

Governor Northam's Proposed Amendments to the 2018-2020 Budget

Economic Outlook and Revenue Forecast

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

December 18, 2018



Aubrey L. Layne Jr., MBA, CPA
Secretary of Finance
Commonwealth of Virginia
www.finance.virginia.gov

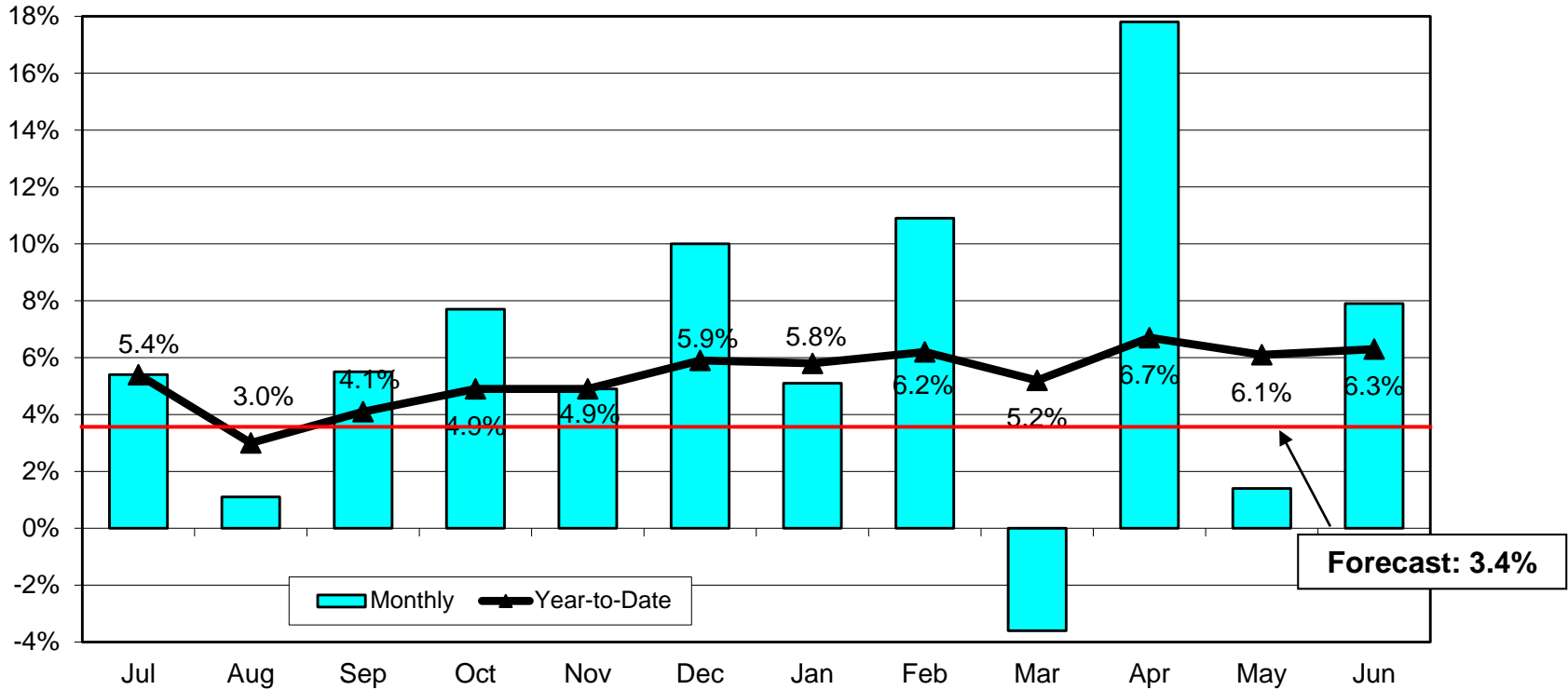
Outline

- Fiscal Year 2018 Year-in-Review
- U.S. and Virginia Economic Outlook
- December Revenue Forecast
- November Revenue Collections
- Next Steps

Fiscal Year 2018 General Fund Revenue Grew at an Average Pace of 6.3 Percent

Growth in Total General Fund Revenue Collections

FY18 Monthly and Year-to-Date



Monthly Growth: 5.4% 1.1% 5.5% 7.7% 4.9% 10.0% 5.1% 10.9% -3.5% 17.8% 1.4% 7.9%

- Total general fund revenue collections exceeded the forecast by \$552.6 million, excluding transfers in fiscal year 2018, a forecast variance of 2.9 percent.
- Total general fund revenues rose 6.3 percent, ahead of the annual forecast of 3.4 percent.

Including Transfers, Fiscal Year 2018 General Fund Resources Grew 6.0 Percent and Finished \$555.5 Million (2.8 Percent) Above Forecast

Summary of Fiscal Year 2018 Revenue Collections (millions of dollars)

Major Sources	As a % of Total General Fund				% Growth Over FY 17	
		Official	Actual	Change	Official	Actual
Withholding	61.5%	\$12,313.3	\$12,540.5	\$227.2	3.5 %	5.4 %
Nonwithholding	15.6	3,147.3	3,472.9	325.6	4.3	15.1
Refunds	(9.6)	(1,968.7)	(1,907.6)	61.1	5.8	2.5
Net Individual	67.5%	\$13,491.9	\$14,105.8	\$613.9	3.4 %	8.1 %
Sales	17.4%	\$3,458.2	\$3,461.8	\$3.6	3.0 %	3.1 %
Corporate	4.3	874.0	861.9	(12.1)	5.7	4.2
Wills (Recordation)	2.0	407.2	394.9	(12.3)	3.3	0.1
Insurance	1.8	362.1	337.9	(24.2)	6.2	(0.9)
All Other Revenue	3.7	734.8	718.5	(16.3)	1.6	(0.6)
Total Revenue	96.6%	\$19,328.2	\$19,880.8	\$552.6	3.4 %	6.3 %
A.B.C. Profits	0.6	\$104.1	\$109.5	\$5.4	(5.8) %	(0.9) %
Sales Tax (0.375%)	1.9	379.1	376.6	(2.5)	3.6	2.9
Transfers	0.9	142.1	142.2	0.1	(19.7)	(19.6)
Total Transfers	3.4%	\$625.3	\$628.3	\$3.0	(4.3) %	(3.8) %
TOTAL GENERAL FUND	100.0%	\$19,953.5	\$20,509.0	\$555.5	3.1 %	6.0 %

- The gain in net individual income tax and sales tax, about \$618 million, was somewhat offset by shortfalls in all other revenue sources.

Recent National and State Economic Indicators Suggest Continued Expansion

- According to the second estimate, real GDP grew at an annualized rate of 3.5 percent in the third quarter of 2018, down from 4.2 percent in the second quarter.
- Payroll employment growth slowed in November, rising by 155,000 jobs after adding 237,000 in October.
- The national unemployment rate remained at 3.7 percent in November.
- Initial claims for unemployment fell by 4,000 to 231,000 during the week ending December 1.
 - The four-week moving average rose by 4,250 to 228,000. Claims are volatile this time of year and the reporting period included the Thanksgiving holiday.
- The Conference Board's index of consumer confidence fell 2.2 points in November to 135.7. Confidence remains strong, with both components near their highest levels since 2000.
- The Conference Board's index of leading indicators rose 0.1 percent in October, suggesting the expansion should continue.
- Conditions in the manufacturing sector improved in November. The Institute of Supply Management index rose from 57.7 to 59.3.

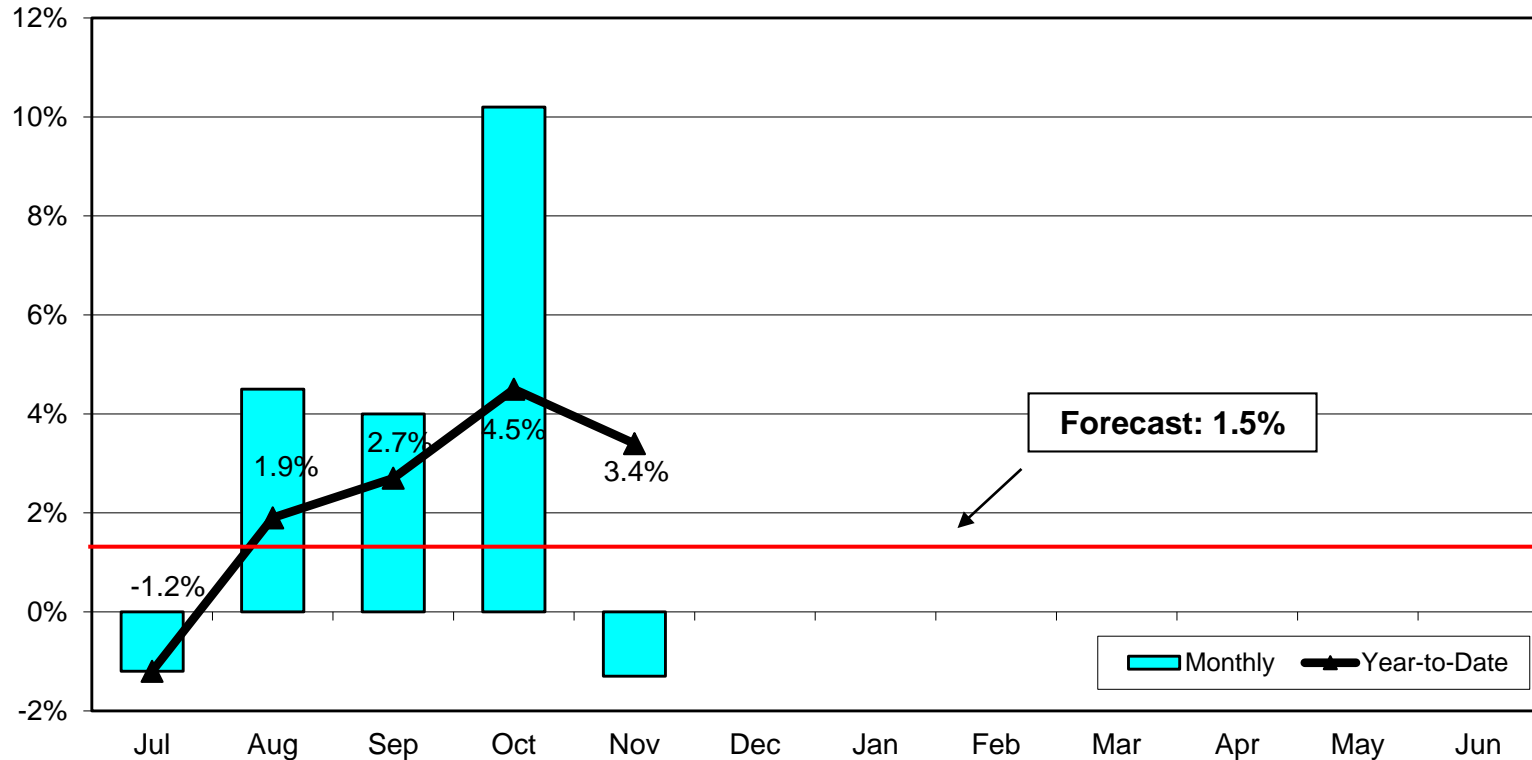
Recent National and State Economic Indicators Suggest Continued Expansion *(continued)*

- The CPI rose 0.3 percent in October after a 0.1 percent gain in September and stands 2.5 percent above October 2017.
 - Core inflation (excluding food and energy prices) rose 0.2 percent, and has increased 2.2 percent from last year.
- At its November meeting, the Federal Reserve left the federal funds rate target unchanged at 2.00 to 2.25 percent.
- In Virginia, employment growth remains solid. Payroll employment rose 2.6 percent in October from a year ago.
 - Northern Virginia posted growth of 2.7 percent, Hampton Roads grew 1.9 percent, and Richmond-Petersburg rose 2.5 percent.
 - The seasonally adjusted unemployment rate held steady at 2.9 percent and stands 0.7 percentage point below October 2017.
- The net impact of federal and state tax relief to Virginians from the *Tax Cuts and Jobs Act* (TCJA) is projected to be about \$4 billion per year.

Fiscal Year 2019 Year-to-Date Revenue Collections Through November

Growth in Total General Fund Revenue Collections

FY19 Monthly and Year-to-Date

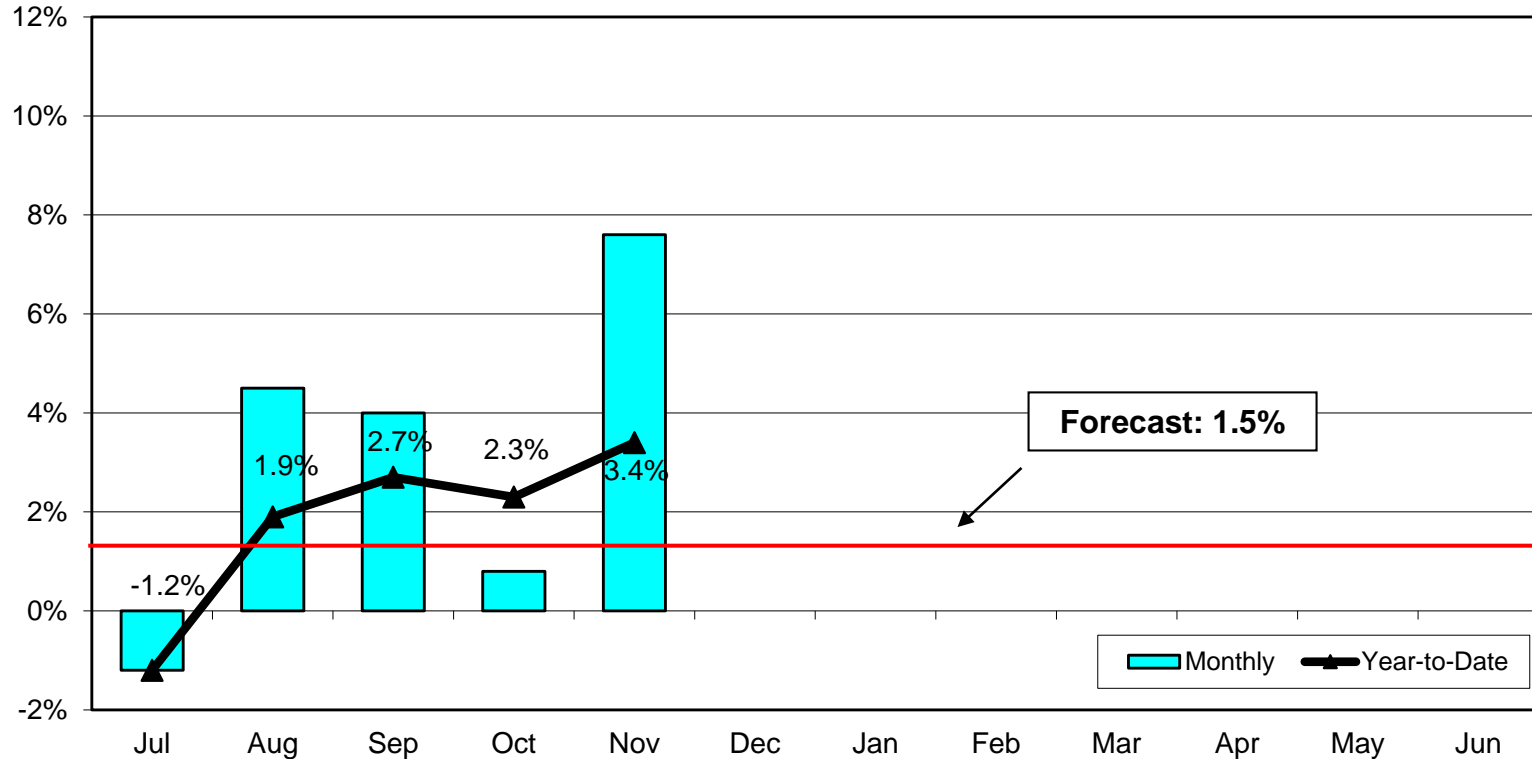


Monthly Growth: -1.2% 4.5% 4.0% 10.2% -1.3%

- Total general fund revenues decreased 1.3 percent in November.
 - Payroll withholding in November had one less deposit day.
- On a year-to-date basis, total revenues increased 3.4 percent, ahead of the annual forecast of a 1.5 percent increase.

Fiscal Year 2019 Year-to-Date Smoothed Revenue Collections Through November

Growth in Total General Fund Revenue Collections FY19 Monthly and Year-to-Date



Monthly Growth: -1.2% 4.5% 4.0% 0.8% 7.6%

- Total general fund revenues are adjusted for the extra October deposit day being counted as November revenue.
 - Each month now has the same number of deposit days.
- For illustrative purposes only.

Fall 2018 Consensus Forecasting Process

- **Joint Advisory Board of Economists (JABE)** met October 11th.
 - The September standard forecast was a bit stronger than the standard outlook adopted last year; 10 members voted for the standard, 4 members thought that Virginia would do better than the standard in the short-term, no members voted for the pessimistic, and no members supported the Moody's Analytics forecast.
- **Governor's Advisory Council on Revenue Estimates (GACRE)** met November 19th.
 - Members evaluated JABE recommendations, revenue collections through October, and the associated revenue forecasts for the FY18-20 biennium.
 - At the GACRE meeting, 11 business members voted for the standard. 1 member voted for a standard plus forecast and 1 for a standard minus forecast for the FY18-20 biennium.
 - No members were expecting a recession to start in this biennium.

GACRE Members Concurred with the JABE Recommended Forecast

- IHS Markit October U.S. standard forecast reflects economic growth slightly higher than the Official October forecast.
 - As a result, FY19 real GDP is expected to grow 3.0 percent, personal income is expected to grow 4.4 percent, and employment is expected to grow 1.6 percent.

Key Virginia Economic Indicators
Official and October Standard Forecasts
Annual Percent Change

	Fiscal Year					
	17	18	19	20	21	22
Employment						
Official (Oct. '17)	1.2	1.3	1.0	0.8	0.7	0.7
Oct. Standard		1.4	1.7	1.1	0.6	0.3
Personal Income						
Official (Oct. '17)	2.4	3.3	4.3	4.6	4.5	4.1
Oct. Standard		4.1	4.1	4.8	4.6	4.5
Wages & Salaries						
Official (Oct. '17)	2.7	3.6	4.4	4.0	4.0	4.0

- With the advice of JABE and GACRE, the October 2018 Virginia Economic Outlook for FY19-20 remains the standard forecast and is higher than the Official (Oct. '17) forecast for employment and in line with the Official forecast for the income variables.

Virginia's Economy Is Expected To Mirror National Trends in Job Growth, and Have Slightly Softer Growth in Wages

Key U.S. and Virginia Economic Indicators

U.S. October 2018 Standard and Virginia Standard Forecast
(annual percent change)

	Fiscal Year					
	17	18	19	20	21	22
Real GDP	1.9	2.6	3.0	2.4	1.7	1.5
Consumer Spending	2.6	2.5	2.9	2.6	2.3	2.0
CPI	1.9	2.2	2.6	2.4	2.4	2.4
3-Month T-bill	0.6	1.4	2.4	3.0	3.2	3.2
Employment						
U.S.	1.7	1.5	1.6	1.3	0.7	0.3
Virginia	1.0	1.4	1.7	1.1	0.6	0.3
Personal Income						
U.S.	3.4	4.5	4.4	4.9	4.5	4.3
Virginia	2.8	4.1	4.1	4.8	4.6	4.5
Wages & Salaries						
U.S.	3.7	4.8	4.6	4.8	4.6	4.4
Virginia	3.3	4.0	4.3	4.2	4.0	3.9

GACRE Revenue Forecast Is Higher As Compared to Chapter 2 – Mainly Due to Strength in Fiscal Year 2018

- Total revenue is \$408.2 million higher than the Chapter 2 Official forecast over the biennium.
- FY19 revenue growth is now at 2.6 percent as compared to the 1.5 percent growth currently required to attain the Official forecast.
- FY20 revenue growth is now at 3.7 percent as compared to the 4.0 percent growth currently required to attain the Official forecast.
- Current law and policies as reflected in Chapter 2 are assumed throughout. Highlights include:
 - AST rollback is continued consistent with enacted budget assumption.
 - Nonwithholding Collar (15.89%) is applied and limited to 1% of general fund.
 - FY19 – Reduce forecast by \$540.0 million then add back \$333.0 million to get net collar reduction of \$207.0 million
 - FY20 – Reduce forecast by \$637.0 million then add back \$423 million to get net collar reduction of \$214.0 million.
 - Fiscal year 2019 payroll withholding model adjusted for the \$120 million in June payments.
 - There were no direct revenue impacts from the TCJA or Wayfair in the GACRE forecasts.

December Revenue Forecast (*Introduced Budget*) Includes Policy Adjustments

- 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 increase the payroll withholding forecast by \$70 million per year based on collection trends.
 - Many GACRE members commented that they believed payroll growth would be stronger given the recent rise in average wages and tight labor market.
- This forecast remains more conservative than the money committees' forecasts presented at the General Assembly retreats last month.
- Some tax policy changes (federal tax conformity and Wayfair estimates) are proposed by the Governor.
- Virginia currently conforms to the federal tax code as of December 1, 2017. A bill will be introduced to set fixed state conformity as of December 31, 2018.
 - The budget introduced today includes fully conforming to the IRS Code.

Fiscal Year Cash Flow of Almost \$600 Million per Year However, Significant Amount Is Not Permanent and Comes with Unknowns

Estimated Virginia Revenue Impact of the TCJA

Fiscal Years 2019 to 2024 (Includes Residents and Nonresidents)

	(\$Millions)					
By Source	2019	2020	2021	2022	2023	2024
Individual Provisions	532.1	443.8	466.7	492.5	520.0	546.1
Business Provisions	29.4	114.6	181.5	300.3	417.2	398.2
International Provisions	32.6	52.7	5.5	5.8	6.0	6.3
Total, All Provisions	594.2	611.1	653.7	798.7	943.2	950.6

	(\$Millions)					
By Provisions	2019	2020	2021	2022	2023	2024
Temporary Provisions (Expiring after 2025)	517.3	433.6	455.7	480.4	506.8	532.5
Permanent Provisions	76.9	177.5	198.0	318.3	436.4	418.1
Total, All Provisions	594.2	611.1	653.7	798.7	943.2	950.6

- Most of the individual provisions are temporary and expire after 2025; the only substantial individual provision that is permanent is related to alternative inflation measures.
- Due to the likely timing of Virginia's conformity to the federal provisions, the full impact for Taxable Year 2018 is recognized in fiscal year 2019.
- Nonresidents account for approximately 11% of revenues.

Internet Sales (*Wayfair*)

Estimated Revenue Impact by Fund (millions of dollars)

State Sales and Use Tax (5.3% net of Dealer Discount)	5.280%	\$ 144.9
GF - Unrestricted ⁽¹⁾	2.015%	\$ 55.3
GF - Restricted 1% Education ⁽²⁾	0.990%	\$ 27.2
Education School Age 1/8% (GF transfer from Restricted)	0.125%	\$ 3.4
Education SOQ 1/4% (GF transfer from Unrestricted)	0.250%	\$ 6.9
Transportation ⁽³⁾	0.800%	\$ 22.0
HMOF (GF transfer)	0.100%	\$ 2.7
Local Option	1.000%	\$ 27.4
Regional Trans. Funds (0.7%) ⁽⁴⁾	0.367%	\$ 10.1
Hampton Roads (TPO)	0.127%	\$ 3.5
Northern Virginia (NVTA)	0.240%	\$ 6.6
Total Sales and Use Tax ⁽⁴⁾	5.647%	\$ 155.0

Notes:

- 1) Includes: 2.025% General Fund Unrestricted, -0.01% Dealer Discount.
- 2) Includes: 1% Education based on school age population, -0.01% Dealer Discount.
- 3) Includes 0.5% TTF, 0.175% HMOF, 0.050% IPROCF, and 0.075% Mass Transit Fund.
- 4) The assumed state, local and regional sales and use blended tax rate is 5.65%, after dealer discount.

December General Fund Revenue Forecast

Composition of the December Revenue Forecast Fiscal Years 2019 and 2020 (millions of dollars)

	FY19	FY20	2019-20 Biennium
<u>GACRE Revenue Forecast</u>	\$20,400.1	\$21,158.0	\$41,558.1
Total Revenue Growth: GACRE	2.6%	3.7%	
<u>Revenue Adjustments</u>			
Payroll Withholding Forecast	70.0	70.0	140.0
<u>Revenue Policy Adjustments</u>			
Wayfair internet sales (unrestricted amount)		55.3	55.3
Wayfair internet sales (restricted K-12 amount)		27.2	27.2
Federal tax conformity - permanent	76.9	177.5	254.4
Federal tax conformity - expires after 2025	517.3	433.6	950.9
Refundable Earned Income Tax Credit	(10.3)	(206.0)	(216.3)
Accelerated Sales Tax -- increase threshold to \$10 million		(27.2)	(27.2)
Miscellaneous minor actions	(3.4)	0.6	(2.8)
Total	650.5	531.0	1,181.5
Total General Fund Revenues	\$ 21,050.6	\$ 21,689.0	\$42,739.6
Total Revenue Growth	5.9%	3.0%	

Note: numbers may not add due to rounding.

Official and December Standard General Fund Forecasts

(Dollars in Millions)

12/18/2018

Major Sources	Fiscal Year 2018		Fiscal Year 2019				
	Actual	% Growth	Official	December	Change	% Growth Over FY 18	
						Official	December
Withholding	\$12,540.5	5.4 %	\$12,870.2	\$13,013.9	\$143.7	2.6 %	3.8
Nonwithholding	3,472.9	15.1	3,368.3	4,001.0	632.7	(3.0)	15.2
Refunds	<u>(1,907.6)</u>	<u>2.5</u>	<u>(2,054.7)</u>	<u>(1,969.7)</u>	<u>85.0</u>	<u>7.7</u>	<u>3.3</u>
Net Individual	\$14,105.8	8.1 %	\$14,183.8	\$15,045.2	\$861.4	0.6 %	6.7 %
Sales	\$3,461.8	3.1 %	\$3,547.3	\$3,591.1	\$43.8	2.5 %	3.7 %
Corporate	861.9	4.2	912.0	910.5	(1.5)	5.8	5.6
Wills (Recordation)	394.9	0.1	407.2	368.6	(38.6)	3.1	(6.7)
Insurance	337.9	(0.9)	376.6	395.3	18.7	11.4	17.0
All Other Revenue	\$ <u>718.5</u>	<u>(0.6)</u>	<u>746.8</u>	<u>739.9</u>	<u>(6.9)</u>	<u>3.9</u>	<u>3.0</u>
Total Revenue	\$19,880.8	6.3 %	\$20,173.7	\$21,050.6	\$876.9	1.5 %	5.9 %
A.B.C. Profits	\$ <u>\$109.5</u>	<u>(0.9) %</u>	\$109.8	<u>\$112.9</u>	\$3.1	0.3 %	3.1 %
Sales Tax (0.375%)	376.6	2.9	386.7	390.0	3.3	2.7	3.6
Transfers	<u>142.2</u>	<u>(19.6)</u>	<u>124.5</u>	<u>119.2</u>	<u>(5.3)</u>	<u>(12.4)</u>	<u>(16.2)</u>
Total Transfers	\$ <u>\$628.3</u>	<u>(3.8) %</u>	\$621.0	\$622.1	\$1.1	(1.2) %	(1.0) %
TOTAL GENERAL FUND	\$ <u>\$20,509.0</u>	6.0 %	\$20,794.7	\$21,672.7	\$878.0	1.4 %	5.7 %

Official and December Standard General Fund Forecasts

(Dollars in Millions)

December 18, 2018

	Fiscal Year 2020						2018-2020 Biennium		
	Official	December	Change	% Growth Over FY19		Official	December	Change	
				Official	December				
Withholding	\$13,368.5	\$13,539.7	\$171.2	3.9 %	4.0 %	\$26,238.7	\$26,553.6	\$314.9	
Nonwithholding	3,635.0	4,118.1	483.1	7.9	2.9	7,003.3	8,119.1	1,115.8	
Refunds	(2,147.3)	(2,277.3)	(130.0)	4.5	15.6	(4,202.0)	(4,247.0)	(45.0)	
Net Individual	\$14,856.2	\$15,380.5	\$524.3	4.7	2.2	\$29,040.0	\$30,425.7	\$1,385.7	
Sales	\$3,625.2	\$3,731.1	\$105.9	2.2	3.9	\$7,172.5	\$7,322.2	\$149.7	
Corporate	926.4	1,043.5	117.1	1.6	14.6	1,838.4	1,954.0	115.6	
Wills (Recordation)	407.2	368.6	(38.6)	0.0	0.0	814.4	737.2	(77.2)	
Insurance	397.6	410.3	12.7	5.6	3.8	774.2	805.6	31.4	
All Other Revenue	763.6	755.0	(8.6)	2.2	2.0	1,510.4	1,494.9	(15.5)	
Total Revenue	\$20,976.2	\$21,689.0	\$712.8	4.0 %	3.0 %	\$41,149.9	\$42,739.6	\$1,589.7	
A.B.C. Profits	\$115.5	\$117.2	\$1.7	5.2 %	3.8 %	\$225.3	\$230.1	\$4.8	
Sales Tax (0.375%)	395.2	409.3	14.1	2.2	4.9	781.9	799.3	17.4	
Transfers Per Act	120.3	103.8	(16.5)	(3.4)	(12.9)	244.8	223.0	(21.8)	
Total Transfers	\$631.0	\$630.3	(\$0.7)	1.6 %	1.3 %	\$1,252.0	\$1,252.4	\$0.4	
TOTAL GENERAL FUND	\$21,607.2	\$22,319.3	\$712.1	3.9 %	3.0 %	\$42,401.9	\$43,992.0	\$1,590.1	

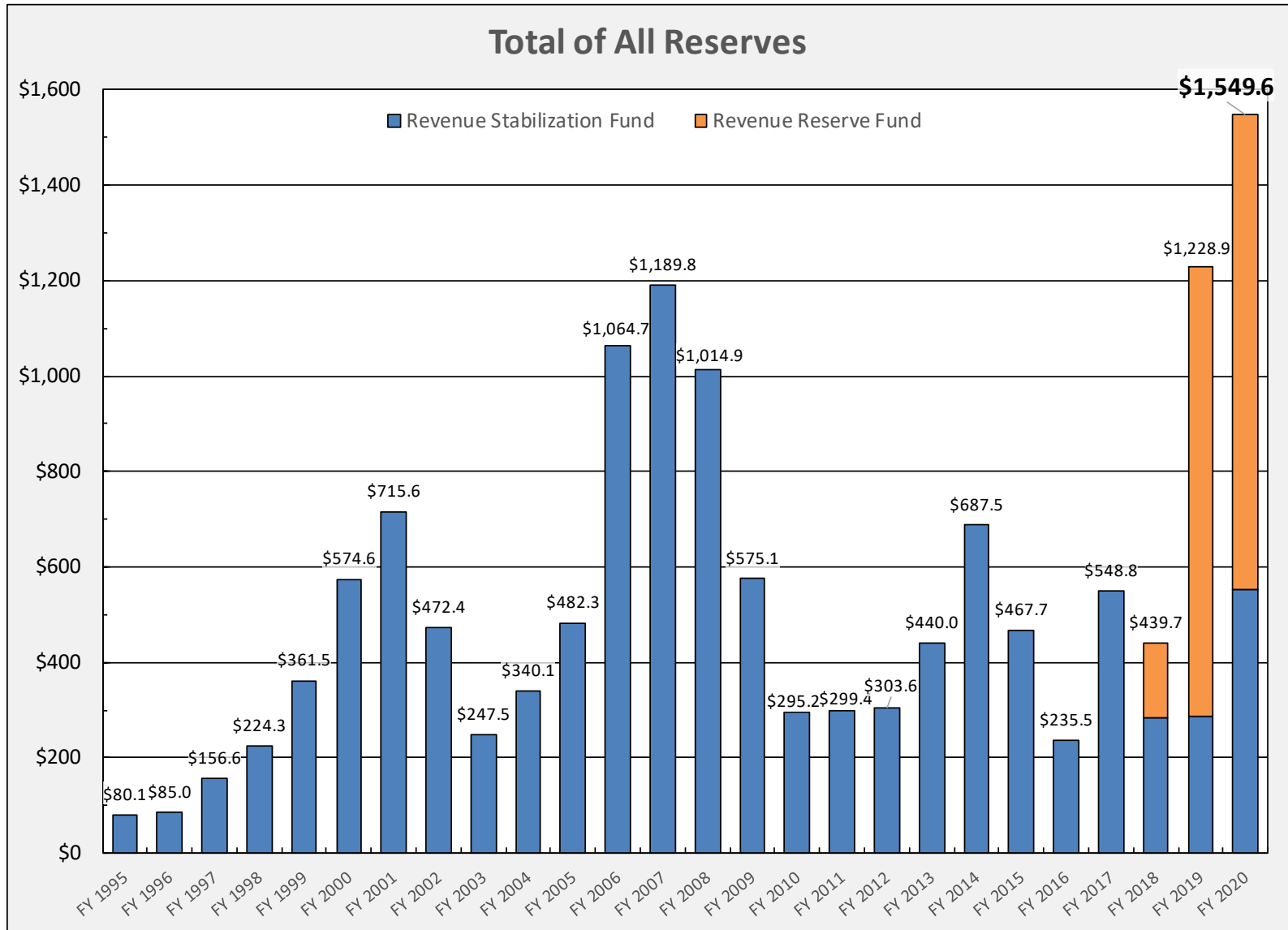
Fiscal Year 2019 Year-to-Date Revenue Collections Through November

November Year-to-Date Collections and FY19 December Forecast

Percent Growth over Prior Year

<u>Major Source</u>	As a % of Total <u>Revenues</u>	<u>YTD</u> <u>Actual</u>	<u>Annual</u> <u>Estimate</u>	<u>Variance</u>	<u>Dec-Jun Req'd</u> <u>to Meet Est.</u>	<u>Prior Year</u> <u>Dec-Jun</u>
Withholding	61.8 %	3.0 %	3.8 %	(0.8) %	4.3 %	6.3 %
Nonwithholding	19.0	12.2	15.2	(3.0)	15.9	18.8
Refunds	(9.4)	6.1	3.3	2.8	2.8	2.0
Net Individual	71.5	3.9	6.7	(2.8)	8.3	11.0
Sales	17.1	4.1	3.7	0.4	3.5	2.3
Corporate	4.3	(14.2)	5.6	(19.8)	14.8	(9.9)
Wills (Recordation)	1.8	(6.0)	(6.7)	0.7	(7.2)	2.1
Insurance	1.9	na	17.0	na	17.0	(0.9)
All Other Revenue	3.5	13.2	3.0	10.2	(2.1)	(1.9)
Total	100.0 %	3.4 %	5.9 %	(2.5) %	7.3 %	7.2 %

By the Close of FY 2020, Total Reserves Are Estimated to Exceed **\$1.5 Billion**, the Largest Total in History



Ongoing Versus One-Time General Fund Revenues

FY2019-FY2020 Revenues

(millions of dollars)

Revenue Source	FY19			FY20			Biennium Total		
	Ongoing	One-Time	Total	Ongoing	One-Time	Total	Ongoing	One-Time	Total
Chapter 2	\$20,173.7		\$20,173.7	\$20,976.2		\$20,976.2	\$41,149.9		\$41,149.9
GACRE November Standard	\$ 226.4		\$ 226.4	\$ 181.8		\$ 181.8	\$ 408.2		\$ 408.2
Post-GACRE revenue adjustments	\$ 70.0		\$ 70.0	\$ 70.0		\$ 70.0	\$ 140.0		\$ 140.0
Federal Tax Conformity	\$ 76.9	\$517.3	\$ 594.2	\$ 177.5	\$ 433.6	\$ 611.1	\$ 254.4	\$ 950.9	\$ 1,205.3
Wayfair internet sales tax				\$ 82.5		\$ 82.5	\$ 82.5		\$ 82.5
Refundable EITC		\$ (10.3)	\$ (10.3)		\$ (206.0)	\$ (206.0)		\$ (216.3)	\$ (216.3)
Accelerated Sales Tax - \$10m					\$ (27.2)	\$ (27.2)		\$ (27.2)	\$ (27.2)
Miscellaneous		\$ (3.4)	\$ (3.4)	\$ 0.6		\$ 0.6	\$ 0.6	\$ (3.4)	\$ (2.8)
Total Revenues	\$20,547.0	\$503.6	\$21,050.6	\$21,488.6	\$ 200.4	\$21,689.0	\$42,035.6	\$ 704.0	\$42,739.6

Note: numbers may not add due to rounding.

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 17** – due date for the fourth quarter corporate estimated income tax payment
 - **January 15** – 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 conformity needs to be passed as soon as possible.**

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 2019-2026
- Commonwealth Transportation Fund Forecast, FY 2019-2024
- Virginia Health Care Fund Forecast, FY 2019-2026
- GACRE November Standard Revenue Forecast
- GACRE November Pessimistic Revenue Forecast
- Growth in General Fund Revenues, FY 1961-2020
- Nongeneral Fund Forecast, FY 2018-2024
- November 2018 Revenue Report