economic development collaborative
SONOMA COUNTY

Manufacturing Industry Insider

2024

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Executive Summary

Despite a historically strong U.S. economy overall, Sonoma County's manufacturing sector is under-performing compared to previous years. Payrolls have declined to levels not seen since the post-COVID lockdown period, indicating that the downturn has been sharper than initially perceived. Beverage manufacturers have fared slightly better than food manufacturers, the latter of which were significantly impacted by price hikes beginning in 2022.

Recent projections suggest a modest outlook for local manufacturers. While the future remains uncertain, Moody's Analytics predicts the president-elect’s economic agenda is likely to contribute to higher inflation and interest rates. In addition, potential labor shortages and unforeseen energy price shocks due to global conflicts could further hamper growth in the sector within Sonoma County.

However, in the long term, the growing popularity of organic farming and the expansion of available real estate could provide some stabilization for the industry. Moreover, despite decades-high inflation and tightening Federal Reserve policies, U.S. consumer spending has proven to be surprisingly resilient. If this trend continues, manufacturers, particularly those in the food and beverage industries, may experience more rapid growth, which would be vital to sustaining Sonoma County's manufacturing sector.

Recent Performance. Sonoma County's manufacturing is struggling. Aside from a brief uptick at the end of 2023, payrolls have trended lower since mid-2022. Net job declines now have manufacturing employment comparable to its post-COVID-19 lockdown low.

The Quarterly Census of Employment and Wages provides a more accurate but lagged view of employment. Those data indicate that as of early 2024, the steep declines for manufacturers were likely sharper than suggested by the monthly payroll survey. Food manufacturers were hit hard by the rise in prices beginning in 2022, but losses are moderating as inflation cools. Beverage manufacturers held up better. The QCEW data show that job losses were not as pronounced relative to food manufacturers and have flatlined this year.

Macro drivers. There are few times in the nation's history that the economy has performed this well, at least in the aggregate. The economy is operating at full employment, with unemployment hovering near 4%, the midpoint of most estimates of the full employment/un- employment rate. Unemployment is low nationwide and across all demo- graphic groups. Unemployment has pushed up a bit in the past year, but this is precisely what the Federal Re- serve was aiming for when it aggressively increased interest rates to cool the job market and quell inflation.

The economy is also growing robustly. Real GDP is up nearly 3% year over year through the third quarter. The full-employment economy can grow this quickly without igniting inflation because the economy's potential growth—which is consistent with the creation of enough jobs to maintain stable unemployment— has accelerated even more. Indeed, judging from the increase in unemployment and applying a historical regularity describing the relationship between unemployment and GDP known as Okun's law, the economy's potential growth has been closer to a stunning 4% in the past year. However, the economy's potential growth will soon throttle back. It has been significantly powered by the surge in foreign immigration and the resulting supply of labor but has been slowing since President Biden's summer executive order to stem the flow of asylum seekers across the south- ern border. Yet the higher potential growth came at an opportune time, allowing for stronger growth with moderating inflation.

While the economy is performing quite well, the outlook is more uncertain. Former President Donald Trump's reelection and the Republican sweep of the Senate and House will result in meaningful changes to economic policy—and, therefore, to the economic outlook. Trump laid out his economic policy agenda in broad terms on the campaign trail. Based on his first term as president, he will pursue policies consistent with his campaign rhetoric, albeit not to the degree that he articulated them during the campaign.

The sum of Trump's economic policies will result in some combination of higher inflation and interest rates—and diminished growth. The financial market reaction to the election results is consistent with this outlook. Most significantly, long-term interest rates have risen sharply since investors began discounting a Trump victory several weeks ago. The 10-year Treasury yield has risen close to 90 basis points, reflecting higher inflation expectations and a wider term premium—the difference between short- and long-term interest rates—which is likely due to prospects for bigger budget deficits and more government debt. The stock market is also up a few percentage points during this period. However, this mostly reflects expectations for a lower corporate tax rate; less regulation on financial services, fossil fuel and technology industries; and a more relaxed view by the incoming Trump administration of mergers and acquisitions.

Industry drivers. Manufacturers will have reason to celebrate heading into next year as goods demand begins to rise. U.S. manufacturing has been stuck in a holding pattern for two years as high inflation and rising interest rates have sapped goods demand, forcing firms to cut back on production and investment in new equipment. Nevertheless, manufacturers have held their own. Like many other businesses, they have successfully passed higher input costs to downstream customers, raising profit margins above normal. In response to weaker demand, manufacturers have mostly opted to cut hours while keeping most of their full-time staff for fear of being unable to find workers when demand recovers. A strong financial standing and an available workforce will enable manufacturers to quickly restart production as falling interest rates unleash pent-up demand for goods.

Sonoma's County's base of manufacturers will follow a similar trend, though the outlook for employment growth is only modest. Productivity enhancements in the food and beverage industry have meant that even while output climbs, employment has been slow to advance. Still, with inflation receding and interest rates retreating, investment in new facilities will improve, boosting margins for the county's food and beverage manufacturers.

Long-term outlook. The mainstreaming of the organic food movement will create new opportunities for county producers, especially as some consumers prioritize environ- mental and ethical practices in the production of the food and clothing they purchase. The county's reputation as a haven for sustainable and organic farming practices will help burnish its advantage as organic food sales grow as a share of total food sales, but mass-market organic brands at large food stores will re- quire that Sonoma County's brands remain ahead of the curve.

Robust growth of food and beverage manufacturing facilities within the county has also cleared some of the inventory of industrial space.

Still, recent progress in industrial building is a welcome sign. According to commercial real estate firm Keegan & Coppin, several planned expansions will increase the supply of industrial buildings in the county and enable firms to expand their operations.

Land and labor constraints rearing their heads throughout the state are becoming even more apparent in coastal areas; Sonoma County is already experiencing waning housing affordability. Net domestic migration remained negative in 2023, although the county lost fewer residents on net than in the previous two years. High-frequency data from Equifax suggest modest improvement in 2024. Immigration has also rallied, but this support is already fading. Demographic trends will be crucial to incentivize more firms to locate in Sonoma County. The housing market will rebalance, and a slower pace of house price appreciation will improve affordability—but it is crucial that it does so quickly to ensure that the supply of workers continues to grow and outruns labor supply shortages.

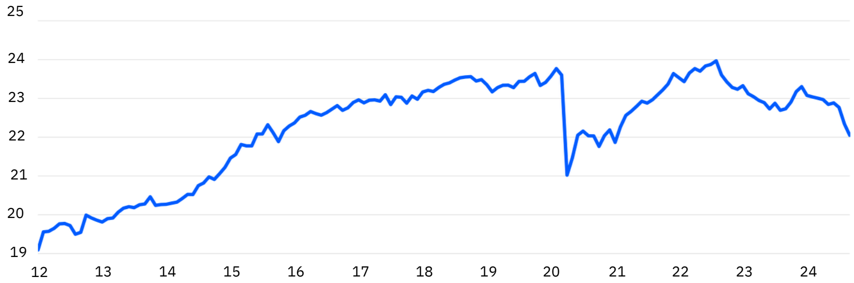
Upside risks. Decades-high inflation and policy tightening by the Fed to bring it down will weigh on consumer spending. Nevertheless, the insatiable U.S. consumer has been surprisingly resilient. Our baseline forecast could again underestimate consumer spending, which would result in faster growth. If consumer spending surprises to the upside, Sonoma County manufacturers would expand more rapidly, especially in the crucial food and beverage industry.

Downside risks. The escalating conflict in the Middle East has caused energy prices to rise. West Texas Intermediate crude oil prices, which fell throughout late summer, have begun to increase. If an un- foreseen shock caused prices to rise higher than our baseline expects, the economic damage would be material. Curtailed production levels, which OPEC+ announced it would prolong, could push prices up. Higher oil prices would hamstring consumer spending and hold back hiring in manufacturing given higher input prices.

Colin Seitz
November 2024

Manufacturing Employment Pulls Back

Manufacturing employment, Sonoma County, ths

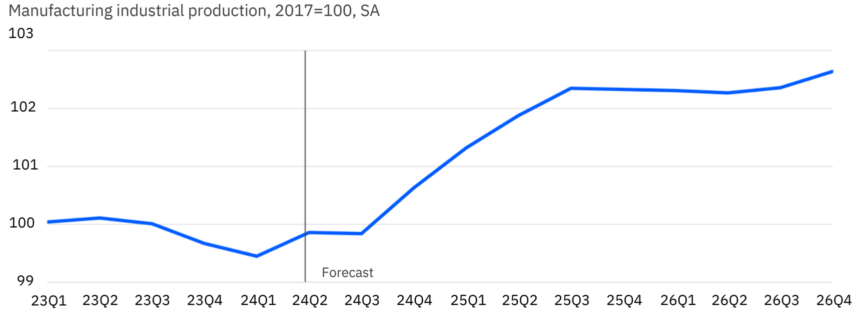


Sources: BLS, Moody's Analytics

Sonoma County's manufacturing base had shifted away from high tech toward nondurable goods manufacturing in the early 2000s. High-tech manufacturing payrolls have increased in recent years, but the growth of food and beverage manufacturers ensures they will command a growing share of manufacturing employment. Payrolls have taken a step back in the past two years as inflation has weighed on spending, but with inflation moderating and the economy navigating a soft landing, job growth will resume.

Conditions Primed for Manufacturing Production to Rise

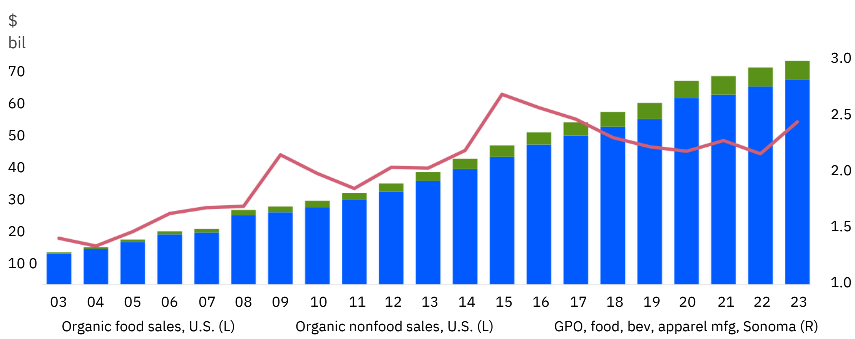
Manufacturing industrial production, 2017=100, SA



Sources: BLS, Census Bureau, Moody's Analytics

Manufacturing is primed for a stronger coming year as interest rates decline and demand improves. In response to weaker demand, manufacturers have mostly opted to cut hours while retaining most of their full-time staff for fear of being unable to find workers when demand recovers. A strong financial standing and available workforce will allow manufacturers to quickly re- start production as falling interest rates unleash pent-up demand for goods. This will specifically benefit Sonoma County's food and beverage manufacturers.

Organic Sales Climb and Output Presses Higher Again

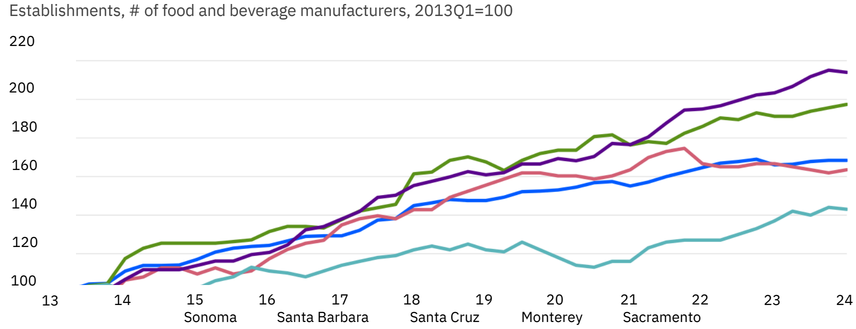


Sources: U.S. Organic Trade Assn., Moody's Analytics

Sales of organic food and nonfood items are consistently increasing at a strong rate, benefiting manufacturers in Sonoma County who focus on these goods. The growth rate for organic products has surpassed the general non-organic market once more, indicating sustained demand for organic and healthy options among consumers despite the inflation challenges that affected spending throughout the last few years.

Sonoma County's Largest Manufacturing Cluster Sees Steady Progress

Establishments, # of food and beverage manufacturers, 2013Q1=100



Sources: BLS, Moody's Analytics

The number of food and beverage manufacturing establishments in Sonoma County continues to increase, even as the total number of firms vastly outpaces some of its nearby metro areas. Unsurprisingly, the pace of additions has begun to slow in recent years given the largely established presence, but continued growth augurs further gains in food and beverage manufacturing employment. Retreating interest rates will provide a tailwind to new and existing manufacturers as the cost of borrowing pulls back.

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