

State of Maryland Board of Revenue Estimates

Louis L. Goldstein Treasury Building, P.O. Box 466
Annapolis, Maryland 21404-0466
E-Mail: bre@comp.state.md.us

Members

Peter Franchot
State Comptroller

Nancy K. Kopp
State Treasurer

T. Eloise Foster
Secretary, Department of
Budget and Management

Executive Secretary:
David F. Roose
Director, Bureau of
Revenue Estimates

March 31, 2009

Honorable Martin O'Malley
Governor, State of Maryland
State House
Annapolis, MD 21401

Dear Governor O'Malley:

In accordance with our continuing policy of keeping you fully advised of developments concerning Maryland's revenue prospects, the Board of Revenue Estimates has reviewed the current estimates of general fund revenue in light of the most recent economic data and developments and recent collection trends. Based on our review, the Board recently revised the general fund revenue estimates to \$13.228 billion for fiscal year 2009 and \$13.022 billion for fiscal year 2010. These figures represent a reduction to fiscal year 2009 estimates of \$445.5 million and to fiscal year 2010 estimates of \$716.5 million from the last official forecast of December 2008. Reflecting the worst downturn since 1982, if not in the post-war period, general fund revenues are now forecast to decline by 2.3% in fiscal year 2009 from fiscal year 2008 levels, and by a further 1.6% in fiscal year 2010.

The US economy has continued to deteriorate since December, as expected, but the pace of decline has been quicker than had been anticipated. In its most recent Beige Book, the Federal Reserve noted the breadth of the recession, affecting almost all regions and industries, and indicated that "contacts from various Districts rate the prospects for near-term improvement in economic conditions as poor, with a significant pickup not expected before late 2009 or early 2010." Uncertainty has spread throughout the entire economy.

Since August 2008, every month's employment report has shown more jobs had been lost than the consensus estimate had anticipated. About 4.4 million jobs have disappeared since the start of 2008, almost half in the last three months. Consumer confidence is at a record low, and several surveys indicate the same for business confidence. Shaken by the rapid deterioration and expectations of worse to come, consumers have dramatically increased savings, with the saving rate increasing from under 2% in the third quarter of 2008 to 5.0% in January. The economy shrank at a 6.2% annual rate in the fourth quarter, the worst quarterly performance since 1982 and the fourth worst since 1947. The \$789 billion American Recovery and Reinvestment Act of 2009 (ARRA) will provide some support to the economy, but will likely not bring an end to the recession in the near future.

The outlook for Maryland's economy has declined along with expectations for the U.S. economy. Our December forecast called for a 2.0% decline in employment in Maryland in calendar year 2009. We now expect a 2.6% drop in 2009, followed by a slight 0.2% decline in 2010. We do expect, in line with most but not all forecasts, a return to reasonably healthy economic performance in 2011, boosted in part by the taking hold of the ARRA and by BRAC activity, with job growth of 1.9%. Our income forecast has been adjusted for these new employment forecasts, with personal income expected to increase by 1.3% in 2009 and 2.7% in 2010. Growth in wage and salary income is now forecast at a scant 0.5% in 2009 and 2.6% in 2010. In current dollar terms, the 2009 forecast for wage and salary income represents the slowest growth since 1958, and for total personal income, since 1954.

Telephone: 410-260-7450

Toll free: 1-888-674-0017 • Fax: 410-974-5221 • For the hearing impaired: Maryland Relay 711 • TTY 410-260-7157 • EOE

This economic forecast incorporates an estimate of the impact of the ARRA on Maryland's economy. It is estimated that the stimulus bill will add roughly 0.2 percentage points to employment growth in calendar year 2009, 0.7 points in 2010 and 0.6 points in 2011. In other words, without the stimulus, our forecast for Maryland employment would have shown a drop of about 2.8% in 2009, another drop of about 0.9% in 2010, and an increase of 1.3% in 2011. Similarly, the forecast for wage and salary income would have been approximately 0.3 percentage points lower in 2009, and almost 2 percentage points lower in both 2010 and 2011.

The primary cause for the revenue writedown in fiscal year 2009 is the sharp decline in estimated individual income tax payments for the fourth quarter of calendar year 2008. Those payments declined 18.6% even though estimated payments were supposed to reflect the higher income tax rates for tax year 2008. This drop, the predominant cause of which may well have been the October selloff in the equity markets, indicates that final payments received with returns in April are likely to fall substantially from last year's levels. Over three-quarters of the reduction to the individual income tax forecast in fiscal year 2009 is attributable to these two components. Our expectations for withholding have also been adjusted downward along with the economic forecast, although this change is relatively modest.

In contrast, reduced expectations for the individual income tax for fiscal year 2010 are more reflective of the slowdown in broader economic activity, as the recession is now expected to be both deeper and longer than previously forecast. Withholding is now expected to increase by 2.1% in 2010, about half the rate anticipated by the December forecast; that change is responsible for about one-third of the writedown to fiscal year 2010 individual income tax revenues. Estimated and final payments are expected to decline again in 2010. Individual income tax general fund revenues are expected to decline 2.3% in fiscal year 2009 and 2.1% in 2010, to \$6.782 billion and \$6.640 billion, respectively. These are only the third and fourth years in which collections from the individual income tax, half of general fund revenues, have declined. The other two years were fiscal years 2002 and 2003, also recessionary periods marked by steep declines in capital gains.

General fund sales tax collections are being revised downward by \$107.0 million in fiscal year 2009 and \$109.7 million in 2010, which is equivalent to a decline of 1.7% this year and a further decline of 0.5% next year. The level of taxable sales is expected to drop steeply—6.1% in FY09. However, the total revenue from this sales level is supported by this year's increase in the sales tax rate. The level of taxable sales has already declined for five consecutive months, 5% so far in FY09. Sales to consumers, sales of construction-related goods, and sales of capital goods have all dropped this year, the latter two by double digits. Sales by utilities have shown strong growth, although the growth was generally during the start of the fiscal year. Further deterioration is expected as jobs are lost and consumer confidence remains at record lows. The expected drop in taxable sales is about three times the fiscal year 1991 decline, the only other recorded drop in sales. The estimated drop in FY10 collections is offset to some extent by the roughly \$3 billion that Marylanders are to receive from the new federal Making Work Pay credit, resulting in the slight decline expected during the year of 0.5%.

Weaker than expected year-to-date performance from the insurance premium tax leads us to expect about \$5.0 million less in both fiscal years 2009 and 2010. A 61 cent increase in the federal excise tax on cigarettes, effective at the end of this month, will raise prices and reduce sales, resulting in

Letter to Honorable Martin O'Malley
March 31, 2009
Page 3

a downward revision to tobacco tax revenues of \$5.4 million this year and \$15.1 million for 2010. Due to forecasts of a bigger drop in corporate profits during the recession than previously expected, the forecast for corporate income tax receipts for fiscal year 2010 is being reduced by \$17.2 million. We are not adjusting the fiscal year 2009 forecast for the corporate income tax despite the fact net collections are currently running ahead of expectations, because that situation can easily reverse by the end of the fiscal year. Lastly, lower balances and interest rates than previously forecast have resulted in a \$6.0 million reduction to the interest forecast for fiscal year 2009 and a \$25.0 million reduction for fiscal year 2010.

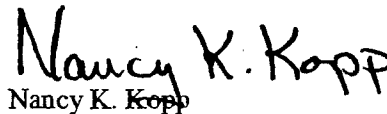
This revision to the forecast is the latest of a series of substantial adjustments since the fiscal year 2009 budget was adopted in April 2008, mirroring the unexpectedly large and rapid deterioration of the economy. Two tables are attached that show how our economic and revenue forecasts have changed over the past year in response to the unfolding recession.

The economy remains extraordinarily unsettled, and as we have seen, conditions can turn overnight. We will continue to monitor the situation.

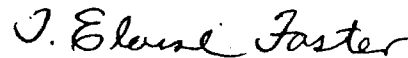
Sincerely,



Peter Franchot



Nancy K. Kopp



T. Eloise Foster

Attachments

Evolution of Maryland's Economic Forecast

	Board of Revenue Estimates				Economic Consultants			
	Mar '08	Sept '08	Dec '08	Mar '09	Feb '08	Aug '08	Nov '08	Feb '09
Employment Growth								
CY 2008	0.7%	0.6%	-0.2%	-0.5%	0.7%	0.8%	0.7%	0.3%
CY 2009	1.5%	0.3%	-2.0%	-2.6%	1.1%	0.4%	-0.4%	-1.7%
CY 2010	1.7%	1.2%	0.1%	-0.2%	1.7%	1.4%	0.2%	-0.2%
Personal Income Growth								
CY 2008	4.7%	4.4%	3.9%	3.6%	4.3%	4.9%	4.2%	3.8%
CY 2009	5.0%	3.4%	1.7%	1.3%	5.0%	4.0%	2.6%	1.7%
CY 2010	5.5%	4.9%	3.4%	2.7%	5.8%	4.8%	3.8%	3.0%
Wage & Salary Income Growth								
CY 2008	4.3%	3.8%	2.9%	2.9%	4.2%	4.9%	3.8%	3.2%
CY 2009	5.3%	3.3%	1.5%	0.5%	5.0%	3.8%	2.4%	1.3%
CY 2010	5.6%	4.5%	3.6%	2.6%	5.7%	4.5%	3.2%	2.2%

Economic Consultants' forecast represents the average of three forecasts of Maryland's economy from economic consulting firms that the Board of Revenue Estimates considers as it develops its economic and revenue forecasts. The three consultants are Sage Policy Analysis, RESI, and Moody's Economy.com.

Evolution of Maryland's General Fund Revenue Forecast
(\$ in millions)

	<u>Mar '08</u>	<u>Sept '08</u>	<u>Change from Mar '08</u>	<u>Dec '08</u>	<u>Change from Mar '08</u>	<u>Mar '09</u>	<u>Change from Mar '08</u>
Individual Income Tax							
FY 2009	7,278	7,310	32	7,104	(174)	6,781	(497)
FY 2010	7,737	7,698	(39)	7,181	(556)	6,637	(1,100)
Sales Tax							
FY 2009	4,183	3,787	(396)	3,718	(465)	3,611	(572)
FY 2010	4,366	3,933	(433)	3,702	(664)	3,592	(774)
Total General Fund							
FY 2009	14,485	14,089	(396)	13,674	(811)	13,228	(1,257)
FY 2010	15,248	14,702	(547)	13,738	(1,510)	13,022	(2,227)

General fund revenue forecasts of the Board of Revenue Estimates since the adoption of the fiscal year 2009 budget (2008 Regular Session). The forecasts from September 2008 and later include legislative changes from the 2008 Regular Session of the General Assembly.

Maryland General Fund Revenues
Fiscal Years 2008 - 2010
 \$ in thousands

	FY 2008 Actual	FY 2009				FY 2010			
		December Estimate	March Estimate	Difference	% Growth	December Estimate	March Estimate	Difference	% Growth
INCOME TAXES									
Individual	6,940,134	7,103,524	6,781,487	(322,037)	-2.3%	7,181,241	6,636,916	(544,325)	-2.1%
Corporations	551,673	582,316	582,316	-	5.6%	617,601	600,402	(17,199)	3.1%
Total	7,491,807	7,685,840	7,363,803	(322,037)	-1.7%	7,798,842	7,237,318	(561,524)	-1.7%
SALES AND USE TAXES	3,675,263	3,717,988	3,610,951	(107,037)	-1.7%	3,701,717	3,592,007	(109,710)	-0.5%
STATE LOTTERY RECEIPTS	497,111	455,843	455,843	-	-8.3%	496,534	496,534	-	8.9%
OTHER REVENUES									
Business Franchise Taxes	207,968	209,236	209,236	-	0.6%	211,623	211,623	-	1.1%
Tax on Insurance Companies	301,831	303,340	298,340	(5,000)	-1.2%	310,347	305,232	(5,115)	2.3%
Death Taxes	243,541	226,555	226,555	-	-7.0%	178,613	178,613	-	-21.2%
Tobacco Tax	376,112	419,215	413,773	(5,442)	10.0%	414,255	399,120	(15,135)	-3.5%
Alcoholic Beverages Excises	28,966	29,009	29,009	-	0.1%	29,584	29,584	-	2.0%
Motor Vehicle Fuel Tax	13,199	6,500	6,500	-	-50.8%	-	-	-	-100.0%
District Courts	91,307	88,323	88,323	-	-3.3%	88,750	88,750	-	0.5%
Clerks of Court	42,559	32,445	32,445	-	-23.8%	32,801	32,801	-	1.1%
Hospital Patient Recoveries	86,556	77,296	77,296	-	-10.7%	66,396	66,396	-	-14.1%
Interest on Investments	166,518	109,000	103,000	(6,000)	-38.1%	98,000	73,000	(25,000)	-29.1%
Miscellaneous	322,901	305,380	305,380	-	-5.4%	310,802	310,802	-	1.8%
Total	1,881,458	1,806,299	1,789,857	(16,442)	-4.9%	1,741,171	1,695,921	(45,250)	-5.2%
TOTAL CURRENT REVENUES	13,545,639	13,665,970	13,220,454	(445,516)	-2.4%	13,738,264	13,021,780	(716,484)	-1.5%
Extraordinary Revenues	-	7,917	7,917	-	100%	-	-	-	-100.0%
GRAND TOTAL	13,545,639	13,673,887	13,228,371	(445,516)	-2.3%	13,738,264	13,021,780	(716,484)	-1.6%