COMMONWEALTH of VIRGINIA

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March 11, 2022

MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: February Revenue Report

The February revenue results support the revised mid-session general fund forecast released on February 18, 2022. February is historically one of the smallest revenue collection months (5.4 percent of this year's forecast) and has historically been subject to timing issues that impact results. That is the case for this year where total general fund revenues were down by 1.2 percent, as more refunds were issued this February due to last year's delayed opening of the refund-processing season, as well as a timing issue with a small number of large employers that caused revenues to be shifted from January to February 2021. The adverse impact of those items is approximately $125-$150 million. On a fiscal year-to-date basis, total revenue collections have risen 13.6 percent through February, ahead of the revised annual forecast of 9.2 percent growth.

The mid-session revised forecast delivered on February 18, 2022 reflected the fact that general fund revenues had exceeded the fiscal year-to-date forecast by approximately $1.45 billion, and maintaining a conservative posture, the Finance staff performed a mid-session review and determined it appropriate to increase the fiscal year 2022 forecast by $1.25 billion, holding back approximately $200 million. The decision to increase the forecast reflected actual results year-to-date and the administration's confidence in the Virginia economy and the resulting major sources of revenue.

Withholding, sales and corporate tax receipts, which represent approximately 75 percent of total general fund revenues, have been consistently strong over the past year, meaningfully exceeding the prior year. While we expect the rates of year-over-year growth to moderate in these categories as we begin to compare to an increasingly vaccinated population and improving economic conditions in the prior year, the current and prospective economic environment supports continued strength in our key revenue sources for the intermediate term. The most important driver is withholding taxes, which are benefitting from increasing wages attributable to the competition for talent that is impacting most employers, as well as job growth. As of December 2021, the most recent data available, the total number of employed Virginians was up 106,100 compared to December 2020, a year over year increase of 2.6 percent. The prospects for continued job growth remain positive with continued strength in the corporate sector, an increasing number of job openings and the broad impact of our economy continuing to open up and the return of our service economy. For similar reasons, we also remain optimistic about the stability of our sales and corporate tax revenues. Elevated inflation will also positively impact our receipts in the near term, through the increase in the cost of goods.

As we have said in the past, we continue to watch nonwithholding tax receipts given the volatile stock market. February is typically a small month in this area but it was a good month versus prior year with such revenues up 27.4 percent. Given the less predictable nature of this stream, there is some conservatism built into this number for the remainder of the year. Regarding refunds, which are a significant item for the remainder of the year, we also have good confidence in both the number and average refund amount for this fiscal year. The timing of the flow is less predictable but the overall amount is fairly predictable based upon past experience.

The war in Ukraine and its potential impact on the Virginia economy and revenues is an issue that is also being closely watched. The reality is that the economies of Russia and Ukraine account for less than 2 percent of U.S. trade, so it is not expected to have a detectable impact on Virginia's economy and main revenue streams. In fact, the increase in U.S. Government spending, particularly in the area of defense, will have a positive impact on our economy. The area that this war directly impacts is oil and gas and other natural resources. Reduced supply as a result of sanctions have already had a significant impact on the cost of these products with an immediate impact on inflation. It is expected that this will lead to a longer period of inflation than previously expected. There are solutions to alleviate this heightened supply/demand imbalance but it is not evident as of this time how the supply chain will respond.

National Economic Indicators

Recent data indicate the U.S. economy continues to expand.

- According to the second estimate, real GDP rose at an annualized rate of 7.0 percent in the fourth quarter of 2021, following 2.3 percent in the third quarter. The growth came as effects of the Delta variant waned and before the Omicron variant surge started. Effects of Omicron will likely be a temporary drag in the first quarter of 2022.

- The labor market added 678,000 jobs to payrolls in February. The gains were broad-based across sectors and exceeded consensus expectations. December and January gains were revised up by a combined 92,000 jobs bringing the three-month average to 582,000. In a separate report, the unemployment rate fell from 4.0 to 3.8 percent.

- Initial claims for unemployment fell by 18,000 to 215,000 during the week ending February 26. The four-week moving average fell by 6,000 to 230,500. In a healthy economy, new filings are typically below 250,000.

- The Conference Board's index of leading indicators fell 0.3 percent in January to 119.6, and follows growth of 0.7 percent in December.

- The Conference Board's index of consumer confidence fell from 111.1 to 110.5 in February. The current conditions component improved while the expectations component declined for the month.

- The Institute of Supply Management index rose from 57.6 to 58.6 in February, and remains above the neutral threshold of 50.0. The manufacturing sector is doing well due to strong demand, but supply chain disruptions continue to weigh on the industry.

- The CPI rose 0.6 percent in January and stands 7.5 percent above January of last year. Core inflation (excluding food and energy prices) also rose 0.6 percent and stands 6.0 percent above a year ago.

- At its January meeting, the Federal Reserve left the federal funds target rate unchanged at the range of 0.0 to 0.25 percent.

Virginia Economy

In late March, the Virginia Employment Commission will release re-benchmarked employment data for calendar years 2020 and 2021, so January data are not yet available. A brief review of the revision will be included in the March revenue letter if the data are released as scheduled.

In December, payroll employment rose 2.8 percent in December from December of last year. Employment in Northern Virginia rose by 3.8 percent; Hampton Roads rose 1.2 percent, Richmond-Petersburg rose 0.2 percent; and the balance of the state increased 4.1 percent. The seasonally adjusted unemployment rate fell 0.2 percentage point to 3.2 percent and stands 2.4 percentage points below a year ago. The number of employed Virginians was up 106,100 in December compared to December 2020.

The data used to compute the Virginia Leading Index for January are not yet available. The index jumped 2.5 percent in December after rising 0.6 percent in November. All components of the Virginia Leading Index: the U.S. leading index, auto registrations, initial claims, and future employment improved in December. The index for Northern Virginia declined in December while the indexes for the remaining ten metro areas increased.

February Revenue Collections

February is not a significant month for revenue collections. Total general fund revenues fell by 1.2 percent in February, as more refunds were issued this February due to last year's delayed opening to the refund-processing season. On a fiscal year-to-date basis, total revenue collections rose 13.6 percent through February, ahead of the revised annual forecast of 9.2 percent growth.

Net Individual Income Tax *(68% of general fund revenues)*: Through February, collections of net individual income tax rose 10.8 percent from the same period last year, ahead of the annual estimate of 7.3 percent growth. Performance in each component of individual income tax is as follows:

Individual Income Tax Withholding *(56% of general fund revenues)*: Collections of payroll withholding taxes declined by 1.3 percent for the month. Year-to-date, collections have risen 9.7 percent from the same period last year, ahead of the annual estimate of 9.0 percent growth.

Individual Income Tax Nonwithholding *(20% of general fund revenues)*: February is not a significant month for collections in this source. Collections in nonwithholding were $93.9 million compared with $73.7 million in February of last year, an increase of 27.4 percent.

Year-to-date, collections in nonwithholding grew by 8.8 percent, ahead of the annual estimate of 2.5 percent growth.

Individual Income Tax Refunds: As the main tax filing season began, the Department of Taxation issued $280.1 million in refunds in February compared with $217.0 million in February of last year, a 29.1 percent increase. Through February, 595,000 refunds have been issued compared to 486,000 last year.

Sales Tax *(17% of general fund revenues)*: Collections of sales and use taxes, reflecting January sales, rose 7.9 percent in February. On a year-to-date basis, collections of sales and use taxes have risen 14.8 percent, ahead of the annual estimate of 11.4 percent growth.

Corporate Income Tax *(7% of general fund revenues)*: Collections of corporate income taxes were $23.1 million in February, compared with receipts of $15.4 million in February of last year. On a year-to-date basis, collections have increased 54.9 percent compared with the forecast of 32.6 percent growth.

Wills, Suits, Deeds, Contracts *(2% of general fund revenues)*: Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were $35.2 million in February, compared with $44.8 million in February of last year, falling by 21.5 percent. On a year-to-date basis, collections are up 0.5 percent, ahead of the annual forecast of a 4.3 percent decline.

Insurance Premiums *(2% of general fund revenues)*: Chapter 986, 2007 Acts of the Assembly required that $180.7 million of collections in this source be transferred to the Transportation Trust Fund in fiscal year 2022 before making any deposits to the general fund. The required transfer was completed in December.

February's collections were $29.8 million, an increase of 123.1 percent. Year-to-date collections of taxes on insurance premiums were $105.0 million through February, compared with $59.4 million in the same period last year.

Other Revenue Sources
The following list provides data on February collections for other revenue sources:

	Year-to-Date	**Annual Estimate**
Interest Income *(0.4% GF revenues)*	9.8%	6.7%
ABC Taxes *(1% GF revenues)*	1.9%	1.4%

All Other Revenue *(2% of general fund revenues)*: Receipts in All Other Revenue rose 1.2 percent in February, $29.5 million compared with $29.1 million a year ago. On a year-to-date basis, collections of All Other Revenue rose 15.5 percent from the same period last year, above the annual estimate of 3.1 percent growth.

Summary

As already stated, we continue to have confidence in our outlook given that underlying economic conditions remain strong and support the continued stability of our revenue streams. February is not a significant month for revenue collections and, while total general fund revenues fell by 1.2 percent, the timing issues on refunds will correct themselves given that total filings are expected to be consistent with last year and other revenue streams remain steady and strong.