



GOVERNOR YOUNGKIN'S PROPOSED AMENDMENTS 2022-2024 BUDGET

Economic Outlook and Revenue Forecast

A BRIEFING FOR THE SENATE FINANCE & APPROPRIATIONS,
HOUSE APPROPRIATIONS, AND HOUSE FINANCE COMMITTEES

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www.finance.virginia.gov
December 15, 2022

TOPICS FOR DISCUSSION

FISCAL YEAR 2022 YEAR-IN-REVIEW

FISCAL YEAR 2023 YEAR-TO-DATE REVENUE COLLECTIONS

CURRENT FISCAL AND ECONOMIC CONDITIONS AND OUTLOOK

DECEMBER REVENUE FORECAST

LONGER-TERM OUTLOOK

SUMMARY

- Year-to-date FY 2023 trends continue to show year-over-year growth in withholding, sales, and nonwithholding taxes. Corporate and recordation taxes are under pressure reflecting the effects of inflation on profits and rapidly rising interest rates on home sales.
- While recent data indicates that inflation may have peaked, it remains close to 40-year highs and the Federal Reserve has made it clear that it will continue to tighten until inflation is at or near its targeted level, +/- 500 basis points below today's level.
- Given the Fed's aggressive stance and after consultation with the Governor's Advisory Council on Revenue Estimates (GACRE), a prudent outlook was adopted by the Governor, resulting in a December forecast that is more cautious, with a recession beginning at the end of Q3 of FY 2023 and lasting two to three quarters. As a result, there will be a steep downturn in nonwithholding taxes with a flattening of withholding and sales and use and a continued year-over-year decline of corporate taxes.
- Given the stronger first half versus the Chapter 2 forecast, the result is a December forecast for the biennium that is \$2.2 billion higher than the forecast assumed in the current budget (before policy adjustments).
- GF revenues are projected to decline from \$28.9 billion in FY 2022 to \$26.4 billion in FY 2023.

SUMMARY (Cont.)

- Prior to enactment of the Governor's proposed amendments, the forecast projects excess resources of \$3.6 billion for FY 2023 reflecting:
 - Higher projected FY 2023 revenues of \$1.7 billion,
 - Prior reserves released on the balance sheet (super deposit and taxpayer reserve totaling \$849 million),
 - Expired appropriations the Governor is reverting to the General Fund (\$233 million),
 - Increased federal resources for Medicaid from the continuation of the public health emergency (\$354 million), and
 - The planned \$509 million rollover of surplus into FY 2024 included in Chapter 2.
- Of the \$3.6 billion in excess resources, the Governor's amendments provide \$1 billion in tax relief for individuals, both large and small businesses, and \$2.6 billion in targeted spending, largely one-time in nature, including capital spending of \$505 million.
- These amendments lead to a structurally balanced budget within the conservative revenue outlook presented.
- In addition, given the present economic uncertainty, an accordion feature has been added that will reduce proposed tax reductions and spending if actual 2023 revenues are below forecast.
- Looking beyond this biennium, per Code, we have prepared projections through FY 2028, which shows that the Commonwealth will experience meaningful excess revenues under conservative assumptions, further supporting the appropriateness of reducing the taxes for our current and prospective citizens.

FY 2022: GENERAL FUND REVENUES EXCEEDED THE FORECAST BY \$1.9 BILLION

General Fund Revenue Collections (in millions of dollars)

Revenue	Fiscal Year 2022			Growth Over FY 2021	
	Official Forecast	Actual	Forecast Variance	Dollars	Percent
Withholding	\$15,267.2	\$15,340.3	\$73.1	\$1,327.4	9.5%
Nonwithholding	5,346.6	6,810.5	1,463.9	1,593.5	30.5%
Refunds	(2,020.7)	(1,740.5)	280.2	185.7	-9.6%
Sales	4,437.6	4,558.1	120.5	391.9	9.4%
Corporate	2,009.6	1,978.7	(30.9)	463.0	30.5%
All Other	1,958.0	1,987.8	29.8	94.9	5.0%
Total GF Revenues	\$26,998.3	\$28,934.9	\$1,936.6	\$4,056.4	16.3%
GF Transfers	\$803.90	\$814.30	\$10.4	55.7	7.3%
Total General Fund	\$27,802.2	\$29,749.2	\$1,947.0	\$4,112.1	16.0%

- Nonwithholding and lower than expected refunds accounted for 90 percent of unplanned FY 2022 revenues vs. caboose budget.

REVENUE MOMENTUM HAS CARRIED FORWARD INTO FY 2023

Adjusted for policy and timing impacts, GF revenues are up 7.5 percent year-to-date.

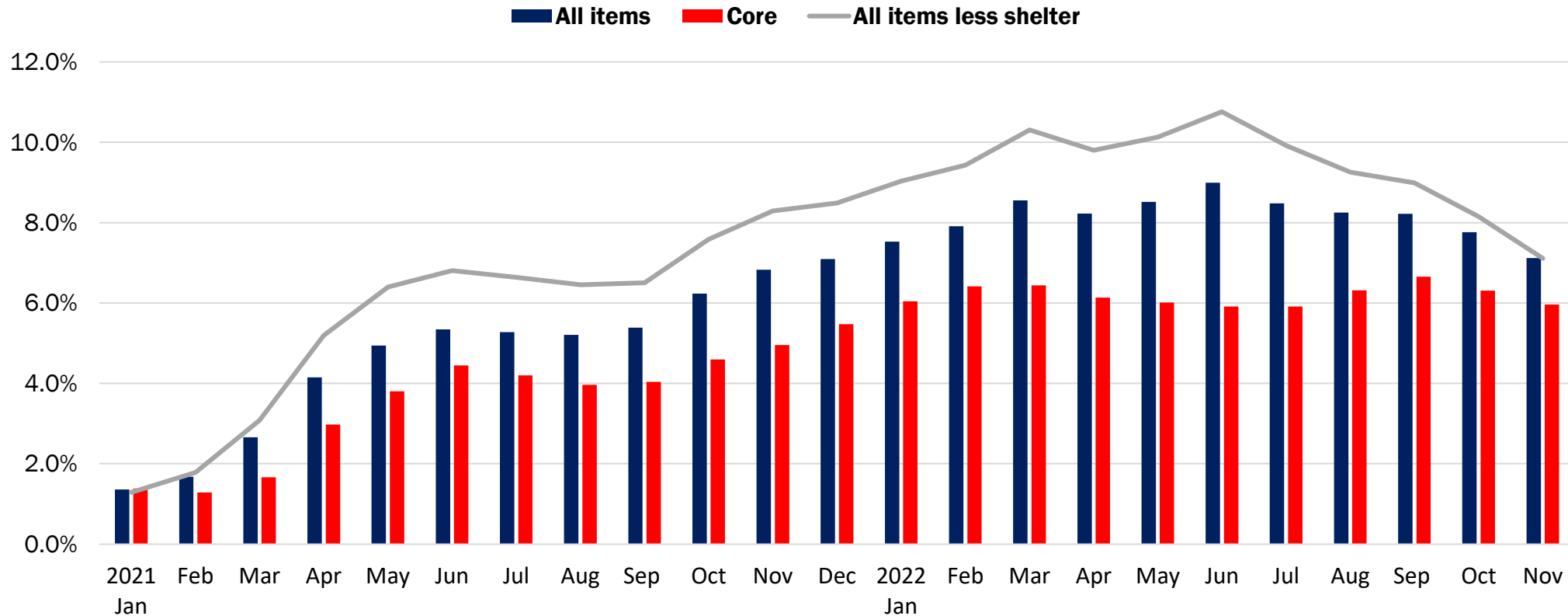
General Fund Revenue Collections

\$ Millions of Dollars

Revenue	FY 2023			November				Fiscal Year-To-Date				
	Ch 2 Estimate	Pct Chg Req by Est	Percent of GF Rev	FY 2022	FY 2023	Change	% Change	FY 2022	FY 2023	Change	% Change	Year-To-Date % of Total
Withholding	\$15,319.9	-0.1%	61.6%	\$1,201.9	\$1,355.5	\$153.6	12.8%	\$5,906.3	\$6,446.1	\$539.8	9.1%	67.4%
Nonwithholding	5,213.6	-23.4%	21.0%	89.4	101.9	12.5	14.0%	\$1,159.8	\$1,313.8	154.0	13.3%	13.7%
Refunds	(3,800.9)	118.4%	-15.3%	(40.9)	(69.9)	(29.0)	70.8%	(\$303.8)	(\$1,313.6)	(1,009.8)	332.4%	-13.7%
Sales and Use Tax	4,497.8	-1.3%	18.1%	374.1	401.8	27.8	7.4%	\$1,726.6	1,987.2	260.6	15.1%	20.8%
Corporate Income Tax	1,737.0	-12.2%	7.0%	93.2	20.7	(72.5)	-77.8%	\$602.3	512.2	(90.0)	-14.9%	5.4%
All Other Sources	1,903.9	-4.2%	7.7%	164.3	191.8	27.5	16.7%	\$598.5	623.5	25.0	4.2%	6.5%
Total GF Revenues	\$24,871.3	-14.0%	100.0%	\$1,882.0	\$2,001.8	\$119.8	6.4%	\$9,689.6	\$9,569.2	(\$120.4)	-1.2%	100.0%
Adjusted Sales								\$1,930.0	\$2,060.4	\$130.4	6.8%	
Adjusted Withholding				\$1,201.9	\$1,293.3	\$91.3	7.6%	\$5,906.3	\$6,442.7	\$536.4	9.1%	
Adjusted Refunds				(\$40.9)	(\$61.2)	(\$20.3)	49.5%	(\$303.8)	(\$318.2)	(\$14.4)	4.7%	
All Other Revenues				\$721.0	\$715.1	(\$5.9)	-0.8%	\$2,360.5	\$2,449.5	\$89.0	3.8%	
Total GF Revenues, Adjusted for AST, Withholding and Refunds				\$1,882.0	\$1,947.2	\$65.2	3.5%	\$9,893.0	\$10,634.5	\$741.5	7.5%	

- Adjusted withholding revenue is 9.1 percent higher year-to-date and 7.6 percent higher year-over-year in November.
- Sales tax revenue is 6.8 percent higher year-to-date and 7.4 percent higher year-over-year in November.
- Corporate income tax collections are down 14.9 percent year-to-date and down 78 percent year-over-year in November

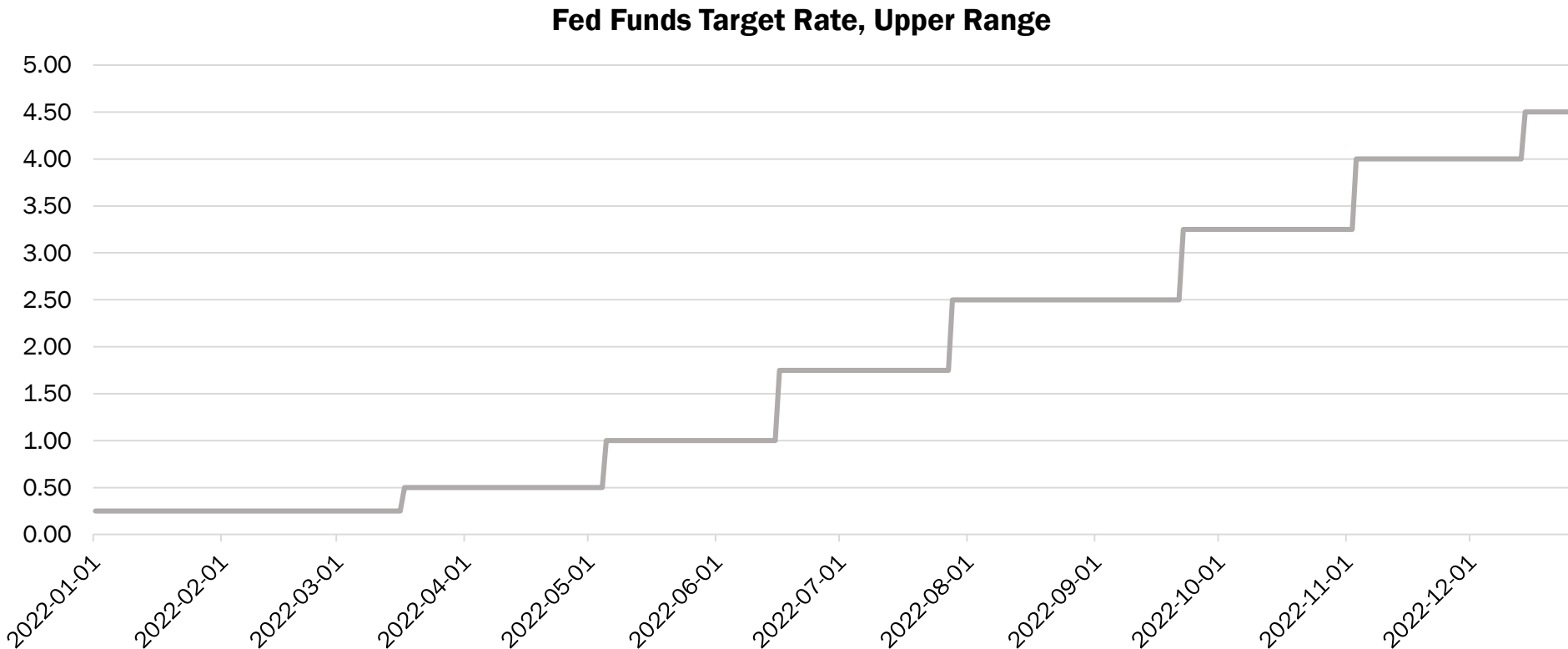
NOVEMBER'S CPI REPORT PROVIDED SOME SIGNS THAT INFLATION MAY HAVE PEAKED



Source: US BLS

- For the twelve months ended in November, the CPI was up 7.1 percent. While lower than in recent months, inflation remains at levels not seen since the early-1980s.

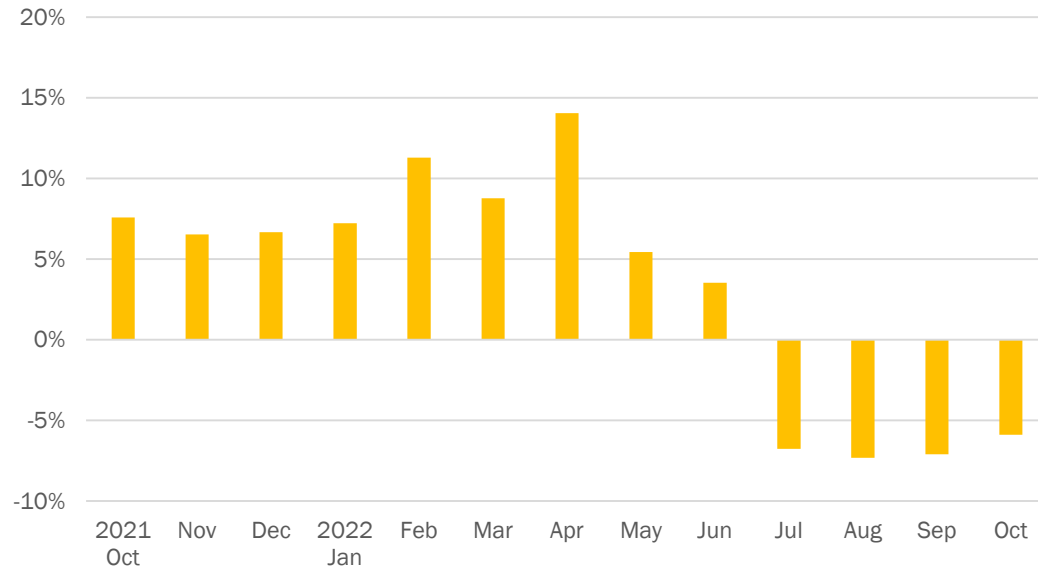
THE FED HAS MADE IT CLEAR THEY WILL CONTINUE TO TIGHTEN UNTIL INFLATION RETURNS TO TARGET LEVELS



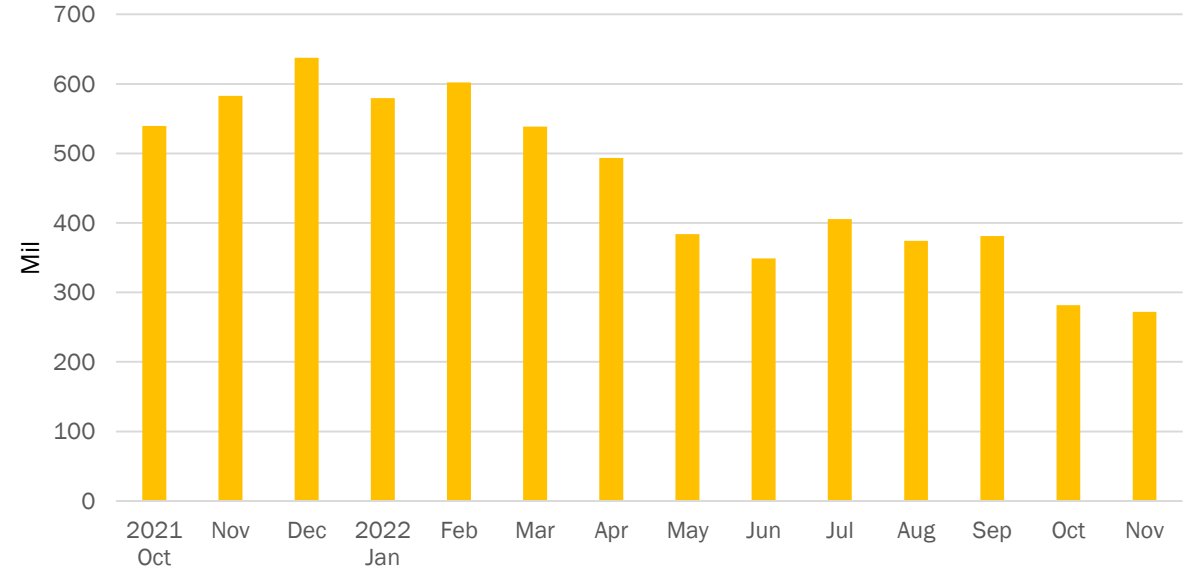
- A 50 basis point rate hike was announced at the December meeting.

THERE ARE SIGNS THAT RISING INTEREST RATES ARE SLOWING THE ECONOMY

Housing Starts, Y/Y % Chg, 3-mth avg



US Employment, M/M Chg 3 Mth Avg

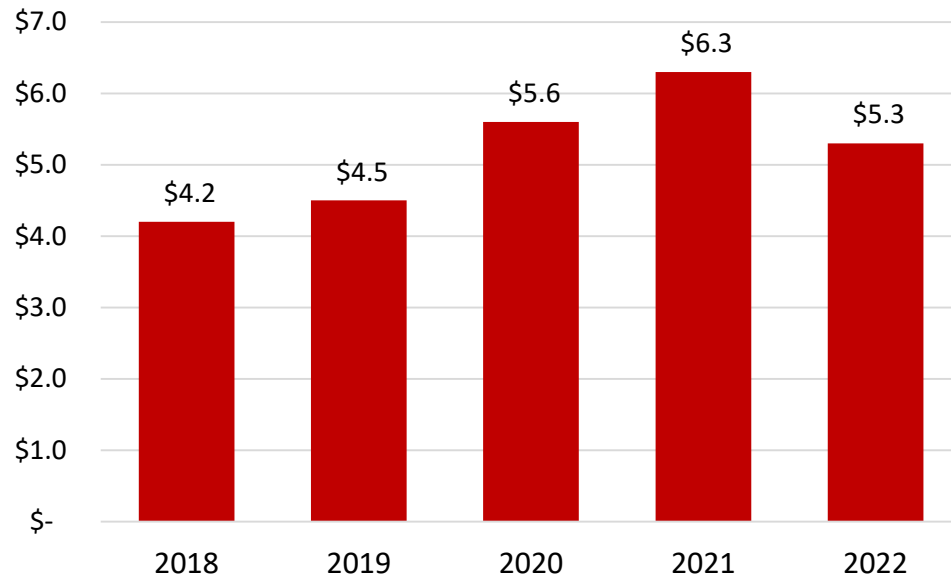


Source: US Census Bureau and BLS

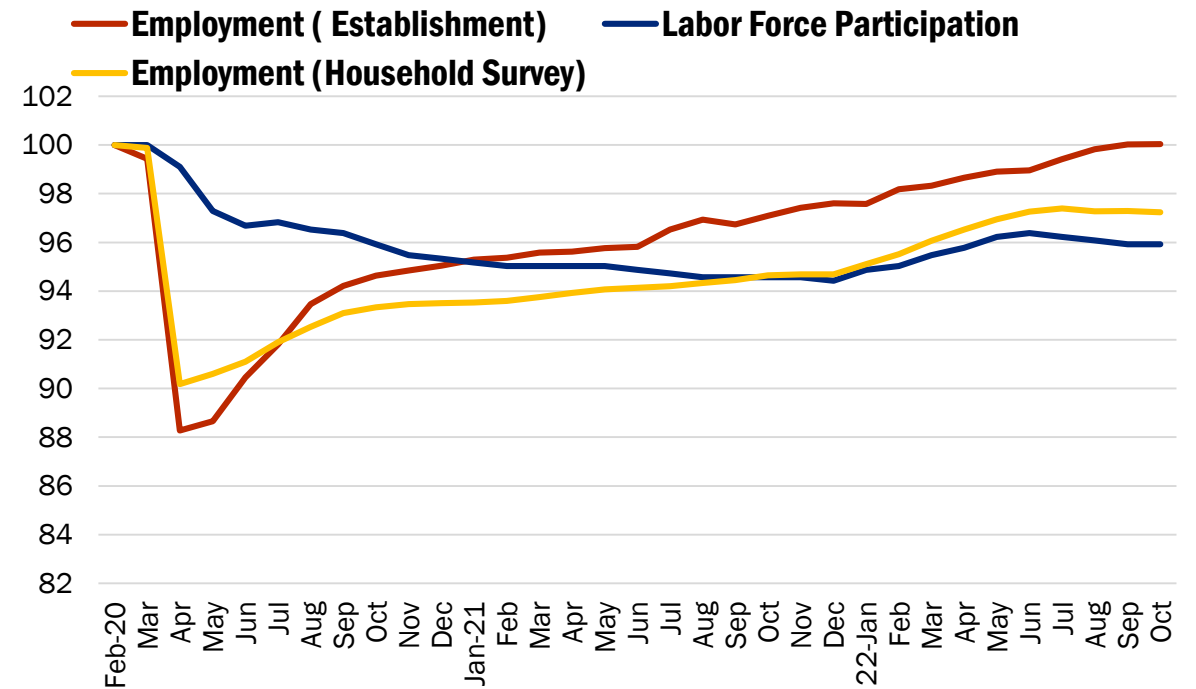
- Interest rate sensitive sectors of economy have already been impacted by Fed hikes
- Labor markets are beginning to soften though not as fast as anticipated. Mass layoffs in the tech sector are not yet reflected in the labor statistics

VIRGINIA'S ECONOMY: HOUSING IS ALSO SLOWING AND HOUSEHOLD EMPLOYMENT HAS YET TO FULLY RECOVER

Virginia Home Sales Dollar Volume \$ Bil, September

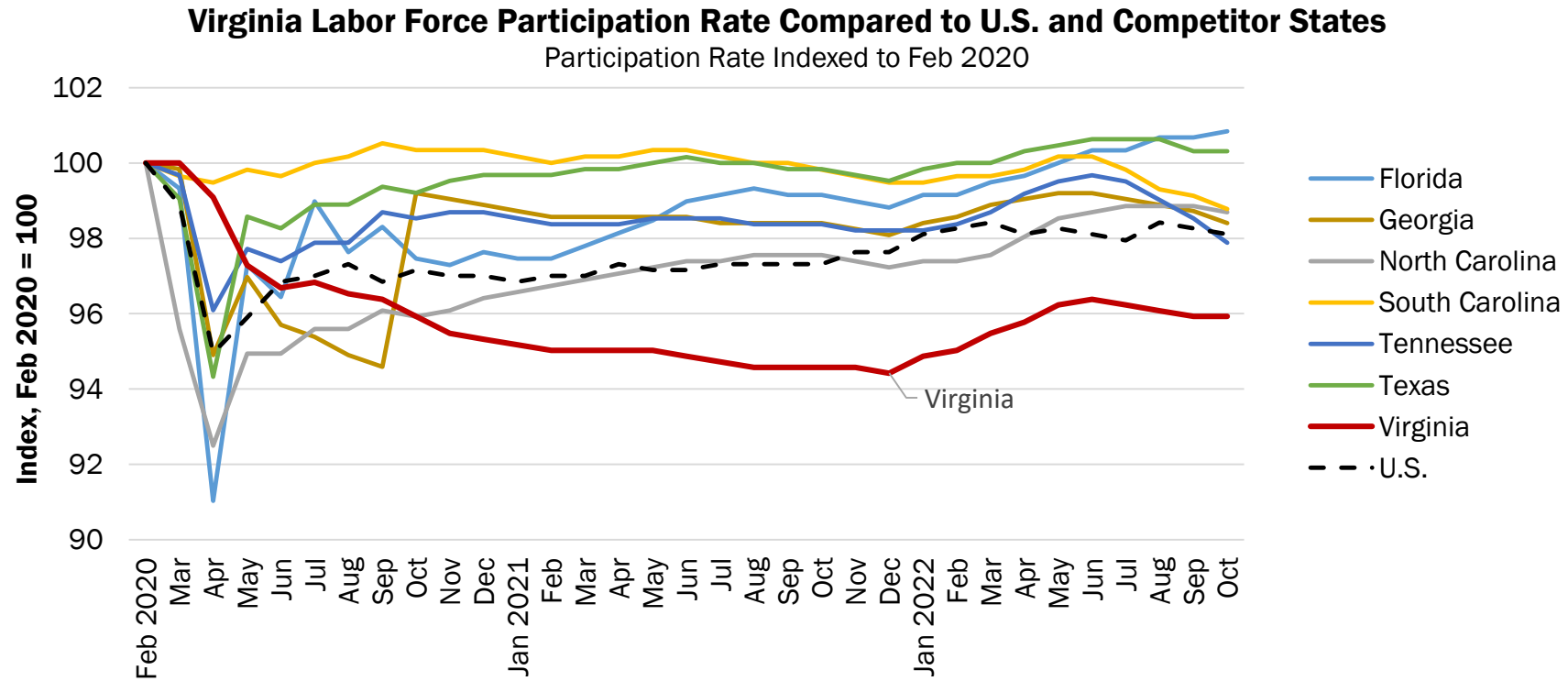


Sources: Virginia Association of Realtors, US BLS



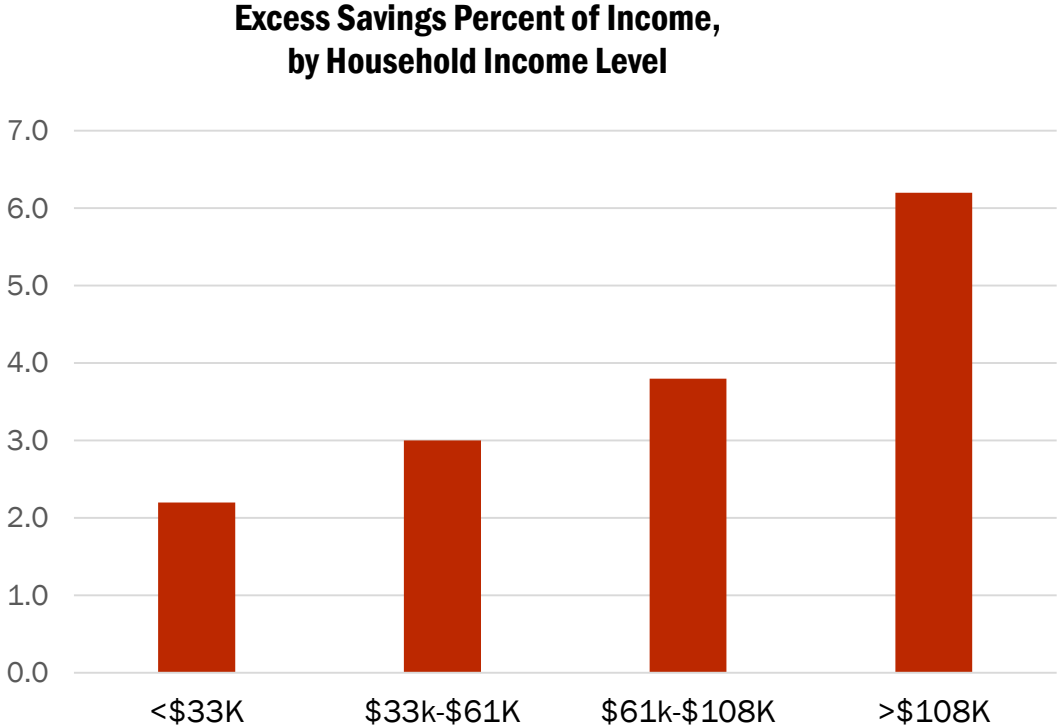
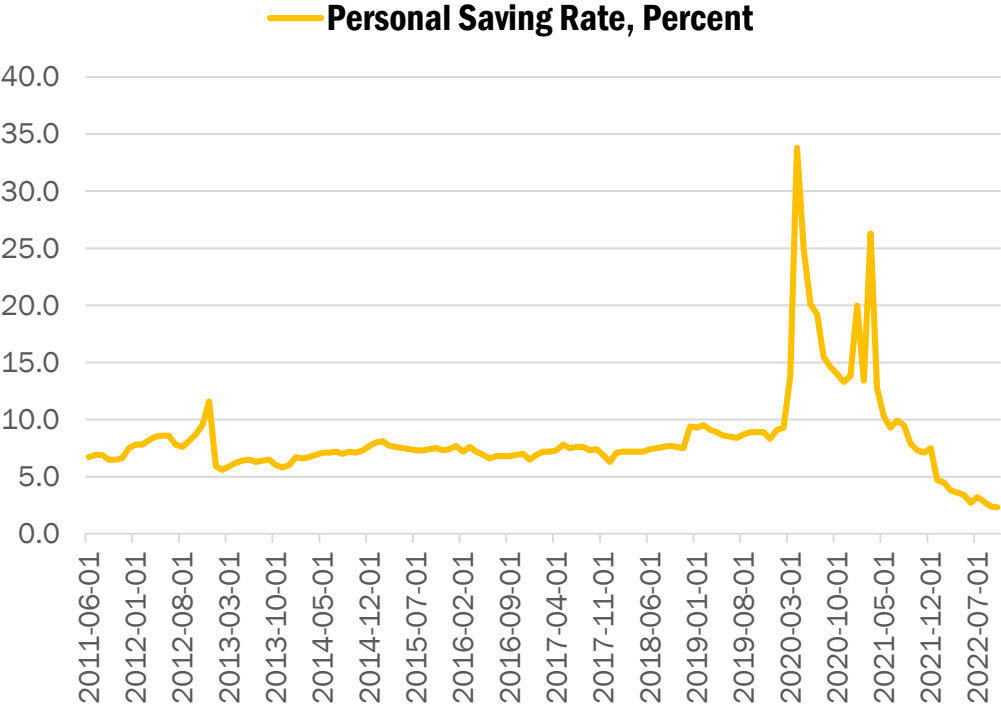
LABOR FORCE PARTICIPATION IS LAGGING

Competitor states have seen quicker recovery.



Source: BLS

MASSIVE SAVINGS ACCUMULATED DURING THE PANDEMIC STILL PROVIDE BUFFER FOR MIDDLE TO HIGHER INCOME HOUSEHOLDS



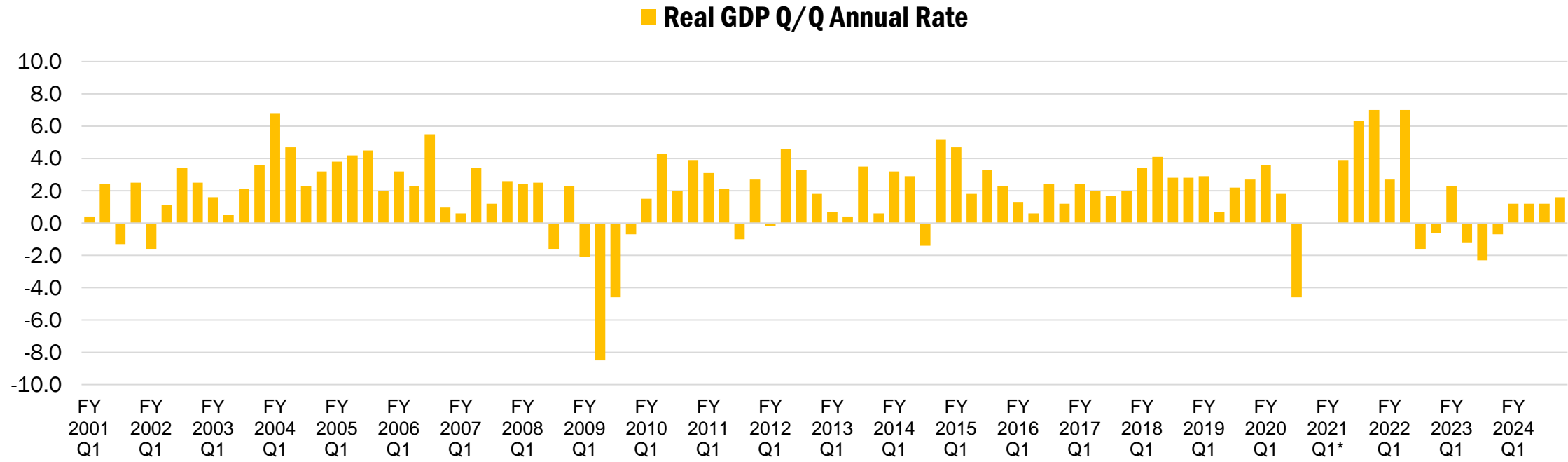
Sources: JP Morgan, courtesy Goldman Sachs, and FRB

- But that cushion is rapidly declining, particularly at lower income levels.

FORECAST PRESENTED TO GACRE: A PRUDENT FORECAST THAT ASSUMES--

- The Federal Reserve Board continues to raise rates to slow the economy and tame inflation.
- Inflationary pressures subside quickly, allowing the Fed to pivot at the end of CY 2023.
- A recession occurs beginning in Q2 FY 2023 and lasts three quarters.
- Recent growth in capital gains and non-wage income is unsustainable implying steep declines in nonwithholding collections.

GACRE ASSUMPTION: A SHORT AND MILD RECESSION BEGINNING IN Q2 FY 2023 AND LASTING THREE QUARTERS

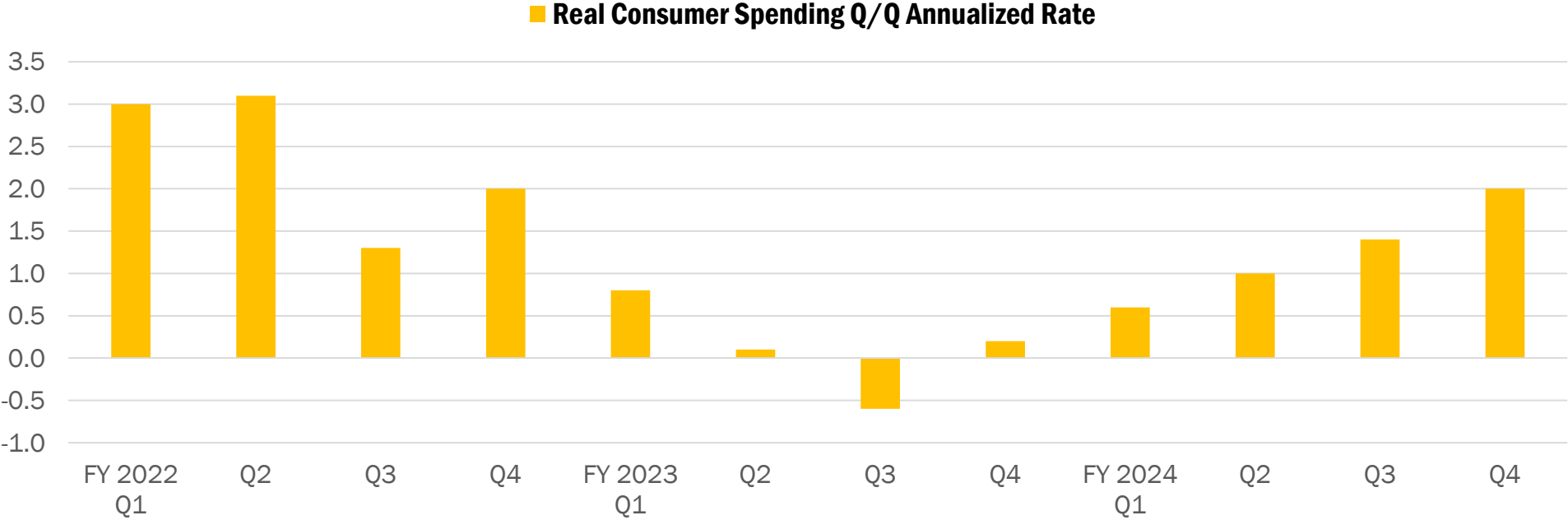


* Pandemic period outliers are not shown

Source: US BEA, IHS Markit

CONSUMERS WILL BE ABLE TO BEAR THE IMPACT OF HIGHER FED RATES

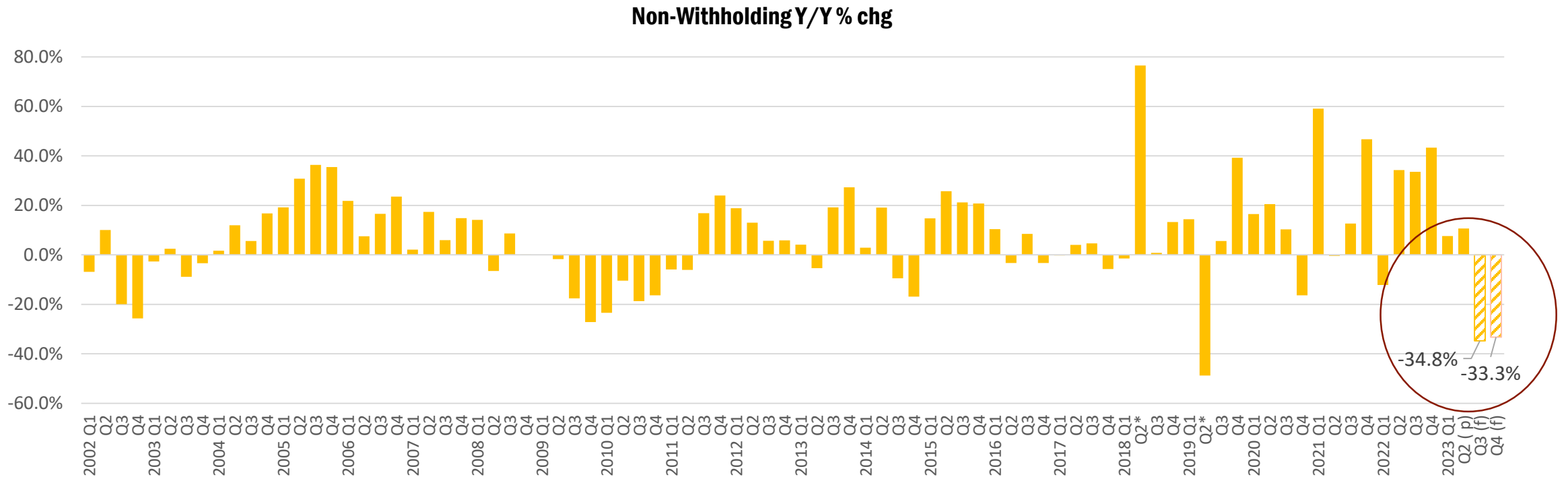
- Real consumer spending dips briefly in Q3 of FY 2023 but remains positive for the year



Source: US Census Bureau, IHS Markit

HOWEVER, RECENT GROWTH IN CAPITAL GAINS AND OTHER NON-WAGE INCOMES IS UNSUSTAINABLE

Nonwithholding is projected to fall sharply in 2023 and again in 2024 reverting to a long-term sustainable trend



Source: Virginia Dept. of Taxation , 2018Q2 reflected income shifting due to the TCJA and SALT cap limitation that shifted income into TY 2017. 2019Q2, as a result, declined

POST-GACRE ADJUSTMENTS

Economic Assumptions:

- The consensus view of GACRE members was that a recession occurs one to two quarters later than the presented forecast.
- As a result, the revenue forecast was increased in FY 2023 and lowered in FY 2024.
- By FY 2025 the economy recovers to the original GACRE forecast reflecting a more pronounced recovery.
- The outlook for Virginia's economy was also revised to reflect more near-term strength followed by a sharper decline.

Policy Adjustments:

- After accounting for the revised economic outlook, the revenue forecast is further adjusted to reflect proposed policy changes.

POST-GACRE ASSUMPTIONS: GROWTH IN FY 2023 IS PROJECTED TO BE SLIGHTLY HIGHER WHILE FY 2024 IS LOWER

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

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

Source: Virginia Dept. of Taxation, IHS Markit

DECEMBER GENERAL FUND REVENUE FORECAST

Composition of the December Revenue Forecast

2022-2024 Biennium

(dollars in millions)

	FY 2022 (Actual)	FY 2023	FY 2024	Total Biennium
General Fund Revenues: Chapter 2	\$28,934.9	\$24,871.3	\$27,263.0	\$52,134.4
General Fund Revenues: GACRE		\$26,279.3	\$28,052.2	\$54,331.5
Increase/(Decrease) Over Chapter 2: GACRE		\$1,408.0	\$789.1	\$2,197.2
Post-GACRE Adjustments:				
Economic Outlook Adjustments		\$180.5	(\$222.1)	(\$41.6)
General Fund Revenues After Economic Adjustments		\$26,459.9	\$27,830.1	\$54,290.0
Policy Adjustments		(\$72.1)	(\$928.9)	(\$1,001.0)
General Fund Revenues: December		\$26,387.8	\$26,901.2	\$53,289.0
Increase/(Decrease) Over Chapter 2: December		\$1,516.4	(\$361.8)	\$1,154.6

Totals may not sum due to rounding. Excludes GF transfers.

GOVERNOR PROPOSES TO CUT TAXES BY \$1.0 BILLION OVER THE BIENNIUM

Tax Cuts 2022-2024 Biennium (dollars in millions)

	FY 2023	FY 2024	Total Biennium
Policy Adjustments:			
Tax Conformity	(\$0.2)	(\$0.3)	(\$0.5)
Individual Rate Reduction (5.5% Top Rate TY24)	--	(333.3)	(333.3)
Standard Deduction Increase (\$9k/\$18k TY24)	--	(94.9)	(94.9)
Remove Age Limit on Military Retirement Subtraction (TY24)	--	(37.8)	(37.8)
Decrease Corporate Income Tax Rate to 5% (TY23)	(71.9)	(290.2)	(362.1)
QBI 10% Deduction (TY23)	--	(162.1)	(162.1)
Increase Business Interest Expense Deduction to 50% (TY23)	--	(10.3)	(10.3)
SUT Exemption for Controlled Environment Ag Facilities*	--	--	--
Total Policy Adjustments	(\$72.1)	(\$928.9)	(\$1,001.0)

*Revenue impact is unknown, but likely insignificant.

AFTER POLICY ADJUSTMENTS, PROJECTED GENERAL FUND REVENUES AND TRANSFERS ARE \$1.2 BILLION HIGHER COMPARED TO CHAPTER 2

	Fiscal Year 2022	Fiscal Year 2023			Fiscal Year 2024			2022-2024 Biennium		
	Actual	Ch. 2 Official Forecast	December Forecast	Change	Ch. 2 Official Forecast	December Forecast	Change	Ch. 2 Official Forecast	December Forecast	Change
REVENUE (\$ mil.)										
Withholding	\$15,340.3	\$15,319.9	\$16,078.3	\$758.4	\$15,775.5	\$16,026.9	\$251.4	\$31,095.4	\$32,105.2	\$1,009.8
Nonwithholding	6,810.5	5,213.6	5,088.6	(125.0)	5,573.0	4,582.7	(990.3)	10,786.6	9,671.3	(1,115.3)
Refunds	(1,740.5)	(3,800.9)	(3,535.2)	265.7	(2,289.9)	(1,882.8)	407.1	(6,090.8)	(5,418.0)	672.8
Sales & Use Tax	4,558.1	4,497.8	4,926.3	428.5	4,472.7	4,876.5	403.8	8,970.5	9,802.8	832.3
Corporate Income	1,978.7	1,737.0	1,809.1	72.1	1,784.9	1,461.0	(323.9)	3,521.9	3,270.2	(251.7)
All Other Sources	<u>1,987.9</u>	<u>1,903.9</u>	<u>2,020.6</u>	<u>116.7</u>	<u>1,946.8</u>	<u>1,836.9</u>	<u>(109.9)</u>	<u>3,850.7</u>	<u>3,857.6</u>	<u>6.8</u>
TOTAL GF REVENUES	\$28,934.9	\$24,871.3	\$26,387.8	\$1,516.4	\$27,263.0	\$26,901.2	(\$361.8)	\$52,134.4	\$53,289.0	\$1,154.6
TOTAL TRANSFERS	<u>814.3</u>	<u>714.7</u>	<u>679.4</u>	<u>(35.3)</u>	<u>733.2</u>	<u>793.2</u>	<u>60.0</u>	<u>1,447.9</u>	<u>1,472.6</u>	<u>24.7</u>
TOTAL GENERAL FUND	\$29,749.3	\$25,586.0	\$27,067.1	\$1,481.1	\$27,996.2	\$27,694.5	(\$301.8)	\$53,582.2	\$54,761.6	\$1,179.4

- The forecast adds \$1.0 billion in projected withholding revenues, as job and wage growth offsets tax reductions.
- \$251.7 million decrease in corporate income tax collections primarily reflects the revenue impact of corporate rate reductions.

LONGER-TERM OUTLOOK CONFIRMS STRUCTURAL BALANCE

- *Va. Code* §§ 2.2-1503 and 2.2-1503.1 require the Governor to prepare a long-term revenue forecast (annually) and a six-year financial plan (biennially).
- The Governor asked the Department of Planning and Budget (DPB) to update the six-year plan to take into account the December Post-GACRE forecast and proposed spending and tax policies in HB 1400 / SB 800.
- The spending projections fully-fund public education (including a 2.0 percent raise each year for teachers), Medicaid/CHIP and TANF, a 2.0 percent raise each year for state employees, VITA costs growing at 5.4 percent each year, and an increase in HB 599 funding to local police departments consistent with Chapter 2.
- It is a reasonable plan prepared by informed state budget professionals, and served as a basis for the Governor's budget deliberations.
- The outlook is backstopped by \$4.2 billion in reserves.

BUDGET RESPONSIBLY RETURNS REVENUE SURPLUS TO TAXPAYERS

General Fund Projections Assuming Enactment of the Governor's Budget, FY 2023 to FY 2028

(dollars in millions)

	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>	<u>FY 2027</u>	<u>FY 2028</u>
Prior to Proposed Amendments:						
Balance, Current Law	\$3,626	\$3,687	\$5,487	\$7,463	\$9,377	\$11,421
Annual Increase in Balance	—	\$61	\$1,800	\$1,976	\$1,914	\$2,043
Proposed Amendments:						
Tax Relief	\$72	\$929	\$1,418	\$1,475	\$1,537	\$1,605
One-Time Spending	\$400	\$1,112	\$4	—	—	—
Ongoing Spending	113	484	377	402	438	429
Capital Spending Financed by Cash	176	329	—	—	—	—
Mandatory GF to Revert	(71)	—	—	—	—	—
TOTAL NET NEW SPENDING	\$617	\$1,925	\$381	\$402	\$438	\$429
Future Potential Required Stabilization Fund Deposit	—	—	—	—	\$175	—
Balance Assuming Enactment of Governor's Budget	<u>\$2,936</u>	<u>\$143</u>	<u>\$145</u>	<u>\$245</u>	<u>\$9</u>	<u>\$18</u>

CALCULATION OF YEAR-END FY 2023 GF BALANCE AVAILABLE FOR APPROPRIATION

	<u>FY 2023</u>
Chapter 2, 2022 Special Session I, FY 2023 Year End Balance	\$509.1
Changes to GF Resources	
Change in Revenue forecast	\$1,588.5
Change in Transfers	92.7
Remove Revenue Stabilization Fund Super Deposit reservation	452.3
Balance sheet amount reserved for Taxpayer Relief	396.9
Discretionary GF Reappropriation to remain reverted	<u>233.4</u>
Total Change in Resources	\$2,763.8
Changes to Spending Estimates Subject to Forecast ¹	
Medicaid PHE continuation, forecast, and related adjustments	(\$350.3)
Child Welfare, TANF and related forecasts	(3.9)
Debt Service effect of interest rate forecast	<u>1.3</u>
Total Changes to Spending Estimates	(\$352.9)
GF Balance Available for Allocation by the Governor	<u>\$3,625.8</u>

Totals may not sum due to rounding.

¹—Effect on spending; negative numbers increase balance.

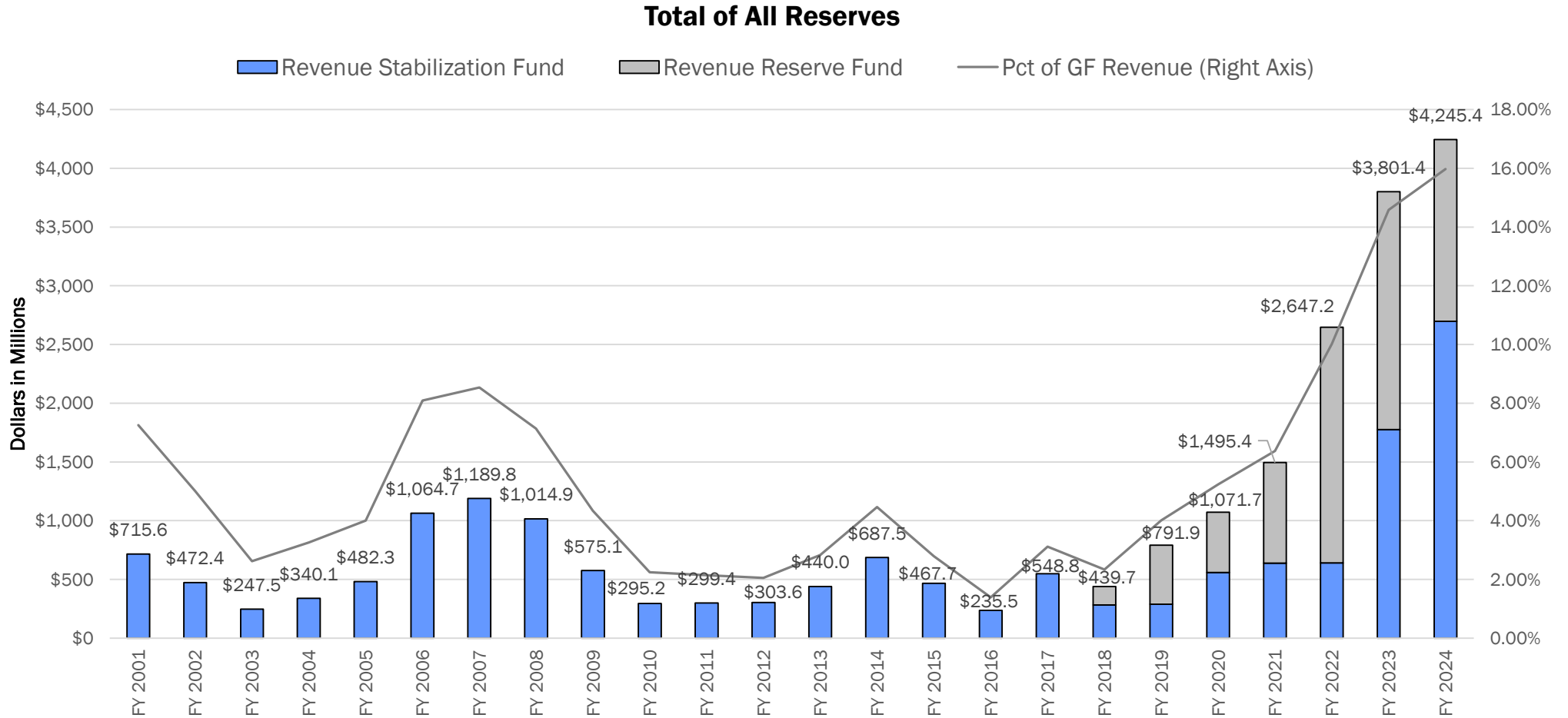
BUDGET INCLUDES TRIGGERS IN CASE RECESSION IS DEEPER THAN ANTICIPATED

Contingent Policies Included in the Budget (dollars in millions)

	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>	<u>FY 2027</u>	<u>FY 2028</u>
Reduction in Top Individual Income Tax Rate	---	\$333.3	\$716.2	\$750.8	\$792.7	\$836.7
Additional Sites Funds	---	250.0	---	---	---	---
Additional Resiliency Funds	---	100.0	---	---	---	---
Employee Performance Bonus Program	---	100.0	---	---	---	---
Capital Supplement Funding	---	300.0	---	---	---	---
Total Contingent Items	---	\$1,083.3	\$716.2	\$750.8	\$792.7	\$836.7

- The Governor’s budget amendments allocate all available resources, but provides that both spending and tax reductions can be reduced if 2023 revenues are below forecast.
- The table shows the order in which contingent items will be maintained to the extent that revenues allow them to be funded.

COMBINED RESERVE BALANCES PROJECTED TO TOTAL \$4.2 BILLION BY FY 2024



CONCLUSION

- Despite the expectation of a recession this biennium, revenue collections to date indicate that revenues should be increased by a total of \$2.2 billion for the amended budget.
- Code-required financial plan estimates through 2028 indicate that excess revenues will continue in the next two biennium, starting at \$1.8 billion in 2025 and growing thereafter.
- The Governor's budget amendments prioritize returning the revenue surplus to Virginia taxpayers, lowering business and individual rates to attract and retain businesses and make Virginia the best place to work, live and raise a family.
- The Governor's budget amendments also responsibly address needs for additional spending for economic development, workforce development, education, public safety, behavioral health and the environment.
- Both tax reduction and targeted spending increases can be accommodated as a result of the enviable financial strength of the Commonwealth, which includes \$4.2 billion in reserves.
- Triggers are in place to mitigate against a revenue decline.
- This is a once-in-a-lifetime opportunity to prepare Virginia to compete to win in the battle with other states for jobs and growth.

APPENDIX

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

- U.S. and Virginia Economic Forecasts
- General Fund Forecast, FY 2022-2030
- Commonwealth Transportation Fund Forecast, FY 2022-2030
- Virginia Health Care Fund Forecast, FY 2022-2028
- GACRE November Standard Revenue Forecast
- GACRE November Pessimistic Revenue Forecast
- Growth in General Fund Revenues, FY 1961-2024
- Nongeneral Fund Forecast, FY 2022-2028
- November FY 2022 Revenue Report