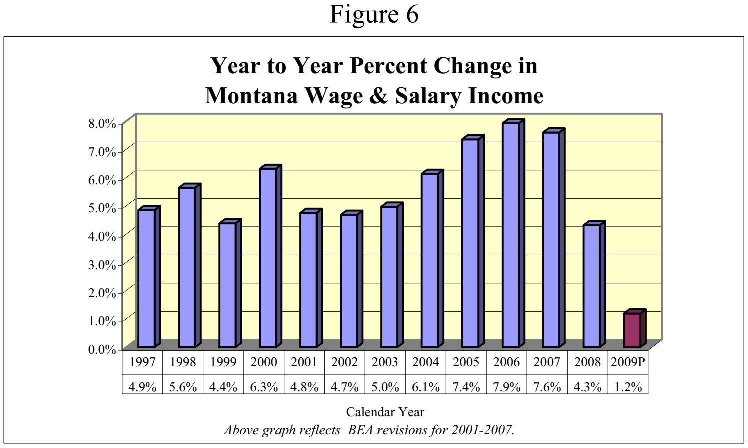
Statistics from the Bureau of Labor Statistics (BLS) show a decline in Montana's labor market beginning in October 2008. Preliminary estimates for non-farm payroll employment indicate that 8,400 jobs were lost between May 2008 and May 2009, a decrease of 1.9 percent year over year. As seen in Figure 5, the velocity of growth diminished significantly from its peak in the middle of 2006, and has actually turned negative since the middle of 2008. Between the months of April and May 2009, the Montana Department of Labor and Industry shows a net reduction of 1,100 jobs, or 0.3 percent. Recent job losses can be attributed to the education sector, health sector, financial sector, and construction sector. Changes in employment are key factors in estimating individual income taxes. The -0.3 percent growth rate, though currently a preliminary estimate translates into slowing wage and salary income growth (see Figure 6) and contributes to the slowdown in individual income tax withholding collections in FY 2009.

Figure 5



US employers report six million job losses since the beginning of the recession. The unemployment rate was 9.4 percent in May, the highest it has been in 26 years. Economists are expecting the unemployment rate to increase to 9.6 percent by the next report of July 2. While the unemployment rate continues to climb, a recent survey by the consulting firm of Watson Wyatt found that 62 percent of employers are planning to reverse hiring freezes over the next 12 months, indicating that the economy may be "inching towards a recovery". However, the survey also found that more than half of the employers expected staff sizes to remain below the pre-recession levels. The May unemployment rate in Montana was reported at 6.3 percent. (Job Market to Stay Dismal Despite Bits of Hope, CNN Money, June 22, 2009).

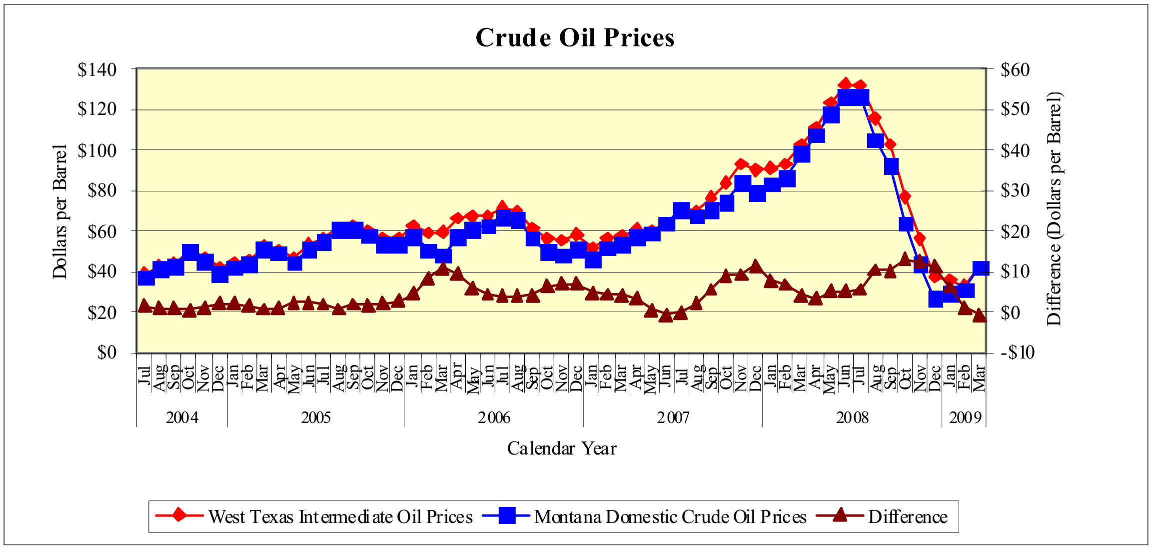
Figure 6



According to the Bureau of Economic Analysis (BEA), the year to year growth in Montana wage and salary income slowed significantly in 2008, to 4.3 percent. The growth in wage and salary income has not been this low in recent memory. Between 1997 and 2007, the average annual growth rate of wage and salaries was 5.9 percent. With only one quarter of data for 2009, wage and salary income increased only 1.2 percent year over year, which is the smallest rate of growth seen in the BEA data series which reports quarterly data back to 1990.

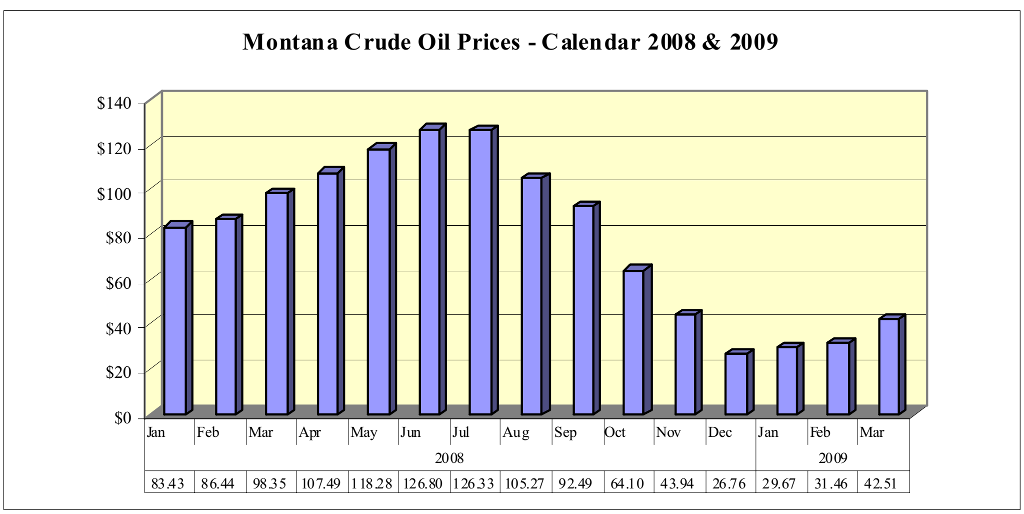
Oil Prices and Production

Figure 7



The price of the West Texas Intermediate Crude (WTI) averaged $97.45 per barrel for calendar 2008. The monthly average WTI price has steadily increased since early 2003, reaching a high of $132.21 per barrel in June 2008. The average difference between the price of WTI and Montana domestic crude price was $4.68 for calendar 2007 and increased to $8.11 for calendar 2008. This difference, however, has declined in recent months and has averaged $2.45 for the first three months of calendar 2009.

Figure 7a

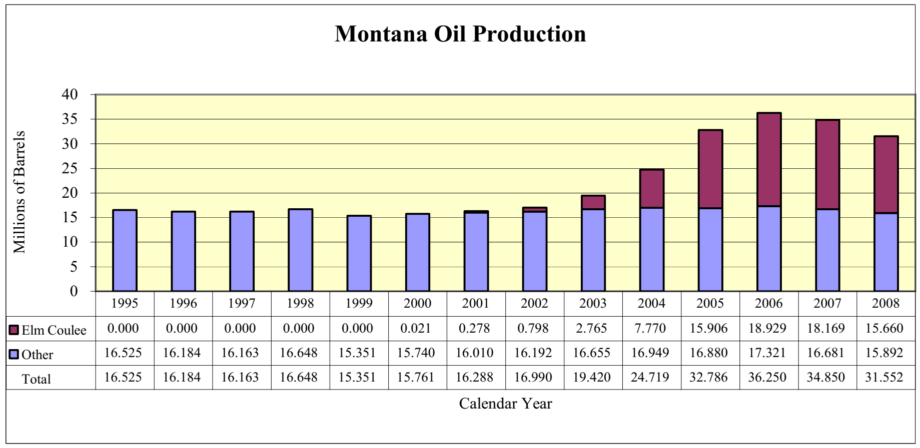


As shown in Figure 7a, the per barrel price averaged $126.80 for June 2008 and then began to decline every month until December 2008 when the price bottomed out at $26.76 per barrel. The average price of Montana domestic crude during calendar 2008 was $89.86, which exceeded the assumed price of $89.77 used by the legislature in developing the estimate of oil production tax revenues in HJ 2.

While oil prices were increasing from calendar 2002 to 2008, Montana's production remained relatively stable until calendar 2003. Beginning in 2003, new production commenced with the development of the Bakken formation in the Elm Coulee field. As shown in Figure 7b, production from the Elm Coulee field has grown from 2.7 million barrels in 2003 to almost 19.0 million barrels in 2006. The Elm Coulee field produced more oil than all other fields combined during calendar 2006 and 2007.

The HJ 2 oil production estimates were based on the Elm Coulee production peaking in 2007 with subsequent years of production following a production decline curve patterned after other fields that use horizontal drilling technologies. New data from the Board of Oil and Gas web database, however, indicate that the Elm Coulee field peaked production in calendar 2006 and declined 0.8 million barrels from calendar 2006 to 2007. Depending on what happens with prices, oil production taxes may have peaked during FY 2008 with the high probability of a declining revenue stream in the future assuming no new significant fields are discovered or drilled.

Figure 7b

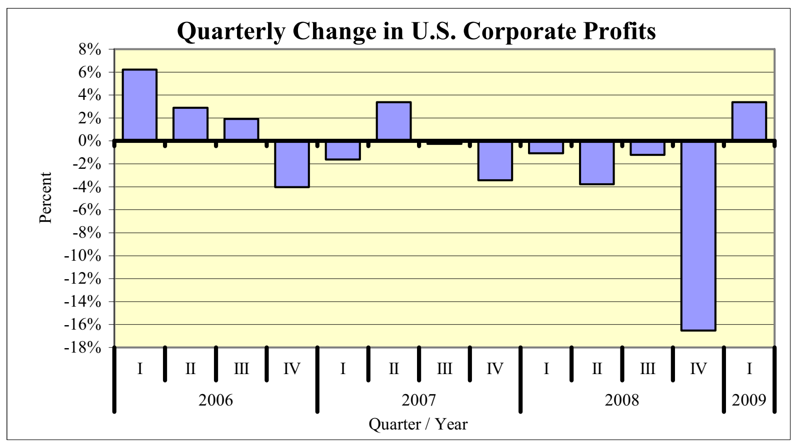


	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Elm Coulee	0.000	0.000	0.000	0.000	0.000	0.021	0.278	0.798	2.765	7.770	15.906	18.929	18.169	15.660
Other	16.525	16.184	16.163	16.648	15.351	15.740	16.010	16.192	16.655	16.949	16.880	17.321	16.681	15.892
Total	16.525	16.184	16.163	16.648	15.351	15.761	16.288	16.990	19.420	24.719	32.786	36.250	34.850	31.552

Corporate Profits

The Bureau of Economic Analysis (BEA) estimates that US corporate profits increased $42.6 billion, or 3.4 percent (at a quarterly rate) in the first quarter of calendar 2009, after decreasing 21.5 percent in the fourth quarter of 2008. However, corporate profits, year over year, were 18.0 percent lower in the first quarter of 2009 when compared to the first quarter of 2008. (Corporate Profits, BEA, May 29, 2009).

Figure 8

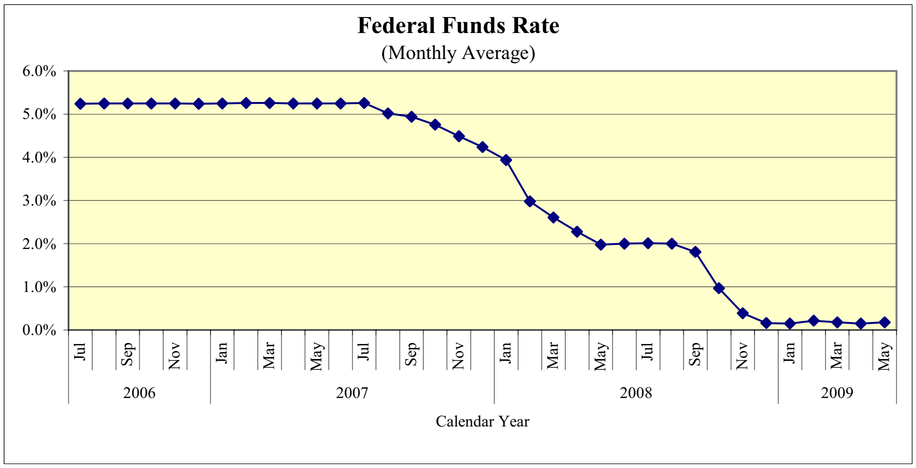


While Montana's corporation tax receipts do not strictly follow the national trend, the direction of change is often similar. When the nation experiences a recession (two quarters of negative growth in GDP), Montana corporation tax revenues tend to follow the trend. As shown in Figure 8, US corporate profits have been predominantly negative since the fourth quarter of calendar 2006. With the nation in a recession, Montana's corporation tax revenues are expected to abate from the high level of collections observed in FY 2008. Collection data through FY 2009 show a weakening in estimated collections as compared to the same period of last fiscal year.

Interest Rates

The federal funds rate, an overnight bank lending rate that influences what consumers pay on various types of loans, started to decline in August, 2007. Since the beginning of the year, the federal funds rate has remained at a historic average low of 0.18 percent. The Fed held the federal funds rate at the near zero rate in the latest Federal Open Market Committee meeting, which concluded June 24, however increases to the near zero rate may be on the horizon as the threat of inflation grows. (Stocks Set to Rise at Open, CNN Money, June 24, 2009).

Figure 9



Interest rates have a significant impact on all of Montana's trusts and interest bearing accounts. While lower rates help to lower the cost of debt service on state loans and bond issues, higher rates increase the revenues earned on many state investments. Montana is highly invested in bonds, and interest rates are one of the key components to determining investment revenue. However, the effect that low interest rates may have on Montana's interest bearing accounts is both positive and negative. While earnings may decline as interest rates drop, to the extent that bonds may be sold at a premium, additional earnings may be realized. Lower interest rates can also reduce individual income tax collections, a major income component of the tax.

SUMMARY

Based on data through the end of June 2009, total general fund revenue collections for FY 2009 have the potential to be below the HJ 2 revenue estimates. While the outlook for most revenue categories has not changed materially since the regular legislative session, the overall trend for general fund revenues for FY 2009 may be showing signs of further weakness. The focus of this analysis was on the major revenue sources especially those sources that were monitored closely during the legislative session. Since individual income tax is the predominate source of revenue in the general fund account, a small percentage change in this source can have a significant impact on total general fund revenues. As detailed in the report, there are concerns over the trends observed for the last two quarters of FY 2009 for withholding taxes and estimated payments. As expressed by our office during the session, a prolonged period of negative growth into the 2011 biennium could potentially reduce the general fund balance to a level that is unacceptable by the legislature.

The obvious question this report generates is, "What does this information indicate for FY 2010 and beyond?" Current trends portray a "gloomy" outlook for FY 2010, but a thorough analysis of the underlying economic conditions is imperative. The economic recession, housing downturn, commodity prices, and consumer sentiment, etc. are all factors that will shape the outlook for future revenue collections. Without this analysis, erroneous conclusions could easily be assumed that may lead to inappropriate fiscal policy during the next legislative session. This may lead to a "boom and bust" cycle similar to the "dot com" bubble that was followed by a precipitous fall in the equity markets and ultimately a reduction in state revenues in the 2003 biennium.

While your staff will continue to monitor revenue trends, a thorough analysis of current revenue trends with an eye toward the future has begun in preparation for the revenue estimate process of the Revenue and Transportation Interim Committee (RTIC). This analysis will be the basis for our revenue estimate recommendations to RTIC for the 2013 biennium.