ECONOMIC AND REVENUE REVIEW AND UPDATE

A BRIEFING FOR THE MONEY COMMITTEES

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TOPICS FOR DISCUSSION

HB 6001 REVENUE ASSUMPTIONS

ECONOMIC UPDATE

AUGUST FISCAL YEAR-TO-DATE REVENUE COLLECTIONS

KEY DATES AND NEXT STEPS

OVERVIEW

- The U.S. economy continues to show resilience even as interest rates have increased significantly over the past year. Second quarter Real Gross Domestic Product (GDP) rose by a seasonally adjusted annual rate of 2.1 percent and grew 2.5 percent on a Q2/Q2 basis.
- The U.S. added 187,000 jobs in August, and the unemployment rate rose slightly as labor force participation increased. However, trends suggest the labor market is cooling.
- In Virginia, the unemployment rate fell to 2.5 percent on a seasonally adjusted basis in July and the labor force participation rate increased to 66.7 percent in July – the highest labor force participation rate since November 2012.
- The risk of recession remains, though professional economists' assessment of the risk has fallen. The latest Wall Street Journal survey of business and academic economists places the probability of a recession at 54 percent, down from 61 percent.
- In August, the CPI was up 3.7 percent year-over-year, an acceleration over recent months. This is mainly the result of rising fuel prices. Core CPI continued its downward trend from 4.7 to 4.4 percent year-over-year over the same period.
- Goods inflation has weakened substantially, while service sector inflation remains stubbornly high.

OVERVIEW (CONT'D)

- Expectations around further Fed rate hikes are mixed with some economists expecting an additional rate increase this year.
- Given the risk of further rate hikes with inflation persisting above Fed targets and other uncertainties including the potential for a federal government shutdown, the HB 6001 revenue forecast is intentionally conservative, and we remain cautious in our outlook over the near term.
- With two months of collections in Fiscal Year 2024, year-to-date collections are up 0.9 percent compared to last year and are running ahead of projections assumed in the amended budget by $204.8 million. While all of the major sources are generally in line or ahead of projections, interest income is overstated in that it includes amounts that will be distributed to NGF accounts in October.
- Adjusting for policy actions to better reflect underlying economic trends, major sources of general fund revenues (excluding interest income and minor sources) increased by 3.0 percent in the first two months of Fiscal Year 2024, compared to the same period of the previous year. For August, adjusted general fund revenues for major sources increased by 3.7 percent compared to August 2022.
- August is typically a smaller revenue month due to lower corporate and nonwithholding payments. Given the importance of the first estimated payments for nonwithholding and corporate payments due in September, the September year-to-date results will be the best indicators of recent trends.

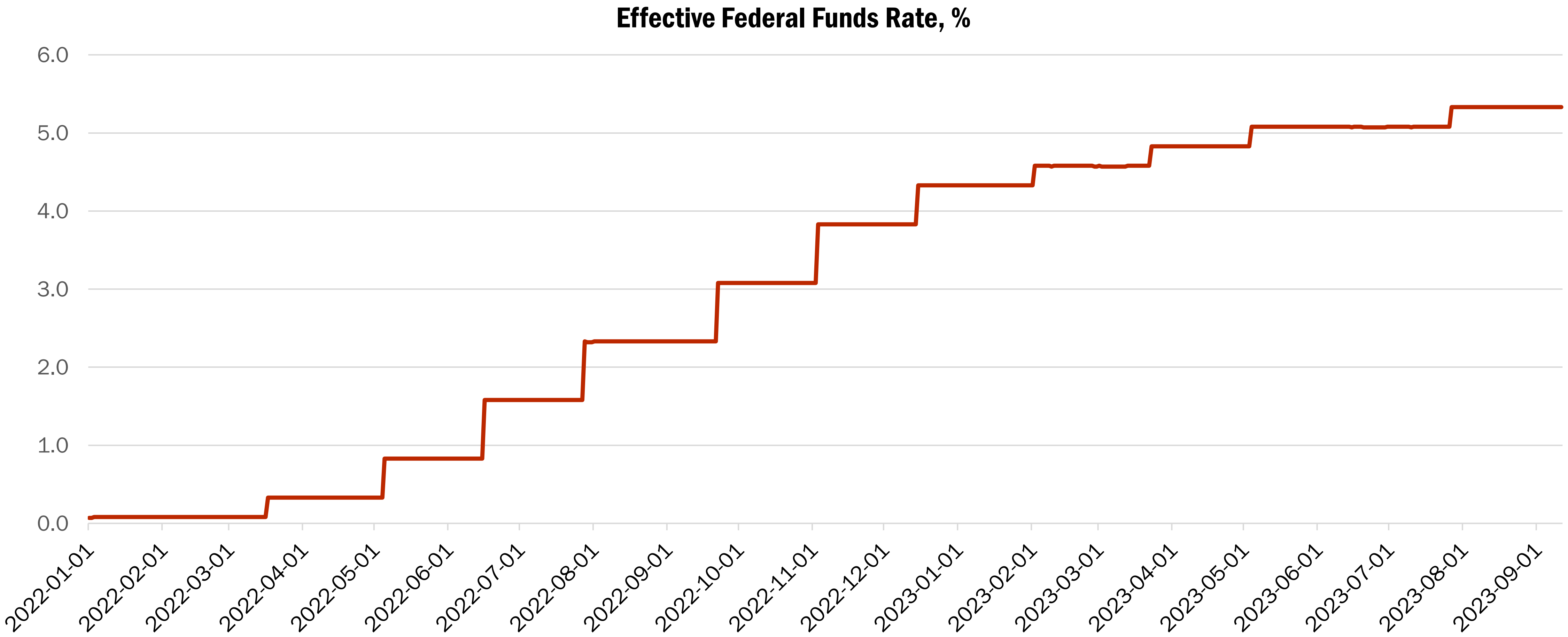
HB 6001 REVENUE ESTIMATE ACCOUNTS FOR DOWNSIDE RISKS FROM POTENTIAL RECESSION

HB 6001 GF Revenue Forecast
($ in millions)

Source	**HB 6001 Forecast**	**% Growth Over FY23**
Withholding	$15,852.9	-0.7%
Non-withholding	4,687.6	-29.3%
Refunds	(2,834.8)	-21.3%
Sales and Use Tax	4,418.2	-6.7%
Corporate Income Tax	1,896.1	-6.6%
All Other Sources	2,349.3	8.7%
Total GF Revenues	**$26,369.3**	**-5.5%**

- The core economic model the forecast is based on is a pessimistic scenario from S&P Global which includes a mild recession.
- The outlook anticipates tightening consumer credit, a weakening labor market, and the risks of a recession in China and potential Federal government shutdown.
- Additionally, stubbornly high inflation, rising oil prices and increases in healthcare costs cause us to remain cautious.

AT JULY MEETING, FED RAISED RATES BY 25 BASIS POINTS

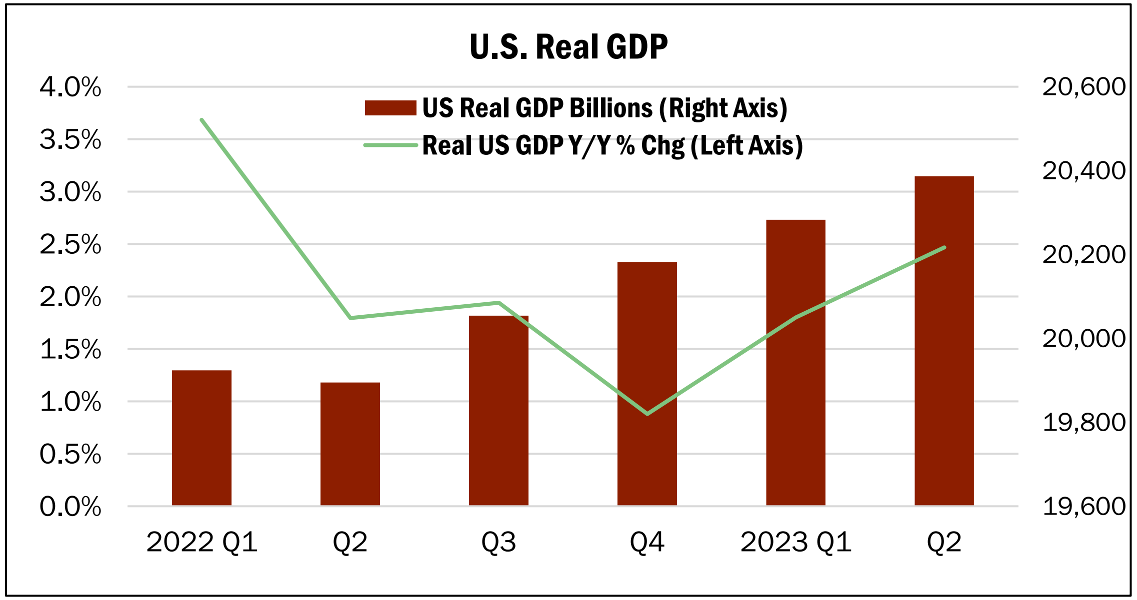


Source: Board of Governors of the Federal Reserve System

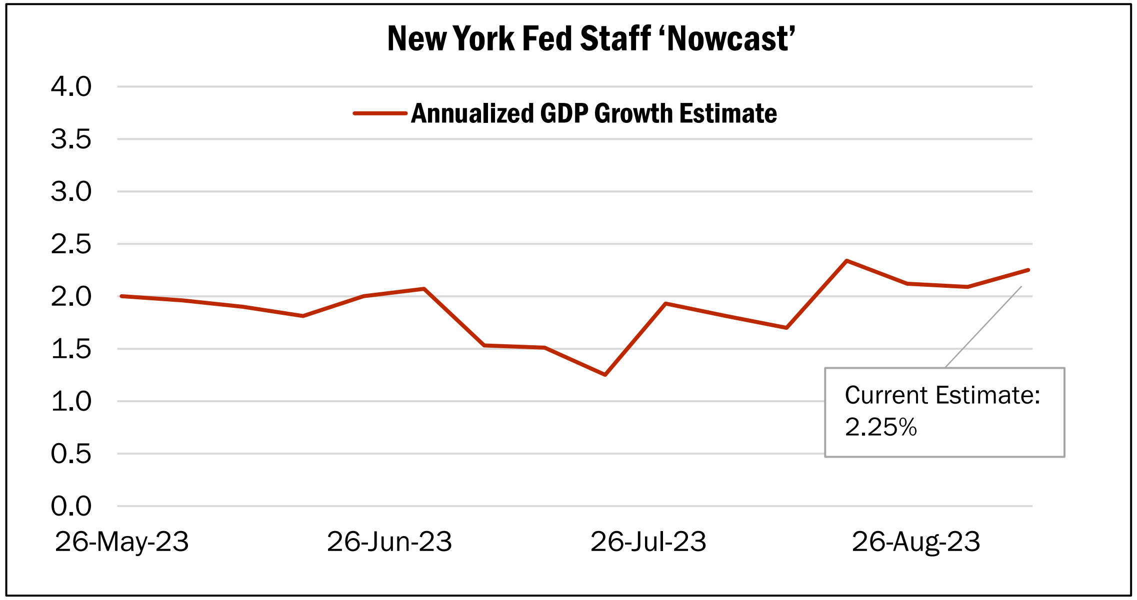
MACRO INDICATORS AND THE FED'S NEXT MOVE

- Fed Chairman Powell has outlined a three-pronged test for inflation success.
    - GDP growth should decline below trend for a period (approximately 1.8 percent).
        - ➢ GDP growth is still elevated (2.5 percent Q2/Q2) but recent measures show economic growth approaching target.
    - Labor market needs to loosen.
        - ➢ Powell's preferred measure, unemployed per job opening, is on the right trajectory.
    - Service inflation must come down.
        - ➢ Current trend is another indicator of a correcting labor market.
- Given the long and uncertain lags in monetary policy effects, the current trajectory has led the general market to project that further rate hikes are unlikely.

DESPITE FED ACTIONS, US ECONOMY CONTINUES TO GROW AT MORE THAN TWO PERCENT



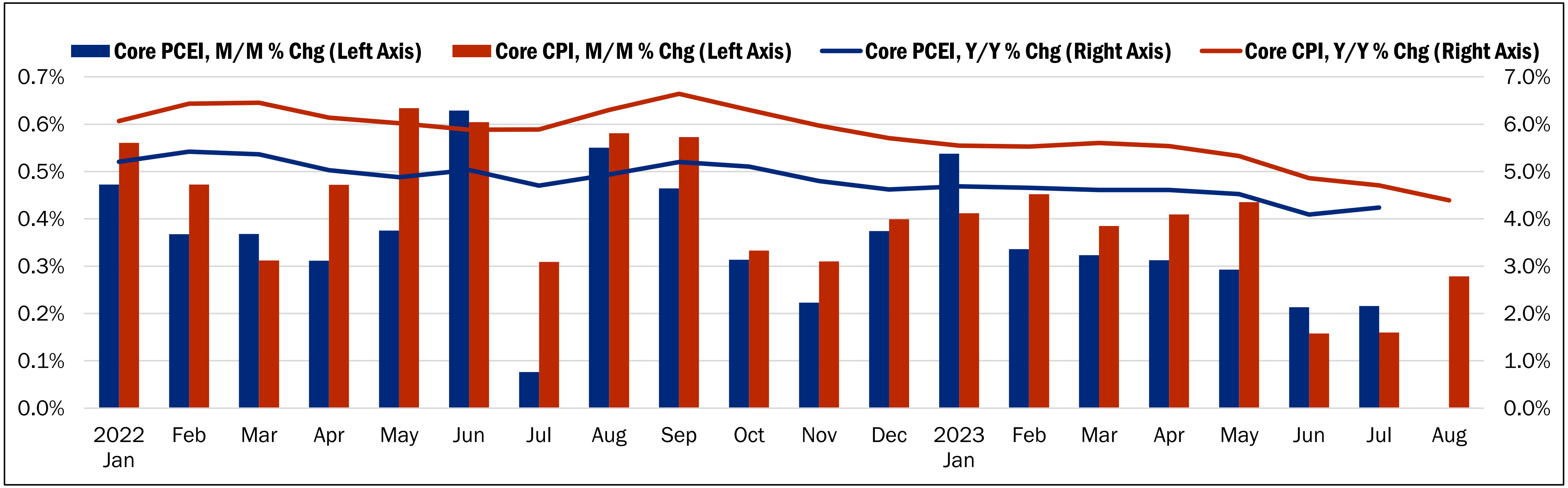
Source: US Bureau of Economic Analysis



Source: Federal Reserve Bank of New York

- Despite high interest rates, official figures for annual GDP growth continue to show growth.
- According to the "second" estimate released by the US Bureau of Economic Analysis, US GDP grew 2.5 percent in the April-to-June quarter compared to the same quarter a year ago.
- New York Fed staff estimates suggest current quarter GDP growth of 2.25 percent, closer to target.

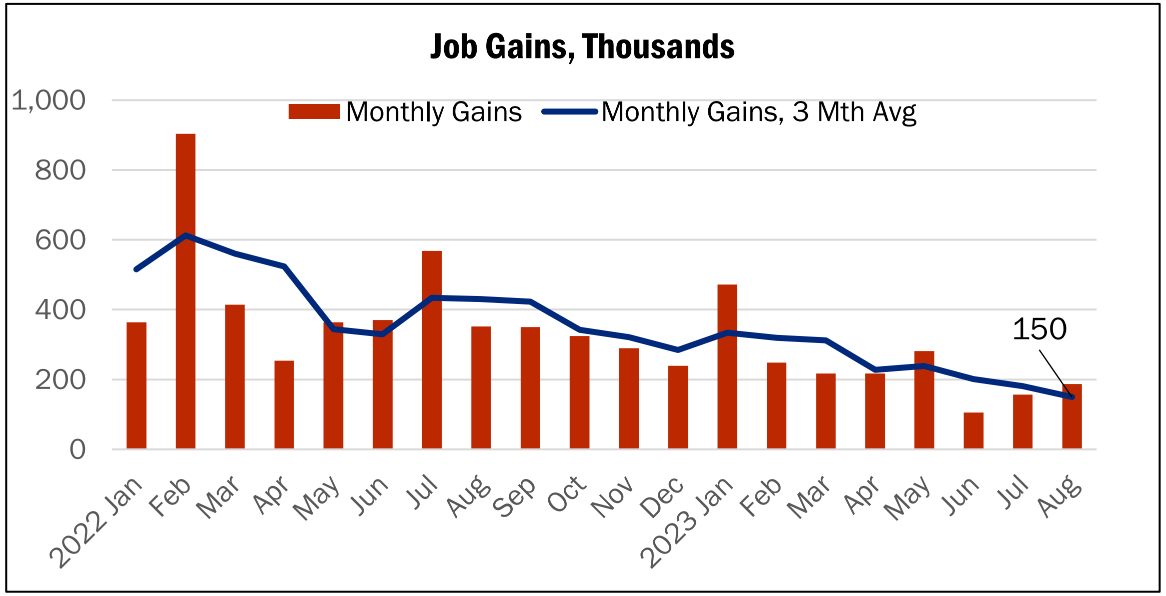
INFLATION REMAINS ELEVATED; OVERALL TREND CONTINUES DOWN DESPITE AN UPTICK IN AUGUST CPI

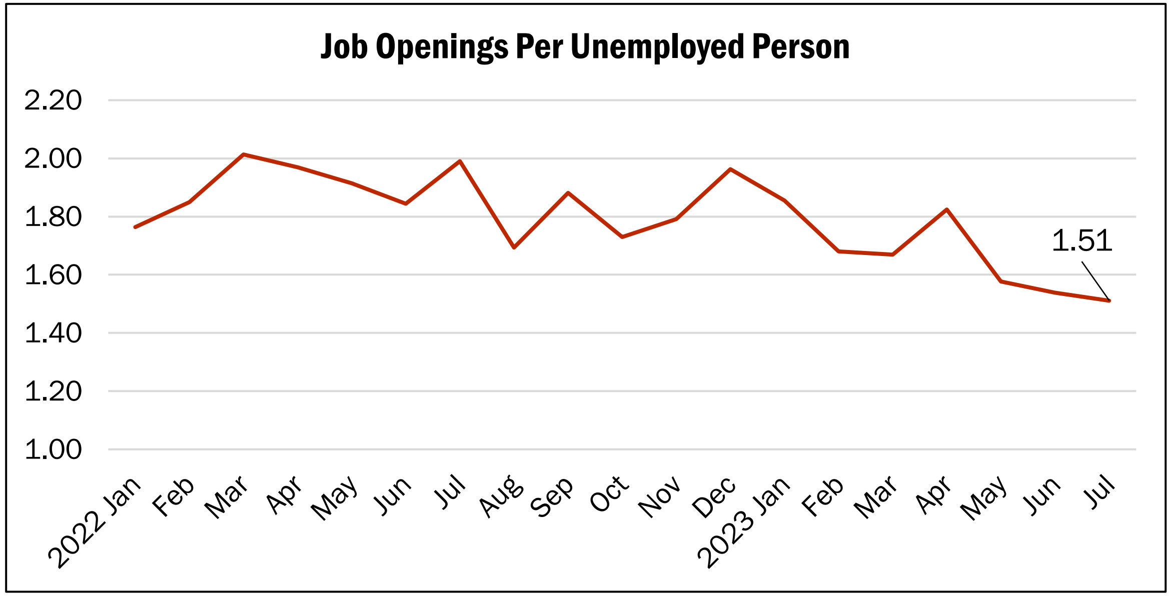


Sources: US BLS, US BEA

- Core CPI increased on a month over month basis, but the trend is still down. This is directly following the two lowest months in recent history.
- The Fed's preferred measure, the core PCEI, measured year-over-year, is still elevated at 4.24 percent.
- Month over month PCEI for both June and July are at an annualized rates of just 2.6 percent.

MEASURES OF LABOR DEMAND INDICATE A COOLING BUT STILL GROWING JOB MARKET

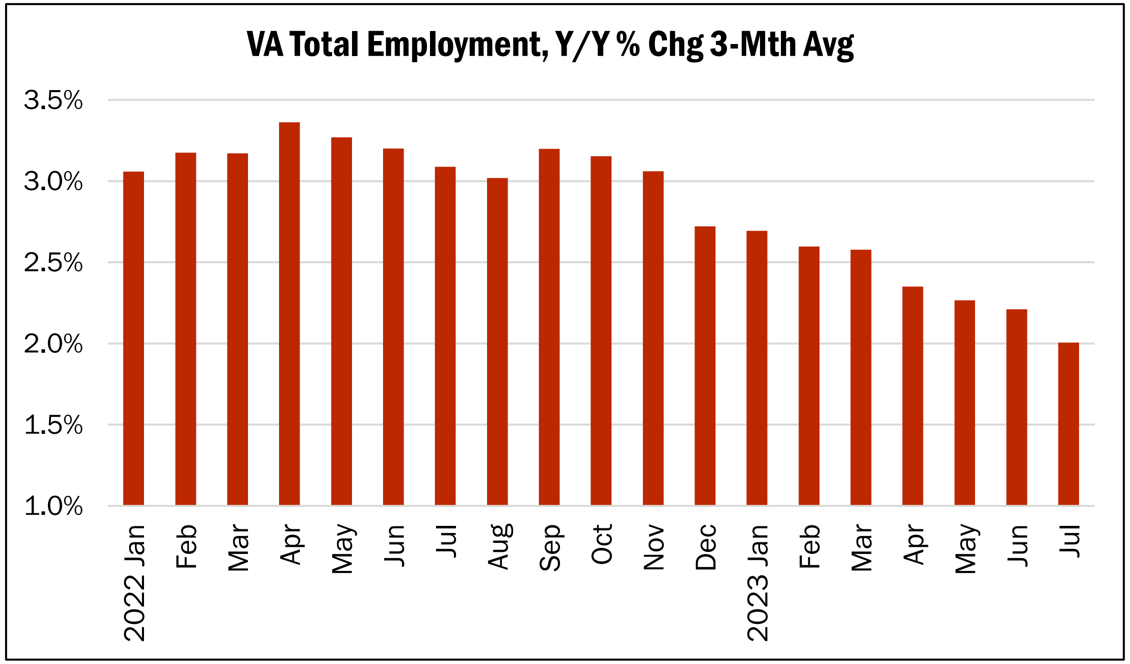




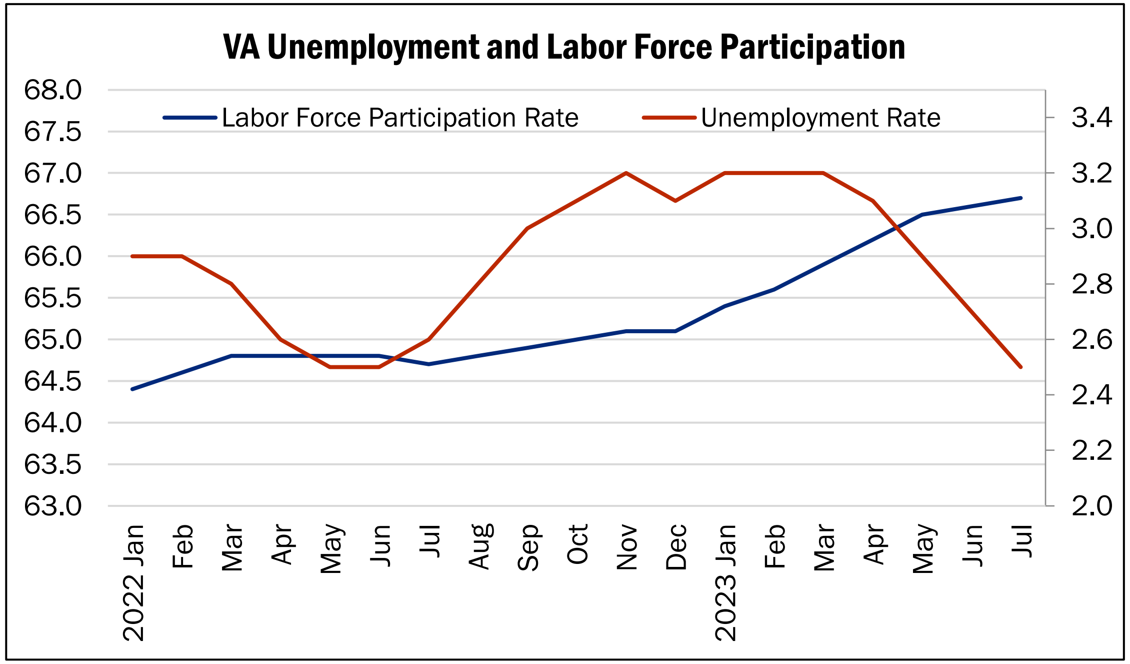
Sources: US BLS. Unless otherwise noted economic data is presented on a calendar year basis.

- Average monthly job gains have slowed to 150,000 in the latest three months, compared to 430,000 in the same period last year.
- Job openings per unemployed person are falling, though it has not reached its pre-pandemic levels of 1.2.
- This is one of Fed Chair Powell’s preferred metrics. The downward trajectory should encourage the Fed to keep rates flat.

EMPLOYMENT GROWTH IS SLOWING IN VIRGINIA, BUT JOBS ARE ABUNDANT



Source: US Bureau of Labor Statistics



Source: US Bureau of Labor Statistics

- Virginia's average employment growth has continued to slow, now at 2.0 percent.
- Despite fewer new jobs, more people are finding jobs. The unemployment rate sits at just 2.7 percent (2.5 percent seasonally adjusted), compared to the US unemployment rate of 3.8 percent (3.5 percent seasonally adjusted).
- The labor force participation rate continues to improve, up to 66.7 percent, higher than the US at 62.8 percent.

THROUGH AUGUST, UNADJUSTED REVENUES ARE $204.8 MILLION AHEAD OF THE HB 6001 FORECAST

	AUGUST						FISCAL YEAR-TO-DATE					
SOURCE, $ Mil	**Actuals**	**Projected**	**Variance $**	**Variance %**	**PY**	**Y/Y %**	**Actuals**	**Projected**	**Variance $**	**Variance %**	**PY**	**Y/Y%**
Withholding	1,354.2	1,334.9	19.3	1.4%	1,342.8	0.9%	2,587.8	2,564.3	23.5	0.9%	2,587.4	0.0%
Non-withholding	117.9	99.3	18.7	15.8%	124.3	-5.1%	220.9	178.5	42.5	19.2%	223.5	-1.2%
IIT Refunds	(132.0)	(144.4)	12.4	-9.4%	(54.7)	141.1%	(298.6)	(303.2)	4.5	-1.5%	106.5	-380.5%
Net	1,340.2	1,289.8	50.4	3.8%	1,412.4	-5.1%	2,510.1	2,439.6	70.5	2.8%	2,704.4	-7.2%
Sales/Use	390.4	380.0	10.4	2.7%	401.1	-2.6%	793.3	787.0	6.3	0.8%	759.8	4.4%
Corporate	19.0	27.4	(8.3)	-43.9%	21.9	-13.1%	105.9	82.0	24.0	22.6%	71.6	48.0%
Wills and Deeds	38.2	31.1	7.1	18.5%	47.5	-19.5%	74.1	63.4	10.6	14.3%	97.8	-24.3%
Insurance	-	-	-	-	-	-	-	-	-	-	-	-
All other	138.7	105.4	33.4	24.0%	61.1	127.1%	298.9	205.5	93.4	31.3%	115.3	159.2%
Total GF Revenues	**1,926.6**	**1,833.7**	**92.9**	**4.8%**	**1,943.9**	**-0.9%**	**3,782.3**	**3,577.5**	**204.8**	**5.4%**	**3,748.9**	**0.9%**

- Compared to the Forecast assumed in HB 6001, all of the major sources are generally in line or ahead of projections.
- Withholding revenues are ahead by $23.5 million year-to-date.
- Through August, collections of corporate income taxes are ahead of projections by $24.0 million.
- Interest income, included in the “All Other” category, is ahead by $93.4 million, but this figure does not reflect forthcoming distributions to NGF funds.

ADJUSTING FOR POLICY ACTIONS, MAJOR SOURCES OF GF REVENUE ARE UP 3.0 PERCENT YEAR-TO-DATE

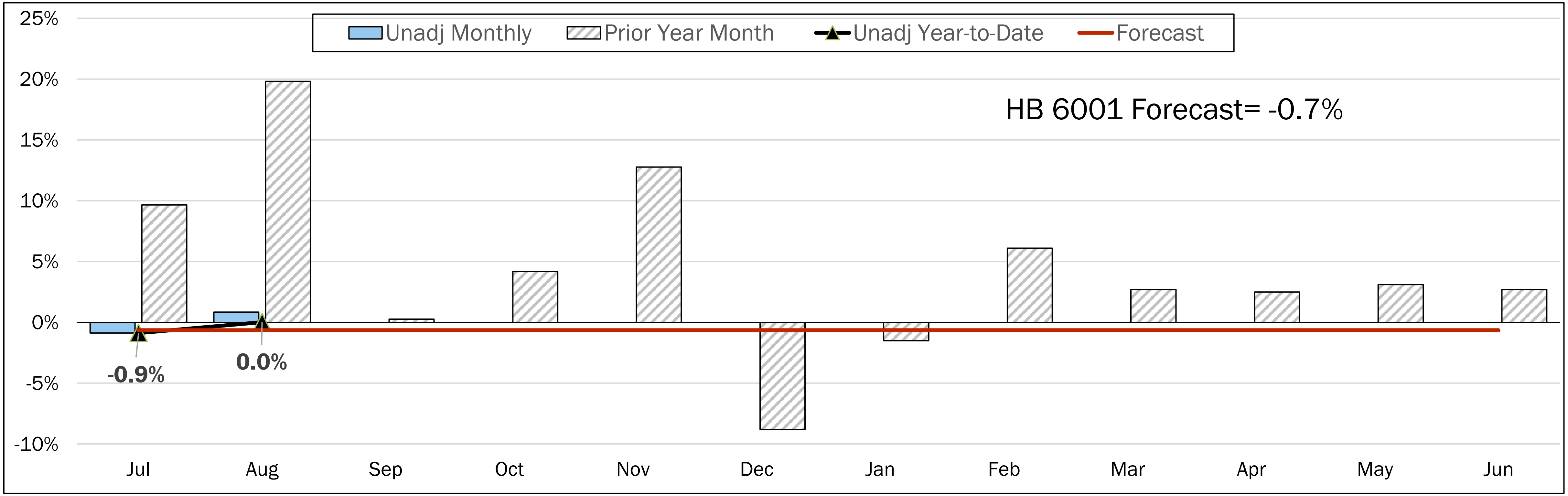
	FY 2023	FY 2024	Pct Chg	AUGUST				Fiscal Year-To-Date				
Unadjusted Revenues	**Actual**	**HB 6001**	**Req by Est**	**FY 2023**	**FY 2024**	**Change**	**% Change**	**FY 2023**	**FY 2024**	**Change**	**% Change**	**% of Total**
Withholding	15,957.2	15,853.0	-0.7%	1,342.8	1,354.2	11.4	0.9%	2,587.4	2,587.8	0.4	0.0%	68.4%
Non-Withholding	6,629.2	4,687.6	-29.3%	124.3	117.9	(6.4)	-5.1%	223.5	220.9	(2.6)	-1.2%	5.8%
Refunds	(3,602.8)	(2,834.8)	-21.3%	(54.7)	(132.0)	(77.2)	141.1%	(106.5)	(298.6)	(192.2)	180.5%	-7.9%
Sales and Use Tax	4,734.6	4,418.2	-6.7%	401.1	390.4	(10.6)	-2.6%	759.8	793.3	33.4	4.4%	21.0%
Corporate Income Tax	2,031.1	1,896.1	-6.6%	21.9	19.0	(2.9)	-13.1%	71.6	105.9	34.4	48.0%	2.8%
All Other Sources	2,160.7	2,349.1	8.7%	108.6	176.9	68.4	63.0%	213.1	373.0	159.9	75.0%	9.9%
Total GF Revenues	**$27,909.9**	**$26,369.3**	**-5.5%**	**$1,943.9**	**$1,926.6**	**(17.3)**	**-0.9%**	**$3,748.9**	**$3,782.3**	**33.4**	**0.9%**	**100.0%**

Adjusted Revenues	FY 2023	FY 2024	Change	% Change	FY 2023	FY 2024	Change	% Change	% of Total
Adjusted Withholding	1,342.8	1,398.3	55.5	4.1%	2,587.4	2,675.0	87.6	3.4%	66.2%
Adjusted Non-Withholding	124.3	118.1	(6.2)	-5.0%	223.5	221.1	(2.4)	-1.1%	5.5%
Adjusted Refunds+Rebates	(54.7)	(31.9)	22.9	-41.8%	(106.5)	(98.6)	7.9	-7.4%	-2.4%
Adjusted Sales (AST+Grocery Tax)	401.1	411.0	9.9	2.5%	759.8	765.1	5.3	0.7%	18.9%
Total GF Revenues, Adjusted	**$1,943.9**	**$2,091.4**	**147.6**	**7.6%**	**$3,748.9**	**$4,041.6**	**292.6**	**7.8%**	**100.0%**

Not all sums may compute due to rounding.

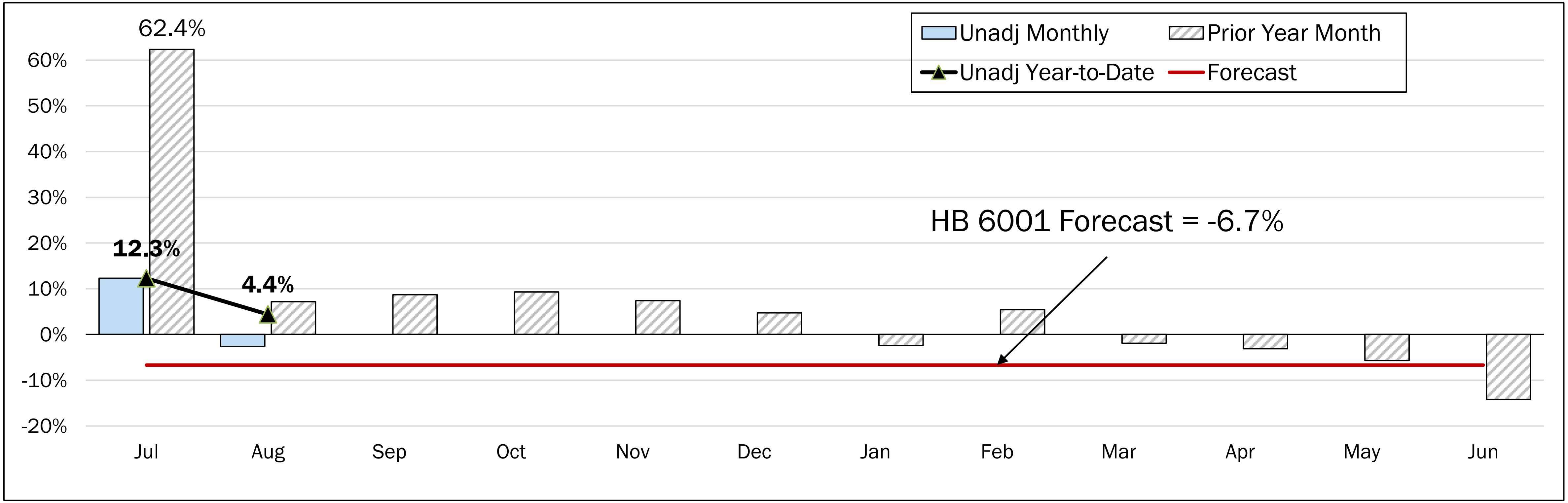
- Withholding collections, adjusted for changes to the standard deduction, are up 3.4 percent year-to-date.
- Year-to-date refunds adjusted to reflect continuing PTET-related refunds of approximately $200 million, are down 7.4 percent compared to the prior year.
- Interest income (included in “All Other Sources”) is not included in adjustments, but future distributions GF interest income to NGF funds will impact GF revenues. Excluding “All Other Sources,” GF revenues are up 3.0 percent year-to-date, and up 3.7 percent for the month of August.

YTD WITHHOLDING REVENUE GROWTH IS FLAT, REFLECTING THE RECENT INCREASE IN THE STANDARD DEDUCTION



- Forecasted growth is negative due to policy actions.
- The standard deduction impact was also slightly higher than originally forecast. Withholding in the past three months has averaged growth of 2.8 percent as the effects of the increased standard deduction have taken hold.

SALES TAX COLLECTIONS ARE SLIGHTLY AHEAD OF EXPECTATIONS, BUT GROWTH IS EXPECTED TO SLOW IN COMING MONTHS



- On an adjusted basis to account for the AST and elimination of the state grocery tax, June sales tax revenue growth was 3.6 percent vs the -14.2 percent unadjusted decline.
- Growth in sales tax revenue will continue to slow due to the elimination of the sales tax on groceries.

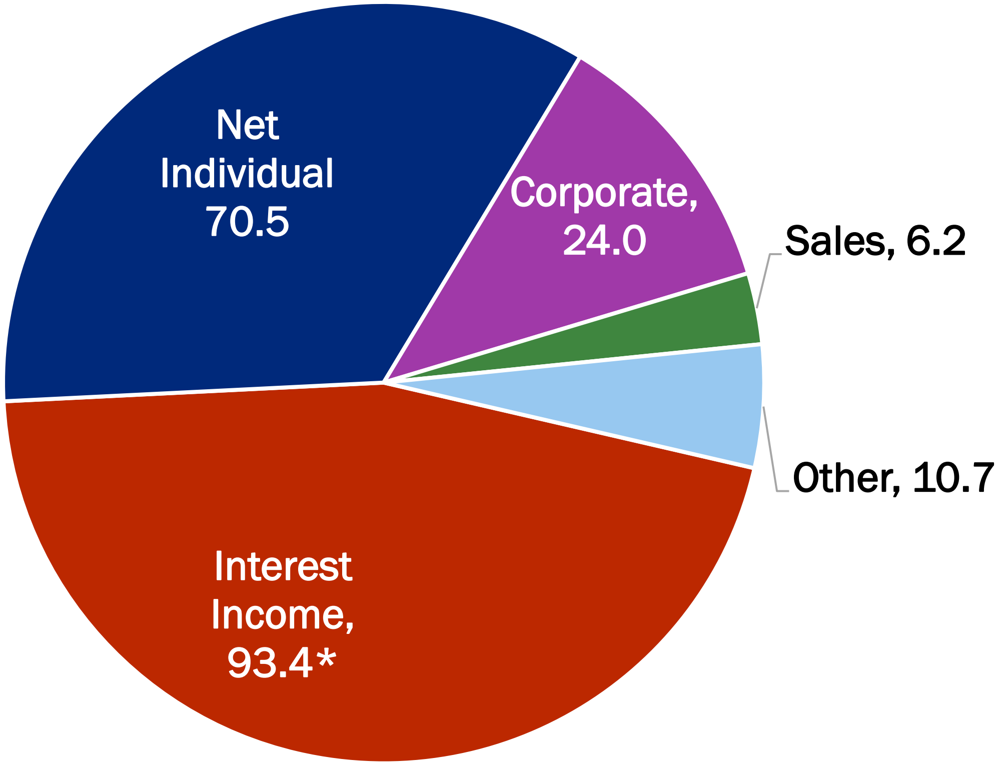
OTHER SOURCES

- Interest income has exceeded projections significantly. However, year-to-date interest income does not reflect quarterly allocations to nongeneral fund accounts which will significantly reduce general fund interest income in coming months when NGF distributions are made.
    - Interest is transferred from the General Fund to NGF funds on a quarterly basis in October, January, April, and June.
- Deed recordation taxes have not been impacted as severely as anticipated. We had expected a 35% drop but have only seen a 24% drop fiscal year-to-date.
- Corporate tax revenues underperformed this month, but fiscal year-to-date revenues are still elevated from an exceptional overshoot in July.

FISCAL YEAR-TO-DATE REVENUE SUMMARY

- General fund revenues are up 0.9 percent fiscal year-to-date through August.
- In comparison to the revenues assumed in HB 6001, year-to-date general fund revenues are ahead of forecast by $204.8 million.
  - Interest income significantly exceeded estimates and account for nearly half of the variance.*
  - Individual income taxes account for the other major portion.
- PTET repayments are thus far approximately on target with an estimated $200M sent out.

Year-to-Date Revenues Above Forecast
($ in millions)



Year-to-date interest income does not reflect forthcoming allocations to NGF accounts. Interest is transferred from the General Fund to NGF funds on a quarterly basis in October, January, April, and June.

KEY DATES

October

- Corporate estimated payments are due.
- Joint Advisory Board of Economists meets on October 11 and reviews economic projections for current and next biennium.

November

- Corporate refunds from extension returns peak.
- Individual income tax extension returns due November 1.
- Governor’s Advisory Council on Revenue Estimates meets on November 20 and reviews revenue forecast for the 2024 - 2026 biennium.

December

- General fund revenue forecast finalized.
- Governor Youngkin’s 2024 budget amendments and the 2024 - 2026 biennial budget are presented to the Joint Money Committee on December 20.