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SONOMA COUNTY

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AGRICULTURE INDUSTRY RECREATION
1850

Moody's Quarterly Economic Outlook

May, 2025

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According to Moody's Analytics, recession probabilities, produced by Moody's new machine learning tool, while down from a recent high of 60%, currently remain elevated at approximately 45%. This sustained level of concern is largely attributed to a resurgence in inflation, driven in part by a broad set of tariffs proposed by the current administration. These tariffs are expected to be passed on to U.S. consumers, increasing prices and dampening consumer spending—an essential driver of the U.S. economy. As a result, business profitability is likely to decline, placing further downward pressure on national economic growth.

In addition, Moody's notes that more restrictive immigration policies may reduce the national labor supply over time, and ongoing uncertainty surrounding federal fiscal policy continues to contribute to economic instability.

Given these factors, the Federal Reserve faces a difficult decision: whether to lower interest rates to support slowing economic growth or to raise them to counter persistent inflation. As such, Moody's expects the Fed to maintain current interest rates in the near term, awaiting further clarity on the direction of federal economic policy.

Sonoma County Outlook

Macroeconomic headwinds are increasingly evident at the local level. While the healthcare sector remains a cornerstone of Sonoma County's economy, growth in the region's tourism industry has slowed, reflecting broader concerns about a potential recession and escalating trade tensions with key international partners. The manufacturing sector is also expected to face economic pressures driven by tariffs. However, Sonoma County's concentration in food and beverage production—which is less sensitive to economic cycles—should offer some resilience.

Agricultural performance remains generally positive. However, if inflation continues to rise and recession concerns deepen, sectors tied to consumer discretionary spending, such as restaurants, may begin to feel the strain.

In the near term, if current economic pressures persist, businesses are likely to exhaust temporary labor adjustments—such as hiring freezes, reduced hours, and delays in backfilling vacancies—before moving to permanent job cuts.

Despite these challenges, several local tailwinds offer cautious optimism. Home price appreciation has begun to moderate, and Moody's Analytics reports an improvement in the affordability index throughout 2024, following a historic low in late 2023. This trend may help slow the out-migration that has recently affected the region.

May 2025 Quarterly Economic Outlook

BY COLIN SEITZ

MACROECONOMIC OUTLOOK

Just how unsure the economy's prospects are is evident in the big swings in economists' assessments of the probability of recession in the coming year. Economists use this probability as a shorthand way of articulating how concerned they are about the economy's near-term prospects. It is, for the most part, a subjective assessment based on various data and estimations. When the probability is more than 50%, the economist is signaling that his baseline outlook, most likely, is for a recession in the near future.

Since the trade war began in earnest earlier this year, many economists' recession probabilities have swung around this 50% threshold: rising above 50% when it appeared there would be higher U.S. tariffs for longer, and below 50% when the tariffs appeared less onerous. Recession probabilities were at their apex, at well over 50%, in the wake of the reciprocal tariffs announced in early April. They have since fallen back to just below 50% with the recent arrangement between the U.S. and China not to set the tariffs so high that they shut down trade between the two countries.

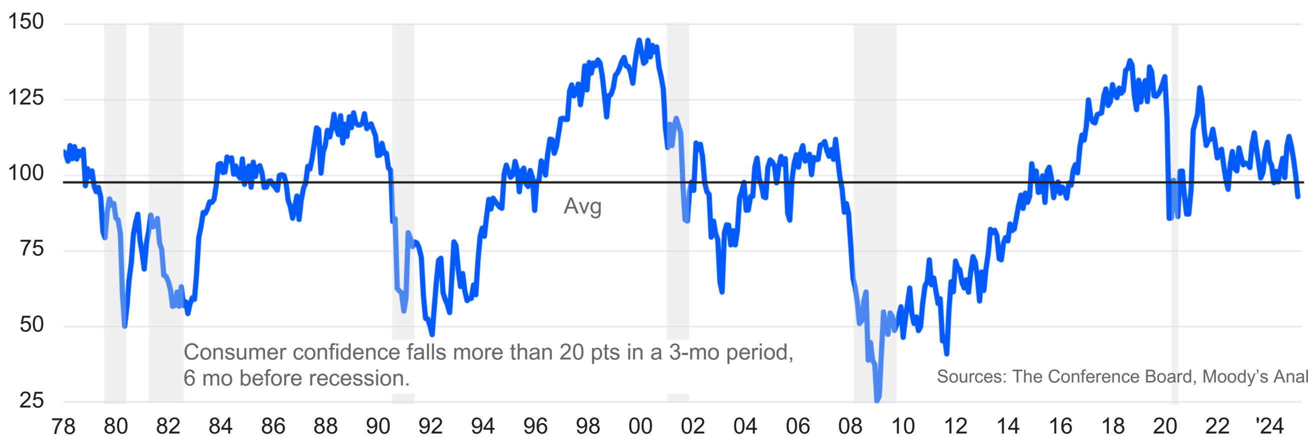
The Moody's Analytics assessment of the probability of recession has been similar. A few weeks ago, the probability was set at 60%. It has since receded to 45%. It is important to note that throughout this period of heightened recession concerns, Moody's Analytics has not had a recession as part of its baseline outlook. Given the extraordinary uncertainty, even 60% probability was not high enough to be sufficiently confident to adopt a recession forecast.

A 45% recession probability is also consistent with that indicated by our newly developed machine learning model. The model is trained on tens of thousands of economic time series and their transformations, with the goal of accurately predicting the nine recessions since the 1960 downturn. The modeling is based on a random forest algorithm that allows for nonlinear relationships and interaction effects.

The economic series ultimately chosen by the model are not particularly surprising. They include various tried-and-true leading indicators of recession such as the shape of the Treasury yield curve, residential building permits, unemployment insurance claims, the growth in manufacturing employment, and oil and gas rig counts. Also important to the model is the Conference Board's leading economic indicator, which is a compilation of economic series that tend to lead economic activity, ranging from stock prices to consumer confidence (see Chart 1). The inclusion of these series in the model is more or less intuitive.

Chart 1: Consumer Confidence Is Fragile...Recession Risks Are High

Conference Board consumer confidence index



Sources: The Conference Board, Moody's Analytics

The model's ability to accurately presage past recessions is reassuring. It predicted all nine recessions with several months' lead, and there was only one false positive in the late 1960s, when it briefly anticipated a recession that did not materialize (see Chart 2). Perhaps most encouraging, it did not predict a recession that most economists (albeit not us) expected in the wake of the Federal Reserve's aggressive tightening in monetary policy in 2022.

The model emphatically predicted a recession in 2020. Not that it anticipated COVID-19, but that there would have been a downturn in 2020, with or without a pandemic. Indeed, the economy was struggling with the trade war that was playing out at the time. That trade war was much smaller than the current one, but even so, the nation's manufacturing and agriculture-related industries were contracting coming into the year. The model strongly suggests that the rest of the economy was set to follow.

In times past, when the economy faltered, the Federal Reserve almost always quickly came to the rescue, aggressively lowering interest rates. This almost surely will not be the case this time. Not that the Fed will not ultimately respond to a seriously weakening economy, but that it will take longer to respond than it has historically. Indeed, counter to the machine learning model's forecast, the Fed may wait so long that the economy does suffer a downturn.

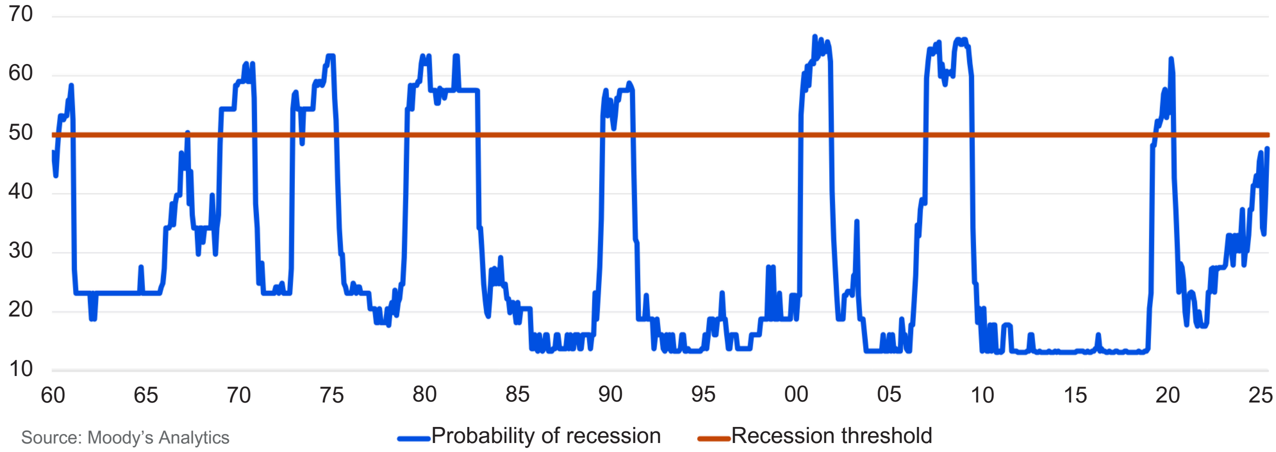
The Fed's atypical reticence to cut rates may be in part because economic policy is so fluid. Fed officials have been notably transparent in their confusion regarding the tariffs. Like everyone else, they do not know how high the tariffs will be, for how long, and on which countries and products. Immigration and fiscal policies are also in flux. Until policymakers get some clarity on these policies, which seems weeks, if not months, away, they will not know the appropriate monetary policy response and have thus put any further interest rate cuts on hold.

Further complicating things for the Fed is that the tariffs are expected to result in higher inflation, as much of the tariff increase likely will be passed to consumers through higher prices and weaker economic growth, as consumers become more cautious spenders as they adjust to their reduced purchasing power (see Chart 3). Businesses that are unable to pass along the cost of the tariffs to consumers will endure reduced profitability and pressure to rein in their payrolls and investment, further weighing on growth. More restrictive immigration policies that impact the availability of labor and specialized expertise reinforce these dynamics, adding to costs and inflation and weighing on growth. It is unclear whether the Fed should raise interest rates in response to the higher inflation or cut rates in response to the weaker economy. Therefore, the Fed will do nothing; it will wait to see whether the inflation or growth effects of the higher tariffs and restrictive immigration dominate.

In our baseline, we expect the negative effects of the tariffs and immigration policies on growth will outweigh the inflation effects, and the Fed will resume slowly cutting rates later in the year. But this is not a gimme, as consumers' inflation expectations have jumped in anticipation of the tariffs. If this translates

Chart 2: Not Quite a Recession (Yet)

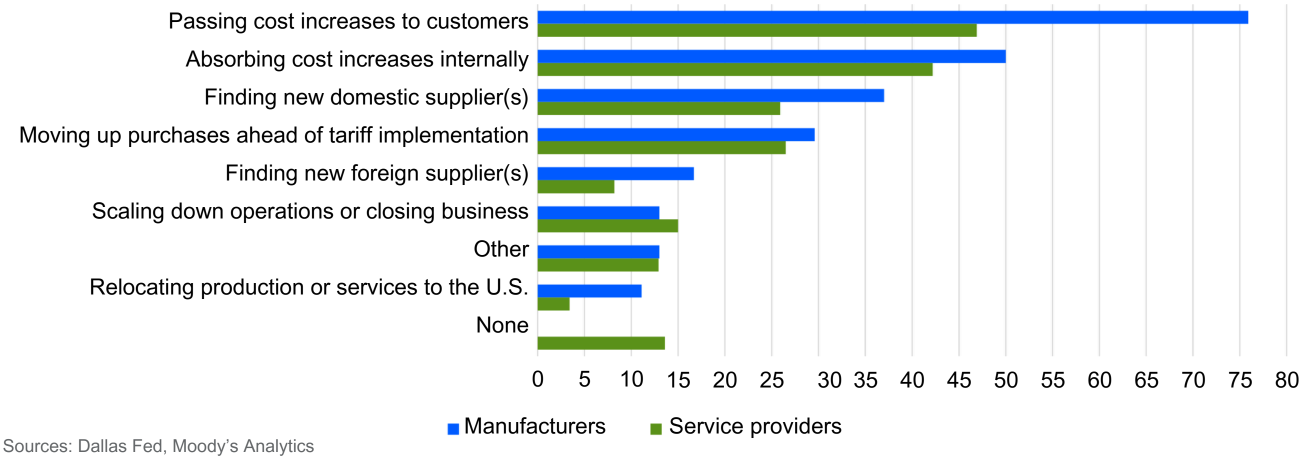
Probability of U.S. recession in the next 12 mo, %, based on a machine learning model



Source: Moody's Analytics

Chart 3: Tariffs Will Hit Consumers & Businesses Hard

Actions firms are taking in response to higher tariffs, %



Sources: Dallas Fed, Moody's Analytics

into bigger wage demands from workers, then inflation may be more persistent, and the Fed will hold policy unchanged for even longer. And if it appears that the dreaded wage-price spiral is taking hold and inflation is becoming entrenched, then the Fed would even raise interest rates. Fed officials would tolerate a recession, appropriately believing that if they did not and inflation took root, a much worse recession would be necessary to root it out.

Lawmakers also appear less likely to use fiscal policy to support the economy if it were to falter, as they have in the past. Congress is heads down, feverishly working to pass the massive reconciliation legislation of tax and government spending cuts. It must pass the bill before the end of the fiscal year to take advantage of the budget reconciliation process, which allows for passage with only a majority of votes in the Senate and House. There is also the Treasury debt limit, which must be increased by as early as August, or the government will run out of cash to pay all of its bills on time. The most viable legislative mechanism to do this is to include it as part of the reconciliation bill.

While the legislation has many moving parts, regarding taxes and spending, from a macroeconomic perspective, it is largely a wash. The biggest part of the bill is simply to make permanent the individual tax cuts that were passed as part of the Tax Cuts and Jobs Act in President Trump's first term. By maintaining the current tax rates, there will be no change in Americans' after-tax income, and thus spending. There are other smaller tax cuts, for both individuals and businesses, included in the legislation, but they are largely paid for by less nondefense discretionary spending and cuts to the Medicaid health insurance program for lower-income households.

Moody's Analytics expects the reconciliation legislation to increase the nation's budget deficit next year by an estimated almost 0.4% of GDP, suggesting a small boost to economic growth. But this does not account for the impact on consumers of the higher tariffs, which is estimated to amount to more than 1% of GDP. The net of all this is that fiscal policy will be something of a drag on growth next year. Of course, there are lots of caveats, but the broader point is that it is unlikely lawmakers will respond as they have in times past and help the economy if it stumbles.

Adding to this concern is that the reconciliation legislation is unlikely to address the nation's worsening fiscal situation. If implemented as anticipated, the nation's publicly traded debt-to-GDP ratio will increase from just less than 100% to approximately 130% a decade from now. This may be one reason why long-term interest rates are rising, instead of falling as would be expected given prospects for a weaker economy and the global flight-to-quality that happens in risk-off environments like now. Consistent with the Congressional Budget Office, we estimate that every 1-percentage point increase in the nation's debt-to-GDP ratio ultimately adds 2 basis points to the 10-year Treasury yield. Bond investors have already discounted passage of the reconciliation legislation and some of the increase in long-term rates, but likely not all that the legislation implies—another reason to worry that recession risks are greater than the models suggest.

Recession is ultimately a psychological phenomenon. It is a collective loss of faith. Consumers lose faith that their jobs are safe and their financial situation is sound, and they turn more cautious and pull back on their spending. Businesses lose faith that they will be able to sell whatever they produce at a profit, and they cut back on their investment and hiring and begin to lay off workers. A self-reinforcing, vicious cycle—a recession—takes hold. Moody's Analytics and the consensus forecast that while it will be close, consumers and businesses will sufficiently keep the faith, keep on spending, investing and hiring, and a recession will be avoided. But uncertainty is elevated.

SONOMA COUNTY OUTLOOK

Sonoma's economy is spinning its wheels. Contrary to initial payroll estimates that showed a strong end to 2023 and continued improvement in 2024, benchmark revisions revealed that payrolls have moved sideways over the past two years (see Chart 4). The county's core driver, tourism, is struggling to build momentum and payrolls are roughly even with their year-ago levels. Healthcare, meanwhile, remains a standout performer and is buoying the labor market amid weakness in the key tourism sector.

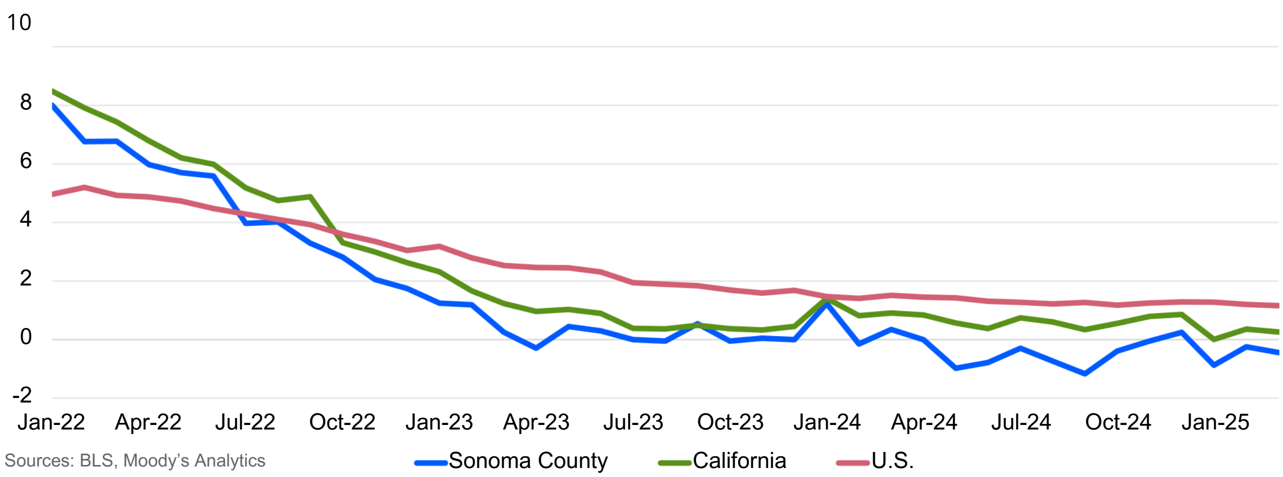
Goods producers remain a drag on growth (see Chart 5) and here, too, the revisions painted a more downbeat picture than the monthly payroll estimates. Goods producers took a further step back in 2024 and are down about 2% on a year-ago basis. However, elevated recession risks and higher-for-longer monetary policy ensure that the improvement will be slow. Local manufacturers will hold off on expanding until there is more certainty about the future path of tariff rates. Furthermore, demand for manufactured goods will be weak as the economy downshifts and narrowly skirts a recession.

The labor market has been remarkably resilient in recent years in the sense that layoffs have remained historically low despite challenges and headwinds. While layoffs are never a firm's first choice in cutting costs, businesses have gone to great lengths to avoid mass layoffs in the post-pandemic economy. This is partly because of the struggles that firms encountered when restaffing following significant layoffs during the initial pandemic lockdowns, and the realization that the labor market will remain tighter moving forward as demographic headwinds weigh on labor force growth.

However, there is only so much that firms can do to adjust to weakening demand for their products and services. The slow, steady decline in job openings represents the lowest-cost adjustment that firms make—simply pulling down open positions or deciding not to backfill vacancies provides a means to adjust headcount, albeit slowly. Another common move that firms make before laying off permanent employees is to cut any temporary positions they might be using and to cut hours for existing employees. Firms have employed both strategies in recent years: Average weekly hours are about as low as they were in the teeth of the pandemic, while temp-help services

Chart 4: Sonoma County Falls Behind

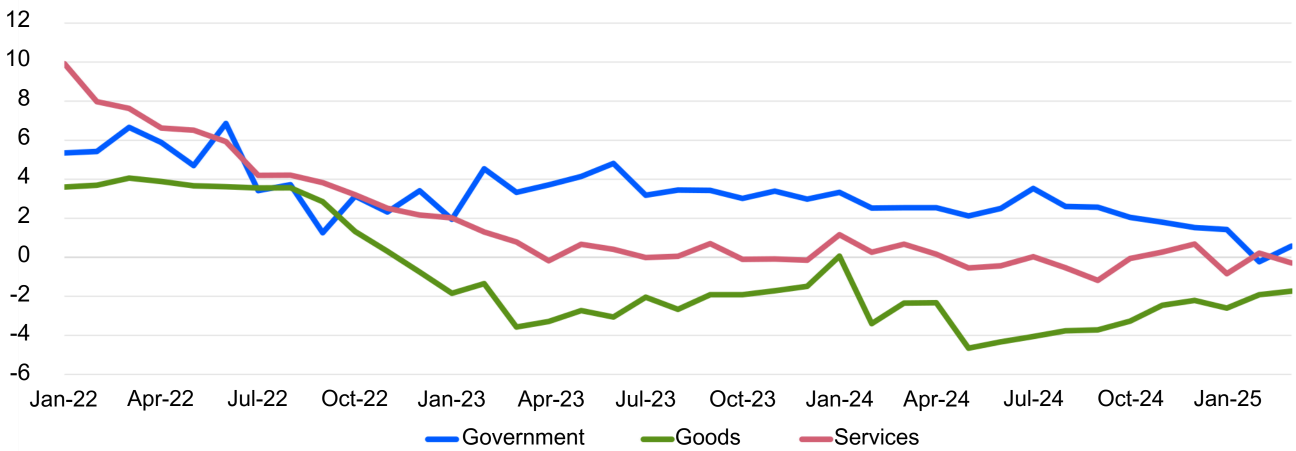
Sonoma County, employment, % change yr ago



Sources: BLS, Moody's Analytics

Chart 5: Labor Market Slows and Goods Producers Are a Drag

Employment % Change yr ago



Sources: BLS, Moody's Analytics

employment is at its lowest point since 2012, excluding a few months in early 2020. Given that these tools have already been largely exhausted, layoffs and unemployment are expected to pick up slightly near term.

Manufacturers will struggle amid weakening demand and a slowing U.S. economy, but the composition of Sonoma's manufacturing industry will help insulate it from more widespread losses. Sonoma's manufacturing cluster is highly concentrated in food and beverage production, and this is generally less cyclical than other manufactured goods. To be sure, there will likely be some pullback in restaurant spending as wage growth slows and consumers grow more cautious given heightened recession risks. However, food and beverage manufacturers will fare better than durable goods producers. Once the economy recovers, Sonoma's food and beverage manufacturers will find another gear as interest rates pull back and entice more capital investments. Food prices are moderating and will help improve margins for the county's food and beverage producers, and consumer spending will improve throughout 2026.

According to the Grape Crush Report, the grape harvest in Sonoma County and statewide ended up being much smaller than previously expected. A late- summer heat wave that primarily affected red grapes led to a precipitous drop in the number of red grapes crushed. Still, according to the SVB Wine Industry report, the harvest quality in Sonoma ranked among the best nationally, with nearly half of wineries reporting an excellent harvest, ahead of Napa and trailing only Oregon in harvest quality.

Leisure/hospitality has hardly budged over the past two years, and prospects for growth this year are limited given stiffening macroeconomic headwinds. As the labor market slows nationally and stock market volatility results in negative wealth effects, demand for vacations will take a hit. According to the Conference Board, as of April, the share of Americans who plan to take a vacation in the coming months sits at its lowest level since the pandemic. Despite strong airport visitor traffic through the first quarter, leisure/hospitality hiring has not followed suit, and more cautious consumers and depressed discretionary spending on travel will further hamper hiring.

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 are still climbing, 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.

Reduced international travel is another headwind. Trade tensions and increasingly hostile rhetoric will discourage overseas visitors. Travel from Canada is already significantly pulling back, with advance bookings through September down 70% compared with a year prior. While this is comparatively less important to Sonoma than other tourism hubs, a pullback in international travel saps the county of a recent source of growth. Combine this with less domestic travel amid a weakening U.S. economy, and tourism in Sonoma is set to plateau.

Healthcare remains the labor market's standout performer. Job growth has hardly skipped a beat over the past three years, and continues at a robust pace even as the broader labor market has weakened. Still, industry job growth trails the heady California average by a significant margin. This is because of weaker demographic trends in the county, and this will continue to hamper prospects. 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 has decelerated in recent years, and this is a positive development for the county should migration patterns finally relent and tilt in Sonoma County. Fortunately, there appears to be some respite in the future. House price appreciation is already moderating and will take a breather when more supply comes on line as mortgage rates retreat. The Moody's Analytics affordability index has inched higher through 2024 after reaching its all-time low in late 2023, and this will stem the tide of out-migration. Further price moderation will give time for incomes to catch up and bring affordability down, albeit slightly. Migration patterns, while still 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 this is expected to improve further. One upside is the 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.

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.

About Moody's Analytics

an increasingly interconnected and complex operating environment, organizations face challenges decoding the intricacies of the global economy. Moody's Analytics Economics team delivers timely and in-depth data, forecasts and analysis of the global economy's latest developments and trends —empowering organizations and policymakers to identify and manage risks, seize new growth opportunities, respond to geopolitical threats, and thrive in an ever-evolving landscape.

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, commercial real estate, 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 fiscal 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.

By combining economic modeling, expansive data resources, and innovative technology solutions, we equip business leaders with critical insights to navigate the complexities of an ever-changing economic landscape. Recognized for our industry-leading solutions and commitment to quality, client service, and integrity, more than 1,000 organizations worldwide—including multinational corporations, governments, financial institutions, real estate firms, and professional investors—trust us to help them turn today's risks into tomorrow's opportunities.

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