



COMMONWEALTH of VIRGINIA

Stephen E. Cummings
Secretary of Finance

P.O. Box 1475
Richmond, Virginia 23218

September 12, 2022

MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: August Revenue Report

In August, total general fund revenues grew by 13.0 percent year-over-year. However, revenue collections were meaningfully inflated by an additional deposit day which included payroll withholding taxes remitted by many of the Commonwealth's largest employers. Adjusting for the additional deposit day, revenues increased approximately 5.4 percent for the month compared to a year ago.

On a fiscal-year-to-date basis, total revenue collections rose 13.5 percent (unadjusted), well ahead of the annual forecast of a 14.0 percent decline. In addition to the additional withholding deposit day in August, year-to-date revenues are impacted by the repeal of accelerated sales tax (AST). Adjusting for the repeal of AST and the impact of the extra day of withholding payments, total general fund revenues rose by approximately 5.3 percent through August.

In February, you made the decision to practice fiscal conservatism and not adjust the original fiscal year 2023 forecast, which, when combined with \$2.3 billion in tax reduction this fiscal year, leads to the current forecast of a decline in revenues of 14.0 percent. Under current revenue assumptions, a \$4.1 billion cushion provides a prudent safeguard against a potential slowdown in revenue growth, as economic data offer a mixed outlook for the remainder of the fiscal year. As you know, that forecast will be revised in coming months to reflect current trends.

With actual revenue collections in the first two months significantly exceeding projected levels, revenue collections for the remainder of FY2023 can decline 17.6 percent year-over-year, or \$4.5

billion, for the remainder of FY 2023 and still meet projections assumed in the current appropriation act.

August is not generally a significant month for revenue collections, with collections mainly from withholding, sales and use taxes, and other sources with regular monthly payments. With an additional deposit day compared to last year, total general fund revenue collections rose 13.0 percent in August. Wage growth, the aforementioned additional deposit day, and a strong labor market, which has produced 100,000 jobs in the six months since January, drove growth in payroll withholding, which increased 19.8 percent in August (8.2 percent adjusted for the extra deposit day) compared to the same period last year. Sales tax collections grew 7.2 percent year-over-year in August and is up 27.7 percent year-to-date, or 4.3 percent when adjusted for AST.

There were 142,000 more Virginians employed in July 2022 than there were in July 2021, an increase of 3.5 percent year-over-year. In a separate survey of business establishments, payroll employment was estimated to have grown 3.0 percent in July versus the prior year.

Virginia has yet to recover more than 113,000 jobs that were lost during the pandemic (now at 97.4 percent of pre-pandemic levels) while our key competitor states – North Carolina, South Carolina, Georgia, Tennessee, Texas and Florida – have all exceeded pre-pandemic employment levels. More improvement in this area is needed and we are optimistic that, with appropriate policy, that gap will continue to close.

Monitoring the broader economic climate and issues that may impact our future revenue streams remains a top priority. Employment growth continues, and the unemployment rate remains low. However, volatility in the financial markets, rising interest rates and persistent high inflation have the potential to cause consumers to tighten spending. Additionally, a softening in the housing market suggests that growth in consumer spending and sales tax collections may slow in the coming months. The average rate on a 30-year fixed mortgage hit 5.89 percent last week, roughly double from levels seen a year ago and the highest in fourteen years. While the NBER Business Cycle Dating Committee has not determined whether the U.S. is in a recession, there remains the possibility of a slowdown in economic activity.

As part of the normal fall consensus forecasting process, Finance staff will update both economic and revenue projections.

Economic Review

Recent economic data are mixed with continued job growth but continued high inflation and rising interest rates have undermined consumer confidence.

- The U.S. labor market added 315,000 jobs to payrolls in August. The net revision to the prior two months was down 107,000 jobs. In a separate report, the unemployment rate increased from 3.5 to 3.7 percent as more workers entered the labor force.
- Initial claims for unemployment fell by 5,000 to 232,000 during the week ending August 27. The four-week moving average fell 4,000 to 241,500. In a healthy economy, new filings are

typically below 250,000, suggesting the labor market is tight and layoffs are low.

- The Conference Board's index of leading indicators fell 0.4 percent in July to 116.6, and followed a revised 0.7 percent decrease in June.
- The University of Michigan consumer sentiment was revised higher to 58.2 in August of 2022 from a preliminary of 55.1. The final August reading is 13 percent above July but remains 17 percent below a year ago.
- The Institute of Supply Management index remained flat at 52.8 in August, and remains above the neutral threshold of 50.0.
- The CPI was unchanged in July, but stands 8.5 percent above July of last year. Core inflation (excluding food and energy prices) rose 0.3 percent and stands 5.9 percent above a year ago.
- At its July meeting, the Federal Reserve raised the federal funds target rate by 75 basis points to the range of 2.25 to 2.5 percent. It is well communicated that there will be continued increases in the federal funds target rate in order to gain control of inflation.
- In Virginia, payroll employment rose 3.0 percent in July from July of last year. Employment in Northern Virginia rose by 3.0 percent; Hampton Roads rose 1.5 percent, and Richmond-Petersburg rose 1.1 percent. The seasonally adjusted unemployment rate declined 0.1 percentage point to 2.7 percent and stands 1.1 percentage points below a year ago.
- The Virginia Leading Index declined 1.3 percent in June after decreasing 0.7 percent in May. Auto registrations, initial claims, and the U.S. Leading Index contributed negatively to the index, while future employment improved in June. The index for Blacksburg rose, while it fell for the remaining ten metro areas.

August Revenue Collections

August is not a significant month for revenue collections, with collections mainly from withholding, sales and use taxes, and other sources that have regular monthly payments. With one more deposit day than last year, total general fund revenue collections rose 13.0 percent in August.

Net Individual Income Tax (67% of general fund revenues): Through August, collections of net individual income tax rose 13.6 percent from the same period last year, ahead of the annual estimate of an 18.0 percent decline. Performance in each component of individual income tax is as follows:

Individual Income Tax Withholding (62% of general fund revenues): With an extra deposit day, collections of payroll withholding taxes rose 19.8 percent for the month. Adjusting for the extra deposit day, payroll withholding rose 6.0 percent in August. Year-to-date, collections have risen 14.7 percent from the same period last year, ahead of the

annual estimate of a 0.1 percent decline. Adjusting for the additional deposit day, withholding collections increased 8.2 percent for the month, and are up 8.9 percent year-to-date.

Individual Income Tax Nonwithholding (21% of general fund revenues): August is not a significant month for collections in this source since the first estimated payment for fiscal year 2023 is due in September. Through the first two months of the fiscal year, collections were \$223.5 million compared with \$242.9 million in the same period last year.

Individual Income Tax Refunds: August is not a significant month for refunds. The Department of Taxation issued \$54.7 million in refunds compared with \$42.9 million in August of last year.

Sales Tax (18% of general fund revenues): Collections of sales and use taxes, reflecting July sales, rose 7.2 percent in August. Adjusting for accelerated sales tax, fiscal-year-to-date collections rose 4.3 percent. This is below the 8.5 percent increase in the July national CPI. On a year-to-date basis, collections of sales and use taxes have risen 27.7 percent, ahead of the annual estimate of a 1.3 percent decline.

Corporate Income Tax (7% of general fund revenues): As with nonwithholding, August is not typically a significant month for collections in this source, as the first estimated payment for the fiscal year is due in September. Through August, collections of corporate income taxes were \$71.6 million compared with \$103.9 million in the same period last year.

Wills, Suits, Deeds, Contracts (2% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were \$47.5 million in August, compared with \$59.3 million in August of last year, a decrease of 20.0 percent. On a year-to-date basis, collections are down 19.0 percent, behind the annual forecast of a 9.2 percent decline.

Insurance Premiums (2% of general fund revenues): Monthly collections of insurance company premiums are being transferred to the Transportation Trust Fund per Chapter 986, 2007 Acts of the Assembly until the required amount of \$202.5 million has been deposited.

Other Revenue Sources

Interest Income (0.4% GF revenues): Interest income was \$23.8 million for the month, up 54.5 percent for the month. For the year to date, interest income has increased 84.6 percent, well above the forecast of 28.1 percent growth.

ABC Taxes (1% GF revenues): ABC taxes yielded \$3.4 million in August and \$4.0 million year to date. Through August, ABC taxes have declined by 62.2 percent compared with a forecast of 1.1 percent growth.

All Other Revenue (2% of general fund revenues): Receipts in All Other Revenue rose 3.5 percent in August, \$33.9 million compared with \$32.8 million a year ago. On a year-to-date basis, collections of All Other Revenue were down 0.9 percent from the same period last year, above the annual estimate of a 5.3 percent decline.

Summary

August is not a significant month for revenue collections, with collections mainly from withholding and sales taxes. With one more deposit day than last year, total general fund revenue collections rose 13.0 percent in August (5.4 percent adjusted for the additional deposit day).

On a fiscal year-to-date basis, total revenue collections rose 13.5 percent, well ahead of the annual forecast of a 14.0 percent decline. Adjusting for the repeal of AST and the impact of the extra day of withholding payments, total general fund revenues rose by approximately 5.3 percent.

September collections will complete the first quarter of fiscal year 2023 and provide a clearer assessment of revenue growth. The first estimated payments from individuals, corporations, and insurance companies are due in September.