COMMONWEALTH of VIRGINIA

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MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: February Revenue Report

For the month of February, total general fund revenues increased 17.3 percent versus the same period last year. The increase was driven mainly by higher net individual income tax collections. February is typically not a significant month for revenue collections, consisting mainly of regular payroll withholding and sales and use taxes.

Nonwithholding collections increased by 96.8 percent compared to February last year, which is a low month for revenues in this source. A small number of taxpayers submitted Pass-Through Entity Tax (PTET) payments which inflated revenues for the month. Withholding collections increased 8.8 percent for the month, reflecting the impact of one additional deposit day due to leap year, and were generally in line with expectations for the month.

Year-to-date, general fund revenues are up 6.3 percent through the first eight months of Fiscal Year 2024. Adjusting for the effects of PTET collections and refunds, and the associated timing of enacted policy actions to better reflect underlying economic trends, revenue collections up 7.2 percent year-to-date.

In comparison to the revenue forecast assumed in the Governor’s amendments to the Fiscal Year 2024 budget and accounting for monthly variations in tax collections, year-to-date revenues are ahead of projections by $827.5 million. Excluding nonwithholding and refunds, which continue to be distorted by PTET, year-to-date collections in core revenue sources are ahead of plan by $339.3 million, a variance of 2.1 percent. The variance is primarily attributable to higher than projected withholding collections.

Among other major sources, corporate tax collections were negative for the month of February, as refunds exceeded receipts. Collections were below plan by $66.7 million. However, February is not a significant month for collections in this source. Sales tax revenues, reflecting January sales, were higher than projections by $29.8 million and are ahead of forecast by $41.3 million on a year-to-date basis. Wills, Suits, and Deeds (mainly recordation) revenues increased year-over-year in February by 22.2 percent and exceeded projections by $3.3 million.

Collections from other sources of revenues were generally in line or exceeded the Forecast as discussed in more detail in the following sections.

Economic Review

- U.S. Real GDP growth was revised slightly lower to a 3.2 percent annual rate in the fourth quarter of calendar year 2023 according to the "second" estimate released by the Bureau of Economic Analysis. The update primarily reflects a downward revision to inventory investment that was partly offset by upward revisions to government purchases and consumer spending. For the full year, real GDP increased 2.5 percent.

- The Conference Board Leading Economic Index for the U.S. fell by 0.4 percent in January, marking the twenty-third consecutive monthly decline.

- U.S. retail sales for January declined 0.8 percent month-over-month and are up a modest 0.6 percent compared to January 2023, according to the “advance” monthly sales report published by the U.S. Census Bureau. On a year-over-year basis, sales for non-store retailers, which includes internet sales, were up 6.4 percent in January, and sales at restaurants were up 6.3 percent. The biggest year-over-year declines were in furniture stores, building materials, gas stations, and electronics & appliance stores.

- U.S. nonfarm payrolls increased 275,000 and the unemployment rate increased from 3.7 percent to 3.9 percent in February. Payroll gains for December and January were revised down by a total of 167,000, bringing the net gain, including revisions, to 108,000. U.S. payrolls were up 1.8 percent in January compared to a year ago. Civilian employment, an alternative measure of jobs that includes small-business start-ups fell in February by 184,000 and was up only 0.4 percent year-over-year.

- While the U.S. economy continues to add jobs, the number of jobs openings at private employers was down 14.8 percent year-over-year in January, suggesting further slowing in the labor market.

- In January, Virginia’s nonagricultural employment, from the monthly establishment survey increased by 8,700 to 4,200,000. December’s preliminary estimate of employment, after revision, increased to 4,191,300. Virginia payrolls were up 1.4 percent year-over-year in January, lagging the U.S.

- Virginia’s seasonally adjusted unemployment rate in January was unchanged at 3.0 percent, which is 0.1 percentage point below the rate from a year ago. Virginia’s labor force participation rate increased to 66.6 percent in January, 0.5 percentage points higher than in January of 2023.

- In February, the Consumer Price Index (CPI) for all items increased to 3.2 percent for the twelve months ending in February. The twelve-month change in "core" CPI, which excludes food and energy, declined slightly from 3.9 percent to 3.8 percent.

- The Personal Consumption Expenditure Price Index, excluding food and energy (core PCE), the Fed's preferred inflation measure, increased 0.4 percent in January and was up 2.8 percent compared to January last year. Core PCE was down from Decembers' reading of 2.9 percent but remains above the Fed's target of two percent.

- The Producer Price Index was higher than expected in February, rising 0.6 percent month-over-month. Producer prices are up 1.6 percent versus a year ago, the highest since September 2023.

- The Federal Reserve's Federal Open Market Committee (FOMC) will meet on March 19-20 where it is expected to maintain the target for the federal funds rate at a range of 5.25 percent to 5.50 percent. The FOMC has kept rates unchanged at its last four meetings. In his semiannual monetary policy report to Congress on March 6, Chair Powell reiterated the Federal Reserve's commitment to bring inflation down to two percent. Powell indicated that while the policy rate was likely at its peak for this cycle, the FOMC does not expect it will be appropriate to reduce rates until it gains further confidence that inflation is moving sustainably toward two percent.

- On March 9, President Biden signed a package of spending bills to avoid a partial government shutdown. Congress continues to negotiate additional spending bills, including for defense.

- According to the Virginia Realtors Association, the number of homes sold in Virginia increased in January by 0.6 percent year-over-year, and the median home price increased 6.3 percent to $371,889. The uptick in closed sales combined with strong price growth lifted sold volume to $2.6 billion in January, up 6.9 percent over the same period last year, the first year-over-year increase in nearly two years.

February Revenue Collections

General fund revenues increased 17.3 percent year-over-year for the month of February on an unadjusted basis. Fiscal year-to-date through February 29, general fund revenues are up 6.3 percent over the prior year.

Net Individual Income Tax (67% of general fund revenues): Unadjusted revenues rose by 30.1 percent for the month compared to last year. Year-to-date net individual income tax collections are up 6.9 percent. Compared to the forecast assumed in the amended budget, year-to-date net individual income tax collections are ahead of projections by $835.6 million, driven by higher-than-expected withholding and nonwithholding, and lower than anticipated refunds.

Performance in each component of individual income tax is as follows:

Individual Income Tax Withholding (58% of general fund revenues): Collections of payroll withholding taxes were 8.8 percent higher for the month on an unadjusted basis. These results were impacted by one additional deposit day due to leap year. Fiscal-year-to-date, collections are 8.2 percent higher than the same period last year after adjustments, and up 5.0 percent on an unadjusted basis. Compared to the Forecast assumed in HB/SB 29, withholding revenues are ahead by $347.4 million year-to-date.

Individual Income Tax Non-withholding (21% of general fund revenues): February collections increased by 96.8 percent year-over-year and are down 1.0 percent for the year, both on an unadjusted basis. This follows an unexpected decline in January of 27.5 percent. Through February, nonwithholding receipts are $327.0 million ahead of forecast. However, the majority of nonwithholding receipts are typically collected in the fourth quarter of the fiscal year.

Individual Income Tax Refunds (-12% of general fund revenues): Through February, the Department of Taxation has issued $1,675.5 million in refunds compared with $1,962.1 million over the same period last year, a decrease of 14.6 percent.

Sales Tax (16% of general fund revenues): Collections of sales and use taxes, reflecting January sales, declined 3.5 percent in February and are down 1.8 percent year-to-date. Fiscal-year-to-date, sales and use tax revenues are $41.3 million above projections. Adjusting for the elimination of the State sales tax on grocery and the end of Accelerated Sales Tax, sales tax collections are up 0.9 percent year-to-date.

Corporate Income Tax (8% of general fund revenues): Net corporate income tax collections were negative for the month of February, as refunds exceeded receipts. Virginia Tax issued $74 million in corporate refunds in February compared to $19 million in February 2023. February is not a significant month for corporate income tax. Generally, about 80 percent of corporate income tax revenues are received in April, June, September, and December. On a year-to-date basis, corporate income tax revenues are up 6.3 percent. Compared to forecast, corporate income tax collections are below plan by $59.6 million year-to-date.

Wills, Suits, Deeds, Contracts (2% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were 22.2 percent higher in February compared to the previous year. On a fiscal-year-to-date basis, collections are down 11.3 percent. Compared to the forecast, collections in this source are behind projections by $22.7 million.

Insurance Premiums (2% of general fund revenues): Year-to-date collections are down 6.5 percent versus a forecasted decline of 1.0 percent.

Other Revenue Sources

The following provides growth data on collections through February for other revenue sources:

	Year-to-Date	Annual Estimate
Interest Income (2% GF revenues)	118.9%	84.2%
ABC Taxes (1% GF revenues)	1.4%	5.4%

Interest income earnings totaled $553.2 million in the first eight months of the year compared to $252.8 million for the same period of the prior fiscal year. Interest is earned monthly in the general fund and credited to nongeneral funds on a quarterly basis in October, January, April, and June.

All Other Revenue (2% of general fund revenues): On a year-to-date basis, collections of All Other Revenue increased by 2.7 percent to $354.4 million fiscal year-to-date compared with $345.3 million a year ago.

Summary

Through February, year-to-date collections are up 6.3 percent compared to last year and are running ahead of projections assumed in the Governor's proposed Fiscal Year 2024 amended budget. Payroll withholding collections are ahead of projections driven partially by additional deposit days in January and February and the timing of certain employers' withholding payments. Sales tax collections are down 1.8 percent year-to-date, modestly ahead of the forecast. Individual income tax nonwithholding revenues are ahead of projections, but January collections, reflecting taxpayers' fourth quarter estimated payments were down a surprising 27.5 percent which could imply that final payments will be lower than expected.

Recent economic data continue to reflect an economy that is slowing. Despite robust job reports in recent months, employment growth is trending downward and alternative measures of labor market health show signs of weakening. Retail sales data suggest some softening in consumer spending. Inflation measures remain stubbornly higher than the Fed's target and may cause a data-driven Fed to delay rate reductions. These factors and continuing geopolitical risks, including the potential for escalating conflict in the Middle East, support our conservative revenue and economic outlook going forward.

Technical Note: *In February, forecasts of monthly withholding collections were adjusted to more accurately reflect the number of deposit days. This technical revision does not affect the full-year forecast, which remains unchanged.*