
Stock Market Volatility Is A Factor In California's Budget, Report Says.

SAN FRANCISCO (Standard & Poor's) Jan. 25, 2016–It's budget time for California, a state that has always had an outsized reliance on capital gains tax receipts. But the stock market has been volatile lately, and history suggests that in a market correction, state revenues will follow stock prices lower, according to a report, "California Initiates Budget Process Amid Rising Stock Market Volatility," published today by Standard & Poor's Ratings Services.

"Similar to the equity markets, the broader economic recovery, now in its seventh year, has already outlasted most expansions," notes credit analyst Gabriel Petek. "Although Standard & Poor's forecasts another year of economic growth and modest stock market appreciation, we cannot rule out the possibility that financial markets and the economy have peaked."

California's recent success in shoring up its finances has come about not just from higher revenues brought about by an improved economy and a higher stock market, but notably from getting its spending under control.

Lawmakers in Sacramento are beginning budget negotiations with more open-ended discretion over general fund spending than they have had in years. "This gives rise to the potential that the state could ramp up its recurring spending commitments just as its revenue trends reach a plateau—or worse, begin to falter, thereby putting the state's fiscal alignment in jeopardy," notes Mr. Petek.

"In our view, the future direction of California's credit quality is closely linked to its ability to maintain balanced fiscal operations. Even without a recession, the escalating schedule for pension contributions and rapidly growing unfunded liability for retiree health care already account for an increasing share of future budget capacity. The stronger revenue performance and much-improved budgetary position of recent years therefore belie somewhat how fragile California's fiscal balance remains."

We have determined, based solely on the developments described herein, that no rating actions are currently warranted. Only a rating committee may determine a rating action and, as these developments were not viewed as material to the ratings, neither they nor this report were reviewed by a rating committee.

The report is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. If you are not a RatingsDirect subscriber, you may purchase a copy of the report by calling (1) 212-438-7280 or sending an e-mail to research_request@standardandpoors.com.

Ratings information can also be found on Standard & Poor's public Web site by using the Ratings search box located in the left column at www.standardandpoors.com. Members of the media may request a copy of this
report by contacting the media representative provided.

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