CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

APRIL 2024

Sonoma, CA

HdL Companies

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STATEWIDE SALES TAX TRENDS

HdL Companies

2023/24 | 2024/25

TOTAL -1.1% | 2.0%

Overview: As 2024 unfolds, many of the same economic conditions remain in play, with varying effects on the overall outlook. Monitoring the Fed to gauge when interest rates will recede is a primary focus. Monthly unemployment trends and inflation results will determine how swiftly and significantly borrowing costs decrease. Results from the final quarter of 2023 confirmed a shift in consumer behavior, with people opting for essential household items over more expensive purchases. With the exception of Business/Industry and Restaurants/Hotels, all other groups saw negative comparisons to the fourth quarter of 2022. Consumer debt has soared while personal savings dwindle, suggesting only modest gains in the coming fiscal year.

2023/24 | 2024/25

Autos/Transportation — -3.6% | 2.0%

The pricing dynamics of new vehicles, particularly within electric and luxury segments, are adjusting following a period of significant inflation. Simultaneously, as dealership inventories stabilize, manufacturers are intensifying incentives, leading to reduced transactional values and impacting tax receipts. Dealerships are facing heightened competition and prevailing high lending rates, prompting potential buyers to exercise caution. Reports indicate a substantial tightening of credit conditions, affecting even creditworthy borrowers and contributing to a deceleration in market activity. Projections suggest a gradual market normalization through 2024, a modest resurgence anticipated in the latter half of the year driven by expected reductions in financing rates.

Building/Construction — -1.3% | 3.1%

Strong demand for repairs to address storm-damaged roofing bolstered the construction sector. Both material suppliers and roofing contractors reported a second consecutive quarter of new business leading to long wait lists. Contractors are optimistic about new project bids for infrastructure work funded by the Infrastructure Investment and Jobs Act, as they drive more business for asphalt and concrete batch plants. Conversely, home improvement centers and lumber retailers experienced declines. Mortgage rates are decreasing, but not enough to stimulate new construction. When the Fed indicates that conditions warrant a reversal of prior rate hikes, a swift response from this sector is anticipated. Expansion in statewide construction activity is projected for FY 2026-27.

Business/Industry — 0.5% | 1.7%

Following several years of expansion, this group experienced a 2.2% dip. Of the group's 21 different sectors, only six landed in positive territory. Fulfillment centers, accounting for 31% of total revenues, ended the quarter essentially even as ecommerce continued to fill more orders from warehouses based in California. The largest gain occurred in energy/utilities, driven by regional energy/solar projects. Most significantly, the medical/biotech sector contracted as equipment and supply needs tapered off. Both heavy and light industry faced inventory, pricing, and demand challenges, while sales in business-to-business and office equipment/IT slowed down. Considering the influencing variables for these various sectors, HdL projects limited growth for the current year followed by slow expansion in succeeding years.

Food/Drugs — -2.7% | 1.5%

Although inflation has softened, consumer spending at grocery stores declined 5% in Q4 of 2023. Shoppers, anticipating flat sales, pulled back on spending. Convenience-liquor stores experienced diminishing profits as younger adults turned to caffeinated non-alcoholic drinks. Cannabis retail sales saw a dismal 10% decrease as businesses and investors alike endure ongoing challenges from the illicit market. Furthermore, as one major drug store chain begins closing multiple locations across the state, consumers are turning to competitors or ecommerce. As this sector right-sizes through closures, mergers, and building consumer confidence, anticipate fewer taxes to be captured in the current year before gradually rising in the coming fiscal year.

2023/24 | 2024/25

Fuel/Service Stations — -2.6% | 1.4%

This sector experienced an overall reduction in the fourth quarter, primarily due to the initially skyrocketing, then plummeting prices of regular and diesel fuel. Oil barrel costs rose more than anticipated, which mitigated the overall reduction in sales tax. A normal historical pattern of prices at the pump, including a boost in the spring and summer months followed by a drop in late fall and early winter, is anticipated throughout calendar years 2024 and 2025. We forecast a minor overall increase in FY 2024 - 25 before returning to stable 2% growth in the outer years.

General Consumer Goods — -1.8% | 1.6%

Core retail categories fell short of expectations for the 2023 holiday quarter, leading to a contraction in direct local tax allocations across nearly all business types. This reinforces the anticipated pullback and tightening of family budgets. Recent CPI readings suggest that core goods prices are flat, so expect near-term results to be more influenced by changes in consumption rather than price. While borrowing costs remain elevated and access to cheap credit is now a thing of the past, the forecast lowered near-term expectations for the current fiscal year. The sooner the Fed implements rate cuts, the sooner consumers could feel some relief and return to purchasing beyond essential goods. The outlook expects mild growth in the 2024-25 fiscal year.

Restaurants/Hotels — 1.9% | 3.3%

Nationally, rising menu prices are reaching a tipping point where diners are opting to eat out less frequently. In California, this is worsened by the upcoming minimum wage hike for fast food restaurants, effective April 1. Savvy restaurateurs are strategically implementing increases to mitigate sticker shock while preparing for the rising operating costs. Meanwhile, other establishments have responded with significant, noticeable menu price surges, garnering attention nationwide. As consumers still desire to eat out and travel, they are making more cost-conscious decisions, resulting in slower growth.

State and County Pools — -0.4% | 2.0%

Ecommerce as a means of purchasing products remained strong. Online holiday spending across the country grew 5% when compared to the same period last year. More sales were made via mobile than desktop for the first time. Additionally, "buy now pay later" emerged as a popular alternative to credit card or cash usage; however, payment obligations rise in the spring and summer months. Year-to-date pool receipts declined in the first two quarters, affected by taxpayer filing changes and significant reductions in private party auto sales. Expansion of AI and voice search deployment along with improvements in personalized customer experiences through technology investments are expected to bolster future use taxes generated via online transactions. The slight downturn for FY 2023-24 should turn positive next year.

NATIONAL AND STATEWIDE
ECONOMIC DRIVERS

2023/24 | 2024/25

U.S. Real GDP Growth — 2.5% | 1.9%

Real GDP grew at an annual rate of 3.2% in 4Q2023, driven by increases in consumer spending, exports, and local and state government expenditures. Despite a decline in confidence, consumer spending rose a solid 2.6%, inflation adjusted, over the past year. Top categories for spending growth include recreational vehicles and goods (12%), new cars (4%), restaurants and hotels (4%) and recreational services (4%). The U.S. will almost certainly experience a reasonable pace of GDP growth in 2024, led by solid growth in consumer demand. Labor markets will remain tight, industrial production will be steady, and long run interest rates will likely stay in the same range. In many ways 2024 will resemble 2023 with a steady, moderately expanding economy. Strong consumer demand suggests inflation will be running hotter than the 2% pace that the Federal Reserve hopes to achieve.

CA Unemployment Rate — 5.2% | 5.4%

The unemployment rate in California has steadily increased since reaching a low of 3.8% in August 2022. In February 2024, unemployment reached 5.3%, marking a 0.8 percentage-point increase year-over-year, and a 0.1 percentage-point increase from the previous month. The state's unemployment rate remains elevated compared to the 3.9% rate in the United States overall. California continues to struggle with its labor supply, which fell by 6,900 in February. Since February 2020, the state's labor force has declined by 243,400 workers, a 1.2% decrease. This lack of growth can be attributed to the low number of housing permits issued in California; a workforce cannot grow if there is nowhere for workers to live.

CA Total Nonfarm Employment Growth — 0.8% | 0.7%

California's total nonfarm employment has grown 20.3% since the economic recovery from the pandemic began. As of February 2024, California had recovered all the jobs that were lost in March and April 2020, and there are now 294,100 more people employed in the state compared to pre-pandemic February 2020. Total nonfarm employment in California has grown 1.7% over this time compared to a 3.6% increase nationally. Job growth has experienced a drag as the labor force has declined in California. Given the sluggishness in labor force growth, the labor market in California is likely to continue cooling.

2023/24 | 2024/25

U.S. Unemployment Rate — 3.9% | 4.2%

Unemployment in the nation remains low despite a slight increase from 3.7% in January to 3.9% in February. In January, there were 1.44 job openings for every unemployed person, indicating a tight labor market, despite higher interest rates. The U.S. job openings rate was 5.3%; lower than its peak in March 2022, but still higher than before the pandemic. Tight labor markets will continue to push up real earnings, which grew at rate of 3.6% in 2023. The labor force participation rate remained steady at 62.5%, slightly below the 63.3% rate right before the pandemic began, which is surprising given the strong real earnings growth.

CA Residential Building Permits — 110,931 | 112,638

Excess demand for housing continues to be a significant issue in California. Although the number of residential permits in the state remains above pre-pandemic levels, there are concerns that the current level is insufficient to close the demand gap. Residential permits rose sharply after 2020 and this trend has persisted, reaching an all-time high at the end of 2023. In the fourth quarter of 2023, the number of residential permits increased slightly at a rate of 6.8% year-over-year. Given the recent easing of mortgage rates, residential permits will likely continue to expand, and a moderate increase in permits is expected in the near term.

CA Median Existing Home Price — $717,173| $762,767

Following the pandemic recession, the median price of a single-family home in California peaked at $837,600 in April 2022. That median declined steadily for nearly a year, reaching $693,800 in January 2023. Since then, price growth has accelerated, with the state's median price rising 11.3% year-over-year by February 2024. Currently, home prices are 38.9% above their pre-pandemic peak in February 2020, with a median price of $784,500. The state's severe housing shortage is the primary reason prices have exhibited robust growth despite high mortgage rates and declining sales. Existing homeowners are reluctant to sell because they are "locked-in" to low mortgage rates, 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 estimates an average statewide decrease of 1.1% for fiscal year 2023-24 and a modest 1.8% gain in 2024-2025. Current projections reflect the county allocation factors published by the SCO in late August 2023 (which should likely change in April 2024). Recent reductions in Bradley-Burns countywide pool allocations elevated direct allocation distributions for a portion of internet-related sales, thus, pro-rata factors are impacted for many counties.

Watch our webinar for more info!

HdL Companies

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.

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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.