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SONOMA COUNTY

Industry Insider, Information Technology

2025

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2025

Executive Summary

Sonoma County, California

Recent Performance:

Sonoma County's information technology sector remains a crucial contributor to the local economy, accounting for 6% of total output despite representing just 2% of total employment. The industry has faced headwinds from high interest rates, causing payrolls to slightly decline since 2021. However, output growth remains strong, with IT consulting services gaining prominence in the region.

Macro-Economy:

The broader U.S. economy is performing well, with GDP growth closing close to 3% in 2024, driven by robust labor force gains and consumer spending. Despite slowing job growth, unemployment remains stable at 4%, signaling a balanced labor market. The Federal Reserve has maintained interest rates, with expected cuts in late 2025 amid policy uncertainties tied to the Trump administration's economic strategies, including tariffs and immigration changes.

Near-Term Outlook:

In the IT sector, venture capital funding is showing signs of recovery, with modest growth through 2024, supporting tech investments. The CHIPS and Science Act has spurred significant semiconductor production, attracting $200 billion in private investment and creating over 40,000 jobs nationwide. This resurgence is expected to benefit related IT industries, including cloud computing, AI, and 5G advancements both locally and nationwide.

Looking Ahead:

Sonoma County's long-term IT outlook is cautiously optimistic, supported by digitalization trends and proximity to the Bay Area. However, challenges such as declining population growth and housing affordability remain concerns. While automation limits job growth, increased productivity ensures steady output expansion. The county's high quality of life and skilled workforce position it well for sustained IT sector growth despite economic uncertainties.

Recent Performance. Sonoma County's information technology payrolls have struggled under the weight of high interest rates, falling slightly since their post-pandemic high in 2021. Still, output growth remains on a strong footing. Information technology remains a small but critical part of the local economy; IT payrolls account for just 2% of total jobs but more than 6% of the county's output, which ranks comfortably in the top half of metro areas nationally.

Telecommunications, computer systems design, and technical consulting services make up most of the IT industry jobs in the county. IT consulting services have become a larger share of the IT industry in recent years. Proximity to the rapidly growing Bay Area tech powerhouse allowed Sonoma County to siphon some growth given its slightly lower costs and agglomeration effects. On the downside, this has led to some weakness in the past few years as tech malaise in San Francisco and Silicon Valley extended to Sonoma County. High interest rates are weighing on tech broadly, and cost-cutting measures are pushing firms to expand in lower-cost areas in the Mountain West. Meanwhile, venture capital funding appears to be turning a corner as the retreat in interest rates has begun. While still far below its peak from a few years ago, venture capital funding is up slightly through the third quarter of 2024 compared with the year before.

Macro drivers. The U.S. economy's performance is about as good as it gets. Growth is strong. Real GDP is on track to grow nearly 3% annualized in the fourth quarter of 2024 and almost that for the entire year. This is well above the economy's estimated long-term growth potential, which is closer to 2%. Indeed, because of extraordinary labor force gains fueled by foreign immigration and a revival in productivity growth, the economy's potential growth last year was closer to 4%. That is not sustainable, as immigration and labor force growth are already slowing. Still, the pickup in the economy's potential came at an opportune time, helping to cool the job market and inflation.

The job market arguably could not be better. Job growth has slowly throttled back, and abstracting from the vagaries of the data, payrolls are increasing by approximately 150,000 per month. Hiring is down, but layoffs are too. The pace of job growth is sufficient to generate enough income to fuel sturdy consumer spending, the principal driver of overall eco- nomic growth. However, it is not so strong that it would cause the tight labor market to tighten further, undesirably pumping up wages and inflation. Unemployment remains remarkably stable at nearly 4%—the Moody's Analytics estimate of full employment—across all demographic groups and from coast to coast.

The Federal Reserve has thus effectively achieved its dual mandate of full employment and low and stable inflation. It was, therefore, a surprise to global investors when the Fed made clear that its latest rate cut in December would likely be the last one for a while. Behind the Fed's reluctance to cut rates further is uncertainty regarding the equilibrium rate—the federal funds rate that neither supports nor restrains economic growth.

Also motivating the Fed to sit on its hands is the extraordinary uncertainty regarding President Trump's economic policies. The reasonable worry is that, just as inflation is coming back to target, higher tariffs and mass deportations will reignite it. Our baseline outlook has the Fed holding monetary policy unchanged until rate cuts slowly resume in September. By that time, officials should have a reasonably good fix on Trump's policies and their economic fallout. Tariffs and deportations will add to inflation but will also diminish growth and be more or less a wash for monetary policy. With the equilibrium rate trending lower, the Fed will cut rates once a quarter until the fed funds rate returns to 3%—our estimate of the equilibrium rate in the longer run. This is consistent with global investors' expectations for the Fed's path.

Industry drivers. The year ahead will be characterized by considerable uncertainty, especially regarding economic policy, tariffs, and immigration. All told, we expect a slightly lower growth environment than the previous year—and with interest rates expected to be higher for longer, a slower recovery in tech than expected. Still, the economy will prove resilient, and consumers will remain a critical firewall for keeping the economy ticking. Despite the significant uncertainty, the outlook for information technology is bright. There will be some lingering near-term pain as tech firms bear the brunt of high interest rates, but a confluence of tailwinds will keep the IT industry chugging along.

The CHIPS and Science Act is driving a resurgence in semiconductor production within the U.S. Since the enactment of this legislation, more than 40 new semiconductor projects have been announced across the country, including the construction of new fabrication plants, expansions of existing facilities, and the development of new sites supplying materials and equipment for chip manufacturing. These initiatives represent approximately $200 billion in private investment and are anticipated to generate more than 40,000 direct jobs in the semiconductor industry nationwide.

The effort to reshore 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.

Long-term outlook. The long-term outlook for Sonoma County's information technology industry is cautiously optimistic. Technological advancements, the push to digitalization and the cloud, and the surge in remote work since the onset of the pandemic offer favorable tailwinds once the U.S. and global economy regain momentum, but challenges remain. Chief among these challenges is rising housing affordability concerns that have severely hampered population growth. The working-age population is already down around 8% compared with its high-water mark in 2010. With the runup in house prices during the past few years, affordability has deteriorated further. While house prices will cool and the housing market will begin to rebalance in the com- ing years, demographic trends will remain a headwind, as the population has been contracting for some time. According to Equifax data, the net outflow of residents is slowing, but the county is still losing residents on net. A shrinking population will weigh on labor force growth, making it more difficult for the county to attract new business investment and possibly pushing existing firms to expand in faster-growing areas.

Greater automation and a general push toward labor-saving technologies will slow the pace of job additions even as the county's producers grow their operations. Thus, information technology's contribution to countywide job and income growth will be contingent on entrepreneurs' abilities to innovate across product lines and pioneer new product segments.

A high quality of life and proximity to the tech powerhouses in the Bay Area confer significant structural advantages and give Sonoma County a leg up. Despite the challenges tech faced in the past year, the Bay Area remains the preeminent destination for tech firms and employs the largest share of tech workers nationally by a comfortable margin. Because of Sonoma County's proximity, these agglomeration and spillover effects will reap benefits and provide ample growth opportunities for the county's new and established infor- mation technology firms.

Global demand for information technology's software and hardware solutions is expected to grow rapidly during the next decade, and the county's IT cluster is forecast to grow at a slightly above-average rate in the long term. While demographic trends will apply restraint, a highly skilled workforce, high quality of life, and proximity to the Bay Area will be lasting advantages for the county and prove enough to outmuscle these labor supply challenges.

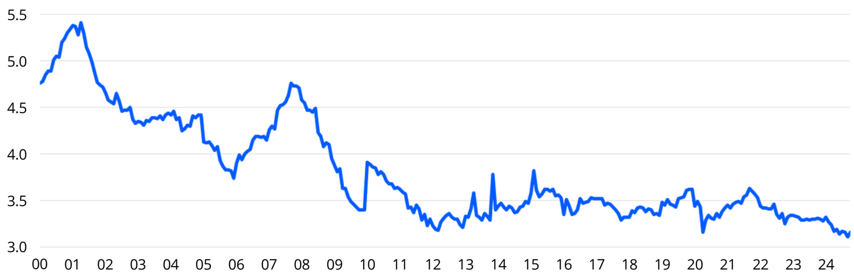
Upside risks. While the balance of risks is tilted to the downside, there is a chance that we are underestimating the resilience of the unsatiable U.S. consumer. Inflation has cooled somewhat for now, but real wage gains will keep consumer spending ticking along. The labor market is loosening but remains tight, keeping job and income growth elevated. We expect demand to soften and job and income growth to pull back, but businesses have been loath to cut staff given the labor supply issues they faced in the aftermath of the pandemic. As a result, household income growth could rise faster than expected, and more flush consumers would lead to a faster-growing economy. All told, this would benefit Sonoma County's IT industry with consumer spending on IT goods rising and more business investment.

Downside risks. A full-blown trade war remains a key downside risk. While the tariffs on Canada and Mexico have been avoided for a month, tariffs remain clearly in the Trump administration's plans. The administration announced big tariff increases on imported goods from Canada, China and Mexico. If these tariff hikes on nearly 40% of all U.S. goods imports are fully implemented soon and remain in place for more than a few months, they will do meaningful economic damage. Canada has already responded with significant retaliatory measures, and China and Mexico are likely to follow. This developing trade war will result in higher inflation and interest rates, and diminished economic growth.

Colin Seitz
February 2025

Information TechnologyEmployment Stabilizes

IT industry employment, ths, Sonoma County

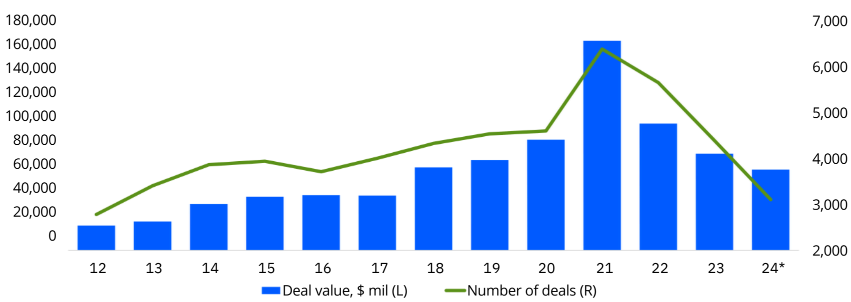


Sources: BLS, Moody's Analytics

Employment in Sonoma County's information technology industry has stalled and is a fraction of its size during the dot-com boom. After some upward momentum following the pandemic-induced recession, aggressive interest rate hikes and financial market uncertainty have led to a slight pullback in net hiring since early 2022. Industry tailwinds will help support growth, but a push for more labor-saving technologies will ensure payrolls improve only modestly in the coming quarters.

Venture Capital Is Turning the Corner

California venture capital investments, through 2024Q3*

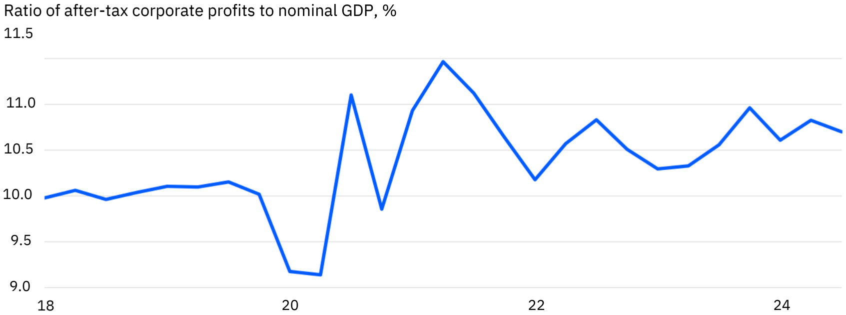


Sources: Pitchbook, Moody's Analytics

Venture capital funding is finally turning the corner. Both deal volume and dollar volume are on the mend after dropping precipitously in recent years. Interest rates are finally pulling back, and although they remain elevated, this has enticed more VC firms to invest. Even modest improvements in VC funding bode well for California's tech industry and will allow for some growth in Sonoma County's cluster of IT consulting and IT goods-producing industries.

Corporate Tax Cut Will Be a Positive for Cash Flow and Business Investment

Ratio of after-tax corporate profits to nominal GDP, %

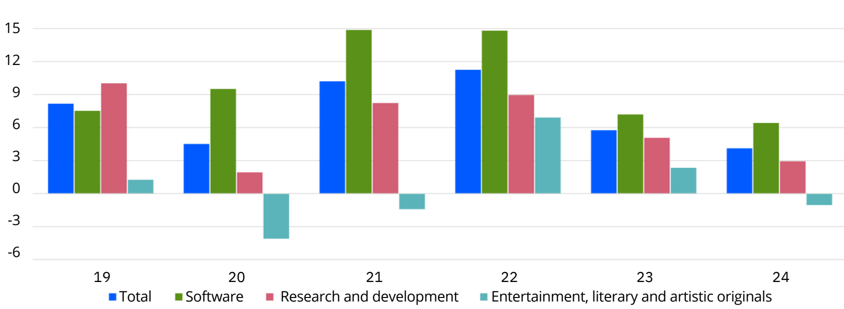


Sources: BEA, Moody's Analytics

Donald Trump's reelection as president should result in some fiscal policies that are favorable for business investment and the IT industry more broadly. The expectation is that the new administration will lower the corporate tax rate from 21% to 15%. This will boost corporate cash flow, which is already elevated as measured by the ratio of after-tax profits to GDP. In general, internal cash flow is a highly significant driver of investment spending. The IT industry is capital-intensive, and increased investment bodes well for growth prospects.

Robust Growth in Software Continues

Business investment spending, annualized % change



Intellectual property product investment has kept business investment spending elevated in recent years. The headwinds of high interest rates and tighter bank lending standards are finally abating and will help unlock investment spending. Spending on software has been especially resilient and has driven the bulk of business investment spending. This will accelerate slightly in the coming years, which will help support further growth in the IT industry.

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