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: January Revenue Report

January is a significant month for revenue collections. Besides the normal monthly payroll withholding and sales tax collections, estimated payments from individuals are due in January and refunds are issued to insurance companies. Total general fund revenues grew 0.4 percent in January, mainly due to a significant drop in individual nonwithholding and corporate income tax payments. In addition, the sources most closely tied to economic activity – payroll withholding and sales tax collections – posted weak but stable growth for the month.

On a fiscal year-to-date basis, total revenue collections rose 1.3 percent through January, trailing the annual forecast of 5.9 percent growth. Although collections are lagging the annual estimate, growth is expected to be higher in the second half 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 at a solid pace.

- According to the third estimate, real GDP rose at an annualized rate of 3.4 percent in the third quarter, following 4.2 percent growth in the second quarter.

- Payroll employment rose by 304,000 jobs in January, well above expectations. December's gain was revised down from 312,000 to 222,000. As a result of the partial federal government shutdown, furloughed government workers were still counted as employed but their absence from their jobs did affect the unemployment rate, which is measured in a separate survey. The unemployment rate increased from 3.9 percent to 4.0 percent in January.

- Initial claims for unemployment fell by 19,000 to 234,000 during the week ending February 2. The four-week moving average rose by 4,500 to 224,750. The level of claims is consistent with a healthy labor market.

- The Conference Board's index of leading indicators fell 0.1 percent in December following a 0.2 percent increase in November and a 0.3 percent decline in October, suggesting economic growth may have weakened.

- As the federal government shut down for 35 days, the Conference Board's index of consumer confidence fell 6.4 points to 120.2 in January. Both the expectations and present conditions components fell for the month although expectations had a more significant negative impact on the index.

- Conditions in the manufacturing sector improved in January. The Institute of Supply Management index rose from 54.3 to 56.6, a level consistent with continued growth.

- The CPI declined 0.1 percent in December after remaining flat in November. The index stands 1.9 percent above December of 2017. Core inflation (excluding food and energy prices) rose by 0.2 percent, and is 2.2 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.

Virginia Economy

In Virginia, payroll employment rose 1.8 percent in December from December of last year. Northern Virginia posted growth of 0.8 percent; Hampton Roads rose 1.7 percent; and Richmond-Petersburg rose 1.6 percent. The seasonally adjusted unemployment rate held steady at 2.8 percent in December, the lowest rate since April 2001.

The Virginia Leading Index was unchanged in December after declining 0.1 percent in November. Auto registrations and future employment improved in December while initial claims rose and the U.S. Leading Index decreased. The indexes for Roanoke, Richmond, and Lynchburg fell, and the indexes for Hampton Roads and Northern Virginia were unchanged in December. The remaining regional indexes increased for the month.

January Revenue Collections

Total general fund revenues grew 0.4 percent in January, mainly due to a significant drop in individual nonwithholding and corporate income tax payments. Sources most closely tied to economic activity – payroll withholding and sales tax collections – posted weak but stable growth for the month. On a fiscal year-to-date basis, total revenue collections rose 1.3 percent through January, trailing the annual forecast of 5.9 percent growth.

Net Individual Income Tax (71% of general fund revenues): Through January, collections of net individual income tax rose 0.4 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 rose 0.9 percent in January. The federal government shutdown did not have an effect this month because the shutdown ended and back pay was issued. Year-to-date, collections have grown 3.9 percent, close to the annual estimate of 3.8 percent growth.
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> ***Individual Income Tax Nonwithholding (19% of general fund revenues)***: Collections in nonwithholding were $434.1 million compared with $448.7 million in January of last year, a decline of 3.3 percent.
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> December and January are significant months for collections in this source, and receipts can be distorted by the timing of payments. Taxpayers have until January 15th to submit their fourth estimated payment for tax year 2018 and some of these payments are typically received in December so the two months must be considered together to assess growth. December payments were $295.8 million below December of 2017. Receipts of nonwithholding for the two-month period of January-December decreased 36.4 percent from last year.
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> Year-to-date collections fell 15.5 percent, trailing the annual estimate of 15.2 percent growth. However, given that some of the extremely large payments from individuals received last December were, in fact, a proxy for their May 1st final payment, it may be until May before a complete analysis can be done.
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> ***Individual Income Tax Refunds***: In January, the Department of Taxation issued $34.6 million in refunds compared with $43.5 million in January of last year. The main income tax filing season begins in February.

Sales Tax (17% of general fund revenues): Collections of sales and use taxes, reflecting December sales, rose 0.8 percent in January. The combined December and January receipts, representing the bulk of the holiday shopping season, was 3.9 percent above the same period last year. On a year-to-date basis, collections have risen 4.0 percent, ahead of the annual estimate of 3.7 percent growth.

Corporate Income Tax (4% of general fund revenues): Collections of corporate income taxes were $23.2 million in January, compared with receipts of $35.4 million in January of last year.

Year-to-date collections have decreased 1.8 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 $27.2 million in January, compared with $27.8 million in January of last year, a decline of 2.0 percent. On a year-to-date basis, collections are down 4.8 percent, slightly ahead of the annual forecast of a 6.7 percent decline.

Insurance Premiums (2% of general fund revenues): Chapter 896 of the 2007 Acts of the Assembly required that $168.7 million of collections in this source be transferred to the Transportation Trust Fund in fiscal year 2019 before making any deposits to the general fund. The required transfer was completed in December.

January was a negative month in this source as refunds were issued to insurance companies. Year-to-date collections through January were $51.4 million, compared with $42.0 million in January 2018.

Other Revenue Sources

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

	Year-to-Date	**Annual Estimate**
Interest Income (0.3% GF revenues)	30.4%	11.5%
ABC Taxes (1% GF revenues)	1.3%	3.5%

All Other Revenue (2% of general fund revenues): Receipts in All Other Revenue rose 5.4 percent in January, $43.0 million compared with $40.8 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 12.1 percent from the same period last year, compared to the annual estimate of 1.5 percent growth.

Summary

Total general fund revenues grew 0.4 percent in January, mainly due to a significant drop in individual nonwithholding and corporate income tax payments. In addition, the sources most closely tied to economic activity – payroll withholding and sales tax collections – posted weak growth for the month.

On a fiscal year-to-date basis, total revenue collections rose 1.3 percent through January, trailing the annual forecast of 5.9 percent growth. Although collections are lagging the annual estimate, growth is expected to be higher in the second half of the fiscal year due to effects of the federal *Tax Cuts and Jobs Act*.