CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

SEPTEMBER 2024

Sierra Nevada Mountains

HdL Companies

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STATEWIDE SALES TAX TRENDS

TOTAL 2024/25 | 2025/26: 0.3% | 2.7%

Overview: The September Federal Funds rate reduction was an economic signal that inflation is coming in near expectations while the labor market weakened over recent months. This action may spur some changes in consumer spending patterns, but overall does not translate into a short-term burst in sales taxes. As the important holiday shopping season approaches, expectations are that buyers will start outlays sooner. Some consumers are expected to spend less as stubborn inflated prices for household obligations (utilities, insurance, and food) take priority over procurement of non-essential and gift items. The current year's minute increase will not recapture the (-1.3%) FY 2023-24 statewide decline; thus, anticipate a slow rise in revenues over the next two years.

2024/25 | 2025/26

Autos/Transportation -0.4% | 3.5%

Tax receipts from vehicle sales continued to decline, normalizing after a period of unusually strong growth that peaked in 2022. Luxury vehicles have been hit hardest, driving a sharper drop in overall car sales. The industry remains burdened by elevated prices, high interest rates, and a challenging economic environment. While the stock market is once again nearing new all-time highs, the bond market has stabilized. Acknowledging that the Federal Reserve began cutting interest rates, recovery in the sector is likely to be gradual. Additional setbacks, such as a cyberattack on automobile dealerships that disrupted transactions during the critical two weeks before the July 4th holiday sales weekend, are expected to obscure any early signs of improvement.

Building/Construction -0.5% | 4.0%

Second quarter 2024 results reflected several changes that lowered sales. Big box home improvement stores saw a sharper downturn as homeowners continue to suspend big-ticket purchases. Lumber and roofing suppliers in some areas are losing sales volume as roofing and general construction projects appear to be slowing. The backlog of contracts to install residential rooftop solar projects following the change in the net metering fee structure two years ago is also winding down, cutting demand for materials. Infrastructure projects using concrete and asphalt products held steady, but some regions are sluggish. With interest rates falling in the short term, the construction industry does not expect this decline will be enough to prompt an uptick in activity.

Business/Industry 2.2% | 2.6%

Consumers continue to embrace the convenience of shopping online, with ecommerce sales rising and more "local" orders filled from CA-based fulfillment centers, comprising a stunning 30% of total B&I revenues. Solar/energy projects created significant gains in the recent quarter. However, medical-biotech, business-to-business, and heavy industrial sales remained relatively flat or declined as economic variables stunted potential growth. Farm/construction equipment, garden/agricultural supplies and IT-related office purchases were also sluggish. Given this group's diversity, growth rates reflect modest expansion. With twenty-one unique tax segments, predictions vary widely based on the size and character of local businesses.

Food/Drugs -0.6% | 1.5%

Grocery stores' profits rose 1.8% in 2Q24 as several businesses introduced new private label items to provide customers with a greater selection and find more value for their money. Convenience-liquor stores felt soft revenues and revealed fewer transactions on discretionary items such as liquor and snack foods. Cannabis returns had a sharp (-10.8%) decline as the price of cannabis products hit a low in the market. Further, closure of more drug stores throughout the state forced customers to shop at alternative retailers for their traditional drug stores merchandise. Last year finished -2.8%; anticipate the fiscal year 2024-25 to remain flat.

2024/25 | 2025/26

Fuel/Service Stations -3.9% | 2.0%

Most factors in this sector sustained downward pressure in 2Q24. Of note, the consumption of motor vehicle gasoline measured in gallons sold has declined 13% since the peak level in 2018. Crude and pump prices are dropping based on weaker demand in China and record levels of California fuel supplies on hand. OPEC is planning to hold current production cuts steady until the end of calendar year 2024. This has not offset impact as West Texas Intermediate barrel prices have dropped to the lowest levels since December 2021. Given these price contractions, our forecast reflects a significant reduction in the associated sales tax in the final two calendar quarters of 2024. Predictions for 2025 show a gradual boost in fuel related taxes.

General Consumer Goods -0.6% | 1.3%

Direct sales tax allocations contracted in the second quarter following a soft downward revision to first quarter data from general retailers. Through the first six months of 2024, general consumer goods declined (-1.2%) compared to the prior year. While consumers remain resilient in this space, broadening of online shopping behaviors and bigger in-state fulfillment shifted allocations to other sectors. Additionally, many segments experienced deflationary pressures resulting in lower sales tax, absent substantial demand expansion. Key indicators include elevated levels of non-discretionary spending, mild personal income gains, and the expectancy for households to attempt to rebuild savings; all of which keep pressure on consumer spending habits. The short-term outlook foresees a tightening in receipts throughout the remainder of the calendar year.

Restaurants/Hotels 1.7% | 3.5%

Menu price increases led to an obvious impact on consumer behavior as foot traffic to restaurants was down about 2.5%. The noticeable shift towards value offerings saw consumers showing resistance to high menu prices. Overall, while some eateries are struggling with fewer patrons, others are finding ways to attract customers by balancing price increases with value and experience. Hotels saw a slow but steady increase in occupancy rates while navigating cost pressures and changing consumer behaviors. Growth in both segments was offset by these persistent challenges.

State and County Pools 2.5% | 3.0%

The taxes remitted to the pools over the last fiscal year declined 1%. Of note, pools remain the largest tax generator of the eight categories highlighted in these forecast publications. Given the nuances in California sales tax law with more online orders processed at local stores or at in-state fulfillment centers, pool revenues softened slightly from the peak of fiscal year 2021-22. Mcommerce (shopping on mobile devices) continues to contribute to an expanding ecommerce portion of national retail sales, and spending by this means broke records during the first months of 2024. Modest pool gains are estimated, offering key opportunities for growth by retailers anchored to Gen Z consumer trends using digital commerce platforms.

NATIONAL AND STATEWIDE
ECONOMIC DRIVERS

2024/25 | 2025/26

U.S. Real GDP Growth 2.4% | 2.3%

Despite concerns over the last two years, the U.S. economy has performed well, averaging a 2.8% real growth rate over the past eight quarters. Propelled by consumer spending, business investment has bounced back even with higher interest rates. Further contributing to real GDP growth are expanding real exports, which hit a record high in the second quarter of the year despite the strong dollar. Modest signs of slowing are seen in the labor and housing markets. Inflation has finally cooled after two years of ongoing efforts from the Fed to a moderate 2.6% pace over the last 12 months. The FOMC followed through and cut interest rates by 50 basis points; the first interest rate cut in over four years. These falling rates will give the U.S. economy a boost in the short run but may increase risks for 2025.

CA Unemployment Rate 5.3% | 5.4%

No longer the national leader, California's unemployment rate has risen to 5.3%, now tied with Illinois for 3rd place. Despite the increase in unemployment from 4.8% to 5.3% over the past year, other labor market indicators such as initial claims for unemployment insurance and data on involuntary job separations have not increased. Although the state's unemployment rate is higher than in some states, its year-over-year change was nearly identical to the national average. As of July 2024, California had 1.6 unemployed persons per job opening, higher than the national average of 0.8. This marks a significant shift from the 0.9 average between January 2022 and January 2024.

CA Total Nonfarm Employment Growth 1.1% | 1.0%

California's labor market gained momentum in the second half of the year, with payrolls up 1.6% as of August 2024, compared to just 0.2% in 2023. There is little to suggest an end to the current expansion, now past the four-year mark, however California's long run growth will be limited by lack of housing. The Federal Reserve's recent 50-basis-point interest rate cut, typically reserved for economic distress, could stimulate California's labor market. The Fed does not foresee a recession in the near future.

2024/25 | 2025/26

U.S. Unemployment Rate 4.3% | 4.3%

The U.S. unemployment rate has risen nearly one percentage point over the last 18 months, with payroll employment numbers revised downward. These trends may be misleading, as involuntary separations and unemployment insurance claims have not increased. Historically, such unemployment rate increases occur during recessions, but this is a lagging indicator, and current economic output is not contracting. The ongoing expansion, now over four years, shows no signs of ending. U.S. households' financial health underpins short-term optimism. Despite a softer labor market, earnings growth outpaces inflation, with weekly earnings up 3.3% over the past year. Record household net worth and low debt burdens support continued spending growth.

CA Residential Building Permits 108,821 | 115,871

Since 2018, residential building permits in California have stagnated, deepening the state's housing crisis. In 2Q2024 the number of residential permits issued was down 8% year-over-year, the lowest since 2Q 2016. Despite growing demand, strict zoning laws, regulatory barriers, and high construction costs have limited new builds, driving up prices and making housing unaffordable for many residents. Recent Federal Reserve interest rate cuts may boost permits by lowering borrowing costs, encouraging more projects. Governor Newsom's new housing bills aim to address the scarcity, but it is uncertain whether they will significantly reduce home prices.

CA Median Existing Home Price $739,332 | $759,640

Housing affordability remains a challenge for California residents. High mortgage rates have increased costs for buyers and reduced the number of sellers. The recent downward trend in mortgage rates bodes well for housing market demand, as the average has declined 1.5 percentage points from its peak in October 2023 to 6.4% today. The 50-basis-point reduction in the federal funds rate might push these rates further, giving some homeowners the freedom to refinance and potentially increase listings. A significant drop in home prices is unlikely due to increased buyer interest. The core issue in the California housing market continues to be a lack of supply.

Proposition 172

Total fiscal year 2023-24 Proposition 172 (P-172) statewide revenues ended about 1% lower than the prior year. The forecast anticipates essentially flat results for the 2024-25 fiscal period, with moderate growth in 2025-26. As the calendar year Bradley-Burns results are impacted by taxpayer modifications, audits, economic impacts, etc. – Proposition 172 pro-rata factors and resultant P-172 revenues will fluctuate for many counties pursuant to the State's allocation methodology.

Watch our webinar for more info!

HdL Companies

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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.