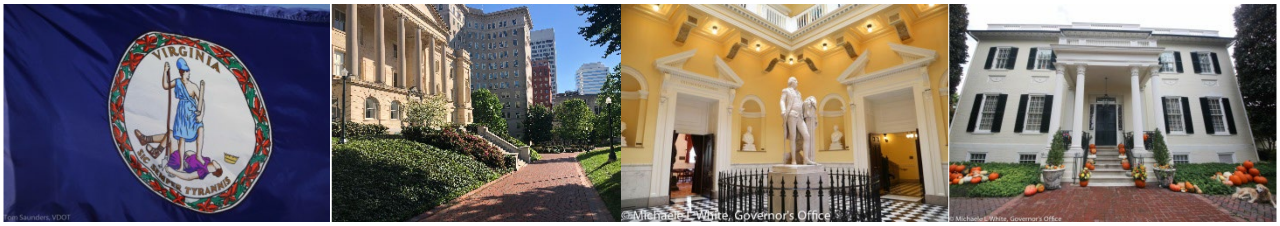
ECONOMIC FORECAST



Review of FY 2022

As IHS Markit prepared the October 2021 forecast, on which the current official revenue forecast is based, it reflected all pandemic relief measures of 2020, including the $1.9 trillion American Recovery Plan Act enacted in March of that year, and the Infrastructure Investment and Jobs Act (about $300 billion of additional spending over the next five fiscal years). Continuing supply restraints and COVID-19 effects were expected to dampen the expansion in the second half of the year.

Over the course of the fiscal year, GDP growth was lower than expected, but income and wage growth were much higher than expected. Prices, as measured by the CPI and GDP deflator, were significantly higher than forecast.

In Virginia, payroll employment growth exceeded expectations in FY 2022. In the official forecast, total nonagricultural employment was projected to increase by 2.8 percent while actual growth was 3.2 percent. Higher-than-expected gains in leisure and hospitality services offset lower growth in many other employment sectors.

U.S. economy vulnerable to falling into a recession

The U.S. economy is more vulnerable to falling into a recession next year than was previously thought. Persistently high and broad-based inflation has prompted the Federal Reserve to raise the federal funds rate more than expected and to signal that it will continue to keep rates as high as needed in order to tame inflation. These higher rates have already caused a significant slowdown in the interest rate sensitive sectors of the economy, particularly the housing market. There are increasing signs that the effects of higher rates are starting to reverberate to other sectors of the economy.

The majority of economists surveyed by the Wall Street Journal now expect that the U.S. economy will experience a mild and short contraction in 2023 as a result of higher rates. The baseline (standard) forecast, based on the IHS October forecast and input from advisory meetings, also assumes that Real GDP growth will show sluggish growth in FY 2023 and will begin to contract by 0.5 percent in FY 2024. In the context of prior recessions, the standard forecast assumes a recession that is significantly less severe and shorter than the Great Recession, and more similar to the 2001 Recession, which lasted about three quarters.

The U.S. labor market has begun to show signs of cooling, although by most measures conditions for job seekers still remain relatively strong. Monthly job gains, measured by the three-month average, have slowed from a pace that exceeded 600,000 in December of last year to 289,000 jobs most recently in October.

With job growth continuing, albeit at a more moderate pace, the nation's unemployment rate remained at a low rate of 3.7 percent in October. The low unemployment rate also can be attributed to a drop in the labor force participation rate during the pandemic when workers remained hesitant to seek work due to health concerns and generous federal assistance kept workers on the sideline. The unemployment rate has more recently started to move upwards but has not fully recovered to pre-pandemic levels.

The Federal Reserve is expected to continue to raise rates in the near term to continue to bring inflation down further. As expected, the Federal Reserve raised rates by 75 basis points at the November FOMC meeting, and the expectation is for a 50 basis point increase at the December meeting. Chairman Powell and other board members have hinted that the terminal federal funds rate could now exceed 5 percent, implying at least two more 25 basis point increases. According to the September dot plot, the Federal Reserve is anticipated to continue increasing rates through the first half of 2023 and then begin to gradually cut rates in 2024 as inflationary pressures subside.

Virginia economy is expected to slow over the forecast horizon

Employment in Virginia's business establishments only recently recovered to its pre-pandemic peak level with September data showing employment exceeding February's 2020 level for the first time. Year-over-year employment growth was 3.3 percent, lagging the nation's rate of 4.4 percent.

However, results of the household survey from the Bureau of Labor Statistics show a less favorable picture. Resident household employment in Virginia continues to lag pre-pandemic levels and the nation. Virginia's labor force participation remains considerably lower than pre-pandemic rates, particularly among older men. It is unknown whether this lower participation rate is temporary, related to the pandemic, or permanent.

Much like the nation, as the full effects of the Federal Reserve's monetary policy take their toll on the economy, local employment is expected to begin to slow in the second half of FY 2023 before slowly rebounding in FY 2024. Compared to the nation's forecast decline of 2.4 percent in 2024, Virginia's decline in 2024 is forecast to be a lower 1.2 percent decline due to the buffer from the federal government sector.

In terms of the private sector breakdown, losses are concentrated in the cyclical trade sector while non-cyclical sectors such as education and health continue to grow. The unemployment rate is expected to reach 4.6 percent in FY 2024.