



LEGISLATIVE ANALYST'S OFFICE

Economic and Revenue Developments

Tax Revenues Up In May

In this UPDATE, we summarize the economic and revenue changes in the May Revision to the Governor's 1995-96 budget proposal, and discuss developments that have occurred since the release of the updated spending plan. In summary:

- *The May Revision contains minor changes to the administration's economic and revenue forecast; it continues to assume modest economic and revenue growth.*
- *State General Fund revenues were up \$234 million in May from the newly-revised forecast; about \$150 million of that gain appears to be permanent.*
- *Much of the revenue gain is due to withholding and sales tax payments, which is encouraging since these payments are indicators of current economic activity.*
- *June will be a pivotal revenue month, with over \$4.9 billion in projected receipts. Its performance will help to clarify the underlying revenue trend.*

Look Inside!



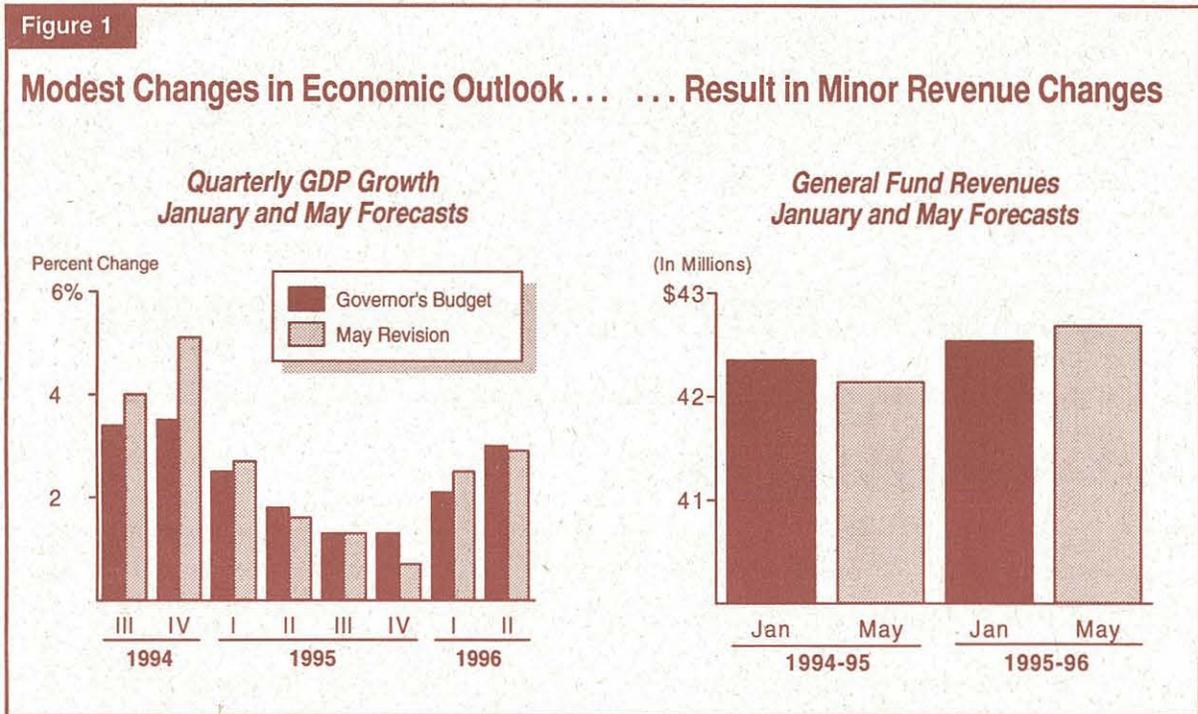
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Figure 1

Modest Changes in Economic Outlook Result in Minor Revenue Changes



Background

Minor Economic and Revenue Changes in May Revision

The May Revision to the Governor's budget proposal, released on May 22, continues to assume that the nation and California will grow slowly in 1995 before accelerating in 1996. As indicated in Figure 1, the widely-reported slowdown in the U.S. gross domestic product (GDP) in early 1995 had already been built into the Administration's January projections. As a result, the May forecast contains only modest revisions to the national eco-

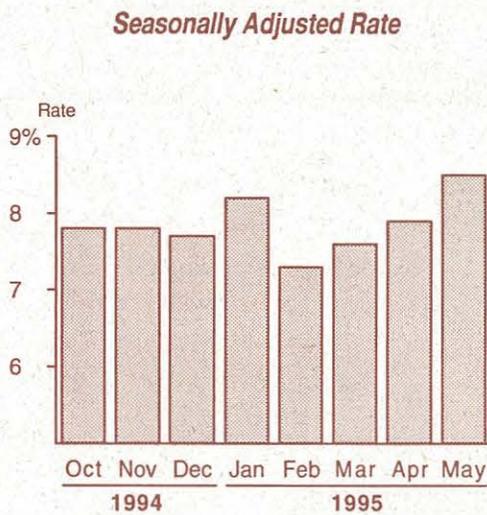
nomical forecast, and similarly minor changes to the California economic and revenue outlooks. The May Revision forecast of revenues for the 1994-95 and 1995-96 fiscal years combined is down just \$64 million from January.

Economic Developments

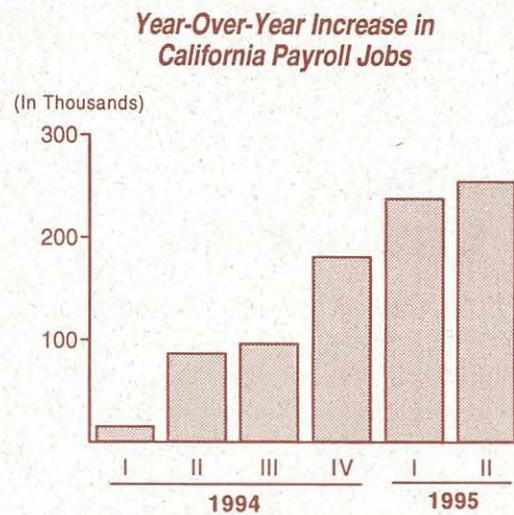
Reports on the California economy that have become available since the release of the May Revision continue to point to modest economic growth, consistent with the Administration's forecast. While the California unemployment rate increased from 7.9 percent in April to 8.5 percent in May, the

Figure 2

Unemployment Rate Rising ...



... But New Jobs Also Increasing



U.S. Bureau of Labor Statistics cautioned that the rate is subject to considerable fluctuation at this time of year because of seasonal factors.

Payroll Jobs Growing

A separate and more reliable survey of payroll jobs shows that wage and salary employment continued to grow during May. Moreover, recent historical revisions have significantly raised the job totals from late last year onward. On June 5, the Department of Finance issued updated benchmark estimates of wage and salary employment for the fourth quarter of 1994. The benchmark shows 101,000 more jobs as of December 1994 than

earlier survey-based estimates had indicated. As a result of these revisions and continued growth in early 1995, wage and salary employment is now up by more than 250,000 jobs from the prior year (see Figure 2). Significant job gains have been experienced in several industries, including motion pictures, business services, retail trade, transportation, and a variety of tourism-related sectors.

Housing Remains Weak

On a less positive note, the real estate markets remained soft in the early spring with home sales and new construction near historic lows in April. A major question for the economic and revenue outlook is whether the

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recent drop in long term interest rates will stimulate mortgage activity in the months ahead. Failure of the real estate markets to experience some rebound could have significant negative implications for California's overall economy and for state General Fund revenues over the next year.

May Revenue Performance Positive

Figure 3 shows that General Fund revenues were up \$234 million in May, reflecting gains from each of the state's three major taxes (personal income, sales, and bank and corporation). Sales taxes experienced the largest gain—up \$101 million.

About \$80 million of the \$85 million corporation tax gain is related to an audit assessment, of which about \$50 million had been expected in June. In addition, about \$40 million of the \$59 million gain in personal income tax receipts is related to a temporary misallocation of receipts between the withholding and unemployment insurance funds. After adjusting for these two factors, about \$150 million of the May revenue gain appears to be permanent.

Most of the ongoing revenue gain is due to higher personal income tax withholding and sales taxes. The increases are positive be-

cause these payments are good indicators of current economic as well as underlying revenue trends.

Figure 3

Revenues Up In May

(In Millions)

Revenue Source	May Revision	Actual	Difference
Personal Income	\$690	\$749	\$59
Sales and Use	1,827	1,928	101
Bank and Corporation	133	218	85
All Other	155	144	-11
Total	\$2,805	\$3,039	\$234

June An Important Revenue Month

While the May performance is encouraging, it is premature to conclude whether the gains are indicative of a higher underlying revenue trend. In this regard, June will be an extremely important revenue month. It is the second largest revenue month of the year, with over \$4.9 billion in projected receipts, and it is a major quarterly payment month for personal income and corporation tax filers. ♦

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