COMMONWEALTH of VIRGINIA

Stephen E. Cummings
Secretary of Finance

P.O. Box 1475
Richmond, Virginia 23218

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MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: October Revenue Report

Adjusted for policy changes and taxpayer rebates, general fund revenues grew 10.3 percent year-over-year in October. On an unadjusted basis, general fund revenues increased 3.0 percent for the month. Year-over-year growth was driven by growth in payroll withholding, individual nonwithholding collections and sales and use tax revenues. Gains were partially offset by the continued issuance of taxpayer rebates authorized by the 2022 General Assembly.

For the fiscal year-to-date, adjusted for policy actions that affect the timing of tax collections, general fund revenues were up 8.3 percent. On an unadjusted basis, general fund revenues decreased 3.1 percent versus the 14.0 percent decline assumed in the current budget, exceeding projections by $840 million.

October is generally not a significant month for revenue collections. Regular monthly collections are due in withholding, sales and use taxes, and most minor sources. Processing of individual income tax extension returns due November 1 also begins in October. Additionally, October marks the first month in which withholding tables were updated to reflect the previously authorized increase in the standard deduction, from $4,500 to $8,000 for single filers, and from $9,000 to $16,000 for married taxpayers filing a joint return. The impact of the increased standard deduction is expected to reduce payroll withholding by 3.5 - 4.0 percent, approximately $50.0 million, per month starting in October.

Overall collections for payroll withholding, after adjusting for the standard deduction, are consistent with the recent pace of payroll employment gains, up 3.4 percent year over year, and wage rate growth of approximately 5.5 percent. Year-over-year increases in sales tax collections primarily reflect the impact of heightened inflation. With inflation continuing to exceed wage growth, this negative impact on real wages is not sustainable. The Federal Open Market Committee has aggressively raised rates in every meeting since March 2022 and has indicated that it will continue to do so until it is clear that inflation is under control. It has further made it clear that it is willing to sacrifice jobs in order to meet its goal.

For nonwithholding, collections have grown through the first four months of the fiscal year. However, it is important to note that, because filers generally make nonwithholding payments at this time of year based on prior year tax liability, current collections do not reflect the volatility in the stock market and its weakness compared to a year ago. Collections of nonwithholding revenues are concentrated in the fourth quarter of the fiscal year when taxpayers make their final tax payments. In Fiscal Year 2022, nonwithholding revenues in the fourth quarter were $4.3 billion, or 63 percent of nonwithholding revenues for the year, a significant increase from prior years. As a result of ongoing heightened inflation and the commitment of the Fed to reduce inflation, there is significant risk to revenues in the second half of Fiscal 2023.

Economic Review

Recent economic data are mixed with continued job growth, albeit at lower levels, and continued high inflation, rising interest rates and lower consumer confidence.

- The U.S. labor market added 261,000 jobs to payrolls in October exceeding expectations. September gains were revised up slightly to 315,000. While continuing to grow, the 3-month average gain of 289,000 jobs represents a considerable slowdown from the 600,000 pace that occurred in the first half of the year.

- In addition to the recent mass layoff announcements from major tech firms, companies from other sectors have begun to announce job reductions as margins have come under pressure. These actions which have yet to be reflected in the labor statistics, also point to future weakening in the labor markets.

- Initial claims for unemployment decreased slightly to 217,000 during the week ending October 29. The four-week moving average was 218,250 up over the last month.

- The impact of higher interest rates continues to take a toll on the housing market.
  New home sales in September plunged 10.9 percent to a seasonally adjusted annual rate of 603,000 units. Housing starts dropped 8.1 percent to a seasonally adjusted annual rate of 1.439 million units.

- The Conference Board's index of leading indicators fell 0.3 percent in August to 116.2, and followed a revised 0.5 percent decrease in July.

- The University of Michigan consumer sentiment index increased marginally to 59.9 in October from the previous reading of 59.8.

- The Institute of Supply Management index dropped from 52.8 to 50.9 in September, but remains above the neutral threshold of 50.0.

- October CPI rose by 0.4 percent in October and stands 7.7 percent on a year over basis beating expectation of a 0.6 percent increase. Core inflation (excluding food and energy prices) rose 0.3 percent and stands 6.3 percent above a year ago.

- At its November meeting, the Federal Reserve raised the federal funds target rate by another 75 basis points to the range of 3.75 to 4.00 percent and indicated it will keep hiking well above the current level. This is the fourth consecutive 75-basis point increase and the target rate is at its highest level in 15 years.

- In Virginia, payroll employment rose 3.4 percent in September from September of last year. Stronger than average gains occurred in Charlottesville up by 3.6 percent and in Blacksburg up 3.7 percent. There were weaker gains in Northern Virginia which rose by 2.6 percent and in Richmond-Petersburg which rose by 2.0 percent.

- In a broader survey of employment that includes the self-employed for September 2022, the number of employed Virginians increased 3.0 percent from a year ago, and the seasonally adjusted unemployment rate remained unchanged at 2.6 percent. The Virginia unemployment rate is 0.8 percentage points lower than the 3.4 percent rate reported in September 2021.

October Revenue Collections

Adjusting for policy actions taken earlier in the year that affect the timing of tax collections, the general fund revenues were up 8.3 percent during the first four months of FY 2023. On an unadjusted basis, general fund revenues decreased 3.1 percent versus the 14.0 percent decline assumed in the current budget and were approximately $840 million ahead of plan.

In the month of October, adjusting for the taxpayer rebates issued in October, total general fund revenue increased 10.3 percent for the month compared to a year ago. Strong gains in nonwithholding and sales/use taxes were offset by income tax refunds -- $88.0 million in taxpayer rebates were issued in October. Unadjusted, total general fund revenues increased 3.0 percent year-over-year.

Net Individual Income Tax (67% of general fund revenues): Through October, unadjusted collections of net individual income tax fell 8.2 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)***: Collections of payroll withholding taxes rose 4.2 percent for the month. Fiscal-year-to-date, collections have risen 8.2 percent from the same period last year. The month-over-month slowdown in withholding collections reflects the implementation of new withholding rates that incorporate the increased standard deduction. Adjusting for the increased deduction, withholding would have been approximately 3.5 - 4.0 percent higher in October.

Individual Income Tax Nonwithholding (21% of general fund revenues): October is not a significant month for this source. Year-to-date, collections were $1,211.8 million compared with $1,070.4 million in the same period last year, a 13.2 percent increase, compared with the forecast of a 23.4 percent decline.

Individual Income Tax Refunds: Through October, the Department of Taxation has issued $1,243.6 million in refunds compared with $262.9 million in the same period last year, a 373.1 percent increase. September and October included the planned issuance of approximately $1.0 billion in taxpayer rebates. Adjusting for these rebates, income tax refunds increased 6.8 percent fiscal-year-to-date.

Sales Tax (18% of general fund revenues): Collections of sales and use taxes, reflecting September sales, rose 9.3 percent in September. On a year-to-date basis, collections of sales and use taxes have risen 17.2 percent, ahead of the annual estimate of a 1.3 percent decline; while adjusting for AST, fiscal-year-to-date sales tax grew 6.6 percent. Fiscal-year-to-date, sales and use tax collections are approximately $90 million ahead of plan.

Corporate Income Tax (7% of general fund revenues): Corporate collections increased 12.2 percent for the month. On a year-to-date basis, collections of corporate income taxes were $491.5 million compared with $509.0 million for the first four months of last year, a 3.4 percent decrease compared with the annual forecast of a 12.2 percent decline. Fiscal-year-to-date, corporate income tax collections are approximately $50 million ahead of plan.

Wills, Suits, Deeds, Contracts (2% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were $35.6 million in October, compared with $55.8 million in October of last year, a decrease of 36.2 percent. On a fiscal-year-to-date basis, collections are down 27.7 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

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

	Year-to-Date	**Annual Estimate**
Interest Income (0.4% GF revenues)	108.4%	28.1%
ABC Taxes (1% GF revenues)	-18.7%	1.1%

All Other Revenue (2% of general fund revenues): Receipts in All Other Revenue rose 29.9 percent in October, $50.6 million compared with $38.9 million a year ago. On a year-to-date basis, collections of All Other Revenue rose 15.1 percent from the same period last year, above the annual estimate of a 5.3 percent decline.

Summary

Adjusting for policy actions taken earlier in the year that affect the timing of tax collections, the first four months general fund revenues were up 8.3 percent. On an unadjusted basis, general fund revenues decreased 3.1 percent versus the 14.0 percent decline assumed in the current budget. However, while year-to-date collections have exceeded projections, aggressive Fed policy to curtail inflation has increased the likelihood of an economic downturn that is likely impact revenue collections in the second half of the fiscal year.

Revisions to the general fund revenue forecast fiscal years 2023 and 2024 will be released on December 15 when the Governor's budget recommendations are presented to the General Assembly.