COMMONWEALTH of VIRGINIA

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April 13, 2022

MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: March Revenue Report

March general fund revenues were very strong, rising by 22.3 percent over the prior year. This was consistent with Finance expectations after a weak February. On a fiscal year-to-date basis, total revenue collections have risen 14.5 percent through March, which is well ahead of the revised annual forecast of 9.2 percent growth. Continued strength in payroll withholding and retail sales tax receipts as well as strong growth in the leading edge of individual final payments due May 2nd drove the growth.

Based upon the strong March revenue results, the mid-session general fund forecast released on February 18, 2022, is well supported. Revenues for the remainder of the year could be down 1.0 percent versus the same period last year and the revised forecast would still be achieved. Given the strength of the key drivers of general fund revenues and the strong economic outlook, that is not anticipated.

The mid-session revised forecast 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 the Governor determined it appropriate to increase the fiscal year 2022 forecast by $1.25 billion, holding back approximately $200 million. With March's receipts increasing by 22.3 percent, the amount of the approximately $200 million holdback has clearly increased, providing additional cushion in our forecast. While there is always some uncertainty entering the critical fourth quarter where the volatile individual and corporate final payments are due for tax year 2021, there is enough visibility on those key areas for us to remain confident in achieving and likely exceeding our forecast.

Withholding and sales tax receipts, which represent approximately 73 percent of total general fund revenues, have been consistently strong over the past year, meaningfully exceeding the prior year. While we expect these growth rates to moderate in the fourth quarter 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 these areas.

Strong withholding collections have been largely driven by wage growth to date. In addition, as of February 2022, the most recent data available, we are seeing continued employment growth, with the total number of employed Virginians up more than 83,300 compared to February 2021, a year over year increase of 2.0 percent. These green shoots are encouraging, and we anticipate more businesses will reopen, expand, and relocate Virginia in the coming months. As a result, we expect to see further support in these revenues from real job growth.

Looking ahead, April revenue collections kick off the all-important fourth quarter. Besides spring hiring and spending that will buoy payroll withholding and sales tax collections, corporate final payments for tax year 2021 and the first estimated payment for tax year 2022 are due. April collections also typically include the leading edge of payments of final and estimated taxes from individuals, which are due May 2nd. This will be the first time in three years that there are normal filing dates and therefore April receipts could be very strong as last year the Virginia individual final payment due date was May 17th to match the federal due date. Typically, Virginia sees two main filing surges, one around the federal April date and then the state date in May. Last year, both dates fell in May, this year we return to the normal April federal date and May state date.

National Economic Indicators

At the national level, the economy continues to perform well with strong demand and a tight labor supply driving employment and wage growth. The highest inflation in four decades (8.5 percent in March, 6.5 percent excluding food and energy), geopolitical uncertainty due the war in Ukraine and the prospect of tightening actions by the Fed are things to watch closely. Offsetting those "watch areas", national unemployment remains low at 3.6 percent, unemployment claims continue to drop and, despite 431,000 new jobs being added in March, job openings continue to remain elevated. The shortage of workers to fill jobs is impacting large and small employers across the country and continued job and wage growth is expected.

- According to the third estimate, real GDP rose at an annualized rate of 6.9 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 431,000 jobs to payrolls in March. The gains were broad-based across sectors. February gains were revised up by 72,000 jobs, bringing the three-month average to 562,000. In a separate report, the unemployment rate fell from 3.8 to 3.6 percent.

- Initial claims for unemployment fell by 5,000 to 166,000 during the week ending April 2. The four-week moving average fell by 8,000 to 170,000. In a healthy economy, new filings are typically below 250,000.

- The Bureau of Labor Statistics reported in March, that on the last business day of February, the number and rate of job openings were little changed at 11.3 million and 7.0 percent, respectively, compared to the prior month.

- At its March meeting, the Federal Reserve raised the federal funds target rate by 25 basis points to the range of 0.25 to 0.5 percent and indicated that "ongoing increases in the target range will be appropriate."

- The CPI rose 1.2 percent in March and stands 8.5 percent above March of last year. Core inflation (excluding food and energy prices) rose 0.3 percent and stands 6.5 percent above a year ago.

- The Institute of Supply Management index fell from 58.6 to 57.1 in March, but remains above the neutral threshold of 50.0. The manufacturing sector is experiencing strong demand, but supply chain disruptions continue to weigh on the industry.

Virginia Economy

In Virginia, the same dynamics are driving wage growth.

- In Virginia, payroll employment rose 2.9 percent in February from February of last year. Employment in Northern Virginia rose by 3.3 percent; Hampton Roads rose 1.6 percent, Richmond-Petersburg rose 2.1 percent; and the balance of the state increased 3.7 percent. The seasonally adjusted unemployment rate fell 0.1 percentage point to 3.2 percent and stands 1.4 percentage points below a year ago.

- In a separate survey of households, the Bureau of Labor Statistics reported that 4.16 million Virginians were employed in the month of February, up 83,394 compared to February 2021.

- Job openings increased 50 percent year-over-year in January, the latest period for which data are available, from 206,000 to 310,000 on a seasonally adjusted basis.

- Official wage statistics from the Bureau of Labor Statistics are lagged, but the latest data available from the third quarter of 2021 reflect a 5.3 percent increase in average weekly wages compared to the same period a year earlier.

- The labor participation rate improved modestly in February, increasing one-tenth of one percent to 63.0 percent. The participation rate remains 3.4 percentage points below pre-pandemic levels.

- The Virginia Leading Index jumped 3.4 percent in February after rising 2.5 percent in January. All components of the Virginia Leading Index (the U.S. leading index, auto registrations, initial claims, and future employment) improved in February. The indexes for all metro areas increased in February.

March Revenue Collections

Total general fund revenues rose by 22.3 percent in March. Continued strength in payroll withholding and retail sales tax as well as strong growth in the leading edge of individual final payments due May 2nd drove the growth. Also contributing to the month were fewer refunds issued in March due to the earlier opening of tax processing, shifting some refunds into February versus March. On a fiscal year-to-date basis, total revenue collections rose 14.5 percent through March, ahead of the revised annual forecast of 9.2 percent growth.

Net Individual Income Tax (68% of general fund revenues): Through March, collections of net individual income tax rose 12.7 percent from the same period last year, ahead of the annual estimate of 7.3 percent growth. Adjusting for timing shifts, net individual income tax grew at a 14.8 percent rate year to date. 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 rose by 11.8 percent for the month. Year-to-date, collections have risen 10.0 percent from the same period last year, ahead of the annual estimate of 9.0 percent growth.
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> ***Individual Income Tax Nonwithholding (20% of general fund revenues)***: March is not a significant month for collections in this source. Collections in nonwithholding were $384.4 million compared with $253.3 million in March of last year, an increase of 51.8 percent. Year-to-date, collections in nonwithholding grew by 13.6 percent, ahead of the annual estimate of 2.5 percent growth.
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> ***Individual Income Tax Refunds***: The main income tax filing season began in February. During the first two months of the main filing season, TAX issued 1.3 million refunds, about the same as last year. Through March, TAX has issued $1,050.4 million in refunds compared with $1,168.1 million through the same period last year. Although TAX has issued about 56 percent of the anticipated number of refunds, only about 38 percent of the anticipated dollars have been issued.

Sales Tax (17% of general fund revenues): Collections of sales and use taxes, reflecting February sales, rose 18.7 percent in March. Sales tax collections were broad-based as some spending from January was probably delayed due to the 4 winter weather events in January. On a year-to-date basis, collections of sales and use taxes have risen 15.2 percent, ahead of the annual estimate of 11.4 percent growth.

Corporate Income Tax (7% of general fund revenues): March is not a significant month for collections in this source. Collections of corporate income taxes were $69.8 million in March, compared with receipts of $72.3 million in March of last year. On a year-to-date basis, collections have increased 49.5 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 $52.0 million in March, compared with $63.8 million in March of last year, falling by 18.4 percent. Higher interest rates and lower housing supplies are contributing to this decline. On a year-to-date basis, collections have fallen 1.9 percent, ahead of the annual forecast of a 4.3 percent decline.

Insurance Premiums (2% of general fund revenues): Final payments in this source were due March 1. Collections were $21.5 million compared with $17.3 million last year. Year-to-date collections were $126.5 million through March, compared with $76.8 million in the same period last year, an increase of 64.7 percent. Estimated payments for insurance companies are due in April and June.

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

	Year-to-Date	**Annual Estimate**
Interest Income (0.4% GF revenues)	-4.0%	6.7%
ABC Taxes (1% GF revenues)	1.7%	1.4%

All Other Revenue (2% of general fund revenues): Receipts in All Other Revenue rose 2.8 percent in March, $39.2 million compared with $38.1 million a year ago. On a year-to-date basis, collections of All Other Revenue rose 13.8 percent from the same period last year, above the annual estimate of 3.1 percent growth.

Summary

Total general fund revenues rose by 22.3 percent in March. Continued strength in payroll withholding and retail sales tax as well as strong growth in the leading edge of individual final payments due May 2nd drove the growth. Also contributing to the month were fewer refunds issued in March due to the earlier opening of tax processing shifting some refunds into February versus March. On a fiscal year-to-date basis, total revenue collections rose 14.5 percent through March, ahead of the revised annual forecast of 9.2 percent growth.

Typically, the last three months of the fiscal year are significant collections months. In addition to estimated and final payments from both corporations and individuals due in April and May, estimated payments are again due in June. While there are important economic matters to watch closely, Finance remains confident in achieving our forecast.