



# **ECONOMIC AND REVENUE REVIEW AND UPDATE**

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# TOPICS FOR DISCUSSION

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ECONOMIC UPDATE

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DECEMBER FISCAL YEAR-TO-DATE REVENUE COLLECTIONS

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LOOKING AHEAD

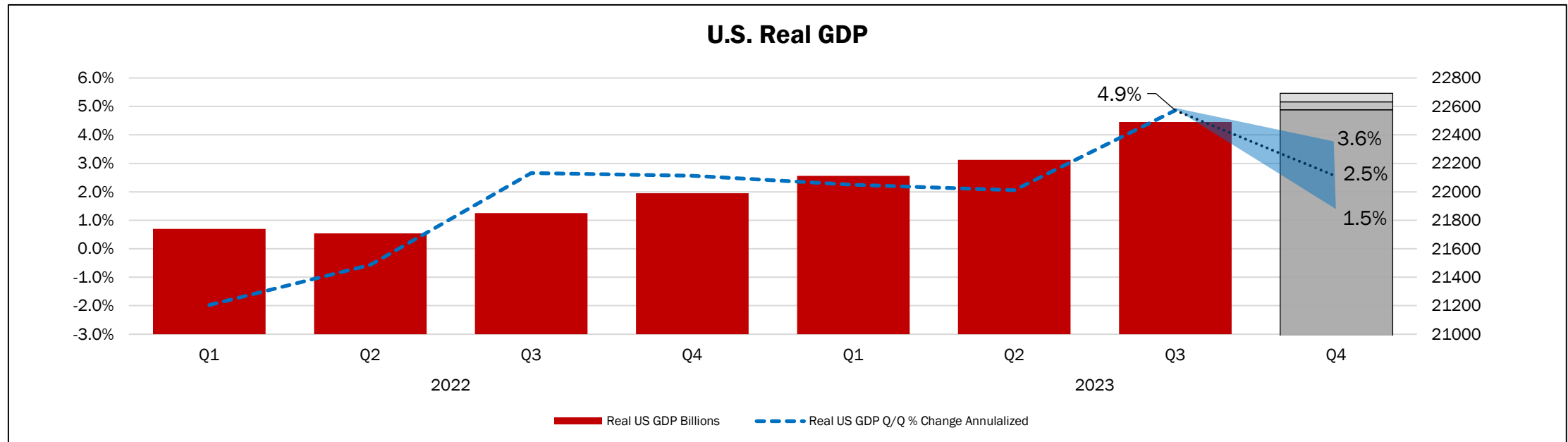
# SUMMARY

- For the month of December, general fund revenue collections grew 0.2 percent year-over-year, driven by an increase in individual income tax collections of \$84 million and interest income of \$43 million.
- Fiscal year-to-date through December 31, unadjusted general fund revenues increased 7.1 percent against the same period last year. Net individual income tax collections (+6.4 percent), corporate income tax (+14.8 percent) and interest income (+184.9 percent) are all higher compared to last year, while sales and use tax collections (-1.3 percent), insurance premiums (-11.0%), and wills, suits and deeds (-16.7 percent) are lower year-to-date.
- Compared to the forecast assumed in the Governor's proposed budget, year-to-date revenues are ahead of projections by \$363.2 million. Excluding nonwithholding and refunds, which continue to be distorted by the recently-enacted elective Pass-Through Entity Tax (PTET), year-to-date collections are ahead of plan by \$85.8 million, a variance of 0.7 percent.
- Adjusting for policy impacts to better reflect underlying trends, general fund revenues are up 5.9 percent year-to-date.
- Among the major sources, withholding collections grew 3.8 percent in December and are up 2.1 percent year-to-date, accounting for policy impacts, withholding is up 5.1 percent year-to-date.
- Collections of sales and use taxes in December, reflecting November sales, declined 4.7 percent and are down 1.3 percent year-to-date. Adjusting for policy, sales tax revenues are up 1.2 percent through December.

# SUMMARY (CONT'D)

- The forecast included in the Governor's proposed amendments to the 2022-24 biennial budget (HB/SB 29) anticipates a mild three-quarter recession beginning in the fourth quarter of fiscal year 2024. The conservative outlook recognizes that despite recent economic growth and slowing inflation, the existence of significant downside economic risks have the potential to impact state tax collections. Among these are:
  - The temporary budget deal in Congress expires January, raising concerns about the risk of an extended federal government shutdown which could cause consumer and business confidence to decline.
  - A period of persistently high interest rates will directly impact corporate profits, curtail housing market activity and reduce consumer spending.
  - Declines in European and Asian economies will hurt U.S. exports and corporate earnings.
  - Escalating conflict in the middle east and OPEC+ oil production cuts could drive significantly higher energy prices.
  - The real estate crisis in China and the resulting impact on financial markets could have ripple effects throughout the broader global economy.
  - Spend down of consumers' pandemic savings and the resumption of student loan repayments will impact consumer spending and likely dampen economic growth further.
- Recent economic data, including slowing employment growth, decelerating inflation, slowing wage and spending growth, recent upticks in unemployment, and high credit card delinquencies are consistent with our outlook of an economy that is slowing.

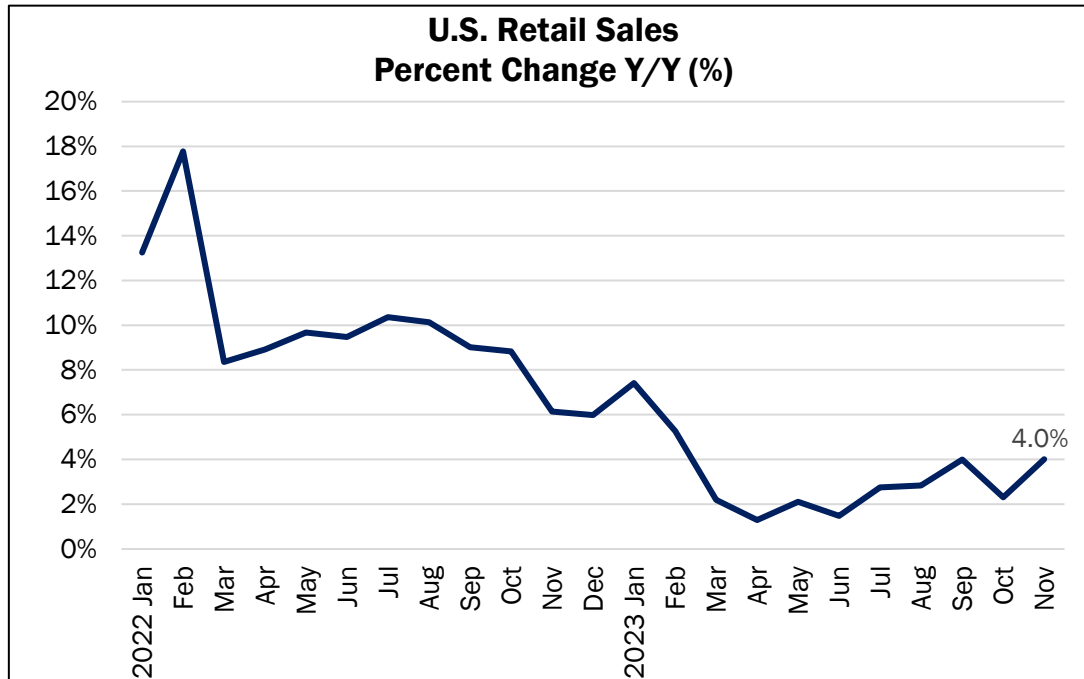
# CURRENT FOURTH QUARTER GDP PROJECTIONS INDICATE SLOWING ECONOMIC GROWTH



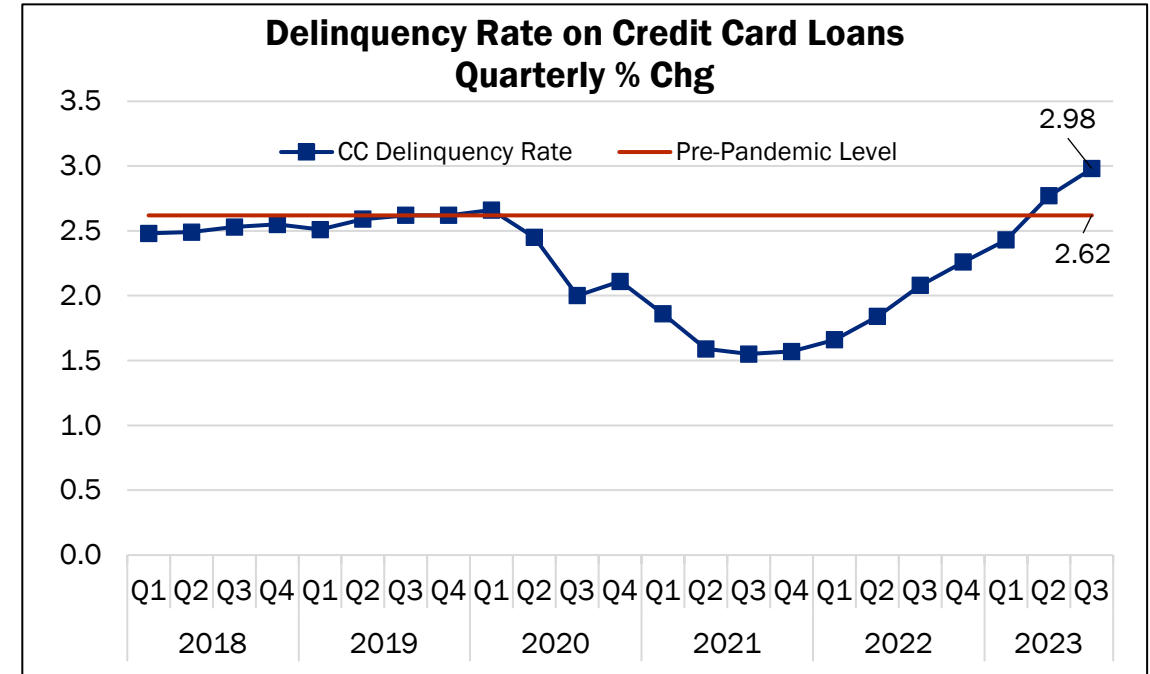
Source: US Bureau of Economic Analysis; Federal Reserve Bank of New York.

- U.S. Real GDP growth for the third quarter was revised down in December from 5.2 percent to 4.9 percent according to the "third" estimate released by the Bureau of Economic Analysis.
- Q4 real time estimates are pointing towards slower growth, The NY Fed "Nowcast" currently estimates Q4 GDP growth at between 1.5 and 3.6 percent, with a central tendency of 2.5.

# CONSUMER DEMAND GROWTH REMAINS, BUT WORRYING TRENDS IN CREDIT CARD DELINQUENCIES POINT TO HOUSEHOLD TROUBLES



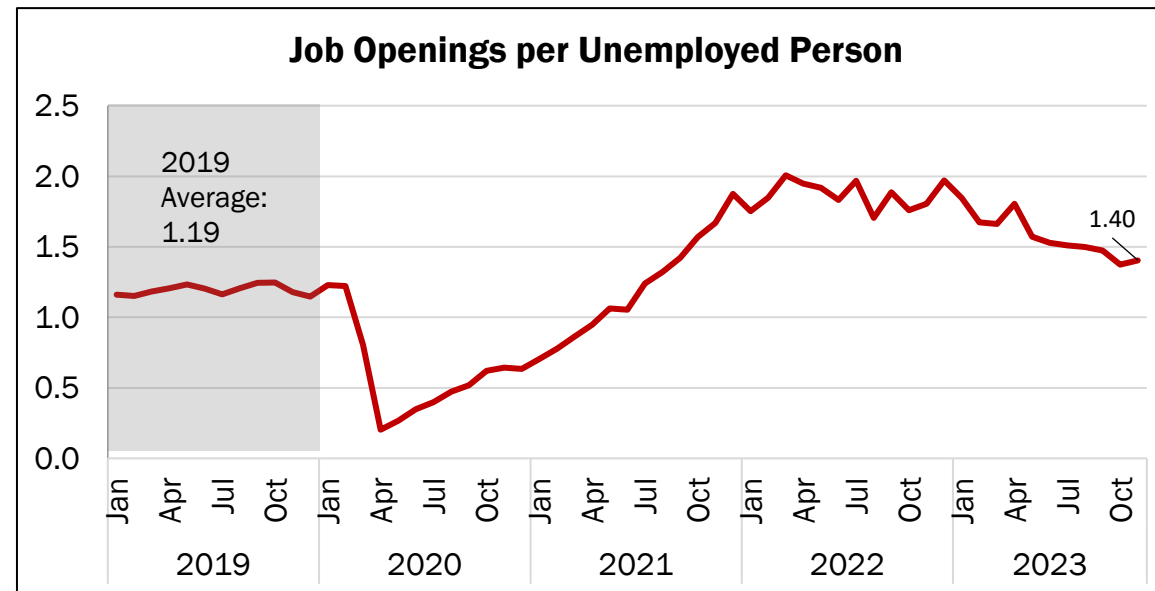
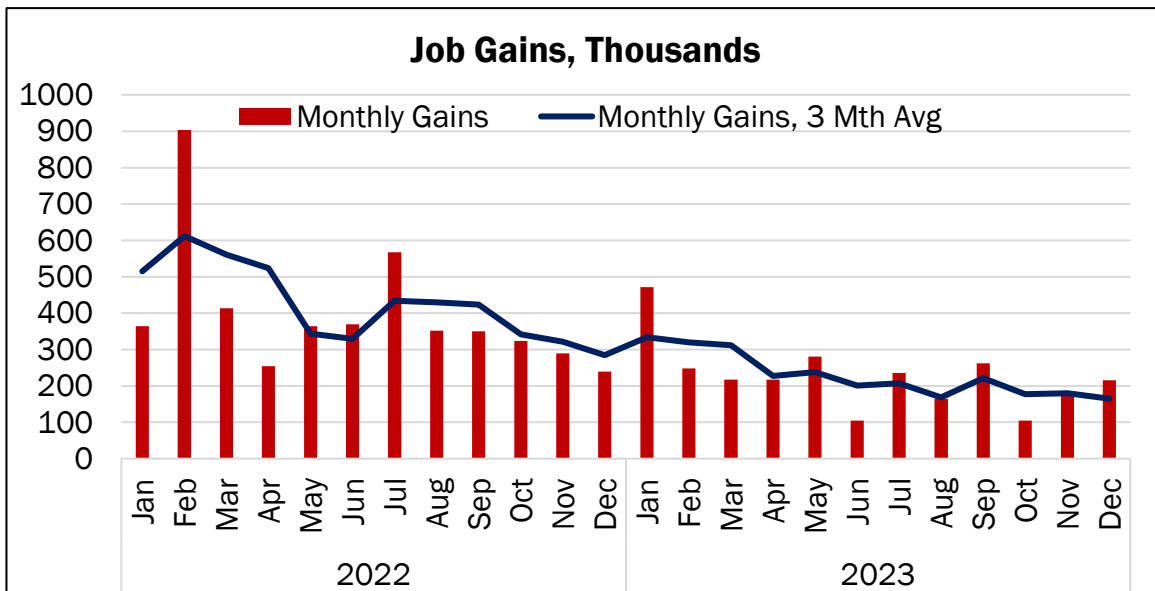
Source: Federal Reserve Bank of St. Louis.



Source: US Bureau of Economic Analysis

- In November, retail sales grew 0.3 percent from the prior month. Compared to the same month last year, sales were up 4.0 percent.
- Meanwhile, credit card delinquencies have ticked up above pre-pandemic levels, indicating a spend down of the cash reserves households accumulated during Covid era programs.

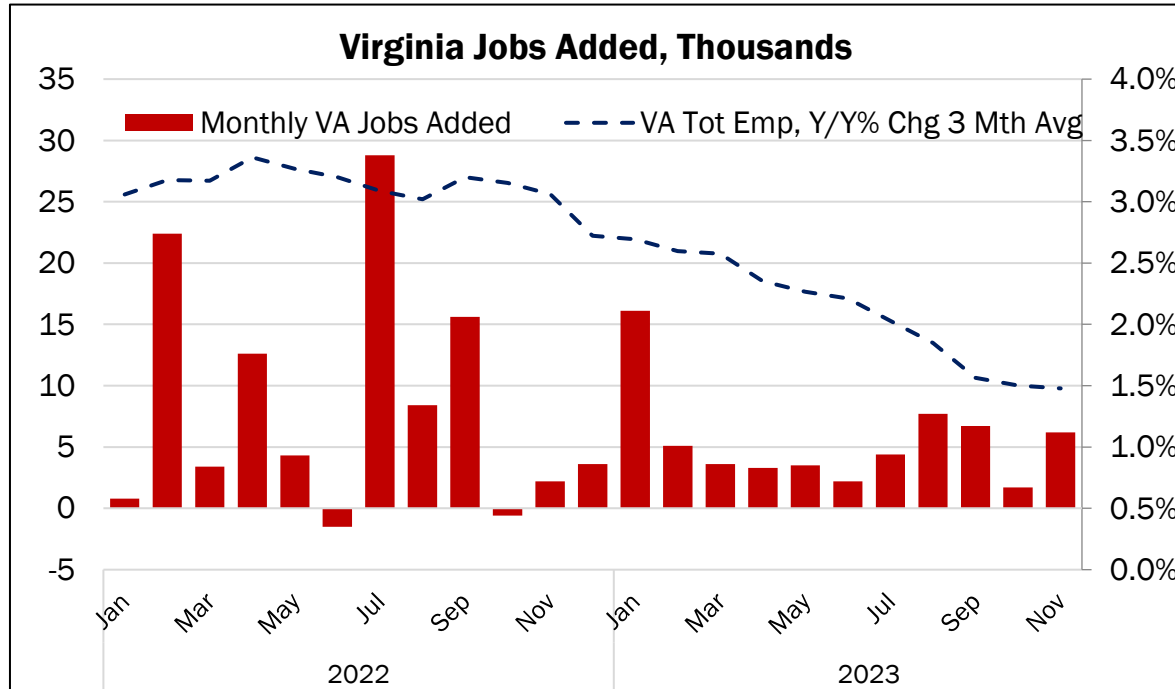
# U.S. LABOR MARKET IS SLOWLY LOOSENING



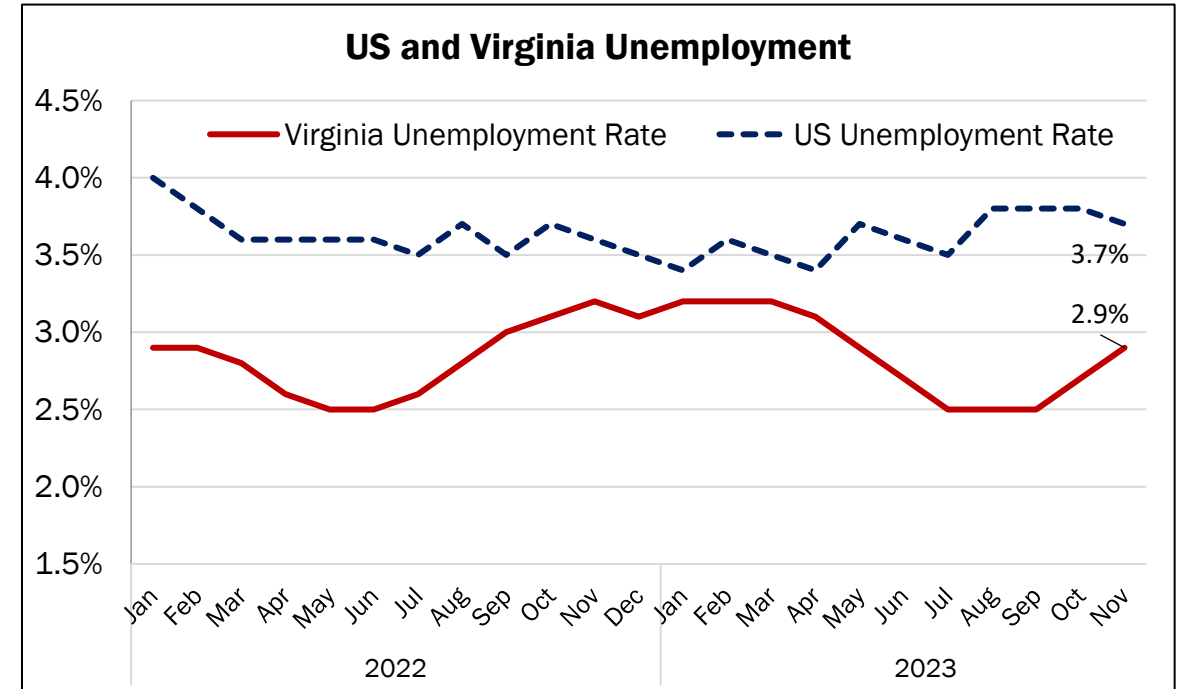
Sources: US Bureau of Labor Statistics.

- U.S. nonfarm payrolls increased 216,000 in December. Employment continued to trend up in government, healthcare, social assistance, and construction, while transportation and warehousing lost jobs. Payroll gains for October and November were revised down by a total of 71,000, bringing the net gain, including revisions, to 145,000.
- Job openings per unemployed person dipped down to 1.4 after remaining flat for four months. The Federal Reserve has specifically mentioned this as an indicator labor supply is still below demand.

# VIRGINIA UNEMPLOYMENT RATE TICKED UP IN NOVEMBER AS THE PACE OF JOB GROWTH CONTINUES TO SLOW



Source: Current Employment Statistics Survey, US Bureau of Labor Statistics

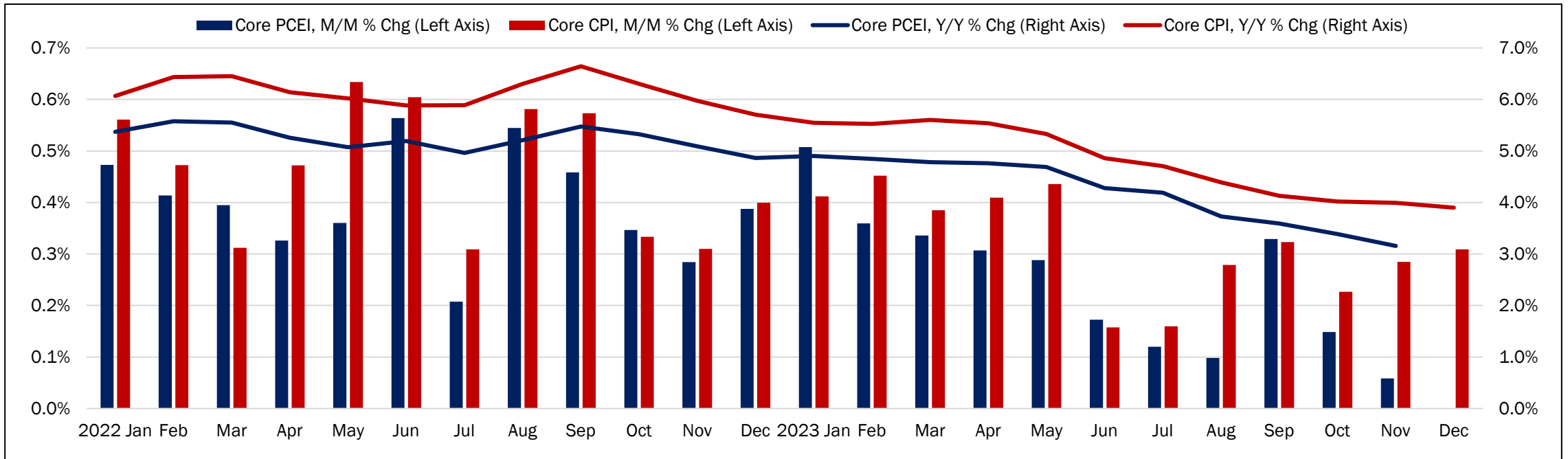


Source: Current Population Survey, US Bureau of Labor Statistics

- In November, Virginia added 6,200 jobs, bringing the state total non-farm jobs to 4.17 million.
- The three-month average year-over-year growth in Virginia employment remained flat, measuring 1.5 percent in November.
- Virginia's unemployment rate in November increased by 0.2 percentage points to 2.9 percent, seasonally adjusted, which is 0.3 percentage points below the rate from a year ago. The labor force increased by 9,331 to 4,62 million as the number of unemployed residents increased by 9,284 to 132,085.
- The labor force participation rate increased by 0.1 percentage points to 66.9 percent in November.



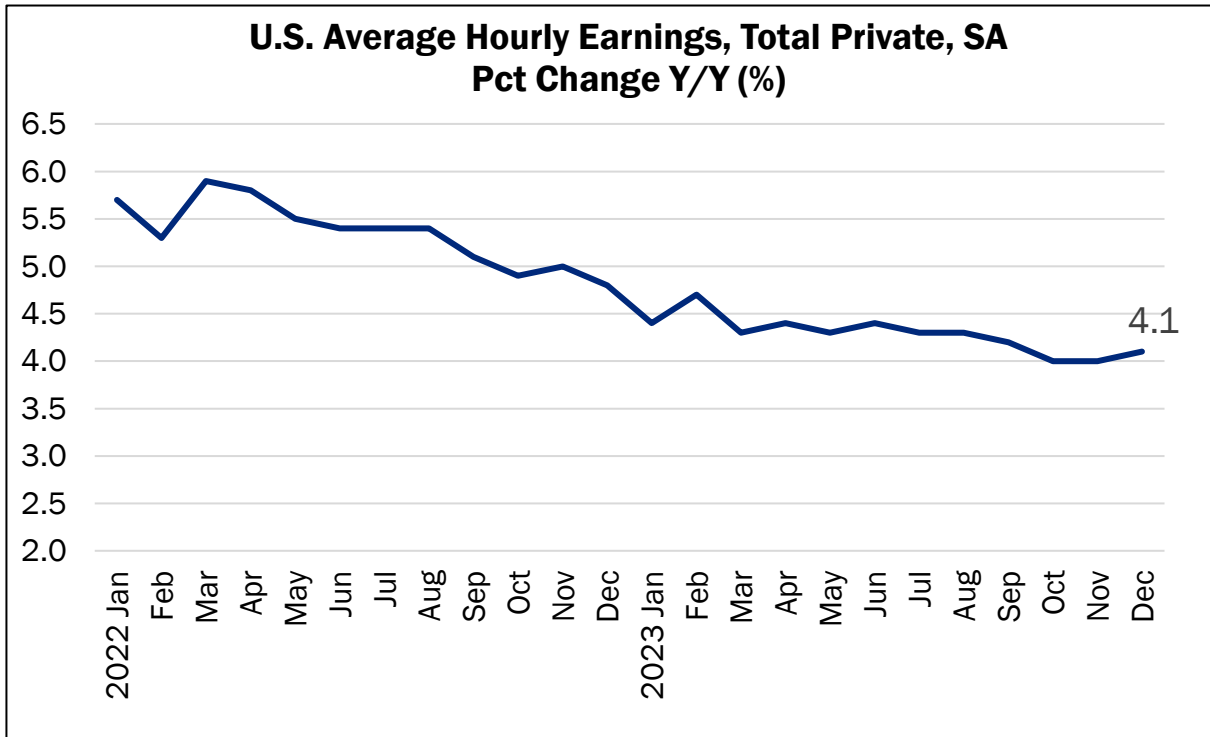
# CORE CPI REMAINS ELEVATED AT CLOSE TO FOUR PERCENT



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

- Core CPI, which excludes food and energy and is available before PCE, indicates inflationary trends only modestly slowed in December. Core CPI is up 3.9 percent over the last 12 months.
- The Core Personal Consumption Expenditure Price Index (Core PCE), the Federal Reserve’s preferred inflation measure, is still being calculated for December.
- While the trend in inflation is promising, lower interest rates are unlikely in the near future.

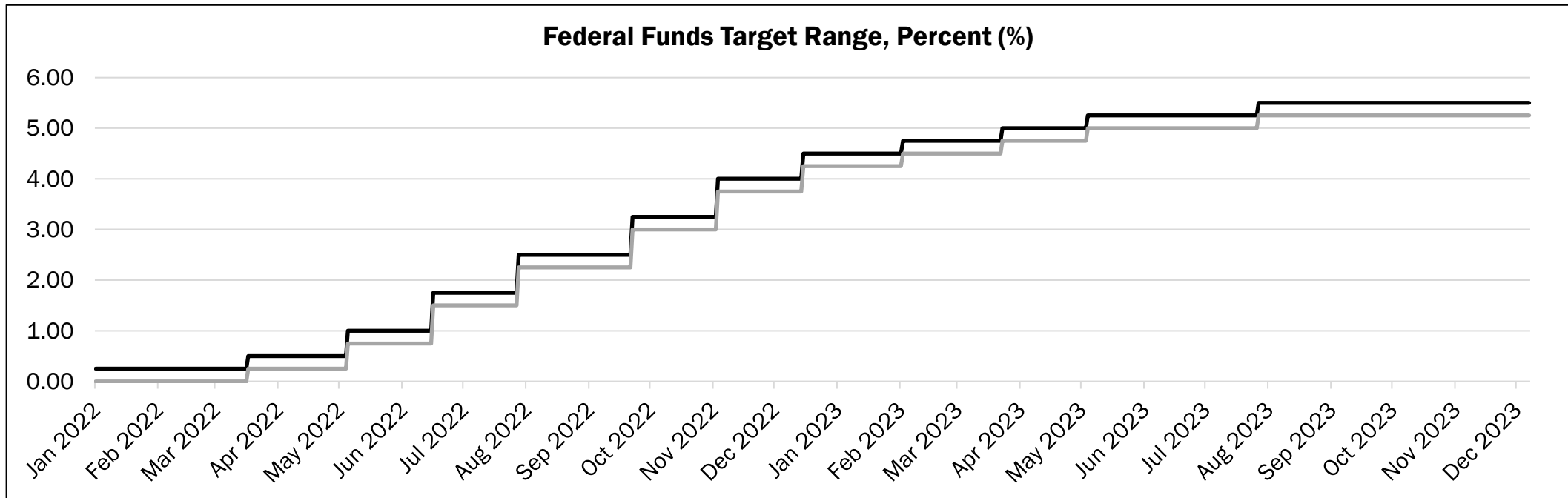
# WAGE GROWTH SLOWING, IN LINE WITH INFLATION TRENDS



Source: U.S. Bureau of Labor Statistics

- Average hourly earnings for all employees on private nonfarm payrolls rose by 15 cents, or 0.4 percent from November to December, to \$34.27.
- Over the past 12 months, average hourly earnings have increased by 4.1 percent, just edging out Core CPI increases.
- The gradual slowing of wage growth is consistent with the broader downward trend in inflation and a slowing economy.

# WITH INFLATION MODERATING, THE FED HAS HELD RATES STEADY SINCE JULY



Source: Federal Reserve Bank of St. Louis.

- The Federal Reserve held rates steady at their December 12-13 meeting and acknowledged that inflation had improved more quickly than anticipated.
- 93 percent of economists surveyed in Bankrate's latest Economic Indicator poll expected lower interest rates in 2024, however the survey group was split on timing. Half expect rates to begin declining before Q3, and half expect after.

# FISCAL YEAR-TO-DATE COLLECTIONS ARE 2.8 PERCENT ABOVE THE DECEMBER FORECAST

SOURCE, \$ Mil	Unadjusted Revenues							
	December				FYTD			
	Actuals	Projected	Variance \$	Variance %	Actuals	Projected	Variance \$	Variance %
Withholding	\$1,439.2	\$1,359.6	\$79.6	5.9%	\$7,995.0	\$7,835.8	\$159.2	2.0%
Non-withholding	626.4	523.3	103.0	19.7%	2,032.7	1,677.5	355.1	21.2%
IIT Refunds	(136.3)	(203.6)	67.3	-33.1%	(1,125.1)	(1,047.3)	(77.7)	7.4%
Net Individual Income	\$1,929.3	\$1,679.3	\$249.9	14.9%	\$8,902.6	\$8,466.0	\$436.6	5.2%
Sales & Use Tax	397.4	388.3	9.1	2.4%	2,372.6	2,387.7	(15.1)	-0.6%
Corporate Income Tax	332.4	392.7	(60.3)	-15.4%	979.7	966.9	12.8	1.3%
Insurance	104.3	118.8	(14.5)	-12.2%	104.3	118.8	(14.5)	-12.2%
Wills, Suits, Deeds	34.0	36.8	(2.8)	-7.6%	198.0	220.0	(21.9)	-10.0%
Interest Income	92.9	94.3	(1.4)	-1.5%	494.8	487.6	7.2	1.5%
All Other	34.2	39.6	(5.4)	-13.5%	315.5	357.4	(41.8)	-11.7%
<b>Total GF Revenues</b>	<b>\$2,924.6</b>	<b>\$2,749.8</b>	<b>\$174.7</b>	<b>6.4%</b>	<b>\$13,367.6</b>	<b>\$13,004.4</b>	<b>\$363.2</b>	<b>2.8%</b>
<b>Total, Excl. NWH and Refunds</b>	<b>\$2,434.4</b>	<b>\$2,430.1</b>	<b>\$4.4</b>	<b>0.2%</b>	<b>\$12,460.0</b>	<b>\$12,374.2</b>	<b>\$85.8</b>	<b>0.7%</b>

- Excluding non-withholding collections and refunds, which continue to be distorted by PTET-related activity, year-to-date GF collections are up 4.2 percent year-over-year and ahead of the forecast by 0.7 percent.
- Non-Withholding has been continued to surprise to the upside, it is 21.2 percent over projections as of December.
- Withholding revenues were \$79.6 million greater than expected in December.
- PTET refunds were lower than assumed this month as return volume dropped and refund ratio shifted.

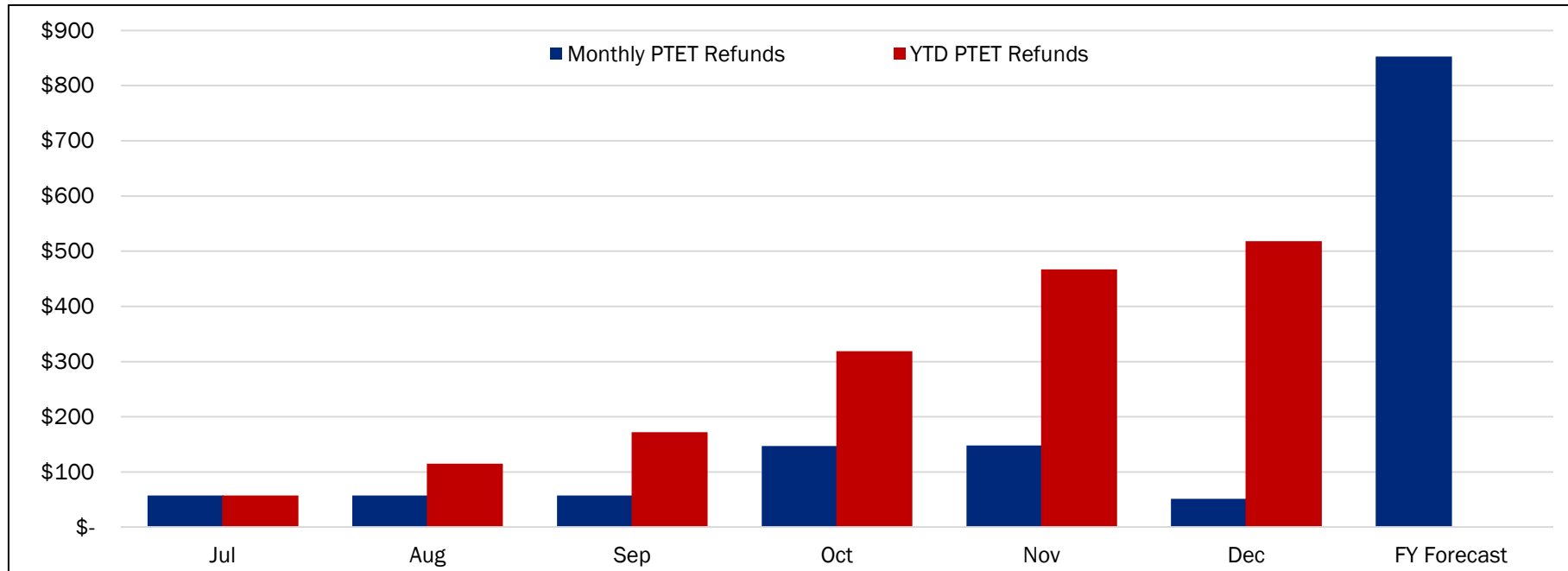
# REMOVING PTET REFUNDS EFFECTS AND ADJUSTING FOR POLICY IMPACTS, GF REVENUES ARE UP 5.9 PERCENT

Unadjusted Revenues	December			Fiscal Year-To-Date		
	FY 24 \$	FY 23\$	Y/Y %	FY 24 \$	FY 23\$	Y/Y %
Withholding	\$1,439.2	\$1,386.3	3.8%	\$7,995.0	\$7,832.4	2.1%
Non-Withholding	626.4	595.7	5.1%	2,032.7	1,909.5	6.5%
Refunds	(136.3)	(65.0)	109.7%	(1,125.1)	(1,378.5)	-18.4%
Sales & Use Tax	397.4	417.2	-4.7%	\$2,372.6	2,404.4	-1.3%
All Other	597.8	583.3	2.5%	\$2,092.4	1,719.1	21.7%
<b>Total GF Revenues</b>	<b>2,924.6</b>	<b>2,917.6</b>	<b>0.2%</b>	<b>\$13,367.6</b>	<b>12,486.8</b>	<b>7.1%</b>
<b>Total Excluding NWH and Refunds</b>	<b>2,434.4</b>	<b>2,386.9</b>	<b>2.0%</b>	<b>\$12,460.0</b>	<b>11,955.9</b>	<b>4.2%</b>

Adjusted Revenues	December			Fiscal Year-To-Date		
	FY 24 \$	FY 23\$	Y/Y %	FY 24 \$	FY 23\$	Y/Y %
Withholding	\$1,484.4	\$1,386.3	7.1%	\$8,235.5	7,832.4	5.1%
Non-Withholding	640.5	595.7	7.5%	2,078.1	1,909.5	8.8%
Refunds	(75.8)	(56.5)	34.2%	(530.9)	(392.5)	35.3%
Sales & Use Tax	419.8	417.2	0.6%	2,507.1	2,476.7	1.2%
All Other	598.5	583.3	2.6%	2,059.0	1,719.1	19.8%
<b>Total GF Revenues</b>	<b>\$3,067.4</b>	<b>\$2,926.1</b>	<b>4.8%</b>	<b>\$14,348.8</b>	<b>13,545.2</b>	<b>5.9%</b>
<b>Total Excluding NWH and Refunds</b>	<b>2,502.7</b>	<b>2,386.9</b>	<b>4.9%</b>	<b>12,801.6</b>	<b>12,028.2</b>	<b>6.4%</b>

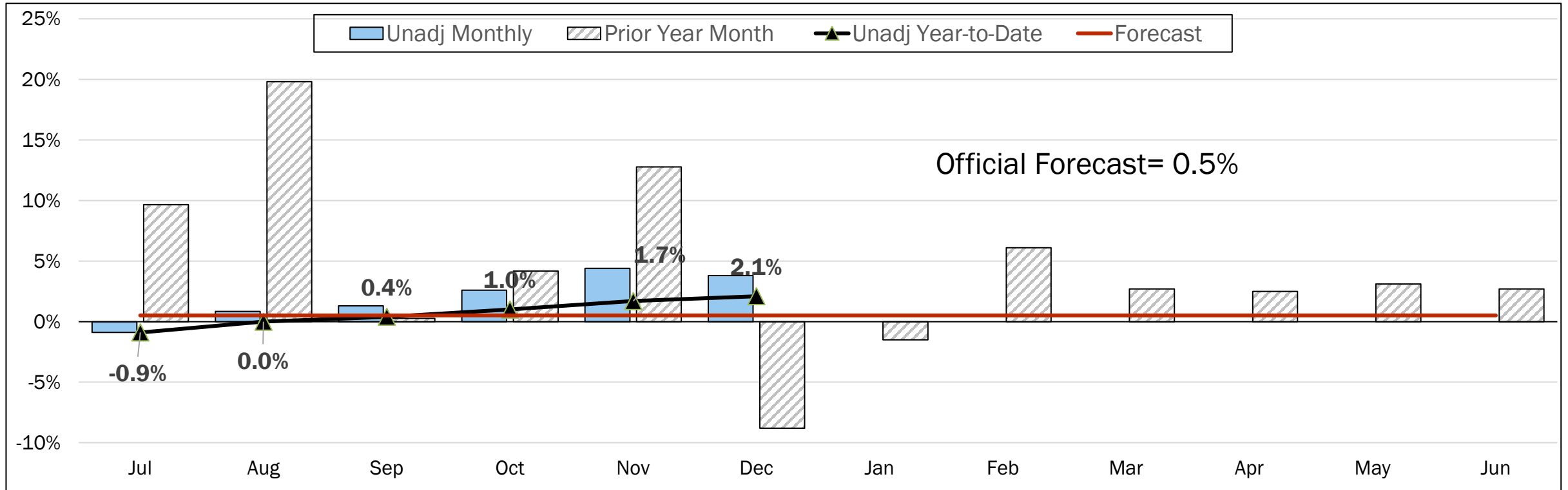
- Adjusting for policy actions reveals very robust growth in withholding and non-withholding at 5.1 and 8.8 percent, respectively.
- Consumption supporting sales tax has seen a relatively sluggish growth of approximately 1.2 percent this fiscal year to date.
- After removing policy impacts, the effect of PTET payments in FY24 and rebates in FY23, FYTD revenues are up 5.9 percent.

# PTET REFUND EXPECTATIONS AND RESULTS



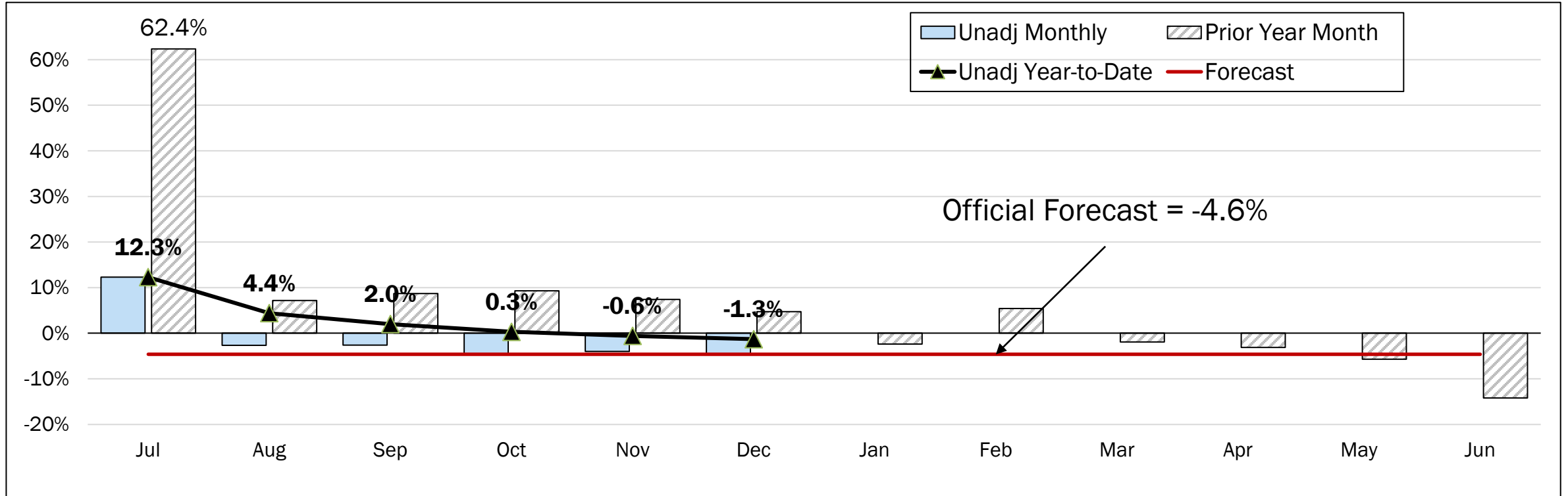
- After a flood of PTE owner returns in the second half of October, the tax department has processed and applied credits for over 10,000 such returns.
- In December, the number of returns being submitted dropped, leading to only \$51 million in TY 2022 PTET credits being refunded.
- The forecast expects over \$300 million in refunds to be processed in the new year, with the bulk falling in the filing season (February-April).

# UNADJUSTED WITHHOLDING COLLECTIONS CONTINUE TO GROW



- Stronger than expected economic performance has resulted in 1.7 percent growth on an unadjusted basis, 2.4 percentage points above the forecasted decline of 0.7 percent.
- On an adjusted basis, withholding revenues are up 4.5 percent year-to-date.

# GROWTH IN SALES TAX COLLECTIONS IS MODERATING AS EXPECTED



- The elimination of the state sales tax on groceries and personal hygiene products pushed forecasted sales tax revenue to -4.6 percent.
- After better-than-expected collections in July, sales tax revenues have steadily trended down.
- Year-over-year growth in sales tax revenue will continue to slow through February due to the elimination of tax on groceries.



# LOOKING AHEAD

- Year-to-date revenues are ahead of projections by \$363.2 million.
- January receipts will serve as the next critical data point in evaluating the outlook for the current fiscal year and serve as the basis for any recommended mid-session adjustment.
  - **Withholding:** Monthly and quarterly filers are due.
  - **Nonwithholding:** December and January are significant months for collections in this source. Taxpayers have until January 15 to submit their fourth estimated payment for tax year 2023. A clearer assessment of growth in this source will be possible at the end of January.
  - **Sales:** January receipts are needed to more accurately assess growth in this source. Given the importance of the holiday shopping season, it is still too early to assess whether the slowdown in sales tax revenue is due to timing issues or reflective of underlying weakness in growth. January 20th is the due date for retail sales tax collections and will reflect overall results for the important holiday shopping season.
  - **Corporate:** The fourth estimated payment will be received from retailers and other companies with February-January taxable years.