COMMONWEALTH of VIRGINIA

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MEMORANDUM

TO: The Honorable Ralph S. Northam

THROUGH: The Honorable Clark Mercer

FROM: Aubrey L. Layne, Jr.

SUBJECT: February Revenue Report

February is not a significant month for revenue collections. Total general fund revenues grew 26.6 percent in February, mainly due to a delay in the start of the individual income tax processing season, which resulted in fewer refunds being issued. In addition, the major revenue sources performed at or better than expectations for the month.

On a fiscal year-to-date basis, total revenue collections rose 3.5 percent through February, trailing the annual forecast of 5.9 percent growth. Although collections are lagging the annual estimate, growth is expected to be higher for the remainder of the fiscal year due to effects of the federal *Tax Cuts and Jobs Act*.

National Economic Indicators

Recent national indicators suggest the economy continues to grow, albeit more slowly.

- According to the initial estimate, real GDP rose at an annualized rate of 2.6 percent in the fourth quarter, following 3.4 percent growth in the third quarter.

- The labor market posted weak gains in February. Payroll employment rose by only 20,000 jobs in February, following January's gain of 311,000. Furloughed government workers were still counted as employed during the shutdown but their absence from their jobs did affect the unemployment rate, which is measured in a separate survey. After increasing to 4.0 percent in January, the unemployment fell to 3.8 percent in February as the shutdown ended.

- Initial claims for unemployment fell by 3,000 to 223,000 during the week ending March 2. The four-week moving average also dropped by 3,000 to 226,250. The level of claims is consistent with a healthy labor market.

- The Conference Board's index of leading indicators fell 0.1 percent in January following no change in December and a slight increase in November. The index suggests that economic growth may weaken.

- Consumer confidence rebounded in February as the federal government shutdown ended. The Conference Board's index of consumer confidence jumped 9.7 points to 131.4 in February, erasing January's loss. Both the expectations and present conditions components contributed to the increase.

- Conditions in the manufacturing sector softened in February. Although the Institute of Supply Management index fell from 56.6 to 54.2, still it remains above the neutral threshold of 50.0 and is consistent with continued growth.

- The CPI was unchanged for the third consecutive month in January. The index stands 1.5 percent above January of 2018. Core inflation (excluding food and energy prices) rose by 0.2 percent, and is 2.1 percent above a year ago.

- At its January meeting, the Federal Reserve left the federal funds target rate range unchanged at 2.25 to 2.5 percent. Only one more increase in the target rate is expected in calendar year 2019.

Virginia Economy

In Virginia, payroll employment rose 1.1 percent in January compared with last year. Northern Virginia posted growth of 1.8 percent; Hampton Roads rose 0.4 percent; and Richmond-Petersburg rose 1.4 percent. The seasonally adjusted unemployment rate was unchanged at 2.8 percent in January, the sixth consecutive month at this rate, which continues to be the lowest rate since April 2001.

The Virginia Leading Index declined 0.7 percent in January after remaining flat in December. Auto registrations and the U.S. leading index declined in January and initial claims rose; future employment was unchanged. The indexes for Northern Virginia, Roanoke, Richmond, Hampton Roads, Charlottesville, Harrisonburg, and Staunton decreased in January, while the indexes for Winchester, Blacksburg, Bristol, and Lynchburg rose.

February Revenue Collections

February is not a significant month for revenue collections. Total general fund revenues grew 26.6 percent in February, mainly due to a delay in the start of the individual income tax processing season, which resulted in fewer refunds being issued. In addition, the major revenue sources performed at or better than expectations for the month.

Net Individual Income Tax (71% of general fund revenues): Through February, collections of net individual income tax rose 3.1 percent from the same period last year, lagging the annual estimate of 6.7 percent growth. As stated earlier, growth is expected to pick up in the second half of the fiscal year due to effects of the federal *Tax Cuts and Jobs Act*. 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 were essentially flat with a 0.1 percent decrease in February. This was expected given that last February saw 11.8 percent growth. Year-to-date, collections have grown 3.3 percent, close to the annual estimate of 3.8 percent growth.
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> ***Individual Income Tax Nonwithholding (19% of general fund revenues)***: February is not a significant month for collections in this source. Collections in nonwithholding were $67.0 million compared with $49.8 million in February of last year, an increase of 34.7 percent. Year-to-date collections are down 13.9 percent, trailing the annual estimate of 15.2 percent growth.
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> ***Individual Income Tax Refunds***: The main filing season began in February; however, adoption of changes in state conformity to the 2017 federal tax law changes delayed the start of individual tax processing. The Department of Taxation issued $218.4 million in refunds compared with $442.6 million in February of last year. In February, TAX issued about 519,000 refunds as compared to last February's 867,000. March should provide a better assessment of refund activity as the backlog of returns is processed.

Sales Tax (17% of general fund revenues): Collections of sales and use taxes, reflecting January sales, rose 4.2 percent in February. February receipts include January post-holiday sales and gift card purchases, completing the holiday shopping season. On a year-to-date basis, collections have risen 4.1 percent, ahead of the annual estimate of 3.7 percent growth.

Corporate Income Tax (4% of general fund revenues): February is not a significant month for collections in this source. Collections of corporate income taxes were $27.1 million in February, compared with receipts of $7.6 million in February of last year. Year-to-date collections have increased 2.7 percent from the same period last year, trailing the forecast of 5.6 percent growth.

Wills, Suits, Deeds, Contracts (2% of general fund revenues): Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were $23.7 million in February, flat with February of last year. On a year-to-date basis, collections are down 4.4 percent, slightly ahead of the annual forecast of a 6.7 percent decline.

Insurance Premiums (2% of general fund revenues): February collections in this source were $24.9 million compared with $18.3 million last year. Year-to-date collections through February were $76.2 million, compared with $60.3 million in the same period last year. Final payments were due March 1 and estimated payments are due in April and June.

Other Revenue Sources

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

	Year-to-Date	Annual Estimate
Interest Income (0.3% GF revenues)	40.0%	11.5%
ABC Taxes (1% GF revenues)	2.8%	3.5%

All Other Revenue (2% of general fund revenues): Receipts in All Other Revenue rose 1.5 percent in February, $30.6 million compared with $30.2 million a year ago. The bulk of the growth was in collections of fines and fees. On a year-to-date basis, collections of All Other Revenue rose 10.7 percent from the same period last year, compared to the annual estimate of 1.5 percent growth.

Summary

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On a fiscal year-to-date basis, total revenue collections rose 3.5 percent through February, trailing the annual forecast of 5.9 percent growth. Although collections are lagging the annual estimate, growth is expected to be higher for the remainder of the fiscal year due to effects of the federal *Tax Cuts and Jobs Act*.