Controller *John Chiang*

California State Controller's Office

October 2007 Summary Analysis Volume 1, Issue 8

Statement of General Fund Cash Receipts and Disbursements

The State Controller's Office is responsible for collecting all State revenues and receipts and for making disbursements from the State's General Fund. The Controller also is required to issue a report on the State's actual cash balance by the 10th of each month.

As a supplement to the monthly *Statement of General Fund Cash Receipts and Disbursements*, the Controller issues this Summary Analysis for California policymakers and taxpayers to provide context in which to view the most current financial information on the State's fiscal condition.

This October Summary Analysis covers actual receipts and disbursements for September 2007. Data are shown for total cash receipts and disbursements, the three largest categories of revenues, and the two largest categories of expenditures. This report also provides the state's latest revenue projections (i.e., from the Budget Act, the Governor's January Budget or May Revise proposals) as points of comparison. Our current point of comparison is the 2007-08 Budget Act passed in August 2007.

At the June 30 close of the 2006-07 fiscal year, Personal Income Taxes (income taxes), Retail Sales and Use Taxes (sales taxes) and Bank & Corporation Taxes (corporate taxes) comprised 94.8% of General Fund revenues. Of these, income tax receipts contributed 54.7% of General Fund revenue, sales tax receipts added 28.8%, and corporate taxes provided 11.3%.

Tax Revenue in September 2007

⇒ General Fund revenues in September 2007 were $322 million (-3.0%) below the Budget Act estimate for the month. Retail sales had the greatest drop below the estimate, coming in $181 million (-8.1%) below. Insurance company taxes were below the Budget Act estimate by $104 million (-19.7%), and corporate taxes were also below by $37 million (-1.6%). Personal income taxes were $24 million (0.4%) above the Budget Act estimate.

⇒ Estimated taxes paid in September are important indicators of anticipated tax obligations for the entire fiscal year. For both income and corporate taxes, receipts were below Budget Act estimates (-0.3% and –0.8%, respectively).

Tax Revenue Fiscal Year to Date

⇒ The Budget Act included actual receipts—not revenue estimates—for July and August, so fiscal year-to-date revenue comparisons to Budget Act estimates reflect only the September differences.

⇒ Total General Fund revenue was $322 million (-1.5%) below the Budget Act estimate for year to date (see Table 1). Retail sales were $181 million below (-2.7%), Insurance company taxes were below by $104

(Continued on page 2)

(Continued from page 1)

million (-15.9%), while corporate taxes were below estimate by $37 million (-1.3%). Personal income taxes came in at $24 million, or 0.2% above the Budget Act.

⇒ Comparing the totals from this fiscal year-to-date to last fiscal year at this time provides a better perspective on revenue trends. Compared to 2006, year-to-date General Fund receipts are $200 million lower (-0.9%). The largest single disparity is the $269 million dip in insurance company taxes (-32.9%). Of the three major taxes, sales tax receipts are the weakest, $104 million (-1.6%) below the year-to-date totals seen in September 2006. For corporate taxes, the fiscal year-to-date total is almost exactly what it was last year (less than $1 million more), and income taxes are $415 million (3.8%) higher.

⇒ Estimated taxes for personal income are 7.6% higher than they were last year at this date, while corporate taxes are 0.9% higher. In September 2006, estimated income taxes to date were 21.5% above the prior year and estimated corporate taxes were ahead by 3.2%. Since estimated taxes are an indication of what taxpayers think they will owe for the year, this indicates that the growth of revenue from these two sources is likely to be slower in 2007-08 than it was in 2006-07.

Estimated Taxes

Estimated tax payments are generally filed quarterly to pay taxes due on income that is not subject to withholding. This can include income from self-employment, interest, dividends, gains from asset sales, or if insufficient income tax is being withheld from a salary, pension, or other income. Estimated tax payments are one indication of future state revenues.

Summary of Net Cash Position as of September 30, 2007

⇒ In September, the State spent $1.9 billion more than it received in revenue. Expenditures were $12.6 billion and receipts totaled $10.7 billion. For the year to date, the State has spent $10.2 billion more than it has received in revenue. Total receipts were $22.6 billion, and expenditures were $32.7 billion.

⇒ A deficit at this point is not unusual. A disproportionate share of the state's revenue arrives during the last four months of the fiscal year, while a large percentage of disbursements occur during the first eight months.

⇒ Of the largest expenditures, $24 billion have gone to local assistance and $7.6 billion to State operations (see Table 2). The State began the fiscal year with a cash balance of $2.5 billion. The net cash deficit at the end of September is $7.7 billion, which has been covered by internal borrowing. The State still has $8.5 billion in unused borrowable resources available to be used until a $7 billion Revenue Anticipation Note is issued on November 1, 2007.

Borrowable Resources

State law authorizes the General Fund to internally borrow on a short-term basis from specific funds, as needed.

Revenue Anticipation Notes

Traditionally, to bridge cash gaps the state borrows money in the private market by issuing Revenue Anticipation Notes (RANs). RANs are repaid by the end of the fiscal year.

Looking Beneath the Surface: California Employment Growth

⇒ When the U.S. Bureau of Labor Statistics (BLS) released the national employment report on October 5, there was considerable surprise that the previously reported August decline of 4,000 jobs had suddenly

(Continued on page 3)

(Continued from page 2)

become an increase of 89,000 jobs. The increase occurred because two large states (Texas and Florida) had moved their public school start dates, affecting the mid-August count of jobs. Once the seasonal factor adjusting for school dates was corrected, national August job growth was a positive 89,000. Since California was not affected by this anomaly, the original data made California growth appear much better than the nation as a whole. With the correction, it is clear that California is experiencing about the same rate of slow (1.1%) employment growth as the rest of the country. As we have often noted in this report, it is important to consider more than one month of data to establish a direction for both the economy and California revenue.

How to Subscribe

This Statement of General Fund Cash Receipts and Disbursements for September 2007 is available on the State Controller's Web site at www.sco.ca.gov. To have the monthly financial statement and summary analysis e-mailed to you directly, sign up at www.sco.ca.gov/ard/cash/email-sub.shtml.

Any questions concerning this Summary Analysis may be directed to Hallye Jordan, Deputy Controller for Communications, at (916) 445-2636.

Table 1: General Fund Receipts, July 1-September 30, 2007 (in Millions)

Revenue Source	Actual Receipts To Date	Budget Act Projections	Actual Over (Under) Estimate
Bank And Corporation Tax	$2,760	$2,797	($37)
Personal Income Tax	$11,453	$11,429	$24
Retail Sales and Use Tax	$6,506	$6,687	($181)
Other Revenues	$998	$1,127	($129)
Total General Fund Revenue	$21,717	$22,040	($322)
Non-Revenue	$872	$823	$49
Total General Fund Receipts	$22,589	$22,863	($274)

*Note: Some totals may not add, due to rounding

Table 2: General Fund Disbursements, July 1-September 30, 2007 (in Millions)

Recipient	Actual Disbursement	Estimated Disbursement	Actual Over (Under) Estimate
Local Assistance	$23,963	$23,381	$582
State Operations	$7,611	$8,030	($419)
Other	$1,176	$2,056	($880)
Total Disbursements	$32,750	$33,467	($717)

Table 3: General Fund Cash Balance As of September 30, 2007 (in Millions)

	Actual Cash Balance	Budget Act Estimated Cash Balance	Actual Over (Under) Estimate
Beginning Cash Balance July 1, 2007	$2,462	$2,462	$0
Receipts Over (Under) Disbursements to Date	($10,161)	($10,604)	$443
Cash Balance September 30, 2007	($7,699)	($8,142)	$443

Featured Articles on California's Economy

Controller John Chiang's Council of Economic Advisors informs the Controller on emerging strengths and vulnerabilities in California's economy, major issues and trends that may affect the State's fiscal health, and how to make the best use of limited government revenues and resources.

The advisors also contribute monthly articles on issues regarding California's economy. The opinions in the articles are presented in the spirit of spurring discussion and reflect those of the authors and not necessarily the Controller or his office.

This month, the Controller asked economists Ryan Ratcliff and David Shulman of the Anderson Forecast, University of California at Los Angeles, to provide their insight into California's economy.

Executive Summary of the 2007 3rd Quarter UCLA Anderson Forecast for the California Economy

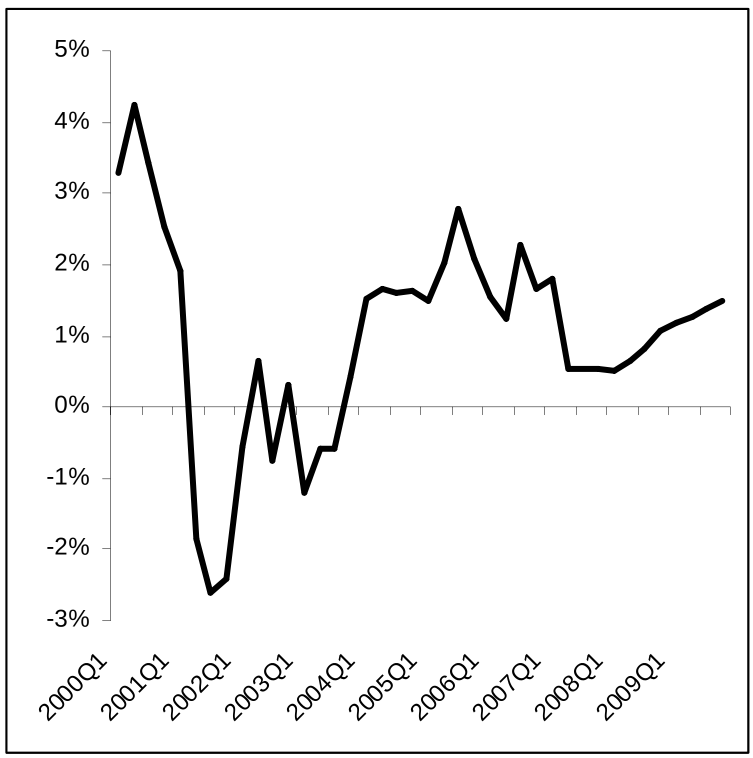
By Ryan Ratcliff
Economist, UCLA Anderson Forecast

The second quarter of 2007 has largely lived up to our expectations, showing substantial job loss in real estate-related sectors and sluggish growth elsewhere. Unemployment and mortgage defaults continue to rise. While these fairly dismal results may sound a lot like the beginning of a recession, overall job growth remains positive, and personal income growth remained strong in the first quarter of 2007. In fact, these are the beginnings of exactly the economy we have predicted for some time: sluggish, but no recession. However, the difference between the two is getting smaller all the time.

The ongoing increase in mortgage defaults and foreclosures continues to occupy center stage in any discussion of local housing markets, with much of the debate centering on whether these trends are driven by cut-and-run real estate investors, or the consequences of the predatory exploitation of working class families. According to the

(Continued on page 5)

Forecast of Growth in California Non-Farm Payroll Employment (SAAR)

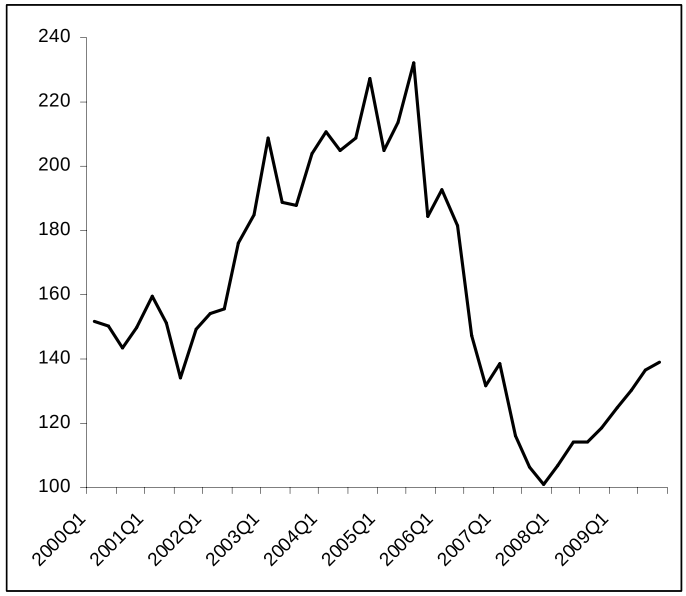


Source: CA EDD, UCLA Anderson Forecast

(Continued from page 4)

results of our wide study of national, state, and local data on this topic, investors have been a significant portion of the sales boom and the defaults that have followed it. However, the majority of mortgage defaults have still occurred in owner-occupied homes. Furthermore, the counties in California with the highest foreclosure rates have been those with a combination of middle-of-the-pack home prices, but extremely high usage of adjustable rate mortgages (ARMs) – exactly the combination we'd expect when working families stretch beyond their means to buy a home. But we find little evidence that mortgage defaults have led to wider financial distress for consumers.

Forecast of California Building Permits Issued (1000 units, SAAR)



Source: CIRB, UCLA Anderson Forecast

The end of 2007 will mark the peak of subprime ARM resets, so we expect to see mortgage defaults peaking sometime in the first half of 2008. With elevated foreclosures, a severe pullback in mortgage lending, and low levels of building activity, we predict that real estate markets will continue to be a drag on California growth through at least the end of 2008. With no other sectors picking up the slack, we expect to see overall growth in non-farm payroll employment of less than 1% through this time next year. This prognosis is worse than previous forecasts in part because of the worse-than-expected job loss in Financial Activities. Unemployment will reach a peak of 5.9% at the end of next year, with corresponding weakness in personal income and gross state product. A pickup in building permits and a moderation in mortgage problems in late 2008 and/or early 2009 marks the light at the end of the tunnel, with the California economy returning to relatively normal levels of growth by the end of 2009.

Executive Summary of the 2007 3rd Quarter UCLA Anderson Forecast for the U.S. Economy

By David Shulman
Senior Economist, UCLA Anderson Forecast

Despite the stronger than expected growth of 4% in the second quarter of 2007, the re-pricing of hitherto very easy credit will cause the U.S. economy to have a "near recession experience." Specifically, we forecast real GDP growth to be just above 1% for the fourth quarter of 2007 and the first quarter of 2008. Thereafter, we forecast growth to remain tepid for the balance of 2008 and return to trend 3% growth in 2009. Nevertheless, by mid-2008 the unemployment rate is forecast to reach 5.2%, up from the current 4.6%. Of course, when the economy slows to a 1% pace, it runs the risk of falling into an actual recession, just as when an airplane's velocity gets too close to its "stall speed" and falls out of the sky.

As in prior quarters, the source of our pessimism remains the on-going deterioration of the housing market. We have once again lowered our forecast for housing activity as the weight of ever-tightening credit

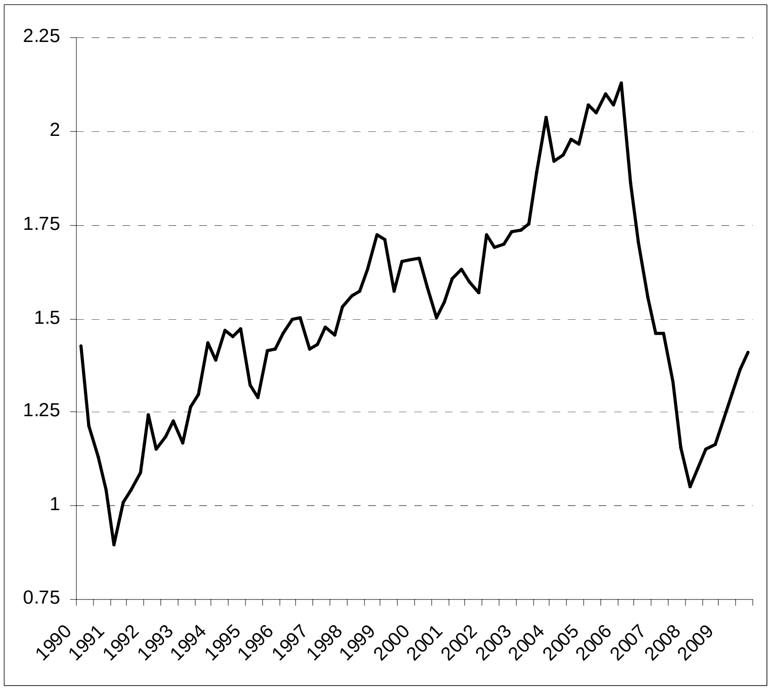
(Continued on page 6)

(Continued from page 5)

standards and an ebbing of the builders' practice of building houses to get out of the underlying land exact their tolls. Where we previously forecast housing starts to bottom in the 1.2-1.3 million unit annual rate range, we have now marked down that forecast to the 1.0-1.1 million units range and, perhaps more importantly, we now believe that the recovery will be far more tepid with starts barely recovering to a 1.4 million unit annual rate by the end of 2009.

Although it has taken longer than what we had previously forecast, the effect of the housing weakness has finally spilled over into consumer spending on durable goods. Automobile sales have been soft, especially in the housing bubble states of California and Florida. As a result, we are now forecasting that automobile sales in 2008 will be 15.7 million units, the lowest since 1998. Furthermore, other consumer durables will suffer, especially the housing-related furniture and appliance categories, and that will lead to an absolute decline in consumer durable spending in 2008.

Forecast of U.S. Housing Starts (in millions, SAAR)



Source: Census Dept., UCLA Anderson Forecast

Nevertheless, we are still sticking to our story that we will not have a classic recession. Why? The trade sector is rapidly improving as a strong global economy increases exports and a sluggish domestic economy reduces imports. Net exports will account for about one-third of the 1.8% growth we envision for next year, and corporate investment in equipment and software will be moderately strong.

California State Controller John Chiang:

300 Capitol Mall, Suite 1850
Sacramento, CA 95814

P.O. Box 942850
Sacramento, CA 94250

Telephone: (916) 445-2636
Fax: (916) 445-6379

777 S. Figueroa Street, Suite 4800
Los Angeles, CA 90017

Telephone (213) 833-6010
Fax: (213) 833-6011

Web: *www.sco.ca.gov*