

# ECONOMIC OUTLOOK

In 2025, both the U.S. and California economies continued to expand at a moderate pace, with their respective Gross Domestic Products (GDP) growing by 2.1 percent and 2.5 percent, a 0.7-percentage point deceleration from 2024 for both economies. For the nation, growth in 2025 was slightly higher than the 2-percent growth projected in the Governor's Budget, reflecting larger contributions from consumption, fixed investment (particularly in computer equipment), and exports. California's 2025 growth was supported in part by stronger-than-expected personal income growth of 5.5 percent compared to 5.3 percent projected at the Governor's Budget due mainly to stronger wage growth in high-paying sectors, particularly information and professional and business services, as well as upward revisions to historical data. Together, these factors indicate stronger underlying economic momentum and a more limited near-term impact of tariffs on labor market conditions than previously assumed.

Despite the stronger-than-projected economic performance in 2025, the outlook has weakened in the near term reflecting broader global and national pressures, including higher global energy prices associated with geopolitical developments, most notably the Iran war, and the delayed impacts of tariffs. The Iran war started in late February, and as of mid-April 2026 when the forecast was finalized, the price of West Texas Intermediate (WTI) crude oil futures was above \$90 per barrel, up from around \$60 at the start of 2026. California is not immune to these global pressures: they are projected to suppress economic activity in 2026, which is expected to be the slowest year for California personal income growth (4.1 percent) before improving through the rest of the forecast period to average 4.7 percent from 2028 through 2030 as productivity is

projected to improve, particularly from broader adoption and more effective use of artificial intelligence.

Higher global energy prices are projected to lead to higher broad-based inflation and reduce real purchasing power, while tariffs are still expected to continue to raise costs for businesses and consumers. The May Revision forecast projects oil prices to remain elevated in the near term, with WTI crude at nearly \$100 per barrel in the second quarter of 2026 and remaining higher than pre-Iran war levels through the end of the forecast period in 2030. This is projected to cause inflation to accelerate before gradually slowing as global oil prices fall after the war is assumed to end in the second quarter of 2026. U.S. Consumer Price Index (CPI) inflation is projected to accelerate from 2.7 percent in 2025 to 3.5 percent in 2026 before decelerating to 2.2 percent in 2027, compared to 2.9 percent in 2026 and 2.6 percent in 2027 as projected in the Governor's Budget. Similarly, California CPI inflation is projected to accelerate from 3.1 percent in 2025 to 4.1 percent in 2026 and 3.1 percent in 2027, compared to 3.3 percent in 2026 and 3.2 percent in 2027 projected in the Governor's Budget. The decline in purchasing power that results from higher inflation is projected to weaken consumer demand and overall economic activity.

In addition, the May Revision forecast incorporates tariff assumptions based on current law as of mid-April, including the Supreme Court ruling in February 2026 that struck down the International Emergency Economic Powers Act (IEEPA) tariffs and tariff rates as of mid-April. The May Revision forecast assumed the IEEPA tariffs would be partially replicated by Section 122 tariffs, which were initially set to expire on July 24, 2026. However, the Section 122 tariffs were deemed unlawful by a federal court on May 7, 2026, and that ruling, in turn, was temporarily paused by an appeals court on May 12, 2026. While lower than assumed in the Governor's Budget, tariffs are expected to remain historically higher than at any period since the 1940s, except for 2025. Trade policy unpredictability remains high, creating significant uncertainty for businesses as they make pricing and investment choices. Therefore, tariffs are expected to continue affecting prices, trade flows, and business decisions through 2026 and into early 2027. This is a more drawn-out timeline than in the Governor's Budget, which assumed that consumer prices would be essentially fully adjusted to tariffs by the first quarter of 2026.

These pressures are occurring alongside a labor market where job growth remains modest and concentrated in a limited number of sectors for both the U.S. and California. California nonfarm payroll employment grew by 55,400 jobs or 0.3 percent from 2024 to 2025; however, this was driven entirely by a gain of 176,200 jobs in private education and health services while all other sectors combined lost a total of 120,900 jobs. California nonfarm payroll employment is projected to slightly contract

in 2026 (-0.02 percent compared to +0.03 percent in the Governor's Budget) and grow slightly in 2027 (0.1 percent compared to 0.2 percent in the Governor's Budget). Projected growth has particularly weakened for low-wage sectors, contributing to a softer outlook for both employment and personal income growth.

Monetary policy is also expected to remain restrictive. Due to inflationary pressures from the Iran war, the Federal Reserve is now assumed to hold interest rates steady until March 2027, maintaining tight financial conditions that limit growth in interest-sensitive sectors such as housing and business investment. By comparison, the Governor's Budget assumed interest rate cuts in June 2026 and September 2026.

Overall, the May Revision forecast projects a period of weaker growth in the near term for both the United States and California, due to a shift in the timing and composition of economic shocks followed by gradual improvement as external pressures are projected to ease and productivity gains related to artificial intelligence expand.

Risks have increased as the Iran war adds to the ongoing uncertainty around federal trade and immigration policies. As in the Governor's Budget, the outlook continues to be shaped by federal administration policy uncertainty and risks, particularly in the near term, including geopolitical pressures affecting energy prices, the timing and magnitude of tariff impacts, and the path of monetary policy.

**Economic Indicators**

Annual Percentage Change unless Otherwise Indicated

	2024	2025	Forecast				
			2026	2027	2028	2029	2030
<b>United States</b>							
<b>Real GDP</b>							
May Revision, April 2026	2.8	2.1	2.1	2.0	2.1	2.0	1.9
Percentage Point Change from Governor's Budget			(0.2)	0.2	0.5	0.2	0.2
<b>Unemployment Rate (percent)</b>							
May Revision, April 2026	4.0	4.3	4.6	4.8	4.6	4.4	4.3
Percentage Point Change from Governor's Budget			0.0	0.3	0.2	0.1	0.1
<b>Nonfarm Employment</b>							
May Revision, April 2026	1.2	0.5	0.0	0.1	0.5	0.6	0.5
Percentage Point Change from Governor's Budget			(0.5)	(0.4)	0.3	0.2	0.1
<b>Personal Income</b>							
May Revision, April 2026	5.6	4.9	4.7	5.9	5.4	5.0	4.7
Percentage Point Change from Governor's Budget			(0.7)	0.4	0.8	0.5	0.1
<b>CPI Inflation Rate (percent)</b>							
May Revision, April 2026	2.9	2.7	3.5	2.2	2.3	2.3	2.3
Percentage Point Change from Governor's Budget			0.5	(0.5)	(0.2)	0.0	(0.0)
<b>California</b>							
<b>Unemployment Rate (percent)</b>							
May Revision, April 2026	5.3	5.5	5.6	5.5	5.3	5.2	5.1
Percentage Point Change from Governor's Budget			0.0	0.0	0.0	0.0	(0.0)
<b>Civilian Labor Force</b>							
May Revision, April 2026	0.9	0.7	(0.1)	0.2	0.3	0.2	0.2
Percentage Point Change from Governor's Budget			(0.4)	0.1	0.1	(0.0)	(0.0)
<b>Nonfarm Employment</b>							
May Revision, April 2026	0.9	0.3	(0.0)	0.1	0.5	0.4	0.6
Percentage Point Change from Governor's Budget			(0.1)	(0.2)	0.1	(0.1)	0.0
<b>Residential Permits (thousands of units)</b>							
May Revision, April 2026	100	103	101	106	111	114	115
Percentage Point Change from Governor's Budget			1.3	2.0	3.0	2.5	0.3
<b>Average Wages</b>							
May Revision, April 2026	5.3	5.6	4.2	4.4	4.5	4.4	4.3
Percentage Point Change from Governor's Budget			0.1	0.0	0.2	0.1	0.1
<b>Personal Income</b>							
May Revision, April 2026	6.8	5.5	4.1	4.4	4.7	4.7	4.7
Percentage Point Change from Governor's Budget			0.0	(0.3)	0.0	0.0	0.1
<b>CPI Inflation Rate (percent)</b>							
May Revision, April 2026	3.1	3.1	4.1	3.1	3.2	3.2	3.2
Percentage Point Change from Governor's Budget			0.8	(0.1)	0.0	0.1	0.0

2026-27 May Revision Forecast based on data available as of April 2026.

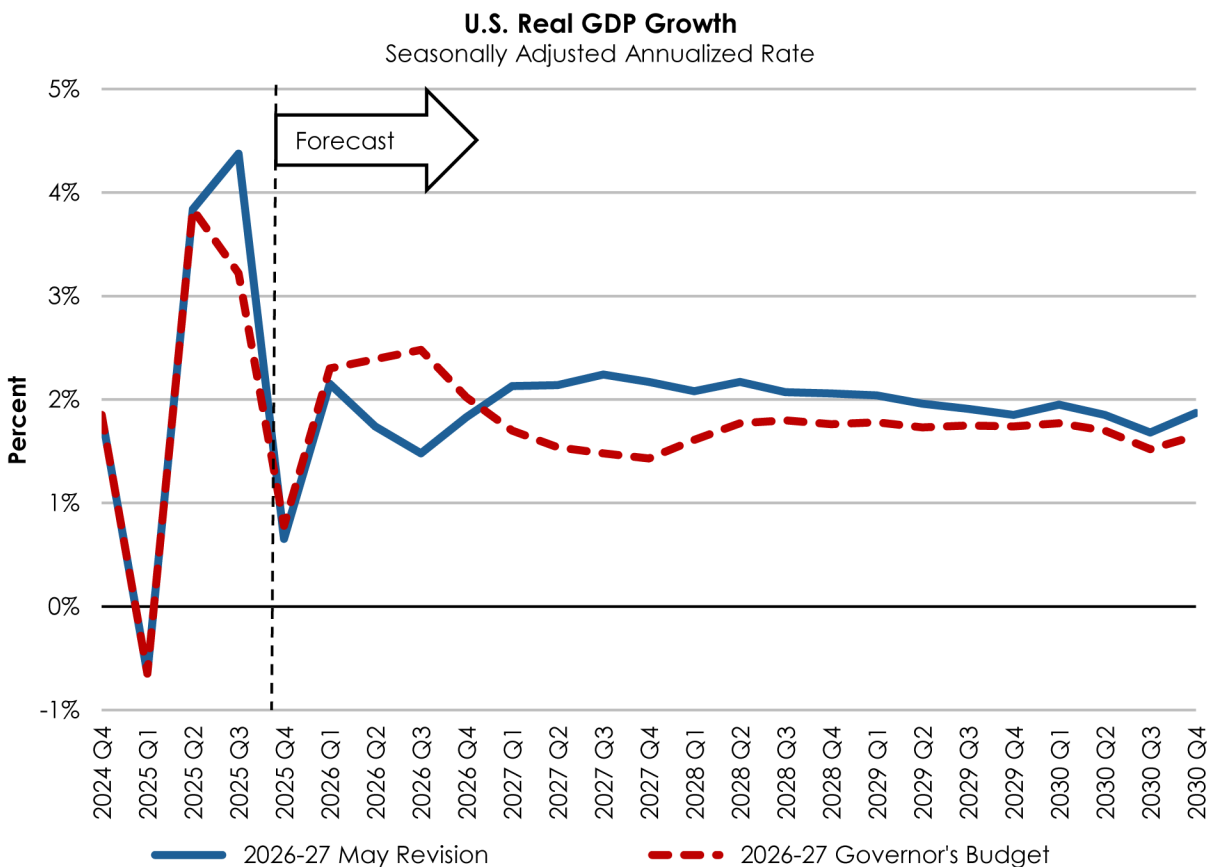
2026-27 Governor's Budget Forecast based on data available as of November 2025.

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, 2026-27 Governor's Budget and May Revision Forecasts.

## U.S. AND CALIFORNIA FORECASTS

### GROWTH GENERALLY REVISED HIGHER AFTER DOWNGRADE IN 2026

As shown in the “U.S. Real GDP Growth” figure, the nation experienced stronger economic growth than projected in the Governor’s Budget in 2025. However, U.S. real GDP growth is downgraded in 2026 due to the projected negative impacts of the Iran war. Starting in the first quarter of 2027 and through the end of 2030, the May Revision forecast projects higher growth compared to the Governor’s Budget due to expected stronger productivity gains from artificial intelligence investment (averaging 2 percent from 2027 through 2030, a 0.3-percentage point increase from the Governor’s Budget). Overall, the May Revision forecast projects moderate but stable growth over the forecast period with no sustained contraction in economic activity.



Source: U.S. Bureau of Economic Analysis (BEA); California Department of Finance, 2026-27 May Revision Forecast.

U.S. real GDP grew by 2.1 percent in 2025 and is projected to grow at the same rate in 2026, representing a slight downgrade from the 2.2-percent growth projected in the Governor’s Budget. Growth is projected to slow to a low of 1.5 percent (seasonally

adjusted annualized rate) in the third quarter of 2026, significantly lower than the 2.5-percent growth projected in the Governor's Budget for that quarter. This slower pace reflects the effects of higher energy prices—which are projected to reduce real household income and increase costs for businesses—as well as the lingering impacts of tariffs.

Despite the initial weakness, the broader trajectory for economic growth is expected to remain stable. As energy markets are projected to stabilize by early 2027 and the effects of tariffs are assumed to gradually diminish and be almost fully passed through to consumer prices by the middle of 2027, growth is expected to remain around 2 percent annually from 2027 through 2030. This represents an upgrade from the 1.7-percent average growth projected in the Governor's Budget, driven primarily by stronger productivity assumptions. Improved utilization of artificial intelligence technologies is assumed to enhance efficiency and support growth in the forecast period.

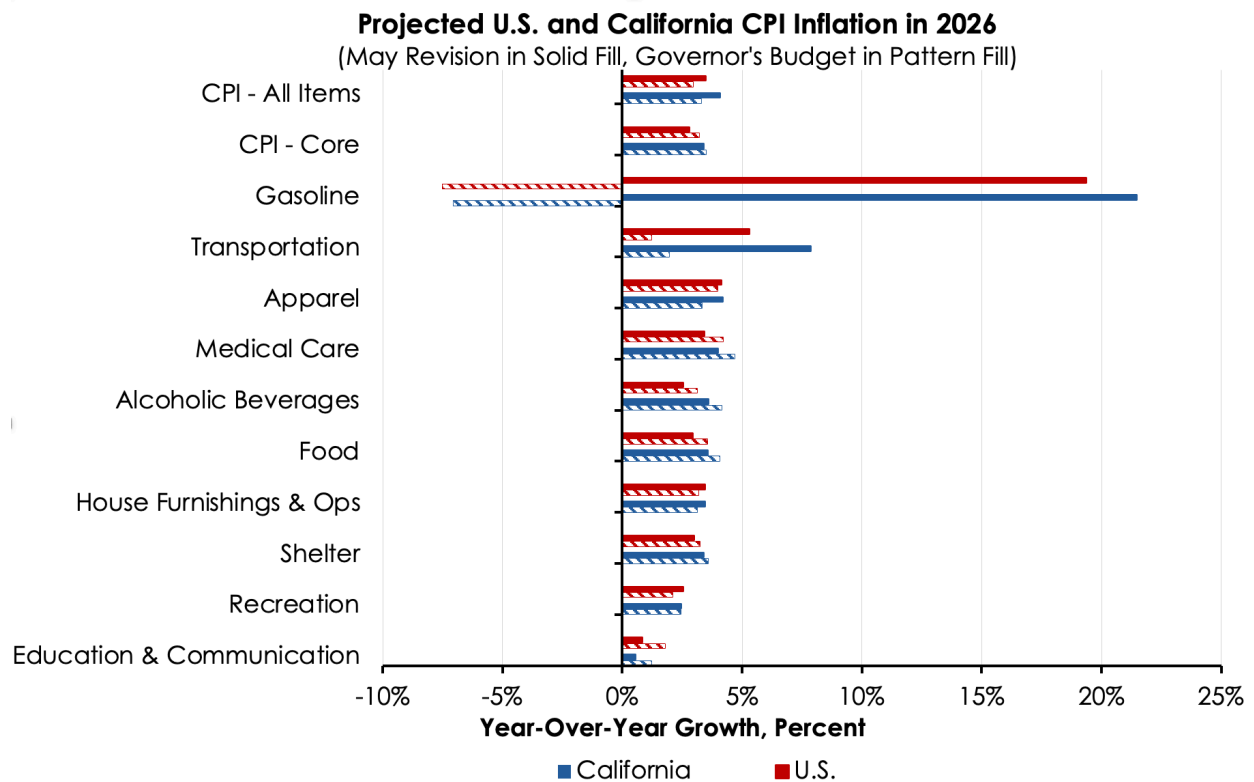
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### **INFLATION PROJECTED TO ACCELERATE SUBSTANTIALLY IN 2026 BEFORE EASING**

Inflation is projected to accelerate considerably in 2026 due to higher energy prices and tariff-related cost pressures. U.S. headline CPI inflation averaged 2.7 percent in 2025 and is projected to accelerate to 3.5 percent in 2026, revised higher from the Governor's Budget projection of 2.9 percent. This acceleration is driven primarily by the sharp rise in global oil prices due to the Iran war, which is expected to affect a broad range of goods and services, as well as the delayed impact of tariffs on consumer prices. Higher energy prices have both direct and indirect effects on inflation. Directly, they raise the cost of gasoline and other energy-related goods. As shown in the "Projected U.S. and California CPI Inflation in 2026" figure, U.S. gasoline inflation is projected to accelerate to 19.4 percent in 2026, compared to the projected deflation of -7.5 percent in the Governor's Budget. Indirectly, higher energy prices increase production and transportation costs for businesses across various sectors, which are often passed on to consumers in the form of higher prices. At the same time, tariffs increase the cost of imported goods, further contributing to upward pressure on prices. Tariff impacts were more muted in 2025 than assumed in the Governor's Budget as businesses were generally able to absorb them.

The May Revision forecast projects pass-through costs to impact consumer prices in 2026 before easing into 2027, reflecting a longer and more delayed impact of tariffs than assumed in the Governor's Budget. Tariffs are projected to add 0.1 percentage

point to U.S. annual average inflation in both 2026 and 2027. Most CPI components are projected to be impacted by tariffs as most businesses rely on imported inputs, with the largest impacts concentrated in categories such as new vehicles and apparel. However, the lower effective tariff rate in the May Revision forecast reduces upward pressure on inflation relative to the Governor's Budget. As these pressures begin to ease, U.S. CPI inflation is expected to decelerate to 2.2 percent by 2027, reflecting stabilizing energy prices and lower pass-through impacts of tariffs. This moderation is consistent with the assumption that the most significant inflationary impacts of recent shocks are temporary rather than persistent.



Source: U.S. Bureau of Labor Statistics (BLS); California Department of Finance, 2026-27 May Revision Forecast.

California's inflation profile is generally expected to mirror the nation; however, the state's inflation is projected to rise more sharply than at the national level. After averaging 3.1 percent in 2025, California headline CPI inflation is expected to accelerate to 4.1 percent in 2026, significantly above the 3.3 percent projected in the Governor's Budget.

As in the nation, inflation in California is expected to moderate the following year, decelerating to 3.1 percent in 2027 as energy prices stabilize. Projected U.S. and California inflation from 2028 to 2030 were generally unchanged from the Governor's

Budget, averaging 2.3 percent and 3.2 percent, respectively. Overall, the May Revision forecast assumes that inflation will spike temporarily in 2026 before gradually returning to more stable rates, although risks remain that inflation could be higher or more persistent than projected depending on the duration of the Iran war which affects the trajectory of global oil prices and tariffs.

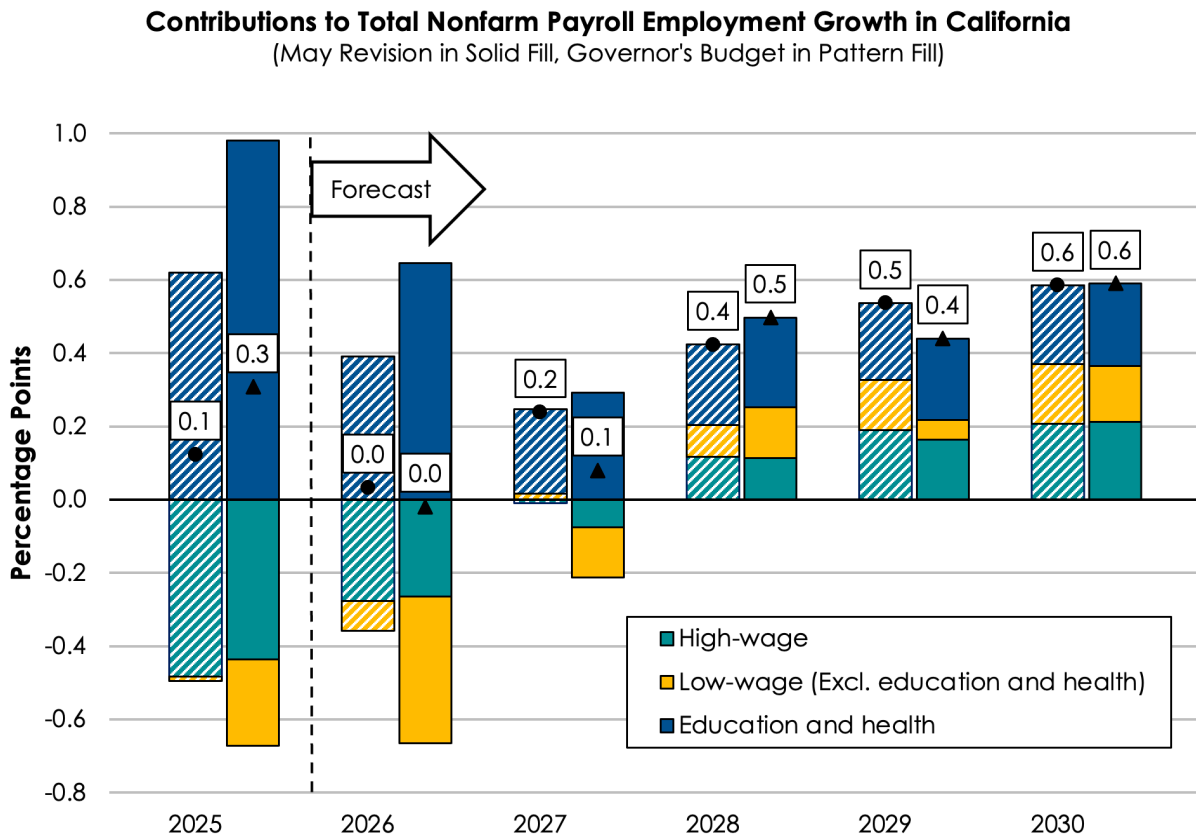
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### **CALIFORNIA LABOR MARKET GROWTH REDUCED DESPITE STRONGER GAINS IN 2025**

Since the Governor's Budget was finalized in mid-November 2025, California added nearly 22,000 jobs per month between October 2025 and March 2026, well above the projected average monthly job loss of 1,900 jobs per month over the same period in the Governor's Budget. The stronger job growth was driven largely by upward revisions to historical data which indicated nonfarm payroll employment levels in 2025 were higher than projected by 78,400 jobs and annual average growth was 0.3 percent, 0.2 percentage point higher than projected. However, this stronger job growth was concentrated primarily in private education and health services and does not fully offset the weaker outlook for future growth. As such, although projected payroll employment levels are higher than in the Governor's Budget by about 48,000 jobs per year from 2026 to 2030, job growth is projected to be flat in 2026 before slowly rebounding thereafter. Job growth is projected to average approximately 0.3 percent annually over the forecast period, downgraded from the 0.4-percent rate projected in the Governor's Budget.

Despite the upward revisions to nonfarm payroll employment, projected job growth in the near term is reduced relative to the Governor's Budget due mainly to substantially weaker job growth in low-wage sectors (see figure on Contributions to Total Nonfarm Payroll Employment Growth in California). "Low-wage sectors" are defined as sectors with an average wage that is lower than the state's average wage—around \$100,500 in 2025—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. Job growth in the near term is projected to remain subdued due to ongoing impacts from tariffs and the Iran war. While the Iran war is projected to have broad-based adverse impacts across most sectors, oil-intensive sectors such as trade, transportation, and utilities, manufacturing, and construction are projected to be disproportionately impacted while leisure and hospitality and other service-providing

sectors are also expected to be negatively affected due to less discretionary spending from higher prices.



Note: Data labels represent total nonfarm payroll employment growth.  
Source: California Department of Finance, 2026-27 May Revision Forecast.

California labor force growth is projected to remain limited over the forecast period, slowing from 0.7 percent in 2025 to -0.1 percent in 2026, compared to 0.8 percent and 0.3 percent, respectively, projected in the Governor's Budget. This reflects underlying demographic pressures as restrictive policies on legal immigration are likely constraining labor supply while elevated domestic and international economic uncertainty may be contributing to individuals stepping out of the labor force. Over the remainder of the forecast period, California labor force growth is expected to average approximately 0.2 percent annually, unchanged from the Governor's Budget.

## CALIFORNIA WAGE GROWTH UPGRADED

California wage growth has also been stronger than projected in the Governor's Budget, particularly in high-wage sectors including information and professional and

business services. Total wages and salaries increased by 5.8 percent in 2025, compared to 5.3 percent projected in the Governor's Budget. The robust growth in total wages and salaries was due mainly to strong growth in average wages which increased 5.6 percent in 2025, compared to 5.1 percent projected in the Governor's Budget. Robust average wage growth was primarily buoyed by the technology-related and artificial intelligence-driven growth in information and professional, scientific, and technical services sectors, where average wages increased 14.9 percent and 8.5 percent, respectively, in 2025, compared to projected growth of 13.8 percent and 6.3 percent, respectively, in the Governor's Budget. This strength reflects continued demand for skilled labor as well as the effects of technological investment, particularly in areas related to artificial intelligence.

Total wages and salaries growth is expected to slow to 4.3 percent in 2026, and 4.5 percent in 2027, compared to 4.2 percent and 4.7 percent, respectively, in the Governor's Budget, reflecting weaker labor market and overall economic conditions. Then, total wages and salaries are projected to average 4.9 percent in 2028 through 2030, slightly upgraded from the 4.8-percent rate projected in the Governor's Budget, primarily reflecting projected productivity gains from the ongoing investment in artificial intelligence. Overall, the outlook suggests continued strength in wage growth that is driven largely by high-wage sectors.

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### **CALIFORNIA PERSONAL INCOME GROWTH REDUCED FOR 2027, OTHERWISE UNCHANGED**

California personal income increased by 5.5 percent in 2025, 0.2 percentage point above the Governor's Budget projection, reflecting stronger total wage growth than projected and upward revisions to historical data. Growth is projected to slow to 4.1 percent in 2026—unchanged from the Governor's Budget—before slightly rebounding to 4.4 percent in 2027, a 0.3-percentage point reduction from the Governor's Budget. The projected slowing from 2025 to 2026 is driven largely by wages and salaries (5.8 percent in 2025 to 4.3 percent in 2026) and proprietors' income (4 percent to 2.8 percent), which are both impacted by the Iran war. Interest income growth is projected at 4.7 percent in 2026, upgraded from the Governor's Budget projection of 3.4 percent due mainly to a higher interest rate forecast. The 2027 forecast reduction relative to the Governor's Budget is driven largely by proprietors' income (2.6 percent in the May Revision compared to 3.7 percent in the Governor's Budget), partly due to delayed impacts of higher global oil prices. Starting in 2028, as inflation is expected to moderate and economic growth is assumed to stabilize, personal income

growth is projected to return to a more typical pace of 4.7 percent, unchanged from the Governor's Budget.

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## CALIFORNIA HOUSING PERMITS SLIGHTLY UPGRADED

Recent housing permitting activity has exceeded expectations, reflecting stronger-than-anticipated construction activity from September 2025 to January 2026, the latest month of data available at the time the May Revision forecast was finalized. During this period, California permitted an average of 112,700 units on a seasonally-adjusted annualized rate basis—14,100 units (14.3 percent) higher than projected in the Governor's Budget.

Looking ahead, housing permits are projected to average approximately 109,400 units annually through 2030, representing a modest upward revision of 1,800 units per year (1.7 percent) compared to the Governor's Budget. Because of stronger performance in 2025, the May Revision permits forecast was slightly upgraded relative to the Governor's Budget despite higher interest rates increasing financing costs for both builders and buyers, the Iran war raising energy costs, and tariffs raising material expenses. The boost in permitting activity was driven primarily by stronger multi-family permitting. Projected multi-family permitting has been revised upward by 2,200 units per year (4.3 percent) on average due to a faster rebound than projected in the Governor's Budget, while single-family permitting was slightly downgraded by 400 units per year (-0.7 percent) on average over the forecast period from 2026 to 2030.

However, even with the slight upgrade in the outlook for permitting, housing construction continues to face significant constraints in California and remains below housing demand in the state.

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## RISKS TO THE BASELINE FORECAST

The May Revision forecast assumes a modest and relatively short-lived impact of the Iran war on the economy, reflected largely in short-term price hikes and disruptions that are resolved by the end of 2026. The outlook then assumes gradual and steady improvement after 2026; however, risks remain elevated and are skewed to the downside, particularly in the near term. A key source of uncertainty is the geopolitical environment, especially the potential for a prolonged or escalating Iran war. Such a development could keep global oil prices elevated for longer or push them even higher, leading to greater inflationary pressures and weaker economic growth than currently projected.

Inflation risks remain significant. If energy prices remain high for longer or if tariff-related costs are passed through more quickly or to a greater extent than projected, inflation could exceed current projections. This, in turn, could prompt a more restrictive monetary policy response from the Federal Reserve, further slowing economic activity.

Monetary policy itself represents an additional source of uncertainty. Interest rates could remain elevated for longer than expected, placing further constraints on growth, or policy could shift in ways that exacerbate inflation pressures. Additionally, the current Federal Reserve Chair's term is set to end in mid-May 2026, which introduces uncertainty around the continuity of monetary policy and the independence of the Federal Reserve in pursuing its dual mandate of maximum employment and price stability. Achieving this mandate is inherently challenging, and current conditions make it particularly difficult, as the economy faces a softening labor market alongside inflation that remains above the Federal Reserve's target rate of 2 percent. Setting the appropriate policy stance is therefore complex, and these challenges could be amplified if there are constraints on the Federal Reserve's independence. If the dual mandate is not met, there is potential for 'stagflation'—a period of high inflation, stagnant economic growth, and increasing unemployment.

Uncertainty surrounding federal policy continues to pose risks to the outlook. Changes in trade policy, including the scope and duration of tariffs, could affect business costs, supply chains, and investment decisions. While the May Revision assumes a lower effective tariff rate than the Governor's Budget, the timing and extent of tariff pass-through to consumer prices remains uncertain and could lead to higher inflation or weaker economic activity than projected. Immigration policy is another key source of uncertainty. Changes in enforcement or policy direction could affect labor supply, particularly in sectors that rely more heavily on immigrant workers. Reduced labor force growth could constrain economic output, while shifts in labor availability could also influence wage growth and inflation. Fiscal policy at the federal level also remains uncertain. Potential changes to spending programs or tax policy could affect household income, business activity, and overall economic conditions. Depending on the direction and magnitude of these changes, federal policy could either support or constrain economic growth relative to the baseline forecast.

Labor market risks are also notable, particularly in California, where employment is expected to weaken in the near term and labor force growth remains subdued. Job growth is already projected to slow in the near term, making the labor market vulnerable to further weakening. Slower economic activity is expected to reduce demand for workers, particularly in low-wage sectors, raising the risk that modest job gains could turn into job losses if conditions deteriorate. At the same time, labor force

growth remains limited due to slower population growth and an aging workforce that constrains the supply of available workers. There is also uncertainty around how advances in technology, including artificial intelligence, may affect hiring needs and the mix of jobs over time. Together, these factors raise the risk of both slower job creation and potential job losses, contributing to a more uncertain labor market outlook.

Financial market conditions present an additional source of uncertainty. While equity markets have performed strongly, driven in part by elevated valuations of firms associated with artificial intelligence, price-to-earnings ratios suggest the market may be vulnerable to a correction; however, the timing or magnitude of such a correction cannot be predicted. Renewed market volatility or a significant downturn would negatively affect household wealth, consumer confidence, and state revenues.

Any of these risks could, if substantially more severe than assumed or occurring simultaneously, tip the economy into a recession. A prolonged period of elevated energy prices, more persistent inflation, tighter financial conditions, or a sharper slowdown in hiring and investment could lead to a broader contraction in economic activity. For California, a recession would likely result in weaker job and wage growth, reduced consumer spending, lower business investment, and softer capital gains and corporate profits. These effects would, in turn, reduce state revenue collections and place additional pressure on the state's fiscal outlook.

Longer-term structural challenges remain, including demographic pressures, declining domestic and international migration, high housing and living costs, and ongoing exposure to financial market volatility. These factors continue to pose downside risks to the state's economic performance and fiscal outlook over the forecast window.

Overall, however, the economic outlook reflects a period of slower growth in the near term for both the United States and California, followed by gradual improvement as external pressures are projected to ease, although the pace and extent of that improvement will depend on the evolution of geopolitical conditions, federal policy, and the trajectory of inflation.