

ECONOMIC OUTLOOK

Economic growth was strong in 2014, resulting in an improved overall outlook for California. Jobs are being added faster than anticipated and the unemployment rate is falling both nationally and in the state. Meanwhile, the falling price of crude oil has kept inflation low and supported higher consumer spending. Although California is experiencing an exceptional drought in 2015, the economy is the most diverse in the United States, and growth in other sectors is expected to keep the overall impacts small.

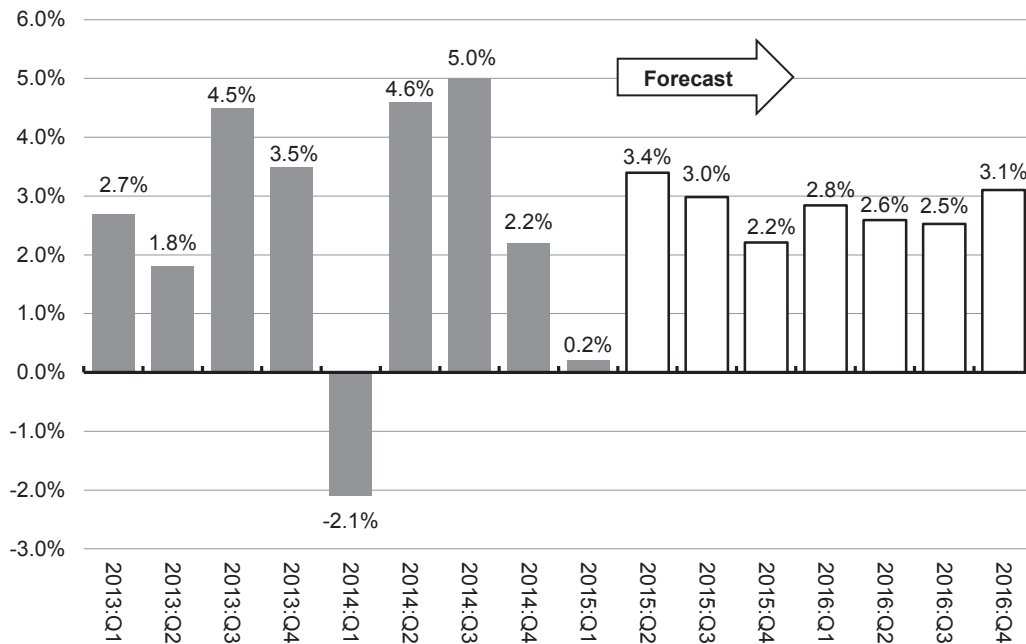
The outlook assumes that global growth remains slow but steady. Risks to the economy continue to include a correction in the stock market or a weaker global economy.

THE NATION – SOLID GROWTH

The nation's economy continues to grow at a steady pace, with lower unemployment and more jobs being added. Real Gross Domestic Product (GDP) growth in 2014 was 2.4 percent, and is expected to maintain momentum in 2015 and 2016 in spite of the slow growth in the first quarter of 2015 (see Figure ECO-01). The slow growth in the first quarter was largely due to poor weather in the East and other temporary factors.

Real GDP growth is supported by stronger consumption growth as people find jobs and spend less on gasoline. As of April 2015, the national unemployment rate fell to 5.4 percent. The decrease in unemployment is due partially to slower growth in the labor force as more workers born during the baby boom reach retirement age. However, payroll job growth has been solid at 3.1 million in 2014 and is expected to continue.

Figure ECO-01
**U.S. Real Gross Domestic Product
 Quarter-to-Quarter growth, annualized**



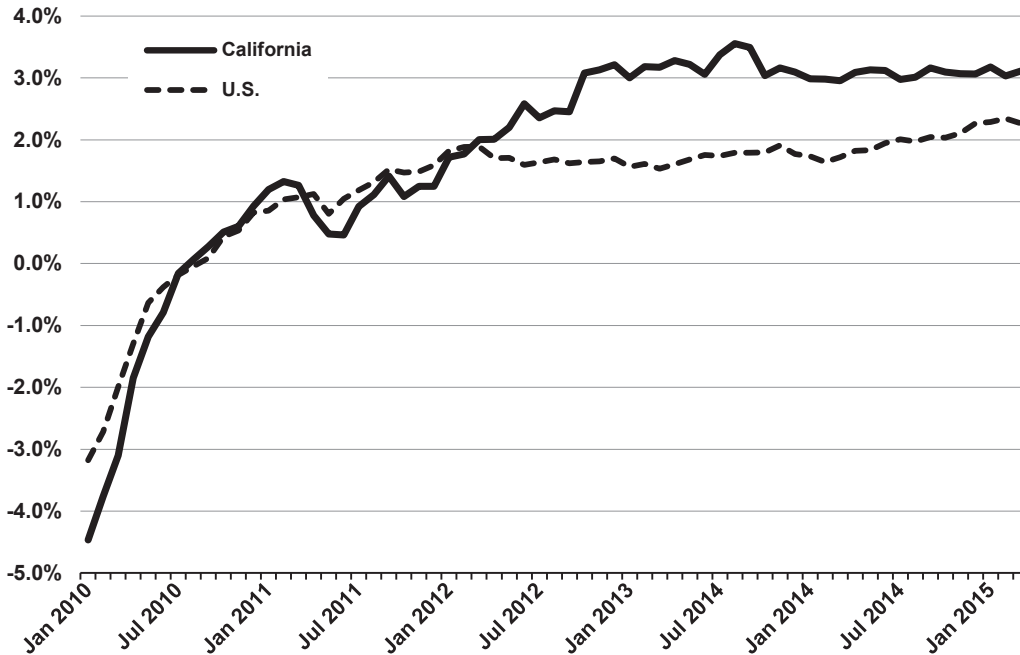
Source: U.S. Bureau of Economic Analysis; CA Department of Finance May Revision Forecast

After the Governor’s Budget forecast was finalized, oil prices fell by more than 30 percent before rebounding slightly in April 2015. Prices are now expected to rise gradually over the forecast, but are still lower than the previous forecast. Lower gasoline prices allow consumers to buy other goods, supporting growth. Besides the growth in personal consumption, investment is also beginning to pick up, both in the housing sector and by businesses. However, exports are expected to grow more slowly in coming years due to weaker global growth. The Federal Reserve has not specified when it will raise the interest rate, and the forecast assumes this will begin in the second half of 2015 and gradually thereafter as the economy improves.

CALIFORNIA – BALANCED GROWTH

California’s employment in 2014 grew at a stronger pace than previously estimated. The unemployment rate dropped to 6.5 percent in March 2015. California is expected to continue to add jobs at a steady pace, and March marked the state’s 56th consecutive month of nonfarm job growth since August 2010 (see Figure ECO-02). However, the unemployment rate is not expected to fall below 6 percent until near the end of

Figure ECO-02
**California and U.S. Nonfarm Employment
 Year-over-Year Percent Change**



Source: California Employment Development Department, Labor Market Information Division

2016 as younger workers join the labor force in large numbers. In addition, although the drought will affect the farm sector in 2015, the forecast assumes the drought does not continue into 2016. The impact on other sectors is expected to be limited, with small overall impacts given California’s diversified economy.

Personal income also increased in 2014 more than previously estimated, and is consistent with more people finding work and business profits rising. All eleven major industry sectors added jobs in 2014—the first time this has happened since the recovery began in 2009. The increase in wages is offset in part by slower growth in interest and other investment income, given a more gradual increase in interest rates.

The number of housing permits issued remained unchanged in 2014 compared with 2013. Issuance began to increase in early 2015, and the forecast expects this trend to continue. Housing prices, as measured by the median sales price of existing single-family homes, continue to increase. Non-residential permits grew strongly, by 13.4 percent on average in 2014, and are expected to maintain solid growth.

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Consumer inflation, as measured by the Consumer Price Index (CPI), has been relatively low throughout the recovery. It is expected to be around 1 percent in 2015 due to the drop in oil prices before rebounding to around 2 percent over the remaining forecast period. However, housing prices have been rising faster than the overall index, particularly in the San Francisco area, and are expected to keep inflation somewhat higher.

See Figure ECO-03 for highlights of the national and California forecasts.

RISKS TO CONSIDER

There are a few key risks in the economy in the short term. For instance, one potential risk is that there could be a correction in the stock market. 2014 marked the sixth year of positive growth in the stock market. Annual growth averaged more than 12 percent in both the Dow Jones Industrial Average and S&P 500 Indices over these six years, a much faster rate of increase than in the overall economy. Pessimism about economic growth prospects could lead to a correction in the stock market.

In addition, many of the United States' major trade partners, including China and European Union countries, have recently experienced economic slowdowns. One direct impact of global economic slowdowns is that these trade partners purchase fewer products from the United States, which could lead to slower economic growth for the United States. This global slowdown could directly impact California's corporate profits, employment, and personal income.

Figure ECO-03

Selected Economic Indicators

United States	2010	2011	2012	2013	2014	2015	2016
						Projected	Projected
Nominal gross domestic product, \$ billions	\$ 14,964	\$ 15,518	\$ 16,163	\$ 16,768	\$ 17,419	\$ 18,117	\$ 18,964
Real gross domestic product, percent change	2.5%	1.6%	2.3%	2.2%	2.4%	2.8%	2.7%
<i>Contributions to real GDP growth</i>							
Personal consumption expenditures	1.3%	1.6%	1.3%	1.6%	1.7%	2.2%	2.1%
Gross private domestic investment	1.7%	0.7%	1.3%	0.8%	0.9%	0.7%	1.2%
Net exports	-0.5%	0.0%	0.0%	0.2%	-0.2%	-0.3%	-0.7%
Government purchases of goods and services	0.0%	-0.7%	-0.3%	-0.4%	0.0%	0.2%	0.1%
Personal income, \$ billions	\$ 12,429	\$ 13,202	\$ 13,888	\$ 14,167	\$ 14,729	\$ 15,302	\$ 15,983
Corporate profits, percent change	25.0%	4.0%	11.4%	4.2%	-0.8%	8.0%	6.5%
Housing permits, thousands	605	624	830	991	1,040	--	--
Housing starts, thousands	586	612	784	930	1,001	1,121	1,308
Median sales price of existing homes	\$ 173,100	\$ 166,200	\$ 177,200	\$ 197,400	\$ 208,900	--	--
Federal funds rate, percent	0.2%	0.1%	0.1%	0.1%	0.1%	0.3%	1.2%
Consumer price index, percent change	1.6%	3.2%	2.1%	1.5%	1.6%	0.0%	2.2%
Unemployment rate, percent	9.6%	8.9%	8.1%	7.4%	6.2%	5.5%	5.2%
Civilian labor force, millions	153.9	153.6	155.0	155.4	155.9	157.9	160.1
Nonfarm employment, millions	130.3	131.8	134.1	136.4	139.0	141.9	144.0
California							
Personal income, \$ billions	\$ 1,579	\$ 1,686	\$ 1,805	\$ 1,857	\$ 1,944	\$ 2,038	\$ 2,144
Made-in-California exports, percent change	19.3%	11.3%	1.5%	3.9%	3.6%	--	--
Housing permits, thousands	44	47	59	86	86	99	111
Housing unit change, thousands	36	36	45	59	69	--	--
Median sales price of existing homes	\$ 305,010	\$ 286,040	\$ 319,310	\$ 407,150	\$ 447,010	--	--
Consumer price index, percent change	1.3%	2.6%	2.2%	1.5%	1.8%	1.0%	2.3%
Unemployment rate, percent	12.1%	11.6%	10.2%	8.8%	7.5%	6.5%	6.0%
Civilian labor force, millions	18.3	18.4	18.5	18.6	18.8	19.0	19.1
Nonfarm employment, millions	14.2	14.4	14.7	15.2	15.7	16.1	16.5
<i>Percent of total nonfarm employment</i>							
Mining and logging	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Construction	3.9%	3.9%	4.0%	4.2%	4.3%	4.5%	4.7%
Manufacturing	8.8%	8.7%	8.5%	8.3%	8.1%	7.9%	7.7%
High technology	2.4%	2.4%	2.3%	2.2%	2.1%	2.1%	2.0%
Trade, transportation, and utilities	18.5%	18.6%	18.6%	18.4%	18.4%	18.4%	18.3%
Information	3.0%	3.0%	3.0%	3.0%	2.9%	2.9%	2.9%
Financial activities	5.3%	5.3%	5.3%	5.2%	5.0%	5.0%	5.0%
Professional and business services	14.6%	14.9%	15.2%	15.4%	15.6%	15.7%	15.8%
High technology	2.2%	2.3%	2.4%	2.4%	2.6%	2.7%	2.9%
Educational and health services	14.5%	14.5%	14.8%	15.3%	15.3%	15.3%	15.3%
Leisure and hospitality	10.6%	10.7%	10.9%	11.0%	11.2%	11.3%	11.4%
Other services	3.4%	3.4%	3.4%	3.4%	3.5%	3.6%	3.6%
Government	17.2%	16.7%	16.2%	15.6%	15.4%	15.3%	15.1%

Forecast based on data available as of April 2015
Percent changes calculated from unrounded data.

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