COMMONWEALTH of VIRGINIA

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MEMORANDUM

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: September 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 revenue forecast is intentionally conservative, and we remain cautious in our outlook over the near term.

For the month of September, total general fund revenues increased 51.9 percent versus the same period last year. The monthly sharp increase is mainly due to the $881 million in tax rebates that were issued in September 2022. Year-to-date, general fund revenues are up 17.9 percent through September. In comparison to the revenue forecast assumed in the amended budget, year-to-date total general fund revenues are ahead by $412.1 million (6.6 percent) primarily due to higher non-withholding revenues. For the month, revenues were ahead of forecast by $278.8 million (10.8 percent).

Adjusting for the September 2022 tax rebates and the associated timing of other policy actions to better reflect underlying economic trends, revenue collections increased by 9.4 percent in September and are up 8.6 percent year-to-date.

Among major sources, withholding was $30.1 million higher than projected in September. Sales tax revenue was up by $1.9 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 third estimate released by the Bureau of Economic Analysis. The first official estimate of third quarter GDP growth will not be released until October 26, but it is expected that growth will exceed two percent.

- U.S. non-farm payroll employment increased by 336,000 jobs in September, and the prior two months gains were revised upward by a total of 119,000. The unemployment rate remained steady at 3.8 percent.

- In September, the Consumer Price Index (CPI) increased at 3.7 percent year-over-year, unchanged from August. Energy prices again boosted the topline figure though to a much milder degree than last month. The CPI for energy rose 1.5 percent in September after jumping 5.6 percent in August. Excluding food and energy, the CPI rose 0.3 percent in September.

- The Federal Reserve held interest rates steady at September 19-20 meeting. Expectations are mixed, in light of recent economic data, many economists expect an additional rate hike before the end of the year. According to the minutes from the September meeting, seven of 19 members believe the fed funds rate is sufficiently restrictive. The remainder believe another 25-basis point hike is likely.

- Virginia's unemployment rate was unchanged at 2.5 percent on a seasonally adjusted basis in August, and the labor force participation rate held steady at 66.7 percent in August.

- The number of employed Virginia residents increased by 7,348 to 4,488,510 in August.

- Additionally, events with potential macroeconomic implications are being closely monitored as they unfold. These include the threat of a federal government shutdown, escalating conflict in the middle east, OPEC+ oil production cuts, and continuing labor strikes.

September Revenue Collections

General fund revenues were up 51.9 percent for the month of September on an unadjusted basis. Year-to-date through September 30, general fund revenues are up 17.9 percent over the prior year. Adjusting for policy and the timing of refunds related to the Pass-Through Entity Tax (PTET), September revenues increased by 9.4 percent and are up 8.6 percent year-to-date. Adjusting for policy, but excluding PTET adjustments, revenues are up 4.0 percent through September.

Net Individual Income Tax (67% of general fund revenues): Unadjusted revenues increased by 90.6 percent for the month compared to last year, reflecting the impact of income tax rebates issued in September 2022. Year-to-date net individual income tax collections are up 18.8 percent. Compared to the forecast assumed in the amended budget, year-to-date net individual income tax collections are ahead of projections by $317.5 million, driven by higher-than-expected non-withholding receipts.

Performance in each component of individual income tax is as follows:

Individual Income Tax Withholding (60% of general fund revenues): Collections of payroll withholding taxes were 1.3 percent higher for the month on an unadjusted basis. Fiscal-year-to-date, collections are 3.8 percent higher than the same period last year after adjustments, and up 0.4 percent on an unadjusted basis. Compared to the Forecast assumed in HB 6001, withholding revenues are ahead by $53.6 million year-to-date.

Individual Income Tax Non-withholding (18% of general fund revenues): September marks the first individual estimated payment in fiscal year 2024 in this source. September collections increased by 10.6 percent and are up 7.8 percent for the year, both on an unadjusted basis. Through the first three months of the fiscal year, non-withholding receipts are $259.0 million ahead of forecast.

Individual Income Tax Refunds (-11% of general fund revenues): Through September, the Department of Taxation has issued $443.5 million in refunds compared with $1,049.0 million over the same period last year, with approximately $880 million in tax rebates that occurred in September 2022.

Sales Tax (17% of general fund revenues): Collections of sales and use taxes, reflecting August sales, grew by 2.8 percent in September and are up 2.5 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 2.0 percent higher year-to-date, running slightly ahead of forecast.

Corporate Income Tax (7% of general fund revenues): As with non-withholding, the first corporate estimated payment for the fiscal year was received in September. Monthly collections increased by 12.9 percent and year-to-date growth is at 18.7 percent. Compared to forecast, corporate income tax collections are ahead of plan by $41.7 million year-to-date.

Wills, Suits, Deeds, Contracts (1% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were 19.4 percent lower in September compared to the previous year. On a fiscal-year-to-date basis, collections are down 22.9 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 September for other revenue sources:

	Year-to-Date	Annual Estimate
Interest Income (0.8% GF revenues)	*291.1%*	*73.9%*
ABC Taxes (1% GF revenues)	*13.6%*	*3.7%*

With a substantial balance sheet and high returns, interest income earnings have continued to surge, totaling $327.7 million in the first three months of the year compared to $83.8 million for the same period of the prior fiscal year. Year-to-date interest income does not reflect the distribution of interest income earned on nongeneral fund accounts managed by Treasury on their behalf, which is distributed to those accounts on a quarterly basis in October, January, April, and June. We will have a clearer assessment of general fund interest income after distributions are completed in October.

All Other Revenue (2% of general fund revenues): On a year-to-date basis, collections of All Other Revenue declined by 5.6 percent to $102.7 million fiscal year-to-date compared with $108.8 million a year ago.

Summary

With the completion of the first quarter of fiscal year 2024, year-to-date collections are up 17.9 percent compared to last year and are running ahead of projections assumed in the amended budget by $412.1 million. All of the major sources are generally in line or ahead of projections.

September collections complete the first quarter of fiscal year 2024 and provide a clearer assessment of revenue growth. The two revenue sources that most closely reflect current economic conditions in the Commonwealth, adjusted withholding and sales, are up a combined 3.5 percent, reflecting steady growth. Similarly, corporate income tax collections are ahead of last year by 18.7 percent year-to-date. Given the conservative outlook assumed in the forecast for the current fiscal year and results year-to-date, we remain confident in our fiscal year 2024 forecast.

Among our most volatile revenue sources, individual income non-withholding continues to surprise on the upside. Included in non-withholding revenues is $380 million in Pass-Through Entity Tax (PTET) receipts. We had anticipated that taxpayers with pass-through entity income would adjust individual income tax estimated payments as they shift their liabilities to the pass-through level. While data limitations continue to be a challenge in tracking and forecasting PTET-related activity, September's data indicate this shift in taxpayer behavior may not have happened.

Looking forward, the outlook for an additional rate increase and the potential negative impacts of a number of geopolitical and macroeconomic events raise doubts about the Fed's ability to engineer a "soft landing." Most notably are the threat of a protracted federal government shutdown if no budget deal is reached by mid-November and the uncertainty around escalating conflict in the middle east. Other economic headwinds that we are closely monitoring include the possibility of rising energy prices resulting from oil production cuts by OPEC and their allies, the potential ripple effects of continued labor strikes, slowing job growth, and persistently high interest rates.

The fall revenue forecasting season that began with a meeting of the Governor's Advisory Council on Revenue Estimates on August 7, continued with the Joint Advisory Board of Economists meeting on October 11. Soon to follow will be 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.