Moody’s Quarterly Outlook

November 2024

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Executive Summary

November 2024

Macroeconomic Forecast

With Former President Donald Trump's re-election and the Republican sweep of the House and Senate, he is positioned to implement the policies outlined during his campaign, though likely in a more measured manner.

Arguably, the most significant policy change will be Trump's proposed adoption of increased tariffs on U.S. imports. Trump has discussed the possibility of tariffs ranging from 10 – 100%, but Moody's Analytics projects the effective tariff rate across all imported goods will increase from its current 3% to 7.5%. While the effects will be felt across all realms of the supply chain, consumers will bear the brunt of these measures, as it will impact inflationary pressures in the long-term.

Immigration pressures also remain significant. Moody's projects that this will lead to reluctance among employers to attract and hire immigrants for specific positions. The firm also notes that, considering the age distribution of deported migrants, these deportations will reduce labor force growth by one-third. Industries heavily dependent on immigrant labor, such as tourism, construction, agriculture, and manufacturing—key sectors of the Sonoma County economy—are expected to experience the greatest impact.

Trump's Tax cuts are an equally important part of his agenda, and it is projected the corporate rate will be cut from its current 21% to as low as 15%. These cuts should provide lift to long-term growth but has also hiked the 10-year Treasury yield to 90 basis points, reflecting higher inflation expectations and the prospect of larger budget deficits and government debt. In short, Moody's suggests Trump's economic policies will thus result in some combination of higher inflation and interest rates, which could, in turn, diminish growth.

Sonoma County Outlook

In Sonoma County, the current portrait is positive. Annual job growth remains comfortably ahead of the U.S. and California. Healthcare continues to be the county's driving industry, and tourism has picked up in recent quarters. Albeit, manufacturing and construction are burdened by higher than average interest rates but are likely to experience long-awaited relief, should they continue to decline.

Demographic challenges remain the county's largest obstacle; however, 2023 saw the lowest level of outward migration since 2016. If mortgage rates decline, house price appreciation may slow, allowing incomes to catch up, improving affordability. With that said, it will be essential to consider the incoming macroeconomic factors established by the new administration and their potential impacts on the regional economy.

November 2024 Quarterly Economic Outlook

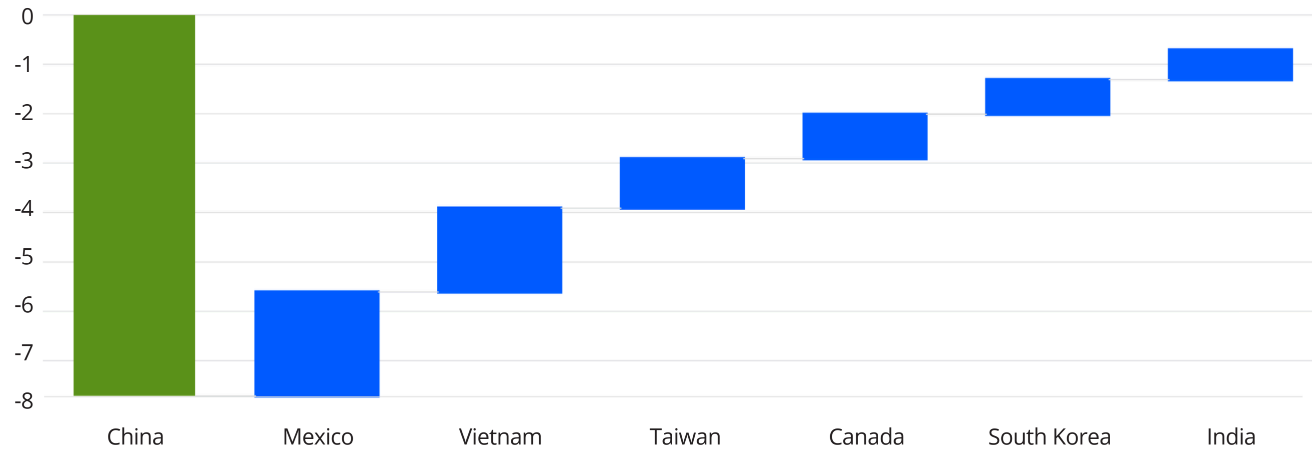
BY COLIN SEITZ

MACROECONOMIC OUTLOOK

Former President Donald Trump's reelection and the Republican party's sweep of the Senate and House will result in meaningful changes to economic policy and, therefore, to the economic outlook. Trump handily won reelection, and the Senate and House are under Republican control. Republicans have a modest majority in the Senate and a thin one in the House. Although Moody's Analytics had attached a high probability to a Republican sweep, equal to the probability that Vice President Kamala Harris would win the presidency with a divided Congress, the latter scenario represented the economic policy status quo and was our baseline outlook. With a Republican sweep, economic policy and the outlook will change. 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. He will also likely implement these policy changes soon after becoming president early next year. Unlike his first term, when it took nearly all of his first year to put an administration together and begin implementing his policies, Trump is well-prepared and ready to go this time. Moreover, his next administration will be run by like-minded officials with plenty of time to think through their policies. He likely also thinks that he has voters' approval for his policies given the magnitude of his election victory. Arguably, the most significant economic policy change will be the adoption of higher broader-based tariffs on imports to the U.S. On the campaign trail, he talked about an across-the-board tariff of 10% or even 20%, 60% on imports from China, and 100% plus on certain products. Talk of tariffs this high is likely political bluster or possibly a negotiating stance with U.S. trading partners. However, it would not be surprising if tariffs significantly increased on China and other countries that have benefited from the diversion of Chinese trade due to current tariffs. Mexico and Vietnam stand out in this regard. Trump has also called out other countries that appear likely to face higher tariffs, including Japan, Korea and Canada. Taken together, we assume that the effective tariff rate across all imported goods will increase from its current 3% to closer to 7.5%. For context, prior to Trump's tariff hikes during this first term, the effective tariff rate was closer to 1%. We expect the tariffs to be phased in throughout 2025 due to logistical and legal impediments, the desire to limit their inflationary impact, and to enhance the U.S. negotiating stance as countries see how far Trump is willing go with the tariffs. We assume Trump will announce tariffs on China via executive order soon after he is inaugurated, with the effective tariff rate on Chinese imports doubling to 40% from their current close to 20%. Tariffs on vehicles produced in the European Union, Japan, Korea and Mexico will likely come next. Next are tariffs on imports from countries that have benefited from the diversion of trade from China since tariffs were imposed in Trump's first term, including Mexico, Vietnam, and other mostly Southeast Asian nations (see Chart 1). Australia and the U.K. will suffer some targeted tariffs but will be the least impacted developed economies. As with the tariffs imposed in Trump's first term, U.S. consumers will bear the brunt of the cost of the new round of tariffs via higher prices for imported goods. While foreign producers will also feel the fallout, as will U.S. distributors and retailers, it is the consumer who, far and away, will suffer the most. Countries facing the higher tariffs will likely respond by imposing their own tariffs on goods coming from the U.S. We expect China to respond tit-for-tat with tariffs and other trade restrictions comparable to those imposed by the U.S. In contrast, other countries will be more circumspect in their retaliation in an effort to appease the Trump administration and cut a better deal. A lesson from the tariffs imposed in Trump's first term is that they will be messy to implement as exceptions are made for certain products and countries over certain periods of time due to national security or other business reasons. The uncertainty this creates will cause businesses to pull back on their supply chain and other investments, adding to costs, impairing productivity, and

Chart 1: Who Will Be in Trump's Tariff Crosshairs?

Change in share of U.S. goods imports, 2017 to 2023, ppt

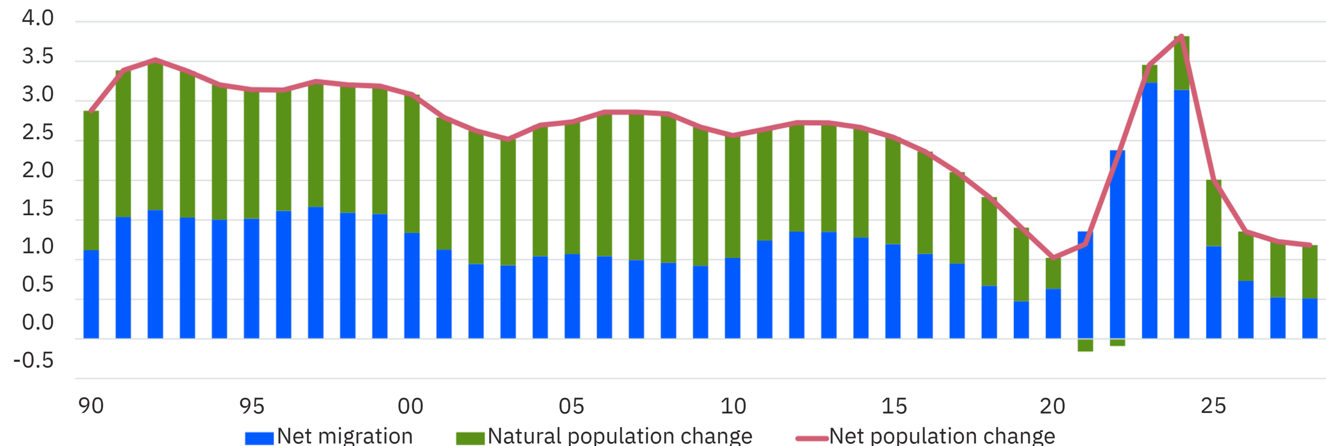


Sources: U.S. Census Bureau, Moody's Analytics

further exacerbating inflation pressures in the long run. The longer the tariffs remain in place and the more often they change, the more persistent the impact on inflation. Trump is also set to impose a much more restrictive immigration policy, particularly when it comes to the estimated more than 11 million unauthorized immigrants already living in the U.S. During his campaign, he consistently talked of deporting these immigrants. Some of this is political bluster since the logistics of mass deportation are not feasible. Still, the new Trump administration is likely to pursue deportations aggressively. And given increased pressure from ICE and other authorities, employers will be more reluctant to hire immigrants, forcing fearful immigrants to self-deport. Trump will use executive orders and supercharge successful strategies developed during the Biden administration to significantly restrict asylum seekers. Immigration to the U.S., which averaged just over 1 million per annum before the recent post-pandemic surge, is expected to fall to close to half a million per annum in Trump's second term (see Chart 2).

Chart 2: Less Immigration, Weaker Population and Labor Force Growth

of people, mil

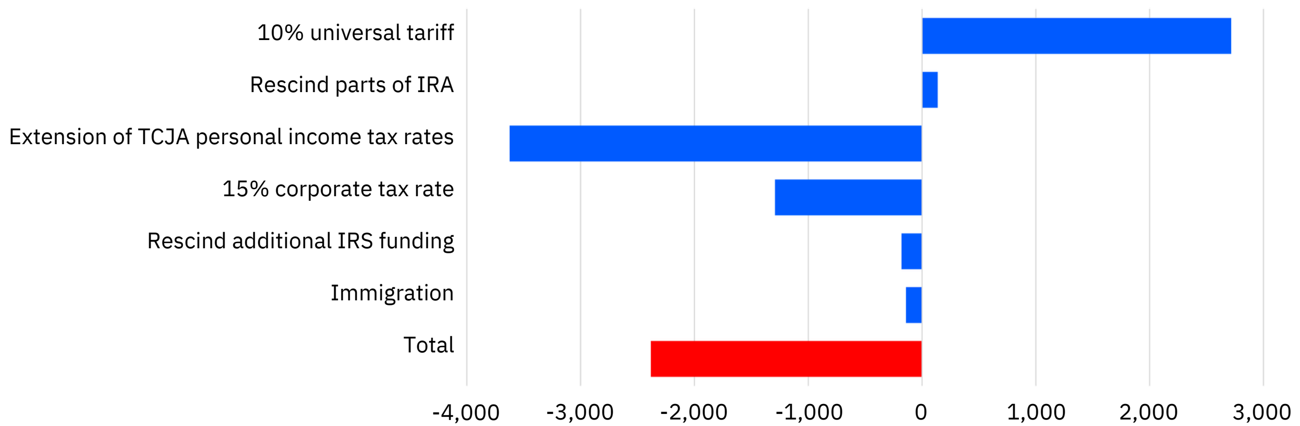


Sources: U.N., Moody's Analytics

Accounting for the age distribution of the deported migrants, the deportations will cut labor force growth by one-third, or by almost 0.2% per annum. A wide range of industries that rely on immigrant labor will be impacted. A good example is the construction trades, where close to one-third of workers are immigrants. In parts of the South and West they are closer to one-half. If a number of these workers are forced to leave their jobs and the country, it will significantly disrupt housing and other construction, as labor shortages are already endemic. Other industries likely to be meaningfully disrupted include agriculture, manufacturing, transportation and distribution, retail, leisure and hospitality, and child and elder care. Promises of tax cuts were also an important part of Trump's reelection bid. He has promised to extend the individual tax cuts passed in his first term and talked about further cutting the corporate tax rate from its current 21% to as low as 15%. Unlike his tariff and immigration policies, which he will likely pursue via executive orders, he will need Congress to pass legislation to cut taxes. With Republicans in control of Congress he will get much of what he wants on taxes, although probably not everything given that Republicans have a slim majority in the House and the legislation will need to be done via reconciliation. Trump has talked of other tax cuts that may result from political horse-trading, including raising the cap on state and local tax deductions, reinstating 100% bonus depreciation and research and development expensing, and increasing the child tax credit. It is unclear how the tax cuts will be paid for—and thus it is unlikely that they will be. Revenues raised from the higher tariffs will help defray their costs, but the tax cuts will be deficit-financed in significant part (see Chart 3).

Chart 3: Trump's Policies Will Result in Bigger Budget Deficits

10-yr static federal budget deficit impact, Republican Sweep scenario, $ bil



Source: Moody's Analytics

This could also complicate making the individual tax cuts permanent, so we expect they will be extended only for the 10-year budget window ending in 2035. The corporate tax cuts should provide some lift to long-term growth, but judging by the modest boost from the much larger tax cuts in Trump's first term, this will be on the margin and play out over years. In the near term, with the economy operating at full employment, the fiscal stimulus provided by the deficit-financed tax cuts will be inflationary.

President-elect Trump has also publicly ruminated that the president should have input into the Federal Reserve's interest rate policy decisions. While directly abridging the Fed's independence cannot be done without legislation—that would be a big stretch—it can be done indirectly through appointments of Fed officials, including the Fed chair, a position that will open no later than spring 2026. As long as the Fed is cutting rates as it is doing now, there is no issue. The problem will be when the Fed should raise rates, but the president feels this is not in his political interest.

Indeed, historically in cases across the globe, when the independence of the central bank is impaired, it ultimately leads to too-easy monetary policy and higher inflation.

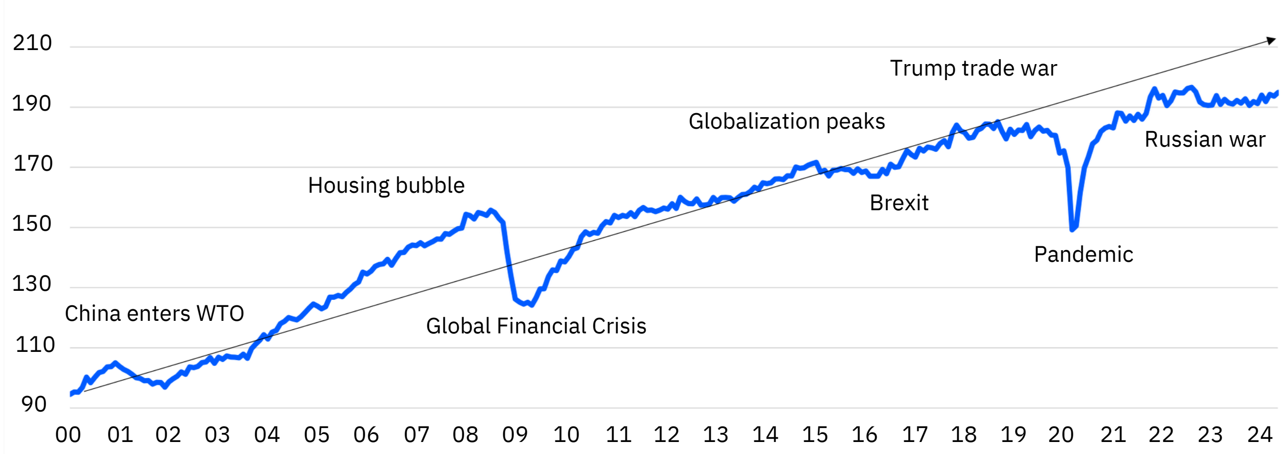
The sum of Trump's economic policies will thus result in some combination of higher inflation and interest rates—and diminished growth. The financial market reaction to the election results is consistent with this outlook. Most significantly, long-term interest rates have risen sharply since investors began discounting a Trump victory before the election. 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—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.

course, the degree to which the economy is impacted depends on the precise policies that are implemented and their timing. It also depends on how Trump responds to feedback from financial markets and business leaders. He showed a willingness to pivot on policy in his first term, notably on tariffs, if it appeared they were doing damage to investor sentiment and the economy. Given this and the underlying strength of the current economy, the policies that are ultimately adopted under President Trump will not undermine the economy. Instead, they will result in growth that is slower than would have been under the economic policy status quo, with higher inflation and interest rates.

While we will not release our new baseline forecast until early December, we have some preliminary estimates of the macroeconomic impact of Trump's assumed economic policy measures, including the decline in global trade (see Chart 4). Real GDP growth will be reduced by 0.2% in 2025 and 0.5% in 2026. The peak impact will be in early 2026 with real GDP down by almost a full percentage point compared with our November baseline forecast.

Chart 4: Globalization Set to Stall Further

Global merchandise exports plus imports, volume basis, 2001=100



Sources: CPB World Trade Monitor, Moody's Analytics

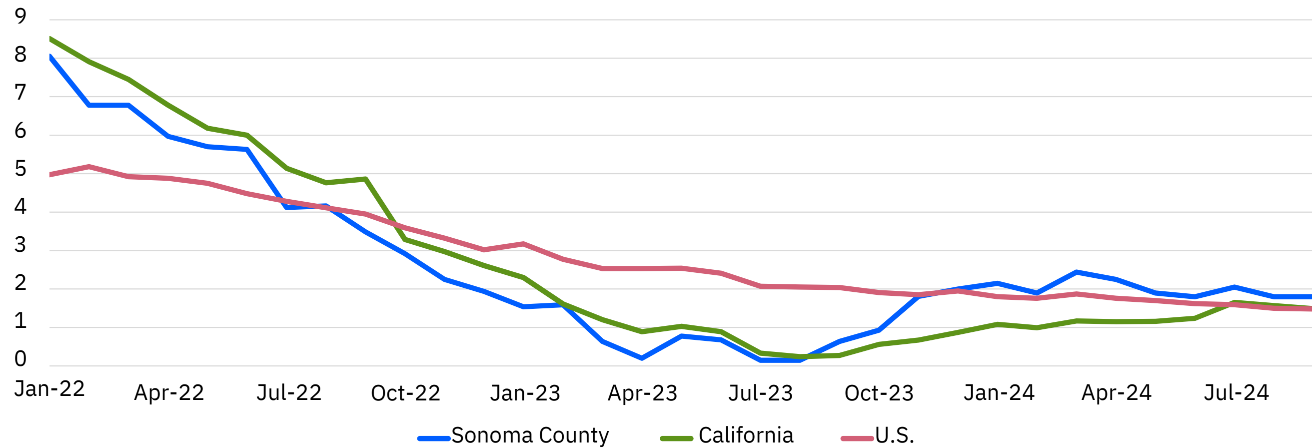
Prospects for higher U.S. tariffs are likely also behind the higher value of the U.S. dollar and weaker stock prices in much of the rest of the world. Other considerations are also at work. Weaker European stock prices, for example, may reflect investor worries over the future of NATO and what Trump's victory means for Ukraine, Russia and the Middle East. Of

SONOMA COUNTY OUTLOOK

Sonoma's economy is performing well. Monthly job gains have abated in recent months, but annual job growth is running comfortably ahead of the U.S. and California (see Chart 5). Healthcare is surging, but the county's key driver, tourism, has given back its gains from late last year and sits approximately at

Chart 5: Sonoma County Retains Slim Lead, but Growth Is Slowing

Employment, % change yr ago



Sources: BLS, Moody's Analytics

the same level as a year ago. The jobless rate has climbed more than 1 percentage point from its low in mid-2022. The uptick has slowed, but this is largely due to modest declines in the size of the labor force this year. Finally, the housing market remains cool. House price appreciation is ticking higher solely due to extremely limited supply, and transactions remain near a decade low.

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 situation, with modest declines for much of 2023 before rallying in early 2024. Job growth will likely be revised lower when the Bureau of Labor Statistics does its annual employment benchmark in early 2025.

Among the key drivers in the county, goods producers have downshifted and are a significant drag on growth (see Chart 6). Manufacturing and construction are feeling the weight of high interest rates. On the plus side, these industries should see the biggest relief from the retreat in interest rates. Slowly declining mortgage rates will unlock the housing market and help alleviate some borrowing constraints

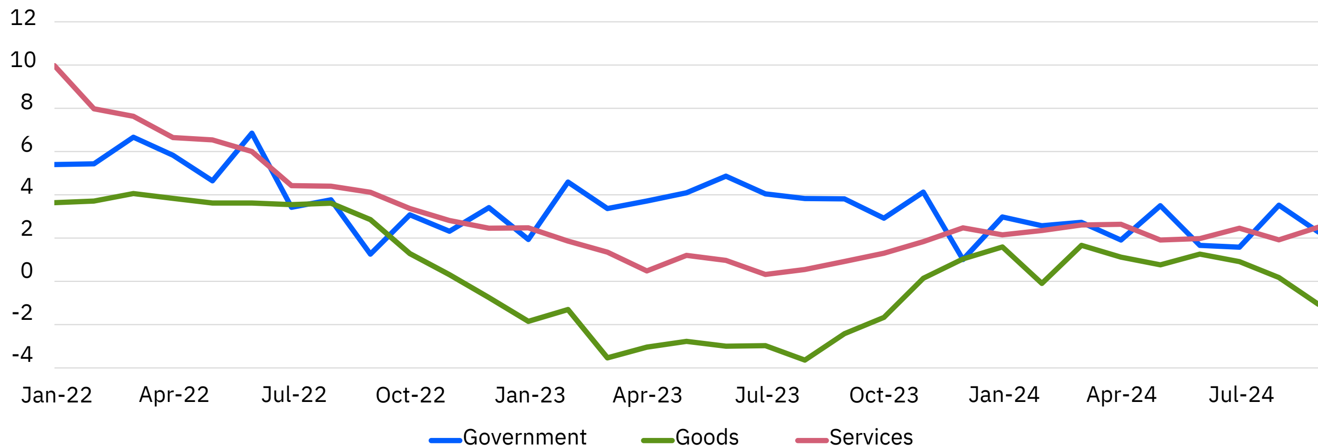
The housing market has been frozen for the better part of the last two years as mortgage rate lock-in effects weigh on supply. The decline in mortgage rates will help unlock supply. Most homeowners did an admirable job refinancing and locking in record-low mortgage rates that prevailed during the pandemic. Nationally, nearly 90% of households with mortgages have a rate that is below 6%. Since mortgage rates jumped as high as 8% with the Fed's tightening, it has made no economic sense for homeowners to move and give up their low-rate mortgages for a much higher rate.

Manufacturers will likewise benefit from the retreat in interest rates. 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, with high inflation and rising interest rates sapping goods demand, forcing firms to cut back on production and investment in new equipment. Food inflation provided less of a tailwind than expected in the second half of last year and producer sentiment dipped in response, weighing on payrolls. Still, food prices are expected to moderate, helping margins for the county's beverage producers. Furthermore, the grape harvest in 2024 is reported to be outstanding, producing both high quality and quantity of grapes. A warm summer and adequate precipitation levels led to a strong harvest season, which bodes well for the county's wineries and winemakers.

A stronger macroeconomic picture with inflation receding and consumer sentiment improving will

Chart 6: Goods Producers Pull Back, Government and Services Drive Growth

Sonoma County, employment, % change yr ago



Sources: BLS, Moody's Analytics

further buoy wineries and breweries in the county. Employment in leisure/hospitality is expected to recover after a decline this year, stabilizing at a more sustainable growth rate. Payrolls have recouped their losses from the pandemic, and staffing levels are normalizing. The total number of passengers moving through Charles M. Schulz–Sonoma County Airport is running significantly above last year's pace; new routes this year have expanded the airport's contribution to the local economy. Visitors will fuel spending at hotels, restaurants and retail shops.

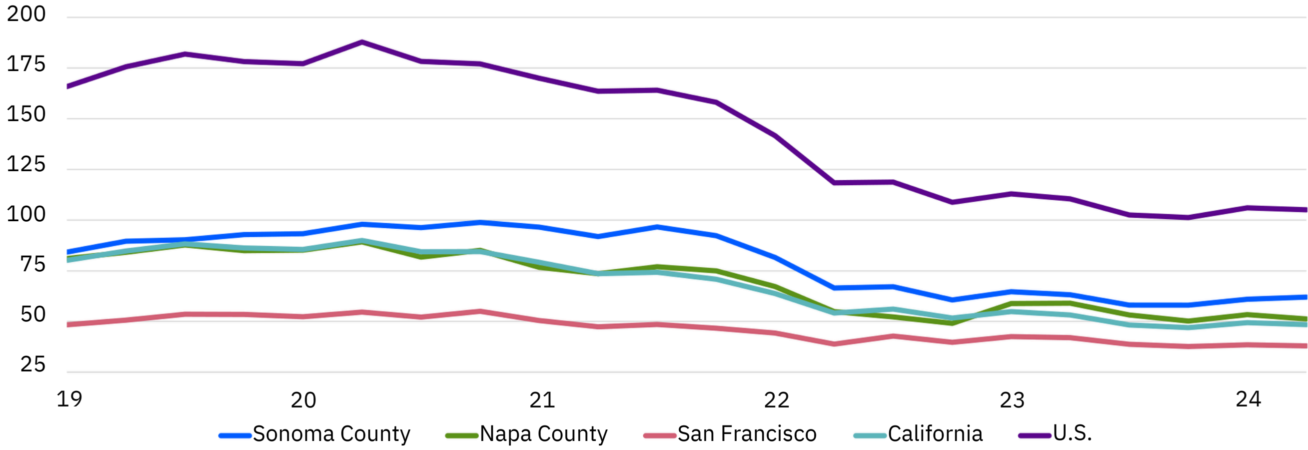
Healthcare is still the standout industry, much like the case nationally, and its contribution to keeping the labor market chugging along cannot be overstated. Healthcare job growth has more than doubled total employment for the better part of the last two years, and the county's healthcare industry is hiring at a more rapid pace than the region. In the near term, the outlook is still bright. The aging of the local population will necessitate additional hires as the elderly consume a disproportionate share of health services. In the long term, this recent pace of growth is unsustainable. Population trends have improved slightly over the last few years, but Sonoma still suffers net out-migration. A dwindling base of young working-age residents will have two effects. It will limit the supply of workers necessary to keep healthcare employment trending higher. It will also be a headwind to growth as a smaller local population requires fewer healthcare workers to service it.

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 due to affordability issues that have intensified in the last decade due to the blockbuster run of house price appreciation, will hamstring the 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. Population losses in 2023 were 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 (see Chart 7). Combined with the mortgage rate lock-in effect, this will muffle out-migration slightly in the years ahead.

Sonoma County's near-term outlook is sanguine, but growth will moderate compared with last year (see Chart 8). Manufacturing will drive growth as lower food inflation gives consumers the confidence to spend and food producers the confidence to hire. Healthcare will lend support, but leisure/hospitality will run out of steam early next year. 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.

Chart 7: Affordability Is Low but Better Than the Neighbors'

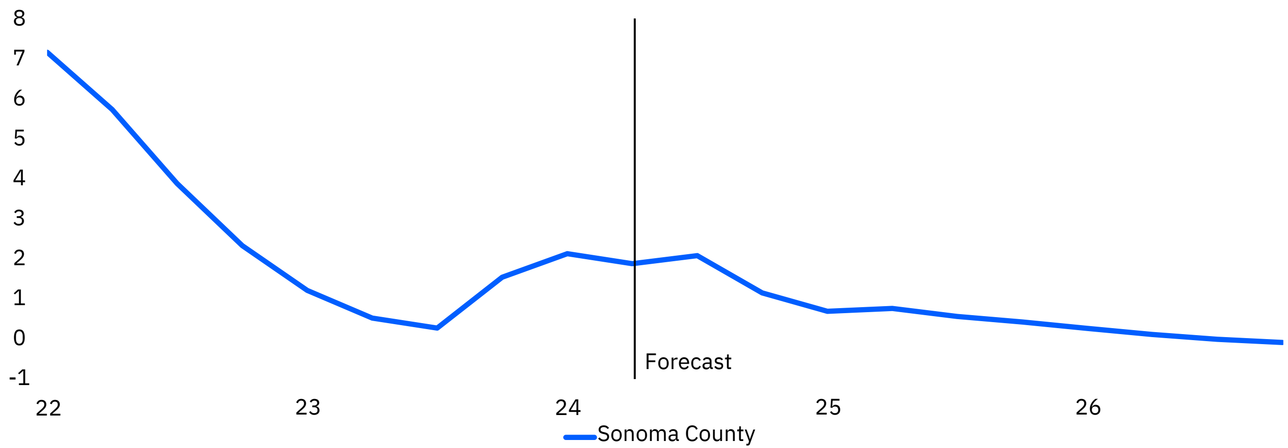
Housing affordability index



Sources: NAR, Census Bureau, BEA, Moody's Analytics

Chart 8: Job Growth Will Decelerate

Employment, % change yr ago



Sources: BLS, Moody's Analytics

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