First Quarter Economic Outlook

2025

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Executive Summary

March 2025

Slowing U.S. Economic Growth

The U.S. economy is showing signs of deceleration as growth slows, inflation picks up, and uncertainty rises. Early 2025 data indicate a moderation in GDP growth to around 2%, down from nearly 3% in the previous year. Consumer inflation surged in January, driven by broad-based price increases, exacerbated by seasonal adjustments and specific disruptions such as avian flu and wildfires. Meanwhile, labor force growth is slowing due to restrictive immigration policies, impacting productivity and economic expansion.

Policy Shifts & Rising Uncertainty

Policy changes under the Trump administration are contributing to economic volatility. Tariffs, immigration crackdowns, and fiscal policy adjustments have created uncertainty, leading to record-high indecision among small businesses. Inflation expectations are rising, fueled by concerns over back and forth tariff policies and potential global trade disputes. Despite these concerns, stock markets remain at historic highs, and household wealth continues to surge due to strong asset valuations. However, stretched stock and bond market valuations raise the risk of a potential correction.

Sonoma County's Economic Landscape

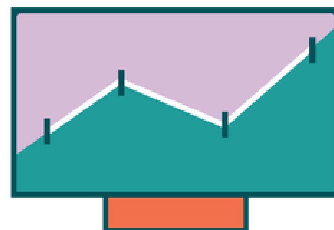
Amidst the national economic & political portrait, Sonoma County's economic growth is steady but unremarkable. While job growth has picked up recently, it remains weaker compared to the state and national levels.

The tourism sector, a key economic driver, is recovering, and healthcare employment remains strong, though growth is moderating. Goods-producing industries, particularly manufacturing and construction, have been constrained by high interest rates and a sluggish housing market. These sectors are unlikely to see significant improvement until interest rates decline, which is now expected to happen later than previously anticipated.

Further, manufacturing employment is under pressure, though food and beverage production may stabilize with moderating inflation. Tourism will continue growing modestly, supported by Sonoma's attractions, but is hindered by slower Bay Area economic growth. Semiconductor manufacturing presents an opportunity, though automation will limit job creation. Healthcare remains a pillar of strength, though demographic challenges, particularly outmigration and affordability issues, pose long-term risks.

The Year Ahead: Long-term Outlook

Looking ahead, economic moderation is expected in both the national and local economies. Sonoma County's growth for 2025 will depend on stabilizing housing affordability, policy clarity, and sustained strength in key industries like healthcare, manufacturing, and tourism.



2025 First Quarter Economic Outlook

BY COLIN SEITZ

MACROECONOMIC OUTLOOK

The economy appears to be losing some of its luster. The January economic data indicate that growth is throttling back. Retail sales and manufacturing production fell, and job growth was uninspiring. It is still early, but real GDP growth in the first quarter is tracking closer to 2% than the near 3% growth enjoyed last year. Moreover, the disinflation from the pandemic and Russian war-induced surge in prices also appears to be over, at least for a while. Consumer price inflation jumped in January with surprisingly big price increases across many goods and services.

Measurement problems may be a factor in the disappointing data. The burst in CPI inflation could be overstated as many businesses raise prices at the start of the year. The Bureau of Labor Statistics seasonally adjusts the data to account for this, but it is tough to get it right, particularly in the topsy-turvy wake of the pandemic. There are also some idiosyncratic factors such as the avian flu's impact on egg prices and the jump in motor vehicle insurance rates. The Los Angeles wildfires and other weather events also may be playing a role. Regardless, prices were up strongly too broadly to result only from measurement issues and natural disasters.

It also would not be surprising if the economy takes a step back from its strong performance of the past couple of years. The economy benefited from a pickup in productivity growth that is proving to be at least in part temporary. Workers who quit their jobs during the Great Resignation landed better jobs more suited to their skills and interests, lifting their productivity. This likely provided a onetime productivity boost.

Labor force growth is also moderating. The immigration surge put enormous strain on many communities across the country, but one economic benefit is that many of those immigrants quickly applied for and went to work. But with President Biden's crackdown on asylum seekers last summer and President Trump's aggressively anti-immigrant policies quickly going into effect, immigration is way off and so too is labor force growth.

Productivity and labor force growth determine the economy's potential growth and, with the economy at full employment, its effective speed limit. Growth must moderate more or less consistently with the slowing in the economy's potential, or inflation and interest rates will increase.

The turn in the economy's performance may also be due in part to the hard shift in economic policy under Trump. The president is moving quickly on policy fronts from tariffs and immigration to fiscal policy and government layoffs and funding cuts. The resulting drama, and in some instances chaos, is creating substantial uncertainty.

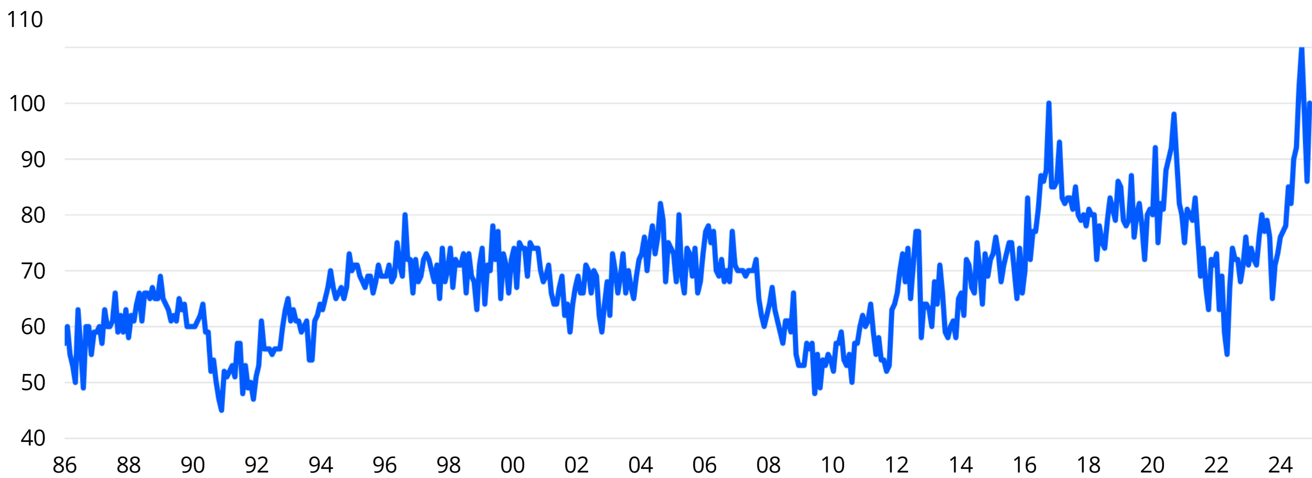
This is evident in the small-business sentiment survey conducted each month by the National Federation of Independent Business. There is a clear political bias in the survey—it skews Republican—so it is not surprising that sentiment has decidedly improved since the election. What is surprising is the jump in the survey's uncertainty index, which measures the number of "don't know" and "uncertain" responses. In the most recent survey, this index was the highest in history, save for a couple of months leading up to the election (see Chart 1).

Businesses have good reason to be highly uncertain given the Trump administration's messy tariff policy and the prospects for a global trade war. Then there are the haphazard Department of Government Efficiency cuts to government jobs and spending. These moves are on-again, off-again given the inevitable court challenges. And all this is before the immigration restrictions are fully implemented and what is sure to be high legislative drama over tax and spending policy and how to handle the Treasury debt limit. Policy uncertainty, at best, casts a pall over business investment and hiring decisions, and if it lasts for long, it becomes a corrosive on the economy's performance.

Another economic side effect of Trump's tariff and other policies is higher inflation expectations. Both global investors and American consumers are discounting higher inflation dead ahead (see Chart 2).

Chart 1: Businesses Are Uncertain

Sum of “don’t know” & “uncertain” answers to questions in the NFIB’s small business sentiment survey

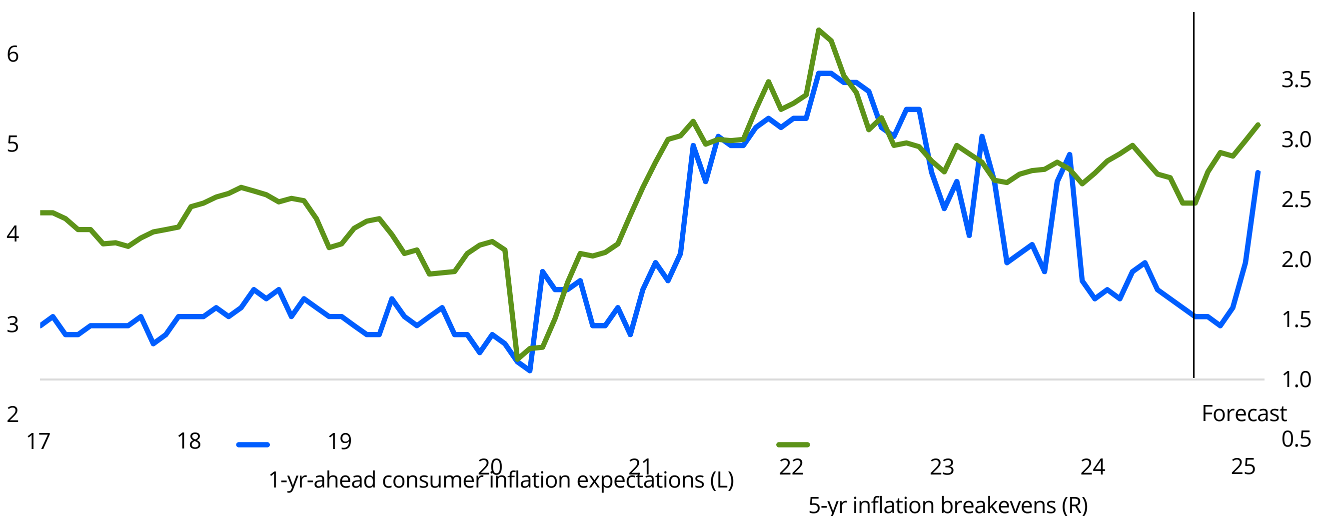


Sources: NFIB, Moody’s Analytics

Five-year inflation breakevens have been rising since September, when Trump’s lead in the election polls and betting markets gained momentum. Consumer expectations of inflation in the coming year have increased even more sharply recently, according to the University of Michigan’s survey. This is especially telling as oil and gasoline prices—often a key consideration in setting inflation expectations—have remained low.

The higher inflation expectations may already be affecting actual inflation. Vehicle dealers reported a spurt in sales as worried buyers look to get ahead of any tariff increases. Trump has consistently called out vehicle imports as a target for higher tariffs. Not surprisingly, the dealers have used the opportunity to pare back price incentives, effectively raising prices. Despite the Sturm und Drang over policy and the developing economic fallout, investors are still nonplussed. Stock prices are flirting with record highs on an almost daily basis, and the Standard & Poor’s 500 stock index has doubled in the five years since just before the pandemic hit. That is a stunning annualized gain of more than 13%. There are only a half dozen other times in the index’s history

Chart 2: Inflation Expectations Jump



Sources: Federal Reserve, Univ. of Michigan, Moody’s Analytics

from the late 1800s that the market has posted such a consistently strong performance.

House values have also taken off. The Moody's Analytics repeat-sales national house price index is up more than 50% since just before the pandemic, an annualized gain of close to 9%. House price gains have cooled with the recent runup in mortgage rates and the resulting hit to affordability and demand, particularly in the South and West, where prices had previously run up the most and homebuilding has been stronger. Even so, national house prices continue their march to record highs.

Surging stock prices and house values have fueled a remarkable increase in household wealth. Household net worth—the difference between the value of what households own and what they owe—has increased by an estimated $56 trillion since just prior to the pandemic. This, in turn, has unleashed a powerful wealth effect (see Chart 3).

The wealth effect is the change in consumer spending that is driven by a change in household wealth. The reasoning is straightforward. Wealthier households are financially more secure and thus more able and willing to spend from their income. That is, they save less than they would otherwise. This is consistent with our estimates of consumer spending by income group, which shows the well-to-do in the top quintile of the income distribution powering the recent growth in spending (see Chart 4).

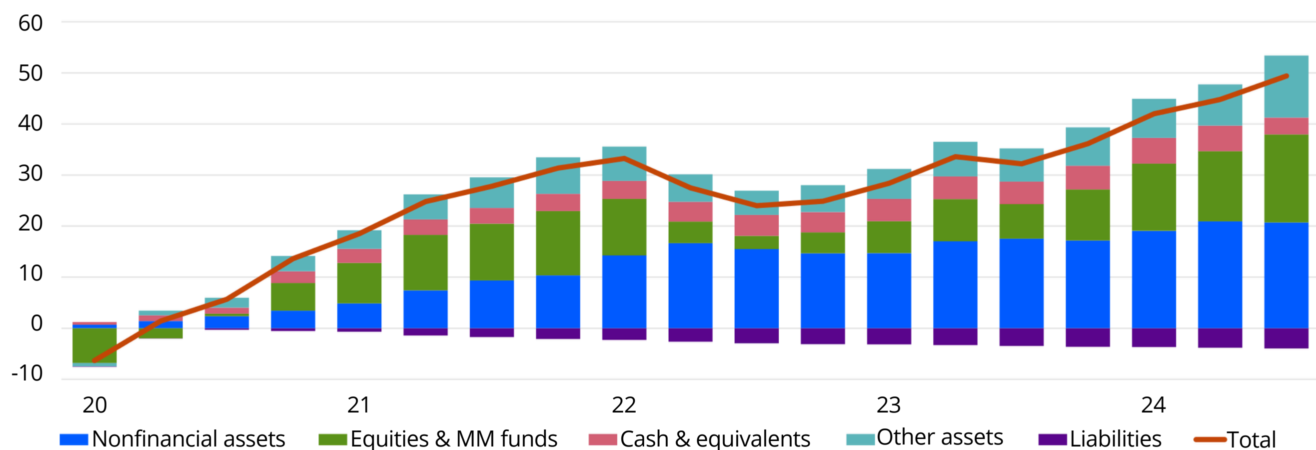
The wealth effect can vary considerably, depending on whether asset prices are rising or falling, which assets are appreciating or depreciating in value, and the volatility in price changes. A good econometrically based rule of thumb is that a sustained and broad-based appreciation in asset prices like we have been enjoying is consistent with a wealth effect of 2 cents. That is, for every $1 increase in net worth, consumer spending ultimately increases by two cents. This seems insignificant at first blush, but do the arithmetic. Last year, the wealth effect added a full percentage point to consumer spending growth and more than 0.7% to GDP growth. An outsize approximately one-fourth of the growth in GDP last year was caused by greater household wealth.

Thus, if asset prices continue at the very least to hold their own, the wealth effect will fade, and consumer spending and overall growth will moderate. This is the Moody's Analytics baseline, or most likely, outlook. However, given stretched asset price valuations, the threats to this sanguine outlook are consequential.

Take valuations in the stock market. The price-earnings multiple on the S&P 500 based on trailing earnings is well over 30 times. This is almost double the average multiple over history, and aside from the financial crisis and pandemic shutdowns, when corporate earnings cratered, the market's PE was higher only once before, during the dot-com bubble (see Chart 5).

Chart 3: Increasing Household Wealth Supercharges Spending

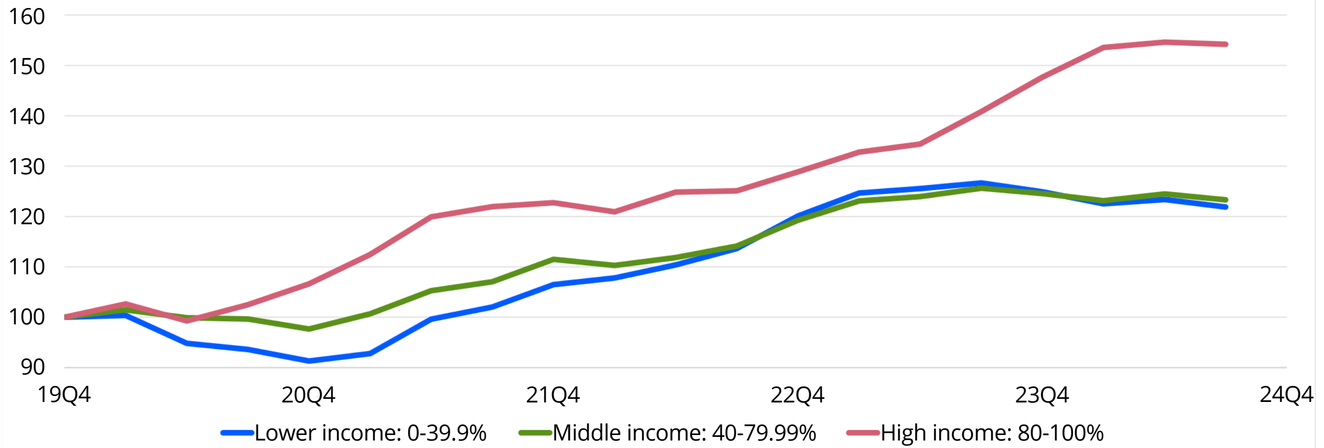
Household net worth, change from 2019Q4, $ tril



Sources: Federal Reserve, Moody's Analytics

Chart 4: The Well-to-Do Power Consumer Spending

Personal outlays by income group, 1999Q4=100



Sources: BLS, Moody's Analytics

Times are different, as the handful of technology companies powering the current stock market run are minting profits and riding a rare technological wave. Nonetheless, the rest of the stock market is also richly (over) valued.

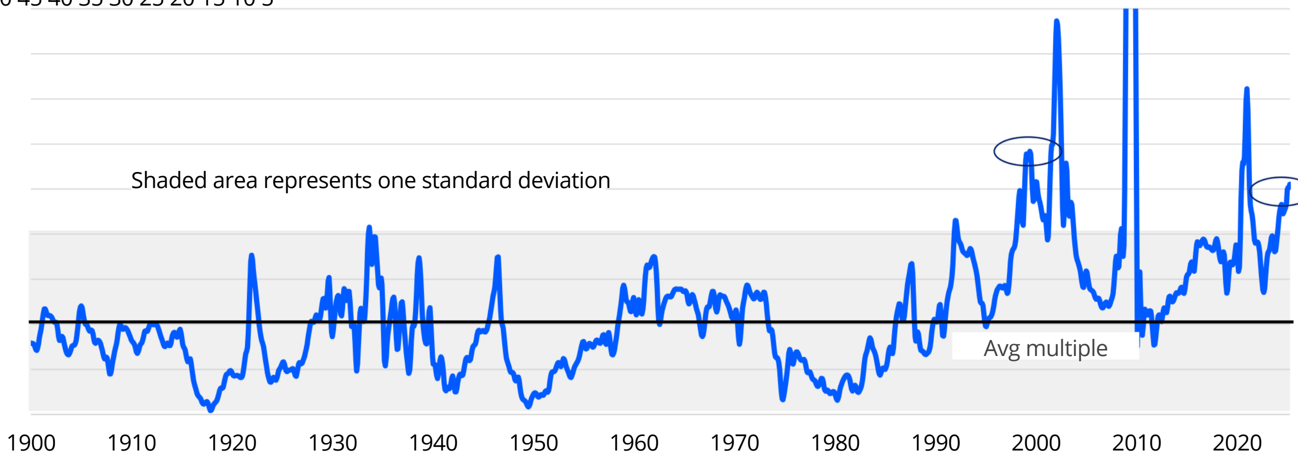
Stretched valuations are also clear in the corporate bond and structured finance markets. Spreads—the difference between the yield on these fixed-income investments and Treasury yields—are about as thin as they have ever been. These spreads are the compensation investors demand for the credit and liquidity risks they are taking compared with Treasuries. Consider, for example, that the spread on high-yield (or below-investment-grade) corporate bonds is about half its historical average. It was narrower briefly once before—just prior to the Global Financial Crisis (see Chart 6).

There are compelling reasons why asset price valuations should be high. After all, businesses are

Chart 5: The Stock Market Is Richly (Over) Valued...

Ratio of S&P 500 price to earnings

50 45 40 35 30 25 20 15 10 5



Sources: S&P Global, Moody's Analytics

Chart 6: ...And Corporate Bond Investors Are (Overly) Sanguine

High-yield corporate bond spreads, %

20 18 16 14 12 10 8 6 4 2 0

Sources: ICE, Moody's Analytics

making lots of money and outside of private equity deals have done a good job managing their leverage. Many also did an admirable job locking in the low interest rates that prevailed at the height of the pandemic and are thus more insulated from the adverse financial impact of the now higher rates.

However, it is reasonable to worry that investors are becoming overly cavalier in their assessment of the risks. Consider the recent hysteria over Trump's newly minted meme coin. This is a cryptocurrency unveiled by the president on social media soon after his inauguration. Its price at once rocketed to more than $70 a coin, and while it has been swinging wildly since, it is trading at close to $17. Despite the slide in price, the total market capitalization of the coin is still an eye-popping $3.4 billion. This is unadulterated speculation—like Dutch tulip bulbs or Beanie Babies on steroids. It is tough to see other asset markets completely inoculating themselves from this greater-fool mania.

While asset markets are stretched and vulnerable to a significant correction, a correction needs a catalyst. Asset prices supported by momentum investors do not cave under their own weight. They need a push, although the more stretched the valuations the softer the push needed. A bum earnings report from one of the high-flying tech companies might be sufficient or a geopolitical misstep.

However, most likely, most immediately are U.S. tariffs and a resulting global trade war. Trump's recent endorsement of reciprocal tariffs stands out. The U.S. will broadly impose higher tariffs based on its determination of the value of the tariffs and other nontariff trade subsidies and restrictions imposed by other countries. It looks increasingly as though Trump is looking to tariffs as an ongoing source of revenues. If so, other countries are more likely to retaliate with their own tariffs and trade restrictions. Publicly traded U.S. companies recently reporting their fourth-quarter earnings are taking note and planning for a trade war. Those companies with exposure to a trade war have no plans to increase their capital spending, while those that do not are planning mid-single-digit increases.

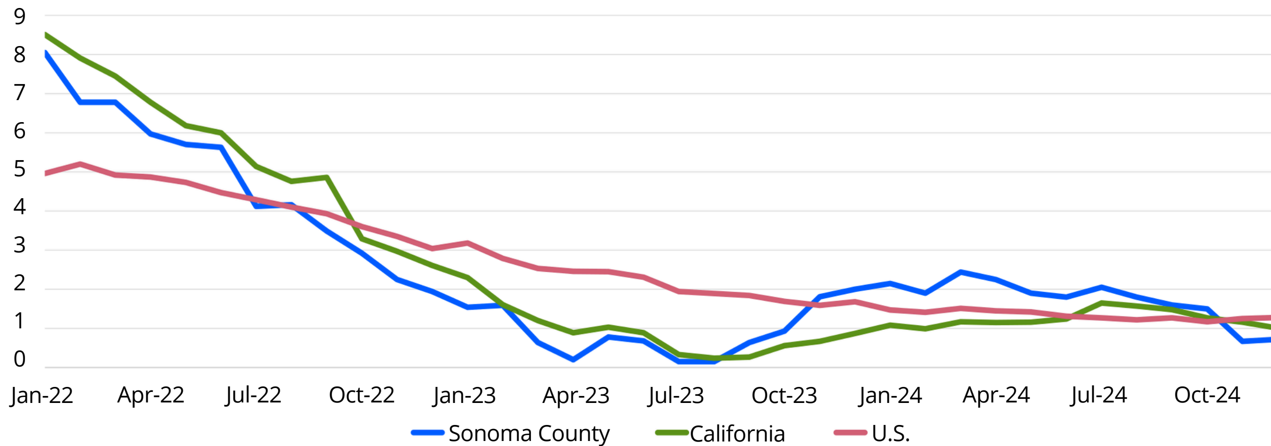
SONOMA COUNTY OUTLOOK

Sonoma's economy is solid but unspectacular. Job growth has finally picked up again in recent months, but a slow start to 2024 has dragged year-ago job growth below that of the state and region for the first time in nearly a year (see Chart 7). The county's core driver, tourism, is edging forward again after a significant pullback early in 2024, and payrolls are roughly even with their year-ago levels. Healthcare, meanwhile, is still strong, though job gains are finally abating somewhat after robust gains for the better part of the last two years.

However, as mentioned in the last update, job growth over the past year is likely overstated. The more accurate but lagged Quarterly Census of Employment and Wages paints a bleaker picture of the employment

Chart 7: Sonoma County Falls Slightly Behind

Sonoma County, employment, % change yr ago

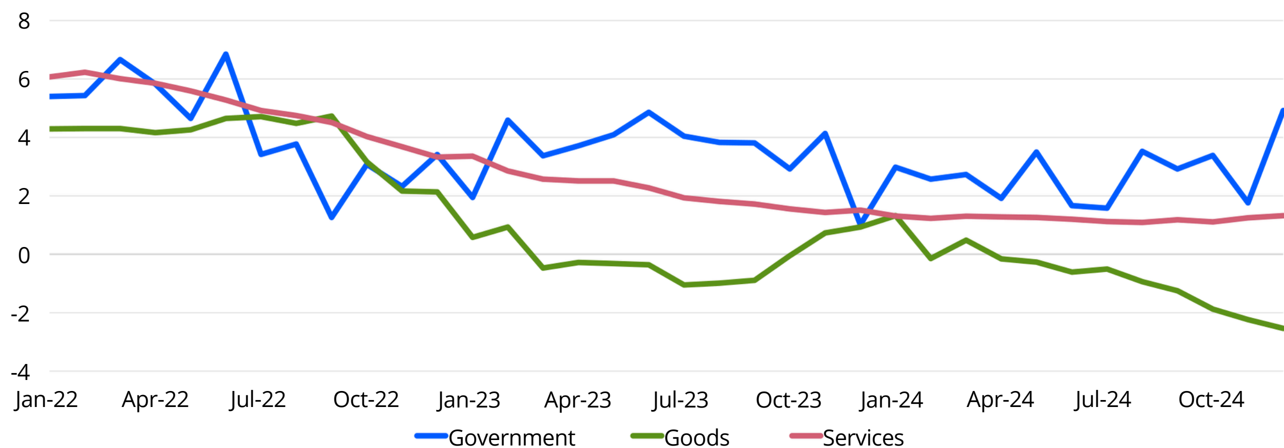


Sources: BLS, Moody's Analytics

situation: at best, flat payrolls for much of 2023 and a more feeble 2024 rally than suggested by the monthly payroll survey. Job growth will likely be revised lower when the Bureau of Labor Statistics does its annual employment benchmark in early 2025. Goods producers remain a drag on growth (see Chart 8) and here, too, the QCEW indicates that losses are larger than the monthly survey suggests. Manufacturing and construction have taken a step back and have been weighed down by high interest rates and a frozen housing market. These industries should see relief when interest rates pull back, but we now expect that to happen at a slower pace. The Fed will likely pause on interest rate cuts until September, when there is more certainty on economic policy and more progress on the inflation front. Manufacturing and construction will, at best, hold steady through most of this year before finally finding another gear in the second half of the decade.

Chart 8: Goods Producers Are a Drag

Employment, % change yr ago



Sources: BLS, Moody's Analytics

The shifting economic policies under the Trump administration will leave inflation a bit higher for longer than previously forecast. This means that interest rate declines will happen at a slower pace as the Fed is in wait-and-see mode. Ultimately, this will result in a housing market that takes longer to emerge from its deep chill. Home sales will remain subdued through 2025 as mortgage rates remain high. Inflation expectations are rising as investors consider the prospects of increased tariffs, mass deportations and rising deficits, keeping bond yields and mortgage rates high. Despite the interest rate headwind, housing inventories and sales will slowly increase as homeowners outgrow their existing houses. A gradual upward adjustment in the months' supply of homes for sale will put downward pressure on prices as decreased affordability forces sellers to make price concessions.

Manufacturers will also see some respite as interest rates retreat, but again the progress will be slow as monetary policy remains more restrictive than previously expected. Manufacturing payrolls have been declining since mid-2022, corresponding with the rise in interest rates. Food and beverage manufacturers, which have driven nearly all the growth in manufacturing payrolls since the pandemic, have backslid over the past year amid higher food inflation and a slight pullback in consumer spending. Food prices are moderating and will help improve margins for the county's food and beverage producers, and consumer spending will remain resilient over the course of 2025 given steady job growth. Finally, the county's grape harvest was excellent in late 2024, which augurs a favorable outlook for the county's wineries and winemakers.

Leisure/hospitality has moved sideways for the better part of the last two years, and prospects are for only modest gains moving forward. Tourism payrolls have recouped their losses from the pandemic, and staffing levels are adequate to satiate the demand from travelers given demographic headwinds. Slower growth in the Bay Area over the last few years has siphoned some growth away given fewer day trips from San Francisco. A still-strong macroeconomic picture, though rife with uncertainty, will safeguard visitor spending and keep leisure/hospitality payrolls ticking modestly higher. The county's abundant wineries and outdoor recreation opportunities will ensure that it garners its fair share of tourism, even if spending eases slightly compared with the previous few years. Passenger totals to Charles M. Schulz airport climbed a healthy 20%, reflecting increased route availability and Sonoma's pull as a tourism destination even in light of the Bay Area's generally weaker economic performance as of late.

The effort to re-shore semiconductor manufacturing is expected to stimulate further growth in the production of related IT goods. As global demand for semiconductors continues to rise, driven by the increasing connectivity of products to the internet, the smart-home and cloud-computing markets are experiencing exponential growth. Additionally, future catalysts such as the implementation of 5G technology, advancements in artificial intelligence, and the development of autonomous driving will sustain the demand for more advanced chips. Rising smartphone penetration globally—as well as the incorporation of additional computer and electronic components into automobiles, airplanes, and other transport vehicles—will amplify sales of top employer Keysight's next-generation signal analyzers and oscilloscopes. While these trends bode well for the industry generally, automation will limit the need for new labor, holding back employment growth compared with the pre- pandemic years. Productivity enhancements ensure that output growth will keep climbing despite the lack of meaningful employment gains.

Healthcare remains the crown jewel of the labor market, but even growth there is beginning to slow given the rapid pace seen over the past few years. The industry was bound to slow after surging since early 2023, and job growth remains strong even despite the slowing. Demographic challenges, however, will begin to weigh on growth. Population declines, while moderating, will limit the need for additional hires in healthcare, though a growing stable of 65-and-older residents will ensure healthcare demand remains sturdy.

These demographic challenges are the biggest obstacles facing the county and the fundamental reason for the slightly below-average medium- and long-run outlooks. Out-migration, largely because of affordability issues that have intensified in the last decade because of the blockbuster run of house price appreciation, will hamstring growth in various industries. Fortunately, there appears to be some respite in the future. House price appreciation will take a breather when more supply comes on line as mortgage rates retreat. This will give time for incomes to catch up and bring affordability down, albeit slightly. Migration patterns, while still a net negative, are improving.

According to high-frequency relocation data from Equifax, the net loss of domestic residents in 2024 was the smallest since 2016, and we expect this to improve further. One upside is Sonoma County's relative affordability compared with neighboring Napa County and most of the Bay Area. Combined with the mortgage rate lock-in effect, this will muffle out- migration slightly in the years ahead.

Job and income growth will moderate over the next several quarters. Manufacturing will drive growth as lower food inflation gives consumers the confidence to spend and food producers the confidence to hire. Healthcare and tourism will lend support, albeit to a lesser extent. Longer term, the shrinking population will take a toll on growth and Sonoma County will struggle to keep pace with more dynamic California metro areas.

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The Economics team has more than 35 years of dedicated experience in economic forecasting and research. Leveraging our team's global coverage and local expertise, our economists provide unrivalled insight on pivotal economic topics, including labor markets, housing and consumer spending, among others, across the Americas, Europe, the Middle East, and APAC. We also provide real-time monitoring of economic indicators, scenario analysis, and thought leadership on critical themes such as monetary and fi scal policy and sovereign risk—all of which support decision makers and policymakers in strategic planning, product and sales forecasting, stress testing, credit risk management, and investment decisions.

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141 Stony Circle, Suite 110
Santa Rosa, CA 95401

SonomaEDC.org