# CALIFORNIA FORECAST

## SALES TAX TRENDS & ECONOMIC DRIVERS

*DECEMBER 2023*

*San Bernadino County*

HdL Companies

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HdL Companies

STATEWIDE
# SALES TAX TRENDS

TOTAL 2023/24 | 2024/25 -0.2% | 2.1%

**Overview:** Confounding some economy experts, consumer spending did not plunge in 2023. Even as product prices, consumer patterns and world influences vacillated through the post pandemic economy these past two years, HdL has consistently not forecasted a recession-based sales tax outlook. Recent trends show inflation has cooled, although not yet hit desired Federal Reserve targets. Interest rate hikes kept borrowing costs for homes, transportation, and equipment above 2022 levels. Financing costs are expected to begin a gradual descent in the back half of 2024. Households should stay on a path of placing greater spending priorities on essential items while deferring non-essential purchases when possible.

2023/24 | 2024/25

## Autos/Transportation -2.1% | 2.0%

Vehicle owners face the highest level of negative equity in over three years, a consequence of soaring prices and financing burdens that have created a precarious situation for recent buyers. Repossessions are on the rise as used car values plummet from their peak just a year ago, intensifying financial strain on shoppers, particularly those with suboptimal credit scores. Consequently, tax revenue from the auto-transportation sector is anticipated to dip slightly over the next three quarters. However, as the Federal Reserve gradually relaxes monetary policies in the upcoming year, there is expectancy of a resurgence powered by the release of significant pent-up demand that has accumulated since the onset of the pandemic.

## Building/Construction -0.8% | 3.5%

Cement and asphalt batch plant activity appears to be growing because of heightened infrastructure work around the state in addition to delayed repair projects related to last year's storms. Roofing supply houses and roofing contractors also saw large sales increases this fall. Lumber prices have plateaued, but most other commodity rates are still increasing. Big-box home improvement centers are drawing fewer customers as shoppers forego appliances and other big-ticket outlays. Recent mortgage interest rate declines did little to benefit new development but with rates expected to move toward their new base by the middle of 2024, new home and commercial development are expected to accelerate, sparking gradual growth in overall sales that stabilizes in fiscal year 2026-27.

## Business/Industry 2.3% | 2.2%

As predicted, results rose 3.7% over the year ago quarter – primarily driven by fulfillment center revenues. Accounting for nearly 30% of total revenues, fulfillment centers expanded as ecommerce leans into satisfying more orders from California-based warehouses (places of sale). Overall, the group posted mixed results. Gains by trailers/auto parts and energy/utilities were partially offset in reductions of other segments. Heavy and light industry faced inventory, pricing, labor and demand challenges that drove down returns significantly. Considering the influencing variables for these various sectors, HdL projects modest overall improvement for this diverse category. Given its unique composition, jurisdictional predictions vary based on the size and character of these companies within each community.

## Food/Drugs 0.1% | 2.0%

Grocery stores climbed 2.3% in 3Q23 from priced-based gains as inflationary pressures pushed up revenues despite smaller volumes. Convenience and drug stores saw weaker sales as consumers became price sensitive, diverting spending to retailers that are more affordable or offer better deals. Cannabis declined 3.3% as demand softened when compared to the spike during the pandemic. Further, competitive merchant pressure caused a significant drop in the price of cannabis products. Drug stores should experience shifting in brand loyalty as one of the major chains begins closing locations throughout the state. Nevertheless, food-drugs should rise modestly at 1% in the short term, gradually increasing to 2% in fiscal year 2024-25.

2023/24 | 2024/25

## Fuel/Service Stations -1.2% | 0.2%

Tax generators experienced a temporary spike in prices of regular, diesel, jet fuel and crude oil late in the third quarter and early fourth quarter of 2023. Given ongoing volatility across the globe, this surge mitigated a portion of the anticipated drop in associated sales tax in the third quarter (meaning revenues fell, but less than was forecast). In addition, future outcomes show a shallower reduction than the previously anticipated change for the fourth quarter of 2023. The forecast now reflects slower historical patterns of growth for the 2024 calendar year and long-term annual gains of 2% from fiscal years 2025-2026 through 2028-2029.

## General Consumer Goods -0.9% | 1.4%

The third quarter 2023 performance slightly outpaced our expectations but still sustained a mild contraction in tax payments. This was driven by tighter family budgets while previously mentioned headwinds permeated the economy in the form of elevated interest rates, diminished savings, and the anticipation of student loan debt payments resuming. Most recent readings of consumer confidence and sentiment reflect favorable expectations for general merchandise sellers. Many retailers have kept their guidance stagnant but strength remains in off-price concepts as consumers enjoy the treasure hunt experience. The outlook for the group remains soft with mild growth returning in the second half of 2024.

## Restaurants/Hotels 2.9% | 3.7%

Menu prices should continue to rise, but at a slower pace than last year. In 2Q24, AB 1228 takes effect, requiring new minimum wages for fast-food restaurants (defined as part of a national fast-food chain with sixty or more establishments in California). This law contributes to these rising prices; of note, a few major corporations already announced intent to pass costs along to patrons. Restaurants are strategically offering deals to entice consumers to keep eating out. Hotel room rates should flatten out, but not drop as vacancy levels remain steady. The one segment that is seeing decline is fine dining as guests opt for more price-conscious alternatives.

## State and County Pools -1.1% | 2.0%

Long-standing eccentricity in sales tax laws led to use taxes paid into county pools declining for the fourth consecutive quarter. Returns for many online merchants are up. More in-state fulfillment has diverted tax allocations away from pools and toward fulfillment center sites as noted in the Business-Industry group, however. Early holiday sales reports showed ecommerce trends produced greater shopper penetration as increases for the entire Cyber 5 period (Thanksgiving through Cyber Monday) rose at a faster pace than the same period of 2022. Acknowledging continuously changing tax distributions to local agencies along with more buy online, pick up in store activity, FY 2023-24 results fell slightly. Outer year's projections capture 2 to 3% per annum growth for pool-based revenues.

# NATIONAL AND STATEWIDE ECONOMIC DRIVERS

Beacon Economics

**2023/24 | 2024/25**

## U.S. Real GDP Growth — 2.5% | 1.9%

Real GDP growth in the third quarter of 2023 came in at 5.2%, a significant acceleration from 2.1% growth in the second quarter. Consumer spending and inventory investment largely drove rapid GDP growth in the third quarter. The U.S. consumer remains a powerhouse, constituting nearly 70% of all economic activity in the nation. Beacon Economics' forecast also calls for a slowing (not recession) of economic growth in 2024 from the current pace, seeing a different pattern of growth than the Fed. Beacon predicts that consumer demand may continue to keep inflation above the Fed's target. This, in turn, means the Fed may not loosen as they are predicting, leading to a more challenging environment for credit-sensitive parts of the economy. According to the GDPNow estimate from the Atlanta Fed, growth in the fourth quarter of 2023 could come in between 2% and 3%.

## CA Unemployment Rate — 4.7% | 5.0%

On a quarterly basis, employment has declined in each month going back to July. Similarly, the state's unemployment rate increased to 4.8% in October, up from 4.1% a year earlier. During the peak of California's labor market in July 2022, there were roughly 2 job openings for every unemployed worker. Since then however, the number of job openings and job seekers has converged. In September 2023, there were an estimated 911,000 job openings and 913,500 job seekers, yielding a ratio of 1.003. A ratio of 1 means there is 1 job opening for every unemployed person.

## CA Total Nonfarm Employment Growth — 1.9% | 0.7%

After 29 months of post-pandemic job growth dating back to April 2021, employment growth in California was flat in September and declined in October. California's total nonfarm employment has grown 17.9% since the trough of the pandemic; however, employment declined 0.2% year-over-year in October, the latest data available. Furthermore, on a quarterly basis, employment has declined in each month going back to July. The cooling labor market is a lagged response to interest rate hikes during the past year and a half. Additionally, employment growth in California is constrained by the state's high housing costs, which have contributed to significant net domestic migration losses.

**2023/24 | 2024/25**

## U.S. Unemployment Rate — 3.9% | 4.3%

Unemployment in the nation remains rock bottom with rates at 3.7% in November, and 3.7% overall in the third quarter of 2023. In October, there were 0.7 unemployed persons for every job opening, indicating a tight labor market, despite higher interest rates. The U.S. job openings rate was 5.3% in October, 2.1 percentage points lower than its peak of 7.4% in March 2022, but still higher than before the pandemic. Moreover, the labor force participation rate continues to increase, suggesting that rising income is having the expected effect of expanding labor supply, albeit at too slow of a pace.

## CA Residential Building Permits — 140,295 | 146,633

California's housing shortage is deep. By some estimates, the state was 3.5 million homes short of what it needed to accommodate its population in 2016. While the state has been building housing units at a rapid pace (about 450,000 units since the beginning of 2020 to the third quarter of 2023, according to the California Department of Finance), that pace of building will need to be sustained and/or accelerated over a decade or more to change the market. Additionally, the CDF's updated forecasts showing a flatlined population growth in California over the next several decades will also need to hold.

## CA Median Existing Home Price — $696,863 | $723,489

After nine months of year-over-year declines stretching back to October 2022, the median sale price for an existing single-family home in California returned to growth in July, rising 1.3%. Since then, price growth has accelerated, reaching 7.6% year-over-year in October 2023, the most recent month of data available. Currently, home prices are 38.5% above the pre-pandemic peak in February 2020, and 1.6% below the pandemic peak in March 2022. On a quarterly basis, Beacon Economics expects home prices to surpass the pandemic peak by mid 2024. The state's severe housing shortage is a major reason why prices have returned to growth even though sales are still declining. Existing homeowners who are reluctant to sell because they are "locked-in" to low mortgage rates are further exacerbating the housing shortage.

## Proposition 172

While Proposition 172 (the 1/2 cent tax rate designated for Public Safety) projections closely track with the statewide Bradley-Burns, calculations vary somewhat due to the state's allocation methodology. HdL projects an average statewide decrease of 0.52% for fiscal year 2023-24 and a 2.17% increase for fiscal year 2024-2025. Estimates capture the recent change in county allocation factors published by the State Controller's Office in August 2023. As Bradley-Burns countywide pool taxes diminish reflecting the shift to direct allocations for some internet-related sales, Proposition 172 pro-rata factors can swing considerably up or down for many counties.

**Watch our webinar for more info!**

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Delivering Insight, Revenue, and Efficiency to Local Government

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California's allocation data trails actual sales activity by three to six months. HdL compensates for the lack of current information by reviewing the latest reports, statistics and perspectives from fifty or more economists, analysts and trade associations to reach a consensus on probable trends for coming quarters. The forecast is used to help project revenues based on statewide formulas and for reference in tailoring sales tax estimates appropriate to each client's specific demographics, tax base and regional trends.

## Beacon Economics LLC

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Beacon Economics has proven to be one of the most thorough and accurate economic research/analytical forecasting firms in the country. Their evaluation of the key drivers impacting local economies and tax revenues provides additional perspective to HdL's quarterly consensus updates. The collaboration and sharing of information between Beacon and HdL helps both companies enhance the accuracy of the work that they perform for their respective clients.