



COMMONWEALTH of VIRGINIA

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Secretary of Finance

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P.O. Box 1475
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MEMORANDUM

TO: The Honorable Ralph S. Northam

THROUGH: The Honorable Clark Mercer

FROM: Aubrey L. Layne, Jr.

SUBJECT: December Revenue Report

This month's revenue report contains general fund revenue collections for the first half of fiscal year 2019. The report incorporates the revised general fund revenue forecast included in the budget bill (SB1100/HB1700) introduced on December 18, 2018. With these post-GACRE (*Governor's Advisory Council on Revenue Estimates*) policy revisions in December, total general fund revenues are now projected to grow by 5.9 percent in fiscal year 2019.

Total general fund revenues fell 5.7 percent in December, mainly due to a significant drop in individual estimated payments received ahead of the January 15th due date. Last December's individual estimated payments totaled \$403.8 million (a historical anomaly caused by the federal *Tax Cuts and Jobs Act*) as compared to this year's \$108 million. Sources most closely tied to economic activity – payroll withholding and sales tax collections – posted strong growth.

On a fiscal year-to-date basis, total revenue collections rose 1.5 percent through December, trailing the annual forecast of 5.9 percent growth. Although collections are lagging the annual estimate, growth is expected to be higher in the second half of the fiscal year due to effects of the federal *Tax Cuts and Jobs Act*. Because the timing of payments at this time of year can distort growth in several sources, December and January collections should be viewed together to accurately assess growth. This is especially true for nonwithholding receipts where fourth quarter estimated payments for the calendar year are normally split between December and January.

National Economic Indicators

Recent national indicators suggest the economy continues to grow at a solid pace.

- According to the third estimate, real GDP rose at an annualized rate of 3.4 percent in the third quarter, following 4.2 percent growth in the second quarter.
- The labor market is healthy. Payroll employment rose by 312,000 jobs in December, well above expectations. In addition, October and November gains were revised higher. In a separate report, the unemployment rate increased from 3.7 percent to 3.9 percent, as more workers entered the labor force.
- Initial claims for unemployment rose by 10,000 to 231,000 during the week ending December 29, although claims data can be volatile during the holidays. The four-week moving average fell by 500 to 218,750. The level of claims is consistent with a healthy labor market.
- The Conference Board's index of leading indicators rose 0.2 percent in November following a 0.3 percent decrease in October and a 0.6 percent increase in September, suggesting the economic expansion should continue.
- The Conference Board's index of consumer confidence fell 8.3 points to 128.1 in December, with both the expectations and present conditions components contributing to the decline.
- Conditions in the manufacturing sector softened in December. The Institute of Supply Management index dipped from 59.3 to 54.1, a level consistent with continued growth.
- The CPI was unchanged in November after increasing 0.3 percent in October. The index stands 2.2 percent above November 2017. Core inflation (excluding food and energy prices) rose by 0.2 percent, and is also 2.2 percent above a year ago.
- At its December meeting, the Federal Reserve raised the federal funds target rate range by 25 basis points to 2.25 to 2.5 percent.

Virginia Economy

In Virginia, payroll employment rose 1.8 percent in November as compared to last year. Northern Virginia posted growth of 1.1 percent; Hampton Roads rose 1.6 percent; and Richmond-Petersburg rose 1.6 percent. The seasonally adjusted unemployment rate fell 0.1 percentage point to 2.8 percent in November, the lowest rate since April 2001.

The Virginia Leading Index decreased 0.1 percent in November after advancing 0.3 percent in October. Auto registrations fell in November while the U.S. leading index and initial claims for unemployment improved for the month. Future employment was unchanged. The index for Roanoke rose and the index for Winchester was unchanged in November while the remaining regional indexes decreased in November.

December Revenue Collections

Total general fund revenues fell 5.7 percent in December, mainly due to a significant drop in individual estimated payments received ahead of the January 15th due date. Sources most closely tied to economic activity – payroll withholding and sales tax collections – posted strong growth. On a fiscal year-to-date basis, total revenue collections rose 1.5 percent through December, trailing the annual forecast of 5.9 percent growth.

Net Individual Income Tax (71% of general fund revenues): Through December, collections of net individual income tax rose 0.5 percent from the same period last year, lagging the annual estimate of 6.7 percent growth. As stated earlier, growth is expected to pick up in the second half of the fiscal year due to effects of the federal *Tax Cuts and Jobs Act*. Performance in each component of individual income tax is as follows:

Individual Income Tax Withholding (62% of general fund revenues): Collections of payroll withholding taxes rose a strong 11.9 percent in December. The partial federal government shutdown had no effect on receipts because payments are received from agencies at the beginning of the month. Year-to-date, collections have grown 4.5 percent, well ahead of the annual estimate of 3.8 percent growth.

Individual Income Tax Nonwithholding (19% of general fund revenues): December and January are significant months for collections in this source, and receipts can be distorted by the timing of payments. Taxpayers have until January 15th to submit their fourth estimated payment for tax year 2018 and some of these payments are typically received in December. Individual estimated payments of \$108.0 million were significantly below the \$403.8 million collected in December of last year. Last December's receipts included significant payments from wealthy individuals making payments to deduct in taxable year 2017 on their federal return as a result of the *Tax Cuts and Jobs Act* limiting the amount of payments they could deduct in tax year 2018.

Year to-date collections were \$828.2 million compared with \$1,045.5 million in the same period last year, a 20.8 percent decline compared with the annual estimate of a 15.2 percent increase. A clearer assessment of growth will be possible at the end of January, when all quarterly payments have been received and December and January collections can be considered together. However, due to some of the extremely large payments from individuals received last December were in fact a proxy for their May 1st final payment, it may be until May before a complete analysis can be done.

Individual Income Tax Refunds: December is not a significant month for refund activity, as it concludes tax year 2017 refund processing. Through December, the Department of Taxation issued \$305.2 million in refunds compared with \$289.0 million in the first six months of last fiscal year.

Sales Tax (17% of general fund revenues): Collections of sales and use taxes, reflecting November sales, rose 7.7 percent in December. November represents the beginning of the holiday

shopping season and a clearer assessment of the season will be possible after receiving December sales tax payments due in January. On a year-to-date basis, collections have risen 4.8 percent, ahead of the annual estimate of 3.7 percent growth.

Corporate Income Tax (4% of general fund revenues): December is a significant month for corporate income tax collections as quarterly estimated payments are due for most corporations. With the main refunding season completed and the first two estimated payments received, collections of corporate income taxes grew 1.2 percent on a year-to-date basis, compared with the forecast of 5.6 percent growth.

Wills, Suits, Deeds, Contracts (2% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were \$32.0 million in December, compared with \$32.4 million in December of last year, a decline of 1.3 percent. On a year-to-date basis, collections are down 5.2 percent, slightly ahead of the annual forecast of a 6.7 percent decline.

Insurance Premiums (2% of general fund revenues): Chapter 896 of the 2007 Acts of the Assembly required that \$168.7 million of collections in this source be transferred to the Transportation Trust Fund in fiscal year 2019 before making any deposits to the general fund. The required transfer was completed in December. Collections of taxes on insurance premiums were \$93.2 million in December, compared with \$94.7 million in December 2017.

Other Revenue Sources

The following list provides data on December collections for other revenue sources:

	<u>Year-to-Date</u>	<u>Annual Estimate</u>
Interest Income (0.3% GF revenues)	26.6%	11.5%
ABC Taxes (1% GF revenues)	1.2%	3.5%

All Other Revenue (2% of general fund revenues): Receipts in All Other Revenue rose 10.1 percent in December, \$25.6 million compared with \$23.3 million a year ago. On a year-to-date basis, collections of All Other Revenue rose 13.9 percent from the same period last year, compared to the annual estimate of 1.5 percent growth.

Summary

Total general fund revenues fell 5.7 percent in December, mainly due to a significant drop in individual estimated payments received ahead of the January 15th due date. Sources most closely tied to economic activity – payroll withholding and sales tax collections – posted strong growth. On a fiscal year-to-date basis, total revenue collections rose 1.5 percent through December, trailing the annual forecast of 5.9 percent growth.

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Because a number of factors can influence the flow of payments and monthly growth rates at this time of year, December and January receipts must be considered together to get a clear picture of revenue growth. This is especially true for nonwithholding receipts where the filing of fourth quarter estimated payments for the calendar year are normally split between December and January.

Partial Federal Government Shutdown

Through the end December, Virginia has not experienced any financial impact from the partial federal government shutdown. We will continue to monitor the situation and report any impacts.