

# Controller *John Chiang*

## California State Controller's Office

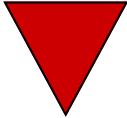

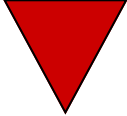
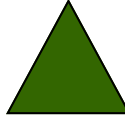
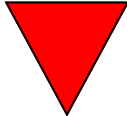
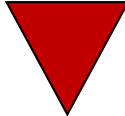
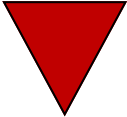
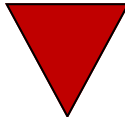


May 8, 2012

Summary Analysis

Volume 6, Issue 5

## State Finances in April 2012

April 2012 compared to <i>monthly estimates</i> in the Governor's proposed budget	April 2012 compared to last April (2011)
 <b>Total Revenues:</b> <b>-\$2.44 billion</b> (-20.2%)	<b>Total Revenues:</b>  <b>-\$702.4 million</b> (-6.8%)
 <b>Income Tax:</b> <b>-\$1.96 billion</b> (-21.5%)	<b>Income Tax:</b>  <b>\$55.9 million</b> (0.8%)
 <b>Sales Tax:</b> <b>-\$445.8 million</b> (-54.4%)	<b>Sales Tax:</b>  <b>-\$580.9 million</b> (-60.9%)
 <b>Corporate Tax:</b> <b>-\$142.7 million</b> (-9.3%)	<b>Corporate Tax:</b>  <b>-\$98.5 million</b> (-6.6%)

## What the Numbers Tell Us

Relative to the 2012-13 Governor's Budget estimates, General Fund revenue disappointed in April 2012. Total revenues were \$2.4 billion below the estimates with all three major sources of revenue — personal income tax, sales and use tax, and corporate taxes — all falling short of expectations. The largest variance came from personal income tax, which came in almost \$2.0 billion lower (-21.5%) than anticipated. However, sales taxes also underperformed the Governor's Budget expectations by \$445.8 million (-54.4%). The \$1.4 billion in corporate tax receipts collected was \$142.7 million lower than projected in April. To date, total General Fund revenues were \$3.5 billion lower than expected by this point in the year (with personal income taxes forming \$2.7 billion of this variance).

While any shortfall in revenue receipts represent a challenge,

*(Continued on page 2)*

### The Challenge of Estimating

Death and taxes may have been a certainty to Ben Franklin in 1789, but even he would find California's tax revenues unpredictable in 2012.

Later this month, the Department of Finance (DOF) will update its revenue numbers from the Governor's January 2012 proposed budget. The "May Revi-

*(Continued on page 3)*

## What the Numbers Tell Us

(Continued from page 1)

there is reason to believe that the situation will continue to improve at a gradual pace. For example, relative to last year, personal income tax revenues were actually up in April by \$56 million (0.8%).

Modest though this may be, it shows that personal incomes in the state are actually growing and this improvement comes in spite of the fact that income tax rates dropped by 0.25 percentage points in the 2011 year. In fact, this means that the underlying income base is growing even faster than the 0.8% year-over-year increase in revenues would suggest.

In addition, and perhaps more importantly, withholding on personal income is actually up on a year-to-date basis according to estimates from the Franchise Tax Board. The FTB figures show that more than \$550 million in the negative variance relative to Governor's Budget estimates for personal in-

come tax last month was driven by more refunds than anticipated. Still, estimated tax payments remain well below projections, so while the underlying data shows that things are gradually improving in the economy, no rapid relief for revenues is on the horizon.

Sales taxes were unexpectedly low as well, though even here, there is cause for caution rather than alarm. Firstly, April is generally not a significant month for sales tax revenues, with the average April receiving just 3.0% of total sales tax each year. Traditionally, February, May, August, and November are large months for sales tax, and so far those months have seen sales tax revenues come in at or above expectations in 2011-12. If May and June post solid performances, sales tax could still end the year relatively in-line with expectations.

**Table 1: General Fund Receipts**

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

Revenue Source	Actual Revenues	2012-13 Governor's Budget		2010-11 Year-To-Date	
		Estimate	Actual Over (Under)	Actual	Actual Over (Under)
Corporation Tax	\$6,137	\$6,601	(\$464)	\$7,205	(\$1,068)
Personal Income Tax	\$40,808	\$43,506	(\$2,699)	\$41,029	(\$221)
Retail Sales and Use Tax	\$14,851	\$15,263	(\$411)	\$20,773	(\$5,922)
Other Revenues	\$3,818	\$3,762	\$56	\$4,505	(\$687)
<b>Total General Fund Revenue</b>	<b>\$65,614</b>	<b>\$69,132</b>	<b>(\$3,518)</b>	<b>\$73,512</b>	<b>(\$7,898)</b>
Non-Revenue	\$3,608	\$3,216	\$392	\$1,985	\$1,624
<b>Total General Fund Receipts</b>	<b>\$69,222</b>	<b>\$72,348</b>	<b>(\$3,126)</b>	<b>\$75,497</b>	<b>(\$6,275)</b>

## The Challenge of Estimating

(Continued from page 1)

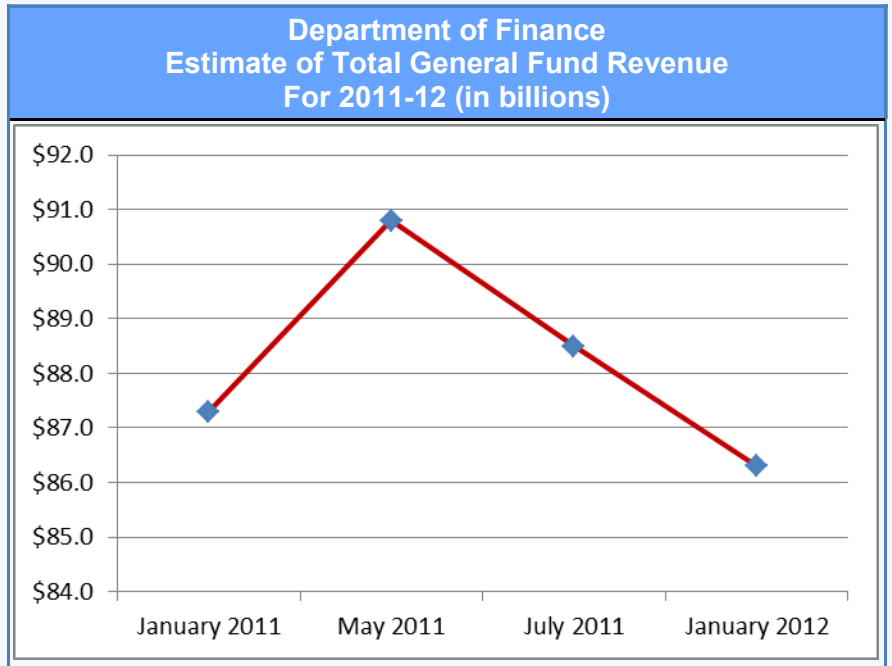
sion” will reflect the department’s review and assessment of recent economic and tax data. If previous revisions are a guide, expect multi-billion-dollar changes in estimated current- and budget-year revenues.

For DOF staff, next week’s revision will be the fifth time in 16 months they estimated total General Fund revenues for 2010-11 and 2011-12. Back in January 2011, DOF staff estimated the revenues would be \$89.7 billion in 2010-11 and \$87.3 billion for 2011-12. They revised the numbers in May 2011, July 2011 and January 2012.

The chart to the right shows how the estimates for the current year changed since January 2011: The estimate increased from \$87.3 billion to \$90.8 billion in May 2011.

This plotted history emphasizes how much revenue estimates can change relative to the initial estimate: In the last year, annual estimates have both increased by more

than 5.0 percent and fallen by more than 1.0 percent. At this year’s May Revision, DOF staff must again measure how much to increase or reduce their January estimates.



## Table 2: General Fund Disbursements

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

Recipient	Actual Disbursements	2012-13 Governor’s Budget		2010-11 Year-To-Date	
		Estimates	Actual Over (Under)	Actual	Actual Over (Under)
Local Assistance	\$59,495	\$59,630	(\$136)	\$59,862	(\$367)
State Operations	\$20,810	\$21,187	(\$378)	\$22,608	(\$1,798)
Other	(\$94)	(\$.644)	(\$94)	\$864	(\$958)
<b>Total Disbursements</b>	<b>\$80,211</b>	<b>\$80,817</b>	<b>(\$607)</b>	<b>\$83,334</b>	<b>(\$3,123)</b>

# A Nicer Spring Than Last Year ... But More Issues Ahead

Christopher Thornberg  
Founding Partner  
Beacon Economics

The preliminary numbers for the first quarter's Gross Domestic Product (GDP) growth are in, and they did not offer much of a surprise. The economy grew at a 2.2 percent pace, led largely by consumer spending. The nation added more than 600,000 jobs as well in the first quarter, and the stock market and oil prices rebounded. In other words, it sounds exactly like how 2011 kicked off—to quote the great Yogi Berra, “it's déjà vu all over again.” So does this mean that the U.S. will slide into a mid-summer slump like the one we saw in 2011?

We don't think so. Unlike last year, there are signs that the current momentum is on steadier foundations.

- ⇒ The housing market has definitely turned the corner. Falling inventories, fewer seriously delinquent mortgages and declining property vacancies indicate that residential construction will start to grow this year, adding another leg to the slow recovery. By the end of the year we expect that home prices will start to rise.
- ⇒ Non-residential construction should help drive the economy forward as well. The numbers were weak in the first quarter—much like last year. But better numbers for March should cause an

upward revision here, and falling vacancy rates suggest better months ahead. Increased transaction volumes and ongoing positive numbers from the Architectural Billing Index would seem to support this view.

- ⇒ Positive signs are also coming from the credit markets. At the start of last year, banks were still on the defensive, and overall loan volumes were flat or falling. This year we're seeing reduced credit standards, along with spreads for the cost of bank borrowing. The volume of both outstanding real estate and consumer loans is starting to grow for the first time since the recession began.
- ⇒ Consumers are in a better financial position as well. While income growth has not been as robust as policy makers might prefer, falling interest rates and reduced debt loads have pushed the financial obligation ratio down to levels not seen since the early 1990s. As oil prices start to fall, real incomes will be given a boost.
- ⇒ Capacity utilization has risen sharply over the past year, and initial claims for unemployment insurance are down. Both would tend to indicate

*(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 4)

that the slack in the economy is finally starting to be removed. This suggests solid job growth as well as growth in business spending on equipment and software.

- ⇒ Most state and local governments are also in better shape. Last year, revenues were on the rise, but most governments were still grappling with leftover deficits from the recession itself. As such, there was still cutting to do to balance the books, creating a substantial drain on GDP. This year revenues have begun to catch up with expenditures for most parts of the U.S., and by the end of the year it is possible to see these institutions starting to add to growth again.
- ⇒ Lastly, the outlook for exports seems to be looking up as well. The dollar has sagged from the mini-rally it saw late last year. This combined with robust growth rates in Asia, particularly since China seems to be growing again, and the rest of America, should offset weaker European demand.

None of these facts would support the idea that the economy will finally get into 'recovery' mode — significantly above average growth rates that will indicate current economic output will start to converge with that long run trend line we were on before the recession began. But they do suggest a steadier path for growth.

Unfortunately, the world economy is not fully out of the woods. But now the sources of weakness have shifted almost entirely into the political sphere.

We must note the brewing crisis in Europe. While the injection of funds to the banks seems to have stemmed the tide in the short term, there are already growing signs that the turmoil is re-emerging. This time the debate will be between Germany, which wants austerity, and the rest of

Europe, which wants something different. While we do not see this as a direct threat to the U.S. economy, if the debate should set off a financial crisis it could cause the U.S. dollar to appreciate sharply, hurting the surge in exports. This is clearly a risk factor for California when much of the recovery is being driven by exports and tourism.

U.S. federal government debt levels are nowhere near crisis proportions, but nevertheless something must be done before it does get to that point.

Spending cuts will fall largely on local government through reduced federal subsidies. Tax cuts for individuals have pushed tax rates to their lowest levels in decades, maintaining consumer spending at a record high share of the economy. Weaning ourselves off the over-spending U.S. population base will be similarly difficult.

<b>California Economic Snapshot</b>		
<b>New Auto Registrations</b> (Fiscal Year to Date)	<b>658,042</b> Through January 2011	<b>707,322</b> Through January 2012
<b>Median Home Price</b> (for Single-Family Homes)	<b>\$249,000</b> In March 2011	<b>\$251,000</b> In March 2012
<b>Single-Family Home Sales</b>	<b>36,417</b> In March 2011	<b>37,481</b> In March 2012
<b>Foreclosures Initiated</b> (Notices of Default)	<b>68,239</b> In 1st Quarter 2011	<b>56,258</b> In 1st Quarter 2012
<b>Total State Employment</b> (Seasonally Adjusted)	<b>14,056,300</b> In March 2011	<b>14,237,300</b> In March 2012
<b>Newly Permitted Residential Units</b> (Seasonally Adjusted Annual Rate)	<b>46,162</b> In March 2011	<b>60,630</b> In March 2012
Data Sources: DataQuick, California Employment Development Department, Construction Industry Research Board, State Department of Finance		