

Controller *John Chiang*

California State Controller's Office

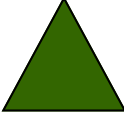

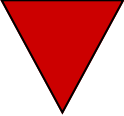

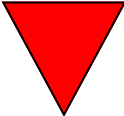

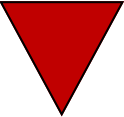
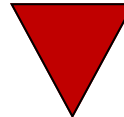


June 11, 2012

Summary Analysis

Volume 6, Issue 6

State Finances in May 2012

| May 2012 compared to monthly estimates in the Governor's May Revision | May 2012 compared to monthly estimates in the Governor's January Budget Proposal |
|--|---|
|  Total Revenues: \$83.5 million (1.3%) | Total Revenues: \$865.5 million (15.4%)  |
|  Income Tax: -\$14 million (-0.5%) | Income Tax: \$394 million (15.3%)  |
|  Sales Tax: -\$106.3 million (-3.7%) | Sales Tax: \$386.7 million (16%)  |
|  Corporate Tax: -\$2.7 million (-1.1%) | Corporate Tax: -\$90.7 million (-26.6%)  |

What the Numbers Tell Us

Overall, total General Fund revenues exceeded the updated expectations contained in the Governor's 2012-13 May Revision estimates. Total revenues came in \$83.5 million higher than expected in May. However, it is clear that the General Fund is not out of the woods. Most of the increase over expectations in May owes to strong growth in the insurance tax, which is a tax on gross premiums, which was up \$130.6 million relative to the estimates for the month.

However, revenues from the "Big 3" sources of revenue—personal income taxes, sales taxes, and corporate taxes—came in 2.0% below estimates. This is important because these three taxes form the lion's share of General Fund revenues, representing roughly 90% of total revenues each year. Sales taxes accounted for most of this shortfall, coming in \$106.3 million below expectations. Corporate taxes were down \$2.7 million, and personal income taxes also fell short by \$14 million. Thus, although General Fund revenues

Deadline for Making Reductions

June has its commemorations and rituals. In the month, Americans mark the end of slavery (Juneteenth). Some celebrate Joyce's *Ulysses* (June 16) or the summer solstice (June 20). The Legislature spends the month balancing the General Fund budget. In fact, if 2012 is like the last three

(Continued on page 3)

(Continued on page 2)

What the Numbers Tell Us

(Continued from page 1)

posted gains over the newly revised 2012-13 May Revision estimates, the major drivers of revenues in the state are still showing signs of weakness.

But the news isn't all bad on the revenue front, as some areas continue to move forward albeit at a relatively lackluster pace. For example, personal income tax revenues were actually \$84.7 million higher in May 2012 than they were in May 2011 despite a tax rate drop of 0.25% across all income brackets. Employment growth, though slowing in April in California and in May at the national level, is still posting modest increases.

The household survey also is showing more folks re-entering the labor force to resume their job search. In fact, despite the weak showing of only 69,000 new jobs in May from the payroll survey, the household survey shows that 642,000 Americans came back into the labor

force, with 422,000 of those moving into the employed category. Thus, although the unemployment rate remained little changed, the underlying numbers could signal a slight increase in optimism about the direction of the economy.

There's no doubt that the overall economic recovery has yet to take off in California or across the nation. National economic growth posted a disappointing 1.9% during the first quarter, and growth during the fourth quarter of 2011 grew at a 3% annual rate — not enough to drive a rapid improvement in overall economic conditions.

The revised estimates from the 2012-13 May Revision call for more tepid improvement in revenues than previously forecasted. This is prudent given the underperformance of revenues during the second half of Fiscal 2011-12 to date.

Table 1: General Fund Receipts

July 1, 2011 – May 31, 2012 (in Millions)

| Revenue Source | Actual Revenues | 2012-13 Governor's May Revision | | Governor's January Budget Proposal | | 2010-11 Year-To-Date | |
|------------------------------------|-----------------|---------------------------------|---------------------|------------------------------------|---------------------|----------------------|---------------------|
| | | Estimate | Actual Over (Under) | Estimate | Actual Over (Under) | Actual | Actual Over (Under) |
| Corporation Tax | \$6,387 | \$6,389 | (\$2.7) | \$6,941 | (\$555) | \$7,481 | (\$1,094) |
| Personal Income Tax | \$43,784 | \$43,798 | (\$14) | \$46,089 | (\$2,305) | \$43,921 | (\$136) |
| Retail Sales and Use Tax | \$17,657 | \$17,763 | (\$106) | \$17,682 | (\$25) | \$24,495 | (\$6,838) |
| Other Revenues | \$4,264 | \$4,057 | \$206 | \$4,033 | \$231 | \$4,969 | (\$705) |
| Total General Fund Revenue | \$72,093 | \$72,010 | \$83 | \$74,745 | (\$2,653) | \$80,867 | (\$8,774) |
| Non-Revenue | \$3,882 | \$3,767 | \$115 | \$3,372 | \$511 | \$2,326 | \$1,555 |
| Total General Fund Receipts | \$75,976 | \$75,777 | \$199 | \$78,117 | (\$2,142) | \$83,193 | (\$7,218) |

Deadline for Making Reductions

(Continued from page 1)

years, the Legislature will devote most of its time to weighing reductions.

This annual cutting ritual began perhaps in June 2008. Between 2007-08 and 2011-12, the Legislature pruned \$12.2 billion from the General Fund. In dollar terms, K-14 school spending fell the most, by \$6.3 billion -- from \$41.9 billion to \$35.7 billion. Medi-Cal had the second biggest reduction, about \$1.7 billion. Agencies had savings by cutting services, increasing efficiencies, shifting costs and deferring payments. The chart to the right shows that K-14 had the greatest rate of annual reduction, about 5.2 percent. UC/CSU and Medi-Cal fell by 4.4 percent and 4.2 percent respectively. Debt service expanded at an annual rate of nearly 8 percent.

Sacramentans can expect 450 hours of daylight during June, more than any other month. The Legislature may use the long days reviewing reductions for 2012-13.

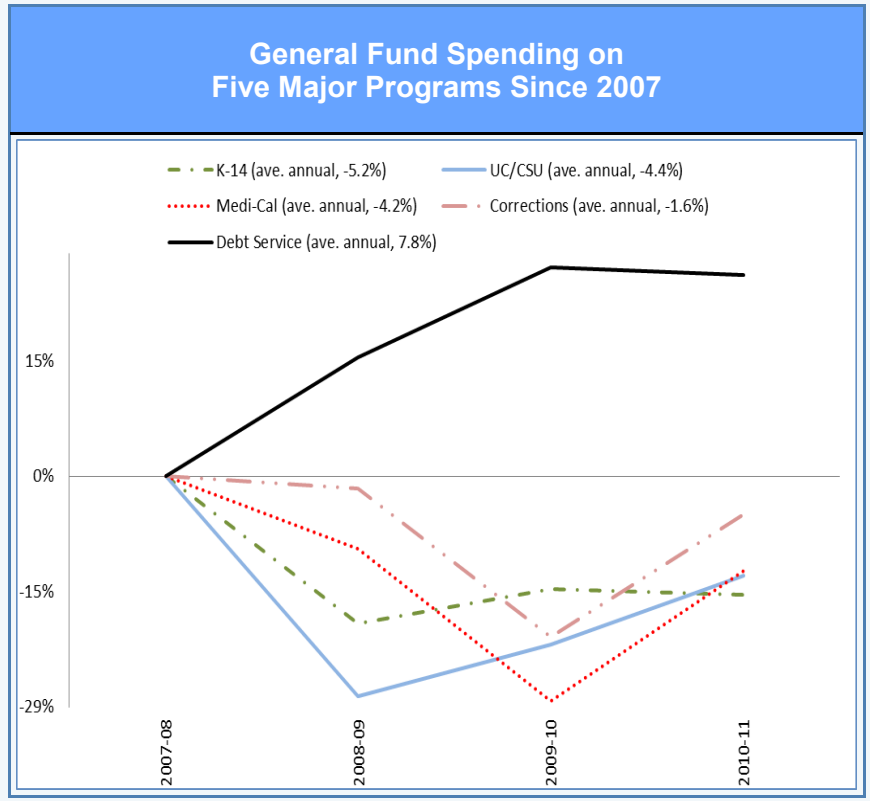


Table 2: General Fund Disbursements

July 1, 2011 – May 31, 2012 (in Millions)

| Recipient | Actual Disbursements | 2012-13 Governor's May Revision | | Governor's January Budget Proposal | | 2010-11 Year-To-Date | |
|----------------------------|----------------------|---------------------------------|---------------------|------------------------------------|---------------------|----------------------|---------------------|
| | | Estimates | Actual Over (Under) | Estimates | Actual Over (Under) | Actual | Actual Over (Under) |
| Local Assistance | \$62,548 | \$62,675 | (126) | \$62,712 | (\$163) | \$62,632 | (\$84) |
| State Operations | \$22,384 | \$22,314 | 69 | \$22,594 | (\$210) | \$24,654 | (2,270) |
| Other | (\$133) | (15) | (118) | \$30 | (\$164) | \$857 | (\$991) |
| Total Disbursements | \$84,799 | \$84,974 | (\$175) | \$85,336 | (\$537) | \$88,144 | (\$3,345) |

Europe's Turmoil: Implications for California

Lynn Reaser, Ph.D.
Chief Economist
Fermanian Business & Economic Institute
Point Loma Nazarene University

As fears continue to mount over the outcome of the debt crisis in Europe, it is important to begin thinking about the impact a Greek exit from the Eurozone would have on the U.S. economy and California. Connecting all of the global economic dots has become more important than ever before.

be positive for some consumers and businesses, but most of them would be seriously adverse.

The dollar would strengthen as investors from around the world flocked to the greenback as a "safe haven." This would help restrain import prices and

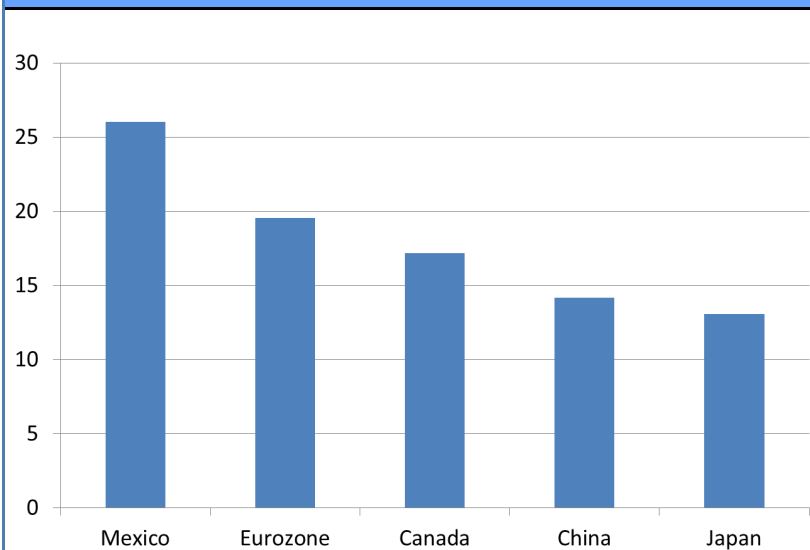
(Continued on page 5)

A Greek departure from the Eurozone, triggered either voluntarily or involuntarily, would spark fears of bank losses throughout Europe and accelerate speculation about Eurozone exits by other countries. The ripple effects would rapidly wash onto Wall Street but would also quickly reach Main Streets throughout the country. California and the West Coast might avoid the largest waves but would certainly bear a sizable amount of the total impact.

The Good, Bad, and Ugly

The first major break of the Eurozone would impact the U.S. economy through a number of channels. Some of these effects could actually

Largest California Export Markets
Billions of Dollars, 2011



Source: WISERTrade; FBFI

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)

help importers of various goods and materials, but hurt exporters selling abroad.

Interest rates would fall further as investors bought U.S. government bonds. The Federal Reserve might launch another round of “quantitative easing” to support financial markets and the economy. Lower interest rates would help mortgage and other borrowers but hurt individuals dependent on CDs and similar investments.

Bank lending standards might tighten again as anxiety about global losses crimp financial markets as they did following the failure of Lehman Brothers in 2008. Businesses and consumers would find it more difficult to qualify for loans.

Oil and other commodity prices would fall as concerns about slowing economic growth increase. The Eurozone economy will struggle even if a Greek exit is avoided. Lower oil and gasoline prices will help many consumers and businesses, although some companies producing various commodities would be hurt. Stock prices would plummet. This would have a pronounced, negative impact on many individuals and pension funds. Consumer confidence and spending would suffer.

The U.S. would face slower economic growth with fewer job gains and higher unemployment if the European situation worsens further. The impact of a deterioration in Europe’s economy would quickly spill over into China and other developing countries. Slower growth abroad would add to the impact of a stronger dollar in restraining exports.

Hitting Home

While California is often thought of as primarily focused on the Pacific Rim, Europe is a critical link in our economic picture. Last year, the

Eurozone represented the second largest export market for goods produced in the state. Approaching \$20 billion, California’s exports to the Eurozone trailed only those to Mexico (\$26 billion) but led those to Canada, China, and Japan. Many California firms will be hurt this year from weakness in Europe.

On balance, while a worsening of Eurozone conditions could help some Californians through lower interest rates and oil prices, the damage from lower exports, tighter lending standards, lower stock prices, and slower economic growth will put the state’s economy further at risk. Californians have a vested interest in the future of Greece and its European partners.

| <i>California Economic Snapshot</i> | | |
|--|---|---|
| New Auto Registrations (Fiscal Year to Date) | 658,042 Through January 2011 | 707,322 Through January 2012 |
| Median Home Price (for Single-Family Homes) | \$249,000 In April 2011 | \$264,000 In April 2012 |
| Single-Family Home Sales | 35,202 In April 2011 | 38,241 In April 2012 |
| Foreclosures Initiated (Notices of Default) | 68,239 In 1st Quarter 2011 | 56,258 In 1st Quarter 2012 |
| Total State Employment (Seasonally Adjusted) | 14,061,400 In April 2011 | 14,237,000 In April 2012 |
| Newly Permitted Residential Units (Seasonally Adjusted Annual Rate) | 46,162 In March 2011 | 60,630 In March 2012 |
| Data Sources: DataQuick, California Employment Development Department, Construction Industry Research Board, State Department of Finance | | |