

ECONOMIC OUTLOOK

Economic growth has picked up, and the outlook is improving. Jobs are being added and the unemployment rate is falling gradually for the nation and California.

The outlook assumes that global growth remains slow but steady. Potential stresses in the economy include a correction in the stock market or the housing sector.

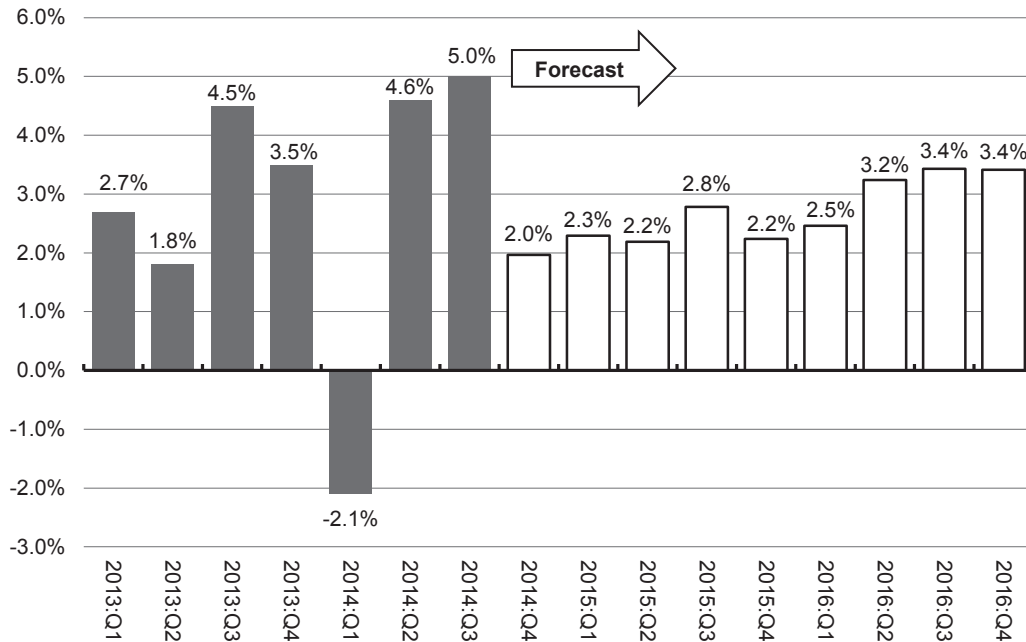
THE NATION – MODERATE GROWTH

The United States' economy continues to grow at a moderate rate, with a lower unemployment rate and jobs being added. Although severe weather on the East Coast in the first quarter lowered real Gross Domestic Product (GDP) growth in 2014, growth is expected to pick up in 2015 and over the next several years. (See Figure ECO-01 for details.)

Real GDP growth is supported by stronger consumption growth as people find jobs. As of November 2014, the national unemployment rate had fallen to 5.8 percent. Although jobs are being added, the decrease in unemployment is due partially from workers leaving the labor force due to retirements. The labor force participation rate is expected to fall as more workers born during the baby boom reach retirement age.

Investment is also beginning to pick up, both in the housing sector and by businesses. Net exports are limiting growth somewhat, but government purchases are beginning to add to real GDP growth. In light of the broad-based growth and falling unemployment rate, the Federal Reserve ended its bond-purchasing program (quantitative easing)

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



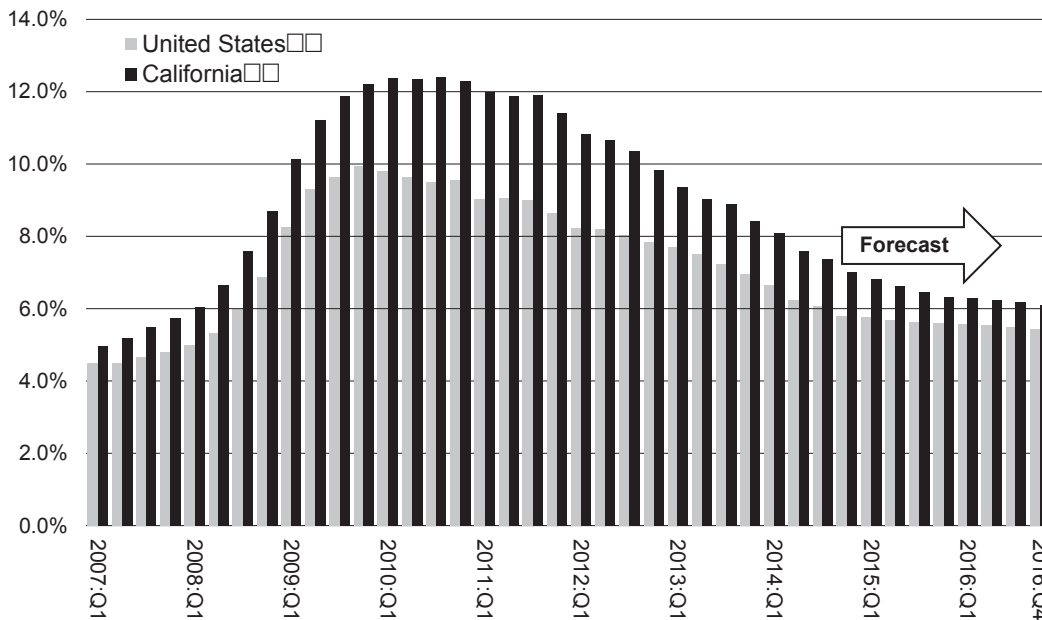
Source: U.S. Bureau of Economic Analysis; CA Department of Finance Governor's Budget Forecast

in October 2014. The Federal Reserve has stated it will be “a considerable amount of time” before the interest rate is raised, and the forecast assumes this will happen in the second half of 2015 as the economy improves.

CALIFORNIA – STEADY GROWTH

California’s economy also continues to improve. The unemployment rate dropped to 7.2 percent in November 2014, and is expected to fall below 7 percent in the first quarter of 2015. By the end of 2015, it is expected to reach 6.3 percent (See Figure ECO-02). California continues to add jobs at a steady pace, with more than 22,000 a month added on average over the first three quarters of 2014. Despite the severe drought in California, farm employment through the first three quarters of 2014 fell by less than 1 percent compared with the first three quarters of 2013. Nonfarm employment is expected to grow steadily over the next several years, although retirements are likely to keep labor force growth below 1 percent.

Figure ECO-02
U.S. and California Unemployment Rates



Source: U.S. Bureau of Labor Statistics; CA Department of Finance Governor's Budget Forecast

Personal income is growing as more people find work and profits rise. With the exception of financial services—which fell by 0.1 percentage point—all major industry sectors are expected to add jobs in 2014, the first time this has happened since the recovery began in 2009.

Growth in the housing sector has been slower than anticipated, with the number of housing permits issued through the first three quarters of 2014 lower than over the same time period in 2013. The forecast expects that strong growth will resume in 2015 and continue through the forecast period. Housing prices, as measured by the median sales price of existing single-family homes, have increased by an average of 12 percent over the first three quarters of 2014, which is likely to increase housing permits in the future. Nonresidential permits are already growing strongly. When measured by value, they grew by almost 20 percent on average over the first three quarters of 2014.

Consumer inflation, as measured by the Consumer Price Index (CPI), has been relatively low throughout the recovery, and is expected to remain around 2 percent over the forecast period. Gasoline prices fell in the second half of 2014, and this trend is expected

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to continue in 2015 due to expanding supplies. However, housing prices have been rising faster than the overall index, particularly in the San Francisco area.

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

RISKS TO CONSIDER

Recent expansions average almost five years, with the longest lasting ten years (April 1991 through March 2001). As of January 2015, the current expansion is nine months longer than the average. Although there are few signs of a recession, over the medium term, there are a few areas where potential slowdowns could be triggered. Areas most likely to change the economic outlook include the stock market and housing.

A correction in the stock market could trigger a change to the smooth path of growth. Over the past few years, the stock market has grown much faster than GDP. Given weak global growth, the United States has attracted investors from across the world, and the low interest rates have led to more cash available to invest. California industries have benefited from these trends, with large investments in the technology sector in particular. However, if there were a correction in the stock market, these investments may look less attractive, leading to slower rates of growth.

Housing prices rising faster than average wages could eventually lead to slower growth, as workers are less able to afford to live where jobs are being created. Many of these jobs are concentrated in urban areas. While higher density has advantages in terms of transportation, it can also take longer to develop new housing projects when space is at more of a premium.

Figure ECO-03

Selected Economic Indicators

United States	2010	2011	2012	2013	2014	2015	2016
					Estimated	Projected	Projected
Nominal gross domestic product, \$ billions	\$ 14,964	\$ 15,518	\$ 16,163	\$ 16,768	\$ 17,406	\$ 18,190	\$ 19,029
Real gross domestic product, percent change	2.5%	1.6%	2.3%	2.2%	2.2%	2.6%	2.8%
<i>Contributions to real GDP growth</i>							
Personal consumption expenditures	1.3%	1.6%	1.3%	1.6%	1.5%	1.9%	2.0%
Gross private domestic investment	1.7%	0.7%	1.3%	0.8%	0.8%	0.8%	1.0%
Net exports	-0.5%	0.0%	0.0%	0.2%	-0.1%	-0.1%	-0.3%
Government purchases of goods and services	0.0%	-0.7%	-0.3%	-0.4%	0.0%	0.0%	0.1%
Personal income, \$ billions	\$ 12,429	\$ 13,202	\$ 13,888	\$ 14,167	\$ 14,766	\$ 15,404	\$ 16,170
Corporate profits, percent change	25.0%	4.0%	11.4%	4.2%	-1.2%	9.5%	3.4%
Housing permits, thousands	605	624	830	991	--	--	--
Housing starts, thousands	586	612	784	930	999	1,197	1,351
Median sales price of existing homes	\$173,100	\$166,200	\$177,200	\$197,400	--	--	--
Federal funds rate, percent	0.2%	0.1%	0.1%	0.1%	0.1%	0.4%	1.6%
Consumer price index, percent change	1.6%	3.2%	2.1%	1.5%	1.9%	1.8%	2.1%
Unemployment rate, percent	9.6%	8.9%	8.1%	7.4%	6.2%	5.7%	5.5%
Civilian labor force, millions	153.9	153.6	155.0	155.4	155.9	157.7	159.7
Nonfarm employment, millions	130.3	131.8	134.1	136.4	138.8	141.4	143.5
California							
Personal income, \$ billions	\$ 1,579	\$ 1,686	\$ 1,805	\$ 1,857	\$ 1,938	\$ 2,026	\$ 2,132
Made-in-California exports, percent change	19.3%	11.1%	1.7%	3.9%	--	--	--
Housing permits, thousands	44	47	58	83	83	101	112
Housing unit change, thousands	36	36	45	59	--	--	--
Median sales price of existing homes	\$305,010	\$286,040	\$319,310	\$407,180	--	--	--
Consumer price index, percent change	1.3%	2.6%	2.2%	1.5%	2.0%	1.9%	2.2%
Unemployment rate, percent	12.3%	11.8%	10.4%	8.9%	7.5%	6.6%	6.2%
Civilian labor force, millions	18.3	18.4	18.5	18.6	18.6	18.7	18.9
Nonfarm employment, millions	14.2	14.4	14.7	15.2	15.5	15.9	16.3
<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%	4.6%
Manufacturing	8.7%	8.7%	8.5%	8.3%	8.2%	8.1%	8.0%
High technology	2.4%	2.4%	2.3%	2.2%	2.2%	2.1%	2.1%
Trade, transportation, and utilities	18.5%	18.7%	18.6%	18.5%	18.4%	18.3%	18.2%
Information	3.0%	3.0%	3.0%	2.9%	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%	14.8%	15.2%	15.4%	15.7%	15.7%	15.8%
High technology	2.2%	2.3%	2.4%	2.4%	2.5%	2.6%	2.7%
Educational and health services	14.5%	14.5%	14.8%	15.2%	15.2%	15.3%	15.3%
Leisure and hospitality	10.6%	10.7%	10.9%	11.1%	11.3%	11.5%	11.6%
Other services	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
Government	17.2%	16.7%	16.2%	15.6%	15.3%	15.1%	15.0%

Forecast based on data available as of November 2014.

Percent changes calculated from unrounded data.

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