Controller *John Chiang*

California State Controller's Office

July 10, 2013 | Summary Analysis | Volume 7, Issue 7

State Finances in June 2013

June 2013 compared to monthly estimates in the **2013-14 May Revision**	June 2013 monthly totals compared to **June 2012**
Total Revenues: ▲ **$1.2 billion (10.1%)**	**Total Revenues:** ▲ **$1.7 billion (15.3%)**
Sales Tax: ▲ **$70.1 million (3.5%)**	**Sales Tax:** ▲ **$268.8 million (15.1%)**
Income Tax: ▲ **$644.6 million (8.7%)**	**Income Tax:** ▲ **$1.1 billion (16.1%)**
Corporate Tax: ▲ **$373.5 million (21.5%)**	**Corporate Tax:** ▲ **$448.2 million (26.9%)**

DOF's Long-Term Forecast: Hope for the Budget-Weary

California's finances are on the mend. According to the Department of Finance, General Fund revenue from the three major taxes will rise from about $80 billion in 2011-12 to $113 billion in 2016-17. This increase, at a rate of about 7.1% per year through the end of the forecast, is driven by

(Continued on page 3)

What the Numbers Tell Us

California finished its fiscal year on a strong note with economic recovery, stock market gains, and tax increases burnishing June's revenue numbers and the State's picture of improving fiscal health. June revenues topped revised estimates issued by the Governor's Office as part of the May Budget Revision by $1.2 billion, or 10.1%.

All three major revenue categories — personal income, corporate taxes, and sales — beat expectations. Personal income tax receipts provided the greatest dollar impetus, surpassing estimates by $645 million, or 8.7%. Rising employment and capital gains, along with the tax increases approved by voters last November, have continued to boost California's most important revenue source. Individuals' estimated income taxes in June were also well ahead of projections.

Higher corporate profits helped to bring corporate tax revenues during June to a level that was $374 million better, or 21.5%, than estimates. Although consumers may still be adjusting to the national hike in payroll taxes that went into effect this

(Continued on page 2)

What the Numbers Tell Us

(Continued from page 1)

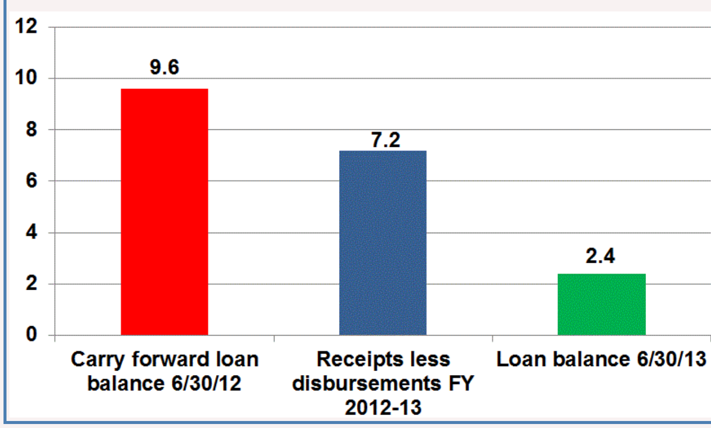
year, even retail sales tax receipts bested estimates by $70 million, or 3.5%. The impacts of economic growth and tax increases are particularly striking in comparing June's revenues this year with those of a year ago. All three primary revenue categories scored double-digit gains relative to June 2012. Overall June revenues totaled $13.1 billion this year versus $11.4 billion a year ago. This represented a jump of 15.3%.

What was the State's fiscal scorecard as of June 30, 2013? Although further progress still needs to be achieved, the progress during the past 12 months has been impressive. Total General Fund receipts topped numbers in the May Revision by $2.1 billion, or 2.1%. Relative to fiscal year 2011-12, total General Fund receipts for fiscal year 2012-2013 were up by $15.7 billion, or 17.8%. (See Table 1.)

Total spending for fiscal year 2012-2013 came in only $306 million above, or 0.3%, projections contained in the May Revision. (See Table 2.) Relative to the prior fiscal year, spending was up by $7.1 billion, or 7.9%. Higher education funding for K-12 schools accounted for the bulk of the increase.

California generated total tax receipts of $103.4 billion in fiscal year 2012-2013, which exceeded disbursements of $96.3 billion by a sizable $7.2 billion. This welcome and sizable positive difference reduced the State's outstanding balance that was carried over from a year ago from $9.6 billion to $2.4 billion. (See Figure 1.) The current loan balance was financed through internal borrowing.

Figure 1: State's Fiscal Picture Improves
(Dollars in Billions)



Economic uncertainties remain, including those related to the possible impact of rising interest rates on housing, the effects of global growth on exports, and crosscurrents that may affect stock prices. The State's critical income tax receipts could be impacted by swings in capital gains. At the same time, resisting political pressures to increase spending in light of improving revenues will be critical. Restoring California's fiscal health will require that the benefits from an improving economy and rising revenues be first used to pay down the State's debt and build its reserve.

Table 1: General Fund Receipts

July 1, 2012 – June 30, 2013 (in Millions)

Revenue Source	Actual Revenues	2013-14 Governor's May Revision		2011-12 Year-To-Date	
		Estimate	Actual Over (Under)	Actual	Actual Over (Under)
Corporation Tax	$7,620.4	$7,224.3	$396.1	$8,051.4	($431)
Personal Income Tax	$67,314.6	$66,073.4	$1,241.2	$50,699	$16,615.6
Retail Sales and Use Tax	$20,073.3	$19,985.4	$87.9	$19,438.4	$634.9
Other Revenues	$5,070	$4,796.7	$273.4	$5,285.1	($215)
Total General Fund Revenue	**$100,078.4**	**$98,079.8**	**$1,998.5**	**$83,473.9**	**$16,604.5**
Non-Revenue	$3,346.3	$3,207.9	$138.4	$4,295.9	($949.6)
Total General Fund Receipts	$103,424.7	$101,287.7	$2,137	$87,769.8	$15,654.9

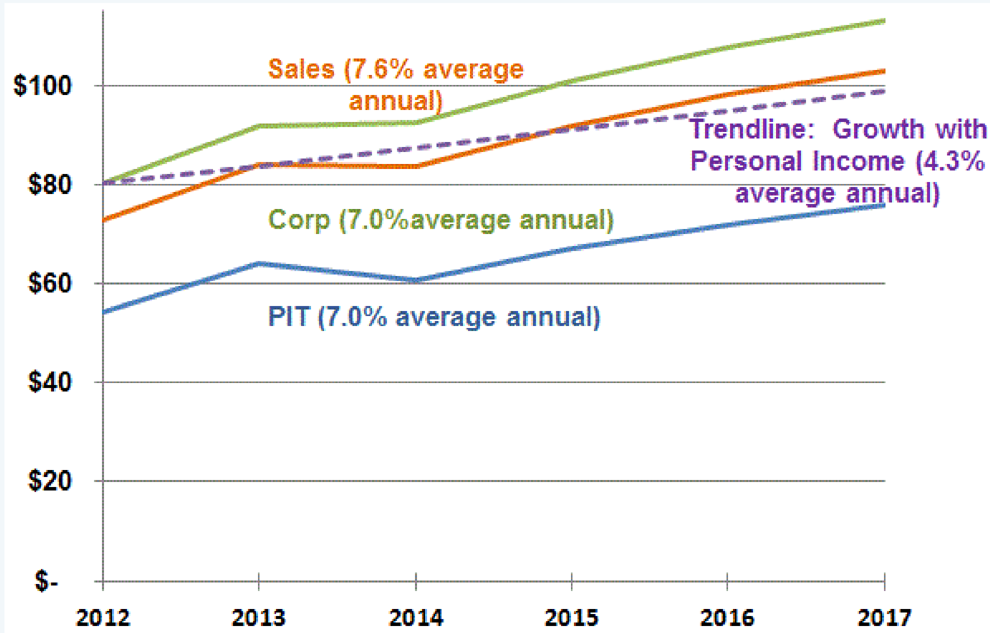
DOF's Long-Term Forecast: Hope for the Budget-Weary

(Continued from page 1)

healthy growth in the personal income, sales and corporations taxes and new tax rates adopted by voters in November 2012.

Figure 2 displays the estimates of the major taxes by year through the forecast period. The department forecasts a slight reduction in income tax revenues between the current and budget years. However, for the entire forecast period, the department expects revenues to grow from $54 million to $76 million, an average rate of growth of about 7.0% per year. Corporate taxes grow at a similar overall rate, from $7 billion to $10 billion (7.0 percent average annual). Sales tax revenue grows even faster — from $19 billion to $27 billion — at an average rate of about 7.6%.

Figure 2: Department of Finance Long-Term Revenue Forecast 2011-12 through 2016-17 (Year Ending June 30)
(Dollars in Billions)



The five-year growth rates are robust. The healthy performance may be explained by the likely expansion of the economy and tax liabilities associated with post-recession economic expansion.

By way of comparison, the department expects California personal income to grow from $1.6 trillion in 2010 to $1.9 trillion in 2014. This is a growth rate of about 4.3% per year — about 280 basis points below what the forecast shows for revenue growth in the major taxes during the forecast.

Table 2: General Fund Disbursements

July 1, 2012 – June 30, 2013 (in Millions)

Recipient	Actual Disbursements	2013-14 Governor's May Revision		2011-12 Year-To-Date	
		Estimates	Actual Over (Under)	Actual	Actual Over (Under)
Local Assistance	$68,095.1	$71,066.4	($2,971.3)	$64,579.7	$3,515.4
State Operations	$26,130.7	$23,781.8	$2,349	$24,431.3	$1,699.3
Other	$2,040.4	$1,111.7	$928.7	$187.6	$1,852.8
Total Disbursements	**$96,266.2**	**$95,959.9**	**$306.4**	**$89,198.6**	**$7,067.6**

California Economic Snapshot

New Auto and Light Truck Registrations (Year to Date)	**358,635** Through March 2012	**403,658** Through March 2013
Median Home Price (for Single-Family Homes)	**$270,000** In May 2012	**$340,000** In May 2013
Single-Family Home Sales	**41,790** In May 2012	**42,293** In May 2013
Typical Monthly Mortgage Payment	**$1,006** In May 2012	**$1,227** In May 2013
Payroll, Non-Farm Employment (Seasonally Adjusted)	**14,612,500** In May 2012	**14,360,400** In May 2013
Newly Permitted Residential Units (Monthly)	**5,705** In May 2012	**7.481** In May 2013

Data Sources: New Car Dealers Association, DataQuick, California Employment Development Department, Census Bureau

A Stronger and Broader Economic Recovery

Esmael Adibi
Director, Anderson Center for Economic Research
Chapman University

The benchmark employment data released earlier this year by the Employment Development Department (EDD) revised upward payroll job growth in 2012 for California and many regions of the state. With these revisions, payroll job growth in California outperformed the U.S. for the first time since the beginning of the 2007 recession.

Not only did the pace of job creation pick up steam, but the recovery was broad-based. Only manufacturing and government sectors showed job losses in December 2012 compared to December 2011. The rebound in home prices and homebuilding activity led to job growth of 5.9% in the construction sector. This fastest-growing sector was followed by growth of 4.4% in leisure and hospitality and growth of 4.0% in professional and business services.

In spite of the pickup in job growth in 2012, California's payroll employment is well below the peak employment level registered in the fourth quarter of 2007. Since the first quarter of 2010, California generated 700,000 payroll jobs compared to job losses of about 1.4 million during the recession. It should not be surprising, therefore, to see that unemployment rates, while lower than peak recessionary levels, are still well above the pre-recession lows.

The outlook for the rest of this year and 2014 depends on the direction of changes in key economic variables that affect the state and local economies. These variables include changes in real gross domestic product (GDP), real exports and real local construction spending.

Real GDP is projected to increase at average growth rates of 2.0% in 2013 and 2.7% in 2014.

Trends similar to the movement in real GDP are projected in the year-over-year percentage changes in real exports. On average, real exports is projected to increase by 2.3% in 2014, slightly higher than our projected growth rate of 1.2% in 2013.

Weak export markets resulting from the recession in Europe and slower growth rates in China and Canada will limit potential job creation in the manufacturing sector. The projected pickup in domestic capital spending, however, will mostly offset soft foreign markets. The net effect will be a higher level of manufacturing output with slight increases in employment.

Construction spending steadily improved over the 2011-12 period. This spending series is measured by projecting total residential and nonresidential permit valuation levels into future quarters, when spending and job creation actually take place. Mainly as a result of continued strength in residential permit valuation, construction spending is projected to increase by about 16.0% over our forecast period.

The rebound in the construction sector, when real GDP and exports growth are sluggish, is welcome news. The construction sector has one of the largest multipliers in the economy. Typically, a construction project with $1 million of spending induces at least $1.5 million of additional spending in the economy. The obvious beneficiaries are retail and wholesale sectors supplying building materials,

(Continued on page 5)

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.

(Continued from page 5)

furniture and appliances, as well as general merchandise, utilities and transportation sectors.

Overall, in annual terms, our forecast calls for a gain of 307,000 jobs in 2013 — a growth rate of 2.1%. With the pickup in real GDP growth, the forecast calls for job growth of 2.3% in 2014. While most of the net new jobs over this period will be in the services sector, the most rapid increase in jobs is forecasted to take place in the construction sector, increasing at about 5.0%.

The federal government sector is the only sector showing job losses over our forecast period. The state and local government sector, which was a major drag in overall job growth since the beginning of the recession, is turning around. Overall improvements in the economy and the passage of Proposition 30 are boosting personal income and sales taxes revenue.

With a stronger job growth and a higher concentration of income from dividends and capital gains, personal income is forecasted to rebound over the 2013-14 period. The increase in income bodes well for housing affordability and housing demand. But home prices are increasing even faster than income growth.

As reported by the California Association of Realtors, median home prices during the past six months have shown a year-over-year average increase of about 27.0%. So what's going on? Many distressed properties that came to the market as foreclosures or short sales during 2008-11 were relatively cheaper homes. At the trough, the median California home price of $245,000 in February 2009 showed a decline of 58.8% from its peak value of $594,000 in May 2007. This sharp decline was in large part due to the mix of homes sold. Now the reverse is happening, with sales activity favoring larger, more expensive homes.

Clearly, even after adjusting for the mix, home prices are on the path towards recovery. Not surprisingly, it all goes back to supply and demand.

On the supply side, although we are projecting increases in the residential permits activity in 2013 and 2014, the supply of completed and available new homes for sale will lag and increase only modestly over our forecast period.

The supply of resale housing units, mainly fueled by distressed properties during the recession, sharply declined in 2012. Current statistics show that the inventory of homes, measured by the number of months on the market before sale, is much lower than last year.

On the demand side, multiple factors are at work. First, job creation is picking up steam. The combination of job creation and a high level of housing affordability should induce additional housing demand. Second, California is a prime market for foreigners seeking to purchase a second home or an investment property. And finally, investors are back. The Federal Reserve is keeping interest rates down, and private-equity funds and hedge funds seeking higher yields are pouring money into real estate, driving prices higher. The combination of strong demand and limited supply will lead to higher home prices this year and next.

On average, the median single-family home price, as measured by the California Association of Realtors, is forecasted to increase by 7.8% in 2014. This projected appreciation rate is significantly lower than our projected double-digit increases in 2013 since the composition of homes sold are normalizing and trending toward normal historical patterns.

Esmael Adibi is a member of Controller John Chiang's Council of Economic Advisors.