ECONOMIC AND REVENUE REVIEW AND UPDATE

A BRIEFING FOR THE MONEY COMMITTEES

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TOPICS FOR DISCUSSION

ECONOMIC UPDATE

OCTOBER FISCAL YEAR-TO-DATE REVENUE COLLECTIONS

LOOKING AHEAD

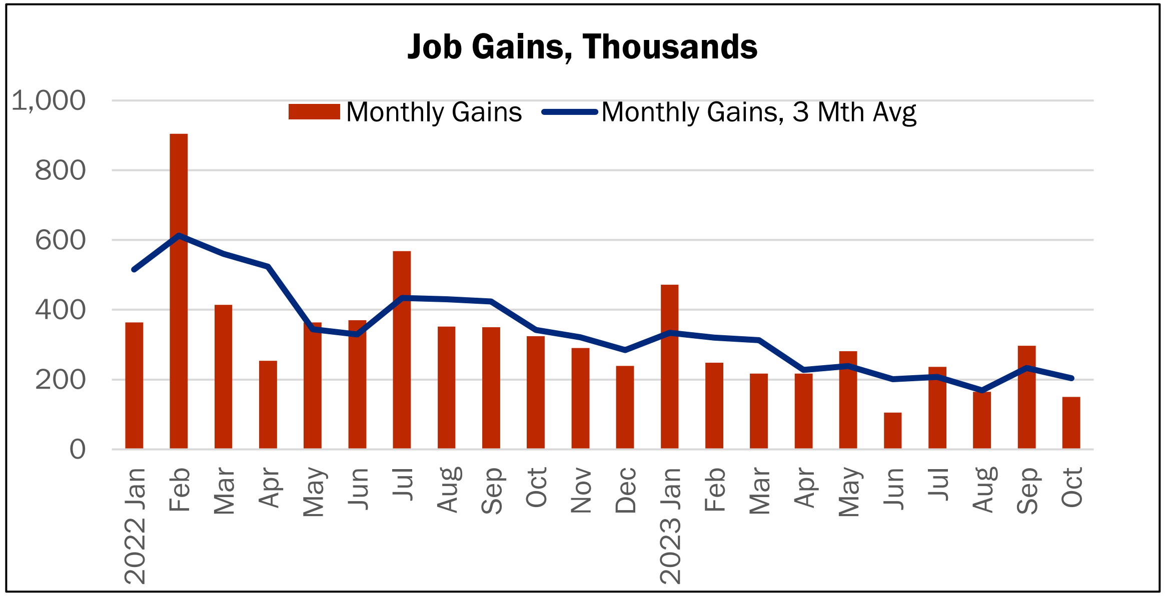
OVERVIEW

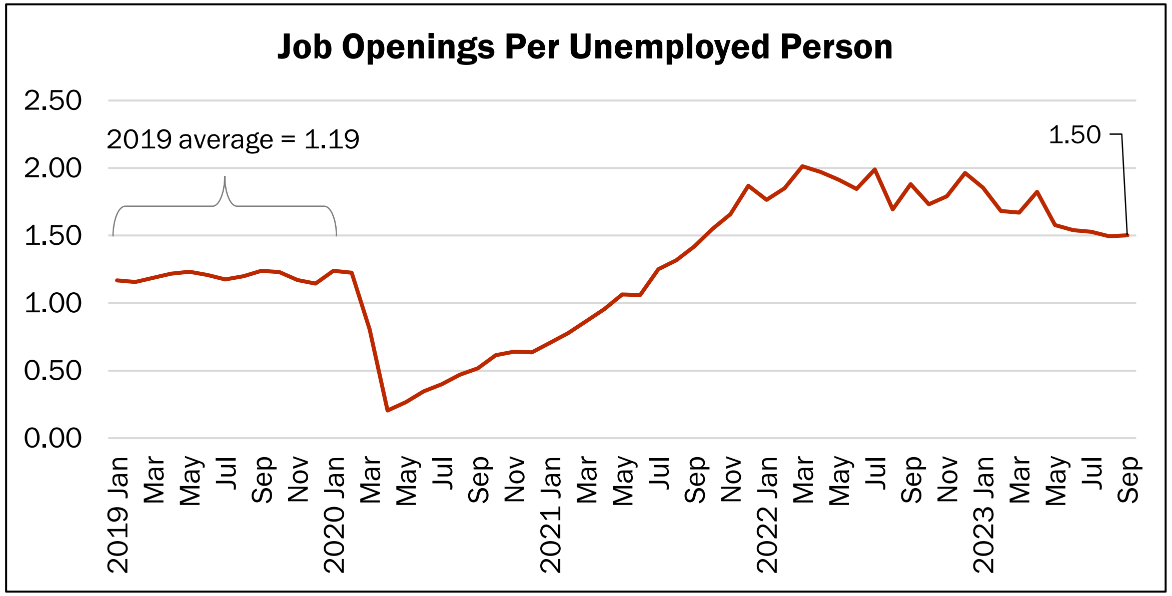
- With four months of collections, Fiscal Year 2024 general fund revenues are ahead of projections based on the forecast assumed in the amended budget (Chapter 1) adopted in September. Major revenue sources are generally in line with or exceed expectations. However, PTET-related activity in non-withholding collections and refunds continue to distort overall revenue collections.
- Excluding non-withholding collections and refunds, GF collections are up 4.4 percent YTD versus a projected increase of 0.9 percent. The two sources most closely tied to current economic activity, withholding and sales tax, are in line with projections with variances of 2.1 percent and 1.0 percent, respectively, through October.
- Unadjusted revenues are up 12.1 percent year-to-to-date compared to the same period last year, and up 1.8 percent after adjusting for policy but excluding PTET-related refunds to better reflect underlying economic growth.
- For the month, unadjusted GF revenues declined 4.6 percent compared to October 2022, mainly reflecting an increase in individual income tax refunds. The increase in refunds is primarily related to two factors: higher individual income tax refunds resulting from the 2022 increase in the standard deduction and continuing elevated refunds of individual income tax overpayments related to PTET.
- Corporate income tax collections grew 68.3 percent in October. For the full year, corporate income tax collections are forecast to decline 6.6 percent. Higher corporate tax refunds are anticipated in November which will temper YTD growth.
- Collections of sales and use taxes declined 4.5 percent year-over year in October. Fiscal year-to-date, sales tax revenues are up 0.3 percent. Growth in sales tax will continue to moderate reflecting the elimination of the state sales tax on groceries and personal hygiene products.
- With the possibility of a recession in the second half of FY 2024, revenue growth is expected to moderate over the balance of the fiscal year.

OVERVIEW

- The U.S. economy has shown remarkable resilience even as interest rates have increased significantly. Third quarter Real Gross Domestic Product (GDP) rose by a seasonally adjusted annual rate of 4.9 percent (2.9 percent Q3/Q3). Current estimates point to continued growth of more than two percent in the fourth quarter.
- While the economy continues to grow, there are significant downside risks that warrant a conservative outlook going forward.
- 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. Given the Fed’s commitment to contain inflation, another rate increase is possible in coming months.
- Other macroeconomic factors pose significant risks, including:
  - The temporary budget deal in Congress expires soon, 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.

U.S. JOB GROWTH CONTINUES TO DECELERATE

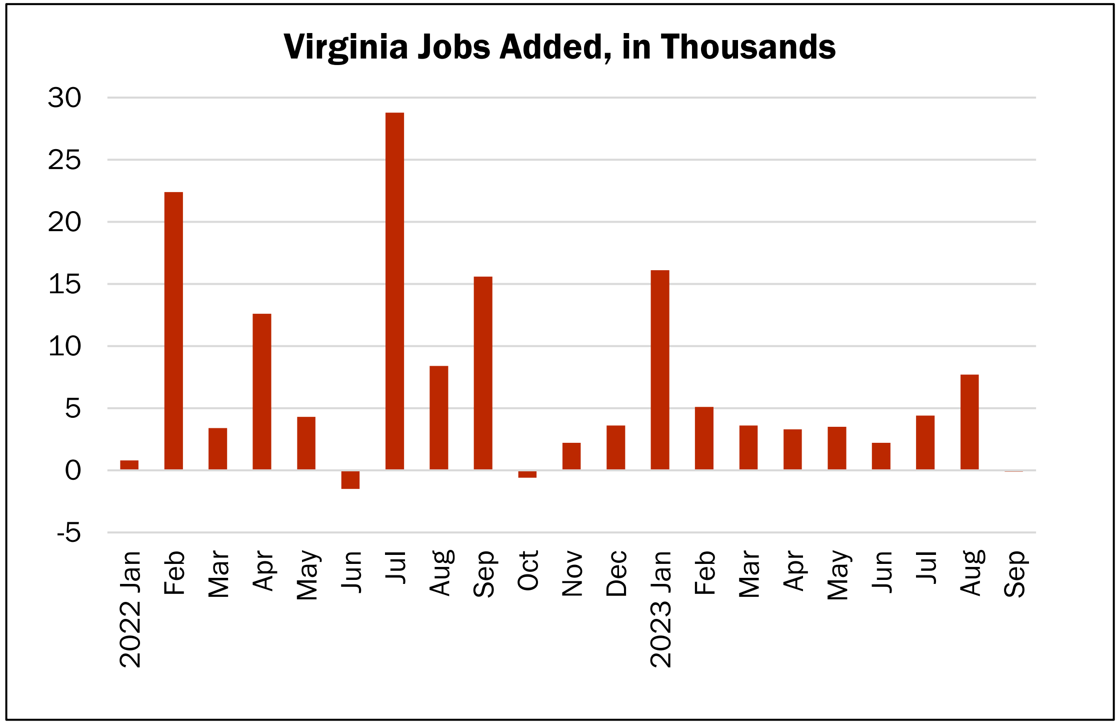




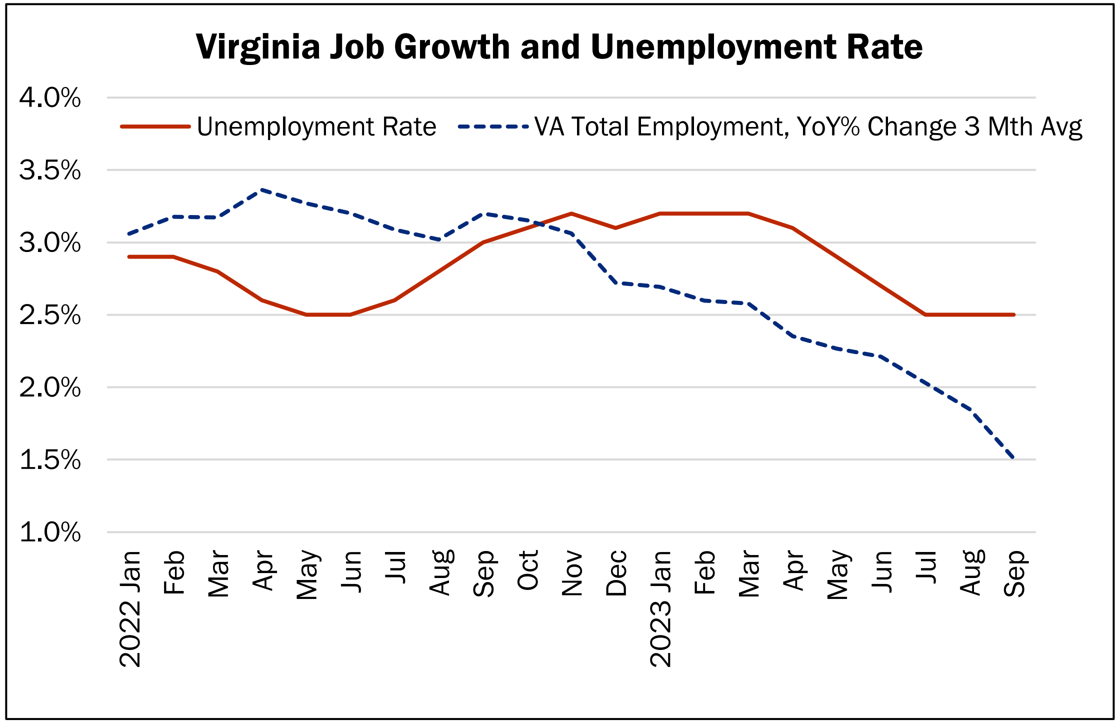
Sources: US BLS. Unless otherwise noted economic data is presented on a calendar year basis.

- U.S. employers added 150,000 jobs in October, returning to trend after September's unexpected spike. October's highest job gains were in health care at 58,000 while manufacturing suffered a decrease of 35,000 mainly due to strikes in the automotive sector.
- Job openings per unemployed person has remained essentially flat since July. The Federal Reserve has specifically mentioned this as an indicator labor supply is still below demand.

VIRGINIA UNEMPLOYMENT RATE UNCHANGED IN SEPTEMBER AS PACE OF JOB GROWTH SLOWS



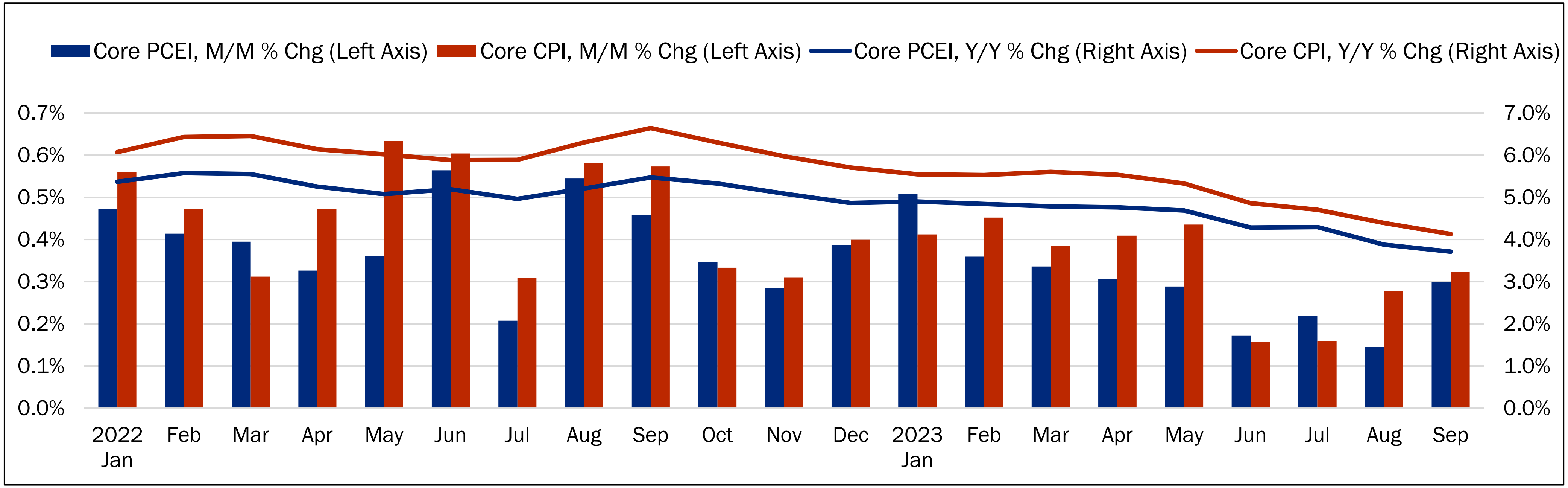
Source: US Bureau of Labor Statistics



Source: US Bureau of Labor Statistics

- Virginia's nonagricultural employment from the monthly establishment survey decreased by 100 to 4.16 million in September, the first month-over-month decline since October 2022. Private sector employment increased by 3,500 while government employment decreased by 3,600. On a year-over-year basis, Virginia employment grew 1.2 percent in September compared to September 2022.
- Virginia's seasonally adjusted unemployment rate in September remained unchanged at 2.5 percent, which is 0.5 percentage points below the rate from a year ago.

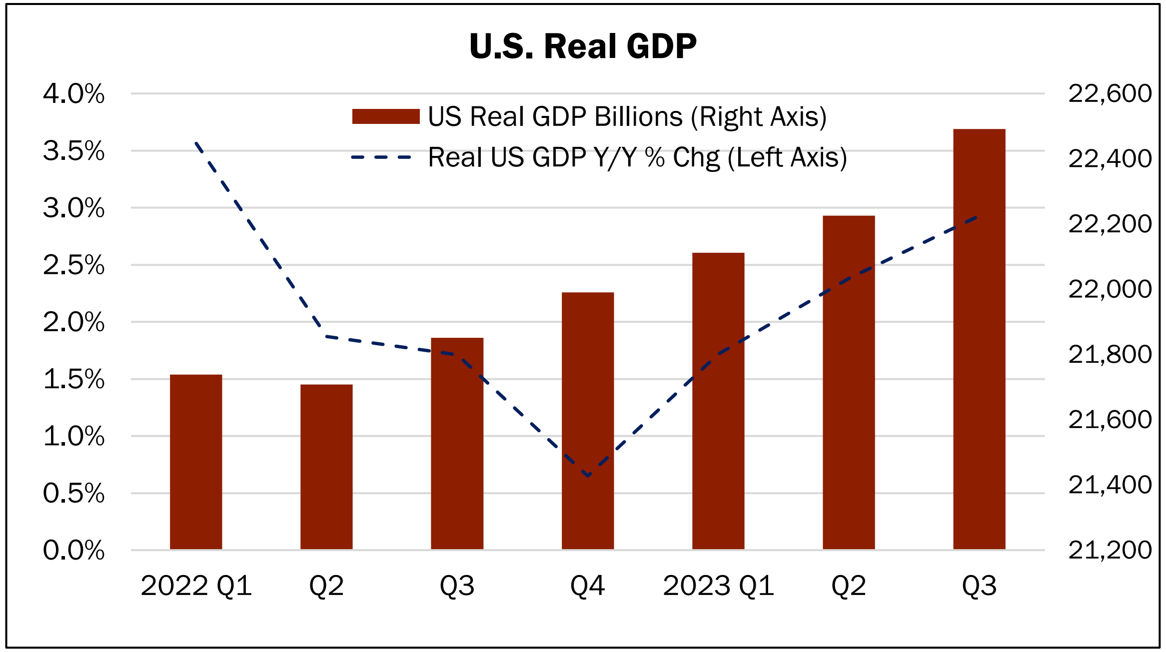
LONG-TERM INFLATION MEASURES ARE TRENDING DOWNWARD, BUT REMAIN ELEVATED



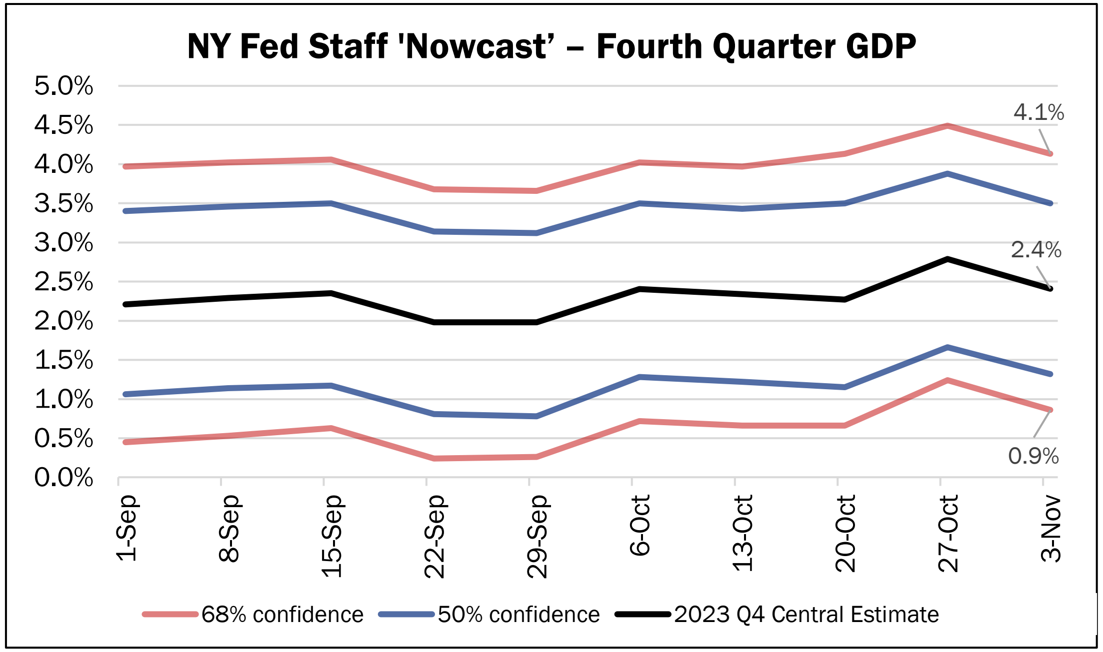
Sources: US Bureau of Labor Statistics , US Bureau of Economic Analysis

- The CPI was up 3.7 percent year-over-year in September, the same as it was in August. Excluding food and energy prices, September's CPI data came in as expected and show a continuation of the steady moderation that began in late 2022.
- The twelve-month change in Core Personal Consumption Expenditure Price Index (Core PCE), the Federal Reserve's preferred inflation measure, continued to fall to 3.8 percent, though it is still well above the Fed's two-percent target.

U.S. REAL GDP GREW AT 2.9 PERCENT YEAR-OVER-YEAR IN THE THIRD QUARTER, CURRENT Q4 GDP ESTIMATES ARE AT 2.4 PERCENT



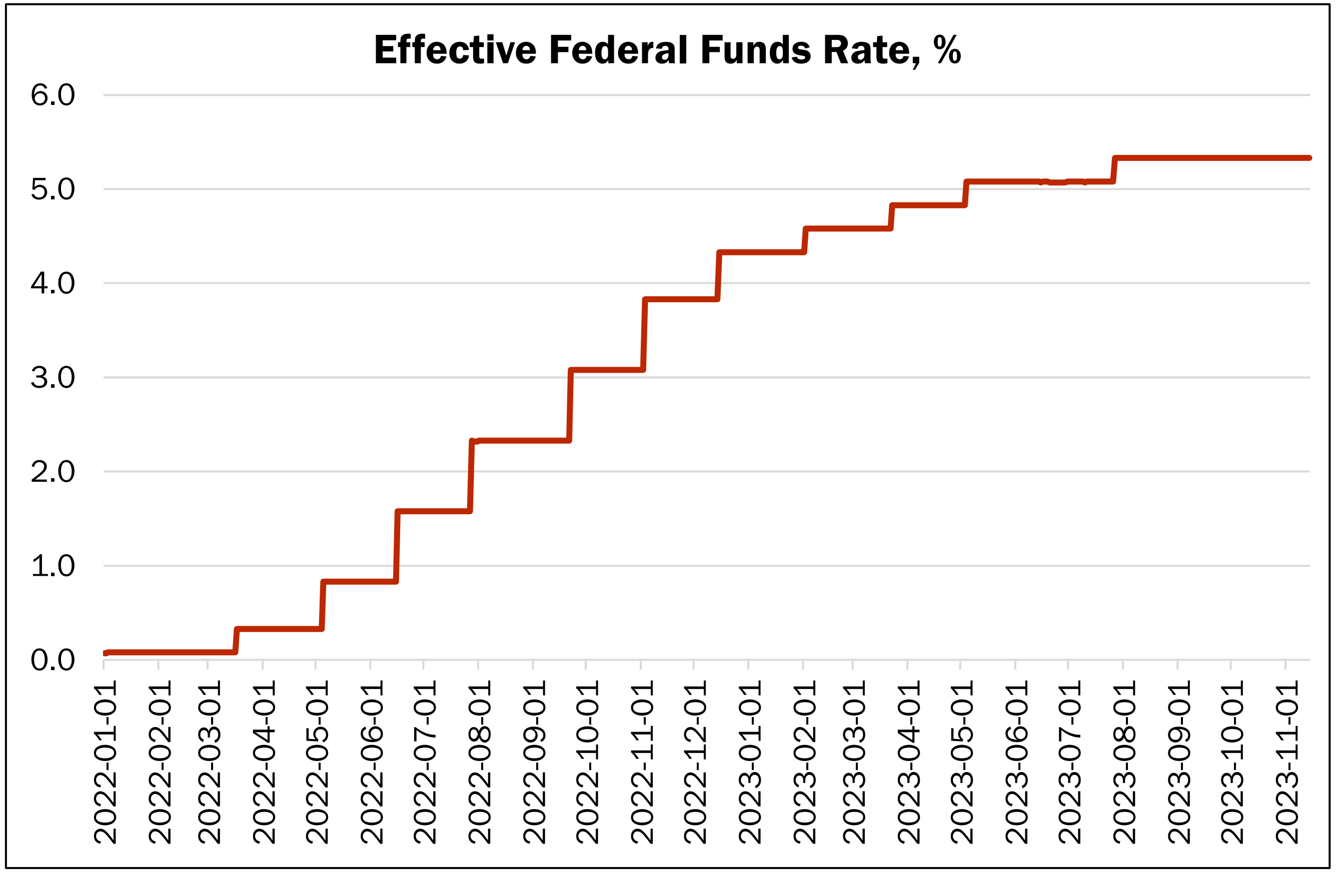
Source: US Bureau of Economic Analysis



Source: Federal Reserve Bank of New York

- Real gross domestic product (GDP) increased at a seasonally adjusted annual rate of 4.9 percent in the third quarter of 2023, according to the "advance" estimate released by the Bureau of Economic Analysis. Comparing Q3 to the same quarter last year, GDP grew 2.9 percent.
- Estimates of fourth quarter Real GDP growth have consequently increased, with a central estimate of 2.4 percent ± 1.5 percent, well above the target of 1.8 percent consistent with slightly below trend growth.

MANY ECONOMISTS EXPECT ANOTHER RATE INCREASE IN COMING MONTHS

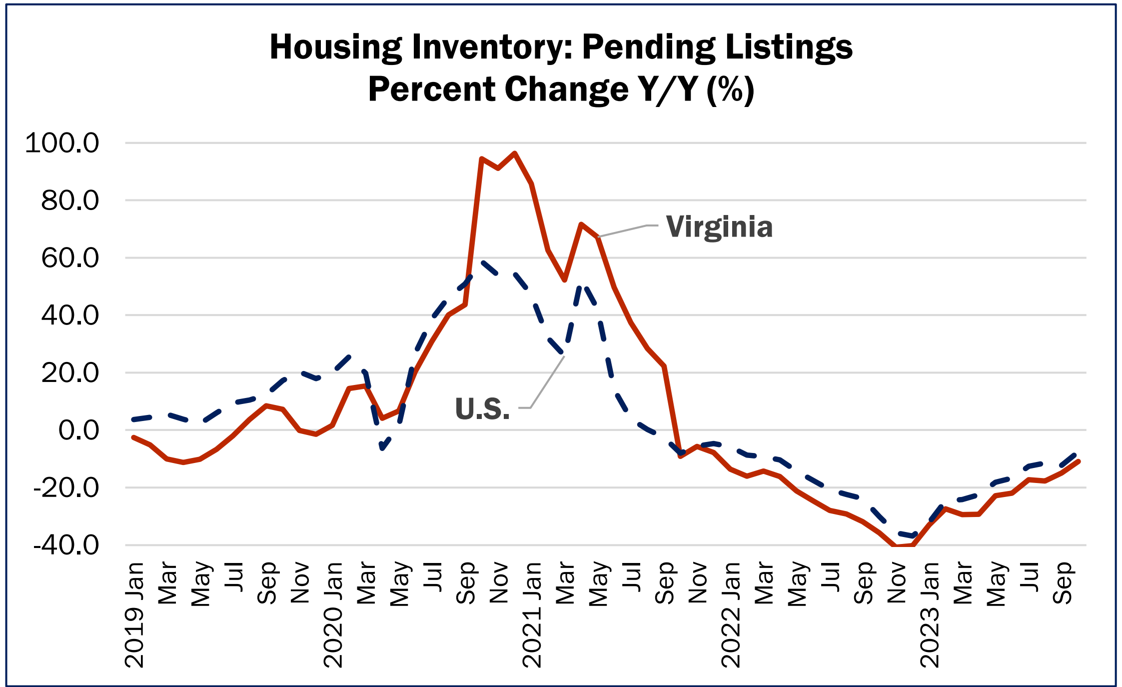


Source: Federal Reserve Board

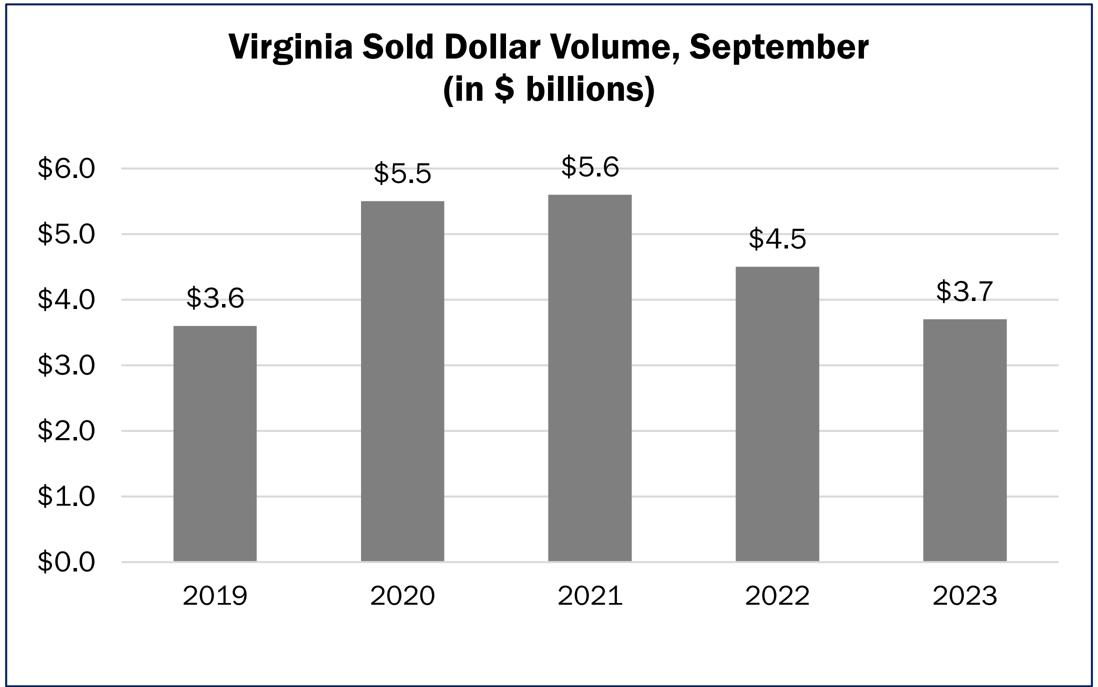
- The Federal Reserve held rates steady at their October 31 – November 1 meeting.
- The outlook for additional rate hikes is mixed with many economists expecting an additional rate increase.
- Market participants now put the probability of a January rate hike at about 20 percent.*
- The minutes from the recent policy meeting indicate there is concern regarding the stronger than expected economic growth, and Chairman Powell has not ruled out further rate increases. The Fed will meet again December 12-13.

**CME FedWatch Tool.*

HOUSING MARKET: INVENTORY AND HOME SALES ARE DOWN SIGNIFICANTLY OVER THE LAST TWO YEARS



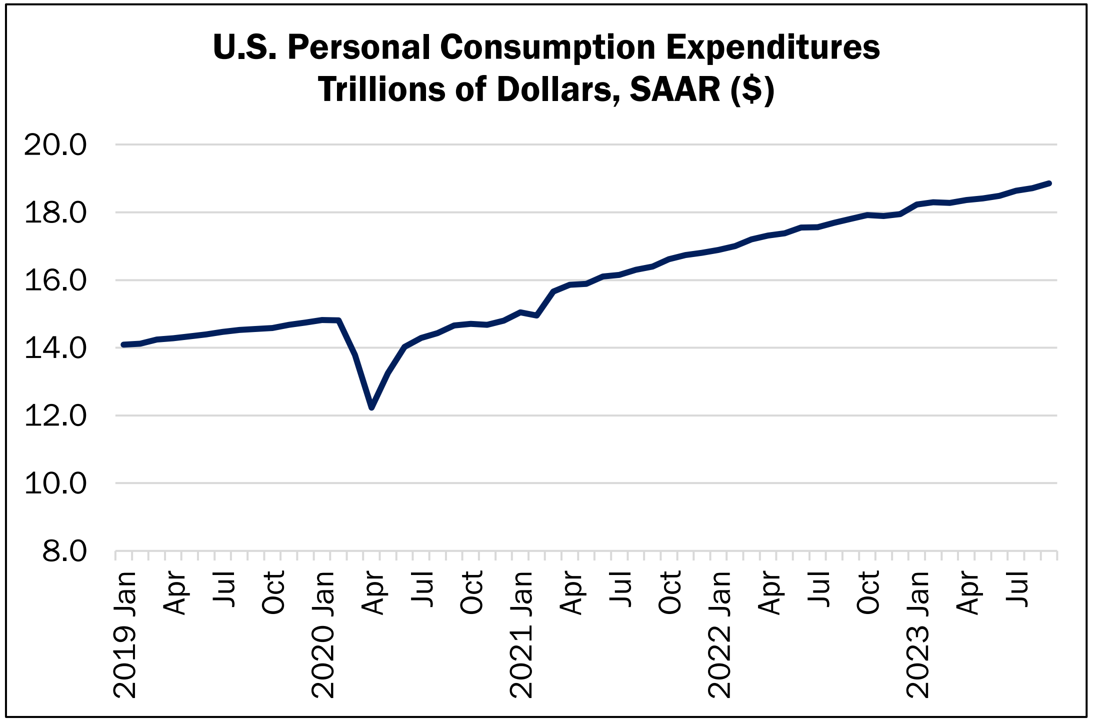
Source: Realtor.com, retrieved from Federal Reserve Bank of St. Louis.

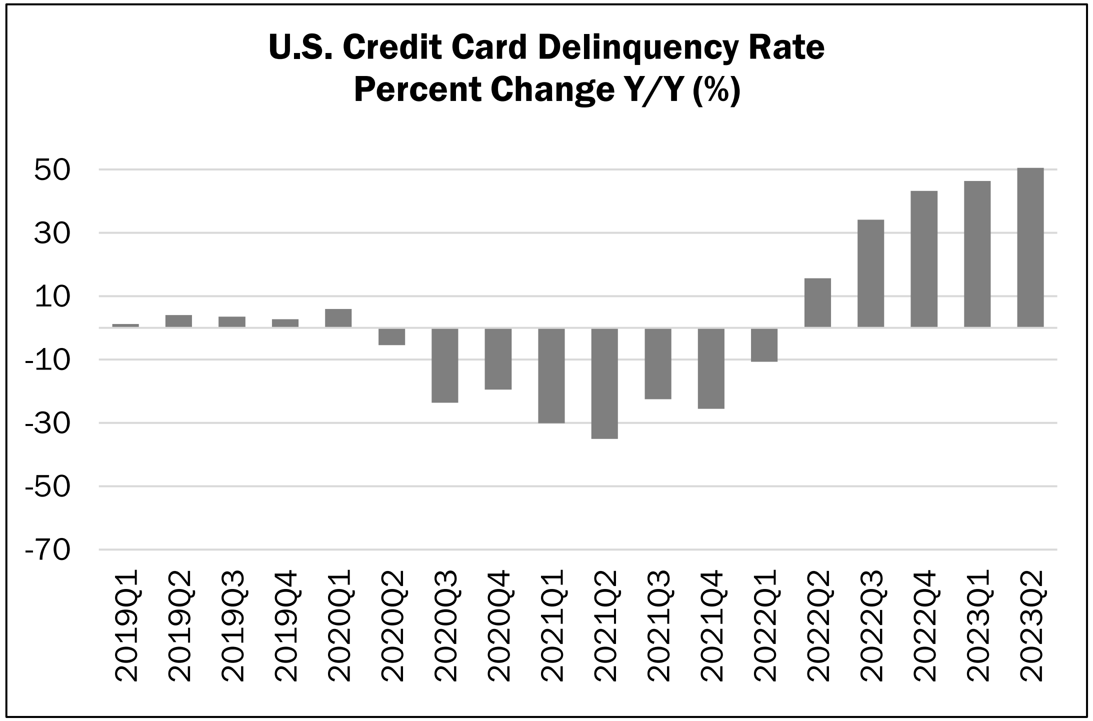


Source: Virginia Association of Realtors.

- The total number of homes for sale in the US, including homes that were under contract but not yet sold, decreased by 7.2 percent in September compared to last year. This is the fifth month in a row that total listings have declined on a year-over-year basis.
- In Virginia, September home sales totaled 8,023 homes sold, 2,149 fewer sales than September last year, a 21.1 percent decline. There was approximately $3.7 billion of sold volume throughout Virginia in September, a 16.5 percent reduction versus the same month last year.

CONSUMER SPENDING HAS BEEN STRONG, BUT RISING CREDIT CARD DELINQUENCIES ARE A CONCERN

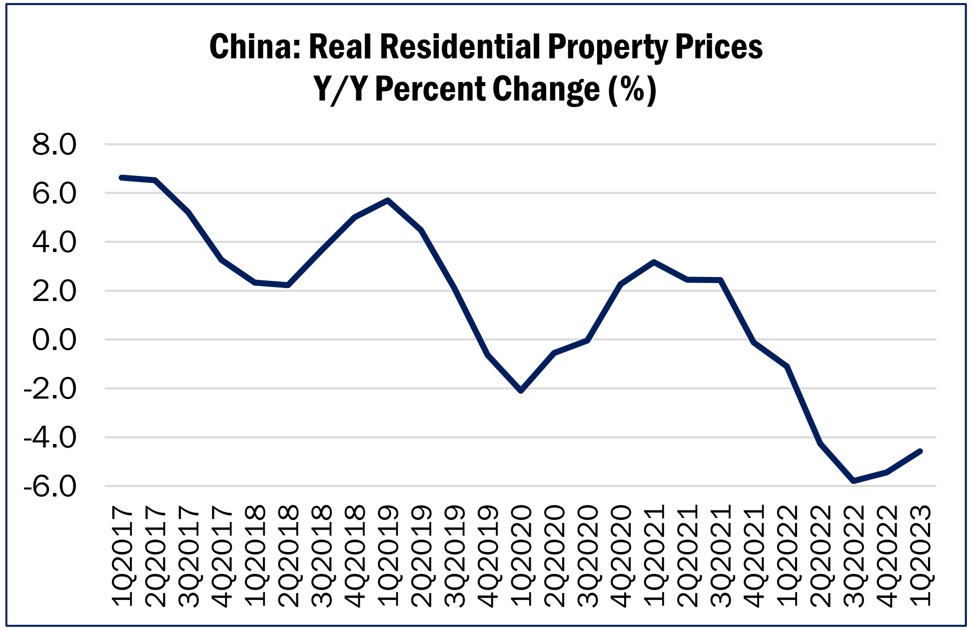




Source: Federal Reserve Bank of St. Louis.

- Delinquency rates are on the rise, suggesting that growth in spending may begin to soften as pandemic savings are spent down.
- The New York Federal Reserve Bank reported that Americans now owe $1.08 trillion on their credit cards, while TransUnion reported that the average balance per consumer grew to more than $6,000, the highest in 10 years.
- Persistent inflation has put many households under financial pressure, leading them to carry more debt and fall behind on payments.

CHINA'S REAL ESTATE CRISIS MAY THREATEN GLOBAL ECONOMIC GROWTH



Source: Bank for International Settlements, Real Residential Property Prices for China, retrieved from Federal Reserve Bank of St. Louis

One former Chinese official was quoted recently saying China's entire population of 1.4 billion would not be enough to fill all the empty apartments in China.

- China's robust economic growth was propelled for decades by a housing boom fueled by a rising population and urbanization. At its peak, China's residential property sector contributed an estimated 25-30 percent of the country's GDP.
- However, China's property sector has been in a severe crisis - initially triggered by government moves to rein in debt - with many developers defaulting on payments as they struggle to sell apartments and raise funds, including Chinese builders Country Garden Holdings and Evergrande.
- Property values have declined rapidly, though it is challenging to quantify because officially reported statistics are not based on standard industry practices. The severity of the crisis may be worse than official data suggest.
- The ongoing correction in China's real estate market could lead to reduced demand for raw materials and goods globally, impacting international markets and export-driven economies.
- Financial market instability in China could have spillover effects on global financial markets, given China's significant role in global finance.

Sources: CNN, Reuters, Axios.

EXCLUDING NON-WITHHOLDING AND REFUNDS WHICH CONTINUE TO SEE PTET DISTORTIONS, YTD COLLECTIONS ARE ROUGHLY ON PLAN

	OCTOBER						FYTD					
SOURCE, $ Mil	Actuals	Projected	Variance $	Variance %	PY	Y/Y %	Actuals	Projected	Variance $	Variance %	PY	Y/Y%
Withholding	1,318.5	1,267.8	50.7	4.0%	1,285.1	2.6%	5,140.6	5,036.3	104.3	2.1%	5,090.6	1.0%
Non-withholding	291.0	226.7	64.3	28.4%	283.9	2.5%	1,291.0	967.6	323.4	33.4%	1,211.8	6.5%
IIT Refunds	(295.3)	(583.7)	288.4	-49.4%	(194.7)	51.7%	(738.8)	(1,032.1)	293.3	-28.4%	(1,243.6)	-40.6%
Net	1,314.2	910.7	403.4	44.3%	1,374.3	-4.4%	5,692.8	4,971.9	720.9	14.5%	5,058.8	12.5%
Sales/Use	400.1	384.7	15.4	4.0%	418.9	-4.5%	1,589.4	1,574.3	15.1	1.0%	1,585.4	0.3%
Corporate	95.4	23.2	72.3	311.6%	56.7	68.3%	611.6	497.7	113.9	22.9%	491.5	24.4%
Wills and Deeds	31.7	30.5	1.2	3.9%	35.6	-11.1%	136.0	122.8	13.2	10.8%	171.0	-20.5%
All other	12.0	37.3	(25.3)	-67.9%	57.0	-79.0%	455.0	439.2	15.9	3.6%	260.7	74.6%
Total GF Revenues	1,853.3	1,386.4	466.9	33.7%	1,942.5	-4.6%	8,484.9	7,605.8	879.1	11.6%	7,567.4	12.1%

- Excluding non-withholding collections and refunds, which continue to be distorted by PTET-related activity, GF collections are up 4.4 percent YTD versus a projected increase of 0.9 percent. The two sources most closely tied to current economic activity, withholding and sales tax, show variances of 2.1 percent and 1.0 percent, respectively, through October.
- Internal PTET refund tracking has only recently been introduced, allowing greater insight on progress. As of October 30th, approximately $320 million in PTET refunds had been issued according to Virginia Tax data.
- Nongeneral fund interest distributions took place in October, reducing the YTD forecast variance in “All Other” from 10.3 percent last month to 3.6 percent this month.
- With the possibility of a recession in the second half of FY 2024, revenue growth is expected to moderate over the balance of the fiscal year.

EXCLUDING PTET REFUNDS AND ADJUSTING FOR POLICY IMPACTS, GF REVENUES ARE UP A MODEST 1.8 PERCENT YEAR-TO-DATE

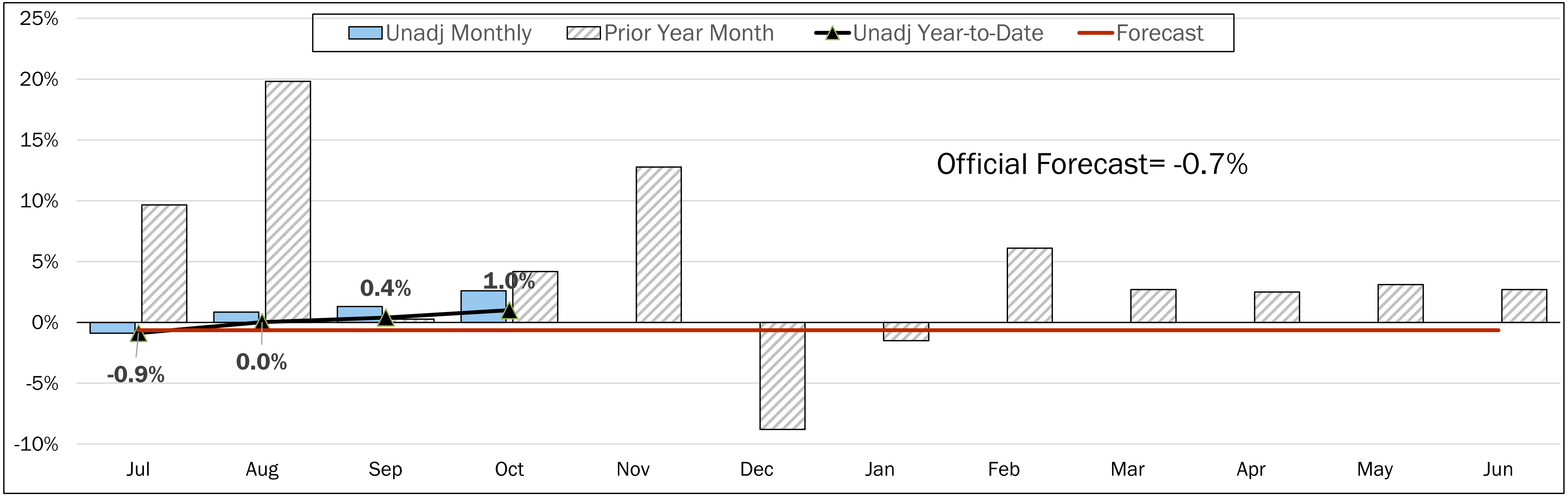
	FY 2023	FY 2024	Pct Chg	OCTOBER				Fiscal Year-To-Date				
Unadjusted Revenues	**Actual**	**HB 6001**	**Req by Est**	**FY 2023**	**FY 2024**	**Change**	**% Change**	**FY 2023**	**FY 2024**	**Change**	**% Change**	**% of Total**
Withholding	15,957.2	15,853.0	-0.7%	1,285.1	1,318.5	33.4	2.6%	5,090.6	5,140.6	50.1	1.0%	60.6%
Non-Withholding	6,629.2	4,688.3	-29.3%	283.9	291.0	7.1	2.5%	1,211.8	1,291.0	79.2	6.5%	15.2%
Refunds	(3,602.8)	(2,834.8)	-21.3%	(194.7)	(295.3)	(100.7)	51.7%	(1,243.6)	(738.8)	504.8	-40.6%	-8.7%
Sales and Use Tax	4,734.6	4,418.2	-6.7%	418.9	400.1	(18.8)	-4.5%	1,585.4	1,589.4	4.0	0.3%	18.7%
Corporate Income Tax	2,031.1	1,896.1	-6.6%	56.7	95.4	38.7	68.3%	491.5	611.6	120.1	24.4%	7.2%
All Other Sources	2,160.7	2,349.1	8.7%	92.6	43.6	(49.0)	-52.9%	431.7	591.1	159.4	36.9%	7.0%
Total GF Revenues	**$27,909.9**	**$26,369.3**	**-5.5%**	**$1,942.5**	**$1,853.3**	**(89.2)**	**-4.6%**	**$7,567.4**	**$8,484.9**	**917.4**	**12.1%**	**100.0%**

Adjusted Revenues								
Adjusted Withholding	1,285.1	1,365.5	80.4	6.3%	5,090.6	5,318.4	227.8	4.5%	59.0%
Adjusted Non-Withholding	283.9	291.4	7.6	2.7%	1,211.8	1,292.8	81.0	6.7%	14.3%
Adjusted Refunds+Rebates	(106.6)	(149.1)	(42.5)	39.9%	(274.1)	(419.4)	(145.2)	53.0%	-4.7%
Adjusted Sales (AST+Grocery Tax)	418.9	422.8	3.9	0.9%	1,585.4	1,619.0	33.6	2.1%	18.0%
Total GF Revenues, Adjusted	**$2,030.6**	**$2,069.7**	**39.1**	**1.9%**	**$8,536.9**	**$9,013.6**	**476.7**	**5.6%**	**100.0%**
Total Excluding PTET Adjustments	**$2,030.6**	**$1,923.7**	**(106.9)**	**-5.3%**	**$8,536.9**	**$8,694.6**	**157.7**	**1.8%**	**100.0%**

Not all sums may compute due to rounding.

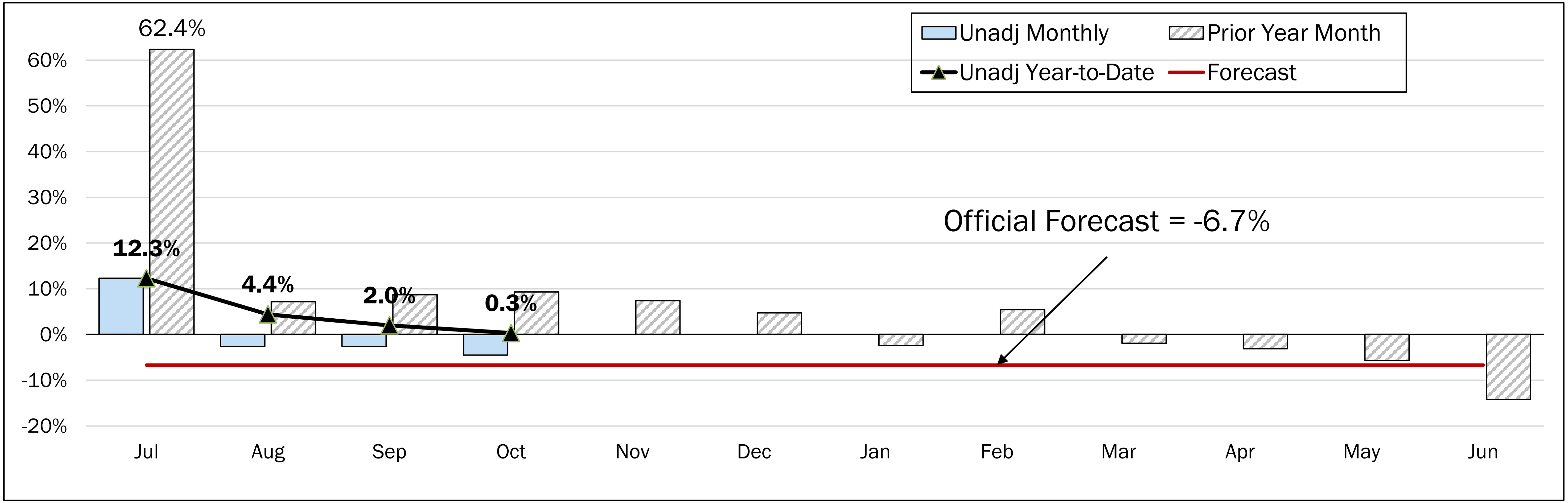
- Underlying employment and wage growth has led to a 4.5 percent increase in adjusted withholding year-to-date.
- PTET-related activity continues to distort overall revenue growth. Excluding PTET refunds and adjusting for tax policy changes, revenues declined in October by 5.3 percent and are up 1.8 percent year-to-date.

UNADJUSTED WITHHOLDING COLLECTIONS CONTINUE MODERATE GROWTH



- Stronger than expected economic performance has resulted in one-percent growth on an unadjusted basis, 1.7 percentage points above the forecast 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 -6.7 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.

OTHER SOURCES

Pass-Through Entity Tax (PTET)

- An estimated $795 million in PTET for Tax Year 2023 was collected as of October 30. It is unclear the extent to which taxpayers reduced individual income tax estimated payments to account for PTET.
- Fiscal year-to-date, PTET refunds are approximately $320 million and are running below expectations.
- With data from the November 1 filing deadline and improved internal tracking, visibility to PTET refund activity is improved; however, data limitations continue to be a challenge in tracking and forecasting PTET-related activity.

Corporate Income Tax

- Monthly collections increased by 68.3 percent and year-to-date growth is at 24.4 percent. Corporate extension returns are expected to show a higher level of refunds in November that is expected to temper October’s robust collections.
- Compared to forecast, corporate income tax collections are ahead of plan by $113.9 million year-to-date.

Other Revenue Sources

- Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – were 11.1 percent lower in October compared to the previous year. On a fiscal-year-to-date basis, collections are down 20.5 percent.
- Non-major sources, which includes interest income, had previously been elevated due to interest income accumulation. Scheduled distributions to non-general funds reduced variance from 10.3 percent to 3.6 percent.

LOOKING AHEAD: A CONSERVATIVE OUTLOOK IS EXPECTED AS BUDGET DEVELOPMENT CONTINUES THROUGH DECEMBER

- Significant economic headwinds exists that suggest the possibility of a U.S. recession in 2024:
    - Potential federal government shutdown.
    - A period of persistently high interest rates.
    - Possible escalation of middle east conflict and OPEC+ oil production cuts that could drive significantly higher energy prices.
    - Economic decline in Europe and Asia.
    - Real estate crisis in China and the resulting impact on financial markets.
    - Potentially weakening consumer spending as consumers spend down pandemic savings and the resumption of student loan repayments.
- The Governor’s Advisory Council on Revenue Estimates (GACRE) will meet on November 20 and review economic and revenue outlook for current and next biennium. Updated revenue outlook for FY 2024 and the revenue forecast for the 2024-26 biennium will be prepared based on the advice of GACRE.
- Governor Youngkin will release FY 2024 budget amendments and introduce the 2024-26 biennial budget on December 20.