



# **ECONOMIC AND REVENUE REVIEW AND UPDATE**

**A BRIEFING FOR THE MONEY COMMITTEES**

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# TOPICS FOR DISCUSSION

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ECONOMIC UPDATE

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SEPTEMBER FISCAL YEAR-TO-DATE REVENUE COLLECTIONS

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KEY DATES

# OVERVIEW

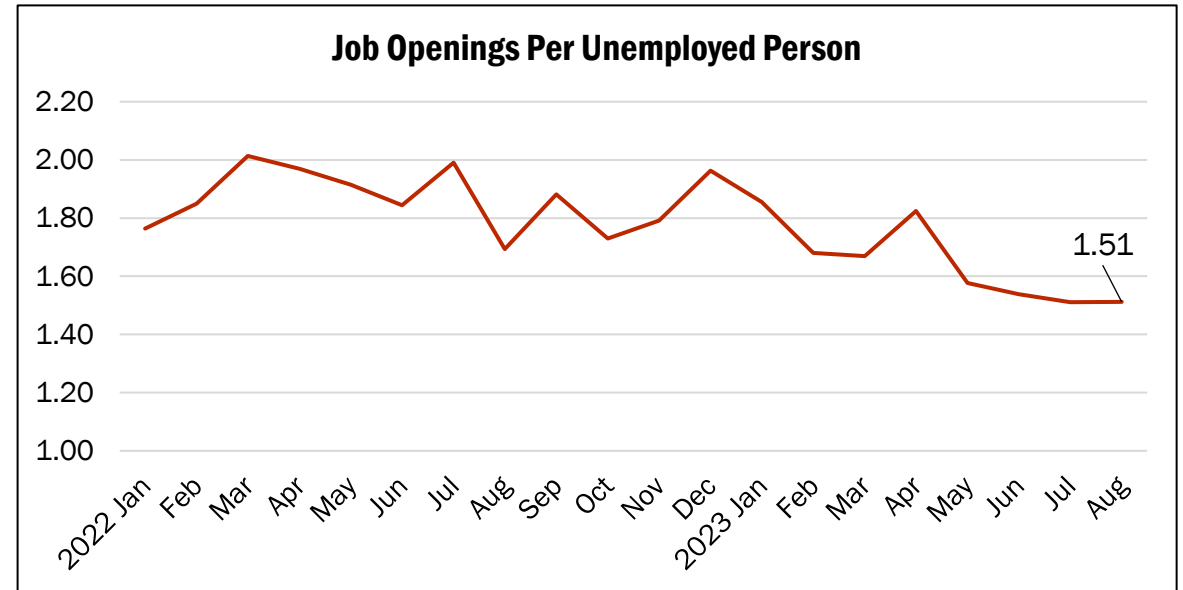
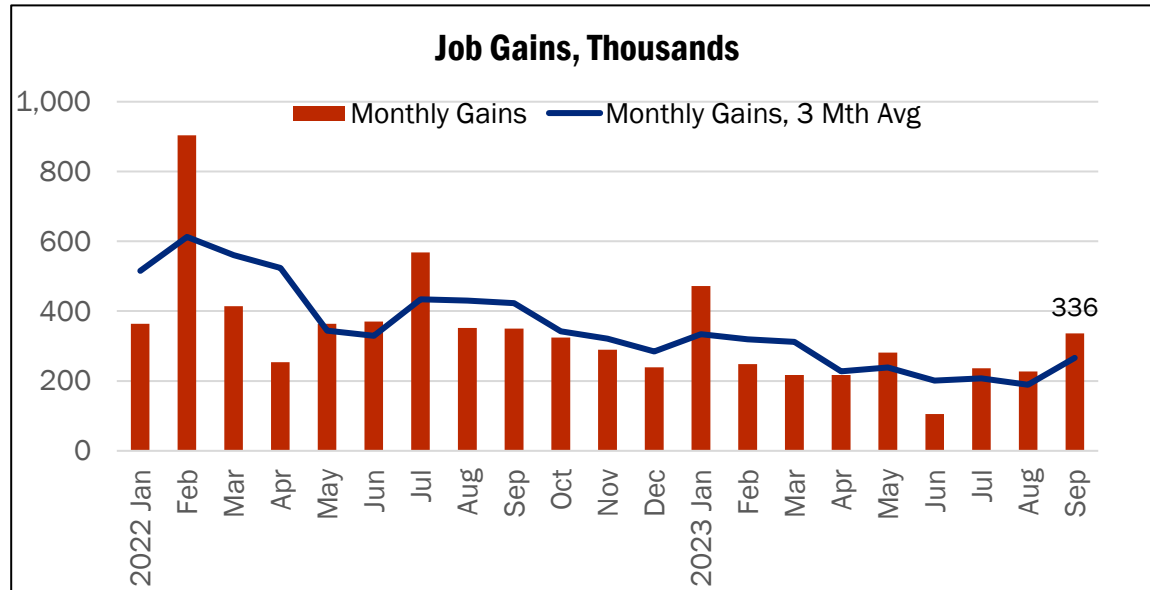
- September completes the first quarter of FY 2024. Through the first quarter, revenues are ahead of projections by more than \$400 million with all major revenue sources in line with or exceeding expectations.
- Unadjusted revenues were up 17.9 percent for the quarter compared to the same period last year, and up 8.6 percent after adjusting for policy and timing impacts. The largest of these adjustments is the approximately \$881 million in tax rebates that occurred in September 2022, adding to refunds paid in that month.
- For the month, GF revenues rose 51.9 percent compared to September 2022, mainly reflecting a decline in individual income tax refunds of \$798 million due to the September 2022 tax rebates.\*
- Also driving the September year-over-year growth were increases in interest income (+\$66 million) and non-withholding collections (+\$75 million).
- September revenues were more than \$270 million above monthly projections based on the forecast assumed in the 2023 amended budget, almost entirely driven by better-than-expected non-withholding collections.

*\*Note: 2023 tax rebates will not be reflected in refunds. Instead, 2023 rebates will be paid from a special fund, whereas 2022 rebates were paid directly from the general fund.*

# OVERVIEW

- Looking forward, the outlook for an additional rate hike and the potential for an economic contraction is mixed with some economists doubtful of the Fed’s ability to engineer a “soft landing.”
- So far, the U.S. economy has shown 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. The first official estimate of third quarter GDP growth will not be released until October 26; however, current estimates point to continued growth of more than two percent.
- While longer term trends suggest the labor market is cooling, the surprise surge in employment in September, and continued GDP growth of more than two percent may prompt an additional rate increase before year-end.
- Despite some improvement, inflation pressures persist. The Consumer Price Index (CPI) rose 0.4 percent in September and remains at 3.7 percent on a year-over-year basis.
- Other macroeconomic factors pose significant risks, including:
  - The threat of a protracted federal government shutdown remains if no budget deal is reached by mid-November.
  - Escalating conflict in the middle east and OPEC+ oil production cuts could drive significantly higher energy prices.
  - Continuing labor strikes will result in lost wages and have ripple effects throughout the broader economy.
  - A period of persistently high interest rates will directly impact corporate profits, curtail housing market activity and reduce consumer spending.

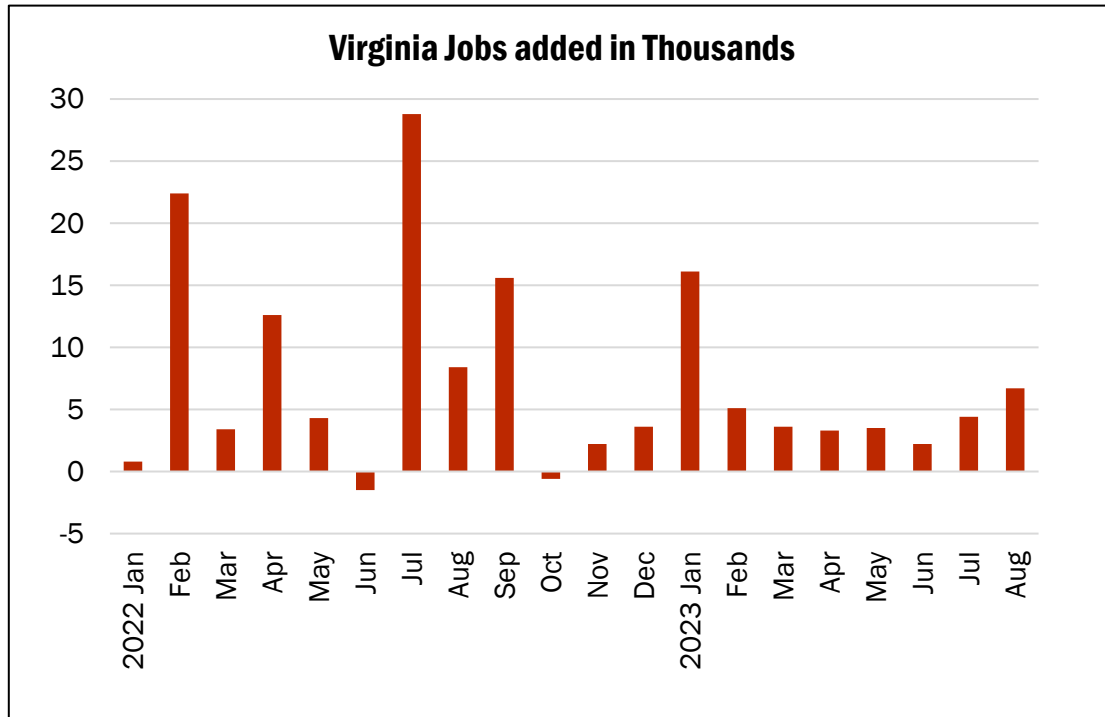
# THE SEPTEMBER JOBS REPORT SURPRISED TO THE UPSIDE; MEANWHILE, JOBS PER UNEMPLOYED FLATTENED IN AUGUST



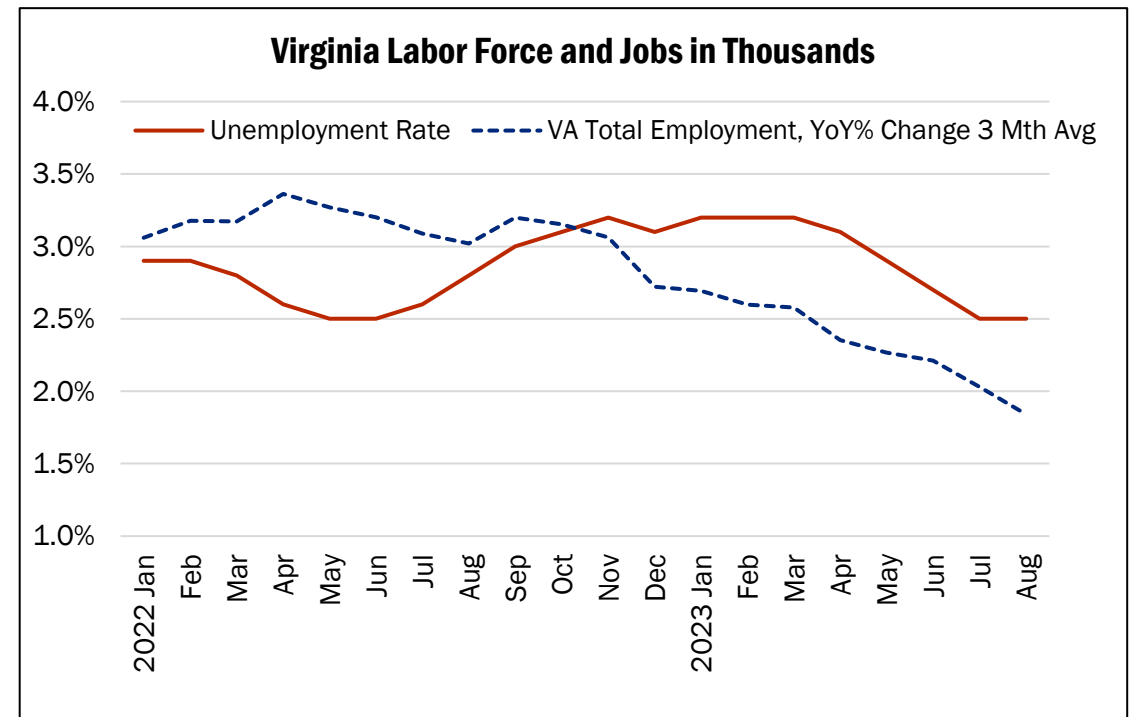
Sources: US BLS. Unless otherwise noted economic data is presented on a calendar year basis.

- U.S. employers added 336,000 jobs in September, well above expectations, and payrolls for July and August were revised upward by a total of 119,000. September’s jobs gains were mostly in leisure and hospitality (+96,000) which is susceptible to measurement error related to seasonal adjustment factors, and government (+73,000).
- Job openings per unemployed person flattened from July to August. This was a result of both unemployment and job openings increasing at the same rate.

# VIRGINIA JOB GROWTH ACCELERATED IN JULY AND AUGUST WHILE LONGER-TERM GROWTH TREND IS SLOWING



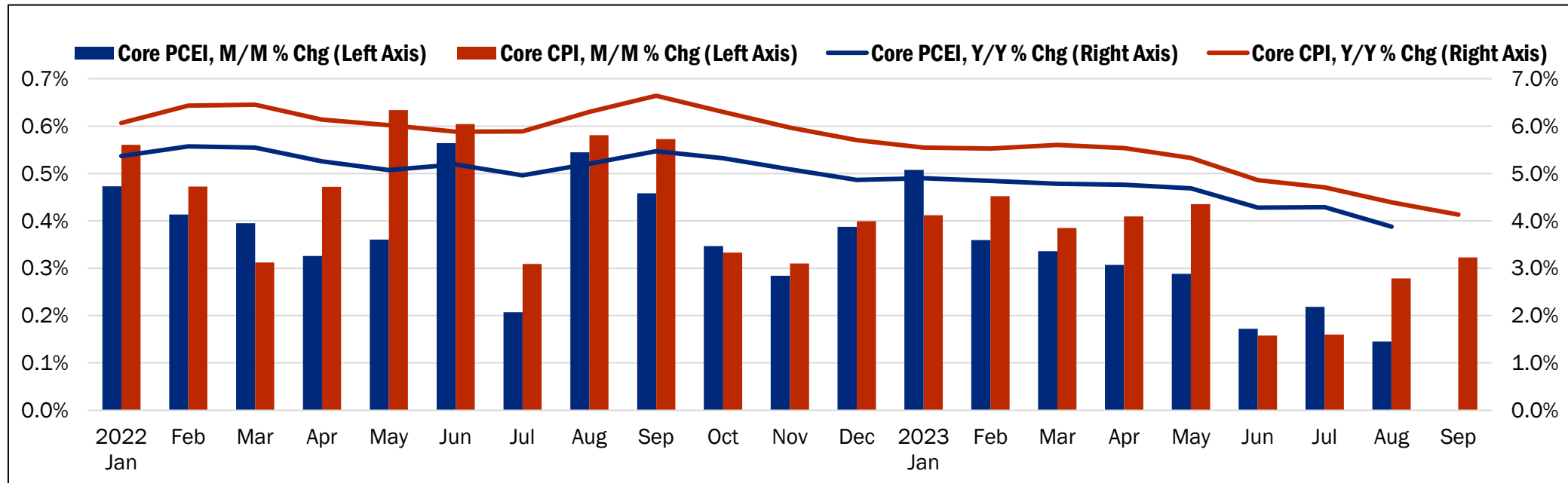
Source: US Bureau of Labor Statistics



Source: US Bureau of Labor Statistics

- Job growth in Virginia accelerated July and August. However, the longer-term trend indicates that employment growth is slowing. Total nonfarm employment increased by 6,700 in August and is 1.6 percent higher compared to August 2022.
- Virginia's seasonally adjusted unemployment rate in August remained unchanged at 2.5 percent, which is 0.3 percentage points below the rate from a year ago. The labor participation rate held steady in August at 66.7 percent.

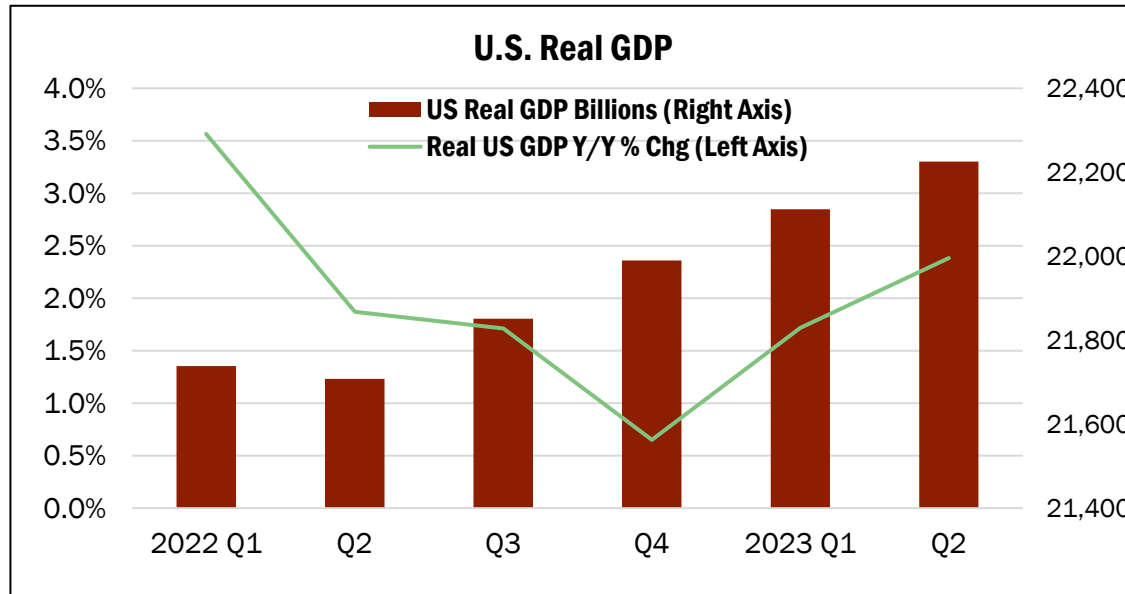
# INFLATION CONTINUES TO DECELERATE; CORE PCEI DROPS BELOW FOUR PERCENT FOR THE FIRST TIME SINCE MAY 2021



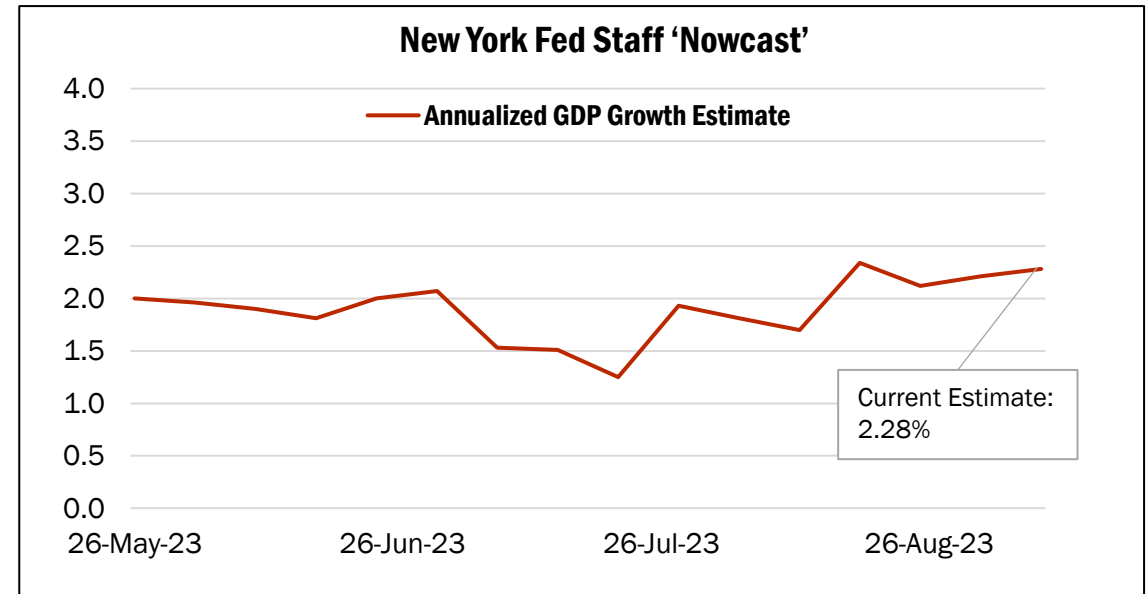
Sources: US Bureau of Labor Statistics , US Bureau of Economic Analysis

- In September, the overall Consumer Price Index (CPI) increased at a 3.7 percent year-over-year rate, unchanged from August. Excluding food and energy, Core CPI grew 0.3 percent in September and is up 4.1 percent year-over-year, down from August's 4.3 percent.
- Concerns about the uptick in July's Core PCE were allayed with August's readings which shows the long-term measure continues to decelerate. At 3.9 percent year-over-year in August, Core PCE was at the lowest level since May 2021.

# REAL GDP GREW AT 2.1 PERCENT IN THE SECOND QUARTER, CURRENT Q3 GDP ESTIMATES ARE AT 2.3 PERCENT



Source: US Bureau of Economic Analysis

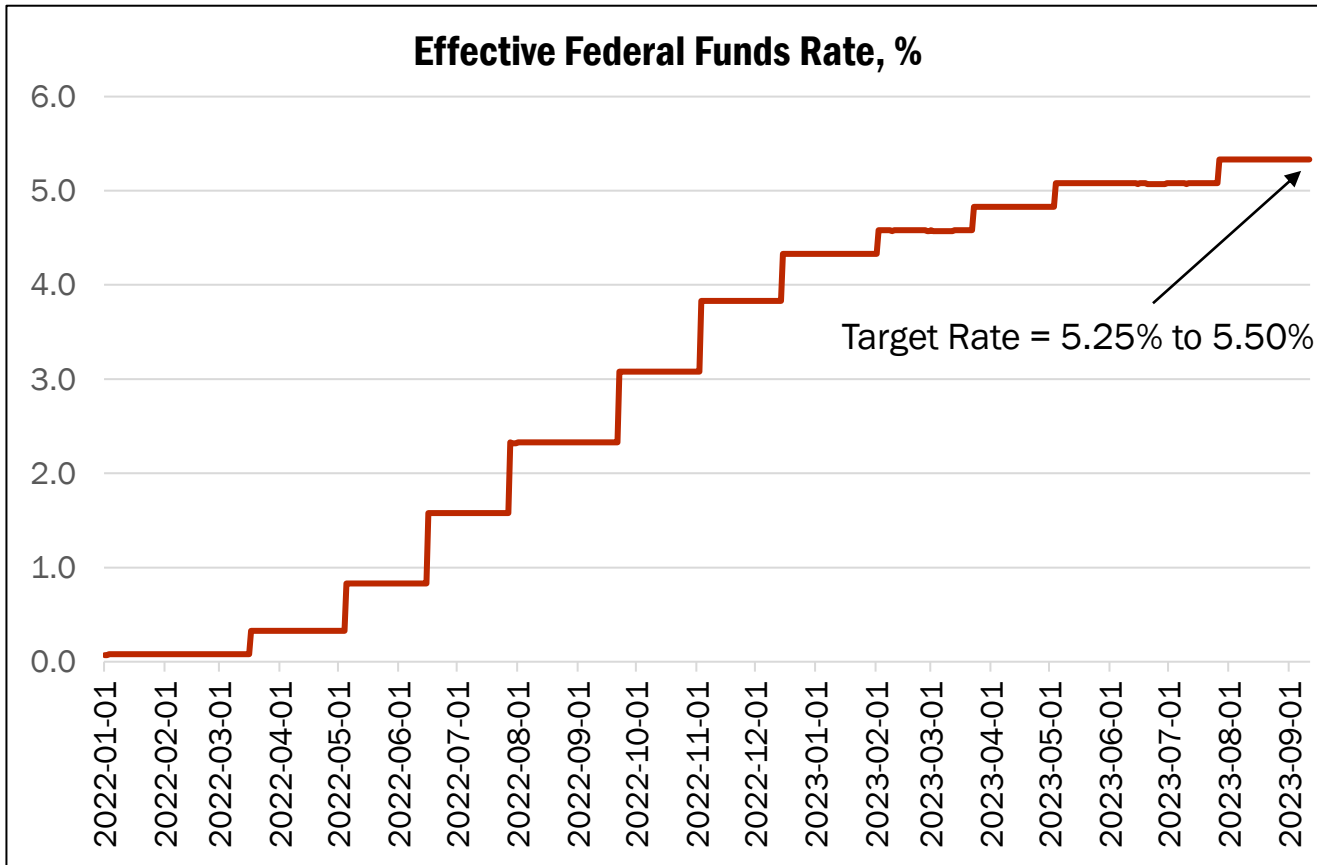


Source: Federal Reserve Bank of New York

- Second quarter Real Gross Domestic Product (GDP) rose by a seasonally adjusted annual rate of 2.1 percent (2.4 percent Q2/Q2).
- The first official estimate of Q3 GDP growth will be released on October 26; however, current estimates point to growth of 2.3 percent, still above the Fed's target of 1.8 percent.
- The GDP estimates and the September jobs report increase the likelihood of a rate hike.



# THE OUTLOOK FOR ADDITIONAL RATE HIKES IS MIXED WITH MANY ECONOMISTS EXPECTING ANOTHER INCREASE IN 2023



Source: Federal Reserve Board

- The Federal Reserve held rates steady at their September meeting.
- The outlook for additional rate hikes is mixed with many economists expecting an additional rate increase before year-end.
- The minutes from the Fed’s September 19-20 policy meeting indicate that a “majority of participants judged that one more increase in the target federal-funds rate at a future meeting would likely be appropriate.”
- However, Fed officials will take a wait-and-see approach with respect to inflation, bond yields, employment and GDP growth.
- The Fed will meet on Oct 31-Nov 1, and again on Dec 12-13.

# THROUGH SEPTEMBER, UNADJUSTED REVENUES ARE \$412.1 MILLION AHEAD OF FORECAST

SOURCE, \$ Mil	SEPTEMBER						FYTD					
	Actuals	Projected	Variance \$	Variance %	PY	Y/Y %	Actuals	Projected	Variance \$	Variance %	PY	Y/Y%
Withholding	1,234.3	1,204.2	30.1	2.5%	1,218.1	1.3%	3,822.1	3,768.5	53.6	1.4%	3,805.5	0.4%
Non-withholding	779.1	562.5	216.6	38.5%	704.5	10.6%	1,000.0	741.0	259.0	35.0%	928.0	7.8%
IIT Refunds	(144.9)	(145.2)	0.3	-0.2%	(942.5)	-84.6%	(443.5)	(448.4)	4.8	-1.1%	(1,049.0)	-57.7%
Net	1,868.5	1,621.6	247.0	15.2%	980.1	90.6%	4,378.6	4,061.1	317.5	7.8%	3,684.5	18.8%
Sales/Use	396.0	394.1	1.9	0.5%	406.6	-2.6%	1,189.3	1,189.5	(0.3)	0.0%	1,166.5	2.0%
Corporate	410.2	392.5	17.7	4.5%	363.2	12.9%	516.2	474.5	41.7	8.8%	434.8	18.7%
Wills and Deeds	30.3	28.9	1.4	4.9%	37.7	-19.4%	104.4	92.4	12.0	13.0%	135.5	-22.9%
All other	144.2	133.4	10.8	8.1%	88.4	63.1%	443.1	401.9	41.2	10.3%	203.7	117.5%
<b>Total GF Revenues</b>	<b>2,849.3</b>	<b>2,570.5</b>	<b>278.8</b>	<b>10.8%</b>	<b>1,876.0</b>	<b>51.9%</b>	<b>6,631.5</b>	<b>6,219.4</b>	<b>412.1</b>	<b>6.6%</b>	<b>5,624.9</b>	<b>17.9%</b>

- Non-withholding, which includes approximately \$380 million in PTET receipts, came in well above projections. The forecast assumed a 20 percent decline. Taxpayer behavior also may not have adjusted to PTET.
- Withholding has not experienced the same volatility and continues to perform moderately above forecast.
- Monthly interest income projections are adjusted to better account for NGF transfers.
- PTET refunds were estimated at \$100M for September. More information will be available after the November deadline for extension filers.

# ADJUSTING FOR POLICY AND TIMING, GF REVENUES ARE UP 8.6 PERCENT YEAR TO DATE

Unadjusted Revenues	FY 2023	FY 2024	Pct Chg	SEPTEMBER				Fiscal Year-To-Date				
	Actual	HB 6001	Req by Est	FY 2023	FY 2024	Change	% Change	FY 2023	FY 2024	Change	% Change	% of Total
Withholding	15,957.2	15,853.0	-0.7%	1,218.1	1,234.3	16.2	1.3%	3,805.5	3,822.1	16.6	0.4%	57.6%
Non-Withholding	6,629.2	4,688.3	-29.3%	704.5	779.1	74.6	10.6%	928.0	1,000.0	72.0	7.8%	15.1%
Refunds	(3,602.8)	(2,834.8)	-21.3%	(942.5)	(144.9)	797.6	-84.6%	(1,049.0)	(443.5)	605.5	-57.7%	-6.7%
Sales and Use Tax	4,734.6	4,418.2	-6.7%	406.6	396.0	(10.6)	-2.6%	1,166.5	1,189.3	22.8	2.0%	17.9%
Corporate Income Tax	2,031.1	1,896.1	-6.6%	363.2	410.2	47.0	12.9%	434.8	516.2	81.4	18.7%	7.8%
All Other Sources	2,160.7	2,349.1	8.7%	126.0	174.5	48.5	38.5%	339.1	547.5	208.3	61.4%	8.3%
<b>Total GF Revenues</b>	<b>\$27,909.9</b>	<b>\$26,369.3</b>	<b>-5.5%</b>	<b>\$1,876.0</b>	<b>\$2,849.3</b>	<b>973.3</b>	<b>51.9%</b>	<b>\$5,624.9</b>	<b>\$6,631.5</b>	<b>1,006.6</b>	<b>17.9%</b>	<b>100.0%</b>

## Adjusted Revenues

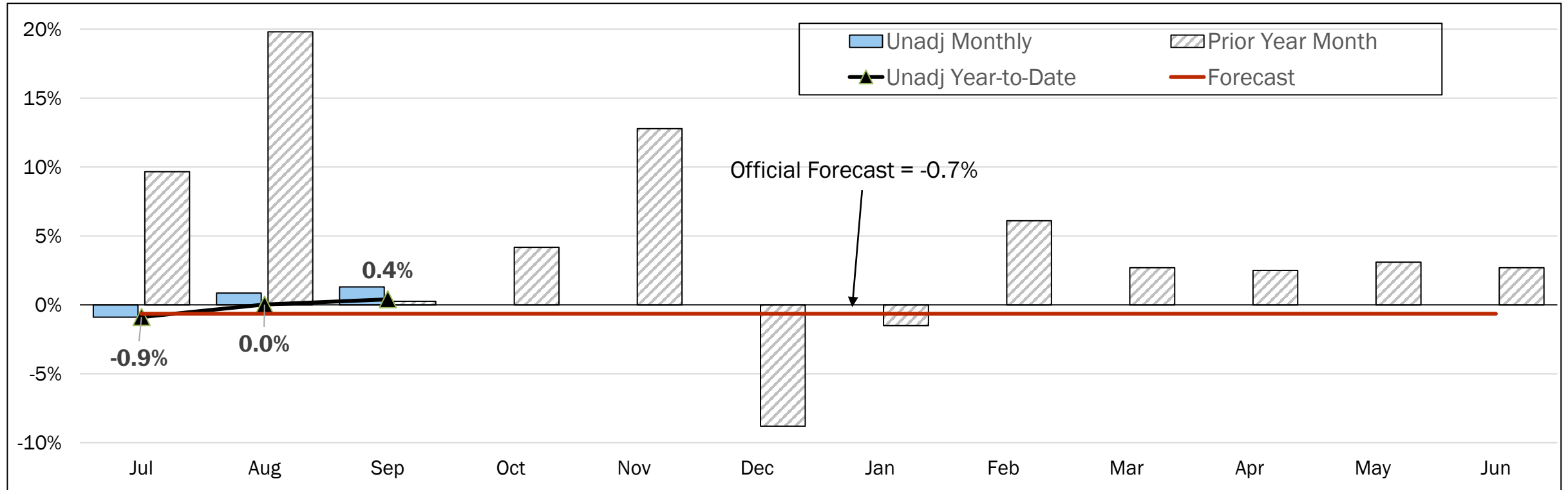
Adjusted Withholding	1,218.1	1,278.0	59.8	4.9%	3,805.5	3,950.6	145.1	3.8%	55.9%
Adjusted Non-Withholding	704.5	780.1	75.7	10.7%	928.0	1,001.3	73.3	7.9%	14.2%
Adjusted Refunds+Rebates	(61.1)	(44.8)	16.3	-26.7%	(167.5)	(143.3)	24.2	-14.4%	-2.0%
Adjusted Sales (AST+Grocery Tax)	406.6	418.1	11.4	2.8%	1,166.5	1,196.2	29.7	2.5%	16.9%
<b>Total GF Revenues, Adjusted</b>	<b>\$2,757.4</b>	<b>\$3,016.1</b>	<b>258.7</b>	<b>9.4%</b>	<b>\$6,506.3</b>	<b>\$7,068.3</b>	<b>562.0</b>	<b>8.6%</b>	<b>100.0%</b>
<b>Total Excluding PTET Adjustments</b>	<b>\$2,757.4</b>	<b>\$2,916.1</b>	<b>158.7</b>	<b>5.8%</b>	<b>\$6,506.3</b>	<b>\$6,768.3</b>	<b>262.0</b>	<b>4.0%</b>	<b>100.0%</b>

Total may not sum due to rounding.

= Results after adjustments.

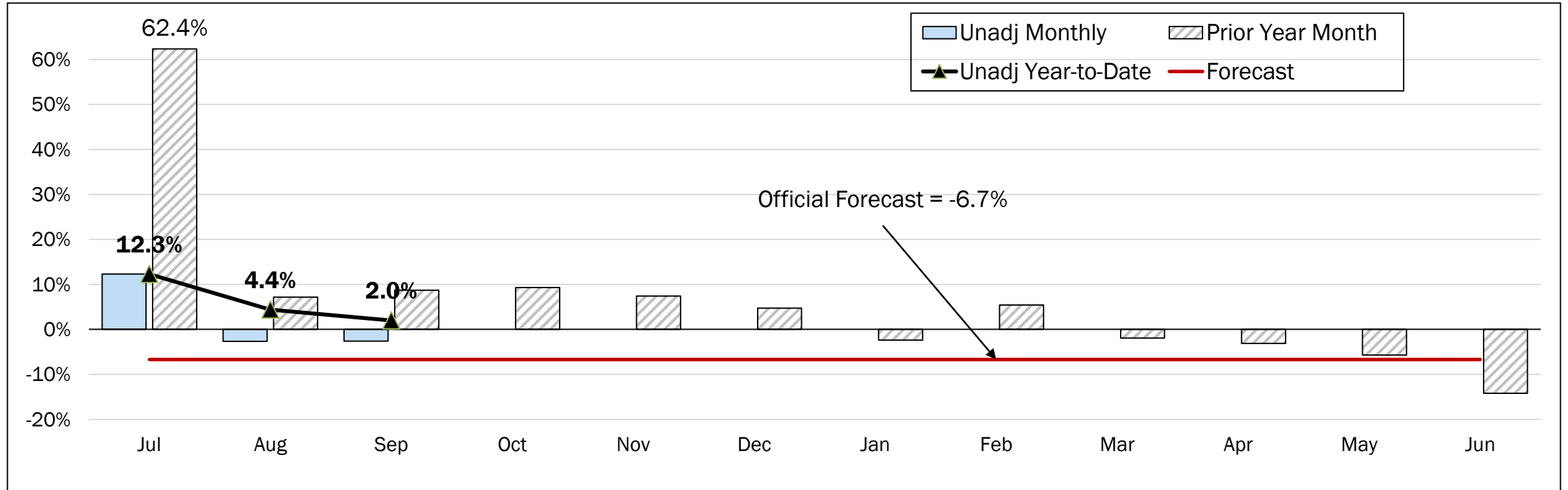
- Refunds last September included \$881 million in tax rebates. After adjusting for this, refunds shrank 26.7 percent.
- Withholding continues to grow, outperforming the forecast which was based on a recession in this quarter.
- Non-Withholding's first major month shows a 10.7 percent growth this month and 7.9 percent on an adjusted YTD basis.
- The macroeconomy's overperformance this year, and the turbulent conditions of last year, have resulted in an 8.6 percent YTD growth. Excluding adjustments for PTET refunds, YTD adjusted revenue growth is 4.0 percent.

# YEAR-TO-DATE, WITHHOLDING REVENUE GROWTH IS MODERATELY POSITIVE ON AN UNADJUSTED BASIS



- On an unadjusted basis, withholding collections grew 1.3 percent year-over-year in September and is up 0.4 percent year-to-date versus the forecast of a 0.7 percent decline.
- Adjusting for policy, withholding grew 4.9 percent for the month and is up 3.8 percent year-to-date.

# SALES TAX COLLECTIONS ARE SLIGHTLY AHEAD OF EXPECTATIONS, BUT GROWTH IS EXPECTED TO SLOW IN COMING MONTHS



- On an adjusted basis to account for the AST and elimination of the state grocery tax, September sales tax revenue growth was 2.8 percent vs the -2.6 percent unadjusted decline.
- Year-over-year growth in sales tax revenue will continue to slow through February due to the elimination of tax on groceries.

# OTHER SOURCES

## Pass-Through Entity Tax (PTET)

- Included in non-withholding is an estimated \$380 million in PTET collected in September. Virginia Tax had anticipated taxpayers with PTEs to correct last year's behavior and reduce individual estimated payments as they shift their liability to the entity level. September's data indicate this may not have happened. Data limitations continue to be a challenge in tracking and forecasting PTET-related activity.

## Corporate Income Tax

- September is the first significant month for corporate income tax collections. For the month, collections exceeded projections by \$18 million and grew 12.9 percent year-over-year. Corporate income tax revenues are up 18.7 percent fiscal year-to-date.

## Other Revenue Sources

- Interest income continues to exceed projections. Monthly projections are being recalibrated in consultation with the Department of Treasury. October month-end will provide a better assessment of GF interest revenues after distributions to nongeneral funds are made.
- Deed recordation continues to outperform the forecast. Though September collections were more in line with projections, only exceeding forecast by 4.7 percent compared to August's variance of 18.5 percent.
- Other sources are generally in line or exceed projections, confirming that the economy is growing more strongly than assumed in the official forecast.

# KEY DATES

- **November 1** – Individual income tax extension returns due.
- **November 20** – Governor’s Advisory Council on Revenue Estimates (GACRE) reviews economic and revenue outlook for current and next biennium.
- **November 30** – Deadline for issuance of 2023 individual income tax rebates for taxpayers filing a return by July 1, 2023.
- **December 20** – Governor Youngkin releases FY 2024 budget amendments and introduces the 2024 - 2026 biennial budget.