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CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

JUNE 2023

Tuolumne County, CA

Delivering Revenue, Insight, and Efficiency to Local Government Since 1983

HdL provides relevant information and analyses on the economic forces affecting California's local government agencies. In addition, HdL's Revenue Enhancement and Economic Development Services help clients to maximize revenues.

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STATEWIDE SALES TAX TRENDS

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TOTAL 2022/23 | 2023/24: 2.2% | -0.7%

Overview: As of June 2023, the uncertainty of whether the nation will enter a recession continues to loom. Over the past year, the most significant trend observed has been strong employment numbers despite certain industry outlooks requiring a smaller workforce. The low unemployment rate has been a key driving force behind the Fed Funds 500% rate increase dating back to the summer of 2022. Yet, inflation lingers. Recent sales tax performance echoed more cautious behaviors by consumers, along with commodity prices fluctuating in multiple directions. Given the melting pot of economic indicators, our current outlook at this juncture is a modest decline in sales tax returns through CY 2023, with small levels of growth beginning in early 2024.

2022/23 | 2023/24

Autos/Transportation — 2.0% | -3.3%

Tax receipts associated with the automotive industry experienced a decline for the first time since the onset of the pandemic in early 2020. This drop can be attributed to hesitation from potential buyers purchasing a high-cost vehicle. Additionally, the increasing inventory of cars available on dealership lots has begun to exert pressure on prices. Though the average transaction price remained slightly higher YOY, it has finally dropped below the Manufacturer's Suggested Retail Price (MSRP) after several years of consumers being required to pay over sticker price. Simultaneously, the wholesale price of used cars has experienced a notable decline, indicating retail prices are likely to follow suit. There is an expectation that both used and new vehicles will become more readily available in the months ahead, leading to increased competition and subsequently exerted downward pressure on vehicle pricing through the remainder of CY 2023.

Building/Construction — 0.0% | -0.6%

Prior to the end of CY 2022, new home construction starts declined significantly, but other types of construction posted stable activity levels. In Q1 of 2023, four noteworthy trends were observed. First, adverse weather limited building activity which impacted painting, groundwork and foundation sets. Wet weather also decreased seasonal homeowner spending on yard improvements. Second, the value of lumber retail prices plummeted as much as 64% compared to a year ago as retailers finally sold off the pricier inventory. The direct result led to a big decrease in comparative sales totals. Third, pro builders started pulling back on new starts until the price of other construction inputs and financing rates rolled back to more profitable levels. Lastly, the fourth trend relates to the average consumer who is now purchasing fewer big-ticket items and scaling back on DIY projects. Expect returns from Q2 2023 to reflect contractors making up for delays. However, short term receipts are predicted to weaken due to the continuous decline of lumber prices and the pause in general construction taking place.

Business/Industry — 5.2% | 2.3%

In a down-shift, only nine of the twenty-one business types in this varied tax group trended positively for the quarter. Claiming almost 30% of all revenues, fulfillment centers continued expanding with more direct taxpayer allocations to agencies. Several regional energy projects bolstered electrical equipment revenues and large (non-auto) transportation equipment sales increased 33%. Technology needs and other B2B efforts buoyed business services outcomes. Conversely, garden-agricultural supply transactions slowed by 19%, likely attributed to financing challenges. After considerable growth during the pandemic, demand faded for medical biotech-related supplies/equipment. The heavy industrial sector also dipped, strained by the cost of capital and uncertainty. HdL projects modest overall growth, however, given the group's unique composition, predictions vary based on the size and character of local businesses and industry taxpayers.

2022/23 | 2023/24

Food/Drugs — 1.4% | 2.0%

Like other sectors, the impacts of higher pricing and shopping behavior yielded only a modest 0.3% bump in Q1 2023 payments. Higher tallies at grocery chains were offset by weaker returns from cannabis merchants and convenience stores. This segment is the most stable of all and is on track to produce an average of 2% gains in 2023 and the years to follow. Expect some contraction from areas of the state where stores are over concentrated. Additionally, expansion of merchant stores is anticipated where new communities are established and regional populations are on the rise.

Fuel/Service Stations — -0.5% | -9.5%

This category is now experiencing downward pressure in all facets. Regular gasoline, diesel, jet fuel, and West Texas Intermediate (WTI) oil barrel prices have all declined while consumption of fuel was lower in CY 2022 and in Q1 of 2023. WTI crude ended CY 2022 significantly below the Q4 2022 projection, with consumption remaining flat. CY 2023 projections are similarly reduced from what was presented in the March edition of HdL's *California Forecast*. As a result of these factors, our forecast now predicts an additional reduction of 10% per quarter through the end of CY 2023, followed by a flattening out in the first two quarters of 2024 and no growth for FY 2024-2025.

General Consumer Goods — 0.1% | -0.5%

Local tax receipts for Q1 2023 showed signs of retreat, contracting 1.9% compared to the same period YOY. As overall demand weakens, retailers appear to expect a slowdown, particularly in the discretionary and durable good categories. Consumer confidence and sentiment have both contributed toward a deceleration within this sector. Consequently, local tax has begun to emulate consumer trends. With excess savings drying up, access to credit becoming more stringent, and modest income gains taking place, households are becoming more prudent with their buying habits which has encouraged some customers to compromise on quality or switching to more affordable brands. Additionally, many consumers are now shifting to spending on services rather than tangible items. Our forecast shifts moderate declines slightly forward through the end of CY 2023 with growth returning in the spring of 2024.

While Proposition 172 (1/2 cent 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 increase of 1.7% for fiscal year 2022-23 and a .73% decrease for 2023-2024. As Bradley-Burns countywide pool allocations are reduced to reflect direct allocations for changes to internet-related sales, Proposition 172 pro-rata factors have shifted considerably for many counties.

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STATEWIDE
SALES TAX TRENDS

2022/23 | 2023/24

Restaurants/Hotels 8.1% | 3.5%

Since Q1 of 2022, the restaurant industry has experienced an increase of menu prices due to various inflationary impacts that have persisted to current day. However, the pace of growth in restaurant sales has slowed in recent months. Though consumers continue to dine out, they are looking for the best value deal and may opt for take-out instead of enjoying sit down establishments. Meanwhile, hotels are still awaiting a full return of international tourism. The slow return of travelers will offset any moderation in the tourism industry over the next few years. Leisure activities are expected to trend at a similar pace as the demand for experiences holds strong.

2022/23 | 2023/24

State and County Pools 0.6% | -0.3%

Patterns of online spending behaviors have held steady. However, with additions of in-state fulfillment centers delivering products to nearby local shoppers, less merchandise is received from out-of-state locations. This trend has resulted in fewer dollars available for distribution in the countywide pools. For the second consecutive quarter, comparative results have decreased. The business development strategy of housing products for local delivery destinations will boost local taxes for a limited number of jurisdictions which have these types of facilities. The tradeoff is expected reductions in available pool use taxes through the end of CY 2023.

Beacon Economics

NATIONAL AND STATEWIDE
ECONOMIC DRIVERS

2022/23 | 2023/24

U.S. Real GDP Growth 1.6% | 1.3%

Real GDP growth in Q1 of 2023 clocked in at 1.1%, a slowdown from the 2.6% growth in Q4 of 2022. Weaker GDP growth in Q1 was driven exclusively by a sharp reduction in inventories. The real growth in final demand, which is a more important measure than output and indicates the pace at which spending drives the economy, reached 3.5%. This growth rate is the highest since the first half of 2021. Moreover, consumer spending was the largest contributor to growth. The U.S. Bureau of Economic Analysis' monthly data on real consumer spending jumped to a record high level in April, suggesting continued consumer spending in Q2 and overall economic growth.

CA Unemployment Rate 4.2% | 4.4%

According to the latest figures from the Bureau of Labor Statistics, the ratio of unemployed persons to job openings in California is 0.9. In short, there are not enough workers to fill the number of job openings. This is because California's labor force contracted during the pandemic. As of Q1 in 2023, there were still 180,000 fewer workers in the state's labor force than there were prior to the pandemic, while the national labor force has expanded over the same period. These figures reveal a contradiction— the state's economy has added jobs since the pandemic, but there are fewer workers active in the California economy. The most plausible explanation is that there has been an increase in the number of workers holding more than one job among the state's workforce. Going forward, worker availability will be a primary constraint on job growth in the state.

CA Total Nonfarm Employment Growth 3.3% | 1.6%

In Q1 of 2023, California total nonfarm employment grew 2.8% YOY, a decrease from the 3.5% YOY growth seen in Q4 of 2022. Nonetheless, the latest monthly data from the Employment Development Department (EDD) showed that the Golden State added about 47,000 jobs in May, indicating a 2.4% increase from May 2022. Notably, California's nonfarm jobs gain during May amounted to 14% of the overall 339,000 jobs gained in the nation during the month. While California's economy has added more jobs relative to other states in the nation, this is mostly a function of its size (whereby a small percentage increase in job growth will translate into a relatively high number of jobs). Overall, California's job growth has still lagged other states, including Texas and Florida.

2022/23 | 2023/24

U.S. Unemployment Rate 3.5% | 3.6%

Unemployment in the nation at the start of 2023 remains rock bottom. In May, unemployment was 3.7% and 3.5% overall in Q1 of 2023 even as consumer spending continues despite inflation. In May, the numbers for job gains exceeded 300,000 and the participation rate continues to increase, suggesting that rising income is having the expected effect of expanding labor supply, though at too slow of a pace. The U.S. job openings rate, while down, is still higher than before the pandemic. However, supply is struggling to keep up with demand.

CA Residential Building Permits 129,553 | 132,703

After three consecutive quarters of double-digit declines, California home sales returned to moderate growth in Q1 of 2023. However, home sales are still down about 40% YOY as higher mortgage rates cool the housing market from its pandemic surge. Despite steep declines in home sale activity, there are only about 75,000 homes for sale in California (about two months of supply), according to recent Redfin data. In other words, if no new units were added to the housing market, based on current sales activity, the number of homes for sale would be exhausted in two months. A healthy housing market is typically considered to be one that has six months of supply. The long-term problem is that California does not build enough housing and the number of permits issued for new housing in the state remains far below historic levels. While California's economy continues to expand, its growth is increasingly constrained by the state's housing market with no apparent relief in sight.

CA Median Existing Home Price $655,154 | $631,186

California house prices have fallen to 10% below their pre-pandemic peak. Despite the pullback, house prices remain 27% above their pre-pandemic levels. Since the start of the pandemic, annual house price growth has averaged 11.3%, compared to 6.1% in the 10 years prior to the pandemic. Price depreciation will be somewhat limited in 2023 despite a high interest rate environment causing further weakness in home prices. Beacon Economics is forecasting house prices to fall 6.3% in 2023. Further house price drops will be limited, especially when compared to the Great Recession, due to consumer balance sheets being stronger today than they were then, unemployment rates remaining at all-time lows, and the acute housing shortage in the state.

Scan to view the *HdL California Consensus Forecast 1Q23* webinar recording. Email solutions@hdlcompanies.com to learn more.

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Growing Revenue

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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.