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# Fiscal Update

**May 7, 2020**

## The COVID-19 Pandemic and California's Budget Outlook

The COVID-19 pandemic has caused enormous hardship for families, businesses and governments across the world, the United States, and California. It has endangered health, stressed the health care system, and caused devastating losses in family and business income.

COVID-19 has caused a national recession, a precipitous decline in income, rapidly rising health and human services caseloads and substantial COVID-19 driven costs. This update reflects the Department of Finance's May Revision forecast, and underscores the necessity of further federal stimulus to help states and local governments support an effective response to COVID-19, a timely and fact-based modification of the stay-at-home order, and a safe, expedited economic recovery.

## California's Pre-Pandemic Budget and Economy

California began 2020 with a strong bill of financial health—a strong economy, historic reserves, and a structurally balanced budget.

- The unemployment rate (3.9 percent) was one-third of its Great Recession peak (12.3 percent).
- The "Wall of Debt" (past budgetary borrowing) was eliminated, and supplemental payments were made to retirement obligations.
- The 2020-21 Governor's budget reflected a $5.6 billion surplus.
- The budget reflected a record level of reserves: $21 billion in FY 2020-21, including $18 billion projected in the state's Rainy Day Fund.
- Revenues through March ran $1.35 billion above January's projections, as markets outperformed the budget forecast.

## COVID-19 Recession

The rapid onset of the COVID-19 pandemic has had an immediate and severe impact on the global, national, and state economies. In California, COVID-19 has led to the following:

- In the last one-week reporting period, nearly 478,000 claims were filed in California for state and federal unemployment benefits. Since mid-March, more than 4.2 million claims have been filed.
- Job losses that have occurred disproportionately in the lower-wage sectors of the economy—amplifying the wage disparity that existed before the pandemic.
- Finance projects that the 2020 unemployment rate will be 18 percent, a much higher rate than during the Great Recession.

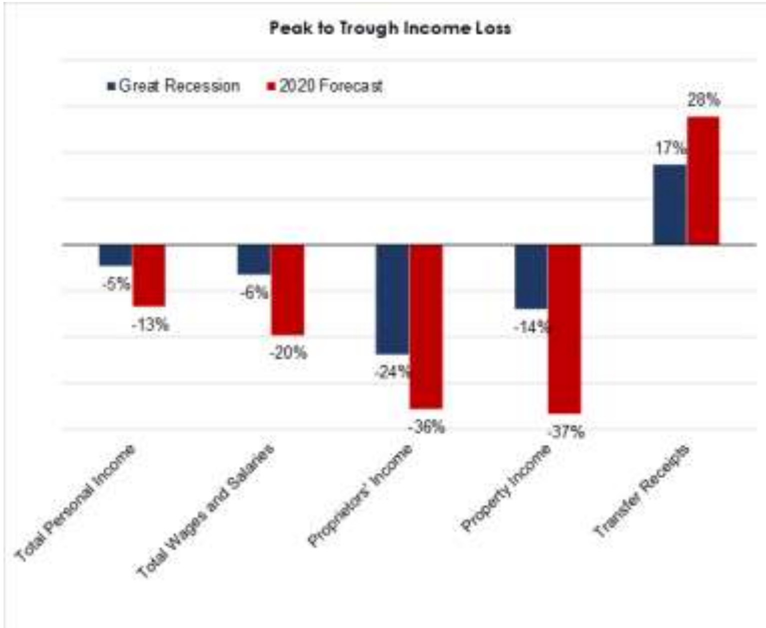
The May Revision economic forecast reflects that COVID-19 impacts will continue to cause economic losses in 2020:

- California personal income is projected to fall by nearly 9 percent on an annual basis in 2020.
- Permits for new housing construction, a key economic indicator, are forecast to drop by more than 21 percent this year.

## How This Compares To Past Downturns

The widespread economic interruption caused by the global pandemic is unprecedented in modern history. The chart below provides some perspective on how different components of personal income are projected to fall in 2020 compared to the Great Recession. Income from transfer payments, unemployment insurance, and other social safety net programs are projected to increase at a faster rate.

The May Revision forecast projects that the impact of these economic losses will be disproportionately borne by low- and middle-income Californians. This is particularly concerning as state median income did not return to the pre-Great Recession level until 2018.




## Impact on Revenues

Job losses and business closures will sharply reduce state revenues. Compared to the January forecast, the state's three main General Fund revenue sources are projected to drop for the 2020-21 fiscal year as follows:

- Personal Income Tax: -25.5 percent.
- Sales and Use Tax: -27.2 percent.
- Corporation Tax: -22.7 percent.

Specifically, Finance projects that General Fund revenues will decline by $41.2 billion below January projections, as follows:

- 2018-19: +$0.7 billion
- 2019-20: -$9.7 billion
- 2020-21: -$32.2 billion

Under Proposition 98's constitutional calculation, this revenue decline results in a lower required funding level by $18.3 billion General Fund for K-12 schools and community colleges.

**Large Budget Deficit, Plus Ongoing Structural Deficits, Are Projected**

The Revenue declines enumerated above ($41.2 billion), combined with $7.1 billion in caseload increases supporting health and human services programs, and other expenditures of approximately $6 billion (the majority in response to COVID) will result in an overall budget deficit of approximately $54.3 billion, of which $13.4 billion occurs in the current year and $40.9 billion is in the budget year.

- This overall deficit is equal to nearly 37 percent of General Fund spending authorized in the 2019 Budget Act.
- This is also nearly three and one half times the revised balance in the Rainy Day Fund ($16 billion).

While the COVID-19 Recession is causing an unprecedented loss of jobs and income, the projected deficit as a percent of General Fund spending is modestly smaller than the budget deficits faced by the state in 2003 and in 2009. This is due largely to the state's prudent fiscal management and strong economic recovery since 2011.

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Additional information regarding this fiscal outlook can be found in the associated PowerPoint presentation linked here:

http://www.dof.ca.gov/Budget/Historical_Budget_Publications/2020-21/documents/DOF_FISCAL_UPDATE_POWERPOINT-MAY-7th.pdf