

ECONOMIC OUTLOOK

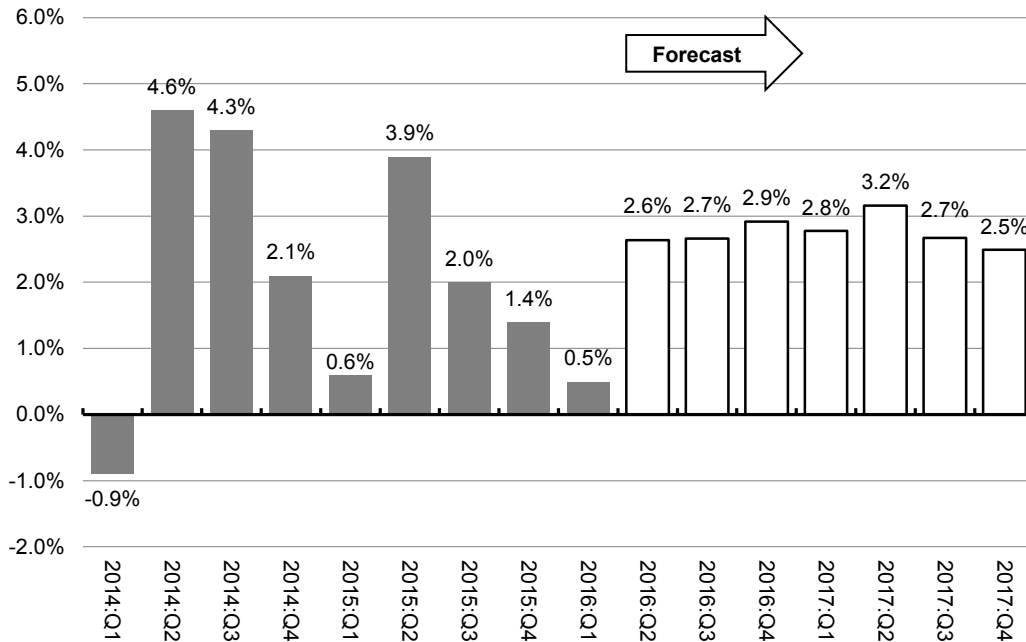
Continued growth is expected over the next few years for California, as rising wages and lower gasoline prices allow consumers to spend more. However, there are some signs that the pace of growth is slowing as the economy returns to pre-recession levels of unemployment.

THE NATION — UNEVEN GROWTH

The unemployment rate in the U.S. has remained around 5 percent since the fourth quarter of 2015. Steady job growth has encouraged workers to rejoin the labor force, with 63 percent of people ages 16 and above either employed or looking for work. While a decreasing or static labor force participation rate is expected with an aging population, the participation rate has been rising, indicating some optimism among workers. Average wages are rising as well, supporting stronger consumer spending on both goods and services—a trend that is expected to continue for the next few years.

With weak business investment and lower exports in the first quarter, real gross domestic product (GDP) growth is expected to be around 2 percent in 2016, down slightly from the growth rates of 2.4 percent in 2014 and 2015. The forecast assumes real GDP growth will rise to 2.8 percent in 2017, as business investment grows and exports strengthen along with the global economy. (See Figure ECO-01 for details.) Inflation remains below 2 percent, and the Federal Reserve is expected to raise interest rates even more gradually than assumed in the Governor's Budget.

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

CALIFORNIA—JOB GROWTH HAS SLOWED

California’s unemployment rate fell to 5.4 percent in March, the closest it has been to the national unemployment rate since early 2007. The number of unemployed workers has decreased significantly from around 2.2 million in 2010 to just over 1 million in early 2016. California’s labor force participation rate has remained at around 62 percent. The state added 40,000 jobs a month on average in 2015, but the pace has begun to slow, with about 15,000 jobs per month added on average during the first few months of 2016. New data on farm employment showed that jobs continued to be added through 2015. With a wet winter in early 2016, farm employment is expected to continue to grow.

Personal income grew much faster than expected in 2015, due to both an increase in jobs and higher wages. The forecast incorporates each of the scheduled minimum wage increases. This leads to slightly slower job growth and slightly faster wage growth than assumed in the Governor’s Budget.

The level of new housing permit activity continues to be well below pre-recession levels, with only 95,000 permits issued in 2015. The increase in housing continues to lag well behind population growth, worsened by the loss of hundreds of homes destroyed by large fires in 2015. Permits are expected to increase slowly over the next few years.

Overall inflation in California has been higher than in the U.S. as a whole, due to higher housing and energy costs, and this trend is expected to continue. See Figure ECO-02 for highlights of the national and California forecasts.

RISKS TO CONSIDER

The main risks to the state's economy remain slowing global growth, a stock market correction, and the eventual end of the current expansion.

Emerging market growth, including China, has been slowing and is expected to remain low. There is also some uncertainty about the growth path in the European Union, particularly if Great Britain exits the union. Slower growth in one or both, or a change in U.S. fiscal policy, could dampen U.S. growth.

The stock market remains volatile, and a major, lasting correction would have consequences for the California economy. The S&P 500 index is around where it was at the end of 2015 after some volatility earlier this year. Downward revaluations of some high-profile technology firms may be an indicator of future drops in stock prices.

The current expansion has lasted since mid-2009, but the average length is only around five years. With the longest U.S. expansion having lasted ten years, it would be unprecedented not to have a recession by 2020. While the forecast assumes all scheduled minimum wage increases through 2023 occur, a recession could result in a pause in scheduled increases. A recession typically is preceded by imbalances in the economy that show up as increased inflation. Overall, inflation is still relatively low at around 1 percent in early 2016. Yet, U.S. inflation has begun to rise slowly due to increased wages and rebounding oil prices since dropping below \$30 per barrel in January.

Figure ECO-02

Selected Economic Indicators

United States	2011	2012	2013	2014	2015	2016 Projected	2017 Projected
Nominal gross domestic product, \$ billions	\$ 15,518	\$ 16,155	\$ 16,663	\$ 17,348	\$ 17,947	\$ 18,591	\$ 19,491
Real gross domestic product, percent change	1.6%	2.2%	1.5%	2.4%	2.4%	2.1%	2.8%
<i>Contributions to real GDP growth</i>							
Personal consumption expenditures	1.6%	1.0%	1.2%	1.8%	2.1%	1.8%	2.1%
Gross private domestic investment	0.7%	1.5%	0.7%	0.9%	0.8%	0.1%	1.0%
Net exports	0.0%	0.1%	0.2%	-0.2%	-0.6%	-0.2%	-0.3%
Government purchases of goods and services	-0.7%	-0.4%	-0.6%	-0.1%	0.1%	0.4%	0.1%
Personal income, \$ billions	\$ 13,255	\$ 13,915	\$ 14,068	\$ 14,694	\$ 15,340	\$ 15,933	\$ 16,707
Corporate profits, percent change	4.0%	10.0%	2.0%	1.7%	-3.1%	1.8%	3.6%
Housing permits, thousands	624	830	991	1,052	1,178	--	--
Housing starts, thousands	612	784	928	1,001	1,107	1,200	1,388
Median sales price of existing homes	\$ 166,200	\$ 177,200	\$ 197,400	\$ 208,300	\$ 222,400	--	--
Federal funds rate, percent	0.1%	0.1%	0.1%	0.1%	0.1%	0.6%	1.4%
Consumer price index, percent change	3.2%	2.1%	1.5%	1.6%	0.1%	1.0%	2.2%
Unemployment rate, percent	8.9%	8.1%	7.4%	6.2%	5.3%	4.8%	4.7%
Civilian labor force, millions	153.6	155.0	155.4	155.9	157.1	159.6	161.7
Nonfarm employment, millions	131.9	134.2	136.4	138.9	141.8	144.5	146.5
California							
Personal income, \$ billions	\$ 1,691	\$ 1,812	\$ 1,850	\$ 1,940	\$ 2,061	\$ 2,174	\$ 2,289
California exports, percent change	11.3%	1.5%	3.9%	3.4%	-4.9%	--	--
Housing permits, thousands	47	59	86	86	95	107	126
Housing unit net change, thousands	36	45	59	69	67	--	--
Median sales price of existing homes	\$ 286,040	\$ 319,310	\$ 407,150	\$ 446,890	\$ 474,420	--	--
Consumer price index, percent change	2.6%	2.2%	1.5%	1.8%	1.5%	2.2%	2.8%
Unemployment rate, percent	11.6%	10.3%	8.8%	7.5%	6.3%	5.3%	5.2%
Civilian labor force, millions	18.4	18.5	18.7	18.8	19.0	19.1	19.3
Nonfarm employment, millions	14.4	14.8	15.2	15.6	16.1	16.4	16.7
<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%	4.0%	4.2%	4.3%	4.6%	4.9%	5.3%
Manufacturing	8.7%	8.5%	8.3%	8.2%	8.0%	8.0%	7.9%
High technology	2.4%	2.3%	2.2%	2.2%	2.1%	2.1%	2.1%
Trade, transportation, and utilities	18.6%	18.5%	18.4%	18.4%	18.3%	18.3%	18.2%
Information	3.0%	2.9%	3.0%	3.0%	3.0%	3.0%	3.0%
Financial activities	5.3%	5.2%	5.2%	5.0%	5.0%	4.9%	4.9%
Professional and business services	14.8%	15.2%	15.4%	15.6%	15.6%	15.4%	15.3%
High technology	2.3%	2.4%	2.4%	2.5%	2.6%	2.6%	2.6%
Educational and health services	14.9%	15.1%	15.2%	15.2%	15.3%	15.2%	15.2%
Leisure and hospitality	10.6%	10.8%	11.1%	11.3%	11.4%	11.6%	11.6%
Other services	3.4%	3.4%	3.4%	3.4%	3.4%	3.3%	3.3%
Government	16.7%	16.1%	15.7%	15.5%	15.3%	15.2%	15.2%

Forecast based on data available as of April 2016.
Percent changes calculated from unrounded data.