Economic Outlook

The trend of a very slow economic recovery continues. The uncertainty of federal fiscal policies has lessened in recent months. This appears to have had a positive effect on consumer and producer confidence. Overall, the economy is expected to improve, with slow and steady growth over the next few years. Unemployment rates for the nation and California continue to drop, with job creation and housing prices improving.

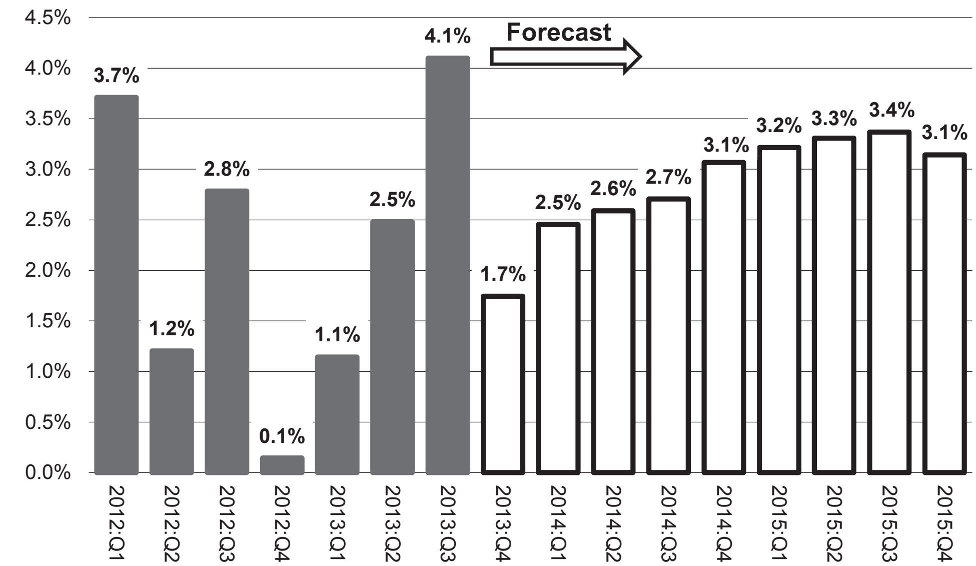
This outlook assumes that the debt ceiling will be raised as needed in the future, and that there will be no significant federal policy changes. Global growth is assumed to remain limited, but the risks of adverse events in Europe and elsewhere have receded.

The Nation—Slow, Steady Growth

Unemployment is falling, jobs are being created, and consumer confidence is improving. The federal government shutdown in 2013 and the uncertainty created by policy disagreements in Congress muted real GDP growth. However, growth is expected to pick up in 2014 to around 2.5 percent before increasing to over 3 percent in 2015 and 2016, as can be seen in Figure ECO-01.

The national unemployment rate decreased to 7 percent in November 2013, down from 7.8 percent at the end of 2012. Job growth has been fairly robust, with an average of 189,000 jobs added per month over this period. Although there have been ups and downs, this means the nation has recovered 94 percent of the jobs lost during the recession. The increased labor force from new entrants has kept the unemployment

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 Governor's Budget Forecast

rate elevated. There are very few signs of wage pressures that might lead to increased inflation, which is forecast to remain below 2 percent through 2015.

Consumption continues to be the main driver of growth for the economy, with purchases of durable goods rising strongly over the past few years. This will likely slow over the forecast period as pent-up demand following the recession trails off. Private domestic investment, such as purchases of producers' equipment, has been increasing faster than the rate of consumption, and should add to GDP growth over the forecast period. After a number of years of public sector cuts, government expenditures are not expected to decrease overall GDP growth. However, net exports continue to be a drag on growth, as import growth outpaces export growth.

California — A Broad-Based Recovery

California's recovery spread to more sectors of the economy in 2013. The unemployment rate fell more quickly than the national rate, to 8.5 percent in November 2013 from 9.8 percent at the end of 2012. The labor force participation rate, which measures the number of employed and unemployed job-seekers as a percent of the population above 16 years of age, remained steady. For California, the labor force is expected to expand slowly despite the retirement of the baby boomers. The jobs lost during the recession are not forecast to be recovered until the end of 2014, and the unemployment rate is not expected to drop below 7 percent until the middle of 2016. Given the slack in the job market, overall inflation is expected to remain below 2 percent in California for the next few years.

Job growth was relatively robust in 2013, and California should continue to add jobs at around a 2-percent annual growth rate (around 340,000 jobs a year) through 2016. Goods-producing jobs, such as in construction and manufacturing are growing at a slower rate than service-providing jobs. Of these, professional and business services jobs (including high technology jobs such as computer systems design and research and development), educational and health services jobs, and leisure and hospitality jobs should be added at a higher rate. Government jobs will begin to grow slowly after a number of years of cuts. As retirements increase, the need for highly skilled workers to replace retirees will also increase, as will the need for more health care professionals.

The housing market has been recovering, with prices of existing single-family homes up roughly 25 percent in October 2013 compared to October 2012. The supply of homes for sale has remained low, with the median number of days to sell at around 30, close to the same length of time as in 2005. Part of the explanation is that the home-ownership rate has fallen, to around 55 percent in 2012 versus a high of 60 percent in 2006. As California has a high proportion of renters, and average housing costs remain high, measurements of the poverty rate have been rising. If consumers have difficulties saving for a down payment given the slowly improving job market, the trends in favor of multi-family housing may continue for some time.

Risks to the Outlook

Given the slow pace of the U.S. recovery so far, there are some risks to consider. First, the persistence of unemployment has meant slow income growth for a broad section of the population. The large numbers of job-seekers hold down wage growth for employees. This impacts the ability of people to save and invest, making it harder to buy homes and build up retirement accounts. The stock market growth in 2013 may have helped mitigate some of the decreased savings, but many retirees, particularly ones who were forced to retire early, may be living on reduced incomes. The U.S. economy is still very dependent on consumption, and lower incomes for large segments of the population will dampen future growth.

Second, economic expansions do not last forever. In the post-war period, the average expansion length is almost five years and the longest expansion was ten years. As of

December 2013, the current expansion has lasted four and a half years. While there are few signs of inflation or tight supply conditions that would trigger a contraction, it would be an historical anomaly for the U.S. not to see another recession before 2020.

One trigger for a negative turn in the business cycle could be an unexpectedly large adverse reaction to monetary policy changes by the Federal Reserve. Federal fiscal policy has generally been a drag on growth over the past few years and supportive monetary policy through low interest rates and bond purchases have helped counteract that. The strong performance of the stock market in 2013 is likely linked to these policies. The Federal Reserve has announced that they will begin to taper the pace of bond purchases in January 2014. While this should not have come as a surprise, previous announcements of a taper have caused large movements in the stock market. A large stock market drop in response to future moves by the Federal Reserve could trigger a broader negative impact on the economy.

See Figure ECO-02 for further details of the forecast.

Figure ECO-02

Selected Economic Indicators

United States	2009	2010	2011	2012	2013 Estimated	2014 Projected	2015 Projected
Nominal gross domestic product, $ billions	$ 14,418	$ 14,958	$ 15,534	$ 16,245	$ 16,755	$ 17,435	$ 18,291
Real gross domestic product, percent change	-2.8%	2.5%	1.8%	2.8%	1.7%	2.5%	3.1%
Contributions to real GDP growth							
Personal consumption expenditures	-1.1%	1.3%	1.7%	1.5%	1.3%	1.7%	1.9%
Gross private domestic investment	-3.5%	1.7%	0.7%	1.4%	0.7%	0.9%	1.4%
Net exports	1.1%	-0.5%	0.1%	0.1%	0.1%	-0.2%	-0.2%
Government purchases of goods and services	0.6%	0.0%	-0.7%	-0.2%	-0.4%	0.0%	0.0%
Personal income, $ billions	$ 12,082	$ 12,435	$ 13,191	$ 13,744	$ 14,133	$ 14,783	$ 15,494
Corporate profits, percent change	8.4%	25.0%	7.9%	7.0%	3.9%	4.2%	4.8%
Housing permits, thousands	583	605	624	830	--	--	--
Housing starts, thousands	554	586	612	783	913	1,139	1,472
Median sales price of existing homes	$ 172,100	$ 173,100	$ 166,200	$ 177,200	--	--	--
Federal funds rate, percent	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%	0.4%
Consumer price index, percent change	-0.4%	1.6%	3.2%	2.1%	1.6%	1.7%	1.8%
Unemployment rate, percent	9.3%	9.6%	8.9%	8.1%	7.5%	6.9%	6.4%
Civilian labor force, millions	154.2	153.9	153.6	155.0	155.4	157.7	159.2
Nonfarm employment, millions	130.9	129.9	131.5	133.7	135.9	138.1	140.5
California							
Personal income, $ billions	$ 1,536	$ 1,579	$ 1,683	$ 1,768	$ 1,813	$ 1,896	$ 1,990
Made-in-California exports, percent change	-17.1%	19.2%	11.1%	1.6%	--	--	--
Housing permits, thousands	36	44	47	58	87	114	134
Housing unit change, thousands	70	36	36	45	--	--	--
Median sales price of existing homes	$ 274,960	$ 305,010	$ 286,040	$ 319,340	--	--	--
Consumer price index, percent change	-0.3%	1.3%	2.6%	2.2%	1.6%	1.8%	1.9%
Unemployment rate, percent	11.4%	12.3%	11.8%	10.5%	8.9%	7.9%	7.3%
Civilian labor force, millions	18.2	18.3	18.4	18.5	18.7	18.8	19.0
Nonfarm employment, millions	14.1	13.9	14.1	14.4	14.7	15.0	15.4
Percent of total nonfarm employment							
Mining and logging	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Construction	4.4%	4.0%	4.0%	4.1%	4.3%	4.3%	4.2%
Manufacturing	9.1%	8.9%	8.9%	8.7%	8.5%	8.5%	8.4%
High technology	2.5%	2.5%	2.5%	2.4%	2.3%	2.3%	2.3%
Trade, transportation, and utilities	18.8%	18.8%	18.9%	19.0%	19.0%	19.0%	18.9%
Information	3.1%	3.1%	3.0%	3.0%	2.9%	2.8%	2.8%
Financial activities	5.6%	5.5%	5.4%	5.4%	5.4%	5.4%	5.5%
Professional and business services	14.6%	14.9%	15.1%	15.5%	15.8%	16.0%	16.2%
High technology	2.2%	2.3%	2.4%	2.5%	2.5%	2.6%	2.7%
Educational and health services	12.5%	12.8%	13.0%	13.1%	13.0%	13.0%	13.0%
Leisure and hospitality	10.7%	10.8%	10.9%	11.1%	11.3%	11.5%	11.6%
Other services	3.5%	3.5%	3.5%	3.5%	3.5%	3.4%	3.4%
Government	17.6%	17.6%	17.1%	16.5%	16.1%	15.9%	15.7%

Forecast based on data available as of November 2013.
Percent changes calculated from unrounded data.

This page intentionally blank to facilitate double-sided printing.