



# **ECONOMIC AND REVENUE REVIEW AND UPDATE**

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## **TOPICS FOR DISCUSSION**

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ECONOMIC UPDATE

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APRIL FISCAL YEAR-TO-DATE REVENUE COLLECTIONS

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COLLECTION BY MAJOR SOURCES AND DRIVERS

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KEY DATES AND NEXT STEPS

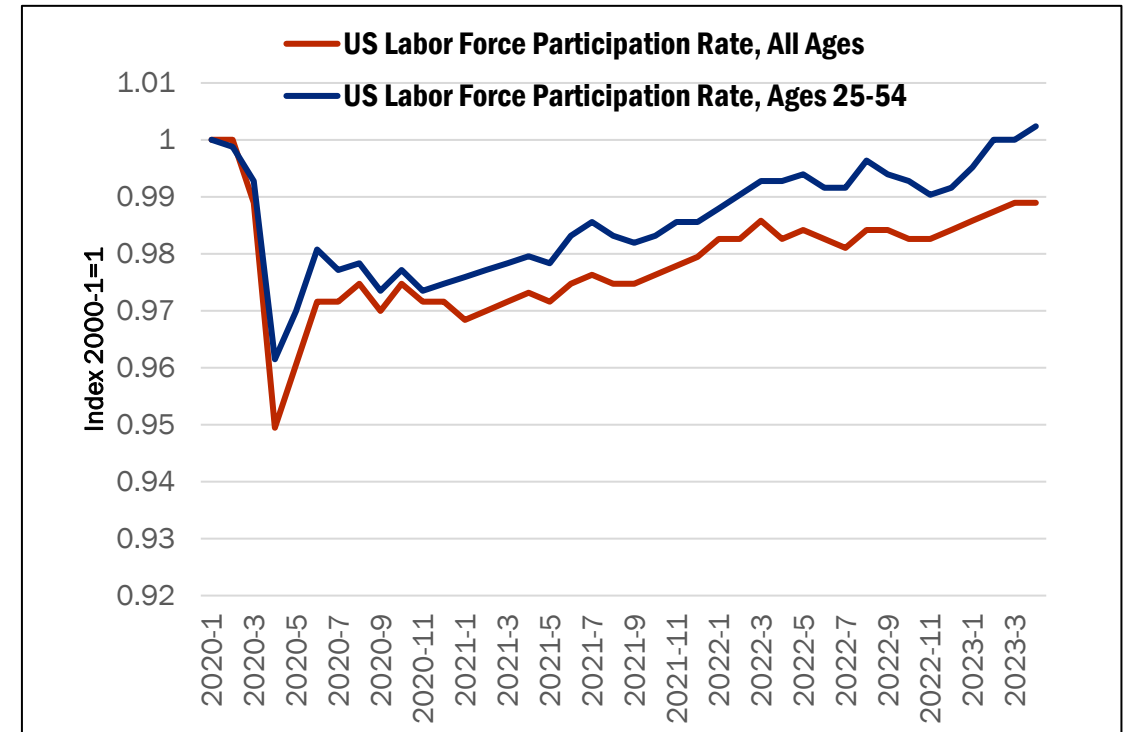
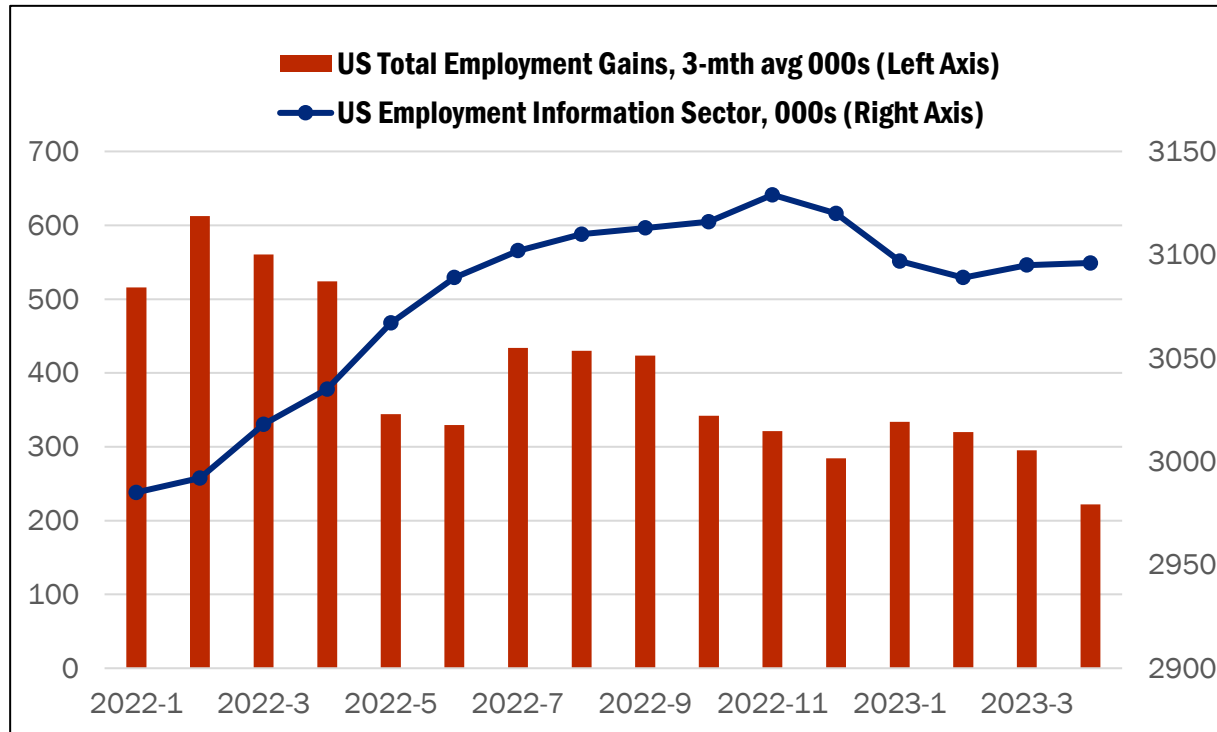
## OVERVIEW:

- The US labor market remains resilient even as other indicators point to slowing growth. US businesses added 253,000 jobs in April.
- While labor markets continue to defy expectations, data on Q1 GDP showed growth slowing to 1.1 percent driven by weakness in investment spending and declining inventory accumulation.
- Overall inflation in April also was slightly lower than expected, at 4.9 percent year-over-year, but key components of the index remain elevated.
- The Federal Reserve raised rates by 25 basis points again in May. Chairman Powell suggested that future hikes may be on hold but also signaled a hawkish stance on the timing of future rate cuts.
- Earlier estimates of an economic downturn and a reversal of recent interest rate hikes have generally been pushed out two to three quarters.
- Concerns and downside risks remain focused on the credit contraction within the banking sector and the implications of the debt ceiling negotiation.

## OVERVIEW:

- Virginia's employment growth has slowed slightly in recent months, wage rate growth is slowing at a faster pace.
- Total general fund revenues declined by 8.2 percent in April compared to last year and are down 0.2 percent fiscal year-to-date. Non-withholding revenues declined in April, but by far less than expected, in part due to timing issues related to the new Pass-Through Entity Tax.
- Compared to the December forecast, actual General Fund Revenues through April exceed projections by almost \$500 Million and by almost \$1.8 billion against Chapter 769 projections.
- Given that the positive revenue impact of a stronger economy relative to the scenario included in the December forecast and positive non-withholding impact of timing issues associated with the implementation of PTET are temporary, it is anticipated that the year-to-date excess revenues may be largely offset by reductions to FY 2024 collections.

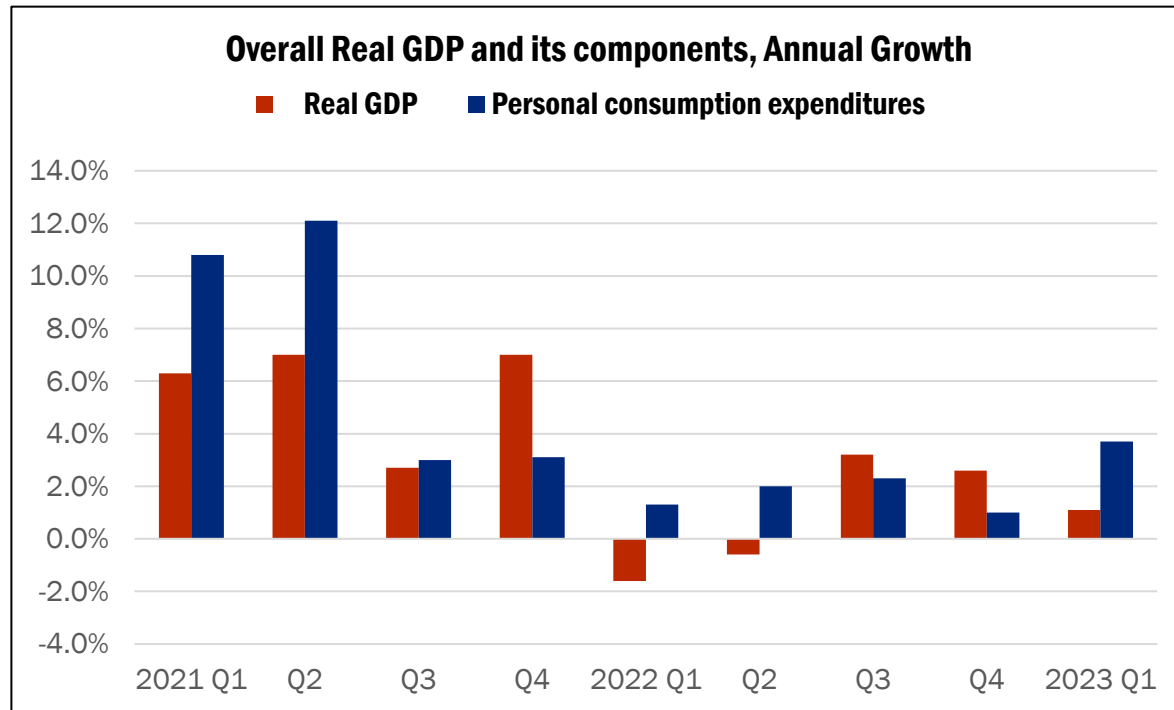
# JOB GROWTH HAS SLOWED BUT REMAINS RESILIENT AS THE LABOR FORCE CONTINUES TO RECOVER FROM THE PANDEMIC.



Sources: US BLS

- Net job gains have occurred even in the tech-heavy information sector where layoffs among bellwether firms have made headline news recently.
- Initial jobless claims for the week ending May 6, rose to 264,000, the highest level since Oct 2021, suggesting further easing in the labor market will occur.

# REAL GDP GROWTH SLOWED TO 1.1 PERCENT ON AN ANNUAL BASIS IN Q1 2023 BELOW EXPECTATIONS OF 2 PERCENT GROWTH.

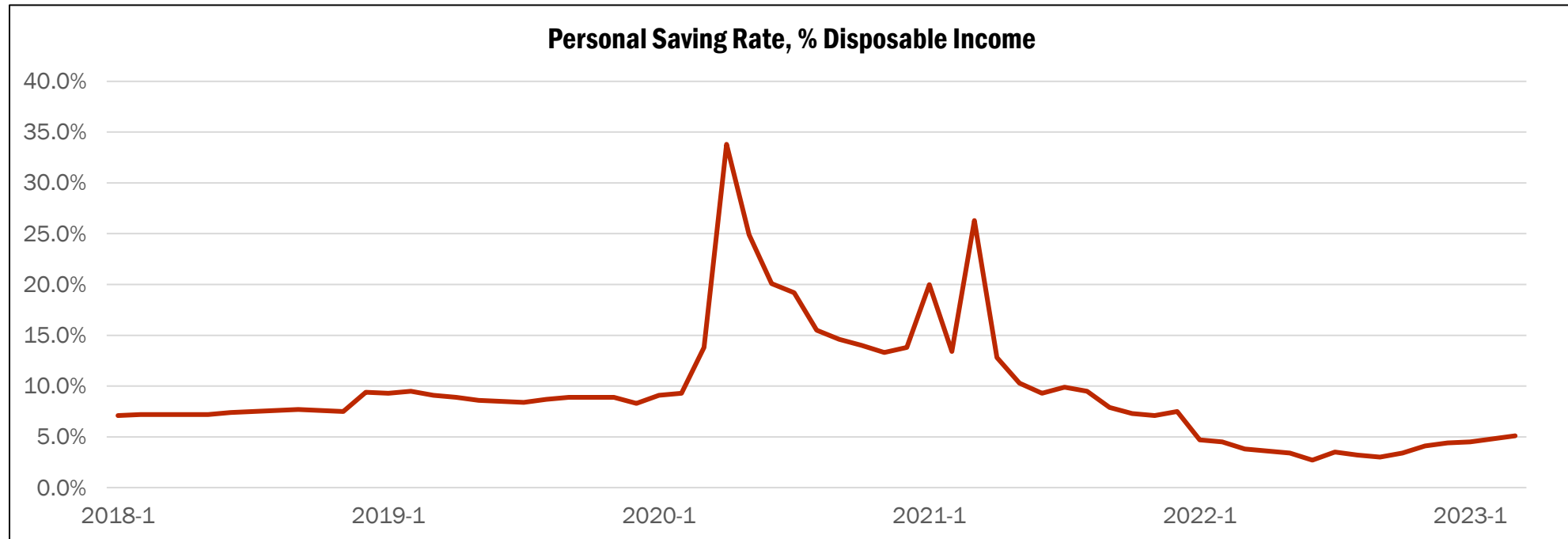


Sources: US BEA

- The slowdown in GDP was driven by large declines in inventory accumulation which dropped by 2.3 percent at an annual rate.
- Consumption growth rebounded, boosted primarily by motor vehicle sales, while consumption of non-durable goods was flat.

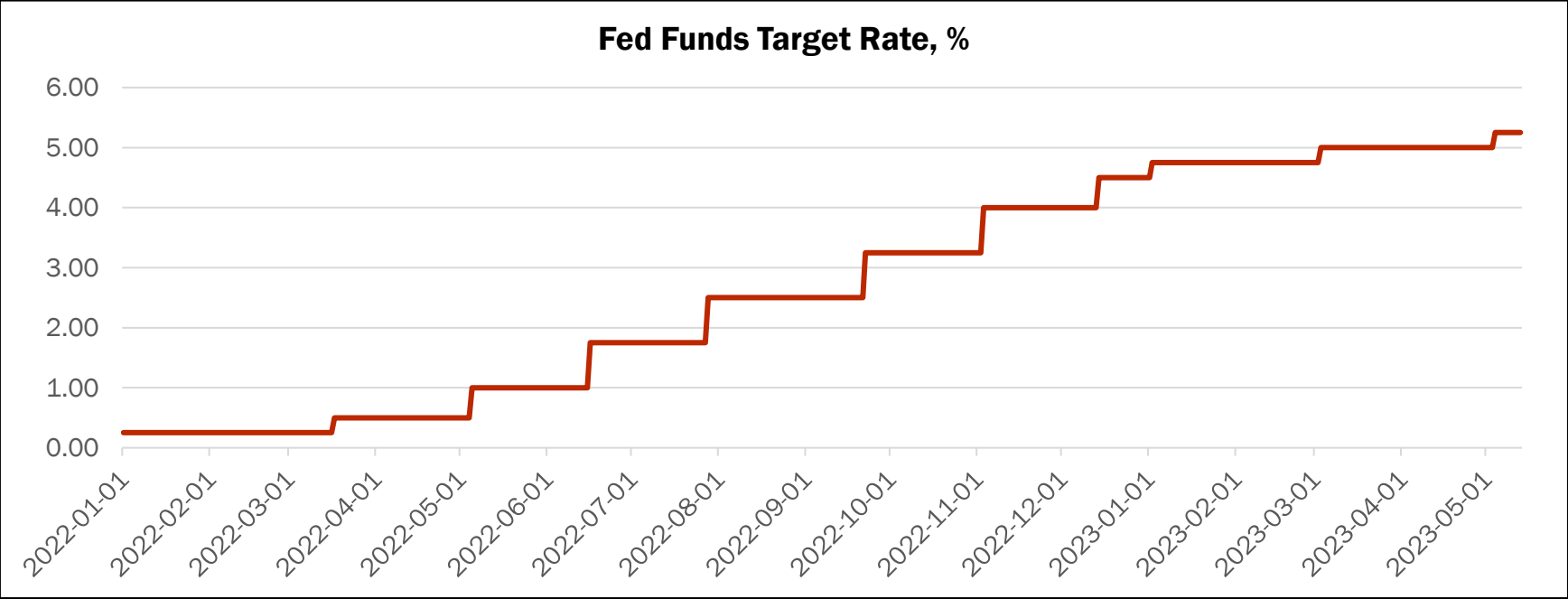
Contributions to 2023Q1 Growth	
REAL GDP (Overall)	1.1
Personal consumption expenditures	2.5
Goods	1.5
Durable goods	1.3
Motor Vehicles	1.1
Nondurable goods	0.1
Services	1.0
Gross private domestic investment	-2.3
Fixed investment	-0.1
Change in private inventories	-2.3
Net exports of goods and services	0.1
Government	0.8

# CONSUMERS ARE BEGINNING TO RETURN TO PRE-PANDEMIC RATE OF SAVING, PORTENDING A FURTHER SLOWDOWN IN CONSUMPTION AND GDP.



Source: US BEA

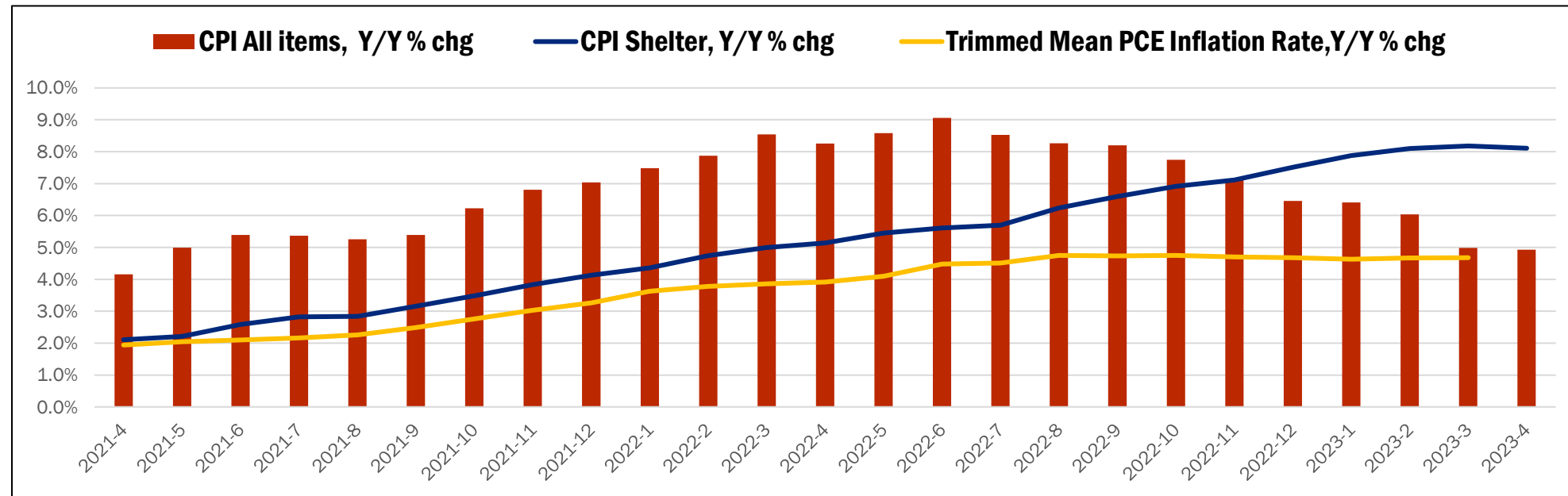
**THE FED INCREASED RATES TO 5.25 PERCENT IN MAY. MOST ECONOMISTS EXPECT THE FED WILL REMAIN ON A HOLD PATTERN NOW AND THAT THE TERMINAL RATE HAS BEEN REACHED.**



- Fed Chairman Powell’s post-meeting comments suggested that the Fed’s may hold rates at this level longer than financial markets expect.



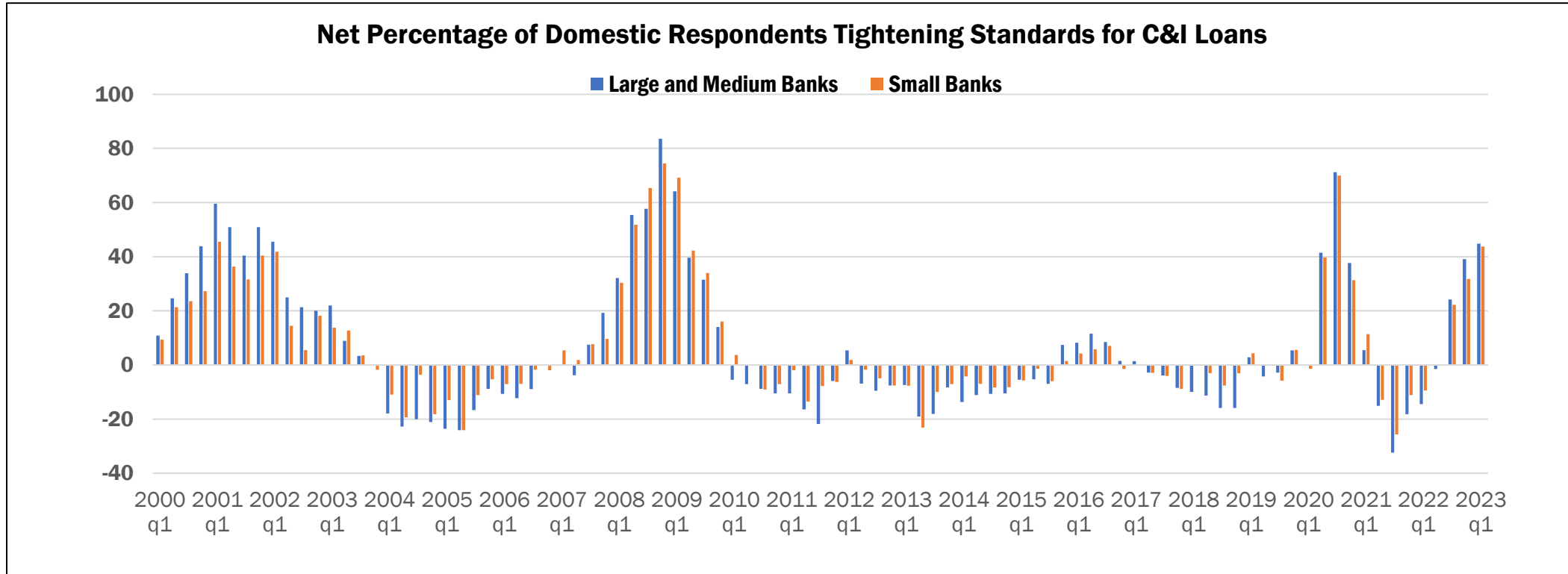
# OVERALL INFLATION FELL BELOW 5 PERCENT FOR THE FIRST TIME IN OVER 2 YEARS CONTINUING THE DOWNWARD TREND SEEN SINCE MID-SUMMER. OTHER MEASURES OF INFLATION REMAIN ELEVATED.



Sources: US BLS, Federal Reserve Bank of Dallas

- The shelter component of the CPI, which accounts for about one-third of the overall index, finally declined slightly in April.
- The Trimmed Mean PCE inflation rate produced by the Federal Reserve Bank of Dallas is a proxy for true core PCE inflation rate that strips out the most volatile components. The resulting inflation measure has been shown to outperform the more conventional “excluding food and energy” measure as a gauge of core inflation.

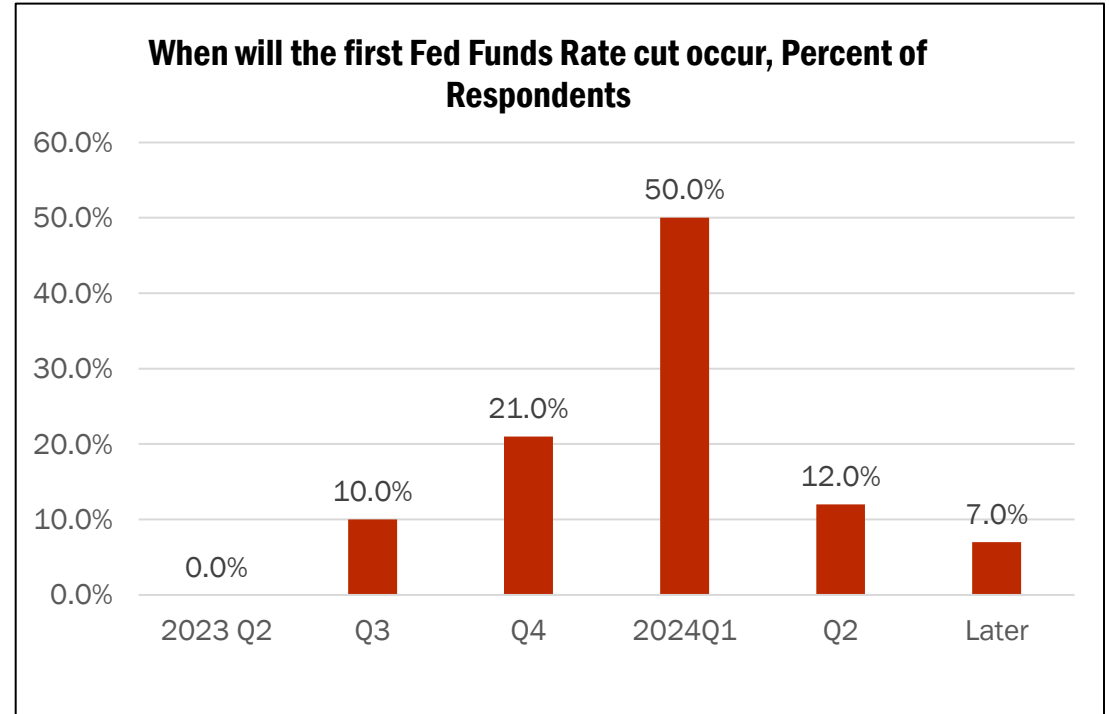
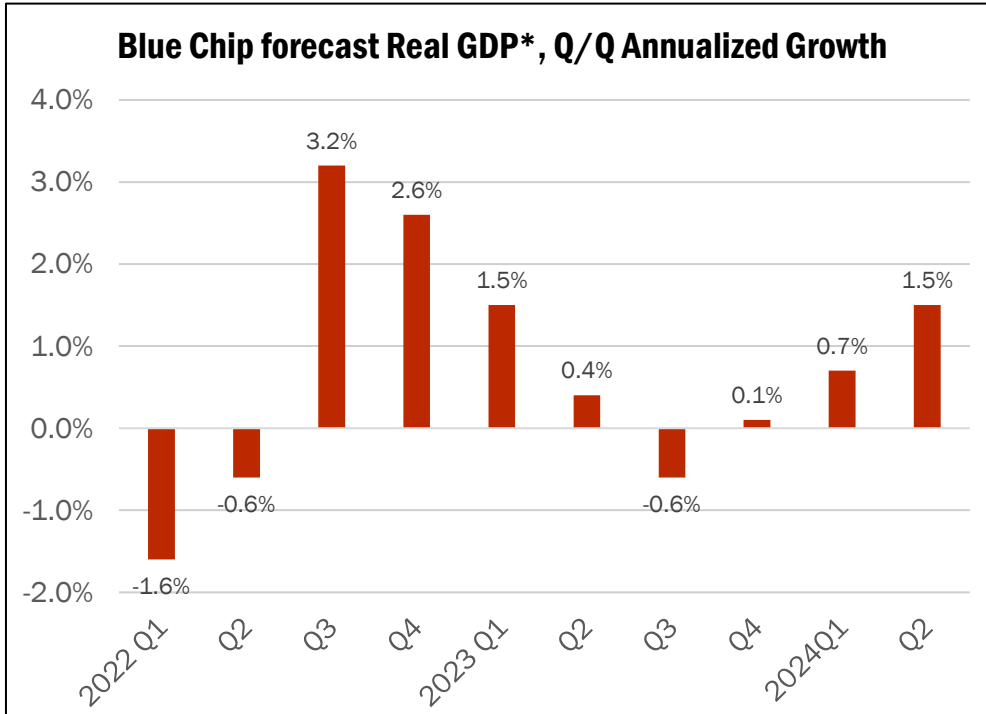
# BANK LENDING STANDARDS HAVE TIGHTENED CONSIDERABLY OVER THE PAST YEAR IN BOTH SMALL AND LARGER BANKS



Sources: Federal Reserve Board Senior Loan Officer Opinion Survey on Bank Lending Practices

- The current tightening is comparable to levels experienced during the 2001 recession but below the levels of the Great Recession of 2008.
- The tightening in lending standards is equivalent to about 50 basis point hike in the Fed funds rate, another reason why the Fed is likely to pause.

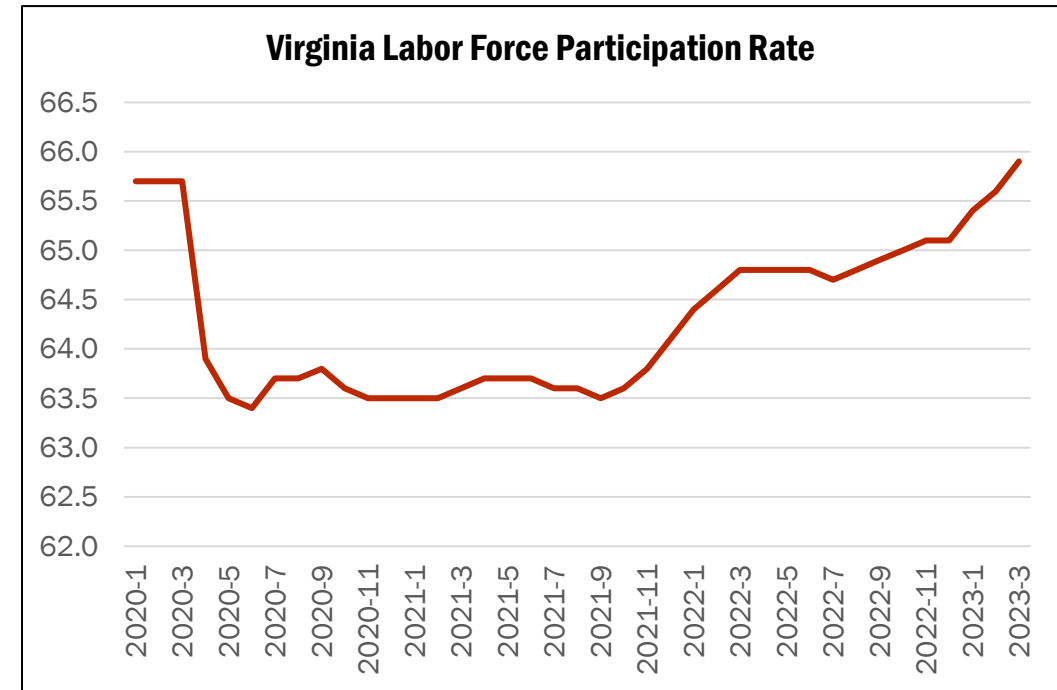
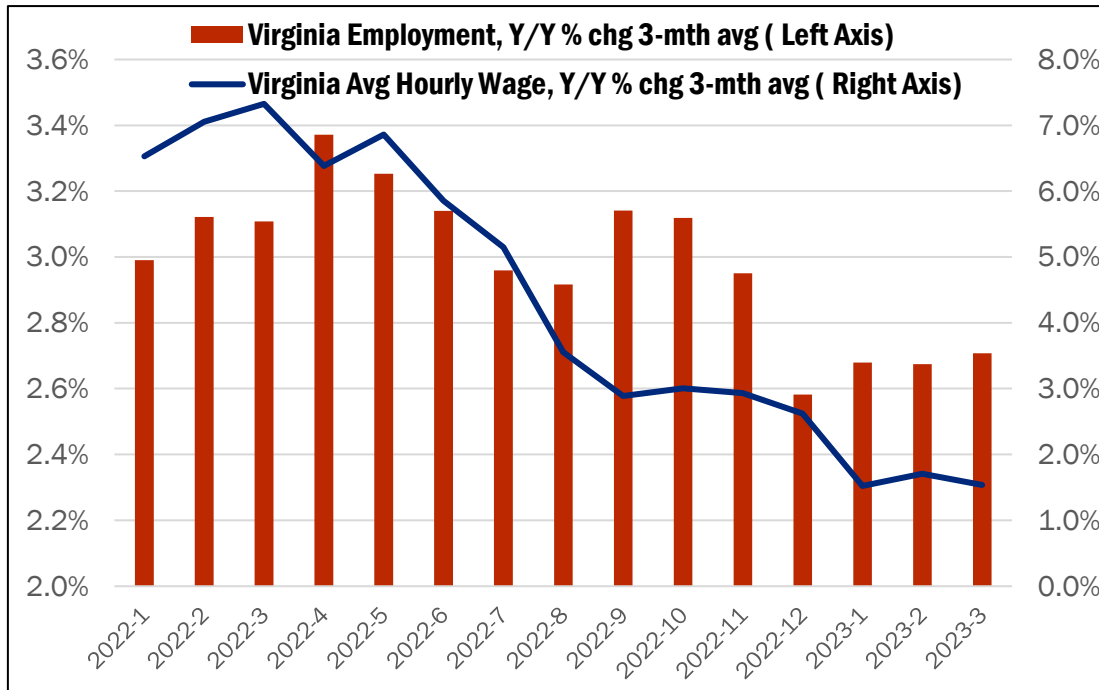
**THE CONSENSUS AMONG ECONOMISTS CONTINUES TO BE THAT THE ECONOMY WILL EXPERIENCE A MILD CONTRACTION IN GDP IN THE LATER PART OF CY 2023. MOST ECONOMISTS EXPECT RATE CUTS WILL ONLY BEGIN IN CY 2024.**



Source: Blue Chip Economic Indicators

- \*The GDP forecast represents the mean forecast of respondents surveyed. Because respondents differ in the expectations of when GDP will contract, the median does not necessarily show a two-quarter contraction.
- The December assumed a contraction beginning in the current quarter.

# VIRGINIA'S EMPLOYMENT GROWTH SLOWED FROM OVER 5 PERCENT AT THE BEGINNING OF THE YEAR TO 2.7 PERCENT RECENTLY. THE DECLINE IN WAGES HAS BEEN MORE PRONOUNCED.



Sources: US BLS, CES Survey (Left Chart), LAUS Survey (Right Chart)

- Virginia's labor force participation has recently rebounded sharply and returned to pre-pandemic levels.

## **COLLECTION TRENDS APRIL FISCAL YEAR-TO-DATE SUMMARY:**

- Relative to the updated December forecast, unadjusted general fund revenues are ahead of forecast by \$500 million year-to-date through April, driven by significantly higher than estimated collections for non-withholding. Revenues are almost \$1.8 billion higher compared to Chapter 769. *(Unless otherwise stated all comparisons hereafter will be made to the December forecast.)*
- April revenues were impacted by the recently enacted Pass-Through Entity Tax. The April 17 filing deadline for the PTET preceded the May 1 filing deadline for Individual Income tax, causing receipts to be shifted into April from May compared to prior years.
- PTET revenues totaled over \$826 million in April, comprising more than 40 percent of all income tax collections. It should be noted that since this is the first year of implementation for this tax, and a significant portion of revenue was made on extension payments, uncertainty surrounding this revenue stream still remains until final payments occur in FY 2024.
- Offsetting some of the strength in non-withholding, refunds totaled \$686 million in April, about \$113 million higher than anticipated in the December Plan.
- Among other major sources, withholding revenue was somewhat lower than expected. Sales tax revenue continued to come in well below expectations. As indicated in prior reports, shifting consumer patterns away from taxable goods, along with weaker overall consumption, have contributed to a larger than anticipated decline in this source of revenue.

## **COLLECTION TRENDS APRIL FISCAL YEAR-TO-DATE SUMMARY: continued**

- Corporate tax revenue surprised somewhat to the upside with a strong month in April that reversed the weakness we had previously seen in this revenue source.
- Deed recordation taxes also continued to come in below expectations and continued a trend of softness due to sustained high mortgage rates. Interest income, was negative in April due to periodic transfers out of the General Fund. Fiscal year-to date interest income is still ahead of forecast by more than \$100 million, more than offsetting the \$65 million unexpected weakness in deeds.
- On an unadjusted basis versus prior year, total general fund revenues were down 0.9 percent fiscal year-to-date and down 8.2 percent for the month of April, mainly due to declines in non-withholding and increases in refunds.

# ON AN UNADJUSTED BASIS, GF REVENUES WERE 8.2 PERCENT LOWER IN APRIL. YEAR-TO-DATE, COLLECTIONS ARE DOWN 0.9 PERCENT, BUT ARE SIGNIFICANTLY HIGHER THAN THE DECEMBER ESTIMATE.

Unadjusted Revenues	FY 2023	Pct Chg	Percent of	APRIL				Fiscal Year-To-Date				Year-To-Date
	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%	1,242.5	1,273.6	31.1	2.5%	12,783.9	13,327.2	543.4	4.3%	59.3%
Nonwithholding	5,088.6	-25.3%	19.3%	2,173.9	1,968.5	(205.4)	-9.4%	4,723.0	5,252.8	529.8	11.2%	23.4%
Refunds	(3,535.2)	103.1%	-13.4%	(467.6)	(687.8)	(220.2)	47.1%	(1,518.0)	(3,224.4)	(1,706.4)	112.4%	-14.3%
Sales and Use Tax	4,926.3	8.1%	18.7%	414.0	401.2	(12.7)	-3.1%	3,680.3	3,946.5	266.1	7.2%	17.6%
Corporate Income Tax	1,809.1	-8.6%	6.9%	439.3	530.0	90.7	20.6%	1,606.2	1,623.1	16.9	1.1%	7.2%
All Other Sources	2,020.7	1.7%	7.7%	232.8	216.8	(16.0)	-6.9%	1,412.8	1,550.1	137.2	9.7%	6.9%
<b>Total GF Revenues</b>	<b>\$26,387.8</b>	<b>-8.8%</b>	<b>100.0%</b>	<b>\$4,034.9</b>	<b>\$3,702.3</b>	<b>(\$332.6)</b>	<b>-8.2%</b>	<b>\$22,688.3</b>	<b>\$22,475.3</b>	<b>(\$213.0)</b>	<b>-0.9%</b>	<b>100.0%</b>

## Adjusted Revenues

Adjusted Withholding	1,242.5	1,341.6	99.1	8.0%	12,783.9	13,759.1	975.2	7.6%
Adjusted Non-Withholding (PTET)	2,173.9	1,555.5	(618.4)	-28.4%	4,723.0	4,839.8	116.8	2.5%
Adjusted Refunds+Rebates	(467.6)	(598.7)	(131.1)	28.0%	(1,518.0)	(2,078.1)	(560.1)	36.9%
Adjusted Sales (AST+ Grocery Tax)	414.0	420.4	6.4	1.5%	3,883.7	4,038.8	155.1	4.0%
<b>Total GF Revenues, Adjusted</b>	<b>\$4,034.9</b>	<b>\$3,446.4</b>	<b>(\$588.5)</b>	<b>-14.6%</b>	<b>\$22,891.7</b>	<b>\$23,512.3</b>	<b>\$620.7</b>	<b>2.7%</b>

- April's year-over-year decline was driven by lower non-withholding revenue. The earlier deadline for PTET revenue added about \$413 million (that would have otherwise been collected in May) to April non-withholding. The elimination of the state sales tax on groceries subtracted \$19 million to sales tax revenues.
- Other policies impacting revenues include the increased standard deduction, the expanded EITC and the military retirement subtraction.

# APRIL COLLECTIONS WERE \$373.1 MILLION HIGHER THAN PROJECTED AND YEAR-TO-DATE COLLECTIONS ARE ALMOST \$500 MILLION AHEAD OF THE DECEMBER FORECAST, MAINLY DUE TO NON-WITHHOLDING.

## Actuals Versus December Forecast

SOURCE \$000s	APRIL					FYTD				
	Actuals	Projected	Variance	Prior Year	Y/Y %	Actuals	Projected	Variance	Prior Year	Y/Y%
Withholding	1,273,619	1,312,555	(38,936)	1,242,519	2.5%	13,327,222	13,398,497	(71,275)	12,783,861	4.3%
Non-withholding	1,968,482	1,514,490	453,993	2,173,908	-9.4%	<b>5,252,791</b>	4,650,680	602,112	4,722,974	11.2%
IIT Refunds	(687,814)	(575,154)	(112,660)	(467,593)	47.1%	(3,224,355)	(3,100,210)	(124,145)	(1,517,983)	112.4%
Net IIT	2,554,287	2,251,890	302,397	2,948,834	-13.4%	15,355,658	14,948,967	406,691	15,988,852	-4.0%
Sales/Use	401,241	458,096	(56,855)	413,986	-3.1%	3,946,464	4,063,404	(116,940)	3,680,324	7.2%
Corporate	530,021	393,752	136,269	439,314	20.6%	1,623,114	1,519,279	103,835	1,606,247	1.1%
Wills	31,472	44,520	(13,048)	54,232	-42.0%	350,534	415,133	(64,599)	542,134	-35.3%
Insurance	146,890	142,091	4,799	142,115	3.4%	292,812	284,450	8,362	268,571	9.0%
All Other	38,421	38,923	(502)	36,457	5.4%	906,705	746,744	159,962	602,131	50.6%
<b>Total GF Revenues</b>	<b>3,702,412</b>	<b>3,329,272</b>	<b>373,140</b>	<b>4,034,938</b>	<b>-8.2%</b>	<b>22,475,365</b>	<b>21,977,978</b>	<b>497,387</b>	<b>22,688,259</b>	<b>-0.9%</b>

- Non-withholding revenue declined by far less than anticipated in the forecast. Year-to date through April, collections for this source exceed the full year forecast already, with May revenues further adding to the surplus in this source. See slides 20-21 for further detail.

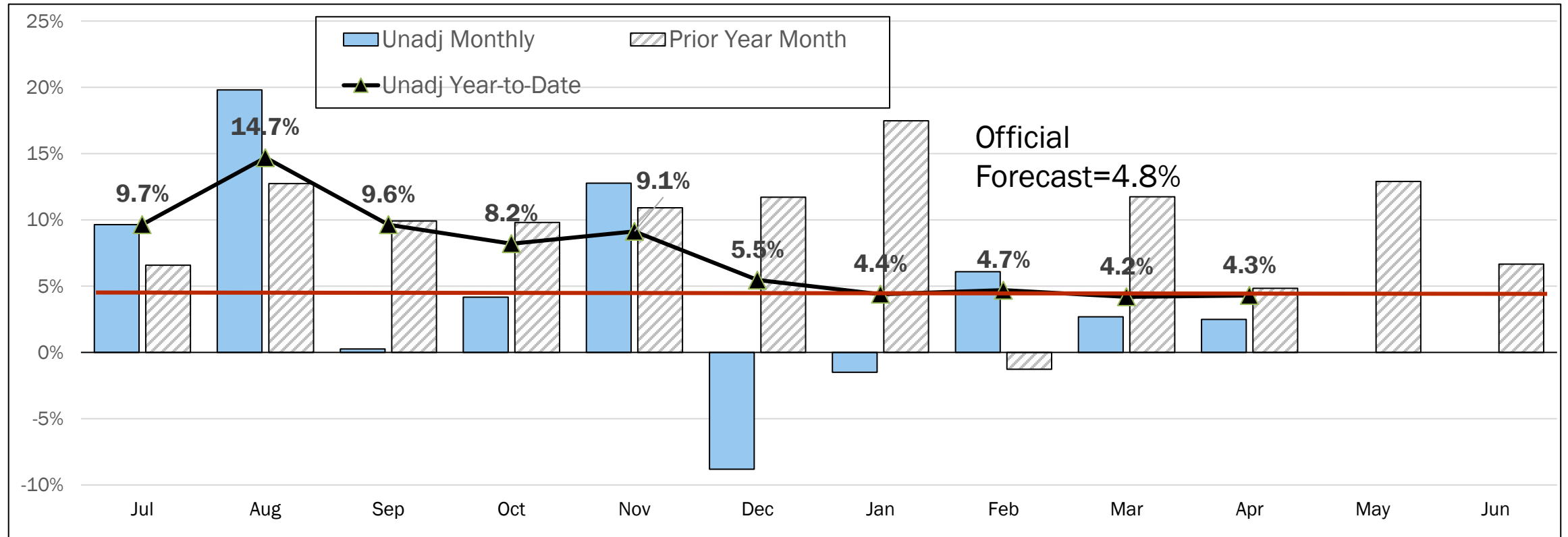


# APRIL COLLECTIONS CAME IN \$609 MILLION HIGHER THAN PROJECTED AND YEAR-TO-DATE COLLECTIONS ARE \$1.8 BILLION AHEAD OF THE CHAPTER 769 FORECAST.

## Actuals Versus Chapter 769 Forecast

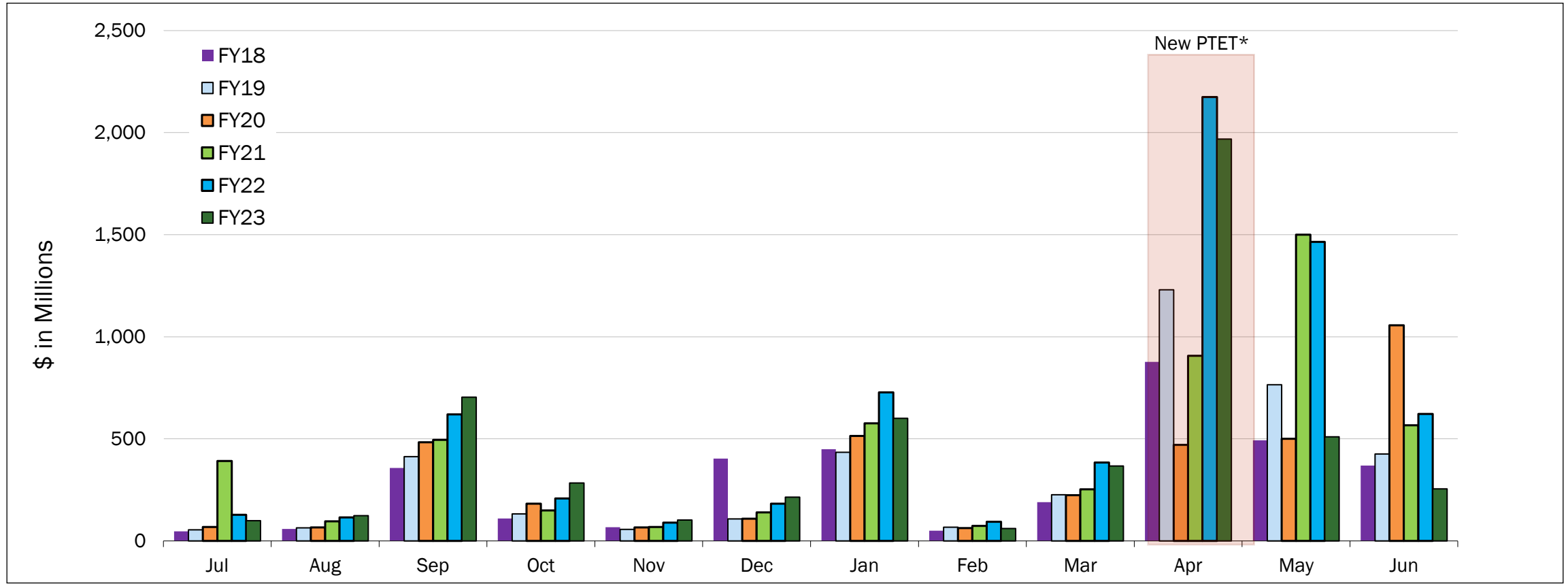
SOURCE \$000s	APRIL					FYTD				
	Actuals	Projected	Variance	Prior Year	Y/Y %	Actuals	Projected	Variance	Prior Year	Y/Y%
Withholding	1,273,619	1,250,627	22,992	1,242,519	2.5%	13,327,222	12,769,575	557,647	12,783,861	4.3%
Non-withholding	1,968,562	1,560,695	407,867	2,173,908	-9.4%	5,252,870	4,759,665	493,205	4,722,974	11.2%
IIT Refunds	(687,814)	(672,140)	(15,674)	(467,593)	47.1%	(3,224,355)	(3,413,853)	189,498	(1,517,982)	112.4%
Net IIT	2,554,367	2,139,183	415,184	2,948,834	-13.4%	15,355,737	14,115,387	1,240,350	15,988,853	-4.0%
Sales/Use	401,241	405,720	(4,479)	413,986	-3.1%	3,946,464	3,771,361	175,103	3,680,325	7.2%
Corporate	530,021	330,052	199,969	439,314	20.6%	1,623,114	1,410,723	212,391	1,606,247	1.1%
Wills	31,472	51,423	(19,951)	54,232	-42.0%	350,534	479,503	(128,969)	542,133	-35.3%
Insurance	146,890	135,105	11,785	142,115	3.4%	292,812	272,468	20,344	268,571	9.0%
All Other	38,421	31,906	6,515	36,457	5.4%	906,705	626,315	280,391	602,132	50.6%
<b>Total GF Revenues</b>	<b>3,702,412</b>	<b>3,093,388</b>	<b>609,024</b>	<b>4,034,938</b>	<b>-8.2%</b>	<b>22,475,365</b>	<b>20,675,757</b>	<b>1,799,608</b>	<b>22,688,261</b>	<b>-0.9%</b>

# WITHHOLDING IS SLOWING AT A SLIGHTLY FASTER PACE THAN PREDICTED. FISCAL YEAR-TO DATE COLLECTIONS ARE \$71 MILLION OR 0.5 PERCENT BELOW ESTIMATE.



- Given the monthly volatility in this revenue source, the forecast for the year is still within a margin that can be made up in the upcoming two months.

# NON-WITHHOLDING TAX COLLECTIONS DECLINED IN APRIL COMPARED TO THE PREVIOUS YEAR, BUT THE DECLINE WAS LESS THAN THE ANTICIPATED, PARTLY RELATED TO TIMING ISSUES DUE TO THE PTET.



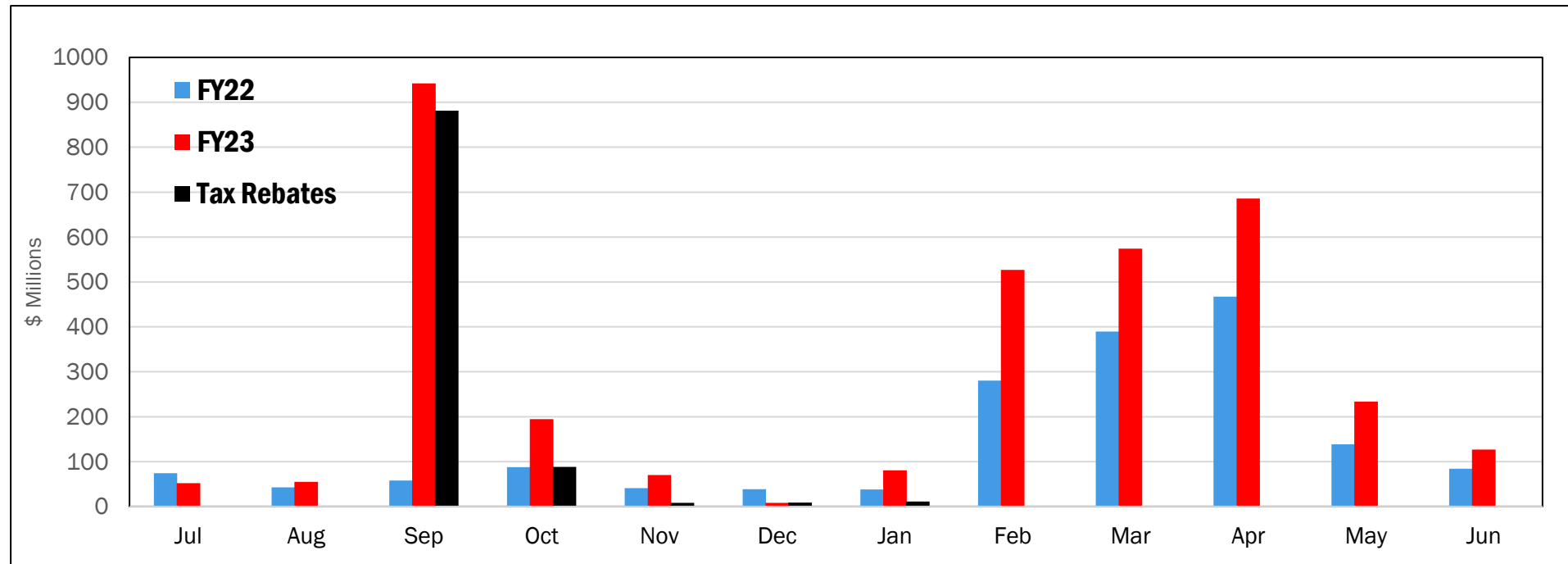
- PTET shifted about \$413 million (1/2 of \$826 million received in April) of income that would have otherwise been received in May.
- May data is preliminary through May 10<sup>th</sup>, while June 2023 is an estimate.

**PRELIMINARY NON-WITHHOLDING COLLECTIONS THROUGH MAY, WHICH REFLECT THE SHIFTING IN TIMING RELATED TO THE PTET, ARE ABOUT 25 PERCENT LOWER THAN IN 2022 BUT STILL CONSIDERABLY HIGHER THAN ANTICIPATED.**

Virginia non-withholding collections April and May preliminary

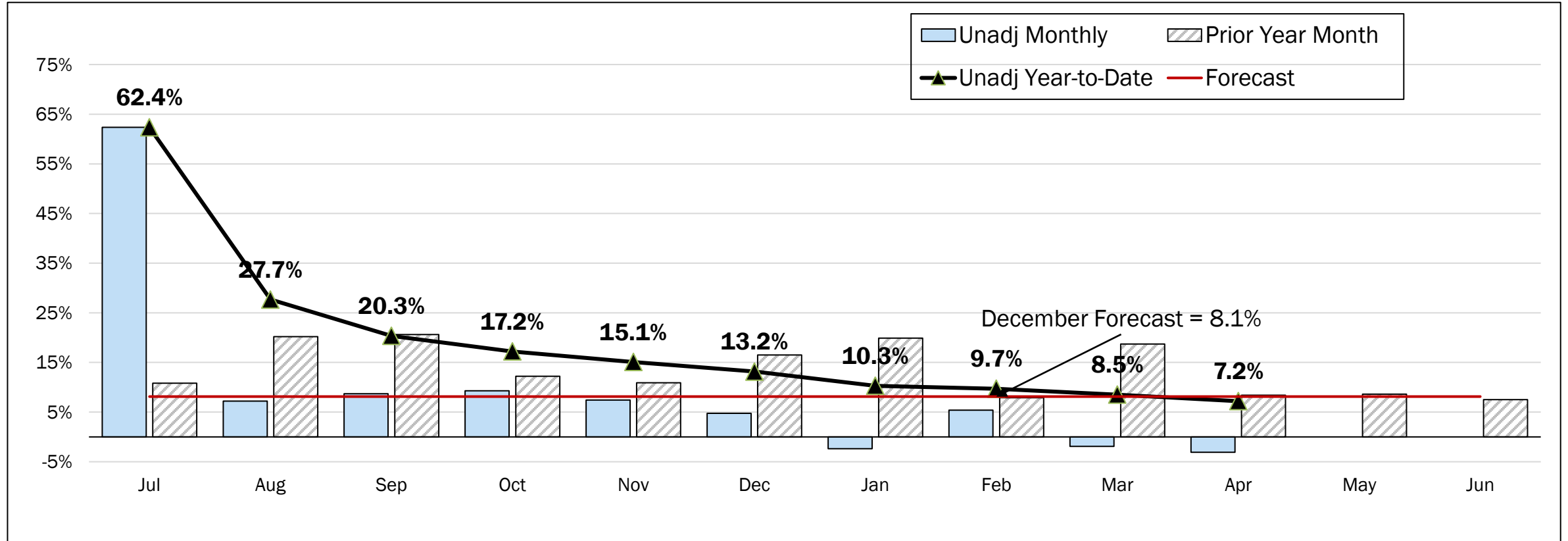
	2023, \$000s	2022, \$000s	Y/Y % chg
April	1,968,482	2,173,908	-9.4%
Through May 10	532,825	1,151,040	-53.7%
Total	2,501,308	3,324,948	-24.8%

## REFUNDS IN APRIL TOTALED ALMOST \$700 MILLION EXCEEDING THE FORECAST BY OVER \$100 MILLION IN APRIL AND \$124 MILLION FISCAL YEAR-TO-DATE.



- The increase in refunds is due in part to policy actions including the increased standard deduction, the expanded EITC and the military retirement subtraction.
- Refunds are also expected to increase as PTET filers claim credits against income taxes paid. This is likely to spill over into FY 2024.

# UNADJUSTED SALES TAX COLLECTIONS DECLINED BY 3.1 PERCENT IN APRIL THE SECOND CONSECUTIVE MONTHLY DECLINE.



- Weakness in sales tax revenues is partly due to the elimination of the State grocery tax and also reflects a shift towards consumption of non-taxable goods that has occurred a faster pace than expected.
- Growth in sales tax revenue will continue to slow due to the elimination of the sales tax on groceries and the full impact of the AST in June. This is expected to further lower collections in June by \$72 million or about 1.1%.

## **OTHER SOURCES:**

- Corporate income tax revenues showed surprising strength in April, reversing the weakness seen in the beginning of the year and are on pace to equal or exceed forecast.
- Deed recordation taxes have been consistently weaker than expected as interest rates have remained high and sharply curtailed refinancing activity. Fiscal year-to-date revenues from this source are almost \$65 million lower than projected.
- Other Revenues exceed forecast by almost \$160 million fiscal year-to-date. The strength is driven mostly by higher interest rate revenues which exceed forecast by about \$90 million. Periodically, interest revenue is transferred to the non-general fund resulting in the general fund receiving no revenue this month.

## **COLLECTIONS SUMMARY:**

- Non-withholding revenues for the 2022 filing season, while declining, has come in higher than expected. To date through the first 10 days of May, revenues from this source already exceed the full year projection by \$700 million.
- There has been a significant shift in revenues due to the new PTET tax that allows filers to circumvent the SALT limitation. Because this is the first year of implementation for this tax, the final liability will only be known in FY 2024. We expect that related overpayments in the current fiscal year will reduce FY 2024 collections as refunds are issued.
- Within other major sources, sales tax collections and deed recordation taxes are significantly trailing estimates. Withholding is also behind forecast but by a lower amount.
- However, weaknesses in these sources are more than offset by other sources. In addition to non-withholding, interest income and corporate income taxes are exceeding forecast.
- While we anticipate that collections for FY 2023 will be above forecast, much of the higher collections are the result of our assumption of when a recession will begin. The resulting shift of revenues into FY 2023 may largely be reversed in FY 2024. More will be known before we develop a forecast for the Governor's biennial budget later this year.