ECONOMIC AND REVENUE REVIEW AND UPDATE

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TOPICS FOR DISCUSSION

ECONOMIC UPDATE

JANUARY FISCAL YEAR-TO-DATE REVENUE COLLECTIONS

COLLECTION BY MAJOR SOURCES AND DRIVERS

KEY DATES AND NEXT STEPS

OVERVIEW:

- Most current economic data continue to indicate a slowdown in the economy consistent with the December US forecast that the economy would begin to contract in CY 2023. Labor markets however continue to defy expectations, with more than 500,000 jobs added in January.

- 2022 Q4 Real GDP growth of 2.9 percent was driven in large part by inventory accumulation, indicating slower growth in the coming months.

- Consumer spending, the largest component of GDP, has been weakening and holiday retail sales were disappointing.

- The Blue Chip consensus now has GDP contracting in the first two quarters of the year and flat in Q3 before rebounding.

- Inflationary pressures are starting to subside although they remain well above the Fed's target rate of 2 percent.

- For Virginia, revenue collections are largely on track with projections. Weakness in sales and corporate income taxes are offset by higher interest payments and non-withholding.

- Sales tax revenue in January was below last year's level, averaging 2.8 percent growth during the entire holiday period.

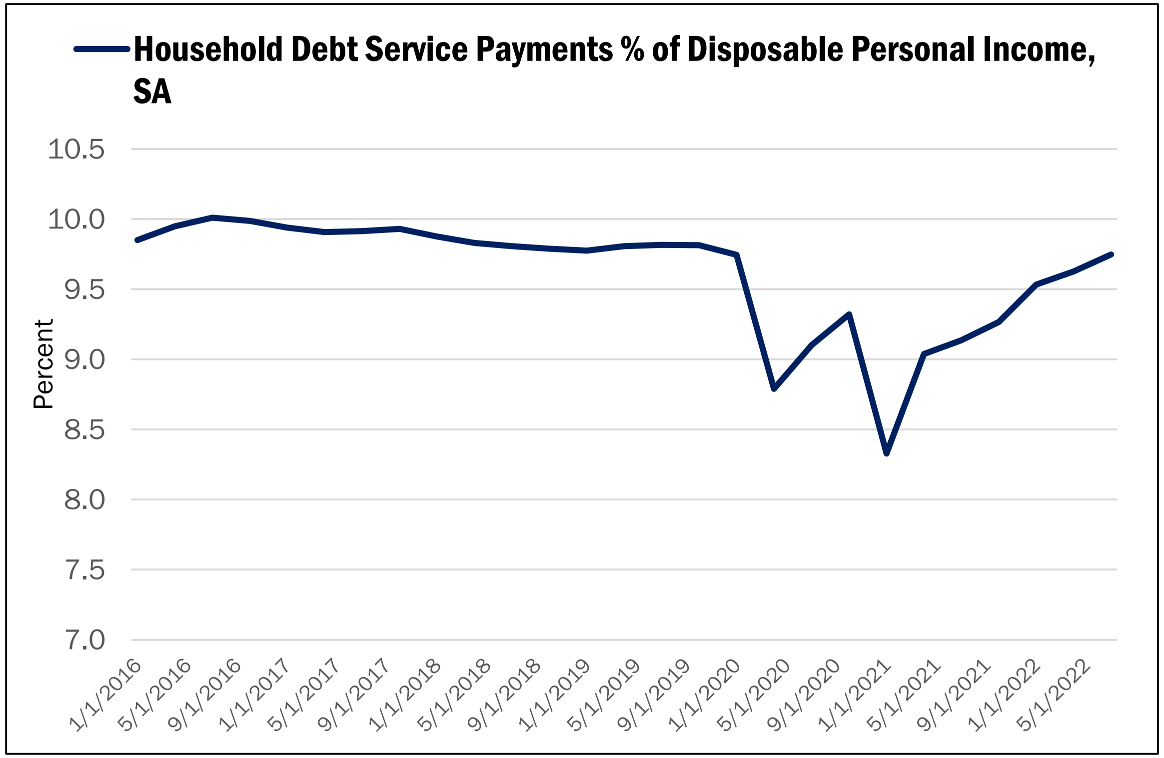
- **Given that the economy and collections are largely on track and there remains considerable uncertainty over non-withholding, the recommendation is for no change to the revenue forecast.**

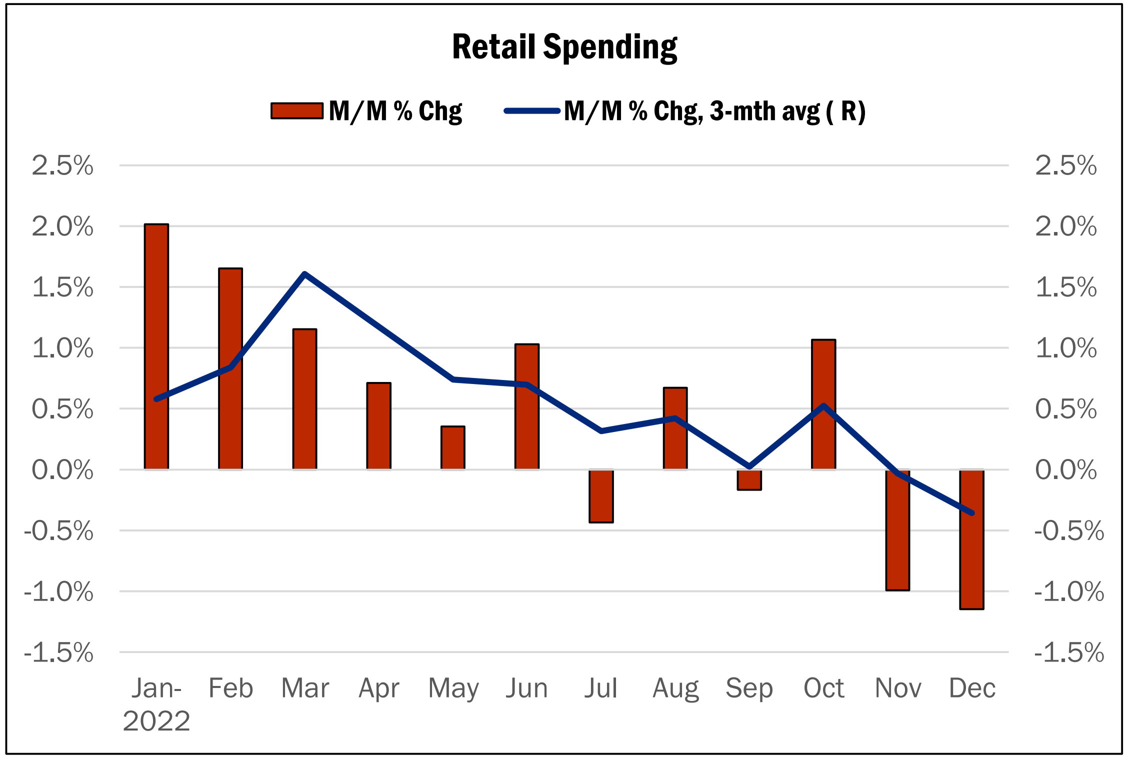
US REAL GDP GREW BY A STRONGER THAN EXPECTED 2.9 PERCENT RATE IN Q4 2022. INVENTORY ACCUMULATION ACCOUNTED FOR ALMOST HALF OF THE GROWTH. COMBINED WITH SLOWING CONSUMPTION, THIS SIGNALS LOWER GROWTH AHEAD.

Contributions to Percent Change in Real Gross Domestic Product	2021				2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross domestic product	6.3	7.0	2.7	7.0	-1.6	-0.6	3.2	2.9
Percentage points at annual rates:								
Personal consumption expenditures	7.0	7.8	2.0	2.1	0.9	1.4	1.5	1.4
Gross private domestic investment (excl. inventories)	1.7	1.1	-0.2	0.1	0.8	-0.9	-0.6	-1.2
Change in private inventories	-2.5	-0.8	2.0	5.0	0.2	-1.9	-1.2	1.5
Net exports of goods and services	-1.0	-0.6	-1.1	-0.2	-3.1	1.2	2.9	0.6
Government consumption expenditures and gross investment	1.2	-0.5	0.0	-0.2	-0.4	-0.3	0.7	0.6

Source: US BEA

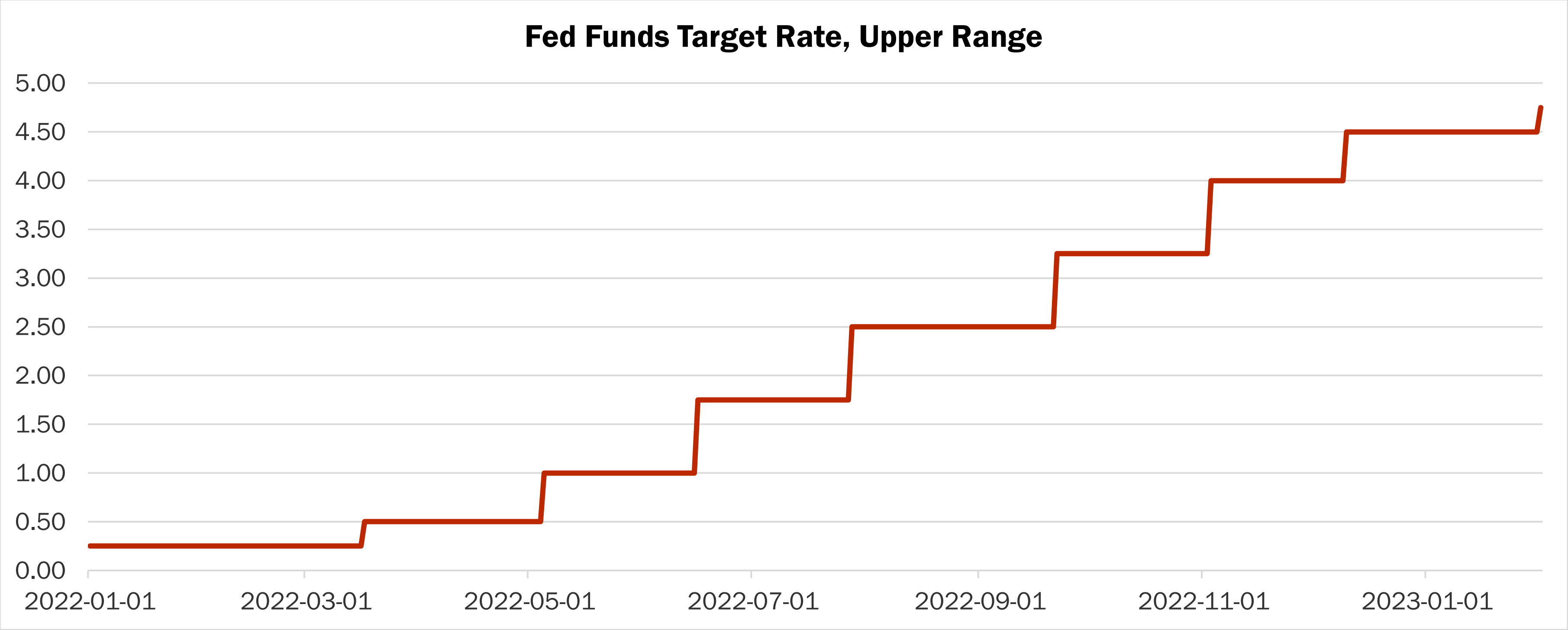
RETAIL SALES CONTRACTED IN NOVEMBER AND DECEMBER AS CONSUMERS STARTED TO FEEL THE IMPACT OF HIGHER INTEREST RATES AND INFLATION.





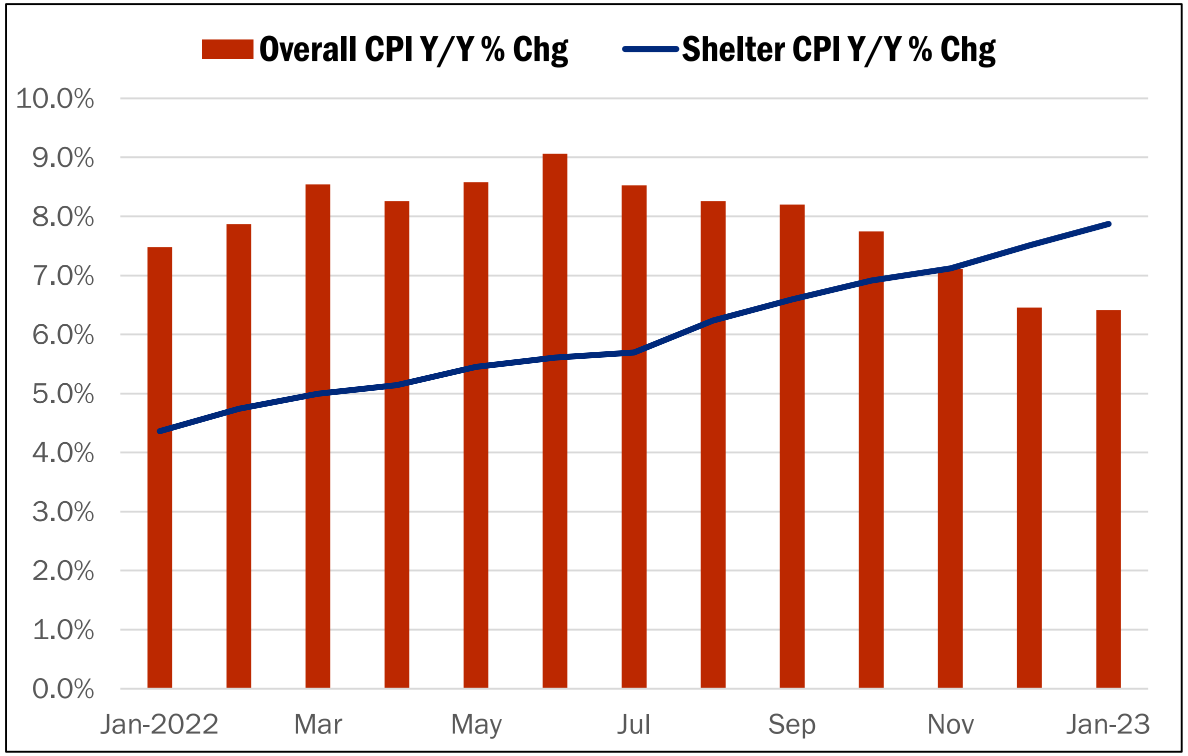
Sources: Federal Reserve Board of Governors, US Census Bureau (Right Chart)

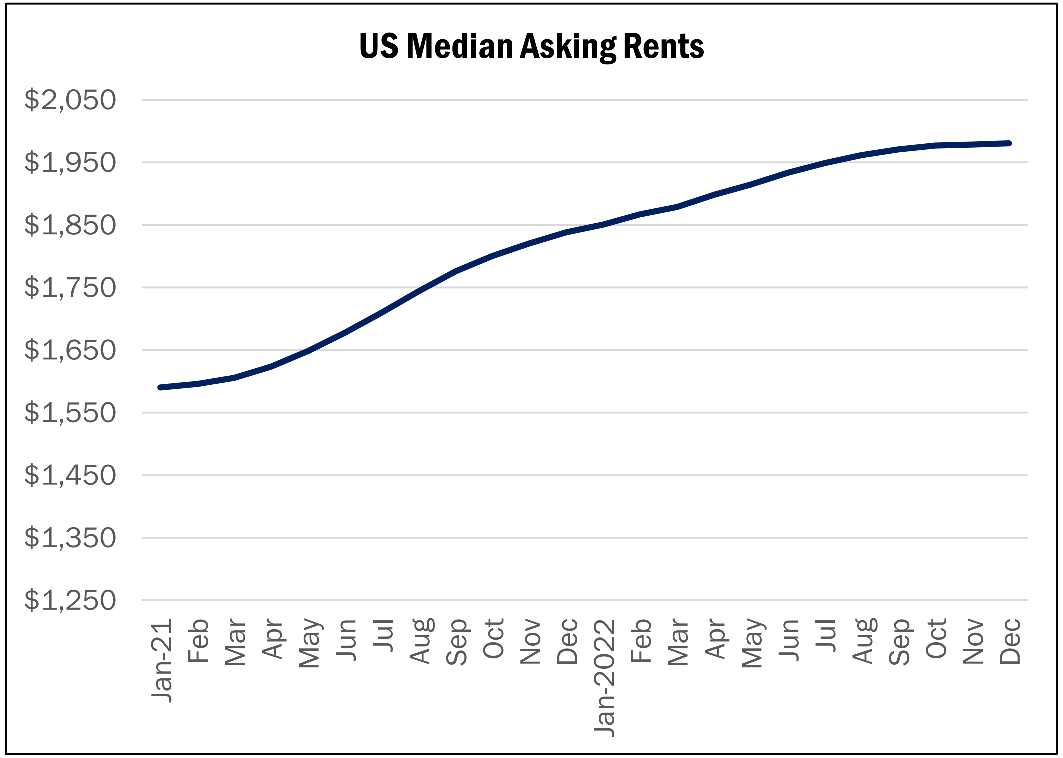
FED POLICY: FURTHER SLOWING IN THE ECONOMY IS EXPECTED TO OCCUR IN 2023 AS THE EFFECTS OF AGGRESSIVE RATE HIKES CONTINUE TO TAKE HOLD.



- The Fed slowed the pace of rate hikes to 25 basis points in February 2023 to 4.75 percent. Most economists expect two or three additional rates hikes to occur in 2023 with a terminal rate of 5-5.5 percent.
- The Fed has also reversed its expansionary Quantitative Easing Policy of purchasing assets to increase liquidity in the economy. Since March 2022, the Fed has reduced the size of its balance sheet, cutting back its bond portfolio by about $95 billion per month (only about 1% of its holdings each month) by not purchasing new securities to replace maturing bonds.

INFLATIONARY PRESSURES ARE STARTING TO SUBSIDE ALTHOUGH THEY REMAIN WELL ABOVE THE FED'S TARGET RATE OF 2 PERCENT. SHELTER INFLATION REMAINS HIGH BUT SHOULD START TO MODERATE.

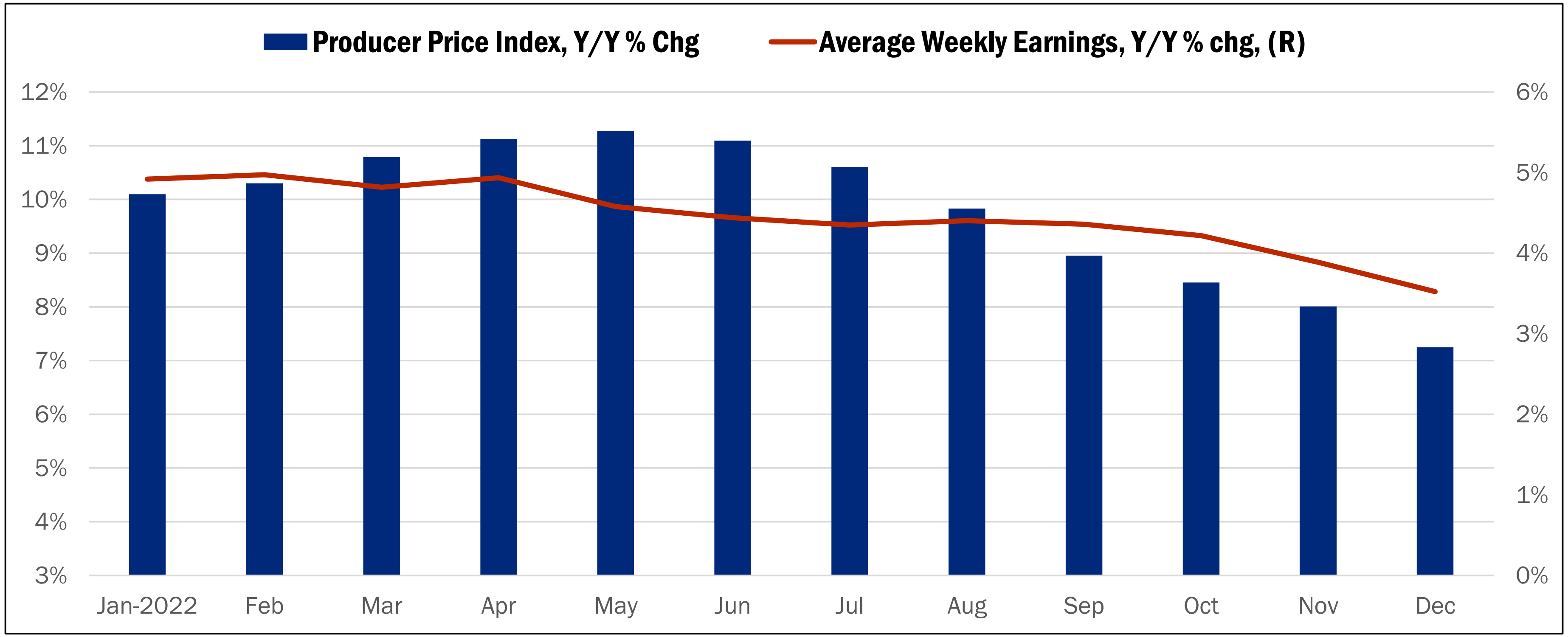




- Rent increases have plateaued and even declined in some parts of the nation.

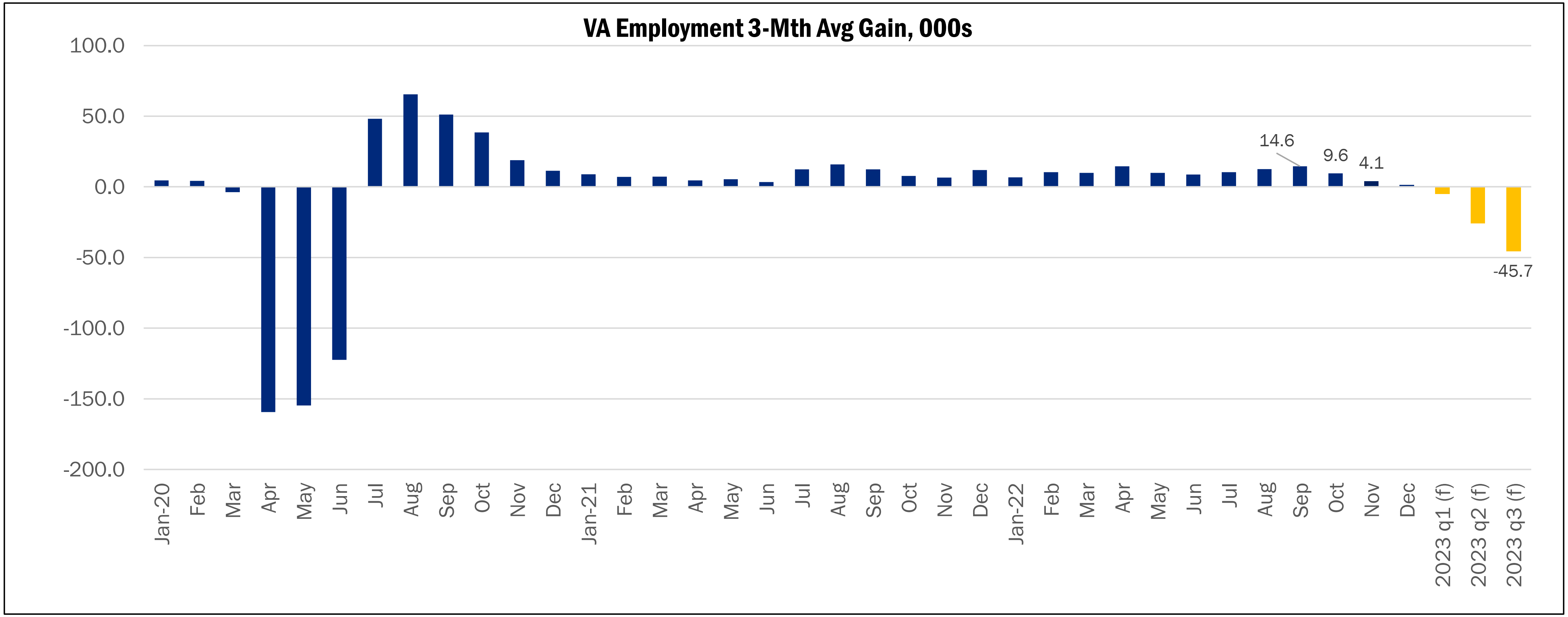
Sources: US BLS, Zillow (Right Chart)

OTHER MEASURES ALSO INDICATE DECLINING INFLATIONARY PRESSURES.



Source: US BLS

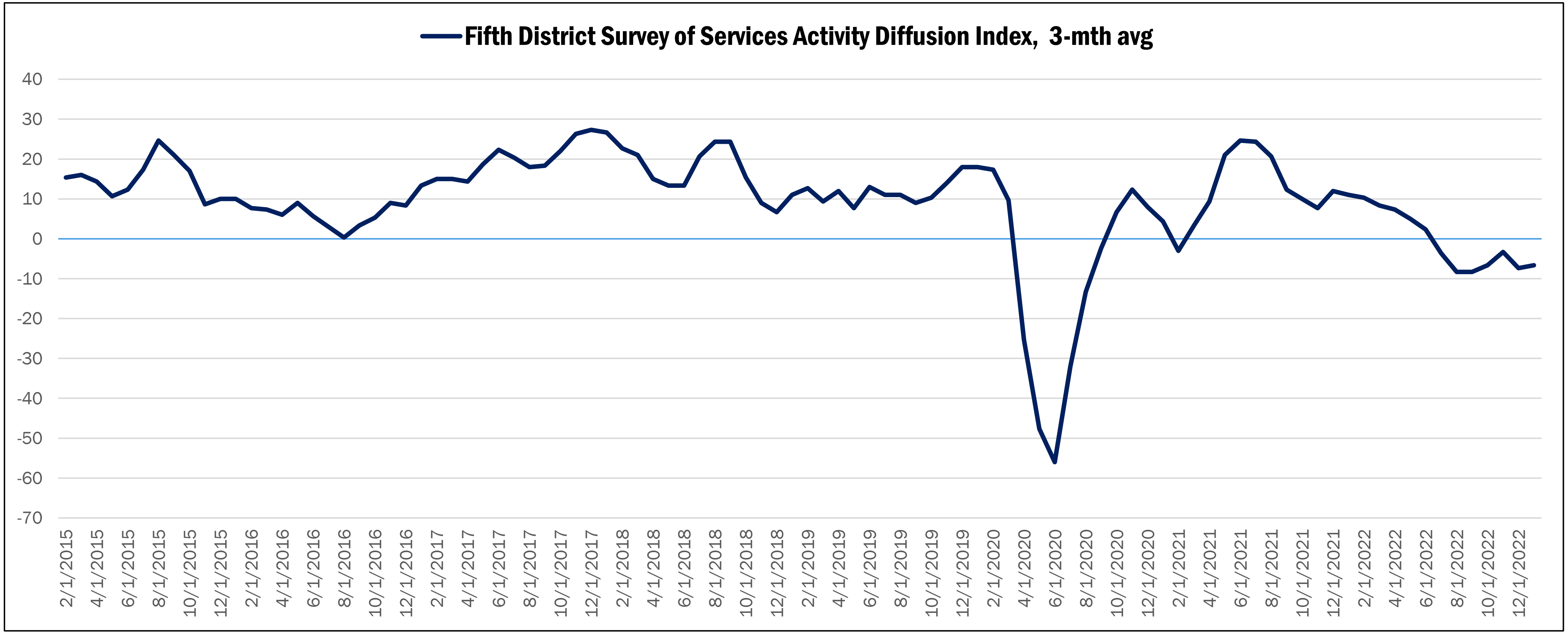
EMPLOYMENT GROWTH IN VIRGINIA SLOWED IN THE LATEST 3-MONTH PERIOD CONSISTENT WITH OUR FORECAST OF SLOWING GROWTH.



- Virginia employment data is preliminary and will be revised in March.

Sources: US BLS, Virginia Dept. of Taxation

SERVICES ACTIVITY IN THE FEDERAL RESERVE'S FIFTH DISTRICT HAS TURNED NEGATIVE IN RECENT MONTHS, THE FIRST TIME THIS HAS OCCURRED SINCE THE PANDEMIC.



Source: Federal Reserve Bank of Richmond: The fifth district covers the District of Columbia, Maryland, North Carolina, South Carolina, Virginia, and most of West Virginia excluding the Northern Panhandle

THE JANUARY BLUE CHIP CONSENSUS FORECAST NOW HAS GDP CONTRACTING IN Q3 AND Q4 OF FY 2023 BEFORE REBOUNDING IN FY 2024, IN LINE WITH THE DECEMBER FORECAST.

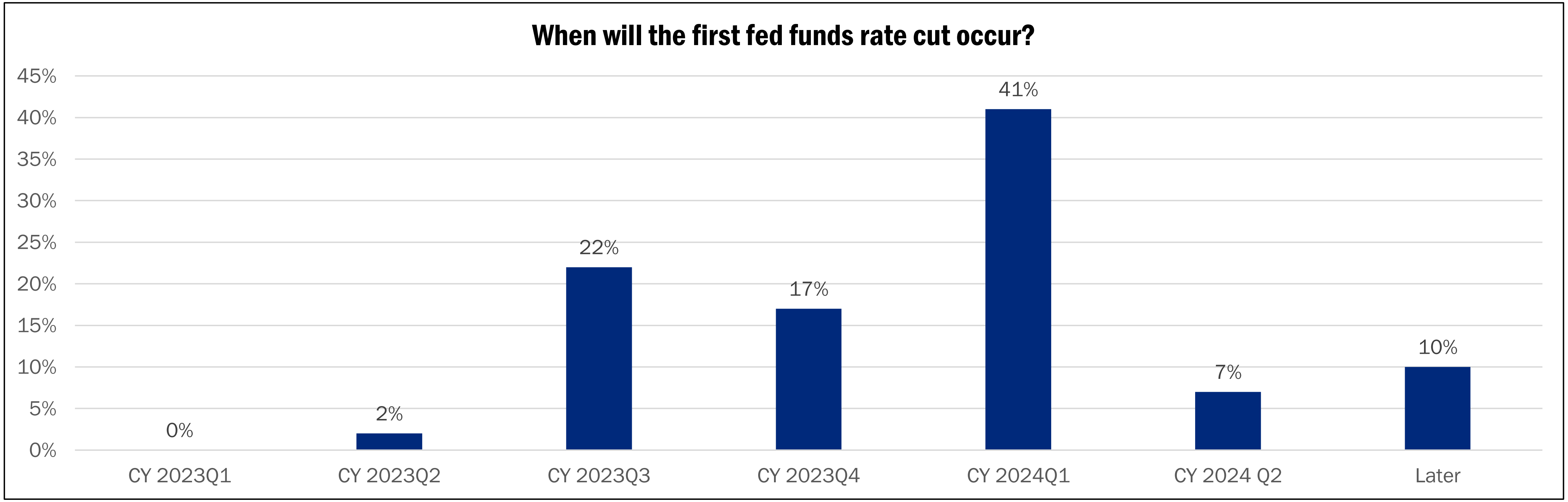
Real GDP, % Chg	FY2023	FY2024
GACRE	0.1	0.3
December*	0.8	-0.5
Moody's Jan	1.0	-0.5
Blue Chip Jan	1.1	0.4
IHS Jan	0.8	0.0

Unemployment Rate %	FY2023	FY2024
GACRE	4.9	5.6
December*	5.0	5.8
Moody’s Jan	5.6	5.3
Blue Chip Jan	4.7	4.8
IHS Jan	4.3	6.7

- The difference in the FY 2023 and FY 2024 forecasts of major indicators is marginal.

** December’s forecast reflects upward revisions to GDP in Q2 and Q3 that occurred after the forecast was released.*
Source: BLUE CHIP ECONOMIC INDICATORS, JANUARY 2023

A MAJORITY OF ECONOMISTS EXPECT THE FED TO BEGIN LOWERING RATES IN CY 2024, BUT 41 PERCENT THINK THAT THIS WILL OCCUR SOONER. FINANCIAL MARKETS ARE ALSO PRICING IN CUTS IN CY 2023.



* Source: *BLUE CHIP ECONOMIC INDICATORS, JANUARY 2023*

JANUARY FORECASTS INDICATE SLIGHTLY LOWER WAGES AND SALARIES GROWTH IN VIRGINIA COMPARED TO THE DECEMBER FORECAST, MAINLY DUE TO LOWER GROWTH IN AVERAGE WAGES.

VA Employment % Chg	FY 2023	FY 2024
GACRE	2.4	-0.4
December Forecast	2.4	-1.0
Moody's (Jan)	1.7	-1.0
IHS (Jan)	2.2	-1.0

VA Wages And Salaries, %Chg	FY 2023	FY 2024
GACRE	7.6	4.0
December Forecast	8.3	2.6
Moody's (Jan)	5.0	2.8
IHS (Jan)	7.3	3.3

AVERAGE WAGE, $	FY 2023	FY 2024
GACRE	78,876	82,189
December Forecast	79,101	82,107
Moody’s	77,067	79,978
IHS (Jan)	78,208	81,642

COLLECTION TRENDS JANUARY FISCAL YEAR-TO-DATE SUMMARY:

- Relative to the updated December forecast, unadjusted general fund revenues are ahead of forecast by $78.7 million year-to-date.
- Among the major revenue sources, after adjustments for timing and policy actions, withholding is 8.1 percent higher fiscal year-to-date essentially in line with the forecast. Sales tax revenue is 4.9 percent higher fiscal year-to date, weaker than expected. Non-withholding is 3.6 percent higher year-to-date, running slightly higher than projected.
- Corporate income taxes, however, are running 11.3 percent lower fiscal year-to-date compared to the previous year. All other sources of revenue are 10.3 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 $798.9 million to collections fiscal year-to-date. These are offset by tax rebates and changes to the standard deduction which subtracted $1.4 billion, for a net reduction of $583.3 million in the first seven months of FY 2023.
- December and January 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 2.1 percent fiscal year-to-date and 8.1 percent for the month of January. 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 JANUARY AND 2.1 PERCENT YEAR-TO-DATE.

	FY 2023	Pct Chg	Percent of	JANUARY				Fiscal Year-To-Date				Year-To-Date
Unadjusted Revenues $ Mil	**December**	**Req by Est**	**GF Rev**	**FY 2022**	**FY 2023**	**Change**	**% Change**	**FY 2022**	**FY 2023**	**Change**	**% Change**	**% of Total**
Withholding	$16,078.3	4.8%	60.9%	$1,341.9	$1,321.7	-$20.1	-1.5%	$8,768	$9,154	$386	4.4%	59.7%
Nonwithholding	$5,088.6	-25.3%	19.3%	$728.0	$905.7	$177.7	24.4%	$2,071	$2,815	$744	35.9%	18.4%
Refunds	-$3,535.2	103.1%	-13.4%	-$38.0	-$56.8	-$18.8	49.4%	-$380	-$1,435	-$1,055	277.3%	-9.4%
Sales and Use Tax	$4,926.3	8.1%	18.7%	$480.3	$468.9	-$11.4	-2.4%	$2,605	$2,873	$268	10.3%	18.7%
Corporate Income Tax	$1,809.1	-8.6%	6.9%	$61.5	$99.3	$37.7	61.3%	$1,074	$952	-$122	-11.3%	6.2%
All Other Sources	$2,020.7	1.7%	7.7%	$53.5	$102.1	$48.6	90.7%	$878	$968	$90	10.3%	6.3%
Total GF Revenues	**$26,387.8**	**-8.8%**	100.0%	**$2,627.1**	**$2,840.9**	**$213.7**	**8.1%**	**$15,016**	**$15,328**	**$312**	**2.1%**	**100.0%**
Adjusted Revenues												
Adjusted Withholding				$1,341.9	$1,466.5	$124.6	9.3%	$8,768.3	$9,479.1	$710.8	8.1%	
Adjusted Non-Withholding (PTET)				$728.0	$625.7	-$102.3	-14.0%	$2,070.8	$2,144.39	$73.6	3.6%	
Adjusted Refunds (Rebates)								-$380.5	-$378.2	$2.3	-0.6%	
Adjusted Sales (AST)*				-	-	-		$2,808.6	$2,946.5	$138.0	4.9%	
Total GF Revenues, Adjusted				**$2,627.1**	**$2,705.6**	**$78.5**	**3.0%**	**$15,219.2**	**$15,911.0**	**$691.8**	**4.5%**	

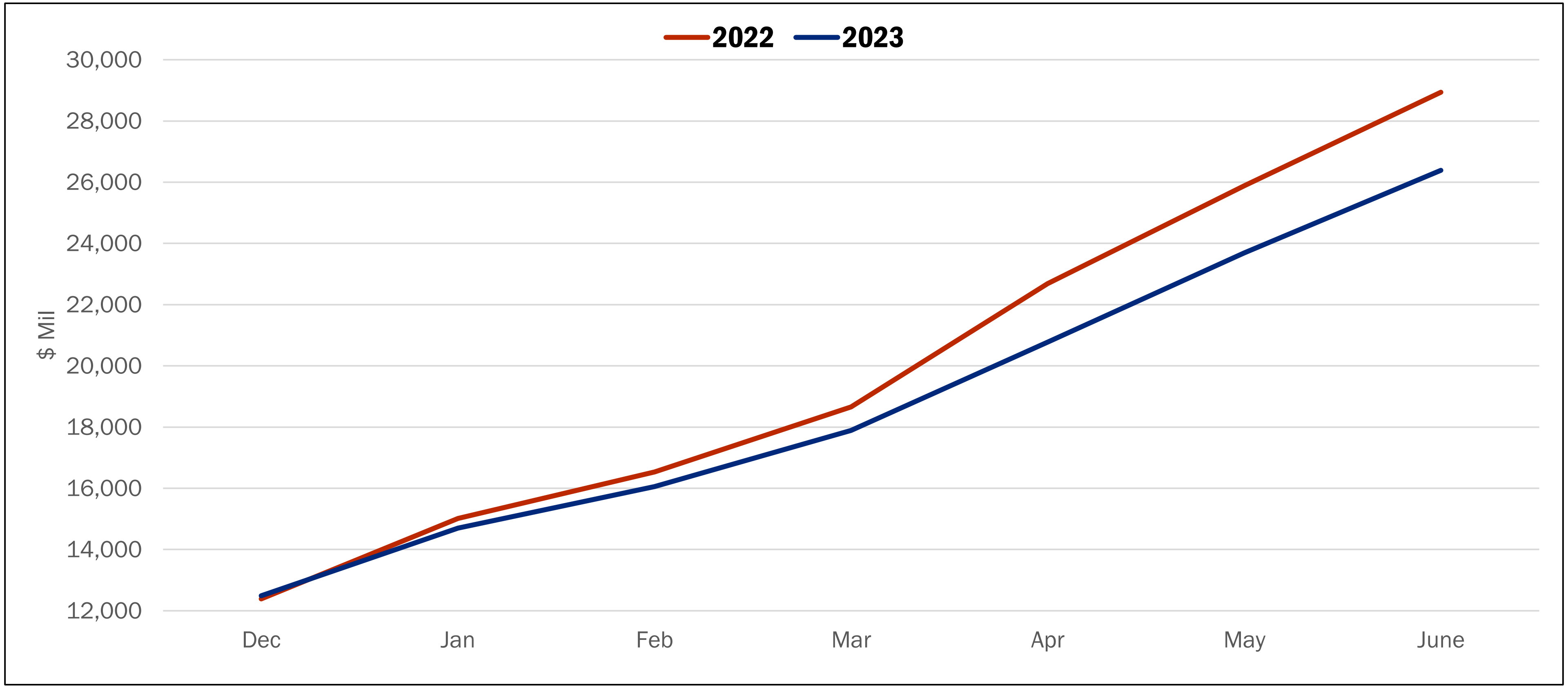
- The newly enacted PTET tax boosted collections by nearly $280.0 million in January. December and January PTET collections will, however, result in lower payments throughout the remainder of the year as the PTET is structured to provide equivalent offsetting credits to individual income tax.
- On an adjusted basis, revenues were up 3.0 percent for the month and 4.5 percent year-to-date.

JANUARY COLLECTIONS CAME IN ESSENTIALLY AS PROJECTED AND YEAR-TO-DATE COLLECTIONS REMAIN AHEAD OF FORECAST.

	JANUARY					FYTD				
SOURCE $ Mil	Actuals	Projected	Variance	PY	Y/Y %	Actuals	Projected	Variance	PY	Y/Y%
Withholding	1,321.7	1,360.4	(38.6)	1,341.9	-1.5%	9,154.1	9,175.3	(21.2)	8,768.3	4.4%
Non-withholding	905.7	873.8	31.9	728.0	24.4%	2,815.2	2,708.1	107.1	2,070.8	35.9%
IIT Refunds	(56.8)	(65.3)	8.5	(38.0)	49.4%	(1,435.4)	(1,411.6)	(23.8)	(380.5)	277.3%
Net	2,170.6	2,168.9	1.8	2,031.8	6.8%	10,534.0	10,471.8	62.1	10,458.6	0.7%
Sales/Use	468.9	495.4	(26.5)	480.3	-2.4%	2,873.3	2,910.8	(37.4)	2,605.2	10.3%
Corporate	99.3	106.9	(7.7)	61.5	61.3%	952.3	969.1	(16.8)	1,074.0	-11.3%
All other	102.1	70.4	31.7	53.5	90.7%	968.1	897.3	70.9	878.0	10.3%
Total GF Revenues	2,840.9	2,841.5	(0.7)	2,627.1	8.1%	15,327.7	15,249.0	78.7	15,015.8	2.1%

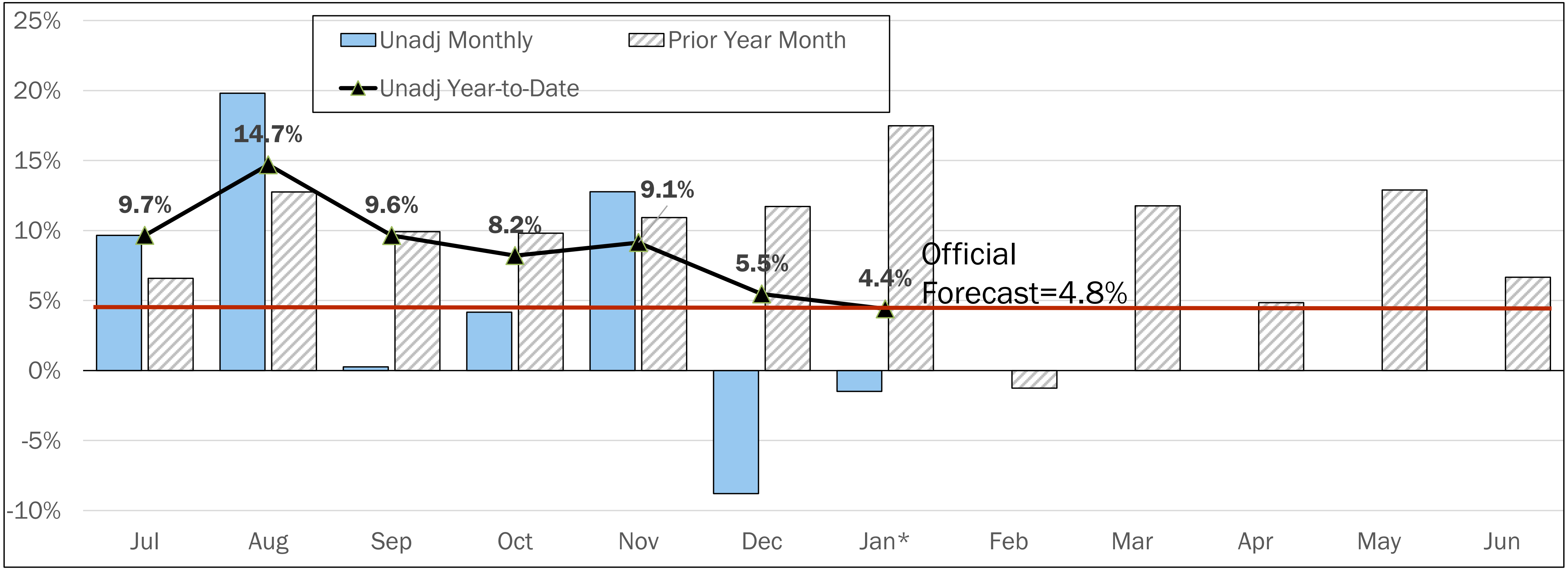
- The positive variance is mainly due to higher than expected collections for Non-withholding and All Other (interest income).

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



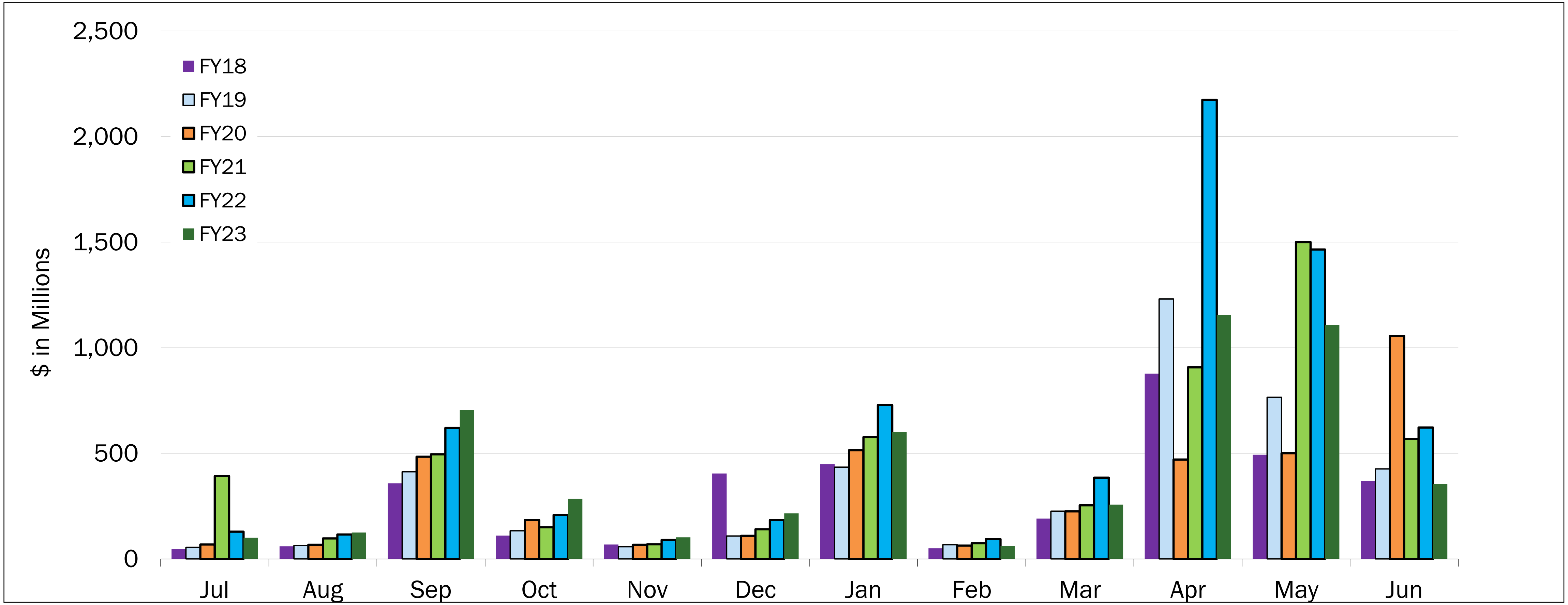
- The last quarter of the fiscal year accounts for 35 percent of all fiscal year revenues. Revenues in Q4 FY 2023 are forecast to be $1.8 billion lower compared to Q4 FY 2022.

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



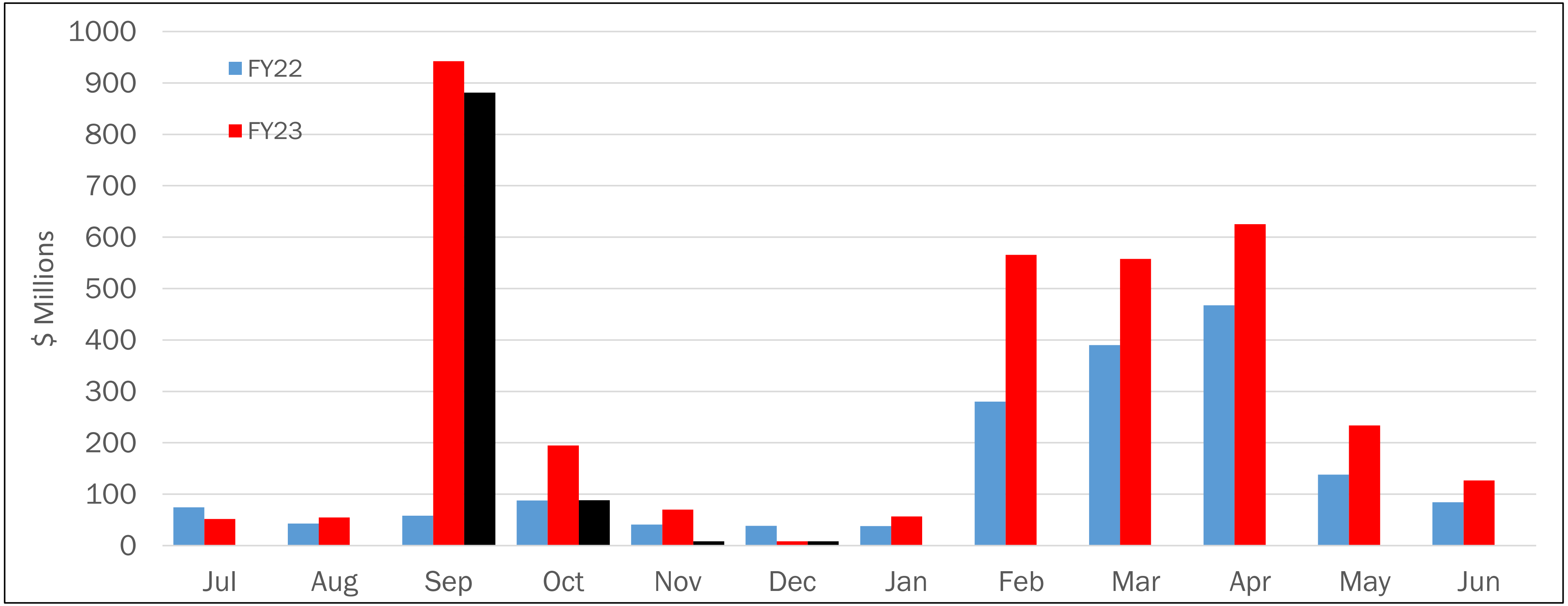
- *There is always some volatility in January collections as filers adjust payrolls for withholding tables and pay increases and due to the timing of bonuses. In addition, January collections were impacted by some filers who delayed withholding payments, accounting for an estimated $70-$100 million which will be received in February.

NON-WITHHOLDING TAX COLLECTIONS, AFTER ADJUSTING FOR THE PTET, ARE RUNNING 3.6 PERCENT HIGHER YEAR-TO-DATE.



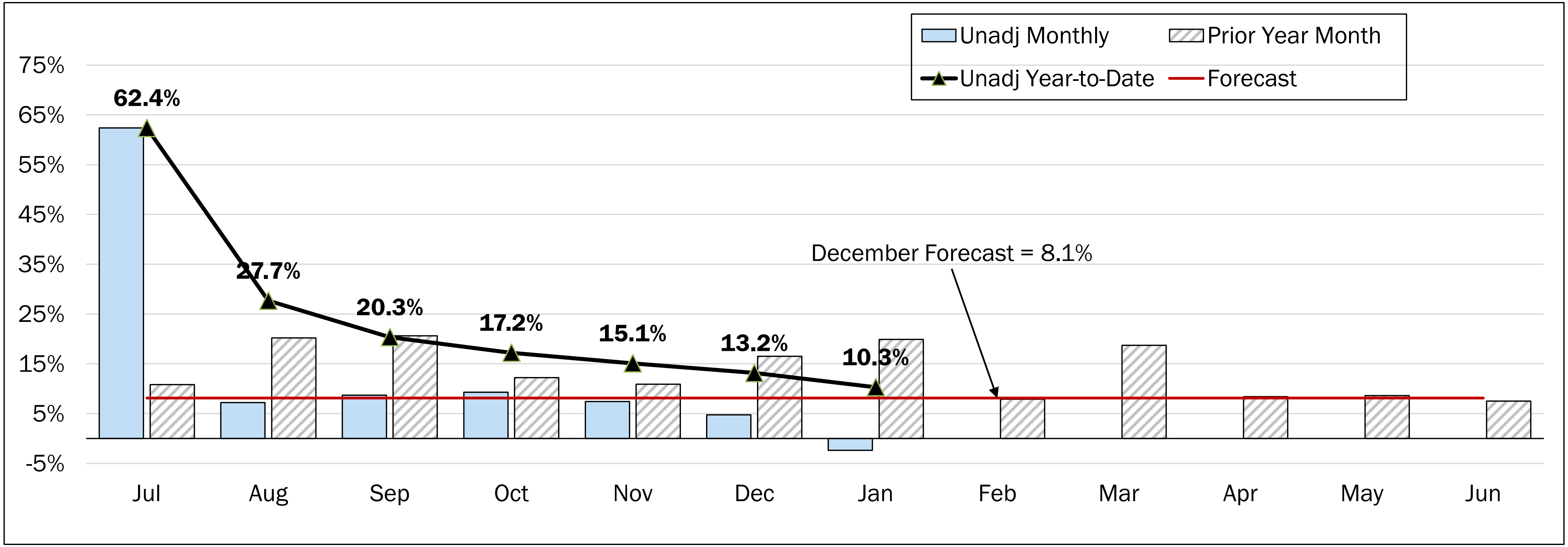
- Non-withholding collections, after adjusting for the PTET, were down by 14.0 percent in January, the first indication that non-withholding collections will be lower in FY 2023 relative to FY 2022.

INCOME TAX REFUNDS HAVE BEEN DOMINATED BY THE FALL'S TAX REBATES. REFUNDS WILL RAMP UP WITH THE TAX FILING SEASON.



- Through January, rebates have totaled over $1.06 billion dollars.
- Refunds are expected to exceed last year's levels, due also to policy changes, as the filing season ramps.

UNADJUSTED SALES TAX COLLECTIONS GREW BY 10.3 PERCENT YEAR-TO-DATE, MAINLY DUE TO THE END OF THE AST PROGRAM IN FY 2022.



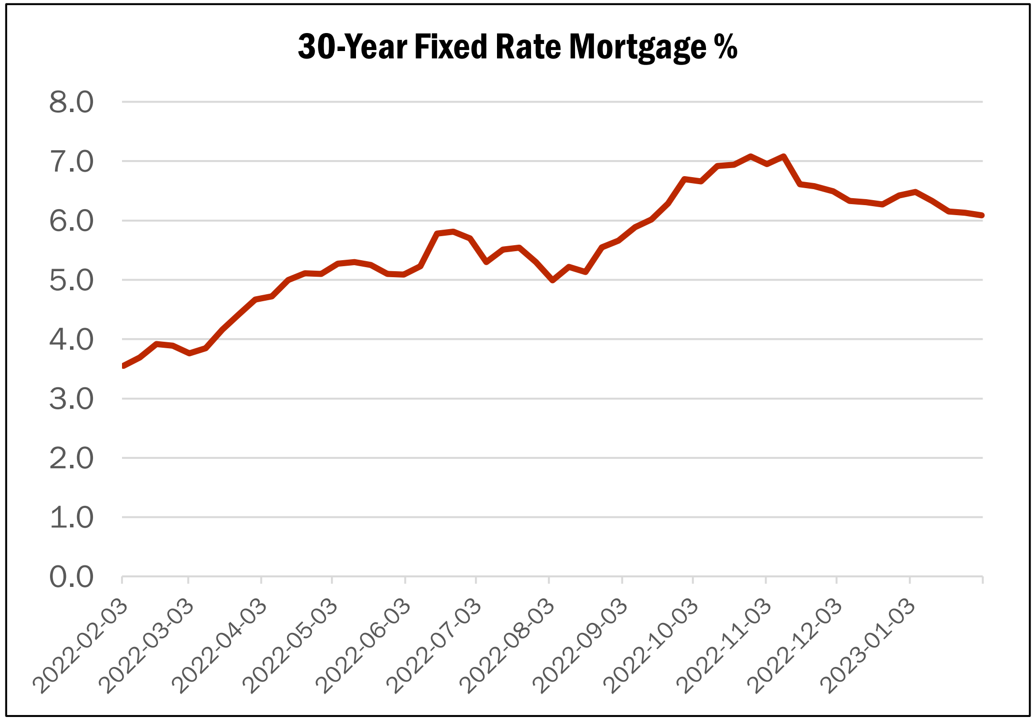
- Sales tax revenue during the October-December holiday period came in lower than expected, with growth of 2.8 percent over the prior year. Total retail sales in the US for the October through December 2022 period were up 6.7 percent over the same period.

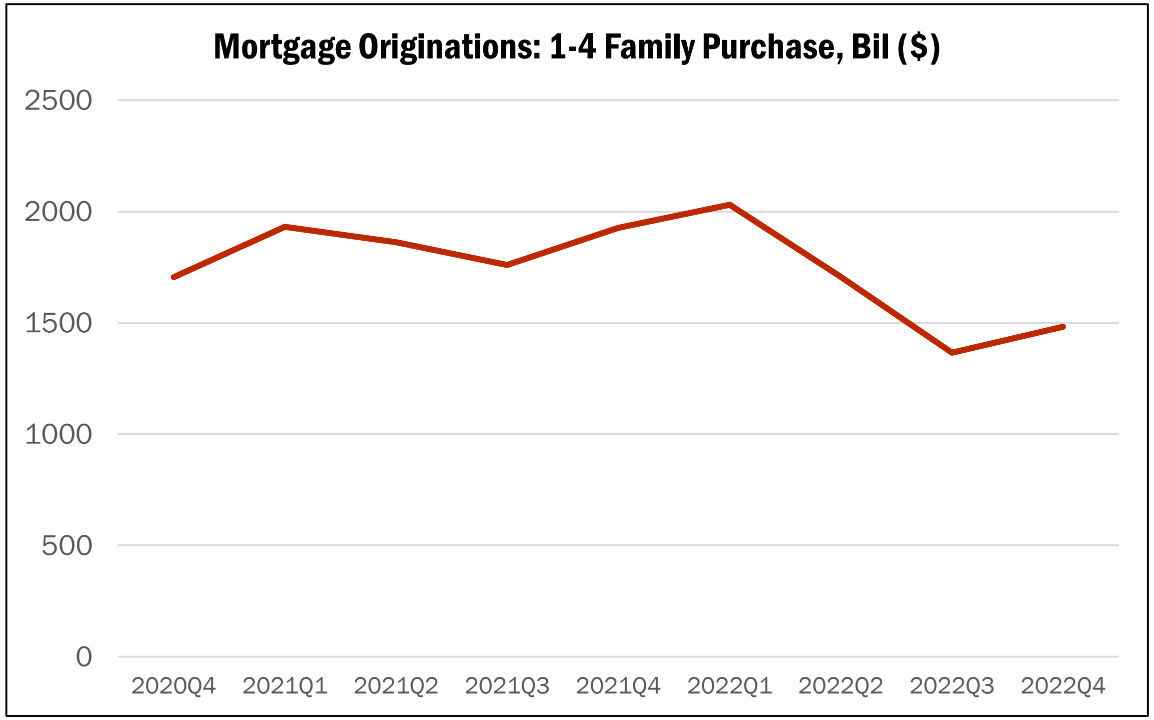
HOLIDAY SALES WERE DISAPPOINTING AND ACTIVITY HAS BEEN SHIFTING AWAY FROM CONSUMPTION OF GOODS BACK TO SERVICES.

- The shifting pattern of goods consumption back to services such as recreation and health is a drag on tax revenues in Virginia as most services are not taxed.

Source: US BEA

RECENT DATA INDICATE THAT HOUSING MAY BE STABILIZING AS MORTGAGE RATES HAVE COME DOWN.





Sources: Freddie Mac, Moody's Analytics (Right Chart)

OTHER SOURCES:

- Corporate income tax revenue fell by 11.3 percent year-to-date, which is more than anticipated.
- Deed recordation taxes are also down sharply, by 35.0 percent year-to-date, reflecting weakening demand for housing.
  - As noted in the previous slide, there are signs that the housing market may be stabilizing.
- Other Revenues are offsetting the weakness in corporate tax and deed tax revenues, exceeding projections by $70.9 million, mainly due to higher interest income.
  - Interest income totals $198.7 million in the first seven months of the year, compared to a full year forecast of $222.6 million.

COLLECTIONS SUMMARY AND KEY UPCOMING DATES

- Year-to-date collections are running ahead of the December updated projections by $78.7 million.

- Among major sources, growth in withholding collections are slowing, but the slowdown is largely anticipated in the forecast. Decelerating growth in sales tax collections are more concerning if the holiday sales period proves to be indicative of sustained weaker spending.

- There is still considerable uncertainty surrounding non-withholding revenues.

- Corporate income tax collections are trailing projections, but overall, the weakness in business and deed recordation revenue is being offset by higher interest income.

- Year-to-date collections and the recent economic outlook continue to support the December forecast.