

Governor McAuliffe's Proposed 2018-2020 Budget

Economic Outlook and Revenue Forecast

*A Briefing for the Senate Finance,
House Appropriations and House Finance
Committees*

December 18, 2017



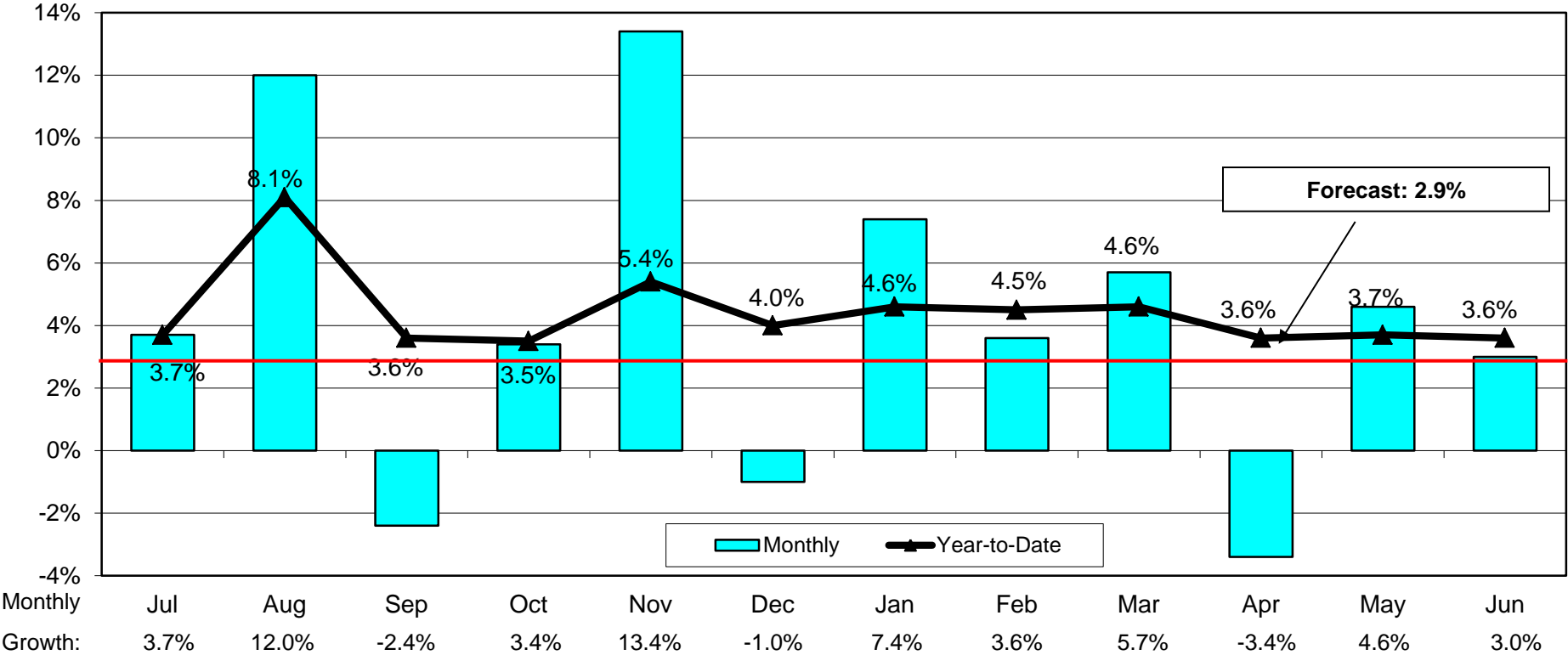
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Outline

- Fiscal Year 2017 Year-in-Review
- U.S. and Virginia Economic Outlook
- December Revenue Forecast
- November Revenue Collections
- Next Steps

Fiscal Year 2017 General Fund Revenue Grew at an Average Pace of 3.6 Percent

Growth in Total General Fund Revenue Collections FY17 Monthly and Year-to-Date



- Total general fund revenue collections exceeded the forecast by \$134.1 million, excluding transfers in fiscal year 2017, a forecast variance of 0.7 percent.
- Total general fund revenue collections rose 3.6 percent, ahead of the annual forecast of 2.9 percent growth.

Including Transfers, Fiscal Year 2017 General Fund Resources Grew 4.0 Percent and Finished \$136.6 Million (0.7 Percent) Above Forecast

Summary of Fiscal Year 2017 Revenue Collections (millions of dollars)

Major Sources	Official	Actual	Change	% Growth Over FY16	
				Official	Actual
Withholding	\$11,713.3	\$11,895.4	\$182.1	3.6 %	5.2 %
Nonwithholding	3,048.5	3,018.5	(30.0)	(0.7)	(1.7)
Refunds	(1,848.0)	(1,861.0)	(13.0)	1.5	2.2
Net Individual	\$12,913.8	\$13,052.9	\$139.1	2.9 %	4.0 %
Sales	\$3,386.8	\$3,357.1	(\$29.7)	2.8 %	1.9 %
Corporate	794.2	827.0	32.8	3.8	8.1
Wills (Recordation)	398.6	394.4	(4.2)	8.0	6.9
Insurance	344.1	340.9	(3.2)	1.5	0.5
All Other Revenue	723.5	722.9	(0.6)	1.1	1.0
Total Revenue	\$18,561.0	\$18,695.1	\$134.1	2.9 %	3.6 %
A.B.C. Profits	\$108.4	\$110.5	\$2.1	25.3 %	27.7 %
Sales Tax (0.375%)	365.4	365.9	0.5	2.8	2.9
Transfers	177.0	176.9	(0.1)	48.0	47.9
Total Transfers	\$650.8	\$653.3	\$2.5	15.9 %	16.3 %
TOTAL GENERAL FUND	\$19,211.8	\$19,348.4	\$136.6	3.3 %	4.0 %

- The gain in payroll withholding and the corporate income tax, about \$215 million, was somewhat offset by shortfalls in nonwithholding and sales tax collections.

Recent National and State Economic Indicators Suggest a Continued Expansion

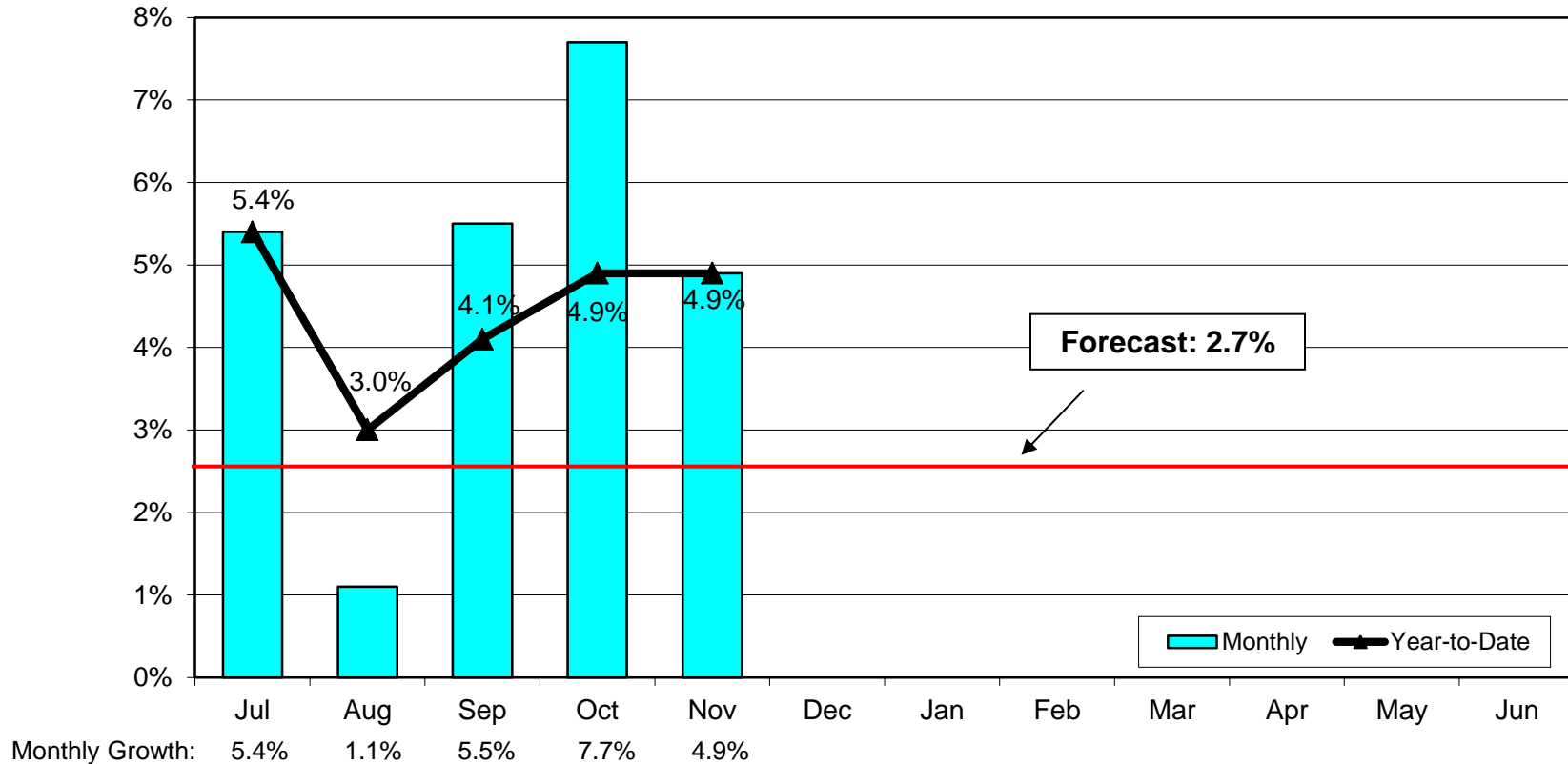
- According to the second estimate, real GDP grew at an annualized rate of 3.3 percent in the third quarter of 2017, up from 3.1 percent in the second quarter.
- Following the hurricane disruptions, payroll employment rose by 228,000 jobs in November and 244,000 in October.
- The national unemployment rate remained at 4.1 percent in November due to a small gain in both the number employed and in the labor force.
- Initial claims for unemployment fell by 2,000 to 236,000 during the week ending December 2.
 - The four-week moving average remained essentially flat at 242,000, this low level is indicative of a labor market in good health.
- The Conference Board's index of consumer confidence increased 3.3 points in November; confidence is at its strongest level in almost 17 years and is up 20.1 points from a year ago.
- The Conference Board's index of leading indicators rose 1.2 percent from 128.9 to 130.4 in October.
- Conditions in the manufacturing sector remained solid, but were weaker than expected in November. The Institute of Supply Management index fell from 58.7 to 58.2.

Recent National and State Economic Indicators Suggest a Continued Expansion *(continued)*

- The CPI rose 0.1 percent in October after a 0.5 percent gain in September and stands 2.0 percent above October 2016.
 - Core inflation (excluding food and energy prices) rose 0.2 percent, and has increased 1.8 percent from last year.
- At its December meeting, the Federal Reserve raised the federal funds rate target to 1.25 to 1.50 percent.
- In Virginia, employment growth slowed in October. Payroll employment rose 0.9 percent in October from a year ago.
 - Northern Virginia posted growth of 0.9 percent, Hampton Roads declined 1.2 percent, and Richmond-Petersburg rose 1.3 percent.
 - The seasonally adjusted unemployment rate fell 0.1 percentage point to 3.6 percent and stands 0.5 percentage point below October 2016.
- The Virginia Leading Index rose 0.1 percent in October after increasing 0.1 percent in September. The U.S. Leading Index and initial claims improved in October while auto registrations fell; future employment was unchanged.
 - With the exception of the Blacksburg and Staunton indexes, all of the regional indexes increased in October.

Fiscal Year 2018 Year-to-Date Revenue Collections Through November

Growth in Total General Fund Revenue Collections FY18 Monthly and Year-to-Date



- Total general fund revenues increased 4.9 percent in November.
 - Strength in payroll withholding and sales tax accounted for about 2/3rds of the growth.
- On a year-to-date basis, total revenues increased 4.9 percent, ahead of the annual forecast of a 2.7 percent increase.

Fall 2017 Consensus Forecasting Process

- The Joint Advisory Board of Economists (JABE) met October 11th.
 - The September standard forecast was close to the standard outlook adopted last year; however, 7 members voted for a standard minus, 2 members voted for the pessimistic, 2 members voted for the standard, and 2 members voted for the standard plus for the Virginia economy in FY18.
 - Nine members recommended the standard forecast for FY19 and FY20.
 - 3 members voted for the standard plus.
 - 1 member voted for the pessimistic forecast.
 - There was no support for the optimistic Moody's Analytics forecast.
- The Governor's Advisory Council on Revenue Estimates (GACRE) met November 20th.
 - Members evaluated JABE recommendations, revenue collections through October, and the associated revenue forecasts for the FY18-20 biennium.
 - At the GACRE meeting, 8 business members voted for the standard, 3 voted for a standard plus forecast, and 2 voted for a standard minus forecast for FY18. The members were about evenly split between the standard forecast and a standard plus or minus forecast for FY19-20.
 - Most members of the General Assembly who attended expressed caution.

GACRE Members Concurred with the JABE Recommended Forecast

- IHS Markit October U.S. standard forecast reflects economic growth similar to the Official October forecast.
 - As a result, FY18 real GDP is expected to grow 2.4 percent, personal income is expected to grow 3.5 percent, and employment is expected to grow 1.4 percent.

Key Virginia Economic Indicators

Official and October Standard Forecasts

Annual Percent Change

	Annual Percent Change		Fiscal Year		
	16	17	18	19	20
Employment					
Official (Oct '16)	2.4	1.5	1.0	0.9	0.9
Oct Standard	2.3	1.2	1.3	1.0	0.8
Personal Income					
Official (Oct '16)	4.1	3.9	4.2	4.9	4.8
Oct Standard	3.4	2.4	3.3	4.3	4.6
Wages & Salaries					
Official (Oct '16)	4.7	4.4	3.9	4.9	5.0
Oct Standard	3.8	2.7	3.6	4.4	4.0

- The October 2017 Virginia Economic Outlook for FY18-20 remains the standard forecast that is consistent with the Official (Oct '16) forecast and the advice of JABE and GACRE.

December Revenue Forecast (Introduced Budget) Is Essentially the GACRE Forecast

- Improved revenue collections through November would suggest that the GACRE forecast is conservative and in-line with the advice of the GACRE members.
- The main post-GACRE revenue adjustment was to reflect actual amnesty results.
- Some minor tax policy changes (federal tax conformity, tax enforcement and compliance) are proposed by the Governor.
- Virginia currently conforms to the federal tax code as of December 31, 2016. A bill will be introduced to set fixed state conformity as of December 1, 2017. The December 1 date avoids any effects of federal tax reform pending in Congress (Federal tax reform efforts were not finalized at the time our introduced budget bill went to press).
 - The General Assembly can address the federal tax reform and changes to the conformity bill once the impacts of federal tax reform on the state are known.

Effects of Possible Federal Tax Reform

Provisions with Positive Virginia Revenue Impact:

- Increasing federal standard deduction and eliminating personal exemptions
- Modifying the itemized deduction for home mortgage interest
- Eliminating many individual income tax deductions
- Modifying the exclusion for gains from sale of a principal residence
- Eliminating exclusions for dependent care/adoption assistance programs
- Modifying the rules regarding net operating losses
- Restricting the special rule allowing deferral of gain on like-kind exchanges
- Disallowing or modifying certain business deductions

Provisions with Negative Virginia Revenue Impact:

- Increasing the amount that small businesses may expense under IRC § 179
- Increasing the annual deduction limitation for certain charitable contributions
- Modifying the accounting methods used by certain small businesses

December General Fund Revenue Forecast

Decomposition of the December Revenue Forecast

Fiscal Years 2018 through 2020
(millions of dollars)

	FY18
<u>GACRE Revenue Forecast</u>	\$19,378.0
Total Revenue Growth: GACRE	3.7%
<u>Policy Adjustments</u>	
Tax Amnesty	(47.3)
Federal Tax Conformity	<u>(2.5)</u>
Total	(49.8)
Total General Fund Revenues	\$19,328.2
Total Revenue Growth: December	3.4%

	FY19	FY20	2019-20 Biennium
<u>GACRE Revenue Forecast</u>	\$20,091.6	\$20,881.4	\$40,973.0
Total Revenue Growth: GACRE	3.7%	3.9%	
<u>Policy Adjustments</u>			
Federal Tax Conformity	(3.3)	0.0	(3.3)
Tax Initiative to Expand Audits	7.9	10.6	18.5
Notification of Payroll System Breaches	<u>0.3</u>	<u>0.3</u>	<u>0.6</u>
Total	4.9	10.9	19.1
Total General Fund Revenues	\$ 20,096.5	\$ 20,892.3	\$ 40,988.8
Total Revenue Growth: December	4.0%	4.0%	

Note: numbers may not add due to rounding.

The Official and December Standard General Fund Forecasts

(Dollars in Millions)

December 18, 2017

	Fiscal Year 2018						2016-2018 Biennium			
	Official	December	Change	% Growth Over FY17		Official	December	Change		
				Official	December					
Withholding	\$12,103.9	\$12,313.3	\$209.4	3.3	%	3.5	%	\$23,817.2	\$24,208.7	\$391.5
Nonwithholding	3,229.7	3,147.3	(82.4)	5.9		4.3		6,278.2	6,165.8	(112.4)
Refunds	(1,943.6)	(1,968.7)	(25.1)	5.2		5.8		(3,791.6)	(3,829.7)	(38.1)
Net Individual	\$13,390.0	\$13,491.9	\$101.9	3.7		3.4		\$26,303.8	\$26,544.8	\$241.0
Sales	\$3,450.6	\$3,458.2	\$7.6	1.9		3.0		\$6,837.4	\$6,815.3	(\$22.1)
Corporate	840.6	874.0	33.4	5.8		5.7		1,634.8	1,701.0	66.2
Wills (Recordation)	407.9	407.2	(0.7)	2.3		3.3		806.5	801.6	(4.9)
Insurance	364.8	362.1	(2.7)	6.0		6.2		708.9	703.0	(5.9)
All Other Revenue	739.4	734.8	(4.6)	2.2		1.6		1,462.9	1,457.7	(5.2)
Total Revenue	\$19,193.3	\$19,328.2	\$134.9	3.4	%	3.4	%	\$37,754.3	\$38,023.3	\$269.0
A.B.C. Profits	\$103.0	\$104.1	\$1.1	(5.0)	%	(5.8)	%	\$211.4	\$214.6	\$3.2
Sales Tax (0.375%)	374.3	379.1	4.8	2.4		3.6		739.7	745.0	5.3
Transfers Per Act	163.5	139.5	(24.0)	(7.6)		(21.1)		340.5	316.4	(24.1)
Total Transfers	\$640.8	\$622.7	(\$18.1)	(1.5)	%	(4.7)	%	\$1,291.6	\$1,276.0	(\$15.6)
TOTAL GENERAL FUND	\$19,834.1	\$19,950.9	\$116.8	3.2	%	3.1	%	\$39,045.9	\$39,299.3	\$253.4

Fiscal Year 2018 Year-to-Date Revenue Collections Through November

November Year-to-Date Collections and FY18 December Forecast

Percent Growth over Prior Year

<u>Major Source</u>	<u>As a % of Total Revenues</u>	<u>YTD Actual</u>	<u>Annual Estimate</u>	<u>Variance</u>	<u>Dec-Jun Req'd to Meet Est.</u>	<u>Prior Year Dec-Jun</u>
Withholding	63.7 %	4.0 %	3.5 %	0.5 %	3.2 %	4.0 %
Nonwithholding	16.3	1.0	4.3	(3.3)	5.1	(2.3)
Refunds	(10.2)	6.1	5.8	0.3	5.7	3.7
Net Individual	69.8	3.6	3.4	0.2	3.2	2.1
Sales	17.9	4.7	3.0	1.7	2.1	4.4
Corporate	4.5	57.8	5.7	52.1	(8.0)	4.8
Wills (Recordation)	2.1	(2.4)	3.3	(5.7)	7.7	2.5
Insurance	1.9	n/a	6.2	n/a	6.2	0.5
All Other Revenue	3.8	2.0	1.6	0.4	1.5	2.2
Total	100.0 %	4.9 %	3.4 %	1.5 %	2.5 %	2.6 %

December Standard General Fund Forecast

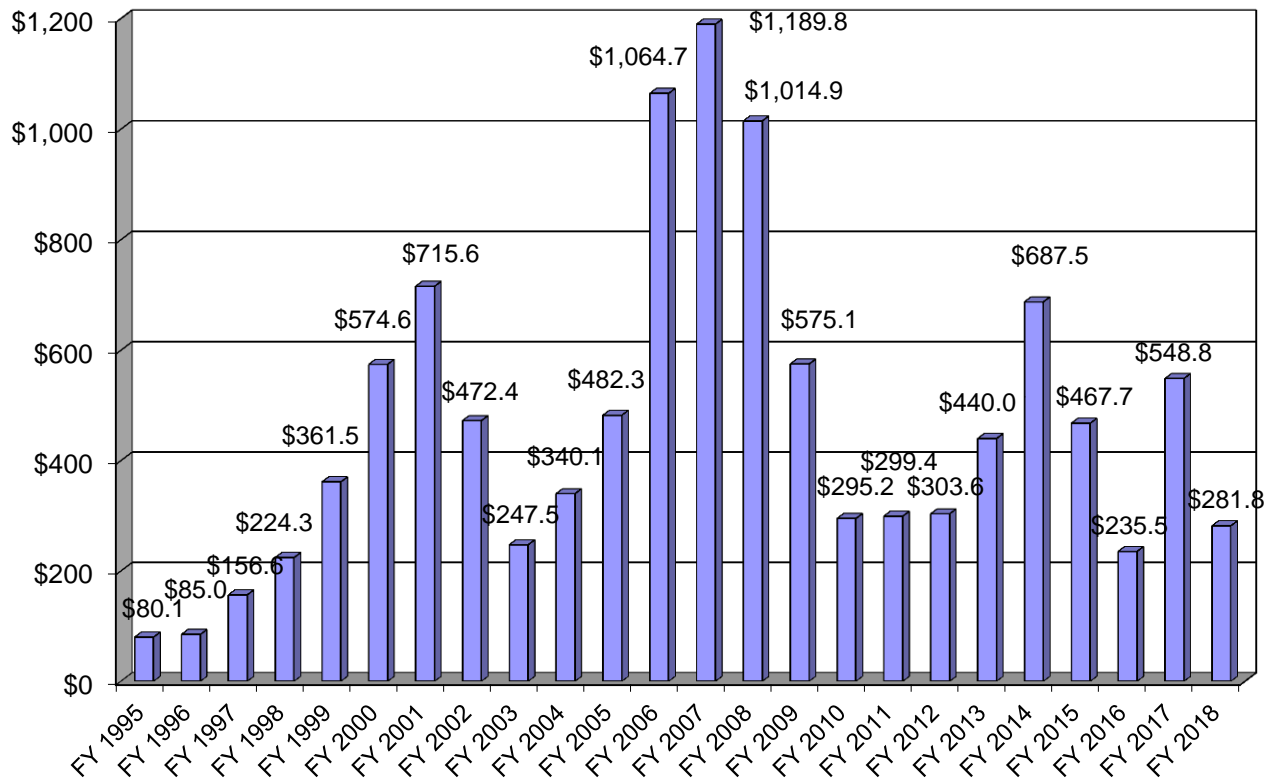
(Dollars in Millions)

December 18, 2017

	Fiscal Year 2019		Fiscal Year 2020		2018-2020 Biennium	
	December Forecast	% Growth Over FY 18	December Forecast	% Growth Over FY 19	December Forecast	% Growth Over 16-18
Withholding	\$ 12,810.2	4.0 %	\$ 13,308.5	3.9 %	\$ 26,118.7	7.9 %
Nonwithholding	3,361.5	6.8	3,631.0	8.0	6,992.5	13.4
Refunds	<u>(2,061.3)</u>	<u>4.7</u>	<u>(2,153.9)</u>	<u>4.5</u>	<u>(4,215.2)</u>	<u>10.1</u>
Net Individual	\$ 14,110.4	4.6	\$ 14,785.6	4.8	\$ 28,896.0	8.9
State Sales & Use Tax	\$ 3,547.1	2.6	\$ 3,625.0	2.2	\$ 7,172.1	5.2
Corporate Income	912.0	4.3	926.4	1.6	1,838.4	8.1
Wills (Recordation)	407.2	0.0	407.2	0.0	814.4	1.6
Insurance	376.6	4.0	384.6	2.1	761.2	8.3
All Other Revenue	<u>743.2</u>	<u>1.1</u>	<u>763.5</u>	<u>2.7</u>	<u>1,506.7</u>	<u>3.4</u>
Total Revenue	\$20,096.5	4.0 %	\$20,892.3	4.0 %	40,988.8	7.8 %
A.B.C. Profits	\$ 109.8	5.5 %	\$ 115.5	5.2 %	\$ 225.3	5.0 %
Sales Tax (0.375%)	386.7	2.0	395.2	2.2	781.9	5.0
Transfers Per Act	<u>119.2</u>	<u>(14.6)</u>	<u>115.0</u>	<u>(3.5)</u>	<u>234.2</u>	<u>(26.0)</u>
Total Transfers	\$ 615.7	(1.1) %	\$ 625.7	1.6 %	\$ 1,241.4	(2.7) %
TOTAL GENERAL FUND	\$ <u>20,712.2</u>	<u>3.8 %</u>	\$ <u>21,518.0</u>	<u>3.9 %</u>	\$ <u>42,230.2</u>	<u>7.5 %</u>

A Mandatory Deposit of \$605.6 Million Was Made to the Revenue Stabilization Fund in FY2017 As Well As A Withdrawal of \$294.7 Million. The Fund Balance was \$548.8 Million as of June 30, 2017.

Revenue Stabilization Fund – June 30 Balance
 FY1995-2017 Actual and FY 2018 Forecast
 (millions of dollars)



- Another withdrawal estimated at \$272.5 million will occur in FY2018.
- A mandatory deposit is not required to the Fund in FY 2018. Also, pending certification by the Auditor of Public Accounts, we estimate no deposit will be required in FY 2019.

Next Steps in the Revenue Forecasting Process

- The mid-session review will incorporate the latest economic and revenue data.
 - IHS Markit January U.S. economic outlook:
 - Impact of any federal budget agreements
 - Holiday retail sales
 - Key additional revenue data will be available:
 - **December 15** – due date for the fourth quarter corporate estimated income tax payment
 - **January 16** – due date for the fourth quarter individual estimated income tax payment
 - **January 22** – due date for retail sales tax collections, reflecting the main holiday shopping season
- Federal tax reform can be addressed separately, if needed, in concert with federal tax conformity legislation during the 2018 session.

APPENDIX

This presentation and the appendix data listed below are available at the Secretary of Finance website (www.finance.virginia.gov).

- U.S. Economic Indicators
- Virginia Economic Indicators
- General Fund Forecast, FY 2018-2024
- Commonwealth Transportation Fund Forecast, FY 2018-2024
- Virginia Health Care Fund Forecast, FY 2018-2024
- GACRE November Standard Revenue Forecast
- GACRE November Pessimistic Revenue Forecast
- Growth in General Fund Revenues, FY 1961-2020
- Nongeneral Fund Forecast, FY 2017-2024
- November 2017 Revenue Report