# *COMMONWEALTH of VIRGINIA*

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**MEMORANDUM**

TO: The Honorable Glenn Youngkin

THROUGH: The Honorable Jeff Goettman

FROM: Stephen E. Cummings

SUBJECT: January Revenue Report

For the month of January, total general fund revenues declined 2.5 percent versus the same period last year. The decline was driven by an unexpected 27.5 percent year-over-year decline in individual non-withholding collections as taxpayers adjusted for lower pass-through income and the timing of the new elective Pass-Through Entity Tax (PTET).

Year-to-date, general fund revenues are up 5.3 percent through the first seven months of Fiscal Year 2024. Adjusting for the effects of PTET collections and refunds, and the associated timing of enacted policy actions to better reflect underlying economic trends, revenue collections increased by 2.4 percent in January and are up 5.3 percent year-to-date.

In comparison to the revenue forecast assumed in the Governor's amendments to the Fiscal Year 2024 budget and accounting for monthly variations in tax collections, year-to-date total general fund revenues are ahead of projections by $704.1 million. For the month, revenues were ahead of forecast by $340.9 million. Excluding non-withholding and refunds, which continue to be distorted by PTET, year-to-date collections are ahead of plan by $419.8 million, a variance of 3.0 percent.

January is a significant month for revenue collections. Regular monthly collections are due in withholding, sales and use taxes, and most minor sources. January collections also include the fourth quarterly installment of individual income tax estimated payments due for Taxable Year 2023.

Among major sources, withholding was $242.2 million higher than projected in January, an increase of 18.8% over prior year's results, but January's year-over-year results are impacted by the timing of payments by certain employers in the prior year and the impact of one additional deposit day. Corporate tax collections were $5.7 million lower, and sales tax revenues, reflecting December sales, were higher than projections by $26.7 million. Non-withholding collections in January were below projections by $136.9 million. While year-to-date non-withholding revenues are generally in line with the forecast, the significant decrease in January estimated payments cautions that collections in the fourth quarter, when the majority of receipts in this source are received, may decline more than anticipated.

Collections from other sources of revenues were generally in line or exceeded the Forecast as discussed in more detail in the following sections.

While year-to-date results remain ahead of forecast, the unexpected decline in individual non-withholding collections in January could imply a change in taxpayer behavior that could lead to final payments, that will be collected later this year, being significantly lower than forecast. Furthermore, other conflicting economic signals in US and Virginia lead us to remain cautious in our outlook.

**Economic Review**

- U.S. nonfarm payrolls increased 353,000 and the unemployment rate was unchanged at 3.7 percent. Payroll gains for November and December were revised up by a total of 126,000, bringing the net gain, including revisions, to 479,000. This gain exceeded expectations. However, average hours worked fell to the lowest level since the beginning of the pandemic.

- Average hourly earnings – cash earnings, excluding irregular bonuses/commissions and fringe benefits – rose 0.6 percent in January and are up 4.5 percent versus a year ago. Aggregate hours declined 0.3 percent in January but are up 0.3 percent from a year ago.

- U.S. Real GDP increased at a 3.3 percent annual rate in the fourth quarter of calendar year 2023 according to the "advance" estimate released by the Bureau of Economic Analysis, exceeding expectations of 2.0 percent. The largest positive contribution to real GDP growth in the fourth quarter came from personal consumption, while every other major component of GDP was up, as well.

- Household debt reached $17.5 trillion in the fourth quarter of 2023, and delinquency rates rose for all debt types except student loans according to the Federal Reserve Bank of New York. Both credit card delinquencies and auto loan delinquencies have ticked up above pre-pandemic levels for the last several months, indicating a spend down of the cash reserves households accumulated during Covid and suggesting consumer spending may soften in coming months.

- In January, the Consumer Price Index (CPI) for all items was up to 3.1 percent for the twelve months ending in January, a smaller increase than the 3.4 percent annual change reported in December but higher than expectations of 2.9 percent. The twelve-month change in “core” CPI, which excludes food and energy, remained unchanged at 3.9 percent.

- At its January meeting, the Federal Reserve maintained the target for the federal funds rate at a range of 5.25 percent to 5.50 percent. This was the fourth straight meeting at which the Fed has held interest rates steady. The Fed indicated that it is likely at its peak for tightening this cycle, but the timing of future rate reductions is uncertain.

- On January 19, President Biden signed a third Continuing Resolution (CR) for fiscal year 2024 to avoid a partial government shutdown. The new measure extends the "laddered" approach from the previous CR, with the first set of appropriations bills expiring on March 1 and the second set of appropriations bills expiring on March 8.

- In December, in contrast to the national increase in jobs of 330,000, Virginia’s nonagricultural employment from the monthly establishment survey decreased by 11,800 to 4,157,000, the first decrease in 14 months. Compared to December of 2022, Virginia nonagricultural employment was up 1.2 percent. November’s preliminary estimate of employment, after revision, decreased by 3,600 to 4,168,800. The labor force participation rate remained unchanged at 66.9 percent in December, the highest it has been since March 2012.

- Virginia’s seasonally adjusted unemployment rate in December increased by 0.1 percentage points to 3.0 percent, which is 0.1 percentage points below the rate from a year ago.

**January Revenue Collections**

General fund revenues declined 2.5 percent year-over-year for the month of January on an unadjusted basis.  Fiscal year-to-date through January 31, general fund revenues are up 5.3 percent over the prior year.

***Net Individual Income Tax (67% of general fund revenues)***: Unadjusted revenues declined by 0.4 percent for the month compared to last year. Year-to-date net individual income tax collections are up 5.0 percent. Compared to the forecast assumed in the amended budget, year-to-date net individual income tax collections are ahead of projections by $685.6 million, driven mainly by higher-than-expected withholding and lower than anticipated refunds.

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

***Individual Income Tax Withholding (58% of general fund revenues)***: Collections of payroll withholding taxes were 18.8 percent higher for the month on an unadjusted basis. These results were impacted by the timing of payments by certain employers in the prior year and the impact of one additional deposit day. Fiscal-year-to-date, collections are 7.7 percent higher  than the same period last year after adjustments, and up 4.5 percent on an unadjusted basis. Compared to the Forecast assumed in HB/SB 29, withholding revenues are ahead by $401.4 million year-to-date.

***Individual Income Tax Non-withholding (21% of general fund revenues)***: January collections declined by 27.5 percent year-over-year and are down 4.5 percent for the year, both on an unadjusted basis. Through January, non-withholding receipts are $218.3 million ahead of forecast.

***Individual Income Tax Refunds (-12% of general fund revenues)***: Through January, the Department of Taxation has issued $1,191.3 million in refunds compared with $1,435.4 million over the same period last year, a decrease of 17.0 percent.

***Sales Tax (16% of general fund revenues)***: Collections of sales and use taxes, reflecting December sales, declined 3.3 percent in January and are down 1.6 percent year-to-date. Fiscal-year-to-date, sales and use tax revenues are $11.5 million above projections. Adjusting for the elimination of the State sales tax on grocery and the end of Accelerated Sales Tax, sales tax collections are up 1.4 percent year-to-date.

***Corporate Income Tax (8% of general fund revenues)***: Monthly collections fell by 15.3 percent year-over-year, and year-to-date growth is at 11.7 percent. Compared to forecast, corporate income tax collections are slightly ahead of plan at $7.1 million over projections year-to-date.

***Wills, Suits, Deeds, Contracts (2% of general fund revenues)***: Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were 9.4 percent higher in January compared to the previous year. On a fiscal-year-to-date basis, collections are down 14.4 percent as higher interest rates have curtailed residential and commercial property sales and mortgage refinancing. Compared to the forecast, collections in this source are behind projections by $26.0 million.

***Insurance Premiums (2% of general fund revenues)***: Year-to-date collections are down 8.3 percent versus a forecasted decline of 1.0 percent.

## Other Revenue Sources

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

| | **Year-to-Date** | **Annual Estimate** |
|---|---|---|
| Interest Income (2% GF revenues) | 123.9% | 84.2% |
| ABC Taxes (1% GF revenues) | 3.2% | 5.4% |

Interest income earnings totaled $444.7 million in the first seven months of the year compared to $198.7 million for the same period of the prior fiscal year. Interest is earned monthly in the general fund and credited to nongeneral funds on a quarterly basis in October, January, April, and June. Net general fund interest income for the month of January was negative $50.1 million after scheduled transfers to nongeneral fund accounts.

***All Other Revenue (2% of general fund revenues)***: On a year-to-date basis, collections of All Other Revenue increased by 4.1 percent to $320.3 million fiscal year-to-date compared with $307.7 million a year ago.

**Summary**

Through January 31, year-to-date collections are up 5.3 percent compared to last year and are running ahead of projections assumed in the Governor's proposed Fiscal Year 2024 amended budget. Payroll withholding collections were generally on plan for the first six months of the fiscal year. However, January withholding collections exceeded expectations, driven partially by a unique timing issue and an extra day of collections. Sales tax collections are down 1.6 percent year-to-date, modestly ahead of the forecast. Individual income tax non-withholding revenues were ahead of projections through December, but January collections were down a surprising 27.5 percent. January estimated payments often provide insight into final tax payments, which could imply that final payments will be significantly lower if the decline experienced in January continues into the fourth quarter.

Recent economic data are mixed. U.S. economic growth, driven by consumer spending, remained strong in the fourth quarter. However, there are a number of risks that remain in our focus and lead us to maintain our prudent outlook, including:

- Job losses in Virginia of 11,800 for the month of December in contrast to significant job gains nationally. We need to see more data to understand the drivers of this.

- Increasing consumer debt delinquencies suggest consumer spending may weaken in coming months.

- Persistently high inflation, in conjunction with a stronger than expected jobs report, may cause a data driven Fed to delay rate reductions.

- The continued risks of a potential federal government shutdown as early as the first of March, escalating conflict in the Middle East, and continued deterioration of the Chinese and European economies.

While we are fortunate to be running ahead of forecast in an uncertain time, we will continue our prudent approach to forecasting and retain our current forecast for budgeting purposes at this time.