

CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS
SEPTEMBER 2025



Napa Valley, CA

HdL Companies

888.861.0220 | solutions@hdlcompanies.com | hdlcompanies.com

Overview: Persistent economic headwinds continue to shape the short-term sales tax outlook. While consumer spending on taxable goods remains steady, recent declines in consumer confidence—driven by inflationary pressures, tariff concerns, and rising unemployment—pose risks to sustained revenue growth. The Federal Reserve’s recent interest rate reduction in September, the first since December 2024, signals a responsive monetary policy aimed at stabilizing economic conditions; this reduction does not alter anticipated spending patterns. Modest increases shown above simply recapture statewide sales tax decreases that occurred in the prior two fiscal years.

Autos/Transportation 2025/26 | 2026/27
0.4% | 3.0%

Forecasts for auto sales tax revenue over the next two years remains cautious as shoppers continue to face elevated vehicle prices, additional upward pressure from tariffs, and restrictive financing conditions, compounded by the September 2025 expiration of the federal \$7,500 tax credit for electric vehicle purchases. While the Federal Reserve took a step to lower short-term interest rates, it is uncertain how much this will affect long-term borrowing costs, which are most relevant for auto lending. At the same time, recent signs of weakness in the labor market raise concerns about consumer demand, leading this quarter’s forecast to be moderated slightly to reflect the risks that a softening job market poses to future auto sales and related sales tax revenues.

Building/Construction -1.5% | 1.8%

Early 2025 saw elevated sales as contractors stockpiled inventory ahead of expected tariff hikes. These purchases tapered off by Q2, except for solar panels, which remained in demand due to the 30% federal credit expiring on December 31. Infrastructure projects contributed less to the tax base, with new developments slow to launch. The forecast assumes the Fed’s September rate cut will make home equity loans and credit lines more appealing, likely prompting a modest rise in home renovations. However, developers are unlikely to respond quickly to lower mortgage rates due to high material costs and ongoing economic uncertainty. Data center projects expected in 2026 will help, but not enough to offset broader declines.

Business/Industry 1.2% | 3.1%

Faced with a variety of economic pressures, the diverse business-industrial group managed a positive result during the spring months of 2025 – expanding 5.7%. Customers heavily favored online shopping; thus, California fulfillment centers propelled revenues higher. Business-to-business benefitted from one-time technology purchases, and energy projects boosted electrical equipment sales. Yet, many categories remained flat or declined with variables such as borrowing costs and tariff fears curtailing growth. Several solar/energy installations concluded – and comparative revenues tumbled. The statewide outlook anticipates low growth for the current fiscal year and modest improvement thereafter, which will vary based on the size and character of local businesses.

Food/Drugs -1.4% | 0.5%

Retail performance in Q2 2025 showed mixed results across key segments. Grocery Stores profits rose 0.05% as retailers enhanced omnichannel experiences and formed cost-saving partnerships to boost profitability. Convenience & Liquor Markets had declined revenues, but stores are evolving into modern convenience hubs by offering fresh food and premium grab-and-go options. Cannabis merchants fell 2.1%; to attract new patrons, retailers are launching cannabis lounges combining entertainment and café-style experiences. Due to store closures and rising costs, shoppers are shifting away from drug stores to discount and big-box retailers. Anticipate fiscal year 2025-26 to drop further as sectors herein struggle to capture sales.

Fuel/Service Stations 2025/26 | 2026/27
3.4% | 4.0%

Fuel prices and consumption were both down again in the second quarter of 2025, with actual results of (-8%) in alignment with a forecasted decline of 7%. Oil barrel prices held fairly steady, but softer statewide demand pushed revenue lower. California’s new Low Carbon Fuel Standards rules, the phased shutdown of Phillips 66, and the planned closure of Valero’s Benicia refinery are all lining up to put pressure on prices starting later this year. While no legislation is currently planned, potential state action to keep the Benicia refinery open would help smooth the impact of that closure. These factors, combined with OPEC supply risks and indicate a slightly better economic outlook. The forecast points to modest recovery in FY 2025–26 with long-term growth settling in the 3–4% range.

General Consumer Goods 0.8% | 1.3%

Consumer spending on general retail categories remained robust in Q2 2025. Absent in-state fulfillment centers and out-of-state retailers, this category contracted 0.7% during the spring. While consumer confidence and sentiment indicators suggest a neutral to less optimistic view of the economy, anticipate a flatter outlook for consumption rather than a large pullback. Rising tariff-related costs continue to pressure household budgets. Looking ahead, payments could see a mild rise in the second half of FY 2024-25. Some expert reports suggest discretionary services spending has diminished, supporting more spending on taxable goods. Wage growth for middle and higher earners should hold up outlays, employment uncertainty remains a potential headwind..

Restaurants/Hotels 2.1% | 3.4%

Restaurants have seen minimal direct impact from tariffs so far. Instead, rising labor and operational costs are driving menu price increases. Many establishments are working hard to limit food and drink hikes, mindful of the fact that lower-income consumers are dining out less frequently. To retain these customers, restaurants are promoting deals and value menus. Meanwhile, Californians spent more of their travel budgets locally this summer, helping to offset the decline in international tourism. Industry closures are primarily affecting underperforming locations while new restaurants continue to open, signaling ongoing resilience and adaptation.

State and County Pools 3.5% | 3.0%

In alignment with HdL expectations, fiscal year 2024-25 saw pool-generated taxes rise 3.2% over prior year totals. Robust investment in online tools and systems such as AI are reshaping shopper experiences, shortening delivery times and optimizing ordering capabilities and supply chain structures. Major brands continue to offer off holiday season ‘events’ over a few days to draw in new website traffic which can boost ecommerce exposure and sales. While the use of technology across demographic segments does vary, the convenience of ordering everything from food delivery to products made internationally is expected to improve pool-based revenues in each of the next two years.



NATIONAL AND STATEWIDE ECONOMIC DRIVERS

2025/26 | 2026/27



U.S. Real GDP Growth

1.9% | 2.2%

The U.S. economy is showing signs of overheating, driven by persistent federal deficits, elevated asset prices, and sustained inflows of foreign capital. These factors suggest that current levels of consumption and investment rely heavily on borrowing and external financing, raising concerns about long-term sustainability. Economists note that when economies expand under such conditions, risks of instability increase if corrective measures are delayed. A prudent long-term approach could include gradual interest rate increases to cool financial markets, while beginning to pay down the national debt through tax increases and spending cuts.

2025/26 | 2026/27



U.S. Unemployment Rate

4.4% | 4.2%

The U.S. economy has been decelerating to a new, steady, lower pace of job growth, around 1% annually, since its post-pandemic recovery, reflecting a structural slowdown despite steady labor demand. Data from the BLS's Job Openings and Labor Turnover Survey show job separations and openings holding within normal ranges, indicating the deceleration of job growth isn't driven by layoffs or weakening demand. Consistent unemployment insurance claims, in the 200,000 - 250,000 range, and the unemployment rate itself remains just above 4%—considered full employment by most economists—further underscore this trend.



CA Unemployment Rate

5.5% | 5.3%

The labor market in California has cooled over the last quarter. Between April and July, the state's unemployment rose to 5.5%, while the rate in the U.S. as a whole held steady at 4.2%. Excluding the pandemic-induced increase in unemployment, the state has not seen unemployment at this level since April 2016. The biggest shift over the past year has been among teenage workers, whose employment-to-population ratio dropped 2.3 percentage points, while their labor force participation fell by 2.8 percentage points year-over-year in July.



CA Residential Building Permits

97,812 | 108,556

Permits in California have held steady at about 100,000 annually for the past 18 months. This pace is roughly one-third of the 310,000 per year needed to meet the state's goal of 2.5 million new homes over eight years. Substantial increases in construction will be required to make meaningful progress on affordability. In 2023, Governor Newsom signed a CEQA reform package aimed at streamlining environmental review, expediting infill and affordable housing projects, and exempting local rezoning from CEQA to accelerate site readiness while maintaining protections for sensitive lands. While these changes may support higher production over time, they have not yet been reflected in permitting data.



CA Total Nonfarm Employment Growth

0.4% | 0.5%

California enters fall 2025 on a slower growth trajectory, short of a downturn but marked by cooling momentum. The state's job market has softened, and inflation is running at a more typical pace, although consumer prices remain high. Housing is steady but tight; home prices are high, sales are flat, and new construction does not meet demand. California's long-term affordability challenge persists, underscoring the need for increased housing supply. Together, these indicators point to a cooling state economy; growth is slower, labor markets are softer, and price pressures have normalized.



CA Median Existing Home Price

\$715,638 | \$763,258

California's housing market is also cooling. In 2020-2021, demand was supercharged by the government's pandemic stimulus and by very low mortgage rates (around 3%). That era is over. Today, rates are holding near 6.5% to 7.5%, mobility has declined, and growth in jobs and incomes has slowed. With fewer new households forming, home sales have weakened and inventory is rising. The interaction between supply and demand determines prices, and with demand cooling and inventory higher, some of the heat has left the market even though prices remain elevated.

Proposition 172

Fiscal year 2024-25 statewide Proposition 172 (P-172) revenues declined 0.5%, following the 1.1% drop in fiscal year 2023-24. The current the forecast anticipates modest growth of 1.2% and 2.7% for fiscal years 2025-26 and 2026-27, respectively. Current county projections include pro-rata factors published by the State Controller's Office in July 2025 (based on updated calendar year 2024 actuals). As the calendar year Bradley-Burns results fluctuate due to taxpayer allocation modifications, audits, economic impacts, etc., pro-rata growth factors and resultant P-172 revenues will vary for many counties.



HdL[®] Companies

Delivering Insight, Revenue, and Efficiency
to Local Government

HdL Companies

888.861.0220 | solutions@hdlcompanies.com | hdlcompanies.com

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

310.571.3399 | BeaconEcon.com

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.