School Services of California INC.
An Employee-Owned Company

COMMUNITY COLLEGE UPDATE

PUBLIC EDUCATION'S POINT OF REFERENCE FOR MAKING EDUCATED DECISIONS

Economic Resilience Persists Despite Inflation

BY JOHN GRAY

BY PATTI F. HERRERA, EDD

posted September 18, 2023

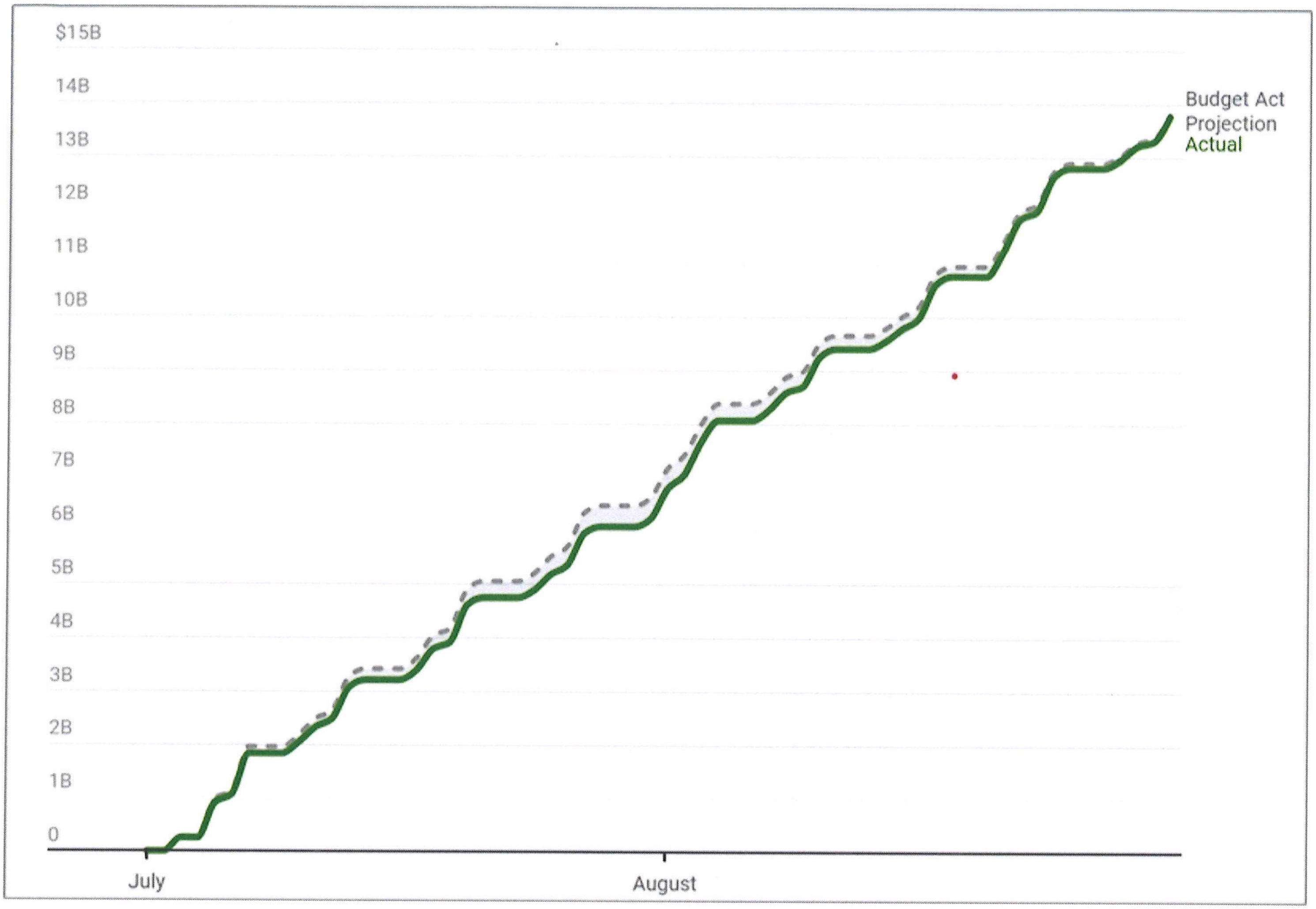
The latest national inflation numbers suggest that the economy is still challenged by rising costs, namely in fuel and shelter, as headline inflation jumped 0.6% in August (up from 0.2% in July) to an unadjusted annual rate of 3.7%. The more stable core inflation rate, which excludes food and energy costs, rose 4.3% annually. The good news is that the rate at which costs increase is abating largely in response to the monetary tightening policies of the Federal Reserve (Fed), which began aggressively increasing interest rates last year in an effort to tame consumer demand.

At its peak of tightening, the Fed raised the federal funds rate by 75 basis points (or 0.75%) four consecutive times in 2022 following more modest increases to address what the Fed then believed would be transient inflationary pressures. The historic pace with which borrowing costs were rising raised fears that the Fed would catapult the economy into a recession. And there were many indicators that began blinking red forewarning a downturn, including the most predictive measure of an impending recession in the inverted yield curve (see "Inverted Yield Curve Signals Looming Economic Downturn" and "Economy Gets Bad Signal" in the *Community College Update*).

The nation's productivity, while slowing, continues to be positive following two consecutive quarters of negative growth in the first half of 2022. By any measure, the economy is enjoying full employment, and the stock market continues to rebound from where it was a year ago.

For California, economic resilience is manifesting as stabilizing state revenues. Recent revenue data show that the state's revised forecast is more accurately reflecting trends. Where predictions were once off by billions of dollars, the forecast gap has narrowed. According to the Legislative Analyst's Office (LAO), income tax withholdings are tracking with 2023-24 Budget Act projections—performing even modestly better than expected.

2023-24 Income Tax Withholdings



Source: LAO

The LAO reports that the regular income tax withholding payments employers make for their employees was $367 million above budget act predictions in August, offsetting equivalent below-forecast performance in July. With the October 16 tax filing deadline for many Californians and corporations looming, the question is if revenues will continue to track accordingly. Recall that $42 billion of state revenues were projected to materialize in October—$28.4 billion in delayed personal income taxes and $13.3 billion in corporation taxes, respectively 23% and 32% of total anticipated revenues of the two taxes for the 2022-23 fiscal year.

State budget officials recognized the considerable risk the deferred tax deadline creates for the 2023-24 Enacted Budget, which of course impacts local planning. We are hopeful that the economy's resilience will be reflected in next month's state tax collections, and that economic stability will be the theme moving towards Governor Gavin Newsom's 2024-25 budget proposal in January.