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California State Controller's Office

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State Finances in June 2012

June 2012 compared to monthly estimates in the **Governor's May Revision**	June 2012 monthly totals compared to **June 2011**
Total Revenues: **$247 million** **(2.2%)**	**Total Revenues:** **-$984.9 million** **(-8.0%)**
Income Tax: **$496.3 million** **(7.7%)**	**Income Tax:** **$433.8 million** **(6.7%)**
Sales Tax: **$1.3 million** **(0.1%)**	**Sales Tax:** **-$895.4 million** **(-33.5%)**
Corporate Tax: **-$305.7 million** **(-15.5%)**	**Corporate Tax:** **-$658.7 million** **(-28.4%)**

The Difficulty of Cash-Flow Projections

"[W]elcome the new year," the poet Rilke is supposed to have written, "full of things that have never been."

At this time of year, the Department of Finance tries to anticipate fiscal surprises which may "have never been." It creates a monthly disbursement schedule

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What the Numbers Tell Us

Due to slightly better than expected receipts and slightly lower than expected expenditures, California ended the 2011-12 fiscal year with a shortfall that was roughly $1.0 billion lower than projected in the Governor's 2012-13 May Revision estimates. Overall, total General Fund revenues in June 2012 were $247 million better than expected in the latest estimates. This was driven by personal income taxes, which exceeded the forecast by $496.3 million, or 7.7%. Importantly, personal income taxes did particularly well, exceeding the amount received in June 2011 by $433.8 million, despite the expiration of temporary increases to the personal income tax rates. In total, General Fund Receipts came in $411.9 million better than expected in the 2011-12 fiscal year, according to the 2012-13 May Revision estimates.

It is important to keep in mind that the 2012-13 May Revision contained more conservative estimates than previously forecasted under the 2012-13 Governor's Budget produced earlier this year, and total General Fund revenues lagged be-

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What the Numbers Tell Us

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hind those earlier figures by $417 million last month. Corporate taxes continue to be the sore spot in the State's finances, with revenues falling $308.4 million short of the updated May Revision estimates for the year and $1.3 billion lower than the 2012-13 Governor's Budget estimates from January. However, personal income taxes did exceed the expectations of the less conservative 2011-12 Governor's Budget expectations in June 2011.

But despite the modest improvement in revenues over expectations, the broader economic recovery continues to be slow. National figures showed that real GDP in the first quarter of 2012 posted a lackluster 1.9% growth, and that the U.S. has added fewer than 100,000 jobs between May and June. In addition, slower retail sales and personal income growth during April and May indicate that economic growth will remain in the sub-3% range for the second quarter of 2012 as well. While this is clearly a far cry from tipping back into recession, the anemic growth will be less than needed to generate a rapid recovery in the nation's economy. Ongoing problems in Europe have continued to put upward pressure on the U.S. exchange rate, which has appreciated for four consecutive months and has caused U.S. export growth to slow substantially from the double-digit gains posted in 2010 and 2011.

Yet, California has not seemed to experience the same slowdown seen throughout the rest of the nation in the first half of 2012. In fact, the state accounted for nearly half of all the jobs created in May, and consumer spending growth during the first quarter came in nearly 10% higher than the first quarter of 2011. This suggests that California could begin to lead the nation once again after falling behind slightly last year.

Additionally, the housing and commercial real estate markets have clearly hit bottom and have even begun to post some improvement. Home prices in the state have appreciated solidly during the first half of 2012 following seven consecutive months of increases, reaching their highest levels since the mid-2010 surge associated with the first-time homebuyer tax credit.

The economy is healing, and while the pace of growth has slowed, things continue to move forward. General Fund revenues ended the 2011-12 fiscal year in better shape than projected in the latest estimates, and expenditures have been lowered below what was envisioned. Yet, the state still faces a steep uphill battle with a cash deficit of nearly $9.6 billion as we enter a new fiscal year.

Table 1: General Fund Receipts

July 1, 2011 – June 30, 2012 (in Millions)

Revenue Source	Actual Revenues	2012-13 May Revision		2010-11 Year-To-Date	
		Estimate	Actual Over (Under)	Actual	Actual Over (Under)
Corporation Tax	$8,051	$8,360	($308)	$9,804	($1,753)
Personal Income Tax	$50,699	$50,217	$482	$50,402	$297
Retail Sales and Use Tax	$19,438	$19,543	($105)	$27,172	($7,733)
Other Revenues	$5,285	$5,023	$262	$5,855	($570)
Total General Fund Revenue	**$83,474**	**$83,143**	**$331**	**$93,233**	**($9,759)**
Non-Revenue	$4,296	$4,215	$81	$2,304	$1,992
Total General Fund Receipts	$87,770	$87,358	$412	$95,536	($7,767)

The Difficulty of Cash-Flow Projections

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based on historical and statutory spending patterns and identifies revenues after accounting for tax withholding-requirements and due dates. The Controller uses this report to monitor the state's reserves and ensure the State makes timely payments.

Because California's finances do not always follow historical patterns, actual cash flows may vary from what was budgeted. Circumstances cause departments to spend more — or at a faster pace —- than planned. This is why the Controller always maintains a prudent cash cushion to ensure that critical payments can be made.

More often than not, monthly disbursements vary by at least 5 percent, while revenues varied by 5 percent for 22 of the last 45 months.

The changes accumulate to effect cash balances, and are displayed in the columns of Figure 1. When the column is short (that is, close to the $0 line), the actual balance is nearly equal to what Finance estimated. Recently, actuals have sometimes been $2.5 billion above or $5 billion below the plan. More often than not the difference is negative, meaning that the state spent more — or received less revenue — than expected.

The dotted line in the figure shows a six-month moving average of the differences and indicates that the balances are generally lower than planned for long stretches of time. For example, during 2011-12 the monthly balance averaged about $1 billion less than expected.

Figure 1: Cash Flow Differences (Actual-Estimate)
Monthly Revenues and Disbursements
Monthly Difference and Six-Month Moving Average
Dollars in Millions, July 2007 through March 2012

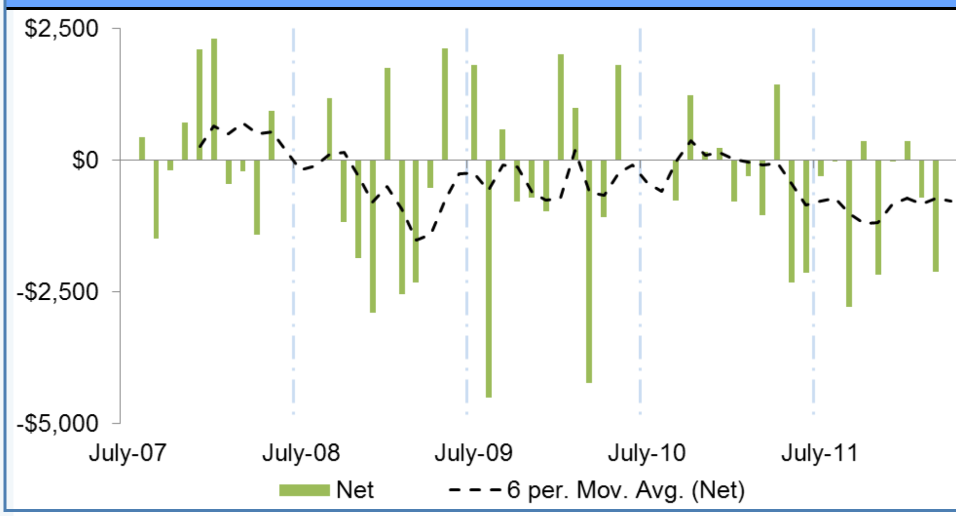

Table 2: General Fund Disbursements

July 1, 2011 – June 30, 2012 (in Millions)

Recipient	Actual Disbursements	2012-13 Governor's May Revision		2010-11 Year-To-Date	
		Estimates	Actual Over (Under)	Actual	Actual Over (Under)
Local Assistance	$64,580	$65,163	($584)	$65,433	($854)
State Operations	$24,431	$24,318	$113	$26,898	($2,467)
Other	$188	$323	($135)	$1,447	($1,259)
Total Disbursements	**$89,199**	**$89,804**	**($606)**	**$93,779**	**($4,580)**

This Recovery Is Not Going To Stall

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While by definition California entered the recovery phase in the third quarter of 2010, the disappointing pace of job growth leaves many sectors of the economy well below their pre-recession employment levels. Only educational and health services gained jobs through the recession and the later recovery periods. Leisure and hospitality, information, and professional and business services sectors are recovering at a respectable pace and growth in these sectors is gaining momentum.

In general, coastal regions of the state with more diversified economies are growing much faster than the inland areas. Rapid job growth of the inland regions prior to this recession was fueled mainly by strong growth in the construction and retail employment sectors. With the construction sector now in the doldrums, these areas have shown subpar overall job growth in 2011, and payroll job gains reported in the first quarter of 2012 show a similar trend.

The rebound in the leisure and hospitality sector is particularly noteworthy. Consumer discretionary spending showed a nice comeback, and that, along with increases in domestic and international tourism, boosted spending and employment in this sector. This trend is consistent with our California Consumer Confidence Index that showed a gradual improvement in overall California consumers' sentiment from a recessionary level of 57.6 in the second quarter of 2008 to a current reading of 92.3.

The good news is the performance of the goods-producing sector of the economy. Manufacturing jobs are growing. This is mainly the result of improvements in consumer spending and business investment along with a pick up in California's exports.

California merchandise exports grew by 11.3 percent in 2011, increasing from $143.2 billion to $159.4 billion. The financial crisis in the Eurozone and the recessionary conditions in some of the Eurozone countries, however, will cut into California's export levels. On a positive note, only Germany and Netherlands are among California's 10 largest export destinations. Our largest trading partners, Canada and Mexico, are projected to show a healthy growth rate for the remainder of the year and 2013.

The other goods-producing sector of the economy is the construction sector. After four consecutive yearly declines, construction spending turned positive in early 2011 and is growing again. In other words, the brunt of the construction nosedive has already been felt in terms of lower employment and spending levels. The current rebound in construction should positively affect employment in this sector.

Of course, the most important variable affecting the California economy is real GDP growth and real GDP is projected to increase by 2.3 percent in 2012 and 2.6 percent in 2013.

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The opinions in this article are presented in the spirit of spurring discussion and reflect those of the authors and not necessarily the Controller or his office.

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Overall, our forecast calls for payroll job growth of 1.4 and 1.6 percent in California in 2012 and 2013, respectively. By 2013, every sector of the economy is projected to show positive job growth.

Construction, professional and business services, and education and health services will show above-average job growth.

One of the consequences of every recession is the growth in the rank of self-employed. During recessions, many laid-off workers gradually stop seeking employment and become self-employed as consultants, contractors or freelancers. On average, self-employment is about 15.0 to 20.0 percent of payroll employment. Therefore, based on our forecast of payroll employment presented earlier, we are projecting total civilian employment which includes the self-employed to increase by 242,000 in 2012 and 271,000 in 2013.

California's labor force is increasing at an annual average rate of about 0.8 percent. Hence, California needs to generate 150,000 civilian employment to absorb the natural increase in the labor force. Based on our projected civilian employment growth rates, a gradual decline in the unemployment rates in California should occur over our forecast period.

Projected job growth along with declining unemployment rates should positively affect personal income growth over the 2012-13 period. That, in turn, will positively influence consumers' spending. Overall, total taxable sales spending is forecasted to increase from an estimated level of $507.0 billion in 2011 to $567.5 billion in 2013, an increase of 5.9 percent and 5.7 percent in 2012 and 2013, respectively.

The combination of job recovery and high housing affordability is gradually improving housing demand. On the supply side, the inventory of unsold homes is shrinking. And with recent declines in notices of default, the share of stressed properties in the market will decline as well.

Higher demand and shrinking supply are stabilizing prices. Our forecast calls for an annual average median single-family home price to increase by 5.0 percent in 2012 and by 6.1 percent in 2013. The forecasted price increases are, however, mostly due to a significant shift in the mix of homes to be sold. This is mainly because there will be a decline in the share of all resale homes that are stressed properties and typically in lower price range.

California Economic Snapshot		
New Auto Registrations (Fiscal Year to Date)	**982,124** Through April 2011	**1,094,544** Through April 2012
Median Home Price (for Single-Family Homes)	**$249,000** In May 2011	**$270,000** In May 2012
Single-Family Home Sales	**35,536** In May 2011	**41,790** In May2012
Foreclosures Initiated (Notices of Default)	**68,239** In 1st Quarter 2011	**56,258** In 1st Quarter 2012
Total State Employment (Seasonally Adjusted)	**14,054,900** In May 2011	**14,276,400** In May 2012
Newly Permitted Residential Units (Seasonally Adjusted Annual Rate)	**49,908** In May 2011	**60,516** In May 2012
Data Sources: DataQuick, California Employment Development Department, Census Bureau, State Department of Finance		