

CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

JUNE 2024



Big Sur, Central Coast



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Overview: From a macro perspective, economic variables are contributing in the short term to households paying close attention to essential needs while limiting discretionary purchases. Stubborn interest rate levels (for mortgages, financed purchases, credits cards) are a key component. Inflation remains a factor, elevating the price of many necessary items. Surges in insurance and utility expenses also contribute to limited discretionary spending, resulting in a soft outlook when closing out fiscal year 2023-24. Next year should see modest improvement across most tax generating groups. The Fed's approach to the funds rate along with consumer confidence trends will influence future spending patterns.

2023/24 | 2024/25

2023/24 | 2024/25



Autos/Transportation

-5.6% | -0.2%

While the number of auto units sold is still inching upwards, many consumers are delaying purchases, hoping for lower interest rates and better deals by year-end. Those buying now are selecting smaller, cheaper cars instead of the fully loaded models that were recently popular. Opting to find the best deal on a lease is becoming more attractive as manufacturers boost lease incentives for affordable monthly payments. This shift, however, defers sales tax revenue to the future, receipts coming monthly over the lease term. Overall, the auto market is normalizing, balancing out the previous years' revenue spikes but leading to moderate declines in tax revenue over the next three quarters.



Fuel/Service Stations

-2.7% | 1.0%

Many of the factors within this group, including gasoline, diesel fuel, and oil barrel prices are experiencing downward pressure compared to a year ago. Statewide consumption of motor vehicle fuel decreased in calendar years 2022 - 2023 and the first two months of 2024. The supply of fuel in California is up, helping to lower prices; however, recent legislation SBX1-2 established lower corporate margin standards thereby restricting the local refineries profits and reducing the incentive to produce fuel in California. This offsetting factor could elevate prices at the pump. Overall, our short-term forecast projects a bump in the second quarter of 2024, followed by overall slow growth in fiscal year 2024-2025.



Building/Construction

-1.3% | 2.7%

As roofing contractors worked through a backlog of repair orders, lumberyards that sell little else benefited from the demand for roof sheathing material and some fledgling subdivision starts. Infrastructure projects maintained steady demand for asphalt and concrete, boosting sales for some outlets by double-digits. Paint sales were flat as the market absorbed the loss of all Kelly Moore outlets. High interest rates continue to curb new development, and changes in net metering prices implemented a year ago are now slowing rooftop solar installations. Significant declines in all sales at home improvement centers also lowered results. Small initial rate cuts by the Feds may be enough to energize the construction market when those take place.



General Consumer Goods

-1.3% | 1.4%

The start of 2024 proved consumer resilience, bouncing back after a soft holiday quarter from direct sales tax allocations. Spending increased within the two largest segments: discount department stores and family apparel, guiding results up 0.5% to beat expectations. Increased foot traffic and customer transactions propelled off-price or value apparel chains to strong gains. Discount department stores rebounded, receiving a small boost from "pulled forward" demand and an extra shopping weekend in the January through March sales quarter. Overshadowing factors like high credit card rates, rising insurance premiums, and a softer labor market linger, putting pressure on household spending. In contrast, consumers have demonstrated over this past year the capacity to shop. The outlook for fiscal year 2024-25 remains modest, recapturing a portion of lost revenues in the current year.



Business/Industry

2.2% | 2.7%

Ecommerce flexed its muscles with a 5.3% increase in "local" online orders filled from CA-based fulfillment centers (places of sale) – comprising about 30% of total revenues. Large solar/energy, and AI technology projects spiked 1Q24 results, as did a bump in medical supply and biotech equipment sales. The industrial segments struggled as inventory, pricing, and demand challenges persisted. Farm/construction equipment sales also slumped in the face of interest rates staying above acceptable acquisition levels. Given the diversity of this tax group, growth reflects slow expansion. With its unique composition, predictions for B&I vary based on the size and character of local businesses and industry for each jurisdiction.



Restaurants/Hotels

2.1% | 3.3%

In response to rising prices, restaurant foot traffic has decelerated. Customers have become more discerning, opting to dine out less frequently. The surge in ingredient costs, labor expenses, and operational overheads has compressed profit margins for restaurants. Unfortunately, more restaurant chains are closing underperforming locations due to these challenges. Diners now prioritize value for their money, gravitating toward fast-casual establishments that offer affordable yet satisfying meals. Meanwhile, fine dining venues and leisure activities may experience a decrease in demand as tighter budgets prompt people to choose options that are more economical.



Food/Drugs

-1.8% | 0.8%

Grocery store revenues grew 2.8% as companies utilized more technology to service customers, and consumers turned to eGrocery to obtain products instead of walking into stores. Convenience-liquor stores experienced soft gains but face challenges from patrons seeking better prices at discount stores. Cannabis retail sales continue to slump with a -4.6% return this quarter as the sector pulled back on marketing. In addition, the closure of a major drug store chain has led to increased competition and affected pricing. As this category goes through a stabilization period, the current year anticipates a decline. Only a modest increase expected in fiscal year 2024-25.



State and County Pools

-0.8% | 2.0%

In the recent quarter, online sales rebounded 1.6%, reversing a five-quarter trend of negative comparisons. Economic data demonstrated consumers increasingly favor ecommerce due to convenience and product variety. Over the past year, Chinese based online marketplace operators and fashion retailers broadened this group's tax base while competing directly with more seasoned merchants. Beyond shopper preferences, strategic technology investments and buyer profile refinement should enhance ecommerce outcomes. Despite challenges, only modest pool shrinkage is anticipated this fiscal year followed by a return to limited expansion in 2025.



NATIONAL AND STATEWIDE ECONOMIC DRIVERS

2024/25 | 2025/26

2024/25 | 2025/26



U.S. Real GDP Growth

2.4% | 2.1%

Two years ago, the first recession concerns began, driven by the surge in inflation and sharp interest rates that quickly followed. Fortunately, a recession never materialized, and the U.S. economy has continued to expand at a steady pace. The nation's economy grew 2.9% in real terms from 1Q2023 to 1Q2024, despite the 10-year treasury jumping from 1.5% to 4.5% between 2022 to 2024. Growth in the second quarter is shaping up to 2%, forecast to continue in this steady 2-2.5% range for the year. In short, the U.S. is settling into a steady expansion, albeit a slow-growth due to sluggish expansion of labor supply.



U.S. Unemployment Rate

4.0% | 4.2%

While the Federal Reserve's higher interest rates in response to inflation did create a negative shock to the U.S. economy, evidenced by a collapse in real estate transactions, failed banks, and reduced borrowing activity, it's important to note that these effects did not significantly impact U.S. consumer spending. Durable goods sales are likely to flatten somewhat given higher consumer inventories, but services spending will likely make up for any weakness. Beacon Economics expects the U.S. unemployment rate to remain low, real wages to grow at a good pace, and industrial production to remain steady.



CA Unemployment Rate

5.4% | 5.1%

California's unemployment rate has continued to rise since its all-time low of 3.9% in the 3rd quarter of 2022. As of the 1Q2024, it stands at nearly 5.3%, while in the nation overall it has remained stable. California now has the highest unemployment rate in the United States. Given its large agricultural workforce, it is not atypical for the state's unemployment rate to be elevated, but this shift is unusual. U.S. Census Current Population Survey data reflects that the increase in unemployment is almost exclusively among young people and may be linked to the state's recent minimum wage hikes. The job openings rate in the state has cooled since 2022, but remains higher than at any time prior to the pandemic. Until labor force growth picks up, the pace of hiring will slow, keeping downward pressure on the unemployment rate in the near term.



CA Residential Building Permits

102,233 | 101,891

Residential permits continue to decline, down 9.9% YoY. This trend dates to the 2nd quarter of 2022. Only 9,189 single-family residential housing permits were approved in 1Q2024, the lowest level in ten years. Construction activity is expected to trend sideways, extending low housing supply in the state. Multifamily housing permits declined by 3.0% from their 1Q23 peak, but remain far above pre-pandemic levels. Multifamily permits are anticipated to remain at this level for the foreseeable future. This lack of further growth, paired with the steady decline in single-family housing permits puts downward pressure on housing affordability in the state in the short term. A housing market with a low inventory and sluggish new home construction will push prospective homeowners into the apartment market putting upward pressure on apartment rents.



CA Total Nonfarm Employment Growth

0.7% | 0.9%

California's labor market expanded during 1Q2024 adding 65,000 nonfarm payroll jobs over the previous quarter. Nonfarm employment has increased steadily for three years, and there are now 480,840 more employed in the state compared to the 1st quarter of 2022. Total nonfarm employment in California has grown 2.8% over this time compared to a 4.2% increase in the United States overall. California's labor force participation rate rose slightly YoY to nearly 62.1% in the 1st quarter of 2024 and appears to have settled at this level, remaining unchanged for three quarters. Labor force participation is of concern in the California labor market, as the labor force remains below pre-pandemic levels by 132,000 people. Growth in the labor force has been restricted by the ongoing housing shortage across the state. Absent a surge in housing supply, stagnant labor force expansion will cool the California labor market and restrict job growth.



CA Median Existing Home Price

\$737,092 | \$763,541

Existing home price growth in California shows no sign of slowing as inventories remain low. While decreases in early 2023 appeared to signal a reversal, the 1st quarter of 2024 saw the median price for an existing single-family home climb to \$715,909, representing a 9.6% YoY jump. High mortgage rates continue to negatively affect both buyers and sellers. The Federal Reserve recently announced that inflation is still above their target level, and they expect to cut interest rates only once this year. This cautious approach means that mortgage rates are likely to remain elevated, continuing to limit home inventory, Beacon Economics expects existing home prices to continue trending upward.

Proposition 172

The forecast projects statewide public safety revenues to decrease 1% for fiscal year 2023-24, rebounding with a modest 1.5% gain in fiscal year 2024-2025. Current county projections reflect updated pro-rata factors published by the SCO in April 2024. As the calendar year Bradley-Burns results fluctuate due to taxpayer modifications, audits, economic impacts, etc. - Proposition 172 pro-rata factors and resultant P-172 revenues also fluctuate for many counties. While the ½-cent Proposition 172 Statewide Public Safety revenue projections track with the statewide Bradley-Burns, county allocations will vary due to the State's allocation methodology.

Watch our webinar for more info!





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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.