

JANUARY 20, 2026

Overview of the Governor's Budget

PRESENTED TO:

Assembly Committee on Budget
Hon. Jesse Gabriel, Chair



LEGISLATIVE ANALYST'S OFFICE

Governor's Budget

General Fund Condition Summary

(In Millions)

	2024-25 Revised	2025-26 Revised	2026-27 Proposed
Prior-year fund balance	\$52,872	\$55,951	\$53,451
Revenues and transfers	232,309	235,162	227,385
Expenditures	229,231	237,662	248,330
Ending Fund Balance	\$55,951	\$53,451	\$32,506
Encumbrances	\$27,998	\$27,998	\$27,998
SFEU balance	\$27,953	\$25,453	\$4,508
Reserves			
BSA	\$18,427	\$11,327	\$14,350
SFEU	27,953	25,453	4,508
Safety net	—	—	—
Total Reserves	\$46,380	\$36,780	\$18,858

SFEU = Special Fund for Economic Uncertainties and BSA = Budget Stabilization Account.

- These revenue estimates represent a \$42 billion upgrade to the June 2025 assumptions, yet the budget is only roughly balanced.
- There is a difference of \$20 billion between revenues and spending in 2026-27.



Budget Faces Two Serious Challenges

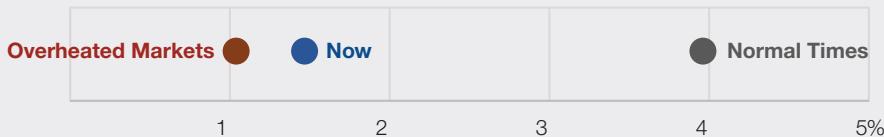
- **Downside Risk to Governor's Revenue Estimates.** Revenue upgrades have been fueled by AI exuberance and corresponding stock market gains. There are several signs that the stock market might be due for a downturn.

Signs the Stock Market May Be Due for a Downturn

Below, we compare stock market metrics from **right now** to **prior overheated markets that ended in crashes** and show that current conditions look a lot like prior overheated stock markets. The data is quarterly and covers 1952 to present. Growth in borrowing and stock ownership are changes from two years prior.

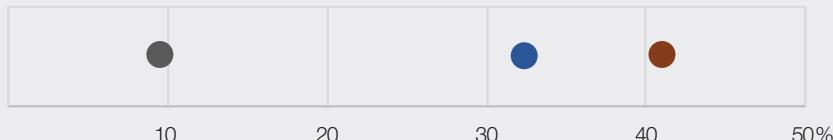
What Returns Are Investors Accepting to Hold Stocks?

When likely returns are low, it could mean investors are paying too much for stocks.



How Much Has Investor Borrowing to Buy Stocks Grown?

When borrowing grows quickly, it could mean prices are being propped up by debt.



How Much Have Households Increased Their Holdings of Stocks?

When households are highly invested in stocks, it could signal overoptimism.



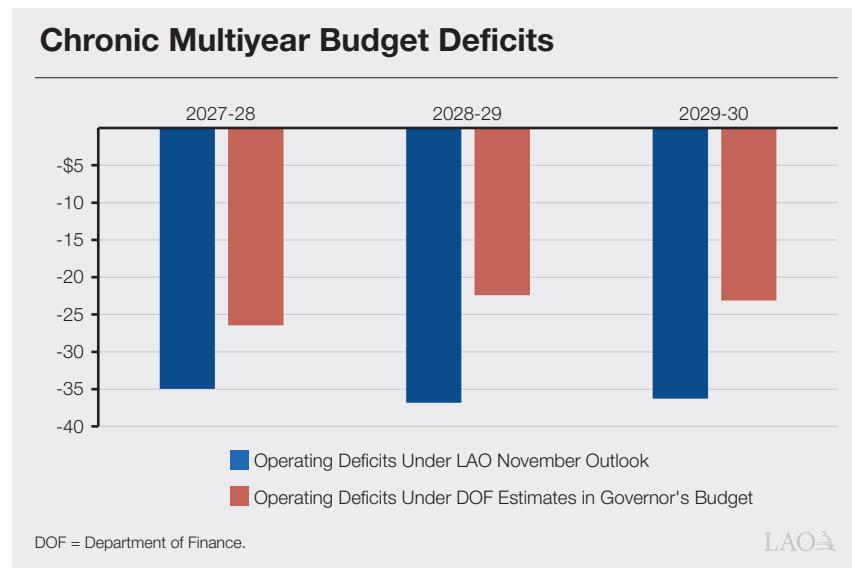
LAO



Budget Faces Two Serious Challenges

(Continued)

- **Chronic Multiyear Deficits.**



Why Are We Here?

Nearly four years ago—on the heels of the pandemic and two years of extraordinary revenue growth and historic surpluses—revenues fell sharply, posting double-digit declines. Since then, revenues resumed growing, even above historic averages, but not fast enough to catch up with the state’s spending level. As a result, deficits have transitioned from cyclical to structural.



Core Question: Do You Want to Take Action to Address These Risks?

- ***Governor Acknowledges These Challenges but Proposes No Material Actions to Address Them.*** The Governor and administration officials have acknowledged the downside risk to the state's revenue picture and the state's multiyear challenges. While the Governor's budget takes some limited actions to address these risks, we do not view these as materially improving the budget's resilience.
- ***Steps for Recognizing Revenue Risk and Addressing Structural Deficits.*** To address these challenges, we recommend the Legislature:
 - ***Acknowledge Downside Risk by Adopting LAO Revenue Outlook.***
 - ***Tackle Budget Problem.***
 - ***Shrink Multiyear Deficits.***



Why Not Wait...

...Until May?

- Beginning deliberation now would provide time for public scrutiny and legislative vetting.
- Delaying until May forces the Legislature to either accept solutions that have not received sufficient deliberation and public discussion or defer action even more.

...Until Next Year?

- Spending cuts and revenue increases involve increasingly more difficult choices as budget problems grow.
- Beginning work this year allows Legislature to take a more thoughtful approach.
- Implementing some reductions now gives time to ensure solutions are working as intended.

