ECONOMIC AND REVENUE REVIEW AND UPDATE

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January 2023

TOPICS FOR DISCUSSION

DECEMBER FORECAST OVERVIEW

DECEMBER FISCAL YEAR-TO-DATE REVENUE COLLECTIONS

COLLECTION BY MAJOR SOURCES AND DRIVERS

KEY DATES AND NEXT STEPS

THE DECEMBER FORECAST ASSUMED THAT ECONOMIC GROWTH WOULD BEGIN TO SLOW IN FY 2023 AND TURN NEGATIVE IN FY 2024

Key U.S. and Virginia Economic Indicators
(annual percent change)

GDP	FY 2022	FY 2023	FY 2024
GACRE	4.0%	0.1%	0.3%
December		0.4%	-0.5%
US Employment	FY 2022	FY 2023	FY 2024
GACRE	4.5%	2.2%	-1.5%
December		2.4%	-2.4%
Virginia Employment	FY 2022	FY 2023	FY 2024
GACRE	3.2%	2.4%	-0.4%
December		2.5%	-1.2%
Virginia Wage Income	FY 2022	FY 2023	FY 2024
GACRE	8.0%	8.0%	3.8%
December		8.3%	2.6%

Source: Virginia Dept. of Taxation, IHS Markit

- The updated December forecast assumes a three-quarter recession beginning in the third quarter of Fiscal Year 2023.
- Despite the projected economic slowdown, the proposed budget still anticipates a general fund balance of more than $3.6 billion at the end of FY 2023.
- Fiscal year-to-date through December, overall general fund revenues are ahead of Plan by $79 million.

REVENUE GROWTH IS ALSO FORECAST TO SLOW SIGNIFICANTLY PARTICULARLY IN VOLATILE NON-WITHOLDING TAXES

Tax Revenue by Major Source

(annual percent change)

	FY 2022	FY 2023	FY 2024
Withholding	9.5%	4.8%	-0.3%
Non-withholding	30.5%	-25.3%	-9.9%
Refunds	-9.6%	103.1%	-46.7%
State Sales & Use Tax	9.4%	8.1%	-1.0%
Corporate Income	30.5%	-8.6%	-19.2%
All Other	5.0%	1.6%	-9.1%
TOTAL	**16.3%**	**-8.8%**	**1.9%**

Source: Virginia Dept. of Taxation

The revenue forecast includes the impacts of all proposed policy changes, including:

- Increasing the standard deduction to $9k/$18k and reducing the top individual income tax rate to 5.5 percent;
- Reducing the corporate income tax rate to 5.0 percent and increasing the business interest expense deduction;
- Creating a 10-percent Qualified Business Income deduction; and
- Removing the age restriction on the military retirement income subtraction.

DECEMBER FISCAL YEAR-TO-DATE SUMMARY:

- Relative to the updated December forecast, unadjusted general fund revenues are ahead of forecast by $79 million year-to-date. After two months of actuals, Department of Taxation continues to be comfortable with the December forecast.
- Accounting for timing and policy adjustments to better estimate underlying economic growth, general fund revenues fiscal year-to-date through December are 6.5 percent higher compared to the previous year. For the month alone, adjusted general fund revenues were 0.7 percent higher compared to December FY 2022.
- Among the major revenue sources, after adjustments for timing and policy actions, withholding is 7.9 percent higher fiscal year-to-date, and sales tax revenue is 6.4 percent higher. Non-withholding is 13.1 percent higher year-to-date.
- Corporate income taxes, however, are running 15.7 percent lower in the first six months of FY 2023 compared to the previous year. All other sources of revenue are 5.0 percent higher with strength in interest income offsetting weakness in wills and deed recordation taxes.
- Major policy and timing adjustments contributing to revenue growth include the AST and the newly enacted Pass-Through Entity Tax (PTET) which combined added $519 million to collections fiscal year-to-date. These are offset by tax rebates and changes to the standard deduction which subtracted $1.23 billion for a net reduction of $718 million in the first six months of FY 2023.
- December's PTET revenue will result in an offsetting credit on income taxes later this year, making this revenue neutral for the fiscal year.
- On an unadjusted basis versus prior year, total general fund revenues were up 0.8 percent fiscal year-to-date and 8.1 percent for the month of December. The unadjusted figures are reflected in the underlying budget which does not strip out policy nor timing impacts.

ON AN UNADJUSTED BASIS, GF REVENUES WERE 8.1 PERCENT HIGHER IN DECEMBER AND 0.8 PERCENT YEAR-TO-DATE COMPARED TO THE PRIOR YEAR

Unadjusted Revenues	FY 2023 December	Pct Chg Req by Est	Percent of GF Rev	DECEMBER FY 2022	DECEMBER FY 2023	DECEMBER Change	% Change	Fiscal Year-To-Date FY 2022	Fiscal Year-To-Date FY 2023	Fiscal Year-To-Date Change	% Change	Year-To-Date % of Total
Withholding	$16,078.3	4.8%	60.9%	$1,520.1	$1,386.3	($133.8)	-8.8%	$7,426.4	$7,832.4	$406.0	5.5%	62.7%
Nonwithholding	$5,088.6	-25.3%	19.3%	$183.0	$595.7	412.7	225.5%	$1,342.8	$1,909.5	566.7	42.2%	15.3%
Refunds	($3,535.2)	103.1%	-13.4%	($38.6)	($65.0)	(26.3)	68.2%	($342.4)	($1,378.5)	(1,036.1)	302.6%	-11.0%
Sales and Use Tax	4,926.3	8.1%	18.7%	398.3	$417.2	18.9	4.7%	$2,124.9	$2,404.4	279.5	13.2%	19.3%
Corporate Income Tax	1,809.1	-8.6%	6.9%	410.2	$340.8	(69.4)	-16.9%	$1,012.4	$853.0	(159.4)	-15.7%	6.8%
All Other Sources	2,020.7	1.7%	7.7%	226.1	242.6	16.5	7.3%	$824.5	$866.0	41.5	5.0%	6.9%
Total GF Revenues	**$26,387.8**	**-8.8%**	100.0%	**$2,699.0**	**$2,917.6**	**$218.6**	**8.1%**	**$12,388.6**	**$12,486.8**	**$98.2**	**0.8%**	**100.0%**

Adjusted Revenues	DECEMBER FY 2022	DECEMBER FY 2023	DECEMBER Change	% Change	Fiscal Year-To-Date FY 2022	Fiscal Year-To-Date FY 2023	Fiscal Year-To-Date Change	% Change
Adjusted Withholding	$1,520.1	$1,569.8	$49.8	3.3%	$7,426.4	$8,012.6	$586.2	7.9%
Adjusted Non-Withholding (PTET)	$183.0	$204.9	$21.9	12.0%	$1,342.8	$1,518.7	$175.9	13.1%
Adjusted Refunds (Rebates)	($38.6)	($56.8)	($18.1)	47.0%	($342.4)	($392.3)	($49.9)	14.6%
Adjusted Sales (AST)*	-	-	-		$2,328.3	$2,477.6	$149.3	6.4%
Total GF Revenues, Adjusted	**$2,699.0**	**$2,718.8**	**$19.8**	**0.7%**	**$12,592.0**	**$13,408.7**	**$816.7**	**6.5%**

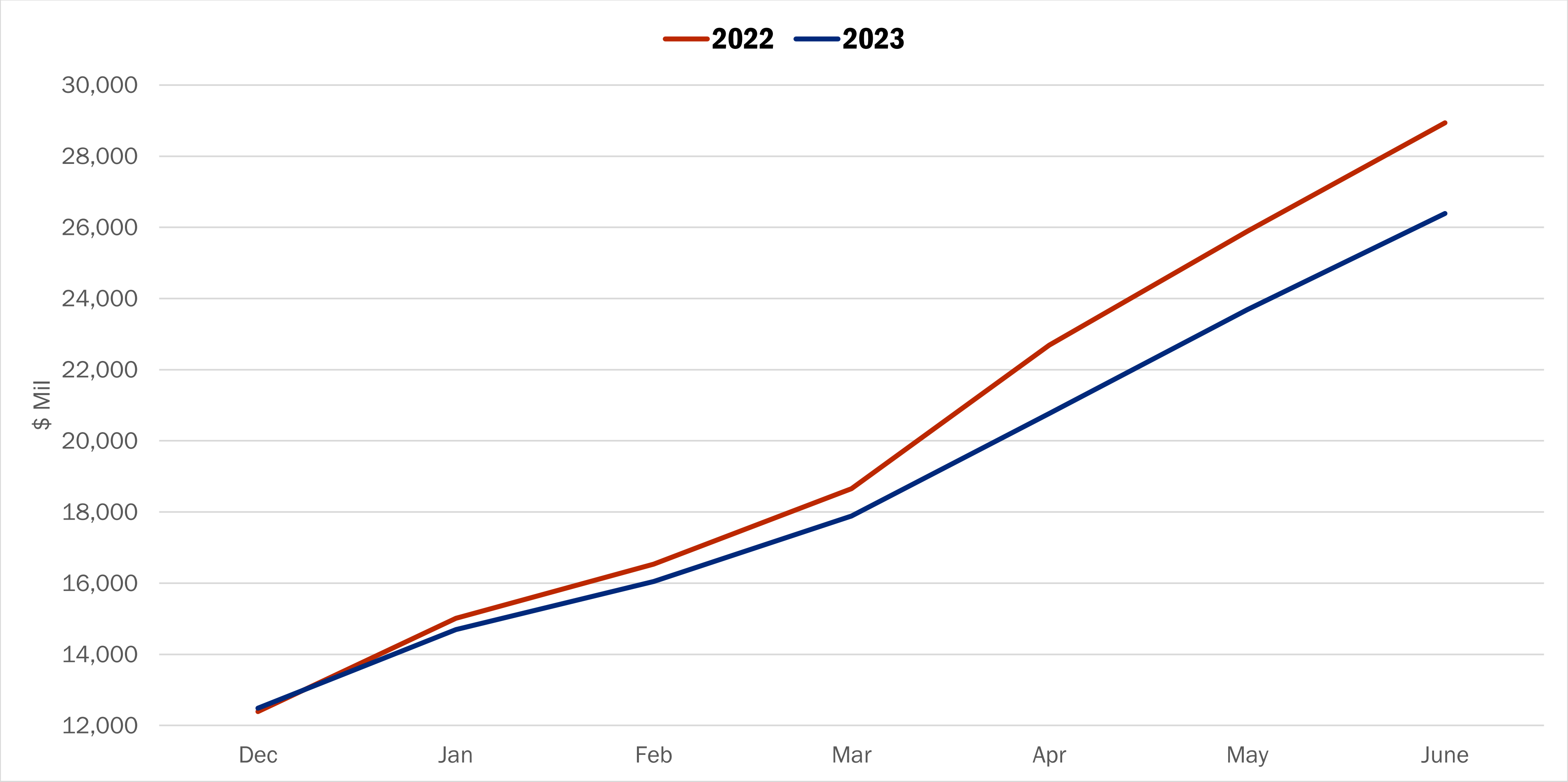
- The newly enacted PTET tax boosted collections by nearly $391 million in December. December PTET collections will however result in lower collections in payments throughout the remainder of the year as the PTET is structured to provide equivalent offsetting credits to individual income tax.
- Overall policy and timing impacts have subtracted $718 million to underlying base revenue growth, which was included in the forecast.

DECEMBER AND YEAR-TO-DATE COLLECTIONS EXCEEDED PROJECTIONS BY $39.1 AND $79.3 MILLION

	DECEMBER			YEAR-TO-DATE		
SOURCE $ Mil	Actuals	Projected	Variance	Actuals	Projected	Variance
Withholding	$1,386.3	$1,357.9	$28.4	$7,832.4	$7,814.9	$17.5
Non-withholding	595.7	566.6	29.1	1,909.5	1,834.3	75.2
IIT Refunds	(65.0)	(49.8)	(15.2)	(1,378.5)	(1,346.2)	(32.3)
Net Individual Income	1,917.0	1,874.8	72.7	8,363.3	8,303.0	60.4
Sales/Use	417.2	428.4	(11.2)	2,404.4	2,415.4	(11.0)
Corporate	340.8	361.6	(20.8)	853.0	862.2	(9.2)
All other	242.6	213.7	28.8	866.0	826.9	39.1
Total Revenues	**$2,917.6**	**$2,878.5**	**$39.1**	**$12,486.8**	**$12,407.5**	**$79.3**

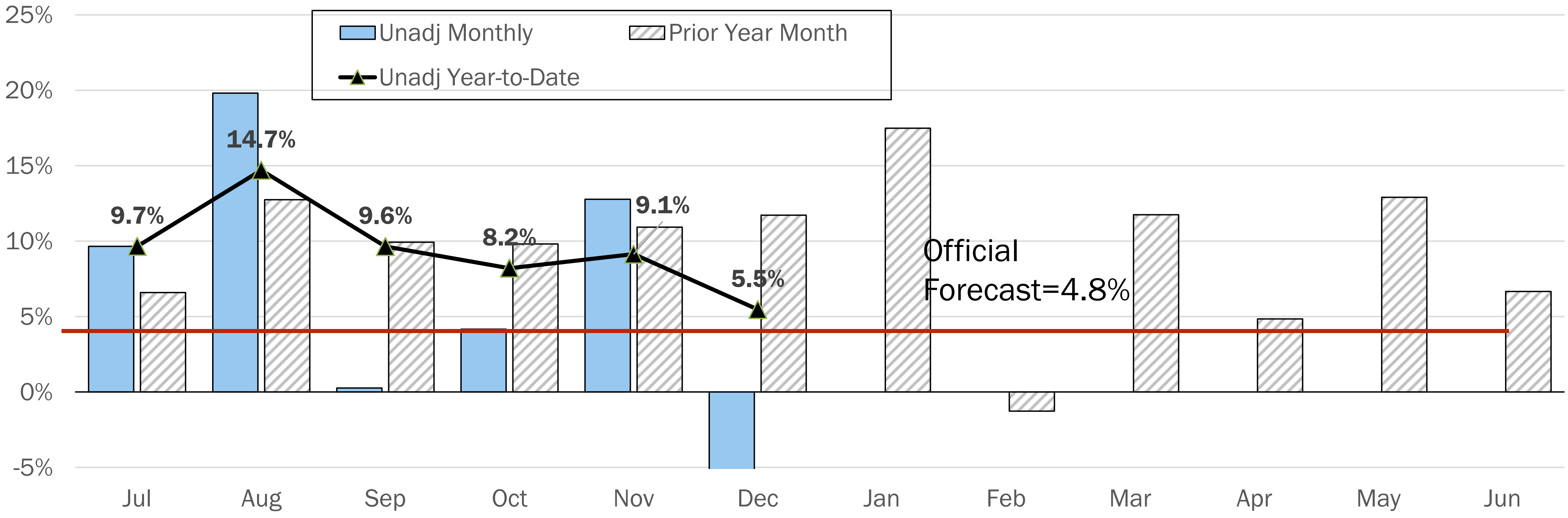
- The positive variance is mainly due to higher than expected collections for non-withholding and other (interest income). Corporate income and sales taxes are running below projections.

THE FORECAST ASSUMES THAT REVENUE GROWTH WILL SLOW SIGNIFICANTLY IN THE COMING MONTHS COMPARED TO FY 2022



The last quarter of the fiscal year, in particular, accounts for 35 percent of all fiscal year revenues. Revenues in Q4 FY 2023 are forecast to be $1.8 billion lower compared to Q4 FY 2022.

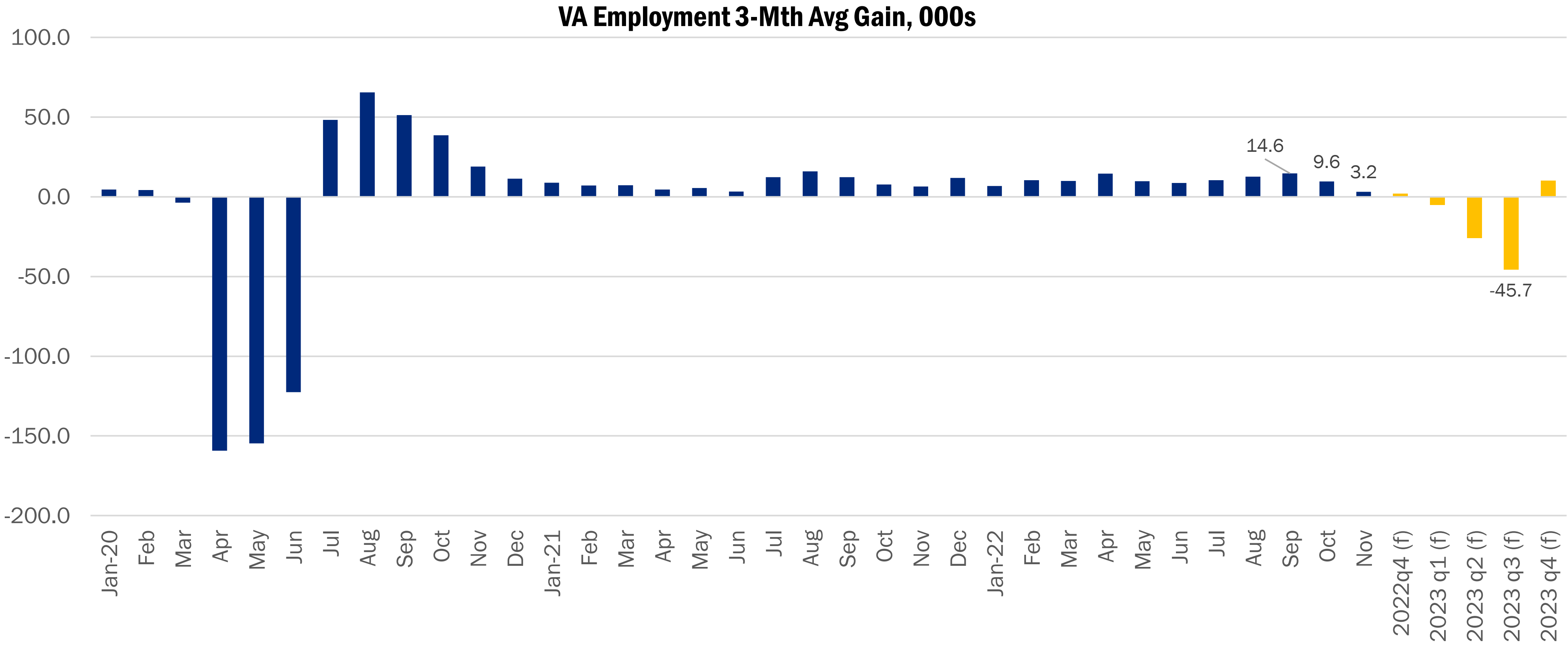
AS EXPECTED, VIRGINIA'S LABOR MARKET IS SLOWING, CONTRIBUTING TO SLOWER GROWTH IN WITHHOLDING COLLECTIONS



- After adjusting for the increased standard deduction, December collections are 7.9 percent higher year-to-date. Growth has slowed from nearly 10 percent at the beginning of the fiscal year.

MIRRORING NATIONAL TRENDS, EMPLOYMENT GROWTH IN VIRGINIA HAS SLOWED TO 3,000 JOBS ON AVERAGE IN THE LATEST 3-MONTH PERIOD COMPARED TO 15,000 EARLIER THIS SUMMER

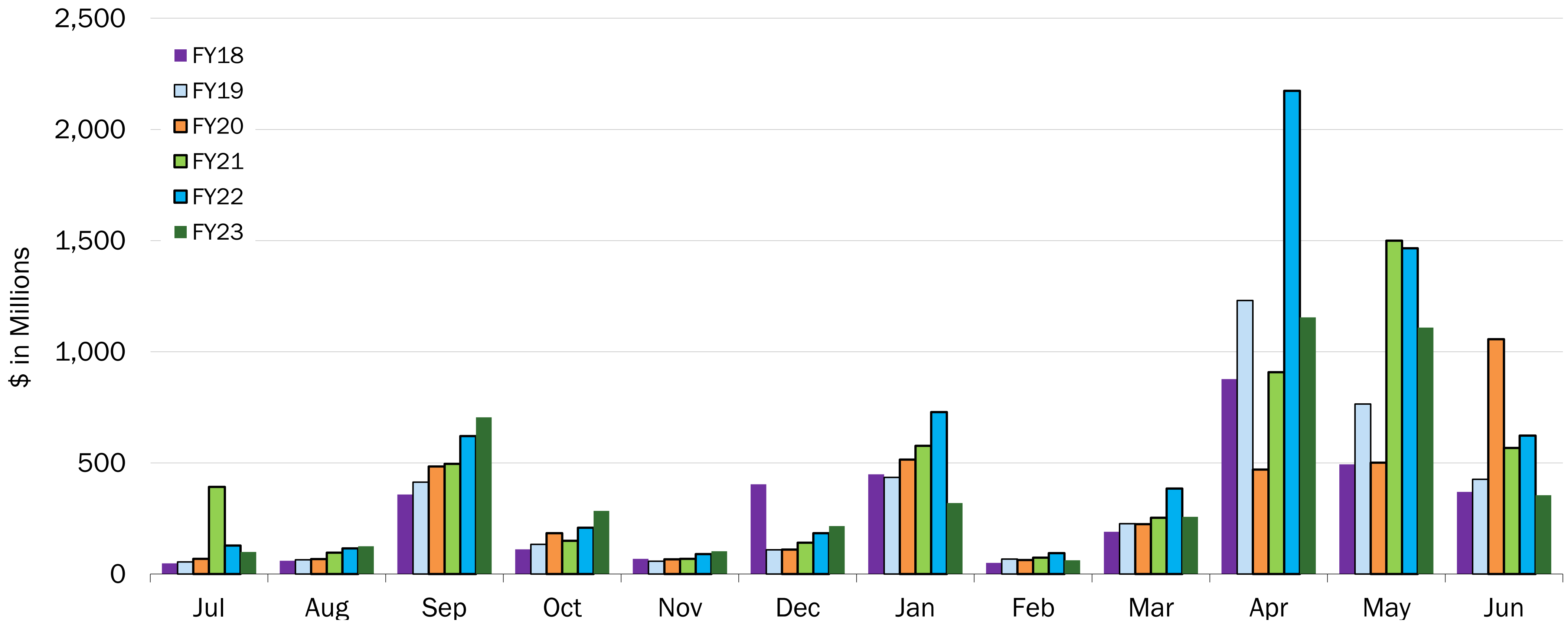
The recent slowdown is consistent with our updated December projections of slowing growth with losses peaking at 46,000 jobs in 2023q3, before growth resumes in 2023q4



Sources: US BLS, Virginia Dept. of Taxation

NON-WITHHOLDING TAX COLLECTIONS ARE RUNNING 13.1 PERCENT HIGHER YEAR-TO-DATE COMPARED TO THE PREVIOUS YEAR

There is still considerable uncertainty surrounding non-withholding collections because the bulk of collections occur in Q4. As shown above, the forecast anticipates sharp declines to occur in the coming months.



PASS THROUGH ENTITY TAX:

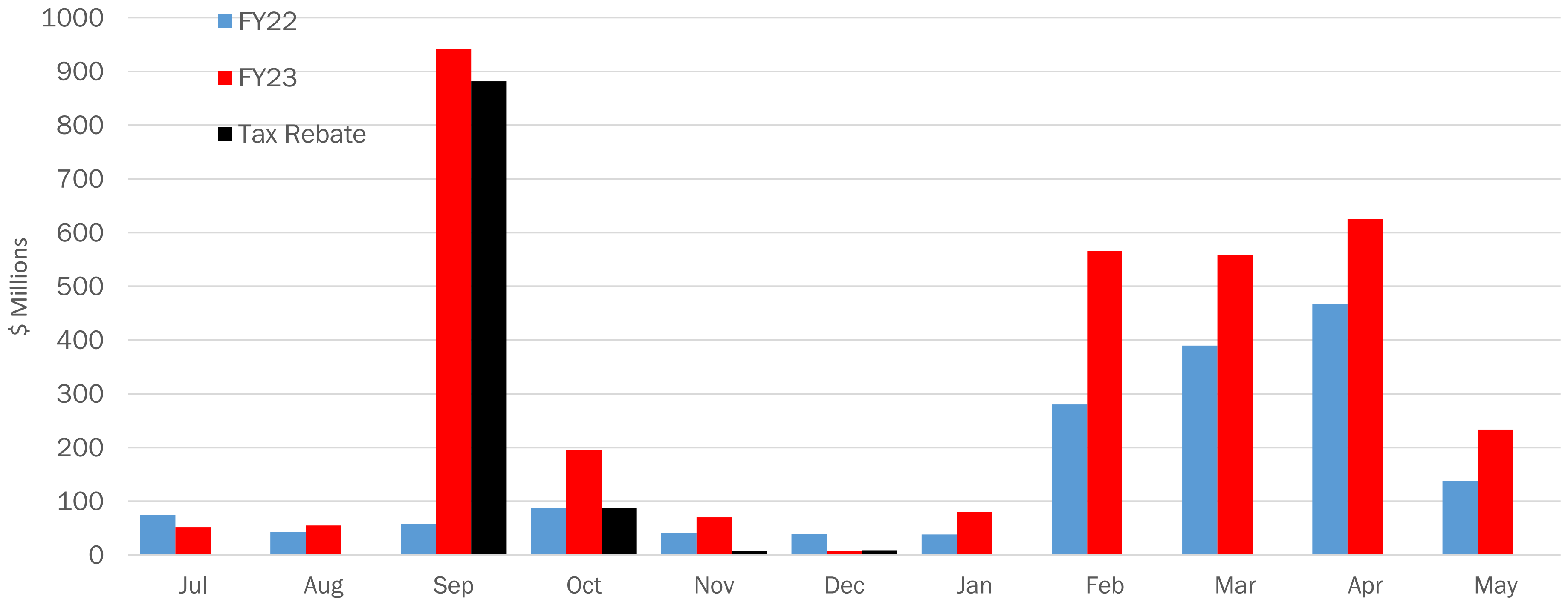
- As structured, the PTET is an optional tax that allows electing eligible unincorporated business filers (partnerships and S-corps) to pay at the entity level where the $10,000 state and local deduction cap imposed by the Tax Cuts and Jobs Act does not apply.

- Since this is the first year of implementation of the PTET in Virginia (SB 682, Petersen, and HB 1121, McNamara), and in order to meet the tax year deadline of December 31, 2022, to fully deduct state and local taxes, this month saw significant collections of PTET.

- It should be noted that the PTET tax is offset by a credit against Virginia individual income tax. PTET revenues realized in December will result in corresponding lower individual income tax payments in the remainder of the year as incorporated in the revenue forecast.

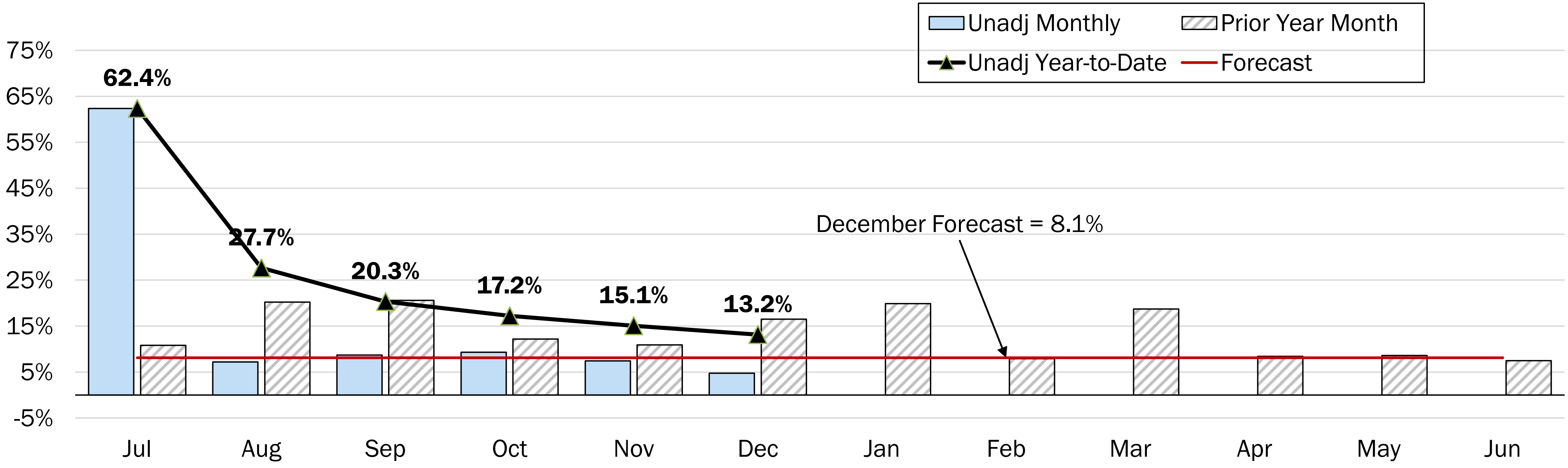
- There is no net effect on state tax liability from the PTET. Taxpayers benefit from lower federal tax liability.

INCOME TAX REFUNDS SO FAR HAVE BEEN DOMINATED BY THE TAX REBATES ISSUED. REFUNDS ARE EXPECTED TO RAMP UP WITH THE TAX FILING SEASON



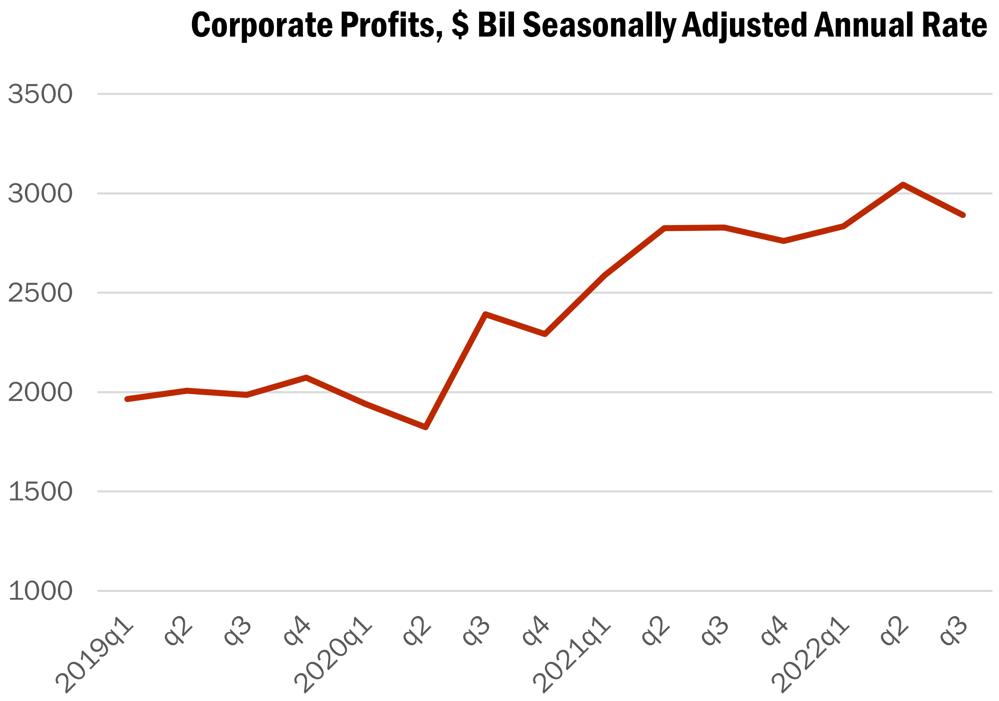
- Through December, rebates have totaled over $1.06 billion dollars.
- Refunds are expected to exceed last year's levels in the forecast as the filing season ramps up.

UNADJUSTED SALES TAX COLLECTIONS WERE 13.2 PERCENT HIGHER YEAR-TO-DATE, DUE PARTLY TO ADDITIONAL $128 MILLION IN AST REVENUE WHICH BOOSTED COLLECTIONS IN JULY

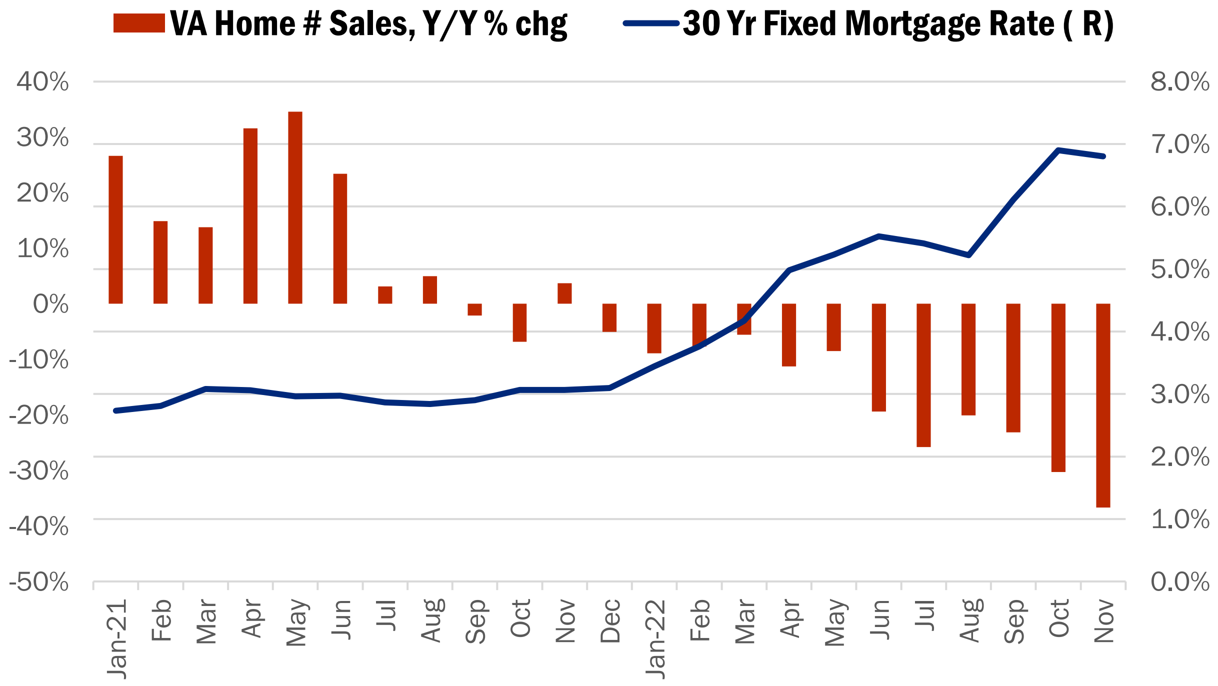


- It is too early to tell whether the monthly slowdown in December is due to shifting shopping patterns around the holiday season or other factors including slower demand or a shift to non-taxed purchases of services.

OTHER REVENUES: DRIVERS OF CORPORATE INCOME AND DEED TAX GROWTH ARE NEGATIVE



Source: US BEA



Source Virginia Association of Realtors

- There has been a noticeable slowdown in corporate profit growth. According to a recent report by Goldman Sachs, S&P 500 EPS, excluding energy, are expected to decline by 5 percent in 2022 Q4, and by 11 percent in CY 2023 in a recession scenario.
- Sales activity in the housing market has been sharply curtailed by soaring interest rates.

OTHER SOURCES

Corporate income tax revenue is falling sharply, by 15.7 percent year to date, which is more than anticipated. This slowdown reflects several factors:

- A lower starting point for FY 2023 as final payments in November came in lower than anticipated. Corporations have accrued credits which they can carry forward to reduce future payments.
- Profits margins are being compressed by inflation and demand is falling compared to the post-pandemic surge.

Deed recordation taxes are also down sharply, by 31.9 percent year-to-date, reflecting weakening demand for housing.

Other Revenues are offsetting the weakness in corporate tax and deed tax revenues, exceeding projections by $39 million, mainly due to higher interest income.

- Interest income totals $174 million in the first six months of the year, compared to a full year forecast of $223 million.
- Corporate income taxes year-to-date total $853 million this year, versus $1.0 billion last year, while deed taxes so far total $238 million in FY 2023, versus $349 million in FY 2022,

CONCLUSION AND KEY UPCOMING DATES

- Year-to-date collections are running ahead of the December updated projections by $79.3 million.
- Among major sources, withholding and sales tax growth are slowing, but the slowdown is anticipated in the forecast.
  - Withholding is running ahead of projections while sales tax collections are trailing slightly.
  - 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.
- There is still considerable uncertainty surrounding non-withholding revenues. Fourth quarter collections are due Jan 15th and will provide some additional insight on non-withholding.
- Corporate income tax collections are trailing projections, but overall, the weakness in business and deed recordation revenue is being offset by higher interest income.
- Positive year-to-date results and economic outlook continue to support the December forecast resulting in a $3.6 billion surplus.