



COMMONWEALTH of VIRGINIA

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September 18, 2023

MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: August Revenue Report

On September 14, House Bill 6001, amendments to the 2023 Appropriations Act, was signed into law. Contained in the Act are revisions to the official revenue forecast for Fiscal Year 2024. The revenue forecast assumed in HB 6001 anticipates a year-over-year decline in general fund revenues of 5.5 percent, including the impact of various tax policy actions adopted in 2022 and 2023 and reflecting the potential for an economic slowdown in the latter part of the current fiscal year. Given the current interest rate environment, with inflation persisting above Fed targets and other uncertainties, the HB 6001 revenue forecast is intentionally conservative, and we remain cautious in our outlook over the near term.

In comparison to the revenues assumed in HB 6001, year-to-date general fund revenues are ahead of forecast by \$204.8 million, though a portion of that variance is attributable to interest income that has yet to be distributed to nongeneral fund accounts, which is done quarterly in October, January, April, and June. Comparing to the prior year, general fund revenues are up 0.9 percent fiscal year-to-date through August. For the month, revenues declined by 0.9 percent but exceeded projections by \$92.9 million. The year-over-year decline is mainly due to tax policy actions and the continuing issuance of individual income tax refunds attributable to Pass-Through Entity Tax (PTET) filers. Timing issues around PTET inflated collections in Fiscal Year 2023 and will result in higher refund levels in Fiscal Year 2024.

Adjusting for policy actions to better reflect underlying economic trends, major sources of general fund revenues, excluding the gains in interest income, increased by 3.0 percent in the first two months of Fiscal Year 2024, compared to the same period of the previous year. For August,

adjusted general fund revenues for the major sources increased by 3.7 percent compared to August 2022.

Among other major sources, withholding was \$19.3 million higher than projected in August. Sales tax revenue was up by over \$10 million. Overall collections from other sources of revenues generally exceeded the Forecast as discussed in more detail in the following sections.

Economic Review

- The U.S. economy continues to show resilience even as interest rates have increased significantly over the past year. Second quarter Real Gross Domestic Product (GDP) rose by a seasonally adjusted annual rate of 2.1 percent according to the second estimate released by the Bureau of Economic Analysis. Compared to the same quarter the previous year, Real GDP grew by 2.5 percent.
- Non-farm payroll employment increased by 187,000 jobs in August, although previous months' job counts were revised lower. The unemployment rate rose to 3.8 percent, as labor force participation rose to 62.8 percent, its highest rate since February 2020.
- In August, the Consumer Price Index (CPI) was up 3.7 percent year-over-year, an acceleration from recent months. This is mainly the result of the recent rise in fuel prices. Core CPI continued its downward trend from 4.7 to 4.4 percent year-over-year over the same period. Goods inflation has weakened substantially. Housing inflation is expected to decelerate as rent growth is trending flat to down. The last of inflation's stickiness remains in the service sector, driven by wages.
- The Federal Reserve hiked interest rates by 25 basis points to 5.25-5.5 percent at the July 25-26 meeting. Expectations around further Fed rate hikes are mixed with some economists expecting an additional rate increase this year. Although the risk of recession remains, economists have generally been pulling back from their assessments of the risk of recession over the next twelve months. In the latest Wall Street Journal survey of business and academic economists, the probability of a recession dropped from 61 percent to 54 percent.
- Virginia's unemployment rate fell to 2.5 percent on a seasonally adjusted basis in July, compared to 2.6 percent a year ago, and the labor force participation rate increased to 66.7 percent in July – the highest labor force participation rate since November 2012.
- The number of employed Virginia residents increased by 17,937 to 4,481,008 in July.

August Revenue Collections

General fund revenues were down 0.9 percent for the month of August on an unadjusted basis. Year-to-date through August 31, general fund revenues are up 0.9 percent over the prior year.

Net Individual Income Tax (70% of general fund revenues): After adjusting for policy actions, on a fiscal-year-to-date basis, net individual income tax payments increased by 3.4 percent. Unadjusted revenues fell by 5.1 percent for the month compared to last year and were down 7.2

percent year-to-date. This was mainly due to the continued issuance of refunds for the aforementioned PTET filers.

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 0.9 percent higher for the month on an unadjusted basis. Fiscal-year-to-date, collections are 3.4 percent higher than the same period last year after adjustments, and flat on an unadjusted basis. Compared to the Forecast assumed in HB 6001, withholding revenues are ahead by \$23.5 million year-to-date.

Individual Income Tax Non-withholding (20% of general fund revenues): August is not a significant month for collections in this source since the first estimated payment for fiscal year 2024 is due in September. Through the first two months of the fiscal year, collections were \$220.9 million compared with \$223.5 million in the same period last year.

Individual Income Tax Refunds (-8% of general fund revenues): Through August, the Department of Taxation has issued \$298.6 million in refunds compared with \$106.5 million over the same period last year, generally in line with expectations. Most of the increase is attributable to the taxable year 2022 PTET filers requesting refunds for tax overpayments.

Sales Tax (16% of general fund revenues): Collections of sales and use taxes, reflecting July sales, grew by 2.5 percent in August and are up 0.7 percent year-to-date, after adjusting for the elimination of the State sales tax on grocery and the end of Accelerated Sales Tax. Unadjusted sales tax collections are 4.4 percent higher year-to-date, running slightly ahead of projections.

Corporate Income Tax (7% of general fund revenues): As with non-withholding, 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 \$105.9 million compared with \$71.6 million in the same period last year, ahead of projections by \$24.0 million.

Wills, Suits, Deeds, Contracts (2% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were 19.5 percent lower in August compared to the previous year. On a fiscal-year-to-date basis, collections are down 24.3 percent as higher interest rates have sharply curtailed residential and commercial property sales and mortgage refinancing.

Insurance Premiums (2% of general fund revenues): Monthly collections of insurance company premiums license taxes are being transferred to the Transportation Trust Fund per Chapter 986, 2007 Acts of the Assembly, until the required amount of \$217.8 million has been deposited.

Other Revenue Sources

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

| | <u>Year-to-Date</u> | <u>Annual Estimate</u> |
|------------------------------------|---------------------|------------------------|
| Interest Income (0.8% GF revenues) | 383.4% | 73.9% |
| ABC Taxes (1% GF revenues) | 136.2% | 3.4% |

With a substantial balance sheet and high returns, interest income earnings have continued to surge, totaling \$224.9 million in the first two months of the year compared to \$46.5 million for the first two months of the prior fiscal year. However, year-to-date interest income does not reflect allocations to nongeneral fund accounts which will reduce general fund interest income in coming months when quarterly NGF distributions are made 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 declined 0.3 percent to \$64.6 million fiscal year-to-date compared with \$64.8 million a year ago.

Summary

With two months of collections in Fiscal Year 2024, year-to-date collections are up 0.9 percent compared to last year and are running ahead of projections assumed in the amended budget by \$204.8 million. All of the major sources are generally in line or ahead of projections.

August is not a significant month for revenue collections, however, with collections mainly from withholding, sales taxes, and other sources that have regular monthly payments. September collections will complete the first quarter of Fiscal Year 2024 and provide a clearer assessment of revenue growth. The first estimated payments from individuals, corporations, and insurance companies are due in September.

The fall revenue forecasting season that began with a meeting of the Governor's Advisory Council on Revenue Estimates on August 7, will continue in earnest next month with a meeting on October 11 with the Joint Advisory Board of Economists followed by a second meeting of the Governor's Advisory Council on Revenue Estimates on November 20. A revised forecast for Fiscal Year 2024 and revenue forecasts for fiscal years 2025 and 2026 will accompany the Governor's proposed budget which will be released on December 20.