ECONOMIC OUTLOOK

Since April 2024 when the May Revision economic forecast was finalized, the U.S. economy has continued on a steady, stable growth path despite slowing job growth and still-elevated interest rates. The outlook for the U.S. and California economies has improved relative to the May Revision economic forecast as U.S. real Gross Domestic Product (GDP) growth has been more robust than projected, inflation has cooled more rapidly, and job growth has been stronger, leading to an overall upgraded personal income forecast.

The Governor's Budget forecast projects U.S. real GDP to grow at an annual rate of 1.5 percent to 2 percent in every quarter of the forecast window, starting with the fourth quarter of 2024. This is upgraded from the May Revision forecast which projected quarterly growth below 1.5 percent in the fourth quarter of 2024 and through the first half of 2025. This upgrade is due to higher projected growth in most categories of GDP, reflecting faster growth in 2024 that is expected to carry over into the near future.

Consumer price inflation slowed sharply from its most recent peaks in June 2022 of 9.1 percent year-over-year for the U.S. and 8.3 percent in California to 2.6 percent and 2.5 percent, respectively, in October of 2024, below the respective May Revision forecast projections of 2.9 percent and 3.2 percent, due mainly to deflation in gasoline prices. In response to slowing inflation, the Federal Reserve reduced its target interest rate range by 0.5 percentage point in September after holding it steady for over a year, by 0.25 percentage point in November and again in December to the range of 4.25 percent to 4.5 percent. Similar to the May Revision, the forecast projects U.S. inflation to stabilize at 2.2 percent to 2.3 percent starting in 2025. Falling gasoline prices will lead projected inflation to decrease to 2.3 percent in 2025 before stabilizing at a higher rate of 2.6 percent for California. The target federal funds rate is projected to be in the range of 2.5 percent to 2.75 percent over the long term.

Since the beginning of 2024, California's job market has rebounded from sluggish growth in 2023 while nationwide jobs continued to grow at a slowing but healthy pace. California gained about 56,000 jobs per quarter on average in the second and third quarters of 2024, substantially higher than the 31,000 jobs projected in the May Revision forecast. Through November 2024, California added 167,000 jobs (0.9 percent year-to-date growth), significantly higher than during the same period in 2023 when the state gained just 113,000 jobs, but still well below the 2015-19 pre-pandemic average of about 326,000 jobs added for the comparable period. The nation added nearly 2 million jobs (1.3 percent year-to-date growth) in the first eleven months of 2024, down from the 2.7 million jobs added during the same period in 2023. California's share of U.S. jobs averaged 11.4 percent year-to-date through November 2024, in line with the 2015-19 pre-pandemic average share of 11.5 percent.

The personal income forecast is upgraded from the May Revision due to better-than-projected actual trends in the first half of 2024. Annualized income in both quarters was over $100 billion, or 3.2 percent, higher than projected in the May Revision, driven mainly by significant increases in wages and salaries, contributing about 1.8 percentage points of the overall increase, and in transfer payments in the first quarter, contributing 1.3 percentage points. Thus, projections for the annualized level of personal income were upgraded by an average of $68 billion (1.8 percent) per quarter over the forecast window from the third quarter of 2024 to the end of 2028, driven mainly by compensation (wages, salaries, and supplemental payments such as pension contributions and health insurance).

With inflation cooling and seemingly in check following its recent highs, policy uncertainty appears to present the biggest risk to the forecast stemming from potentially disruptive trade and immigration policies proposed by the incoming federal administration. The forecast is based on current law and does not incorporate any assumptions of potential future policy changes. There also remains the risk that the trajectory of monetary policy shifts, especially if inflation reverses course due to federal policy changes. Finally, geopolitical risks remain, including possible further escalation in the Middle East or the Russian invasion of Ukraine.

Economic Indicators
(Annual Percentage Change unless Otherwise Indicated)

Column1	2020	2021	2022	2023	Forecast 2024	2025	2026	2027	2028
United States									
Real GDP									
Governor's Budget, November 2024	**(2.2)**	**6.1**	**2.5**	**2.9**	***2.7***	***2.1***	***1.8***	***1.7***	***1.8***
May Revision, April 2024	(2.2)	5.8	1.9	2.5	*2.5*	*1.4*	*1.7*	*1.8*	NA
Unemployment Rate (percent)									
Governor's Budget, November 2024	**8.1**	**5.4**	**3.6**	**3.6**	***4.0***	***4.3***	***4.5***	***4.6***	***4.5***
May Revision, April 2024	8.1	5.4	3.6	3.6	*3.9*	*4.2*	*4.5*	*4.5*	NA
Nonfarm Employment									
Governor's Budget, November 2024	**(5.8)**	**2.9**	**4.3**	**2.3**	***1.6***	***0.8***	***0.2***	***0.1***	***0.2***
May Revision, April 2024	(5.8)	2.9	4.3	2.3	*1.4*	*0.1*	*0.0*	*0.3*	NA
Personal Income									
Governor's Budget, November 2024	**6.8**	**9.2**	**3.1**	**5.9**	***5.7***	***4.7***	***5.1***	***4.6***	***4.5***
May Revision, April 2024	6.9	9.1	2.0	5.2	*5.0*	*5.2*	*5.0*	*4.8*	NA
CPI Inflation Rate (percent)									
Governor's Budget, November 2024	**1.2**	**4.7**	**8.0**	**4.1**	***2.9***	***2.3***	***2.2***	***2.2***	***2.3***
May Revision, April 2024	1.2	4.7	8.0	4.1	*3.1*	*2.2*	*2.2*	*2.3*	NA
California									
Unemployment Rate (percent)									
Governor's Budget, November 2024	**10.2**	**7.3**	**4.3**	**4.7**	***5.3***	***5.2***	***5.1***	***4.9***	***4.7***
May Revision, April 2024	10.2	7.3	4.3	4.7	*5.2*	*5.3*	*5.1*	*4.9*	NA
Civilian Labor Force									
Governor's Budget, November 2024	**(2.2)**	**0.0**	**1.1**	**0.7**	***0.3***	***0.3***	***0.4***	***0.4***	***0.4***
May Revision, April 2024	(2.2)	0.0	1.1	0.7	*0.5*	*0.4*	*0.3*	*0.3*	NA
Nonfarm Employment									
Governor's Budget, November 2024	**(7.1)**	**3.5**	**5.5**	**0.8**	***1.0***	***0.8***	***0.6***	***0.7***	***0.8***
May Revision, April 2024	(7.1)	3.5	5.5	0.9	*1.0*	*0.4*	*0.6*	*0.8*	NA
Residential Permits (thousands of units)									
Governor's Budget, November 2024	**105**	**120**	**113**	**110**	***103***	***107***	***112***	***118***	***125***
May Revision, April 2024	105	120	113	110	*110*	*116*	*122*	*129*	NA
Average Wages									
Governor's Budget, November 2024	**11.2**	**7.8**	**(0.7)**	**3.3**	***6.4***	***3.4***	***3.7***	***3.9***	***4.0***
May Revision, April 2024	11.2	7.7	(0.7)	4.3	*3.5*	*3.8*	*3.8*	*3.9*	NA
Personal Income									
Governor's Budget, November 2024	**9.0**	**8.7**	**(0.2)**	**5.4**	***6.7***	***4.2***	***4.6***	***4.7***	***4.7***
May Revision, April 2024	9.0	8.9	(0.2)	4.2	*4.6*	*5.0*	*5.0*	*5.0*	NA
CPI Inflation Rate (percent)									
Governor's Budget, November 2024	**1.7**	**4.3**	**7.4**	**3.9**	***3.0***	***2.3***	***2.6***	***2.6***	***2.6***
May Revision, April 2024	1.7	4.3	7.4	3.9	*3.3*	*2.7*	*2.7*	*2.7*	NA

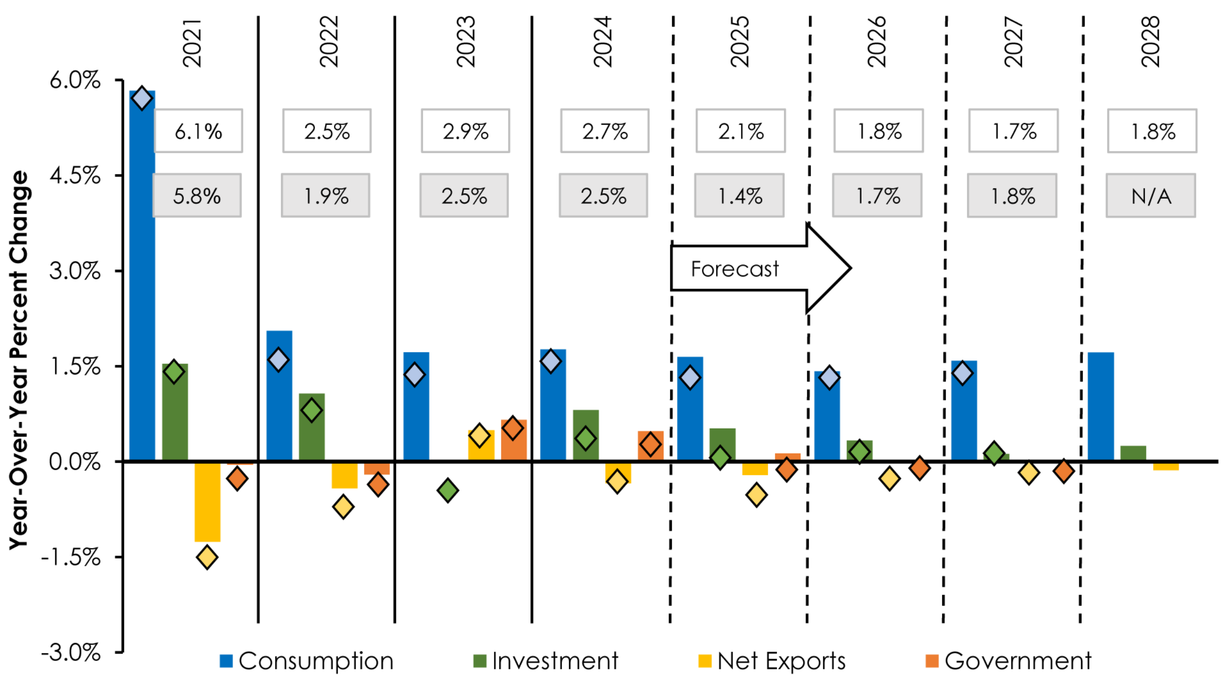
2024-25 May Revision Forecast based on data available as of April 2024.
2025-26 Governor's Budget Forecast based on data available as of November 2024. Figures in italics indicate forecasts.
Source: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; U.S. Census Bureau; California Employment Development Department, Labor Market Information Division; California Department of Finance, 2025-26 Governor's Budget Forecast.

U.S. AND CALIFORNIA FORECASTS

SLOW, STEADY, AND STABLE GDP GROWTH

Economic growth is expected to continue in the forecast, driven by strong but slowing personal consumption, with U.S. real GDP growth projected to be on average 0.1 percentage point faster than expected in the May Revision forecast through the end of the forecast period. While the annualized U.S. real GDP growth rate has been 2.4 percent or higher in all but one of the last nine quarters through the third quarter of 2024, the forecast projects GDP growth to gradually slow to 1.5 percent in the third quarter of 2026 and stay in the steady-state range of 1.5 percent to 2 percent for the entire forecast period. The projected slowdown stems from somewhat lower expected growth in consumption and investment spending as interest rates are projected to remain well above their pre-pandemic levels. The end of the temporary boost from federal manufacturing incentives, such as the Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act, is also expected to hinder new business investment.

Contributions to U.S. Real GDP Growth
(2024-25 May Revision Projections in Gray)

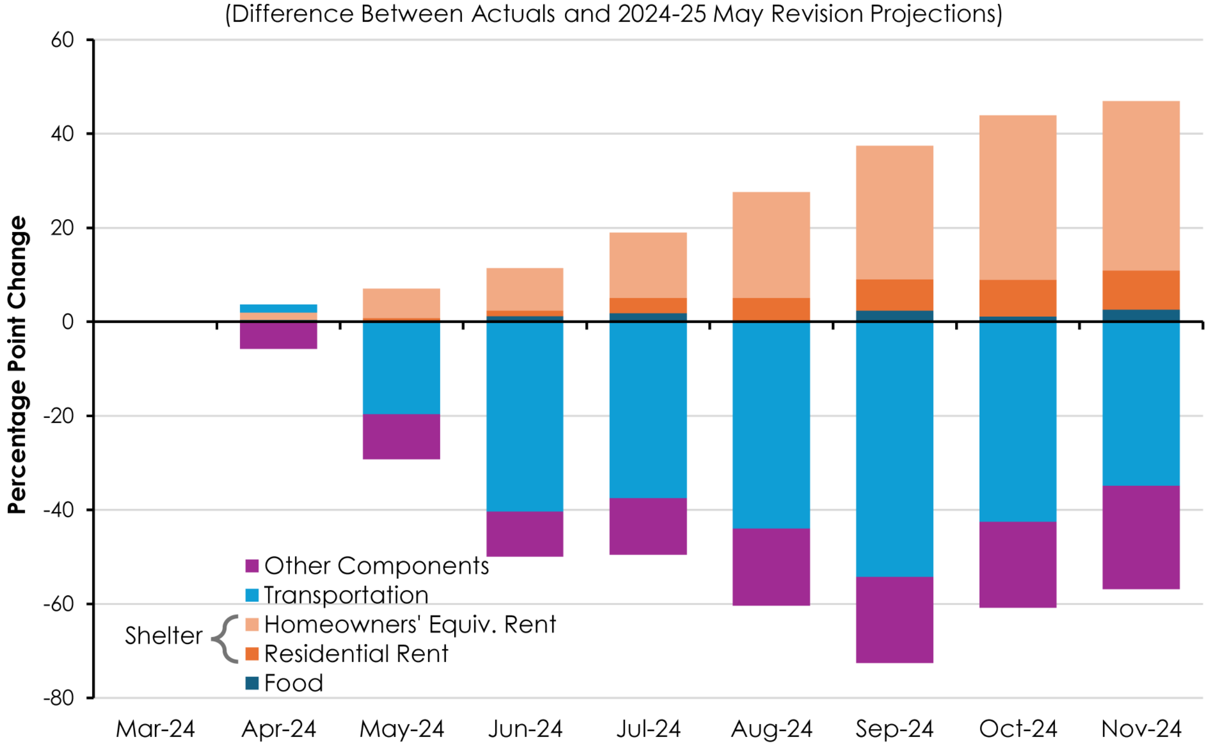


Note: Colored diamonds represent the 2024-25 May Revision projections for each component.
Source: U.S. Bureau of Economic Analysis, California Department of Finance, 2025-26 Governor's Budget Forecast.

INFLATION PROJECTED TO CONTINUE TO MODERATE

The forecast projects California headline inflation will continue to moderate. Inflation is projected to slow to historical rates of between 2 percent and 2.5 percent for both the nation and the state by early 2025, with the state having a slightly higher rate of inflation in line with historical trends. The annual average state inflation rate in 2025 is projected at 2.3 percent compared to 2.6 percent in the May Revision, with the downward revision due mainly to base effects from declines in gasoline prices in late 2024. The projected longer-term inflation path for the U.S. is similar to the May Revision while the California projection is just 0.1 percentage point lower in steady state at 2.6 percent. This slight reduction is due to lower projected inflation in a number of components such as household fuels and medical care.

Contributions to U.S. Consumer Price Index
(Difference Between Actuals and 2024-25 May Revision Projections)



Source: U.S. Bureau of Labor Statistics, California Department of Finance, 2025-26 Governor's Budget Forecast.

CONTINUED SLOWING JOB GROWTH

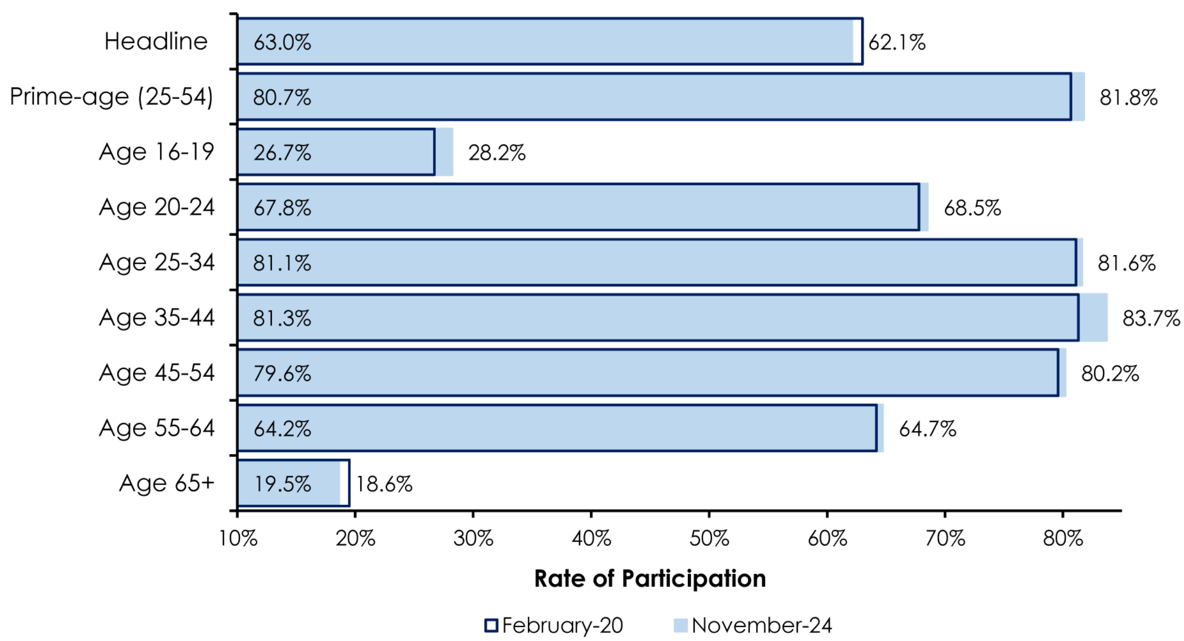
Nonfarm payroll job growth slumped in 2023, due mainly to disproportionate losses in high-wage sectors even as outsized job gains in the low-wage sectors kept the state's labor market afloat. "Low-wage sectors" are sectors with an average wage that is lower than the state's 2022 average wage of about $88,000 while "high-wage sectors" have average wages above the state average. According to this definition, low-wage sectors are comprised of construction, trade, transportation, and utilities, private education and health services, leisure and hospitality, other services, and government while high-wage sectors are comprised of mining and logging, manufacturing, information, financial activities, and professional and business services. In 2023, high-wage sectors averaged 15,000 job losses per month which were more than offset by gains of 27,000 jobs per month in the low-wage sectors. In the first eleven months of 2024, job losses in high-wage sectors slowed to around 4,000 jobs per month on average. In contrast, low-wage sectors have again buoyed overall job growth, averaging a solid 19,000 jobs added per month during that same period. In comparison, the May Revision forecast projected low-wage sectors to add around 11,000 jobs per month in 2024 while high-wage sectors were projected to gain on average around 2,000 jobs per month. Across all sectors, 15,000 jobs were added per month in the first eleven months of 2024, slightly higher than the 13,000 jobs per month projected in the May Revision forecast.

Projected job growth in the forecast is 0.1 percentage point higher on average between 2024 and 2027 compared to the May Revision forecast due to stronger-than-expected job growth and resilient labor market conditions. The forecast projects job growth to slow to a low of 0.6 percent year-over-year in the second half of 2026, a slightly delayed time frame but a less pronounced slowdown compared to the May Revision forecast which projected the slowest growth of 0.4 percent year-over-year to occur in mid-2025. This is due mainly to continued robust U.S. real GDP growth in 2024, and relatively healthy nonfarm payroll employment growth through the third quarter of 2024, particularly in low-wage sectors which account for about 70 percent of the state's payroll employment. Given the typical lag of about 18 months between overall economic activity and employment, California nonfarm payroll employment is projected to slow, but remain positive, from late 2024 through the second half of 2026 following the projected softening in U.S. real GDP growth. Thereafter, the state's nonfarm payroll employment is projected to rebound from below-trend growth and return to a steady state average rate of 0.7 percent by 2027.

The California labor force increased by 54,000 persons or 0.3 percent in the first eleven months of 2024, slightly lower than the 0.4-percent growth projected in the May Revision. This was driven mainly by trends in the first half of 2024 as the third quarter labor force annualized growth of 0.8 percent exceeded the May Revision projection of 0.5 percent. The slower pace of labor force growth in the first half of 2024 was due mainly to the decline in labor force participation of prime-age Californians (those between the ages of 25 and 54), and particularly the 25-34 and 45-54 age groups whose participation rates declined by 0.6 percentage point and 0.4 percentage point, respectively, from December 2023 to June 2024.

California's headline labor force participation rate has shown signs of stabilizing in recent months, remaining unchanged at 62.1 percent from August through November 2024 and staying between 62 percent and 62.2 percent since March 2023. While headline participation remained 0.9 percentage point below its pre-pandemic February 2020 level of 63 percent, participation amongst prime-age workers surpassed its pre-pandemic February 2020 rate of 80.7 percent in September 2022, and was at 81.8 percent as of November 2024. The higher prime-age labor force participation rate further emphasizes California's slow but ongoing labor force recovery.

California Labor Force Participation Rate Recovery by Age
(Relative to Pre-pandemic February 2020 Rates)



Note: Data labels at the base represent February 2020 labor force participation rates.
February 2020 was the pre-pandemic peak, except for age group 16-19 (June 2020) and 20-24 (March 2020).
Source: California Employment Development Department, Labor Market Information Division;
California Department of Finance, 2025-26 Governor's Budget Forecast.

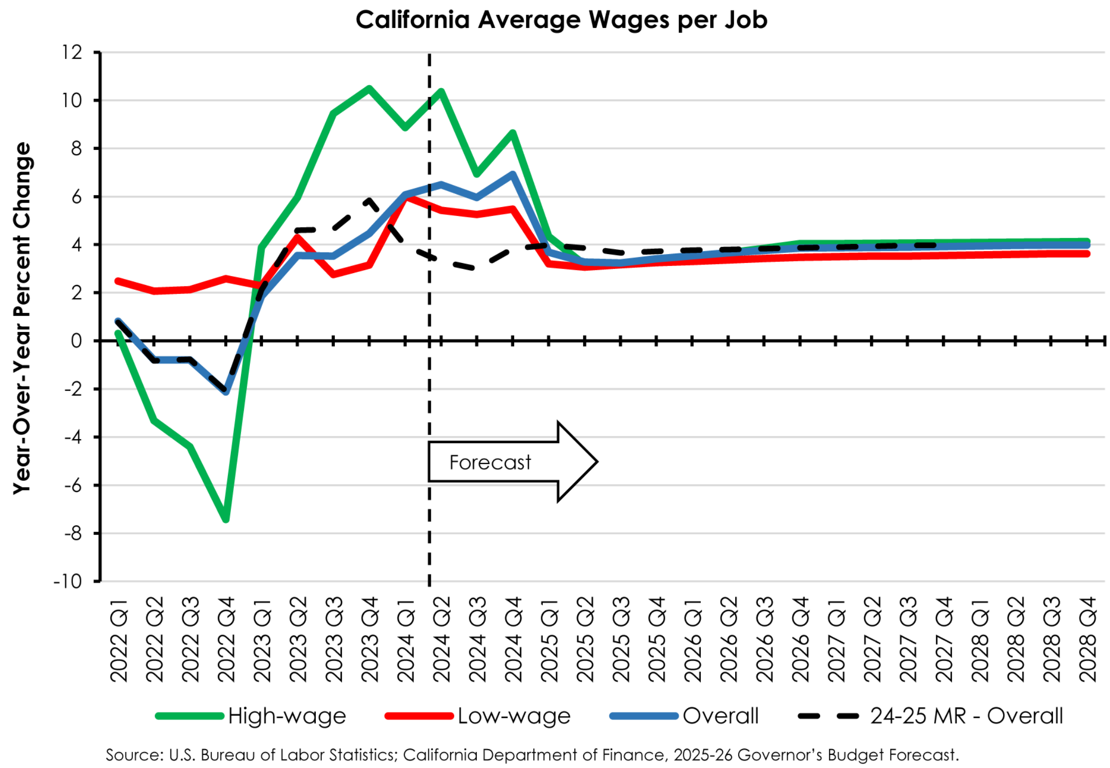
Due to lower-than-projected growth since finalizing the May Revision in April, projected labor force growth in the forecast is slower by an average of 0.1 percentage point in 2024 and 2025. From 2026 to 2028, California's labor force growth is projected to average 0.4 percent, compared to 0.3 percent projected in the May Revision forecast, in line with the state's upwardly revised population projections in the out years, particularly for working-age individuals.

California's unemployment rate averaged 5.3 percent in the first three quarters of 2024, higher than the May Revision projection of 5.2 percent. The slightly higher unemployment rate than projected was due to subdued civilian household employment since the turn of the year, growing by an average of just 0.1 percent (annualized rate) over the first three quarters of 2024 instead of the 0.4-percent growth assumed in the May Revision. California's unemployment rate was 5.4 percent as of November 2024, 1.6 percentage points higher than its historic low of 3.8 percent in August 2022 and higher than its 2015-19 pre-pandemic average of 5 percent. In comparison, the U.S. unemployment rate fell to a 70-year low of 3.4 percent in January and April 2023 and has since increased to 4.2 percent as of November 2024, slightly lower than its 2015-19 average of 4.4 percent.

The projected California unemployment rate in the forecast is 0.1 percentage point higher in 2024, compared to the May Revision forecast, due largely to civilian employment contracting more than expected so far in 2024. Civilian employment declined by an average of nearly a thousand persons a month in the first eleven months of 2024, more than the projected decline of about 800 persons per month in the May Revision. As civilian household employment is projected to increase only gradually, the unemployment rate is projected to stay at around 5.3 percent through the first quarter of 2025 before moderating thereafter. The Federal Reserve is expected to continue to loosen its still-restrictive monetary policy, which, in turn, is expected to stimulate economic activity and employment (including self-employment). California's unemployment rate is projected to gradually decline from averaging 5.3 percent in 2024 to 4.7 percent in 2028.

MODEST WAGE GROWTH PROJECTED FOLLOWING STRONG 2024

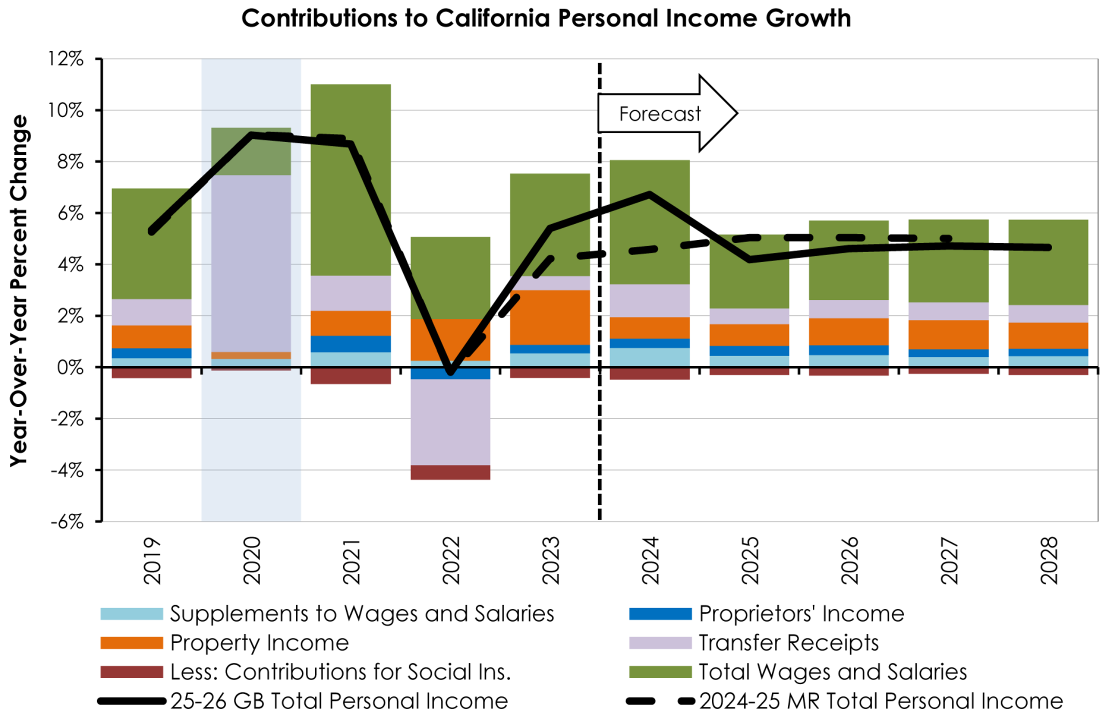
Projected average wage growth in the forecast is 0.5 percentage point faster on average than in the May Revision, due to the significant wage growth in the first half of 2024 in the information and professional and business services sectors. The overall average wage for all sectors is projected at 6.4 percent in 2024. Average wages are then projected to moderate growing between 3.4 percent and 4 percent from 2025 to 2028, similar to the 3.5 percent-to-3.9 percent growth projected in the May Revision.



PERSONAL INCOME GROWTH REVISED LOWER, BUT LEVELS REMAIN HIGHER

California headline personal income captures the total amount of income received by all persons who live in the state from all sources and is not adjusted for inflation. The personal income forecast is upgraded from the May Revision due to new higher-than-projected estimates for the first half of 2024. As the 2024 base is higher, personal income is higher in each year of the forecast than in the May Revision despite slower projected growth rates from 2025 on.

Personal income growth is projected to slow from 6.7 percent in 2024 to 4.2 percent in 2025 before settling at 4.6 percent to 4.7 percent over the rest of the forecast window through 2028. In contrast, the May Revision projected just 4.6 percent growth in 2024 followed by higher growth of 5 percent in 2025 and beyond. This lower projected future growth trajectory is due mainly to weaker projected growth in dividend and interest income.



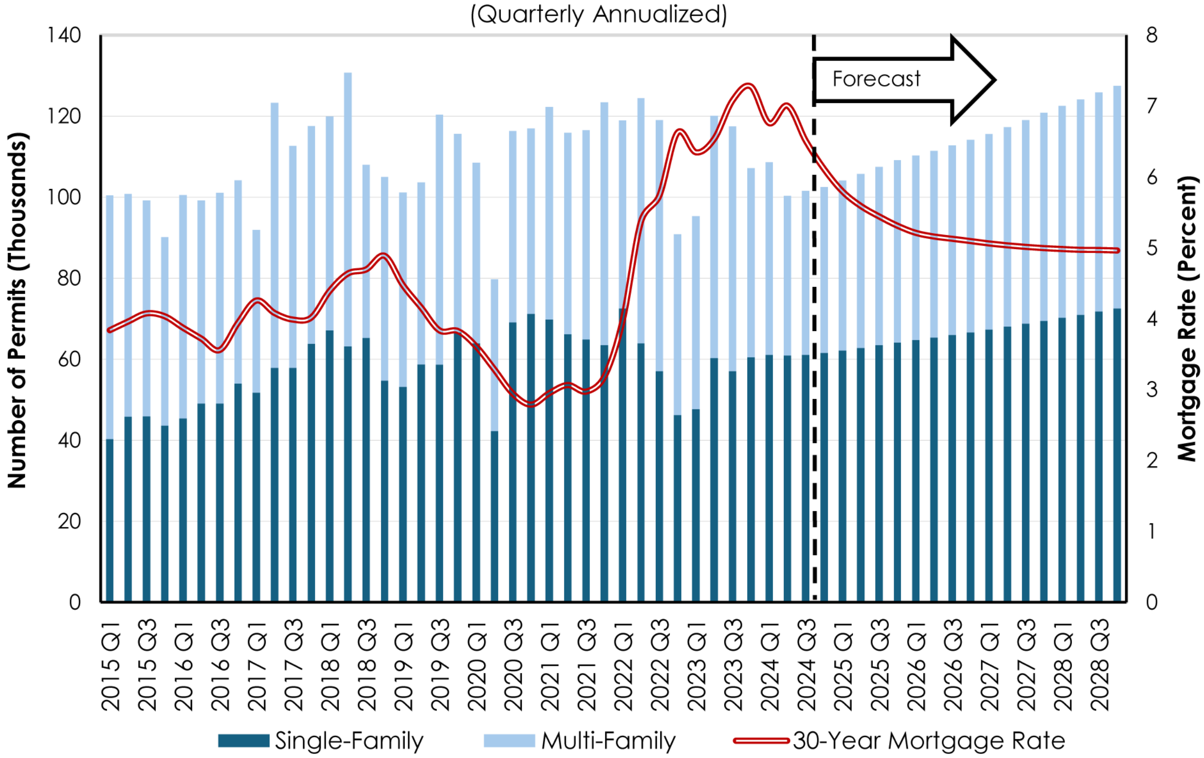
Shaded areas indicate previous U.S. recessions.
Source: U.S. Bureau of Economic Analysis; California Department of Finance, 2025-26 Governor's Budget Forecast.

HOUSING PERMITS TO GRADUALLY ACCELERATE AFTER SOME NEAR-TERM WEAKNESS

High interest rates for mortgages and other loans continue to negatively impact California's residential construction sector as residential permitting has fallen substantially in 2024, with total permit growth in the third quarter falling by 13.5 percent from the previous year to an annualized rate of just around 102,000 permits per month. Total residential permits have steadily declined since averaging nearly 120,000 in 2021, when interest rates were near record lows. Multi-family permitting was weak in 2024, declining by 23.9 percent on a year-to-date average annualized basis through November 2024. In contrast, single-family permits have increased by 5.4 percent on a year-to-date average annualized basis, as high interest rates have a smaller negative effect on single-family construction due to lower capital borrowing requirements. Actual annualized permits through November 2024 averaged 100,000, significantly less than the 110,000 permits projected in the May Revision forecast for 2024 and well below the 2018-19 annualized quarterly average of 113,000 units. Permits are one of several ways to measure likely housing production and development and there is a variable lag between permits issuance and housing building completion.

Projected total permits in the forecast are lower than the May Revision by roughly 9,000 permits, or nearly 8 percent on average, through the forecast window due to subdued permitting in 2024 moving the baseline much lower than the May Revision. Residential permitting is projected to accelerate from around 106,000 in the second half of 2025 to 125,000 in 2028 as the Federal Reserve decreases interest rates, making construction inputs more affordable and lowering mortgage rates.

California Residential Building Permits
(Quarterly Annualized)



Source: U.S. Census Bureau, S&P Global, California Department of Finance, 2025-26 Governor's Budget Forecast.

RISKS TO THE BASELINE FORECAST

Uncertainty about federal policy presents the most immediate risk to the forecast. The forecast is based on current law, and thus does not reflect any future policy changes that may be implemented by the new federal administration. In particular, the incoming administration has proposed broad tariffs at very high rates that would lead to price increases in many categories of consumer and producer goods that are commonly imported. In addition, domestic producers that do not generally face foreign competition—but that buy imported intermediate inputs or other goods they use in the course of conducting business—would likely also raise their prices to pass on the higher costs to their customers. Tariffs of the scale and scope proposed by the incoming administration would be highly inflationary and likely lead the Federal Reserve to pause its interest rate cuts and possibly raise target rates again. California would also be especially vulnerable to tariffs as the ports of Los Angeles, Long Beach, and Oakland and the logistics industry that is concentrated in the Inland Empire are highly dependent on foreign trade.

The incoming administration has also proposed to reduce legal immigration and to deport millions of undocumented immigrants, many if not most of whom are workers. To the extent that existing workers are deported and potential new workers banned or discouraged from immigrating, many sectors of the U.S. and California economies could face labor shortages, leading to price increases in the goods and services produced by these sectors. These shortages will likely be most acute in construction, manufacturing, agriculture, leisure and hospitality and other service-oriented sectors. Generally, reductions in the size of the labor force are inflationary and reduce the economy's potential output.

The potential paths of inflation and interest rates also pose risks. If inflation is slow to return to the Federal Reserve's target rate of close to 2 percent or increases due to federal policy or other reasons, the Federal Reserve could pause cutting rates or reverse course and increase rates, which would result in additional drag on interest-sensitive spending. The current high-interest rate environment could also hamper economic activity more than projected, especially given more cautious lending practices and if consumers curtail discretionary spending. Additionally, if geopolitical conflicts persist, this will increase economic uncertainties despite any potential economic boost from increased defense spending.

The Department of Finance has not modeled a recession scenario for the forecast. However, in the case that inflation takes longer to cool to the Federal Reserve's target rate of 2 percent, the Federal Reserve's monetary policy could result in tighter credit conditions, which would likely dampen economic activity. This could deepen the expected slowdown in U.S. real GDP growth and push the economy into a mild recession, which would likely entail steeper declines in investment and interest-sensitive consumption than assumed in the baseline forecast. GDP and nonfarm payroll employment would likely contract and the unemployment rate would increase. This would then likely result in lower total wage and personal income growth as well as lower business and consumer spending on taxable goods negatively impacting revenues.

Other long-term structural downside risks to the state economy and budget also remain, including climate change and its more frequent extreme weather events such as wildfires, drought, and floods, the challenges of an aging cohort that is becoming an increasingly larger share of total state population, declining migration inflows, lower fertility rates, stock market volatility, and persistently high housing and living costs.