

HdL⁺ Companies

CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

MARCH 2023



Sacramento, 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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Overview: During the early months of 2023, fluctuating key indicators led many experts to draw mixed conclusions regarding the fluid economic outlook. Strong jobs numbers and low unemployment rates allowed consumption spending to stay solid. Recent bank closures have tested the stock market and as a result, both investors and customers are nervous about the security and accessibility of their funds. One of the most vulnerable segments includes taxable discretionary merchandise as consumers are closely monitoring their own financial situation. From a sales tax perspective, our forecast does not differ from recent estimates. While no recession is anticipated, current year results will slow and then decelerate into little or no growth for FY 2023/24.



Autos/Transportation

2022/23 | 2023/24

3.8% | -3.3%

Supply chain disruptions during the pandemic caused auto production to slow, resulting in record-high prices and a shortage of available vehicles at dealerships. To compound the problem, financing costs have increased significantly as the average interest rate for auto loans increased from 5% to 8% in the year. Consequently, many buyers are struggling to afford their monthly payments with 16% of new car loans requiring monthly payments exceeding \$1,000. Simultaneously, the economy is slowing down, inflation is pushing up the prices of essential goods like groceries, and concerns about a potential recession continue to grow. Recent data indicates that Americans are falling behind on their car payments and automobile repossessions are climbing. Therefore, sales tax receipts from the auto-transportation sector are expected to dip slightly in the next fiscal year.



Food/Drugs

2022/23 | 2023/24

1.8% | 2.0%

Grocers' recent gains revealed ongoing, inflated prices of food and other taxable merchandise sold in the aisles of both major chains and independent stores. Conversely, cannabis retailers have experienced diminishing returns in recent quarters due to competition, complex regulations, unlicensed sellers, and market saturation. When combined with drug stores, the other key segment, this group will experience a modest improvement in sales tax revenues for the current and next year.



Fuel/Service Stations

3.3% | -6.4%

During the early part of CY 2023, this sector experienced upward pressure. Regular pump and oil barrel prices were significantly higher and many regions throughout the state have seen this rising trend over an extended period. The cost of jet fuel remains much greater than historical averages. Refinery breakdowns and maintenance, combined with the annual production of the more expensive summer blend of gasoline, are also contributing to heightened per gallon pump charges. Compared to the last forecast, a slowing of the estimated decline by 5% in the first half of 2023 resulted from these combined factors. The forecast continues to anticipate a strong reduction of consumption and demand for fuel starting in FY 2023/24.



Building/Construction

3.5% | 0.7%

Statewide construction permit data reflected a shift this period as the total value of issued permits rose just .79%. Permits issued for single-family housing declined in number all year while multi-family permits showed strength in quantity and value. Non-residential construction reported a reduction in permit issuance value. Home Depot and Lowe's have indicated sales for the rest of 2023 should be flat to slightly negative as consumers are spending less on all but the essentials. Though foot traffic in stores has shrunk 5-7%, inflated prices will keep sales on-par with 2022. Widespread damage from recent storms triggered a flurry of emergency purchases in the short-term. Increased demand for road repair and material suppliers will extend through 3Q23. Overall, the loss of SFR construction is offset by steady work on home improvement projects and modest growth in non-residential construction. Therefore, HdL anticipates no loss in taxable sales, but a flat start to FY 2023/24.



General Consumer Goods

0.9% | -0.3%

Core inflation above the federal reserve's target level continues to be a key factor in rising local tax receipts from general consumer goods. Indicators reflected personal consumption declined in the last two months of 2022, while preliminary January figures showed retail sales continued to be resilient. Growing monthly expenses have provided consumers with a reason to remain frugal, fueled by rising mortgage and credit card interest rates. Major retailers that propel the sector offered cautious outlooks with ongoing softness surrounding discretionary categories. Labor market conditions and rising incomes offer consumers the ability to continue to spend in the short-term, but tighter financial conditions may limit household spending over the next twelve months. The short-term outlook expects the group to remain flat with a chance for a modest decline throughout CY 2023.



Business/Industry

6.9% | 3.3%

This classification is comprised of 21 unique business types that range from agriculture to information technology to industrial equipment, many of which have demonstrated fourth quarter gains. Comprising nearly 33% of this category's revenue, eCommerce fulfillment centers grew 11% as newly opened centers expanded direct taxpayer allocations to agencies. The high cost of materials, order backlogs, and a slight easing of supply and labor challenges supported industrial receipts. Several energy projects bolstered electrical equipment revenues and large (non-auto) transportation equipment sales increased 59%. Technology demands and other B2B needs buoyed business services outcomes. Projections reflect continued growth through the end of 2023, with modest improvement in 2024. Given the wide-ranging composition of this group for each jurisdiction, predictions vary based on the size and character of local industrial companies.

While Proposition 172 (1/2 Cent for Public Safety) growth projections closely track with the statewide Bradley-Burns, calculations vary somewhat due to the state's allocation methodology. HdL forecasts a statewide increase of 3% for FY 2022/23 and .475% for FY 2023/2024. As some counties rebound from significant sales tax losses these past two years, and the Bradley-Burns countywide pool allocations are reduced to reflect direct allocations for some internet-related sales, Proposition 172 pro-rata factors have shifted significantly for many counties.

2022/23 | 2023/24



Restaurants/Hotels

7.9% | 3.6%

Due to the shift from consumers spending less on tangible items and more on experiences, spending on travel and leisure is expected to surge while local restaurants will begin to see slowing foot traffic. Among other challenges, the industry staffing crisis is impacting the ability to provide the optimal level of service at a time when service is the key attribute of the restaurant/hotel experience. Additionally, customers are looking for the best value deal which will spur competition between businesses. Passing along higher labor, food, and other costs to patrons in the form of increased menu prices or charges at venues will be commonplace. Subsequently, this group will experience increased future tax collections over the next two years.

2022/23 | 2023/24



State and County Pools

2.0% | 3.0%

Experts remain optimistic that eCommerce growth will raise the percentage of retail sales coming from consumer's mobile spending preferences over the next few years. However, in California, inventory changes for online-based purchasing activity are ever evolving. Recent data reflected the opening of more in-state fulfillment facilities, coupled with many retailers choosing to use local retail outlets as the resource for delivery of products in lieu of shipping from out-of-state warehouses. The result has dampened pool revenues and this trend is expected to continue in the short-term, impacting lower county pool outlooks for the next three quarters. Outer years anticipate modest gains as retailers evolve platforms to enhance and improve customer experiences.



NATIONAL AND STATEWIDE ECONOMIC DRIVERS

2022/23 | 2023/24



U.S. Real GDP Growth

1.5% | 2.5%

Real GDP growth in the first quarter of 2023 is likely to settle between 1% and 2%. While there are clear signs of stress in the economy driven by higher interest rates, the economy has yet to experience a complete downturn. Thus the expansion should continue for the foreseeable future. Today's economy is fragile and highly susceptible to further negative shocks. Beacon Economics does not view a recession as a foregone conclusion as many other forecasts have suggested. However, we acknowledge that certain choices by policymakers in the months ahead could trigger an economic crisis.



CA Total Nonfarm Employment Growth

2022/23 | 2023/24

3.4% | 2.0%

In Q4 of 2022, California total nonfarm employment finally reached pre-pandemic levels. While the state reached this milestone more slowly than the national economy, recently revised jobs data from the U.S. Bureau of Labor Statistics show that California's labor market has recovered significantly better from pandemic-related job losses than previously estimated. The revisions reveal that there are 197,000 more people employed in California now than there were prior to the pandemic. As such, the state's labor market has tracked the national recovery, rather than lagging it as the original estimates suggested. While California's economy has added the fourth highest number of jobs of any state 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 been about five times slower than job growth in states such as Florida and Texas.



U.S. Unemployment Rate

3.5% | 3.8%

Unemployment in the nation at the start of 2023 remains rock bottom. In February, unemployment was 3.6% even as consumer spending marched forward despite inflation. Interest rates have started to stabilize and as a result, asset markets have slowed their swoon. The U.S. economy is clearly operating at capacity, the exact opposite of what economists refer to as a 'recession' – a period during which an economy, driven by some type of negative shock, produces less than it could.



CA Residential Building Permits

129,592 | 132,910

Despite the decline in home sales activity, there is only two months of housing supply available in California. 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 Unemployment Rate

4.1% | 4.3%

As of January 2023, there were 1.25 million job openings in the state, but only 800,000 unemployed workers. 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. There are still 320,000 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 Median Existing Home Price

\$648,170 | \$632,546

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 4Q22 webinar recording. Email solutions@hdlcompanies.com to learn more.





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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.