

The California Economy

Recession, Forecast, Budget, Issues

City National Bank

Annual Economic Forecast Conference

Stephen Levy, CCSCE

February 2, 2010

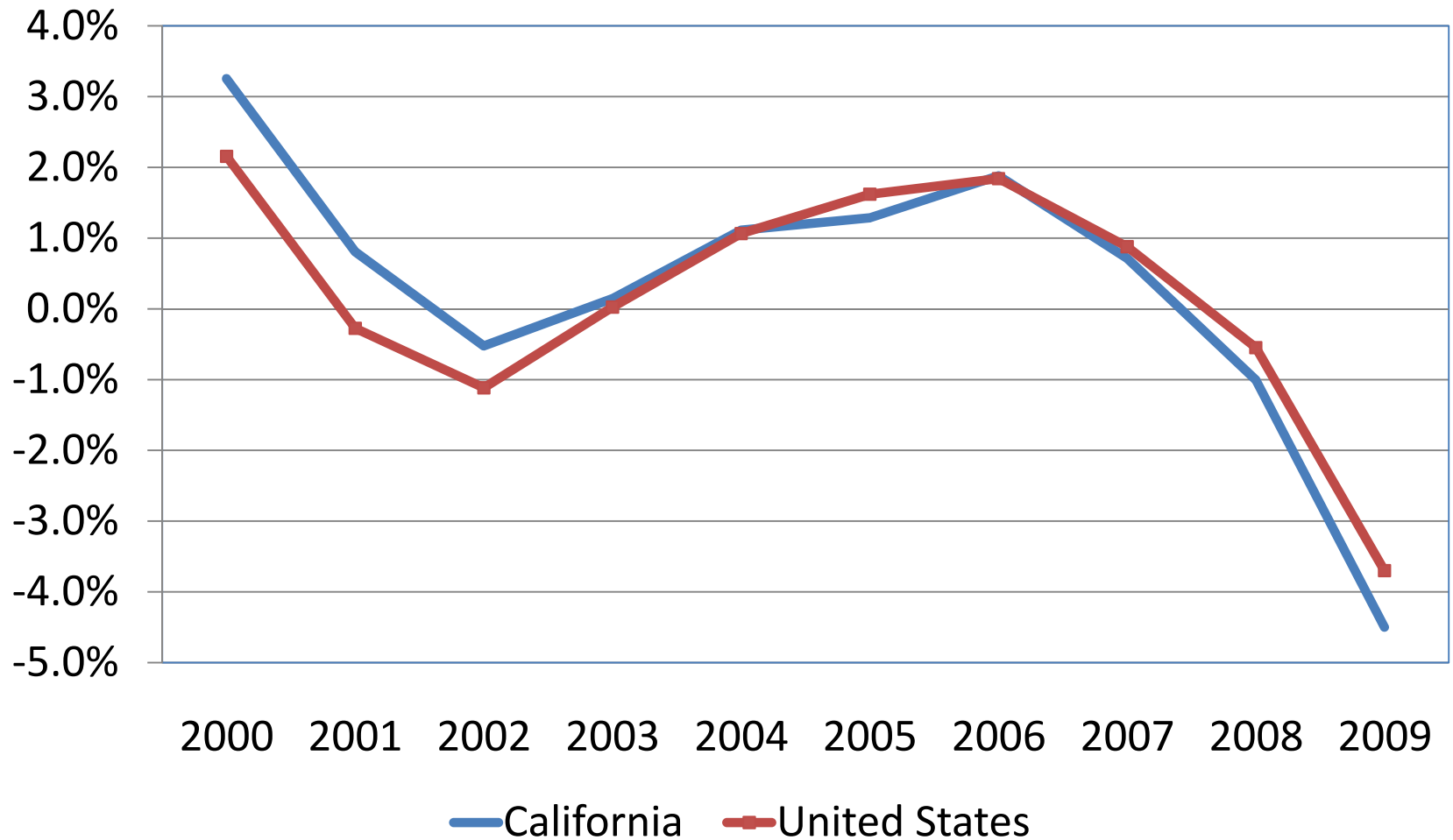
California -- Economy and Budget-- Outlook and Issues

- Economy Bottom Line—modest recovery, substantial long-term opportunities, MANY CHALLENGES
- Budget Bottom Line—numbers don't add, lousy choices, bad feelings, BIG GRIDLOCK
- The relationship of the budget, policy and the California economy—getting beyond blame to create a great future for our children

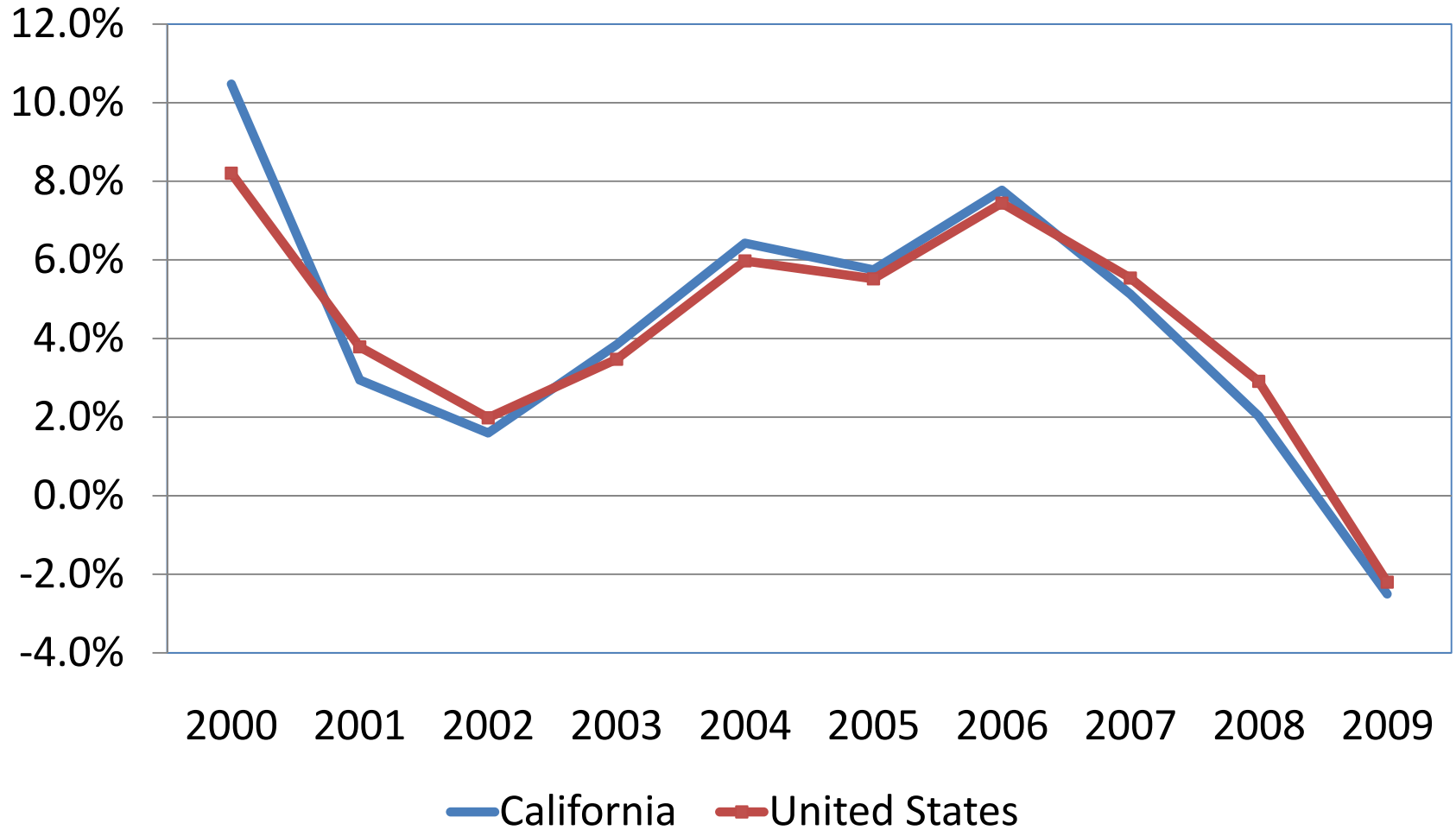
Background

- The California economy closely tracks the national economy. So the California forecast depends heavily on the national forecast.
- California has become an average growth state measured by jobs, income and population.

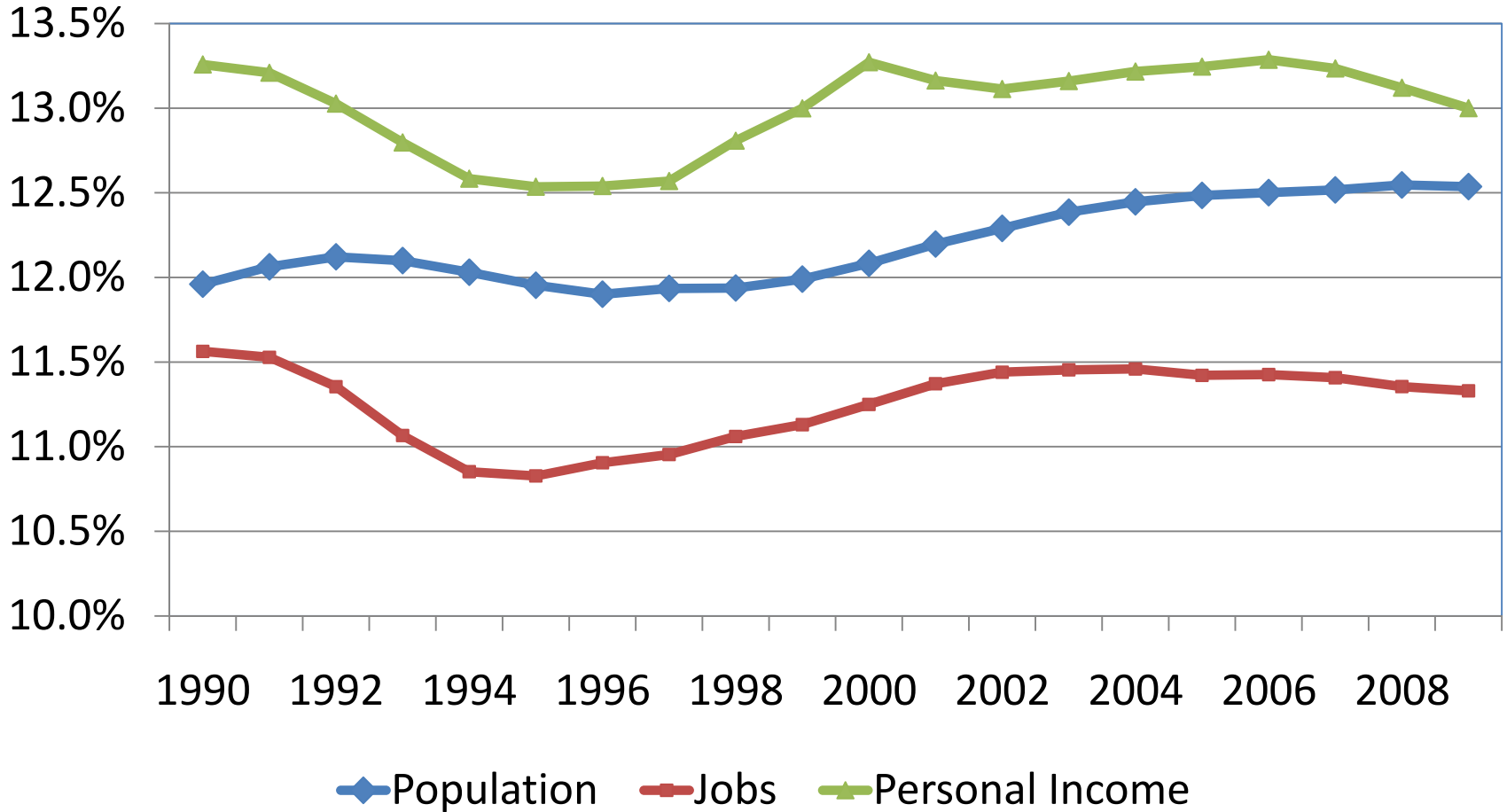
Annual Change in Total Jobs



Annual Change in Personal Income



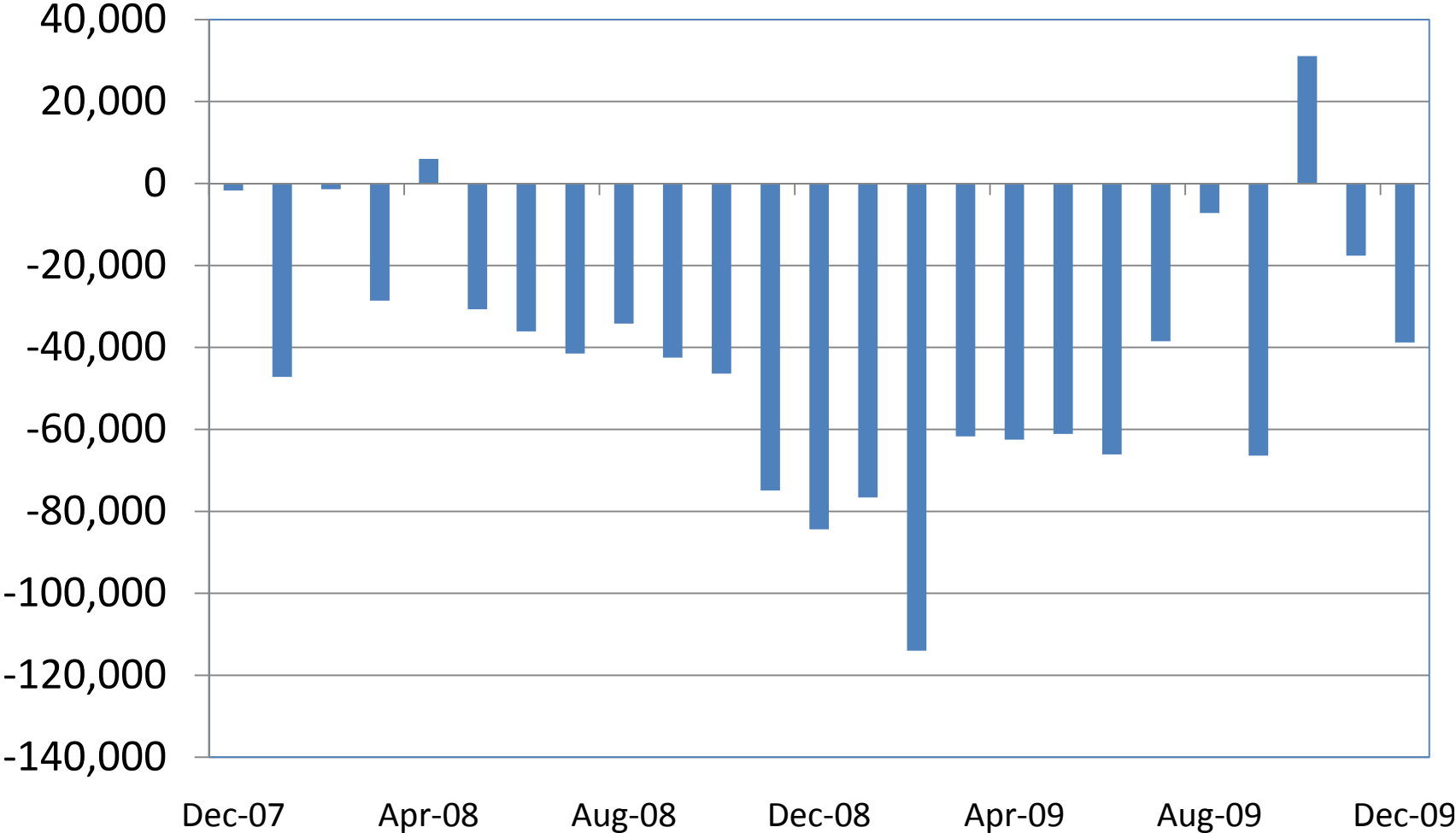
California as Share of U.S. Now an Average Growth State



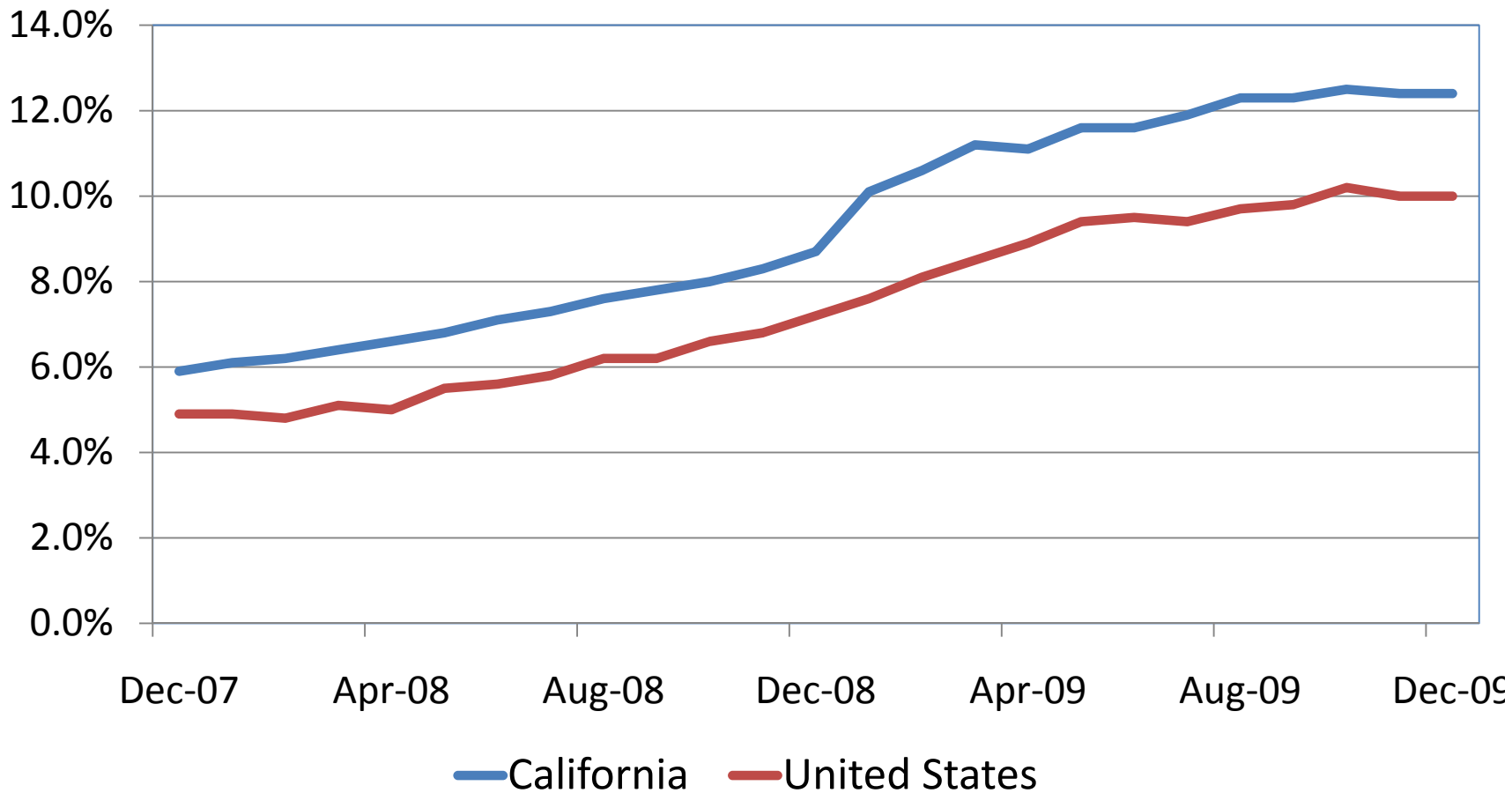
A Deep Recession- A million Lost Jobs

- In 2 years CA lost more than 6% of job base
- The unemployment rate more than doubled
- Construction led the recession falling by 60% or \$60 billion
- As a result, California's recession was deeper than the nation's
- The recession hit businesses, consumers and devastated government revenues

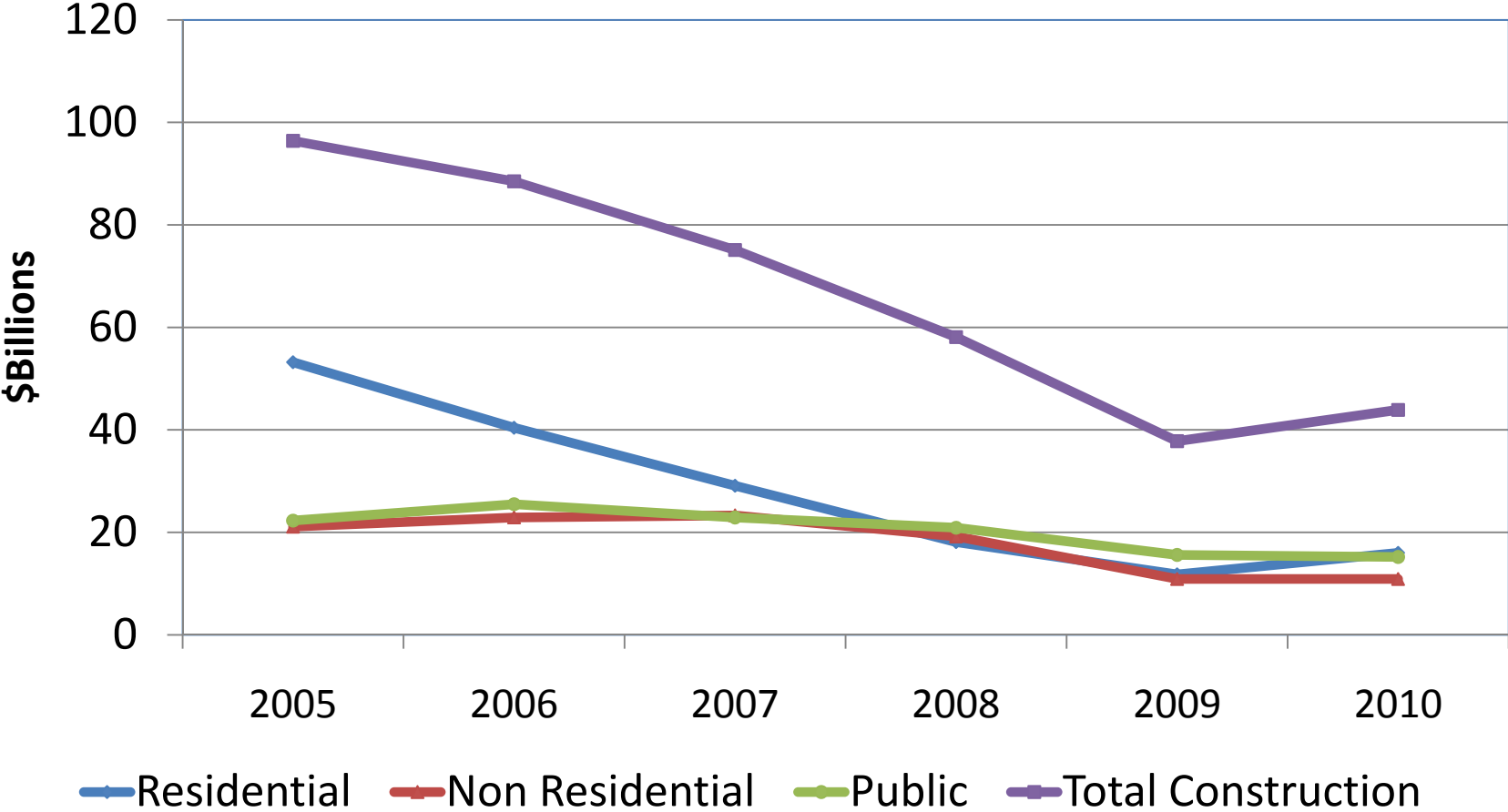
California Loses A Million Jobs



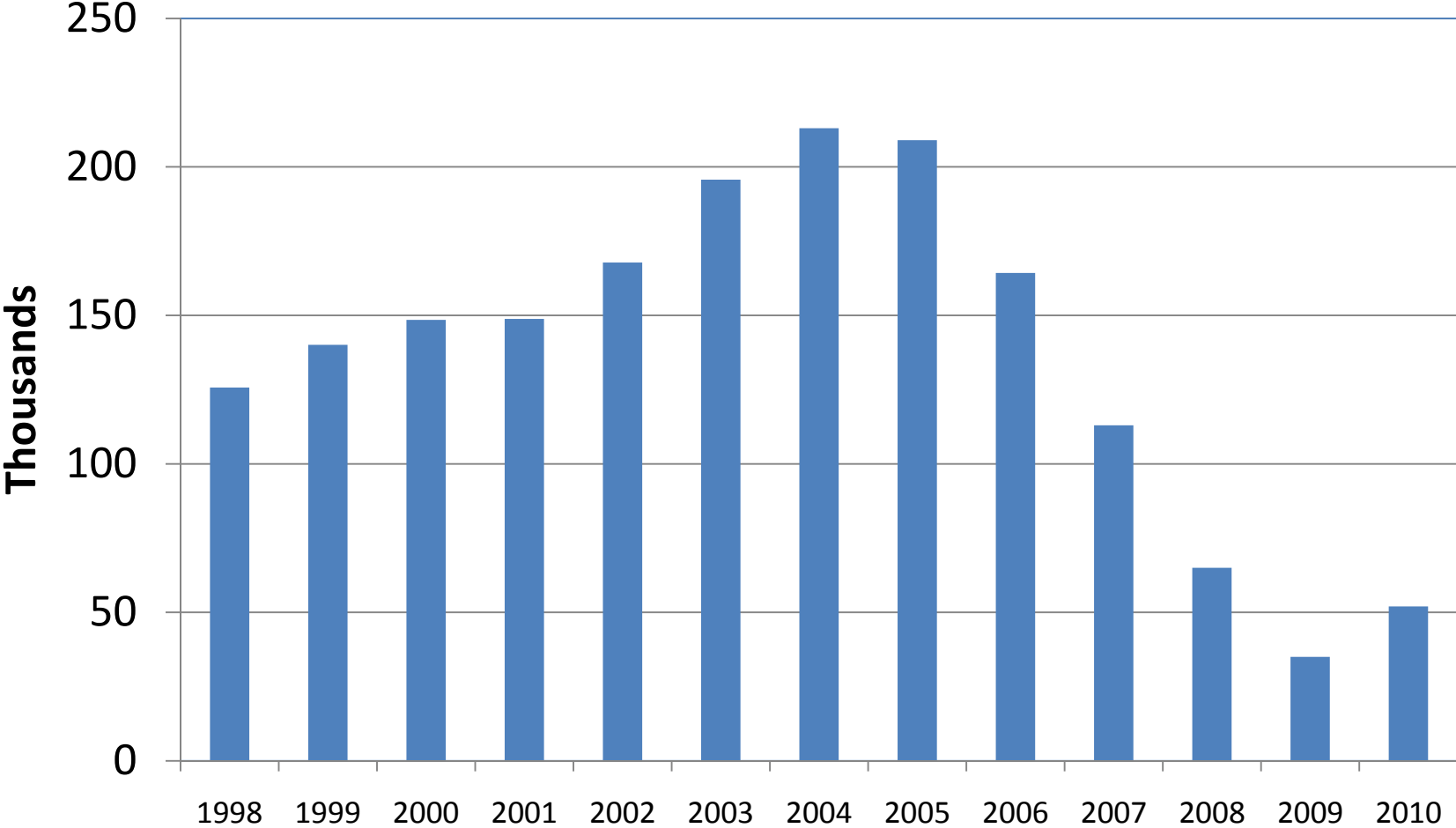
Unemployment Rates Surge Wiping Out the Decade's Job Gains



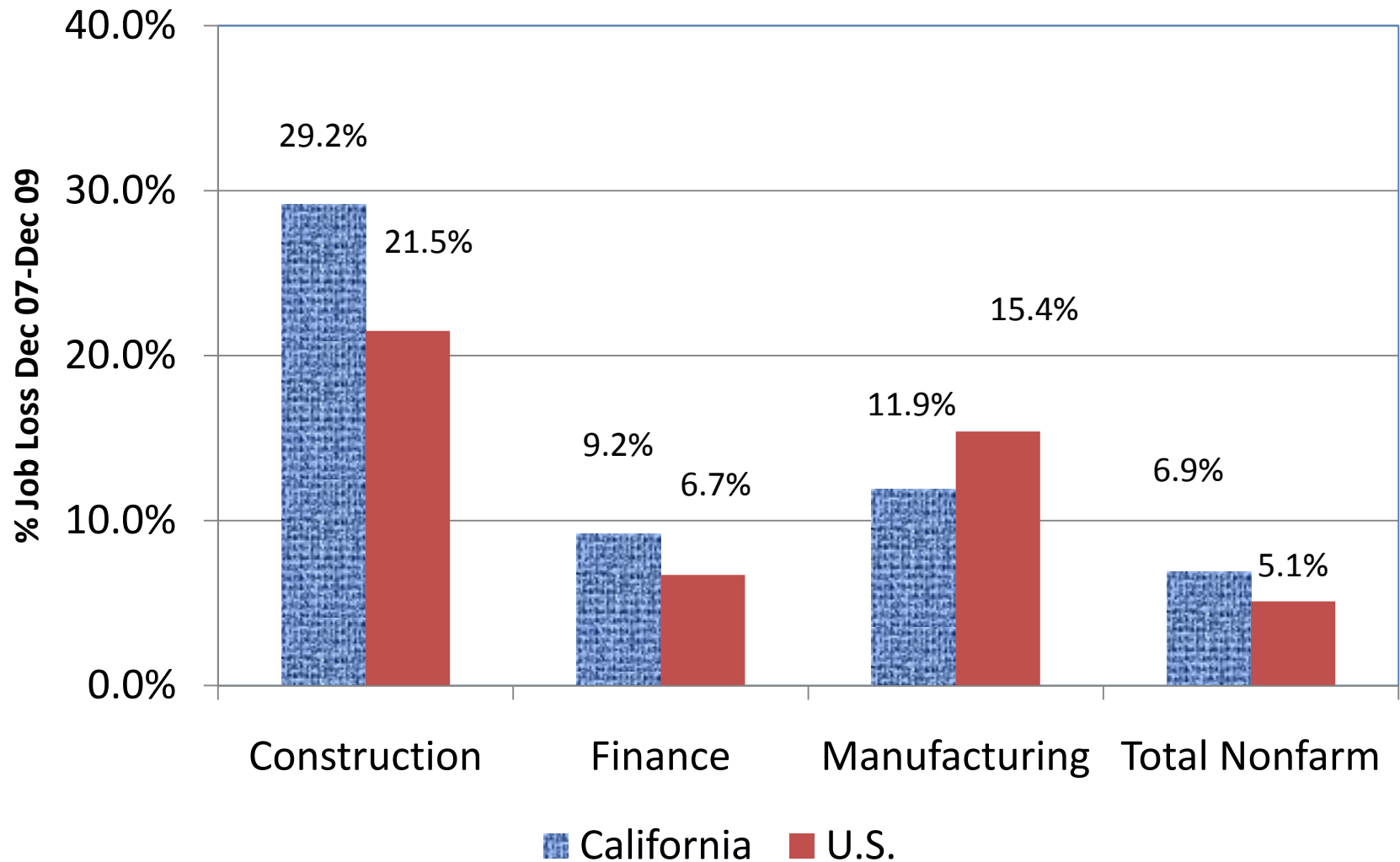
California Construction Spending



Residential Permits in California



CA Job Losses Driven by Construction Decline



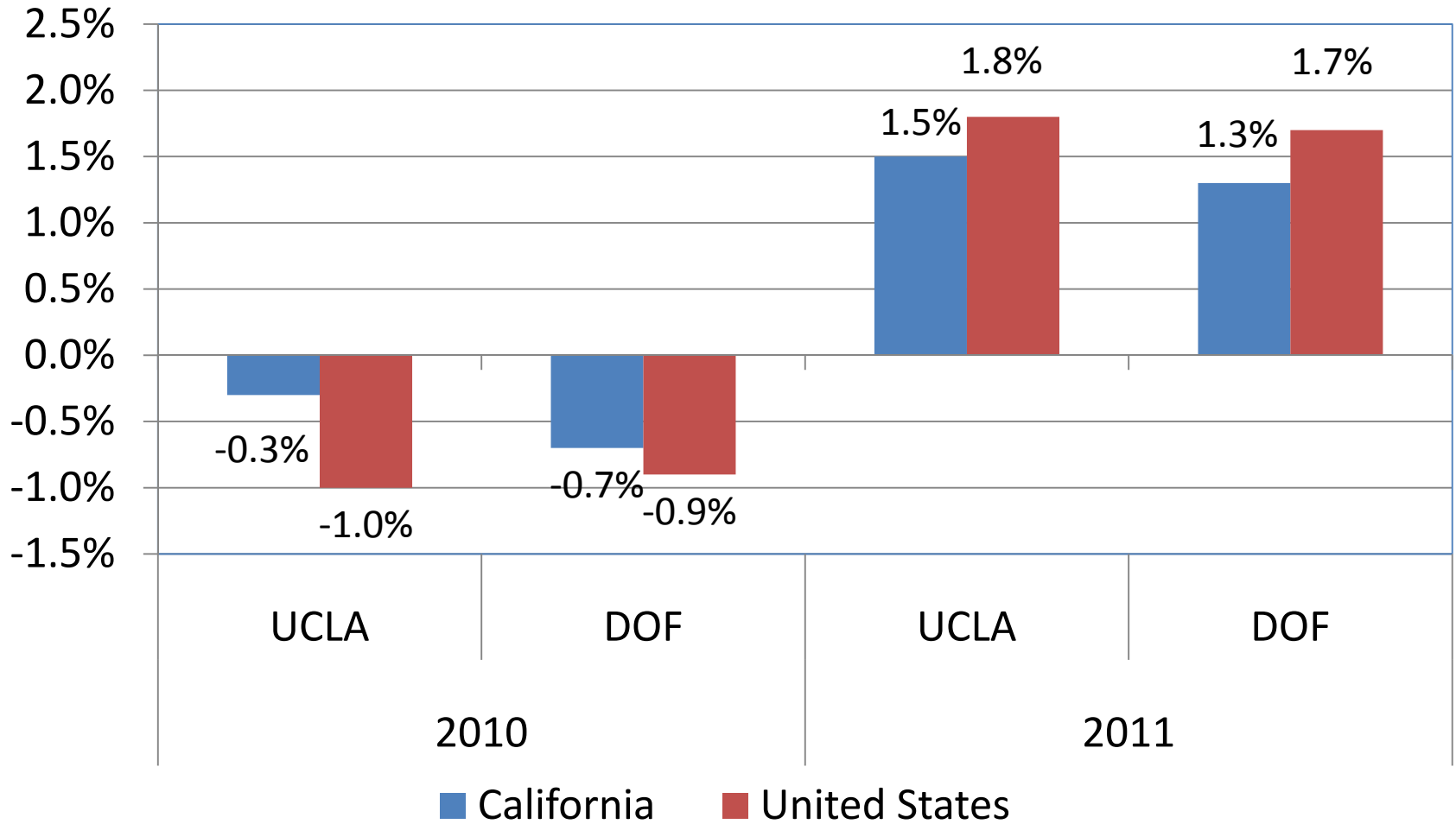
The California Outlook

- Broad consensus on slow recovery
- Pace depends on the nation's recovery
- Positives for CA—1) world recovery, 2) allocation of federal funds; 3) VC recovery
- Negatives for CA—1) long delay for construction as we work off the large stock of homes, office and retail space; 2) gridlock— are we still a welcoming state?

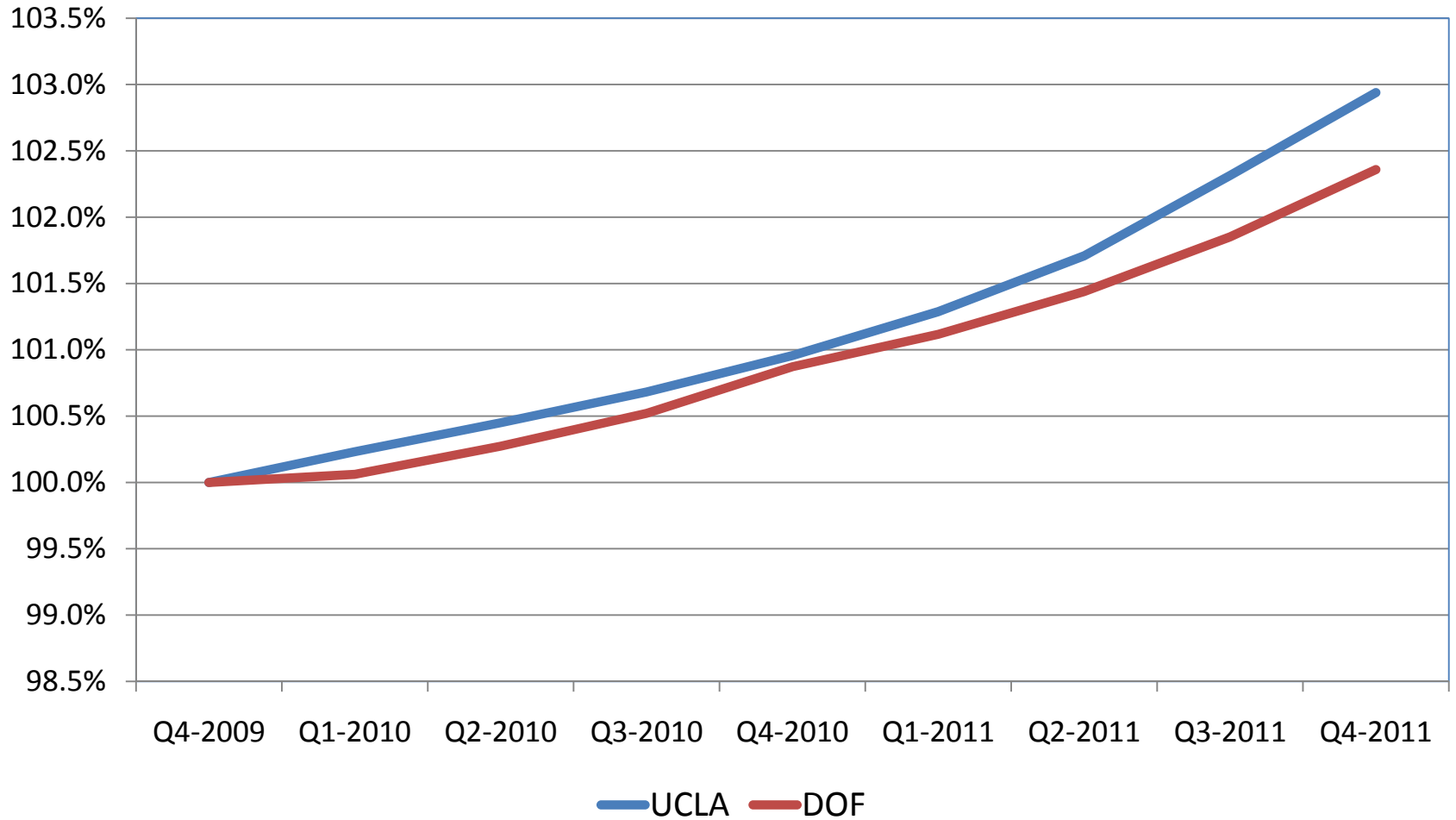
Let's Get the Arithmetic Right First

- Most forecasts for California show negative job growth and slow income growth in 2010 compared to 2009
- But that is on a year over year basis
- The same forecasts show growth starting in Q4-2009—but slower than in previous cycles
- California's question is the nation's question— if we are done with the recession, how soon and strong will the recovery be?

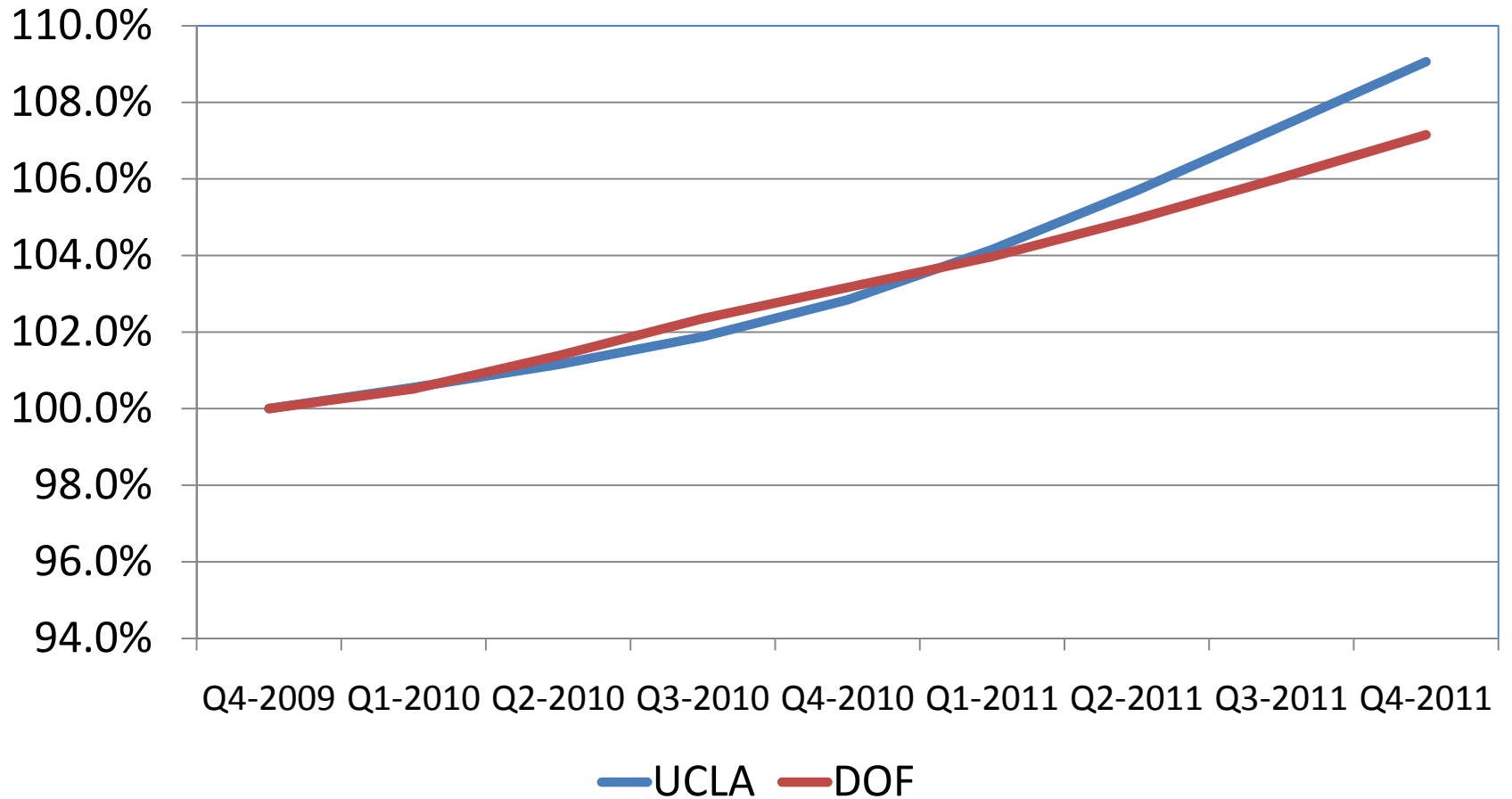
Nonfarm Job Growth



Job Growth in CA from Q4-2009



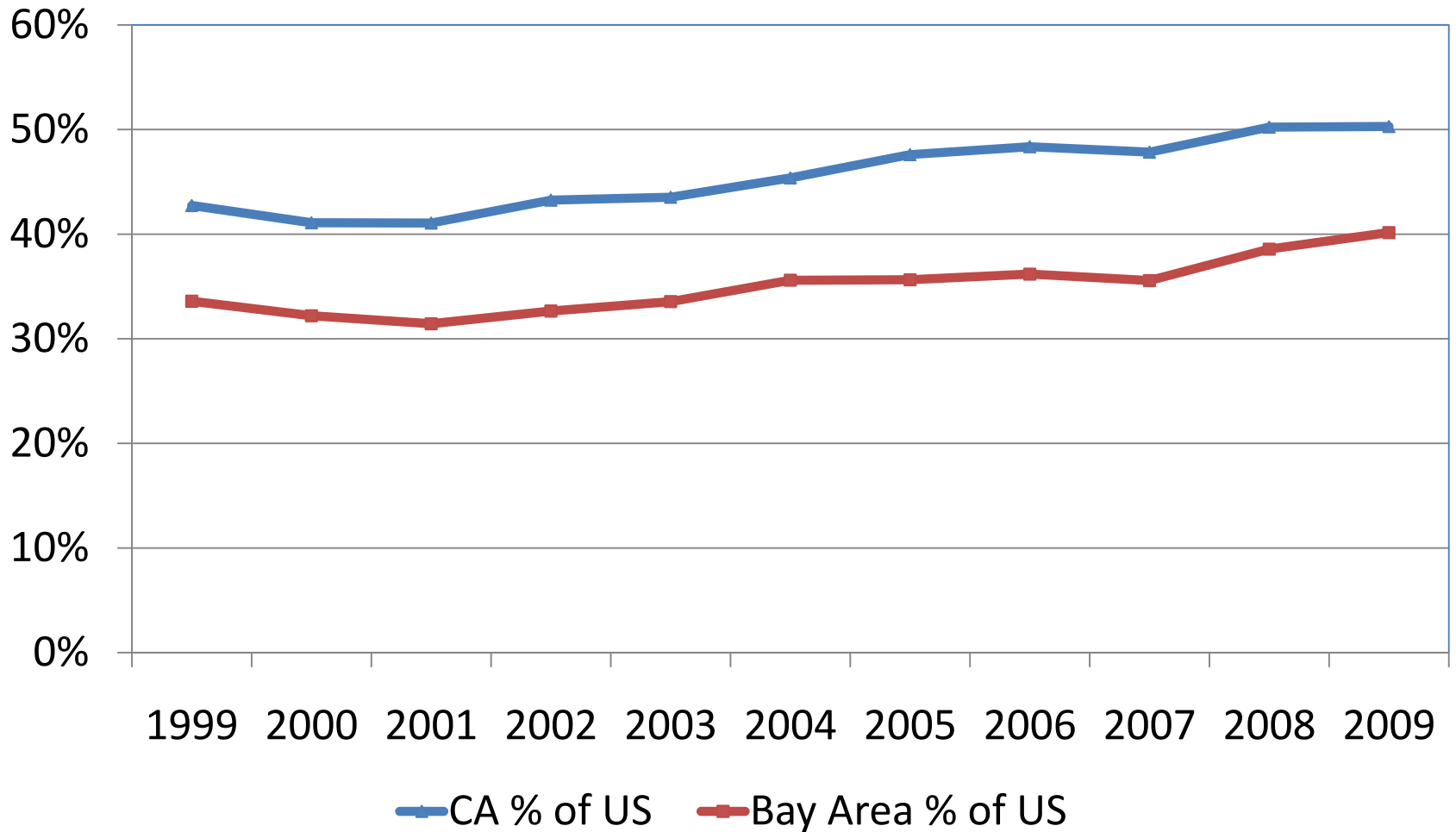
Income Growth From Q4-2009



The Positives in California

- The world economy is recovering—that means exports, tourism and investment dollars for CA
- Domestic capital spending is recovering—we sell technology embodied in capital goods
- The federal agenda favors investment in technology to address energy, health care and other issues. CA getting a high share of grants
- VC funding should rise in response to these opportunities
- CA offers creative talent—always in demand

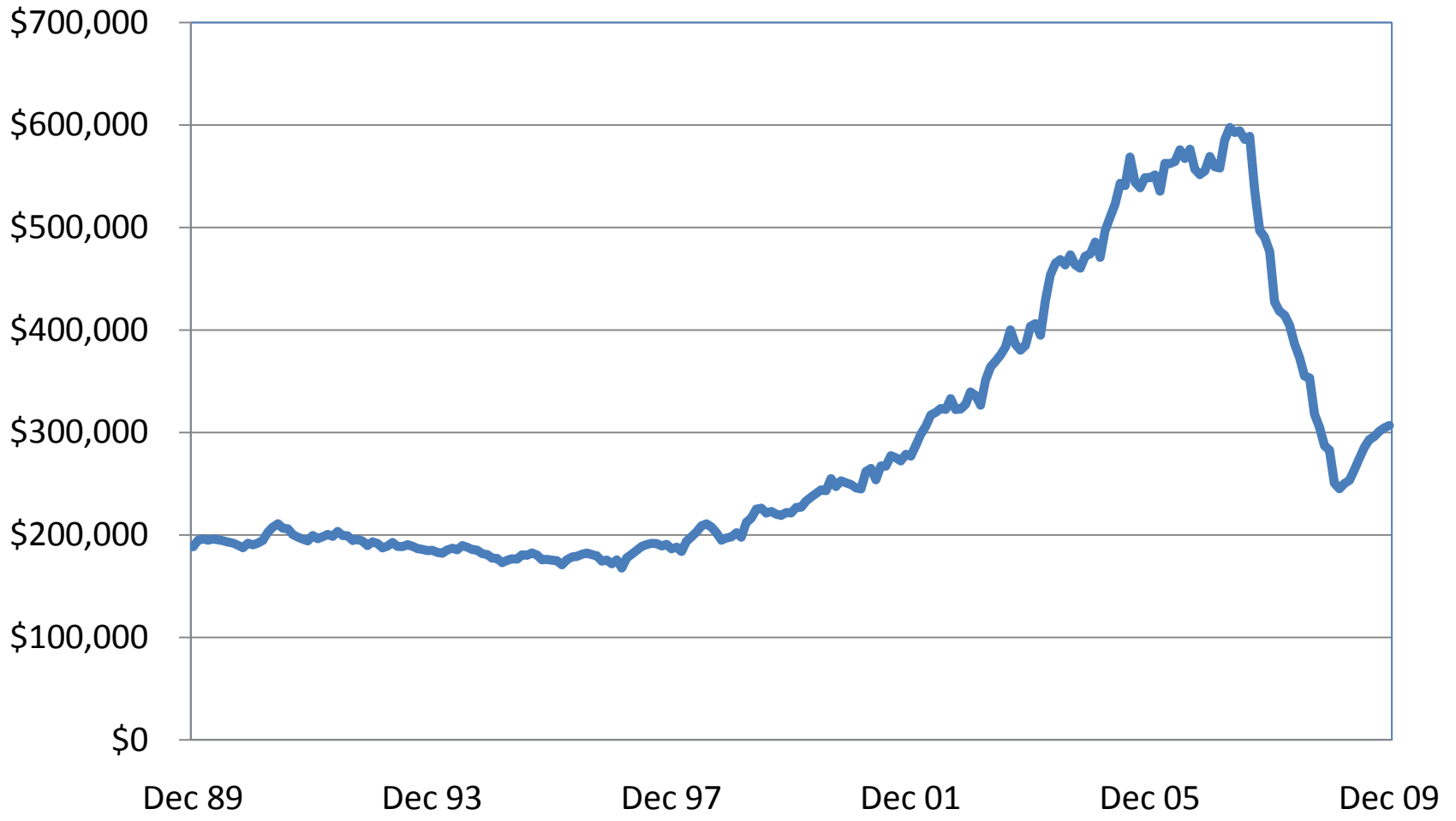
Share of U.S. Venture Capital



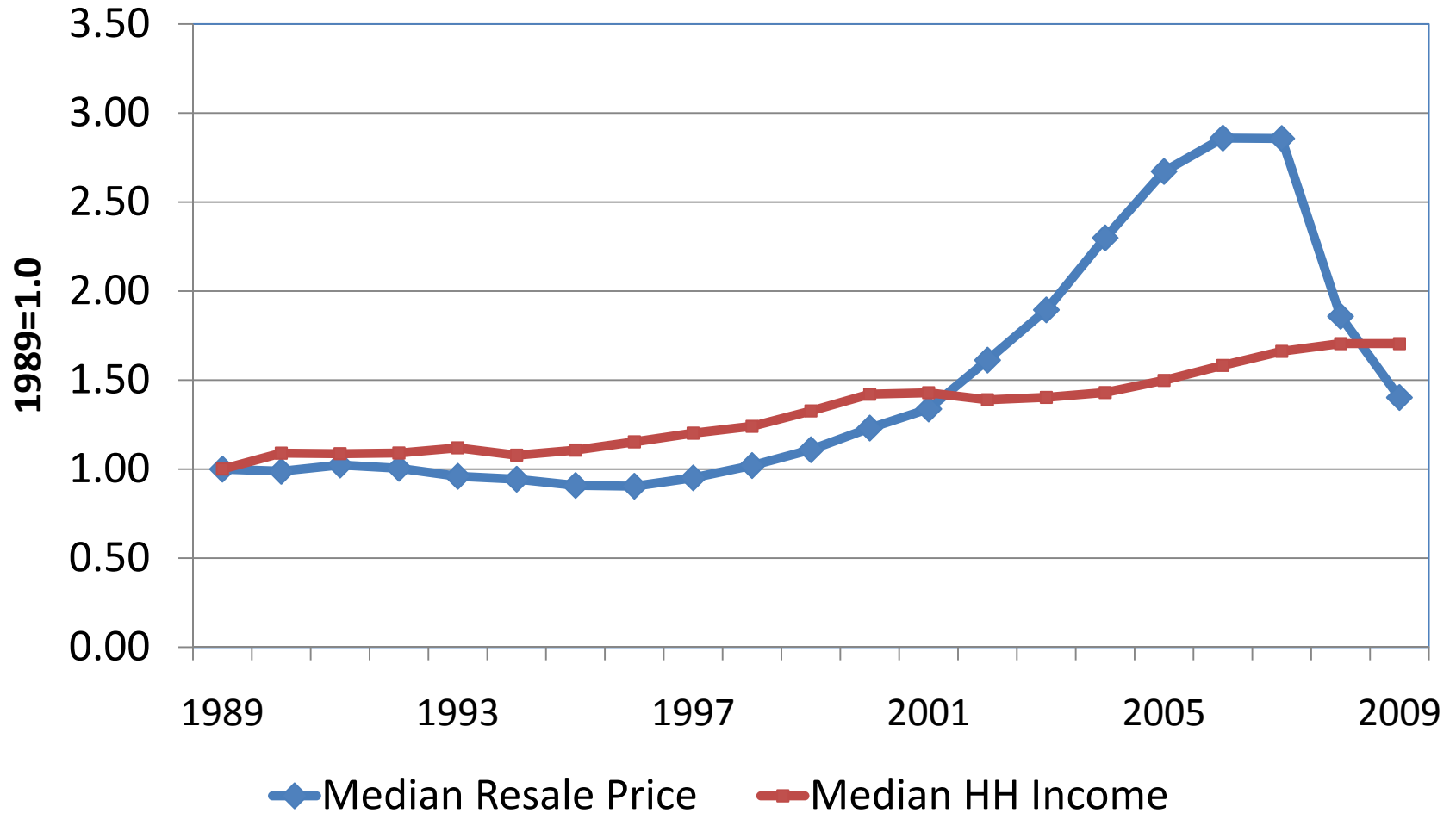
Negative Short Term Trends

- The desire of consumers to rebuild balance sheets—probably more to rebuild in CA
- The need to work through the inventory of distressed residential and commercial properties before new building can occur
- The contraction in state and local government employment
- The CA budget and policy gridlock

California Median Resale Home Price



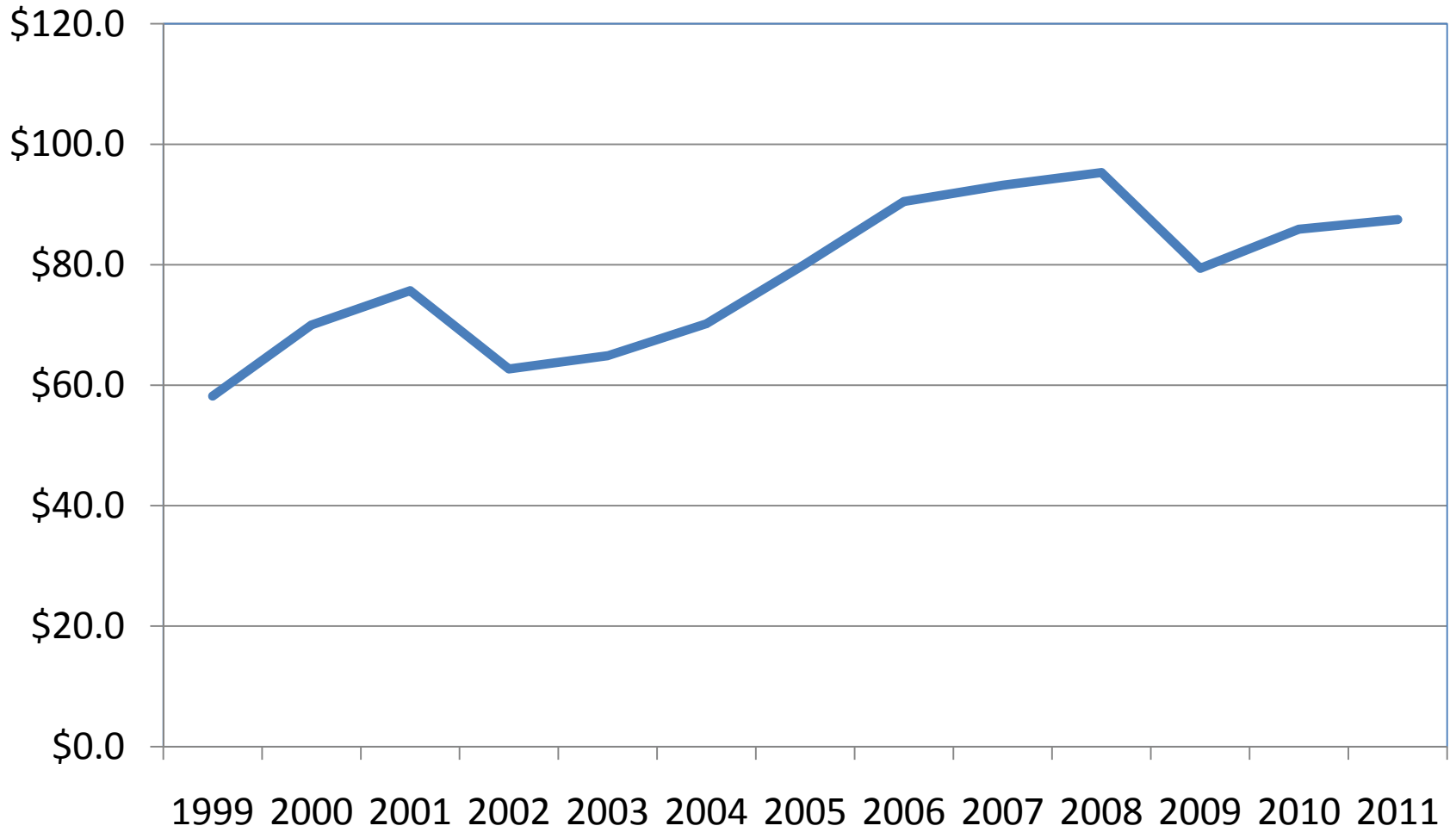
California Home Prices and Income



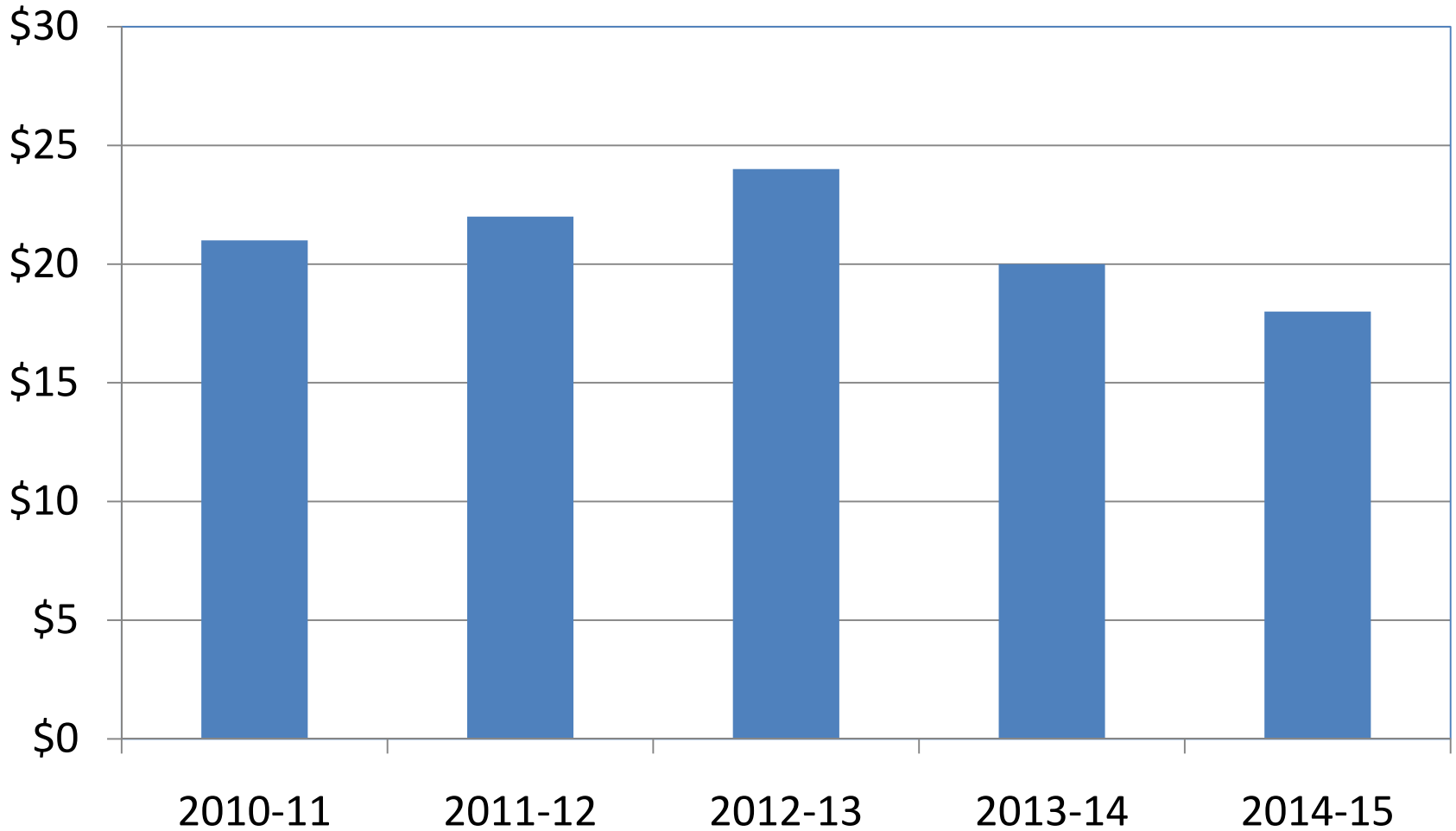
CA Budget and Economy

- Two budget problems—structural deficit from 2000 and deep recession
- In 2000 CA spent peak revenues on new spending and tax cuts—huge majority votes
- Unlike businesses, when government revenues fall, the number of customers rises
- We are in gridlock about how the budget affects the economy and what choices to make

General Fund Tax Revenue (\$Billions)



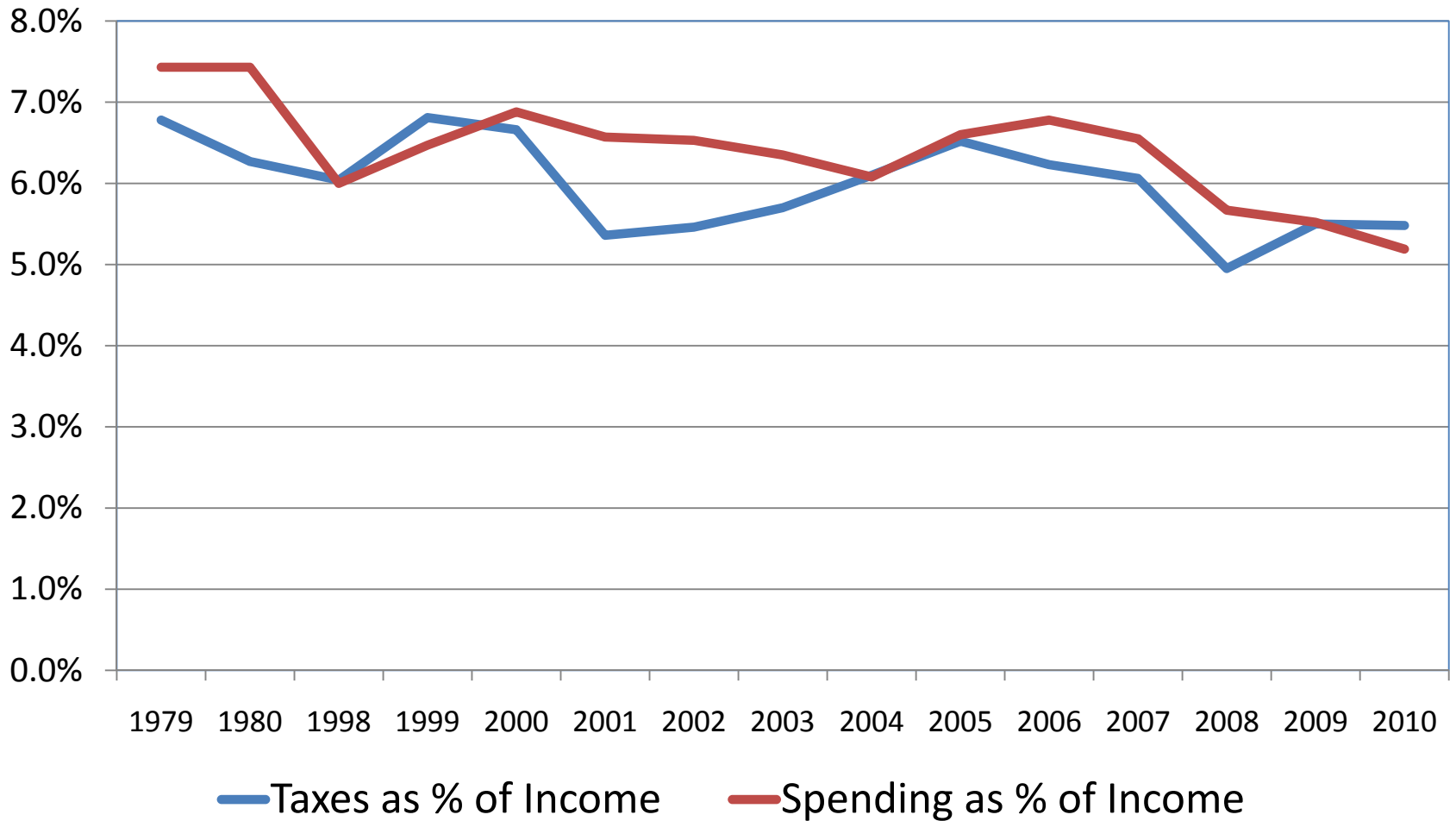
General Fund Shortfall (\$Billions)



General Fund Budget

- K-12 40%
- Higher Ed 10%
- Medi-Cal 15%
- Social Services 15%
- Corrections 10%
- Other 10%
- Retirement and Debt Service included in categories—approximately \$5 billion each

General Fund as % of Personal Income



Budget Choices and Issues

- The current revenue structure, even with economic recovery, does not support historical spending choices
- The situation will get tougher as rising retirement and debt service levels kick in
- Yet CA ranks 45th-50th in the number of teachers, librarians, and counselors in K-12, is turning students away from colleges and plans large new infrastructure investments

Thoughts to Ponder from Jan 27

- Tom Friedman—Adults Only, Please “We badly need leaders inspired by sustainable values, not situational ones. Without that we’ll just be digging our hole deeper and making the reckoning that much more ferocious”
- Barack Obama—“As hard as it may be....it’s time to get serious about fixing the problems that are hampering our growth”

Budget Choices and Issues

- We give legislators a mixed message—don't cut spending, don't raise taxes and then get mad at them when they say “Got it!!”.
- So what kind of budget do we want for our state, our economy and our children?
- How do we connect to our future and resolve gridlock?
- The story of LA voters amidst recession—what is the lesson?