INDUSTRY INSIDER 2024

WHOLESALE/RETAIL TRADE

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Executive Summary

Macroeconomic Impacts:

The U.S. economy demonstrates notable resilience, with projections indicating a 3% growth in real GDP for this year, an unemployment rate just above 4%, and inflation approaching the Federal Reserve's 2% target. This favorable economic backdrop creates potential for stabilization in Sonoma County's wholesale and retail sectors in the coming quarters.

Short Term Outlook:

If the Federal Reserve implements further rate cuts, combined with robust consumer spending and a slowdown in population decline, modest growth in Sonoma’s retail sector is likely. However, the outlook for wholesale trade is slightly better than retail, primarily due to the region's strong agricultural focus.

Long Term Risks:

Although, increasingly unpredictable weather patterns linked to climate change pose risks to wholesale trade. Additionally, the long-term outlook for retail is concerning due to Sonoma County's declining population, which is particularly sensitive to demographic shifts and labor supply shortages. This potential slowdown in retail growth could adversely impact hiring within wholesale trade.

Recent Performance. Sonoma County's wholesale and retail trade industries are weathering headwinds. Wholesale trade has been shedding jobs since the pandemic. Job losses have abated this year, but industry payrolls are still down a whopping 14% since early 2020.

After a swift but incomplete initial rebound, retail payrolls moved sideways for much of the post-pandemic recovery. Over the past year, industry jobs picked up the pace, according to the monthly payroll survey, with growth outpacing total employment on an annual basis. Payrolls are within arm's reach of their pre-pandemic level. However, this uptick ought to be taken with a grain of salt: The Quarterly Census of Employment and Wages indicates that the industry's decline hastened through the first quarter of this year in contrast to the modest improvement suggested by the monthly payroll survey.

Macro drivers. It is no stretch to say the U.S. economy is performing well, at least in the aggregate. Growth is robust with real GDP set to post a near 3% gain this year, powered by strong immigration-fueled labor force growth and healthy labor productivity gains. Unemployment is low at a shade more than 4%, and while job growth has moderated, it is roughly consistent with the estimated 125,000 per month needed to ensure unemployment remains low. Inflation is quickly closing in on the Federal Reserve's 2% target regardless of the inflation measure. Stock and house prices are at record highs, and household debt service burdens remain light by historical standards.

This is not to say the economy is without a few blemishes. Lower-income households are struggling financially, evidenced by the increase in credit card and subprime auto loan delinquency rates. Home sales and mortgage origination volumes remain depressed, and prices for mostly lower-quality office properties and high-end multifamily buildings have fallen sharply over the past two-plus years. Manufacturing has also been moribund, dragged down by the lackluster vehicle and aircraft industries and stiff overseas competition due in part to the high value of the U.S. dollar.

Still, these blemishes are fading as the Federal Reserve cuts the federal funds rate. Treasury yields fell in advance of the September rate cut, with the 10-year Treasury yield well below 4%. Fixed mortgage rates have followed and are just over 6%. Vehicle loan rates have also peaked. And rates on credit cards, home equity lines, and small-business loans should decline in rough tandem with the Fed moves. We expect 0.25-percentage point rate cuts at the November and December meetings of the Federal Open Market Committee and then a 0.25-point cut each calendar quarter until the federal funds rate settles at its estimated neutral rate of 3%. Investors expect substantially more aggressive rate-cutting, which cannot be ruled out, particularly if the job market stumbles or financial markets become unsettled.

Industry drivers. With the U.S. economy on firm footing and interest rates set to decline, the stage is set for Sonoma's wholesale and retail trade industries to stabilize. Wholesale trade employment has already been in decline given efficiency enhancements and a cost disadvantage relative to neighboring counties Sizable manufacturing and agriculture industries will ensure that wholesale trade remains an important, if small, part of the local economy. Manufacturing is in a lull, much like the case nationally. This, combined with a reduction in goods spending as consumer spending has normalized, has been a headwind for wholesale traders. However, the outlook is brighter in the coming quarters. Lower interest rates will decrease the borrowing costs in the capital-intensive agriculture and manufacturing industries. As these industries find a footing, so will wholesale trade. Retail trade is already on better footing than wholesalers, and the resilience of the U.S. economy bodes well for the county's retailers. Income growth is outpacing inflation, leading to real income growth that is sustaining consumer spending. Excess savings that were built up during the pandemic are being churned through, but there are significant supports to spending, especially for higher-income households that make up the bulk of consumer spending. House prices are still cresting new heights, and the stock market reaches record highs seemingly daily. Consumer debt burdens are also low by historical standards, and the wealth effect from rising house and equity prices will provide generous tailwinds to consumer spending, ensuring it remains strong even as the labor market continues to slow. Real consumer spending growth will remain around 2%, and this will provide the runway for retailers to continue to add jobs at a modest pace. Resilient consumer spending and a slower pace of population losses will pave the way for modest growth in Sonoma's retail base in the near term. Still, retail employment will struggle to move the needle. Efficiency gains via automation and a shift toward e-commerce have led to secular declines in employment even as retail sales in the county remain strong. Long-term outlook. A shrinking population base will weigh on economic growth long term. Retail is especially sensitive to demographic headwinds, and a declining local population will weigh on growth even as the labor market and consumer spending continue to press higher. Payrolls will make modest near-term gains, but demographic headwinds will take a toll in the second half of the decade. The outlook for wholesale trade is slightly better. Employment likewise sits below its high from the previous business cycle, and high costs and demographic headwinds present a barrier to growth. Wholesale trade will benefit from the county's large agriculture industry, which should advance thanks to improved drought conditions over the past year. Longer term, continued risk of drought and more variable weather patterns due to climate change pose long-term risks to the agriculture industry and, by extension, a more limited downside risk to wholesale trade. Demographic headwinds pose a problem as they do in the retail trade outlook, and weaker growth in retail will necessitate fewer hires in wholesale trade.

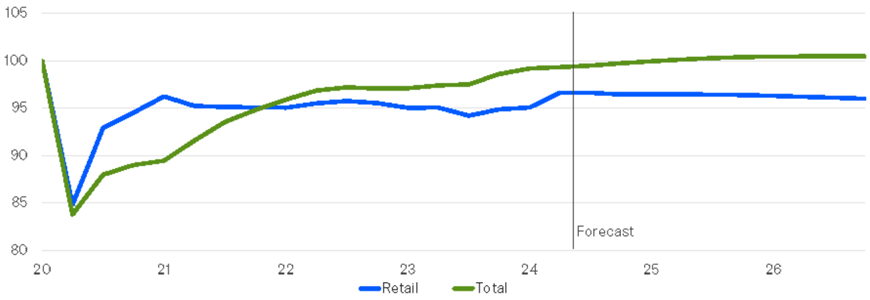
Upside risks. The labor market is loosening but remains tight, keeping job and income growth elevated. Businesses calculate correctly that the labor supply issues in the aftermath of the pandemic are here to stay. This is leading them to retain staff despite slowing demand, a dynamic that could push up household income faster than expected. Since much of that income would be spent, the economy would grow above expectations. This would be especially beneficial for Sonoma's cluster of retail and wholesale trade employers.

Downside risks. A misstep by the Fed is diminishing in likelihood, though it remains the primary downside risk to the U.S. outlook. Nevertheless, if the Fed is too slow in loosening policy, the robust labor market may soften excessively. Rising joblessness would hit household income and consumer spending, leading to what would have been an avoidable economic downturn.

Colin Seitz
October 2024

Retail Employment Will Move Sideways...

Employment, Sonoma County, 2020Q1=100, SA



Sources: BLS, Moody's Analytics

Retail trade employment initially recovered much faster than the overall labor market but has since struggled. Strong income growth over the past few years has not translated into job gains. The pandemic accelerated consumer spending preferences for online purchases, and subpar demographic trends have reduced foot traffic at Sonoma-based retailers. These trends will persist even as the labor market remains on solid footing and the economy navigates a soft landing.

...Even as Retail Sales Growth Remains Solid

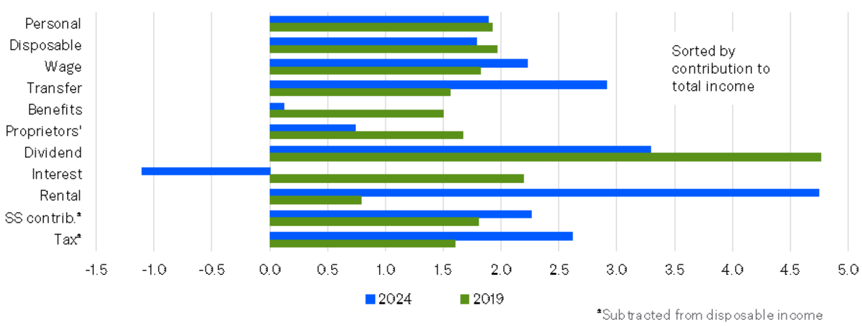
Retail sales, % change yr ago

Sources: BEA, Moody's Analytics

The resilient labor market has buoyed Sonoma County's retail sales even without a commensurate rise in retail trade employment. Income growth is once again outpacing inflation, leading to real increases in purchasing power. Wage growth is expected to slow as the labor market loosens and the economy downshifts, but slower inflation and some leftover excess savings from the pandemic will keep a floor under retail sales growth. This, in turn, will ensure that retailers remain on firm footing, though job growth will be modest.

Aggregate Real Income Growth Near Pre-Pandemic Levels

Real personal income, compound annualized growth over 5 yrs ending Jun...

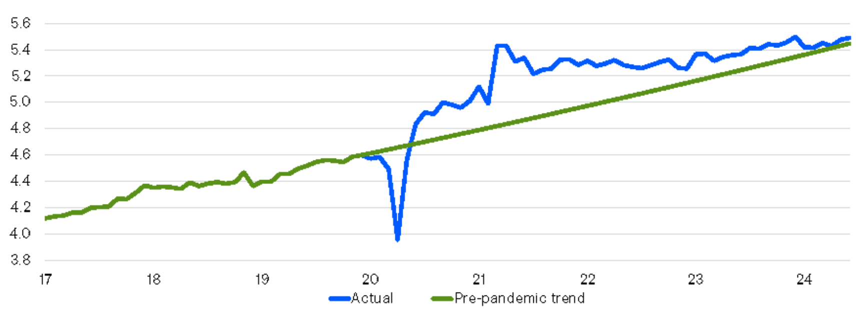


Sources: BEA, Moody's Analytics

Growth in real after-tax, or disposable, income over the five years ended in June was 1.8% per year. This is healthy and only modestly below the 2% growth in the prior five-year period. The gap was even smaller a few months ago, but real income growth has slumped of late. Beyond that, nominal income growth has been much stronger in the recent period—5.4%, compared with 3%. The factor undermining real income growth has been high inflation.

Goods Spending Overdone

Real goods spending, $ tril



Sources: BEA, Moody's Analytics

Consumers' desire to keep spending may also be in question. Goods spending, outside of a few categories such as vehicles, where supply constraints were severe, was extremely strong during the pandemic, leaving little, if any, pent-up demand. Some of the buying may have been ahead of needs, coming at the expense of current spending. There was pent-up demand for some services such as travel, but just how long before that demand is met is difficult to assess. Lower goods spending will put a speed limit on growth for wholesale trade employment, which will advance at a tepid pace.

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SONOMA COUNTY