COMMONWEALTH of VIRGINIA

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MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: March Revenue Report

For the month of March, total general fund revenues increased 5.0 percent ($102.6 million) versus the same period last year. The year-over-year increase was driven primarily by higher net individual income tax collections and higher interest income.

March revenue collections consist mainly of withholding and sales tax receipts, as well as the normal monthly collections for other sources. In addition, March collections typically include the leading edge of final payments from corporations and individuals, which are due April 15 and May 1, respectively. Therefore, the timing of these final payments, along with the timing of refunds in both sources, can distort monthly growth rates.

With two fewer deposit days, withholding collections declined 5.6 percent ($92.5 million) for the month compared to last year, but this was taken into account in monthly projections based on the forecast assumed in the Governor's amendments to FY2024 budget (House Bill 29). Nonwithholding collections increased by 3.5 percent ($12.8 million) compared to March last year, and refunds were down 25.1 percent ($144.0 million) compared to last year. Interest income was higher by 90.1 percent ($54.5 million) versus last March, reflecting higher earnings on the Commonwealth's cash balances in interest-bearing accounts.

Year-to-date, general fund revenues are up 6.2 percent ($1.15 billion) through the first nine months of Fiscal Year 2024. Adjusting for the effects of the elective Pass-Through Entity Tax (PTET) collections and refunds, and the associated timing of enacted policy actions to better reflect underlying economic trends, revenue collections are up 7.8 percent ($1.55 billion) year-to-date.

Compared to the revenue forecast assumed in House Bill 29 and accounting for monthly variations in tax collections, year-to-date revenues are ahead of projections by $1.06 billion. Excluding nonwithholding and refunds, which continue to be distorted by PTET, year-to-date collections in core revenue sources are ahead of plan by $399.2 million, a variance of 2.2 percent.

Among the major revenue sources, withholding revenues exceeded projections by 7.0 percent ($101.7 million) in March and are ahead of forecast by 3.7 percent ($449.1 million) year-to-date. Corporate tax collections declined 36.2 percent ($46.2 million) year-over-year in the month of March and fell short of projections by $75.0 million. However, March is not a significant month for collections in this source. Sales tax revenues, reflecting February sales, were higher than projections by 17.4 percent ($52.1 million) and are ahead of forecast by 2.7 percent ($93.4 million) on a year-to-date basis. Wills, Suits, and Deeds (mainly recordation) revenues declined slightly year-over-year in March and are below projections for the year by 7.7 percent ($23.9 million).

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

Economic Review

- U.S. Real GDP growth was revised slightly higher to a 3.4 percent annual rate in the fourth quarter of calendar year 2023 according to the "third" estimate released by the Bureau of Economic Analysis. The update primarily reflects upward revisions to consumer spending and nonresidential fixed investment that were partly offset by a downward revision to private inventory investment. For the full year, real GDP increased 2.5 percent.

- U.S. retail sales for March rose 0.7 percent month-over-month and were up 4.0 percent compared to March 2023, according to the "advance" monthly sales report published by the U.S. Census Bureau. The January to February percent change was also revised upward, from up 0.6 percent to up 0.9 percent. On a year-over-year basis, sales for non-store retailers, which includes internet sales, were up 11.3 percent in March, and sales at restaurants and bars were up 6.5 percent. The biggest year-over-year declines were in furniture stores and sporting goods and hobby stores.

- U.S. nonfarm payrolls rose by 303,000 and the unemployment rate ticked down from 3.9 percent to 3.8 percent in March. Payroll gains for January and February were revised up by a total of 22,000, bringing the net gain, including revisions, to 325,000. U.S. payrolls were up 1.9 percent in March compared to a year ago. Civilian employment, an alternative measure of jobs that includes small-business start-ups increased in March by 489,000 and was up 0.4 percent year-over-year.

- In February, Virginia's nonagricultural employment, from the monthly establishment survey, increased by 10,600 to 4,209,900. January's preliminary estimate of employment, after revision, decreased by 700 to 4,199,300.

- Virginia's seasonally adjusted unemployment rate in February was unchanged at 3.0 percent, which is the same as the rate from a year ago. Virginia's labor force participation rate also remained unchanged at 66.6 percent.

- The Consumer Price Index (CPI) for all items increased to 3.5 percent for the twelve months ending in March, a larger increase than the 3.2-percent increase for the 12 months ending February. The twelve-month change in "core" CPI, which excludes food and energy, was unchanged at 3.8 percent.

- The Personal Consumption Expenditure Price Index, excluding food and energy (core PCE), the Fed's preferred inflation measure, increased 0.3 percent in February and was up 2.8 percent compared to February last year, above the Fed's target of two percent.

- The Producer Price Index (PPI), which measures pipeline costs for raw, intermediate, and finished goods, increased 2.1 percent year-over-year in March, the biggest move since April 2023. The PPI is considered a leading indicator for inflation as it indicates costs early in the supply chain.

- The Federal Reserve's Federal Open Market Committee (FOMC) announced on March 20 that it would 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 five consecutive meetings. Chairman Powell reiterated the Federal Reserve's commitment to bring inflation down to two percent. He emphasized the committee will continue its data-dependent approach and evaluate rate hike decisions on a "meeting by meeting" basis.

- The number of expected Fed rate cuts has fallen significantly in the last three months. According to the CME Group, which calculates interest rate probabilities based on Federal Funds futures prices, in January, financial markets were expecting as many as seven one-quarter-point rate cuts by year-end. Markets are now pricing in the higher likelihood of two or fewer cuts by December.

- On March 23, President Biden signed a package of spending bills fully funding the federal government through September and avoiding a potential government shutdown.

- According to the Virginia Realtors, the number of homes sold in Virginia increased in February by 3.5 percent year-over-year, and the median home price increased 3.9 percent. Sold volume increased year-over-year by $319 million, an increase of 11.0 percent. In addition, for the first time in nearly three years, pending sales activity outpaced the prior year, increasing by 8.0 percent compared to February 2023.

March Revenue Collections

General fund revenues increased 5.0 percent year-over-year for the month of March on an unadjusted basis. Fiscal year-to-date through March 31, general fund revenues are up 6.2 percent over the prior year.

Net Individual Income Tax (67% of general fund revenues): Unadjusted revenues rose by 4.5 percent for the month compared to last year. Year-to-date net individual income tax collections are up 6.6 percent. Compared to the forecast assumed in the amended budget, year-to-date net individual income tax collections are ahead of projections by $1.11 billion, 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 5.6 percent lower for the month on an unadjusted basis. These results were impacted by two fewer deposit days compared to March 2023. Fiscal-year-to-date, collections are 6.8 percent higher than the same period last year after adjustments, and up 3.6 percent on an unadjusted basis. Compared to the Forecast assumed in House Bill 29, withholding revenues are ahead by $449.1 million year-to-date.
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> ***Individual Income Tax Nonwithholding (21% of general fund revenues)***: March collections increased by 3.5 percent year-over-year and are down 0.5 percent for the year, both on an unadjusted basis. Through March, nonwithholding receipts are $385.5 million ahead of forecast.
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> ***Individual Income Tax Refunds (-12% of general fund revenues)***: During the month of March, refunds totaled $430.4 million versus $574.5 million last March, a 25.1 percent decline. Approximately 170,000 fewer refunds were issued in March compared to the same month last year, a decline of 21 percent. Year-to-date, the Department has issued $2,105.9 million in refunds compared with $2,536.5 million over the same period last year, a decrease of 17.0 percent.

Sales Tax (16% of general fund revenues): Collections of sales and use taxes, reflecting February sales, increased 5.9 percent in March and are down 1.1 percent year-to-date. Fiscal-year-to-date, sales and use tax revenues are $93.4 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 1.4 percent year-to-date.

Corporate Income Tax (8% of general fund revenues): Net corporate income tax collections were down year-over-year by $46.2 million in March, a 36.2 percent decline. March is not a significant month for this source. 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 1.3 percent. Compared to forecast, corporate income tax collections are below plan by $134.7 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 1.6 percent lower in March compared to the previous year. On a fiscal-year-to-date basis, collections are down 10.3 percent. Compared to the forecast, collections in this source are behind projections by $23.9 million.

Insurance Premiums (2% of general fund revenues): Year-to-date collections are 1.1 percent versus a forecasted decline of 1.0 percent.

Other Revenue Sources

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

	Year-to-Date	Annual Estimate
Interest Income (2% GF revenues)	113.3%	84.2%
ABC Taxes (1% GF revenues)	1.7%	5.4%

Interest income earnings totaled $668.3 million in the first nine months of the year compared to $313.3 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 2.4 percent to $392.8 million fiscal year-to-date compared with $383.8 million a year ago.

Summary

Through March, year-to-date collections are up 6.2 percent compared to last year and are running ahead of projections assumed in the Governor's proposed Fiscal Year 2024 amended budget by $1.06 billion after accounting for monthly variations in tax collections. Excluding nonwithholding and refunds, which continue to be distorted by PTET, year-to-date collections in core revenue sources are ahead of plan by $399.2 million, a variance of 2.2 percent.

The Commonwealth's results have consistently exceeded forecast, which was constructed prudently. Notwithstanding persistent inflation,Virginia's economy remains strong. Recent employment reports have generally been positive, and several prior reports have been adjusted upwards, including the troubling preliminary report for December 2023 that indicated that Virginia had experienced its first month of job losses in 14 months. This report was subsequently adjusted from a monthly loss of 11,800 jobs to a gain of 4,000. Withholding is the most important revenue driver for the Commonwealth, and as a result of steady job gains over the past two years, more than 200,000 in total, the Commonwealth has the most people working in its history which gives us confidence in our current position.

However, at the national level, given the stronger than expected job growth and persistently higher inflation relative to the Fed targets, the market's expectations of the timing and number of rate reductions have changed significantly since January suggesting that rates will remain higher for longer. These factors combined with continuing geopolitical risks, including the potential for escalating conflict in the Middle East, supports our conservative outlook in the near term which continue to incorporate the impact of a mild recession beginning in the next two to three months and continuing for two quarters should one occur.