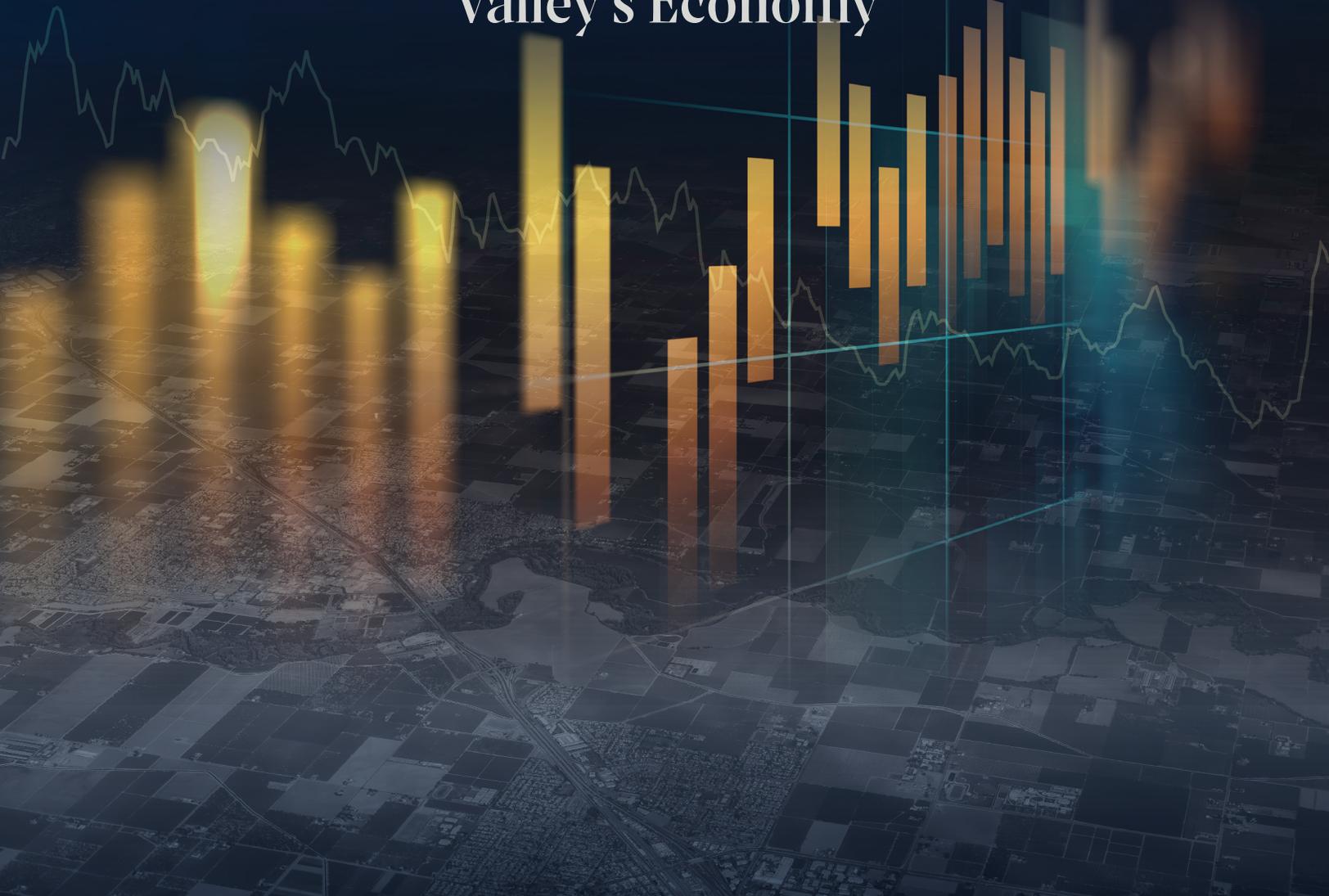


San Joaquin Valley

BUSINESS FORECAST

Emerging Trends in the
Valley's Economy



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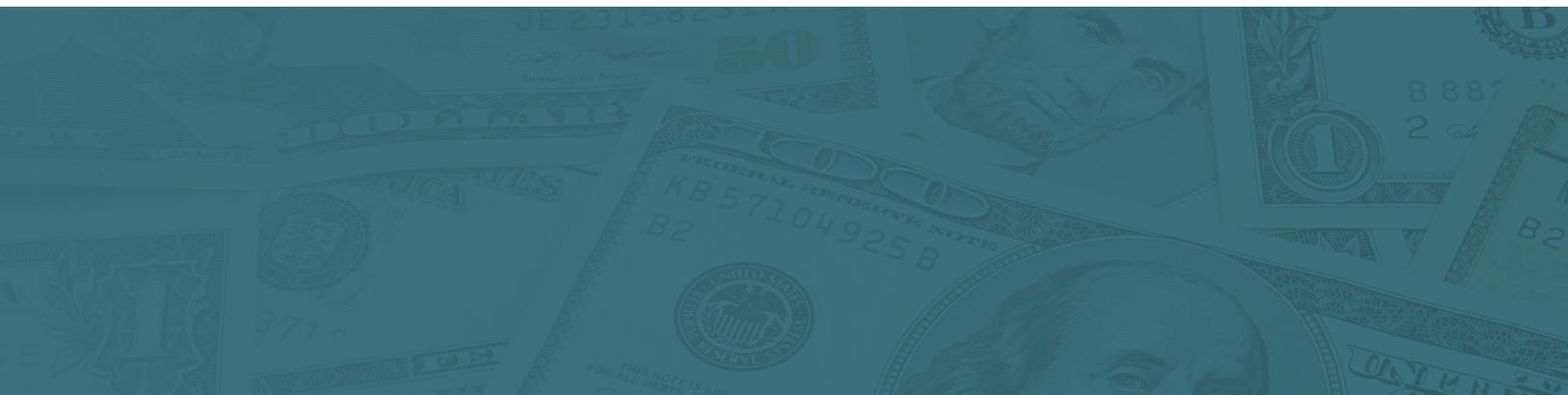


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After registering negative growth during the first and second quarters of 2022, the Valley economy — and the nation — entered a recession, according to the general definition, two consecutive quarters of negative real economic growth. We stated in our previous report that the severity of the recession would depend on how fast and how high the Federal Reserve increased interest rates. It takes time for rate hikes to influence the economy, and concerns are mounting that the Federal Reserve is raising rates too quickly without waiting to see the effect on the economy. A closely watched predictor of recessions, the yield curve on the two-year versus ten-year bonds yields inverted a few times beginning in late March, once again accurately predicting a recession. Now, there are increased worries that the rate hikes from by Federal Reserve to bring down inflation will steer the economy to a hard landing.

In the Valley, all employment categories except for financial activities grew in 2022. Growth was multifold of respective long-term benchmark growth rates, continuing the strong pace from 2021. Projections point to slower growth rates due to the Federal Reserve's committed stance to fight inflation and to implement additional rate hikes this year.

Financial activities employment declined by 0.34 percent in 2022, continuing to worsen in the Valley as it did in 2021. Despite the ongoing drought, farm-related Valley wholesale trade employment grew 3.48 percent, more than three times faster than in 2021. For the first time since the pandemic began, education and health services employment grew 4.33 percent in 2022, which was faster than the long-term benchmark growth of 3.24 percent. Government employment growth at 3.52 percent came in as expected with a lag, which had declined by 1.35 percent in 2021.

Valley leisure and hospitality services employment, one of the employment categories most sensitive to interest rates, grew 12.71 percent, which is about 4 percent less than the 2021 rate. Despite the decline, leisure and hospitality services employment registered the fastest growth in the Valley. Surprisingly, structurally problematic information employment grew 6.47 percent, which is about twice the growth rate observed in 2021, making it the second fastest-growing employment category. Trade, transportation and utilities employment came in third at 4.60 percent followed by Valley construction employment, which grew 3.25 percent in 2022, slower than the 4.95 percent observed in 2021. Another sensitive category, retail services employment, grew 2.52 percent, falling by approximately 4 percent from the 2021 rate. Manufacturing employment grew 2.29 percent faster than the previous year and at the fastest pace since 2015. Given the stricter policy variables to fight inflation, employment levels are expected to grow at negative rates in 2023 but are expected to only to partially recover in 2024, sparing any catastrophic outcomes resulting from the Ukraine-Russia war contributing to global supply chain shortages.

Valley building permits increased 18.92 percent, about half of the phenomenal 35.65 percent rate seen in 2021. These double-digit increases reflect supply chasing demand to close the Valley's big housing inventory shortage. There were no foreclosures in 2022, much like 2021. Freddie Mac 30-year rates increased steeply after a series of rate hikes and high inflation in 2022. The average yearly inflation rate was 8.29 percent in 2022, more than three times the typical rate of 2.61 percent. Valley home values increased 21.46 percent in 2022 on top of the 16.83 percent increase in 2021. This year's increase was more than three times the long-term 5.96 percent benchmark growth. Some of the increase is due to high inflation rates seen in 2022. Beginning with the third quarter of 2022, home values are likely to decrease by 2 percent from the previous quarter until in line with long-term benchmark growth rates. A crisis comparable to levels seen during the Great Recession is not expected because lenders are stricter, unemployment is still low and there is a significant lack of available housing inventory in the Valley. Most of the home sales occurring are due to family events or are investment related. However, some realignment of home values is underway given the steep increases in long-term interest rates.

Wage inflation and price of oil as a cost-push factor contributed to high inflation in 2022. Average weekly wages rose 3.28 percent but stayed below the overall price growth of 8.29 percent, corresponding to a decline in real wage, a purchasing power loss of 5 percent in the Valley. Since wages typically fall during recessions, projections point to lower growth rates in the coming two-year interval and further declines in Valley consumers' purchasing power.

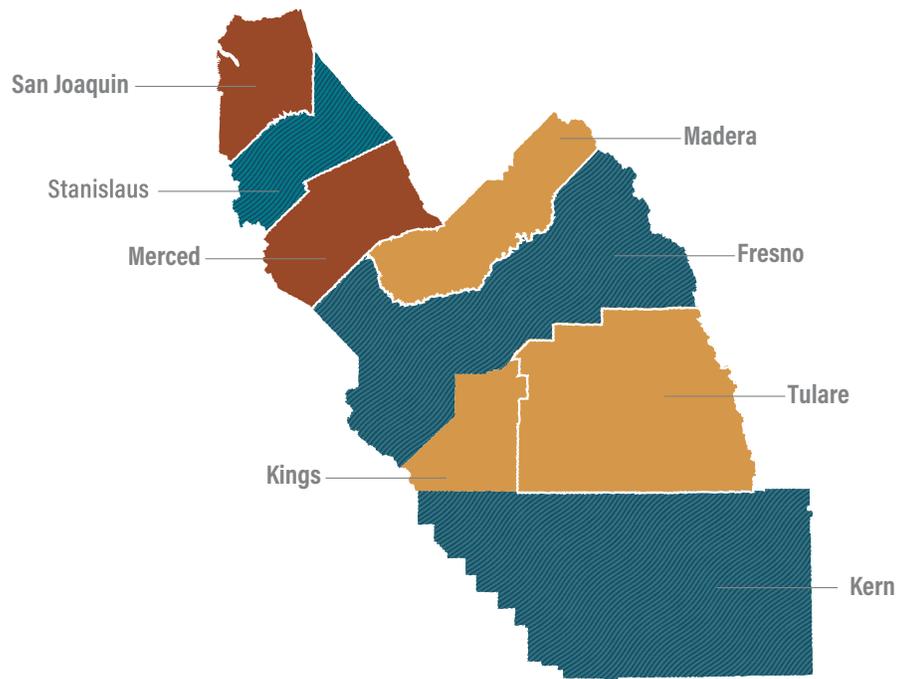
Valley community bank total deposits grew 9.57 percent, about half the rate of 2021 and in line with the long-term benchmark rate of 8.95 percent. In contrast, net loans and leases experienced no growth in 2022. Growth at 0.10 percent was nonexistent and a sharp reversal to the 11.36 percent growth in 2021. This imbalance between total deposits and net loans is like the pattern observed during the Great Recession. This is concerning because it means Valley banks have stopped extending additional loans. Unlike the Federal Reserve intervention during the COVID-19 pandemic, Valley bank nonaccruals trended sharply upward in 2022, creating another unease for the coming months. Community bank assets in default 30 to 89 days and assets in default more than 90 days were higher in 2022 than 2021. As projected, nonaccruals rose much faster in 2022 as the Federal Reserve's intervention ended and balance sheet reduction and tapering began.

As we recommended in our previous issue, Valley businesses and residents can take precautionary measures by switching from flexible to fixed rates, decreasing leverage by reducing debt, increasing cash holdings, renting housing rather than owning and switching to credit cards that offer zero introductory interest charges.

Time series data spans from January 2001 to October 2022. The two-year medium-term forecasts are from November 2022 to December 2024. Forecasting a range rather than a point provides a more realistic assessment of future values. When actual numbers fall within the upper and lower forecast bands, the forecast becomes accurate.

The remainder of this report is structured as follows: Section B analyzes labor market conditions for the San Joaquin Valley; the region's real estate market, based on eight metropolitan statistical areas, are examined in Section C; Section D reviews trends in prices and inflation; indicators from local banking and capital markets are examined in Section E. Section F is concluding remarks.

San Joaquin Valley





Employment Indicators

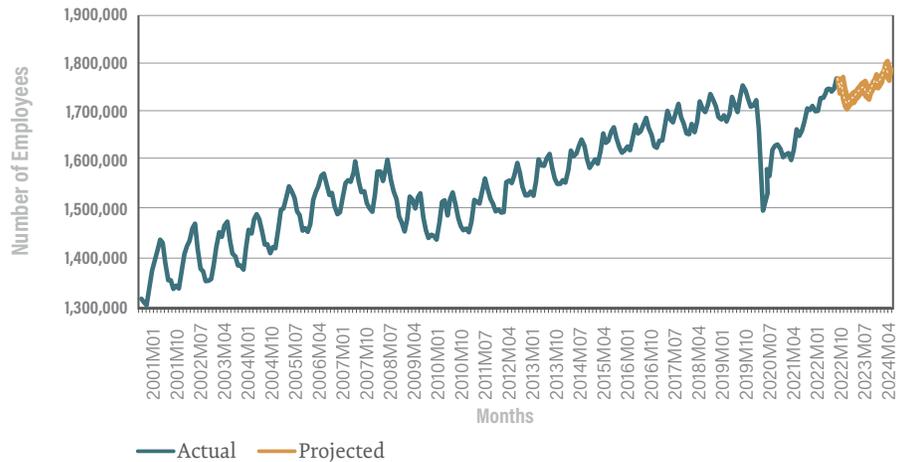
Total employment continued to grow at fast rates for all counties in 2022.

The employment growth in 2022 was so strong that many counties reported growth multifold of their benchmark growth rates. Fresno County reported growth at 6.84 percent, followed by Tulare County at 6.81 percent. Merced County registered the third fastest growth at 6.23 percent. Madera County, the only county that reported a decline in 2021, grew 5.95 percent in 2022. San Joaquin County grew 5.54 percent, while Kings County reported 4.99 percent growth. Among the eight counties of the San Joaquin Valley, Stanislaus County total employment grew the slowest at 4.68 percent, which was still more than four times the long-term benchmark growth rate.

THE EMPLOYMENT GROWTH IN 2022 WAS SO STRONG THAT MANY COUNTIES REPORTED GROWTH MULTIFOLD OF THEIR BENCHMARK GROWTH RATES.

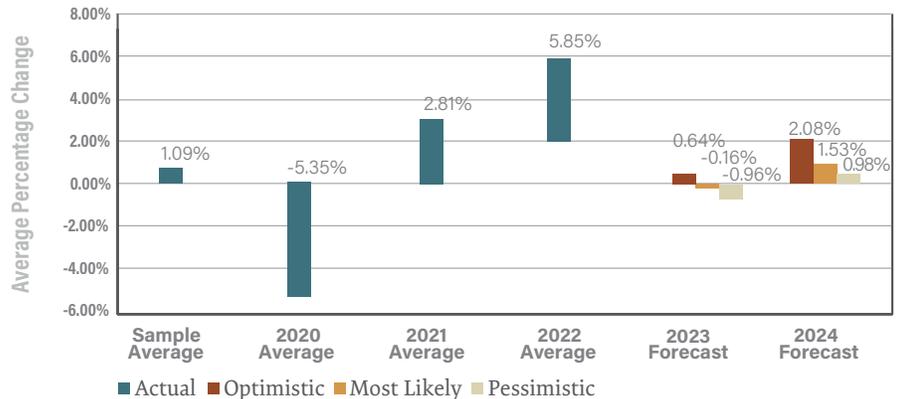
All categories of employment except financial services grew in 2022. Financial services employment declined 0.34 percent in 2022, but the decline was less than 0.98 percent. The historically problematic information employment category continued to register significant growth rates, much like the prior year. Government employment growth switched from negative to positive territory after registering 3.52 percent growth. Despite the ongoing drought, farm-related wholesale trade employment in the Valley grew 3.48 percent, significantly faster than the 1.01 percent seen in 2021. Education and health services employment grew faster in 2022 than the previous year, increasing by 2.57 percent to 4.33 percent. After a 4 percent drop from 2021, leisure and hospitality services employment grew 12.71 percent in 2022, becoming the Valley's fastest growing employment category.

Total Employment



Total employment in the Valley grew at an average yearly rate of 5.85 percent – more than twice the rate of 2.81 percent in 2021. Given the projected decline in growth rates, the Valley's total employment is expected to continue to stay below 1.8 million until the first half of 2025. Projections point to a decline in growth of 0.16 percent in 2023 followed by 1.53 percent growth in 2024 when the influence of steep rate hikes begin to be felt in the economy. ▼

Total Employment: Historical vs. Projected Average Yearly Growth



The Consumer Confidence Index (CCI) is one leading economic indicator that has the predictive power to tell which direction the economy is headed. The steep increase in the early months of 2021 shows higher consumer confidence immediately after the pandemic. The rate hikes, however, reversed that trend, and consumer confidence had been continuously decreasing since the second half of 2021. Despite an upward turn in September 2022, confidence in consumer spending is not expected to exceed a value of 130 points in the coming months due to the uncertainty from interest rate hikes and regional conflicts.

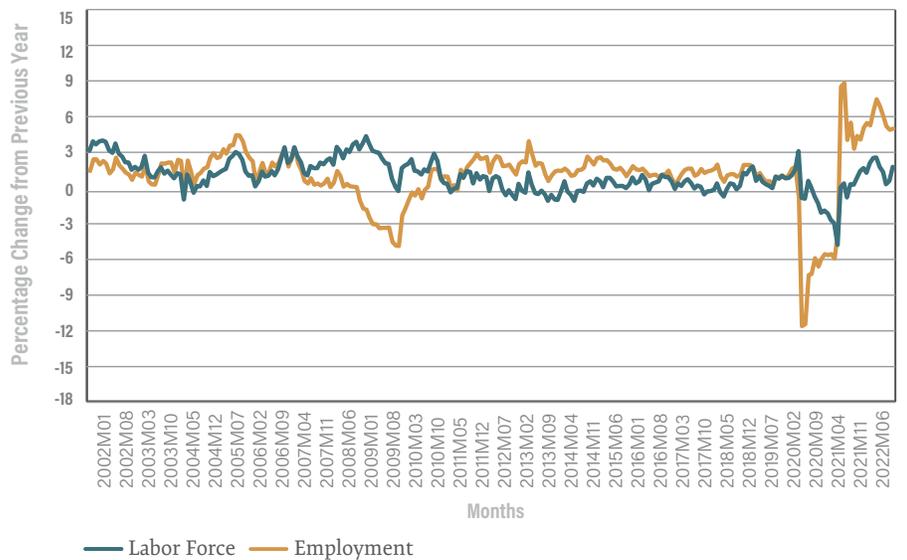
The Labor Force Participation Rate, unlike previous quarters, began showing a clear sign of increase following the first quarter of 2021. The labor market remains strong as of the third quarter of 2022. Upon careful examination of the displayed patterns of both series, the tendency to switch directions is now acting as a new leading indicator for our region. It appears that both series are on a path to crossing each other, which would serve as a leading indicator of a contraction.

Limited by the oceans California cannot expand westward, which makes the Valley a growth area. Employment growth in the Valley relative to California is supposed to be faster, but this pattern was not observed in 2021. However, both series are now displaying almost identical growth rates for the first time since the first quarter of 2020. The impact of interest rate hikes will be telling in the coming months to determine whether the Valley's employment growth will exceed the state's.

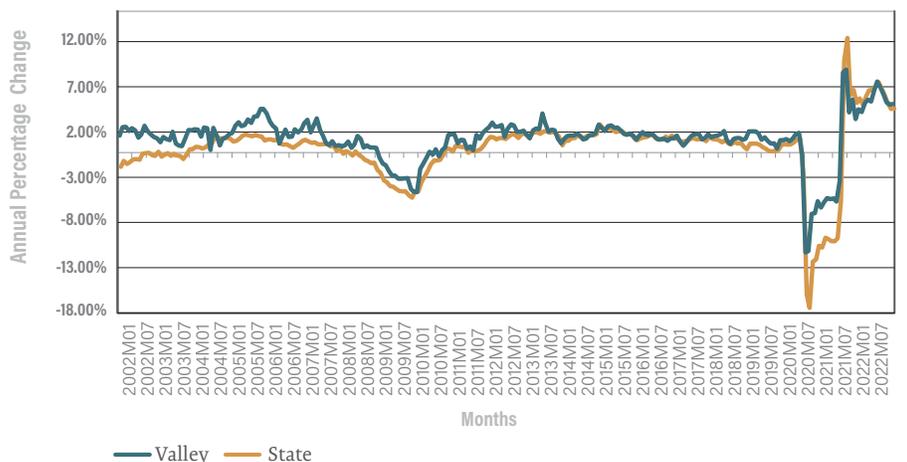
Consumer Confidence Index



Labor Force vs. Employment Growth



Employment Growth: State vs. San Joaquin Valley





Given the two consecutive quarters of negative real economic growth during the first and second quarters of 2022, we are now officially in a recession. The impact has not yet affected the job market, but some significant slowdowns have been observed in the latter part of the third quarter. Projections point to a deepening recession in 2023 only to enter an expansionary phase in 2024 as the effect on the labor market is felt. What's noteworthy is the unemployment rate reached a minimum in May 2022 then gradually began to rise in the following months. Normally, the Valley's unemployment rate reaches a seasonal minimum in the third quarter of each year.

Over a 12-month period, education and health services employment reported 2.57 percent growth, switching from negative to positive territory in 2021. The long-term growth trend catches growth trends that have existed before the pandemic. Delays in school openings and priorities on COVID-19 healthcare workers undoubtedly caused employment in these sectors to recover with a lag relative to other employment categories in the Valley.

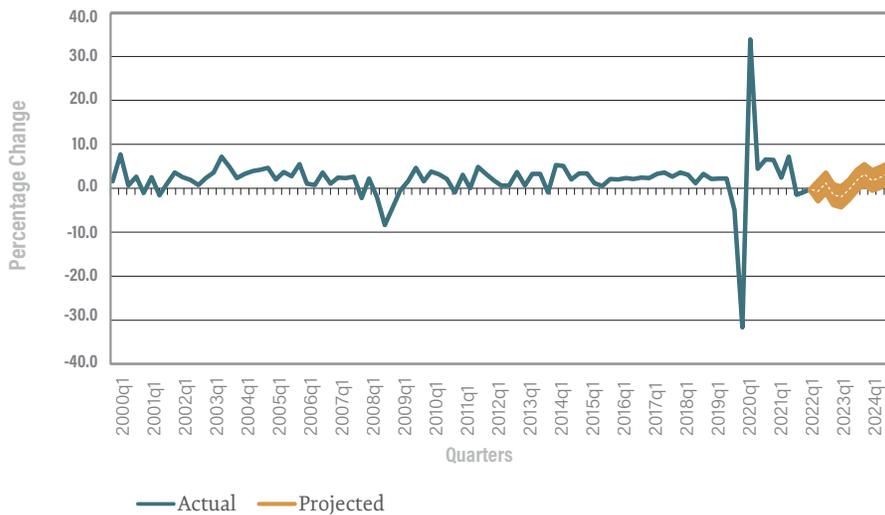
Given the Federal Reserve's commitment to further increase interest rates, employment levels in education and health services employment are projected to stay below 255,000 by the end of 2024. Employment in this category is robust relative to the other employment categories.

Education and health services employment continued to grow even during the 2008 Great Recession. Projections point to growth at an average yearly rate of 1.29 percent in 2023, which is below the benchmark growth rate, and then at a faster pace of 2.13 percent in 2024.

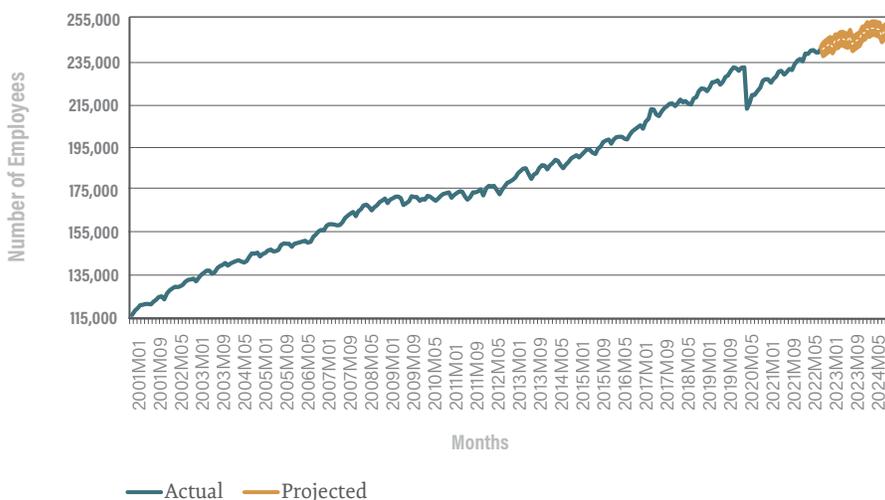
OVER A 12-MONTH PERIOD, EDUCATION AND HEALTH SERVICES EMPLOYMENT REPORTED

2.57% GROWTH

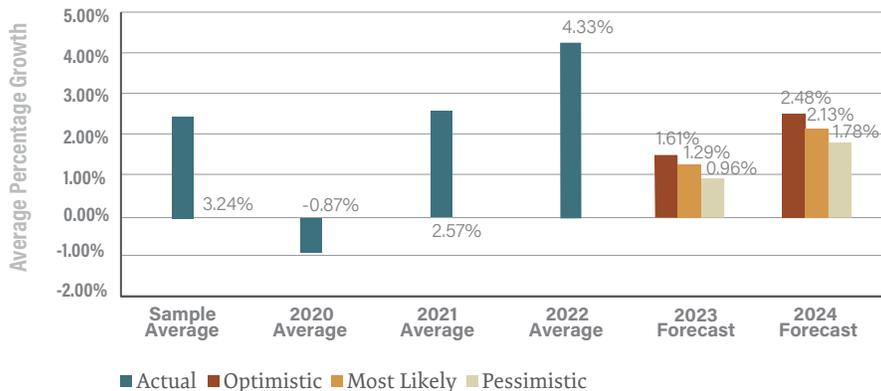
U.S. Real GDP Annual Growth



Education and Health Services Employment



Education and Health Services Employment: Historical vs. Projected Average Yearly Growth



Valley manufacturing employment grew 2.29 percent in 2022 compared to 1.50 percent in 2021, a significant improvement over the prior year despite the ongoing drought. Employment levels in this category will likely oscillate at around 115,000 by the end of 2024. After the robust growth that continued into 2022, the Valley's manufacturing employment long-term benchmark growth continues to remain in positive territory and further increased to 0.19 percent. ▶

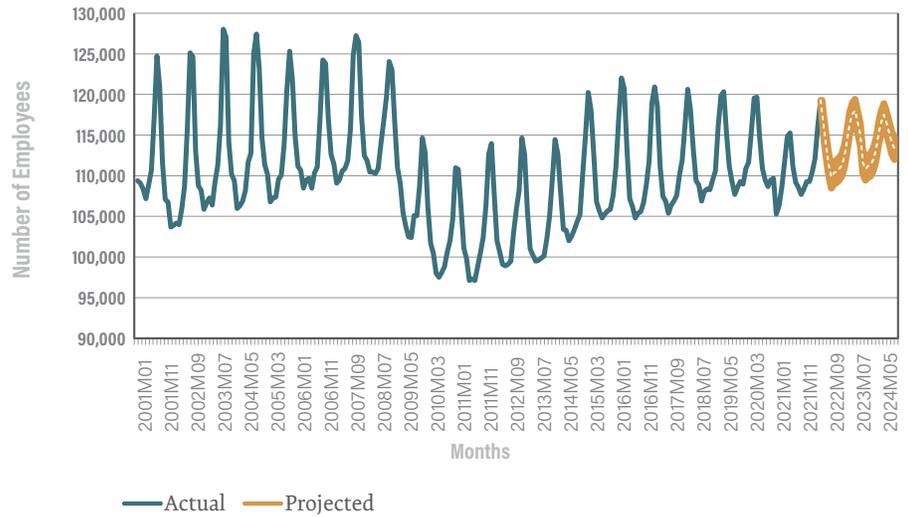
VALLEY MANUFACTURING EMPLOYMENT GREW

**2.29%
IN 2022**

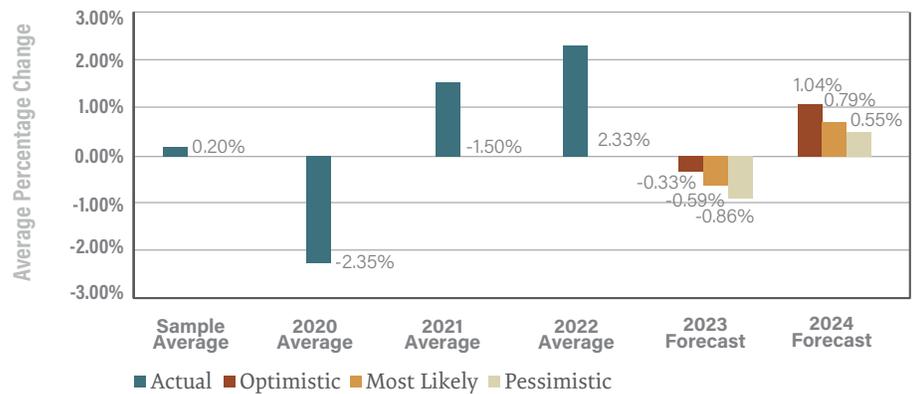
Given the Federal Reserve's continued interventions to fight inflation, growth in manufacturing employment will slow in the coming months. Projections point to an average annual decline of 0.59 percent in 2023 and a faster pace of growth of 0.79 percent in 2024. ▶

The Institute of Supply Management's (ISM) Manufacturing Purchasing Managers Index is an important leading indicator that predicts where manufacturing activity will head in the coming months. The ISM Purchasing Managers Index reached an all-time high in the first quarter of 2021 but has been on a steady decline since then stemming from worries that the recession may deepen in 2023. However, the index appears to stay above the value of 50, pointing to an expansion thus far. With more scheduled increases in the Federal Funds rate, further declines below 50 in this index are expected. ▶

Manufacturing Employment



Manufacturing Employment: Historical vs. Projected Average Yearly Growth



Purchasing Managers Index





In 2022, leisure and hospitality services employment continued to be the Valley's fastest-growing employment category.

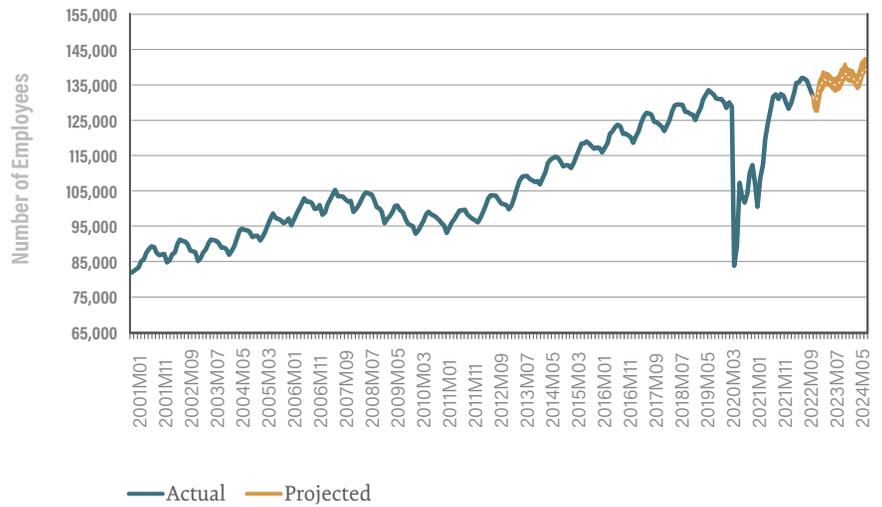
Even after a 4 percent drop from 2021, employment in this category maintained the top position in terms of the speed of growth. Leisure and hospitality services employment grew 12.71 percent in 2022 and is expected to stay below 135,000 by the end of 2024. If the pandemic had not occurred, employment levels in this category would have already exceeded 145,000 in the Valley. ▶

Multifold growth rates registered in 2021's and 2022's long-term benchmark growth for leisure and hospitality services employment increased further, rising to 2.43 percent. Being one of the employment categories most sensitive to changes in economic conditions, about 30,000 workers in this category alone were laid off in 2020. Leisure and hospitality services employment, along with retail trade, hires the greatest number of unskilled workers in the Valley. Projections point to an average annual growth of 1.08 percent in 2023 and 1.70 percent in 2024. ▶

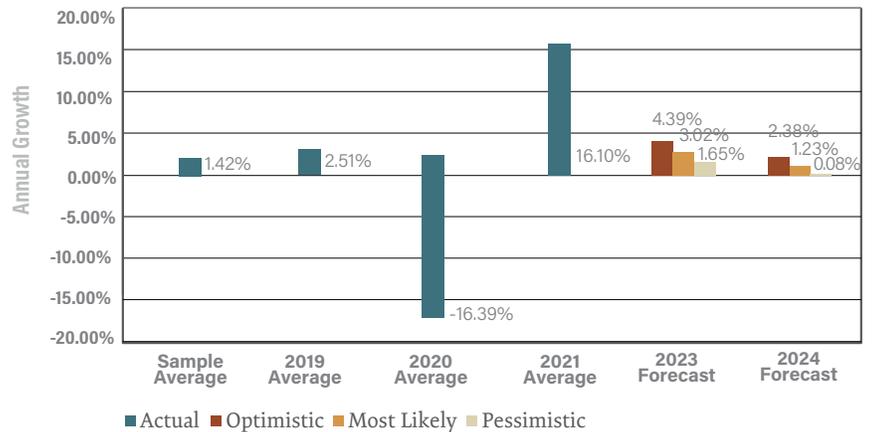
IN 2022, LEISURE AND HOSPITALITY SERVICES EMPLOYMENT CONTINUED TO BE THE VALLEY'S FASTEST-GROWING EMPLOYMENT CATEGORY.

Trade, transportation, and utilities employment in the Valley was the only category to post growth, even during the worst months of the pandemic. The pace of growth decreased from 6.63 percent to 4.60 percent in 2022. However, 2022 growth was still more than twice the benchmark growth of 2.04 percent. Even after declining to 4.60 percent in 2022, employment in this category was the Valley's third fastest-growing category. Trade, transportation and utilities employment is projected to stay below 330,000 by the end of 2024. ▶

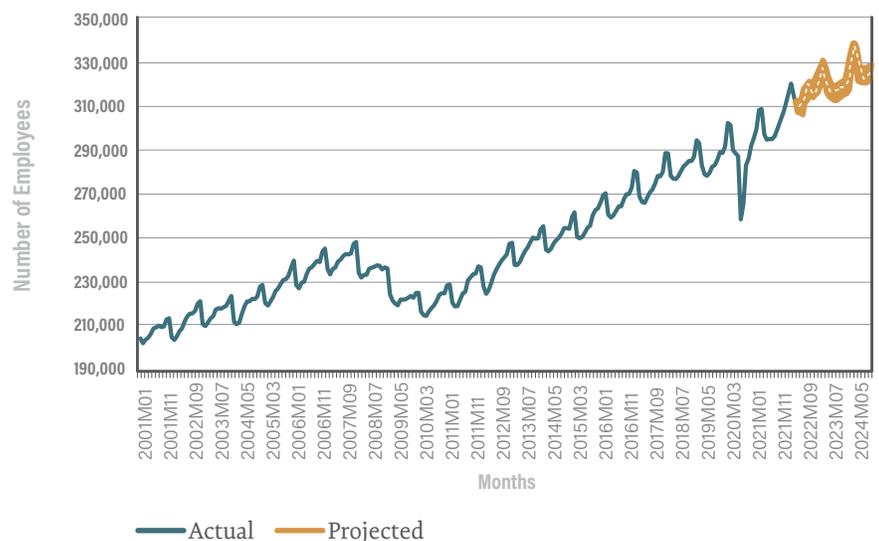
Leisure and Hospitality Services Employment



Leisure and Hospitality Services Employment: Historical vs. Projected Average Yearly Growth



Trade, Transportation and Utilities Employment



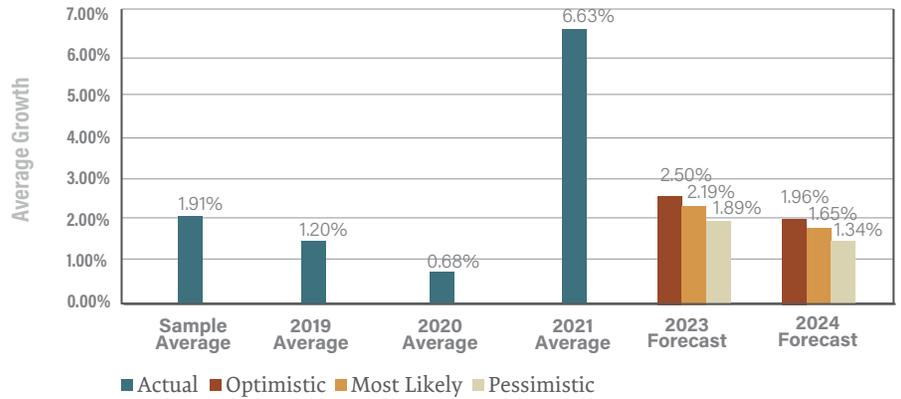
Trade, transportation and utilities was the only category that did not switch to a remote work environment since goods have to be physically transported from one location to another, explaining the growth during the pandemic. Truck driver shortages will continue into the coming months but at gradually slowing intensities. Trade, transportation and utilities employment is projected to grow slower than the benchmark pace of growth at an average yearly rate of 1.47 percent in 2023 and then pick up pace and grow at a faster rate of 2.37 percent in 2024.

Valley retail trade employment growth slowed to 2.52 percent in 2022 from 6.30 percent growth in 2021. This slowdown was not surprising considering that retail trade employment is one of the categories in the Valley most sensitive to changes in the interest rate. Retail trade employment is comprised of unskilled workers who are most vulnerable to changes in economic conditions. Employment levels in this category are expected to stay below 160,000 by the end of 2024.

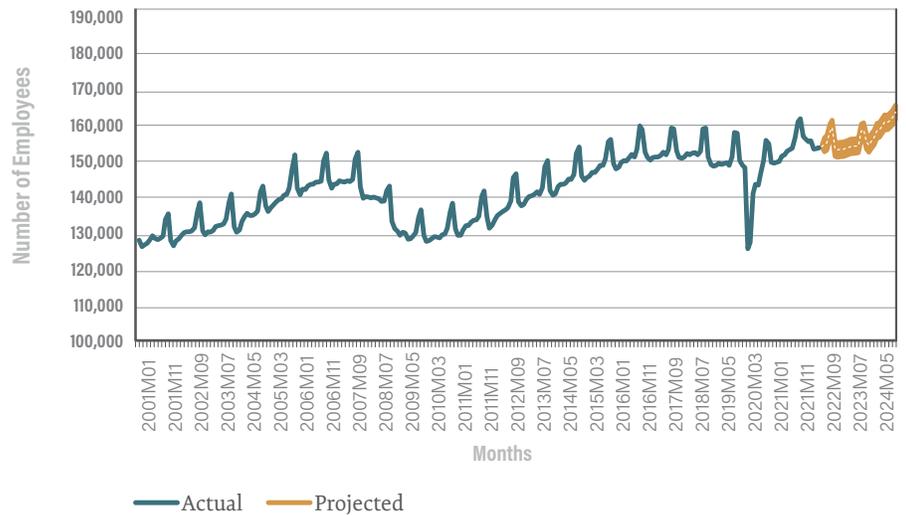
The long-term benchmark growth now stands at 0.97 percent, resulting from continued growth in 2021 and 2022. Additional rate hikes scheduled for the remainder of 2022 will have the most negative impact on this category in 2023. Projections point to a decline of 0.70 percent in 2023 and a switch to positive territory with 2.86 percent growth in 2024.

VALLEY RETAIL TRADE EMPLOYMENT GROWTH
SLOWED
TO 2.52%
IN 2022

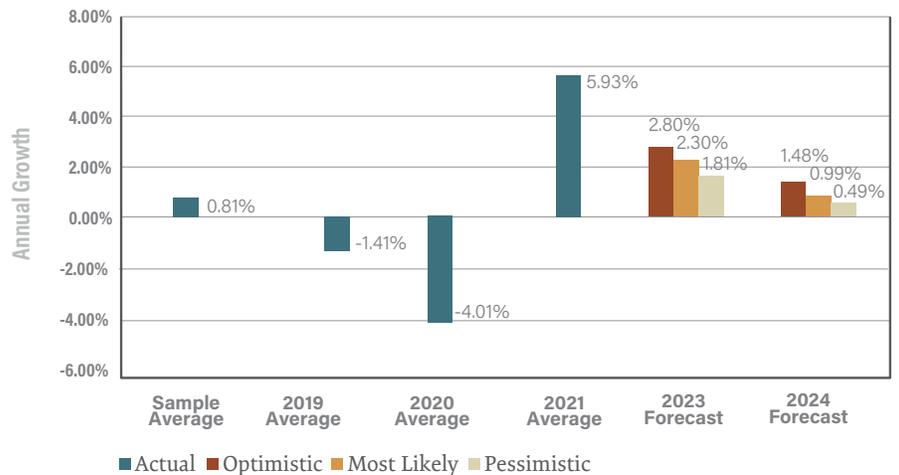
Trade, Transportation and Utilities Employment: Historical vs. Projected Average Yearly Growth



Retail Trade Employment



Retail Trade Employment: Historical vs. Projected Average Yearly Growth





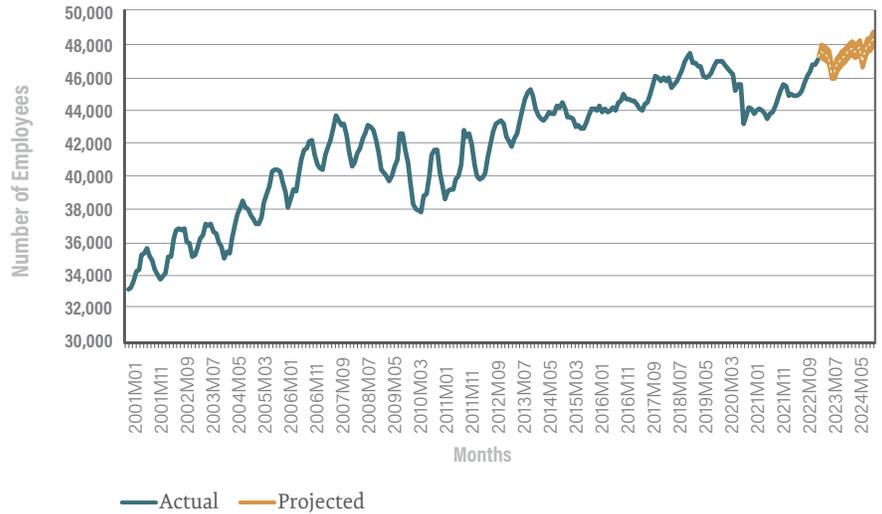
Valley wholesale trade employment slowly began to resume the seasonal dynamics that were lost during the pandemic and the drought. More than three times the long-term benchmark rate of growth in wholesale trade employment was surprising given the ongoing drought in 2022. Employment levels in the category are expected to stay below 48,000 by the end of 2024. ▶

Valley wholesale trade employment grew 3.48 percent in 2022, which was more than three times the 2021 growth of 1.01 percent. A farm related category of employment, wholesale trade employment in the Valley was affected little by skyrocketing fertilizer prices resulting from the Ukraine-Russia war. Wholesale trade in the Valley is comprised of necessities, explaining the growth in 2022 despite the higher cost of fertilizers and price of oil. Projections point to 1.15 percent growth in 2023 followed by 2.48 percent growth in 2024. ▶

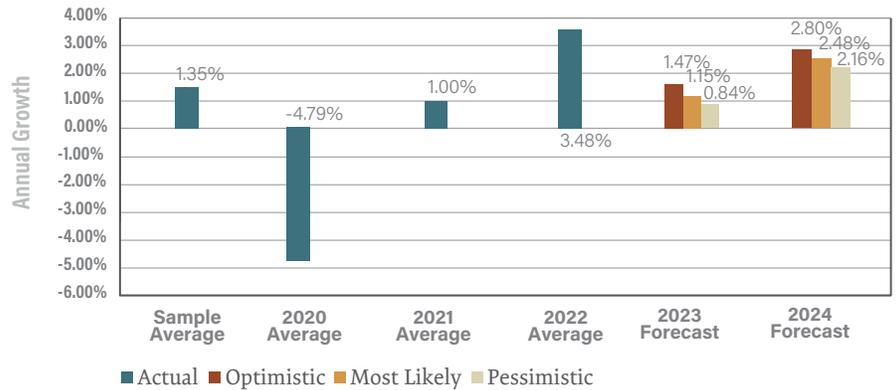
AFTER DECLINING FOR MANY YEARS EVEN BEFORE THE PANDEMIC, VALLEY INFORMATION EMPLOYMENT GREW 6.47% AT THE SECOND-FATEST RATE IN 2022.

After declining for many years even before the pandemic, Valley information employment grew 6.47 percent at the second-fastest rate in 2022. However, the growth in 2022 was not enough to erase prior years' continued declines. Employment levels in this category will likely oscillate around 8,500 during the two-year interval. ▶

Wholesale Trade Employment



Wholesale Trade Employment: Historical vs. Projected Average Yearly Growth



Information Employment

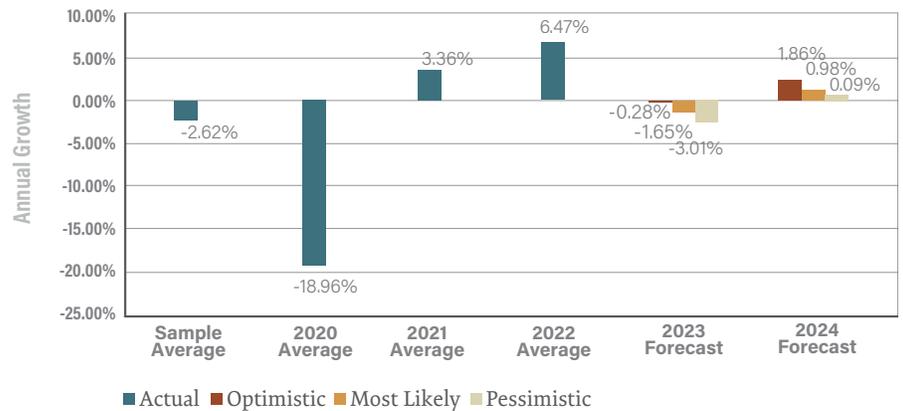


The long-term benchmark rate decline in information employment slowed to 2.62 percent in 2022. The long-awaited switch in growth from negative to positive territory took place in 2021 and remained positive through 2022, taking away worries of a temporary improvement. Information employment has been problematic over the years due to the increased use of digital social media. Projections point to a decline of 1.65 percent due to slowing economic conditions resulting from further rates rather than industry specific conditions in 2023 and 0.98 percent growth in 2024.

Seasonal variations in Valley construction employment tend to disappear during recessions and other negative shocks to the economy. A clear pattern in seasonal behavior reflects a healthy state of the construction industry, as can be seen in 2022. It is not certain if the reappearing seasonal variation will continue to exist in the coming months due to the Federal Reserve's stance. Employment in this category grew 3.20 percent in 2022, which was a slower than the 4.95 percent in 2021. Vibrant construction activity throughout the Valley is clearly visible. Inventory shortages will keep construction alive in the coming months despite additional rate hikes.

On the demand side, rate hikes are projected to lower demand for Valley home purchases relative to previous years. Foreclosures, which were at all-time lows during the pandemic, will begin to rise steeply in the months ahead as borrowing costs continue to increase. A rise in unemployment rates would have an amplified effect on this employment category. Projections point to slower growth at an average annual rate of 1.21 percent in 2023 and a faster rate of 2.60 percent in 2024.

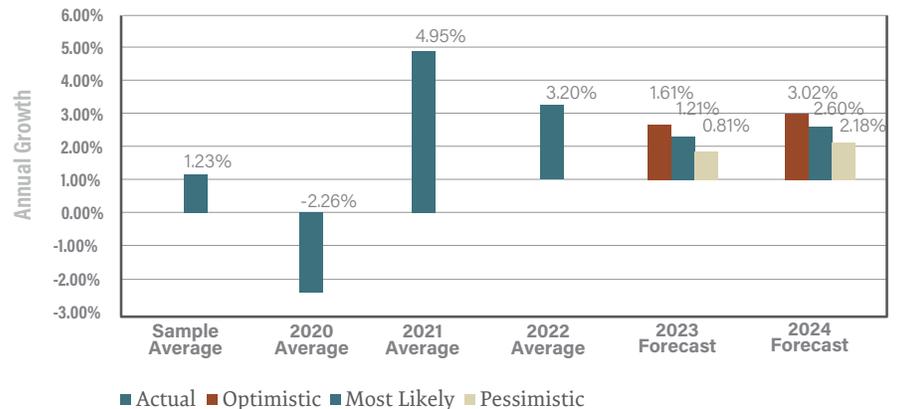
Information Employment:
Historical vs. Projected Average Yearly Growth



Construction Employment



Construction Employment:
Historical vs. Projected Average Yearly Growth





Employment Indicators

Government employment, a lagged indicator of economic activity, switched from negative to positive territory in 2022. Considering this category makes up about 20 percent of the Valley’s total employment, government employment is an important driver of economic activity. In the Valley, government employment grew 3.52 percent in 2022 – about five times the long-term benchmark rate of 0.76 percent – quickly recovering from a 1.35 percent decline in 2021. ▶

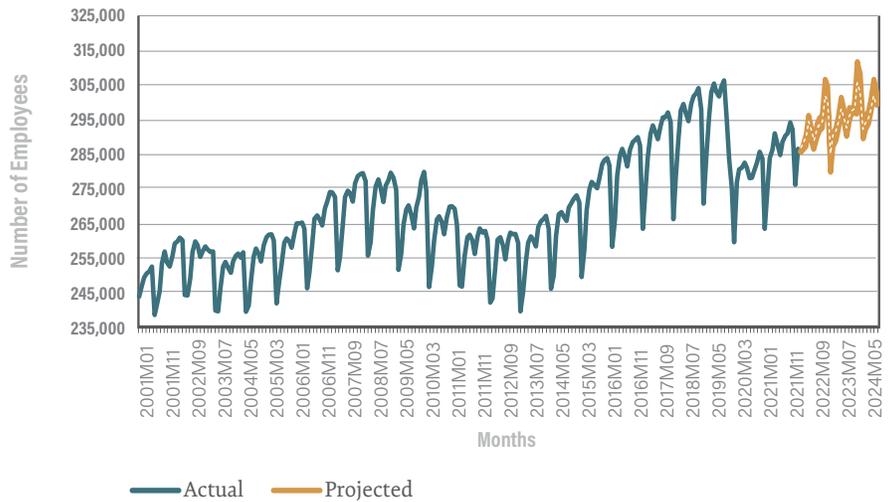
Seasonally adjusted employment levels in this category are likely to remain below 300,000 in the coming two-year interval. A discrepancy of about 12,500 employees will continue to prevail in the months ahead. Projections point to an average yearly growth of 2.01 in 2023 and 1.60 percent in 2024. The faster projected increase in 2023 results from displaying a lagged response to changes in economic conditions. ▶

IN THE VALLEY, GOVERNMENT EMPLOYMENT GREW 3.52% IN 2022

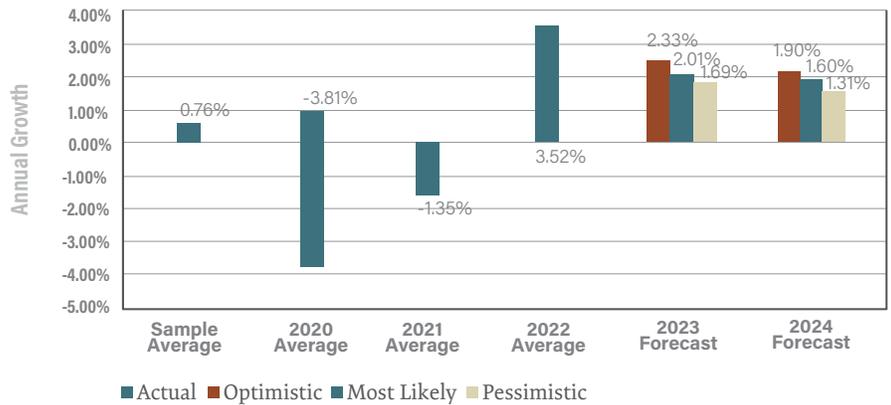
Valley financial activities employment was the only category that experienced a decline in 2022. The decline constituted a third consecutive year of falling employment. However, at negative 0.34 percent, the decline in 2022 was less than the two prior years’ decline of 3.83 percent and 0.98 percent in 2020 and 2021 respectively. Given a slowing economy, a switch from negative to positive territory is not expected in 2023. Employment levels in this category are projected to drop below 42,000 by the end of 2024.

Unlike other series of employment, the ▶ prevailing growth trend before the pandemic ceased to reappear in the recovery months afterwards. Instead, the trend after the pandemic appears to be flat. Financial activities employment is projected to decline further in 2023 at 0.80 percent and then switch to positive territory and grow at 1.29 percent in 2024.

Government Employment



Government Employment: Historical vs. Projected Average Yearly Growth



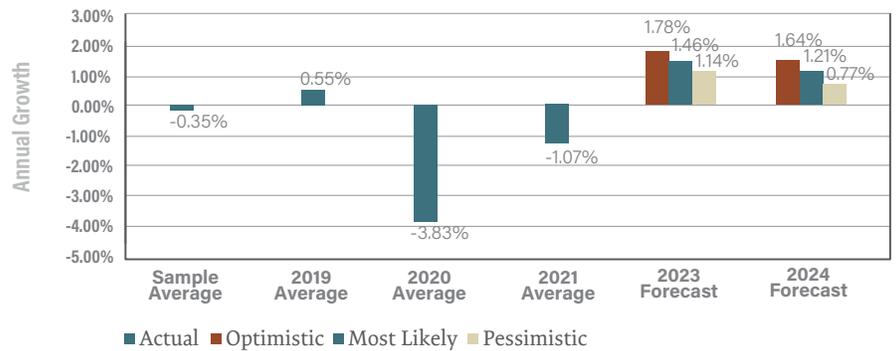
Financial Activities Employment



AN OFFICIAL RECESSION ALREADY BEGAN IN THE FIRST AND SECOND QUARTERS OF 2022, BUT THE LABOR MARKET HAS BEEN STRONG.

Due to the Federal Reserve's commitment to tame inflation by resorting to a series of interest rate hikes, tapering and balance sheet reduction, the Valley's economic activity is expected to slow in 2023. An official recession already began in the first and second quarters of 2022, but the labor market has been strong. There are increasing concerns that the Federal Reserve is rushing to increase rates without first observing the impact on the economy, since the effect of any rate hikes occurs with a significant lag. Incoming unemployment rate numbers point to a minimum rate reached in May 2022, and unemployment rates have gradually increased since then. Given the economic landscape, a return to a clearly defined expansionary phase of the business cycle is not expected until 2024.

Financial Activities Employment:
Historical vs. Projected Average Yearly Growth



Fresno, Bakersfield-Delano, Hanford-Corcoran, Madera-Chowchilla, Merced, Modesto, Stockton and Visalia-Porterville comprise the Bureau of Labor Statistics' eight Metropolitan Statistical Areas (MSAs) that make up the San Joaquin Valley.

The aggregated data from these eight MSAs constitute the Valley's total single-family building permits.

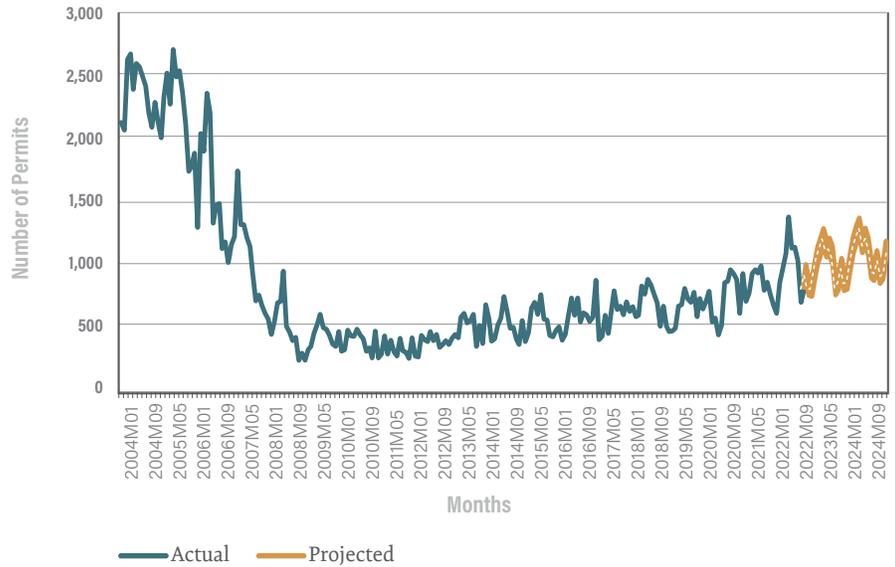
Housing permits rose 18.92 percent in 2022 following a 35.65 percent increase in 2021. Considering the long-term benchmark rate is 8.21 percent, the increase in both years was strong. Even during the pandemic, housing permits increased by 13.26 percent. Given the economy's slowing, Valley housing permits are not projected to exceed 1,000 per month by the end of 2024.

In 2022, Stockton took the lead with 1,801 permits, while Fresno dropped from first to second with 1,252 permits. Bakersfield issued 1,040 permits followed by Visalia's 702 permits and Madera's 539. There was a significant increase from the prior year in Modesto with 384 permits issued this year compared to 50 permits in 2021. Hanford and Merced issued 278 and 177 permits respectively compared to no permits issued in 2021. As rate hikes basically continue and the impact begins to be felt more intensely, the average annual growth in 2023 is projected to slow to 3.60 percent and then pick up some pace in 2024 at 8.04 percent.

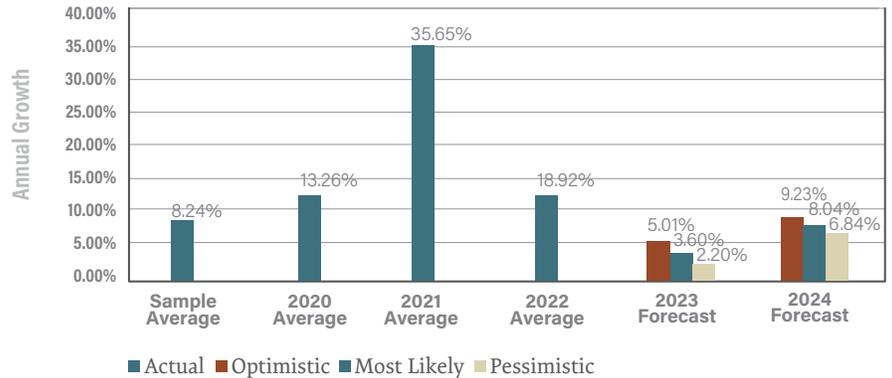
The foreclosures-started series remained at their lowest level ever in 2022 as it did in 2021. However, it is still early for foreclosures to begin displaying a rising trend. As the unemployment rate begins to increase gradually, there is likely to be some upward foreclosure activity. Valley bank accruals began to rise further in 2022, an early indicator of what is to come.

Perhaps the most concerning indicator to watch is the 30-year fixed interest rate, which began to display the steepest and most prolonged increase ever seen in the series. After reaching an all-time minimum of 2.68 percent in the first quarter of 2021, long-term rates have steadily risen along with the Federal Reserve's continued rate hikes. Such a drastic pattern is the underlying concern that rates are being increased too fast and are too high for the economy to achieve a soft landing.

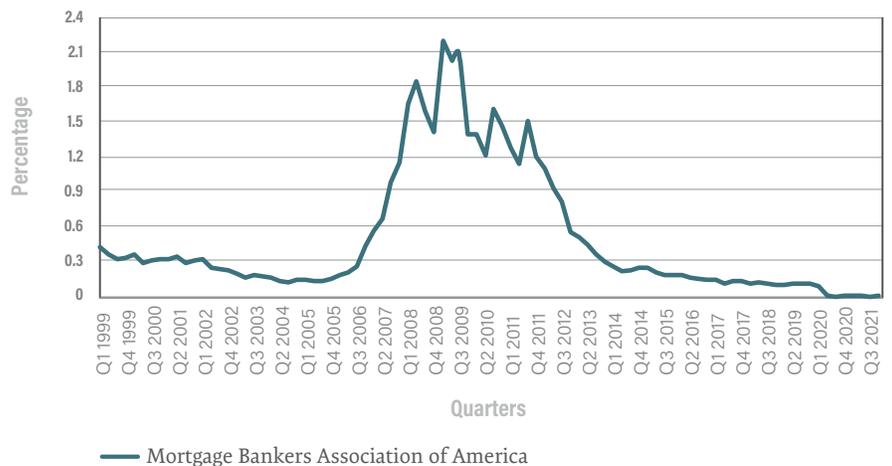
Single-Family Building Permits



Single-Family Building Permits: Historical vs. Projected Average Yearly Growth



Foreclosures Started in California

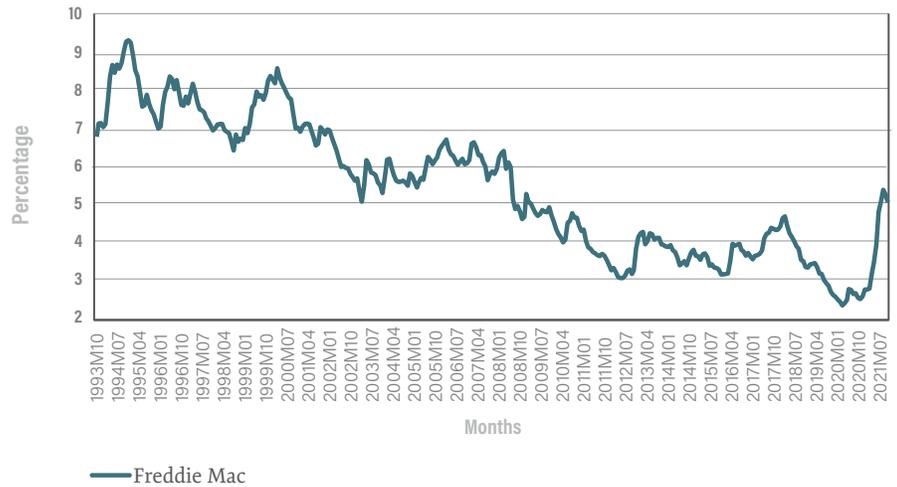


Valley home values increased at an average annual rate of 21.46 percent at the nominal level, which corresponded to 13.17 percent real appreciation after removing the effect of inflation. Double-digit increases are clearly not sustainable and mean reversion to the long-term benchmark rates is likely to occur in the coming two-year interval. Because lenders are stricter this year than in 2021, and the unemployment rate is low, a crisis at the level of the Great Recession is not expected. However, there would be concerns if double-digit unemployment rates prevail in the economy. In addition, inventory shortages, homeowners hanging on to their property rather than selling and home sales resulting from family-related events are other reasons to expect a correction of a lesser degree in the coming months.

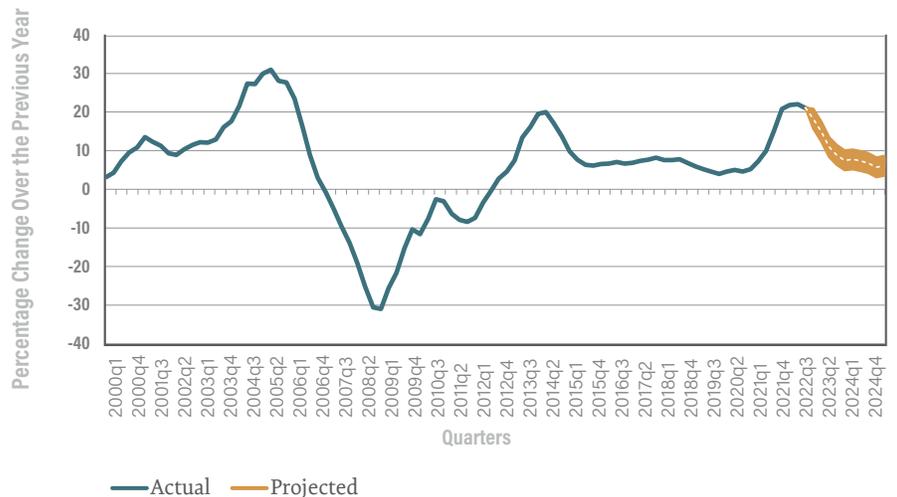
The increase in home values was more than three times the benchmark rate of 5.96 percent. Home value appreciation of 16.83 percent in 2021 was the fastest since the Great Recession. The increase in 2022 – even at a higher pace of 21.46 percent – quickly took over the record set in 2022. Even in real terms, the appreciation was one of the fastest and more than twice the benchmark rate. Therefore, home values are expected to rise at a slower pace and rates will be more consistent with benchmark rates in the coming two-year interval.

A surprise Metropolitan Statistical Area (MSA) took the lead in fastest increase in home values in 2022. Madera reported a 23.10 percent increase in 2022, ending the reign of Stockton and Bakersfield, which registered 22.60 percent and 22.55 percent growth, respectively. Visalia came in with the fourth fastest increase in average home values at 21.18 percent. Fresno trailed Visalia at 20.56 percent. Merced reported 22.30 percent growth followed by Modesto at 19.88 percent average yearly appreciation. Hanford came last with a 19.47 percent increase in 2022. Projections point to an 8.61 percent increase in 2023 and a 6.33 percent increase in 2024.

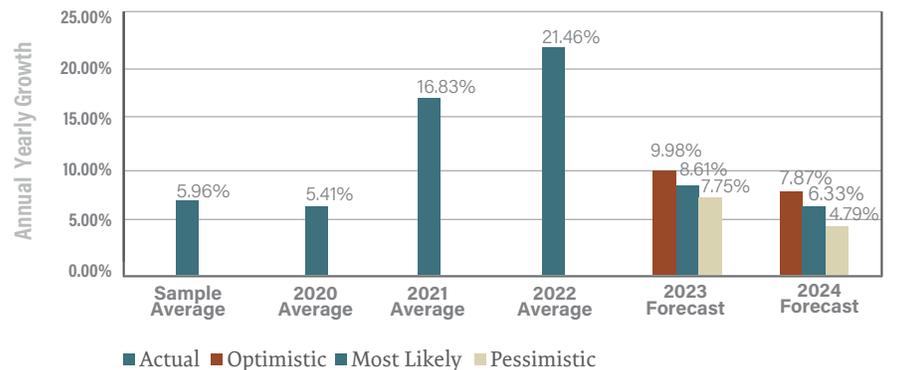
30-Year Fixed Rate



Yearly Percentage Change in Housing Prices



Yearly Growth in Housing Prices: Historical vs. Projected Average Yearly Growth





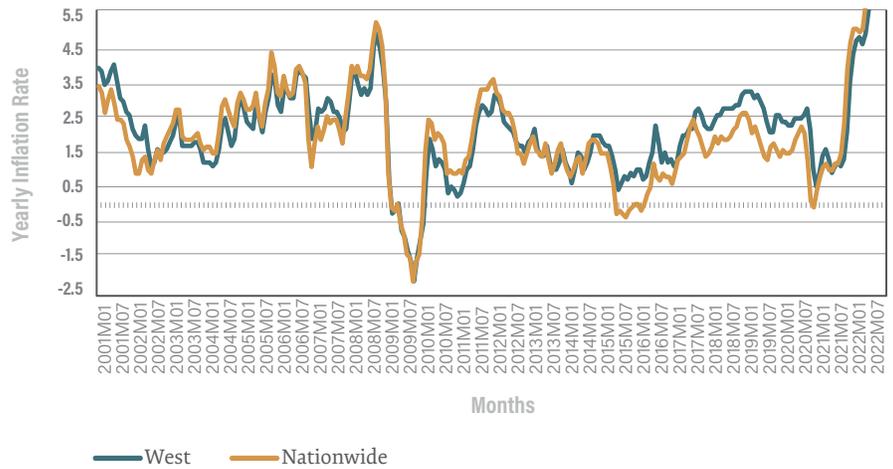
Inflation and Prices

It is well known that inflation runs higher in the west than at the national level. When the two series display identical or reversing patterns similar to what occurred during the Great Recession, economic activity declines. There appears to be a tendency for such a pattern in recent months, acting as a coincidental indicator of a slowdown for our region. ▶

At an average yearly rate of 8.29 percent, the inflation rate in 2022 was more than three times the benchmark rate of 2.61 percent and more than twice 3.66 percent rate in 2021. Both cost-push and demand-pull factors continued to put upward pressure on the overall price level in 2022. Given that inflation is driven by the price of oil, OPEC's decision to curtail output is likely to maintain this pressure.

Other factors that put upward pressure ▶ on overall price levels are the ongoing Ukraine-Russia war, unresolved supply chain issues and wages, although the effect of the latter has subsided during the second half of 2022. Inflation rate projections for the Western region point to an average yearly increase of 3.36 percent in 2023 and 2.31 percent in 2024.

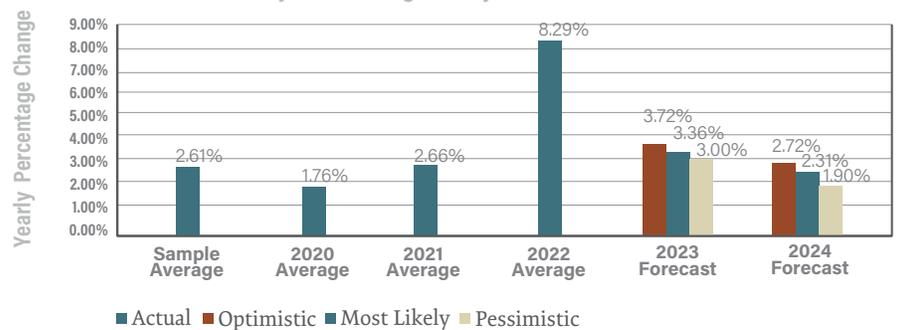
Inflation Rate: Nationwide vs. West



U.S. West Inflation Rate



U.S. West Inflation Rate: Historical vs. Projected Average Yearly Growth



IT IS WELL KNOWN THAT INFLATION RUNS HIGHER IN THE WEST THAN AT THE NATIONAL LEVEL.

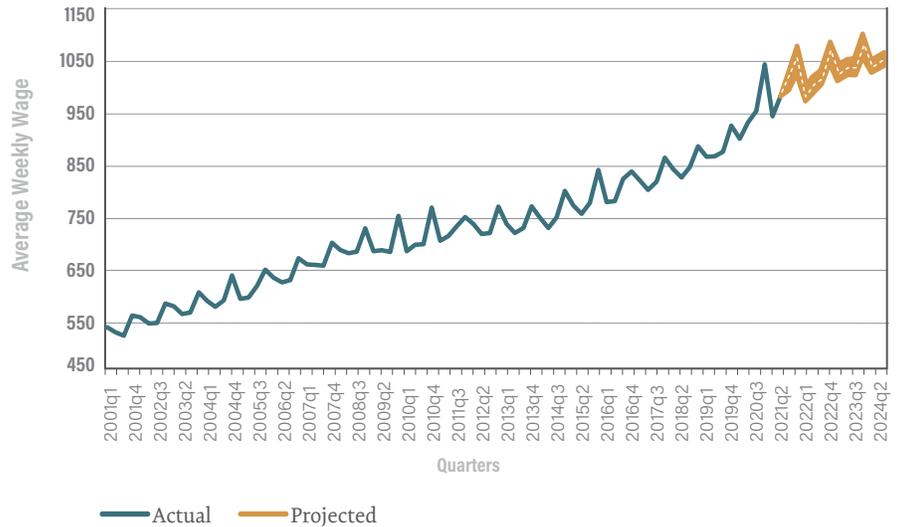
DURING 2022, THE AVERAGE RATE OF INFLATION STOOD AT 8.29%

After a significant 8.48 percent increase in 2020, wages decreased steadily, registering 4.93 percent increase in 2021 and 3.28 percent increase in 2022. As the recovery was underway, workers' reluctance to re-enter the workforce gradually dissipated, increasing the supply of labor and decreasing wage growth by nearly one-third of rates seen in 2020. Wage growth in 2022 is now in line with the benchmark growth of 3.24 percent and is likely to oscillate around that value in the coming months.

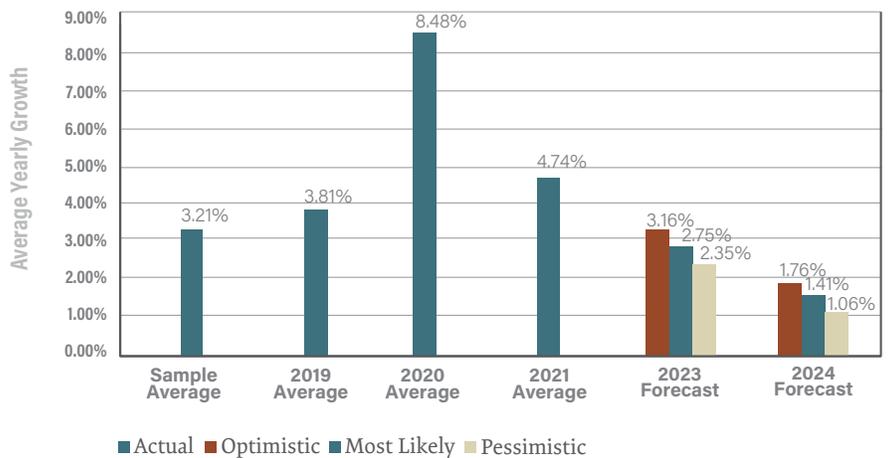
The reservation wage of a typical Valley employee fell as workers gradually reported to work, brushing away worries about infection, vaccinations and being better prepared against variant strains of the COVID-19 virus. Average weekly wages in the Valley are likely to stay below \$1,050 by the end of 2024. Projections point to an average yearly increase of 3.08 percent in 2023 and a 2.09 percent increase as inflation subsides in 2024.

During 2022, the average rate of inflation stood at 8.29 percent. During the same time, average weekly wages rose 3.28 percent, resulting in a fall in real wages and a remarkably high loss of purchasing power of 5.01 percent. This loss in purchasing power will continue in the coming months.

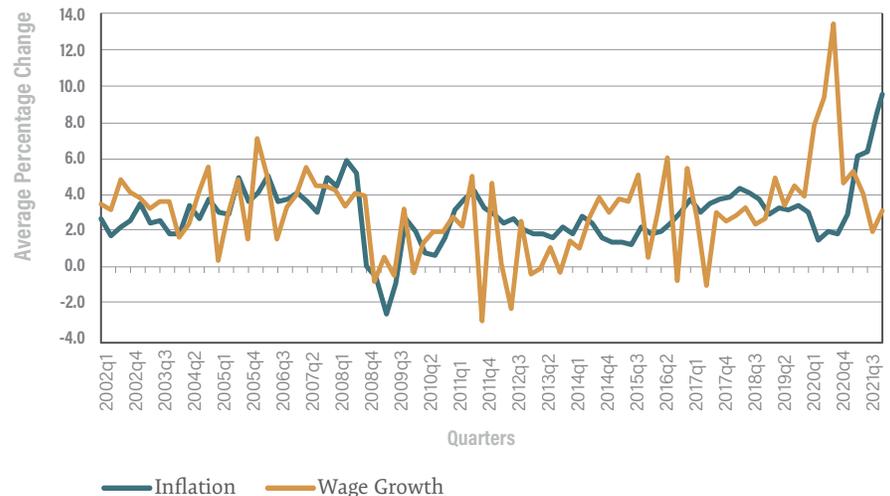
Quarterly Average Weekly Wages



Weekly Wage Growth: Historical vs. Projected Average Yearly Growth



Yearly Wage Growth vs. Inflation

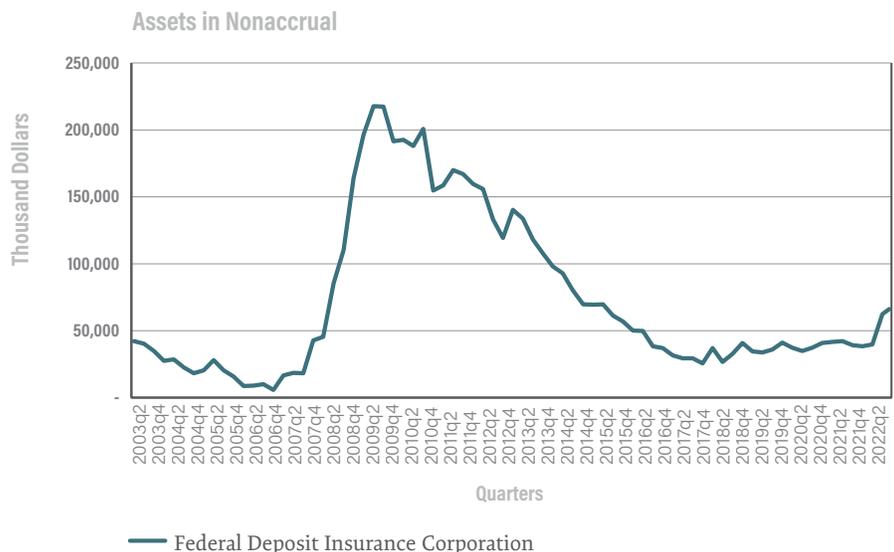
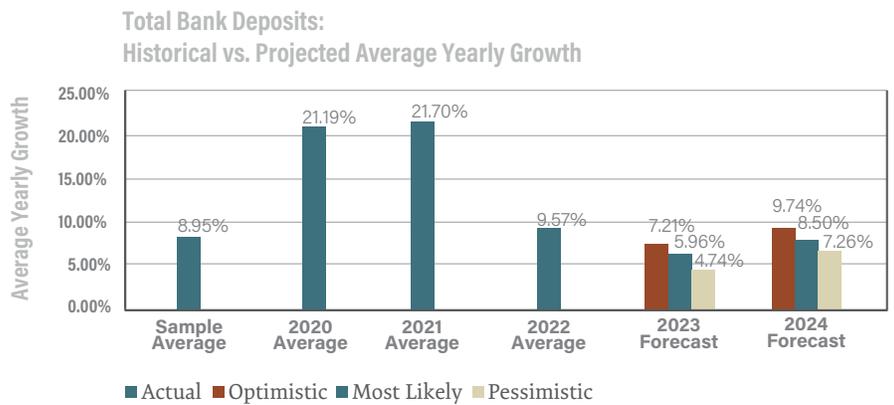
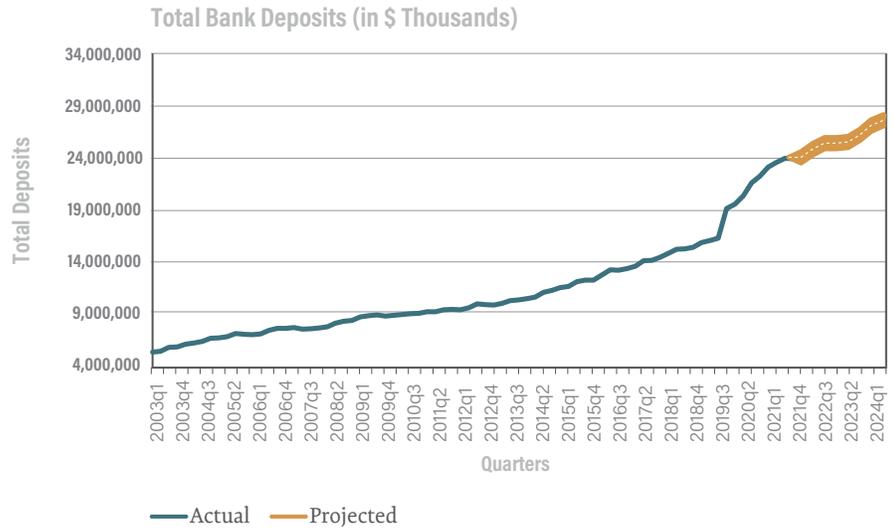


There was a clear change in the dynamics of the Valley’s community bank total deposits and net loans in 2022. This change resulted from Federal Reserve’s interest rate hikes, balance sheet reduction and tapering which began in the first quarter of 2021.

Valley total bank deposits rose 9.57 percent in 2022 – about half the rate seen in 2020 and 2021. The 9.57 percent increase in 2022 was also consistent with the long-term benchmark rate of 8.95 percent, and therefore was more sustainable in the long run. Given the slowing activity, Valley total bank deposits are projected to increase at an average annual rate of 5.96 percent, a value below the benchmark rate, and pick up an increase of 8.50 percent in 2024, at rates more in line with the long-term benchmark growth rate.

The upward movement in bank assets in nonaccruals became more pronounced in the first and second quarters of 2022 when the trend became steeper compared to previous quarters. With the passage of time after the end of mortgage forbearance programs by September 2021, nonaccruals naturally picked up speed as rates continued to rise. Further increases in interest rates will likely make it harder for Valley residents to pay their mortgages and meet their other financial obligations, leading to even steeper increases in nonaccruals.

The upward movement in bank assets in default 90-plus days was earmarked with a significant spike in the first and second quarters of 2022. This spike was confirmed by the Federal Deposit Insurance Corporation (FDIC) for accuracy. At least one of the community banks reported a roughly ten-fold increase in assets in default 90-plus days. Keep in mind that to make both series comparable assets, in default 90 days is multiplied by 10. As in previous reports, the pattern observed in bank assets in default 30 to 89 days and assets in default 90-plus days is now consistent in the direction of change. As rates rise further and unemployment continues to gradually rise, the trend in both series is likely to become much steeper.



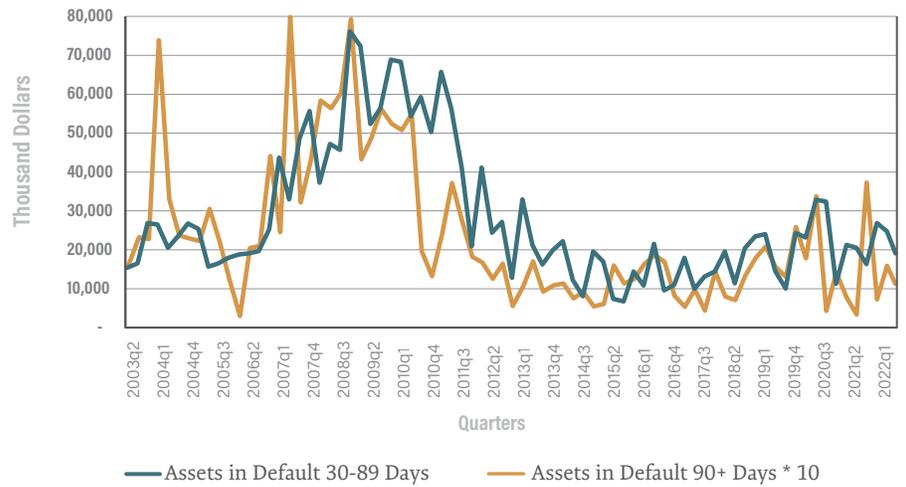
Community banks became much stricter in extending loans in 2022 compared to 2021. This is reflected in the rate of increase in community banks net loans and leases, which came to an abrupt halt, registering a trivial 0.10 percent increase in 2022. This drastic drop in growth rate was quite significant considering net loans and leases increased 11.36 percent in 2021 and 17.63 percent in 2020. Furthermore, when compared with the benchmark growth rate of 7.75 percent, a 0.10 percent change basically reported no increase from the previous year. This phenomenon was a first since we started tracking the series in 2001, bringing with it worries of a deepening recession.

With interest rates continuing to rise further, balance sheet reduction and tapering on the part of the Federal Reserve, a faster falling trajectory of the economy is likely in the two-year period ahead. Projections point to net loans and leases increasing at an average yearly rate of 2.48 percent in 2023 — about one-third of the benchmark rate and 5.79 percent in 2024. ▶

The worry is whether the recession will deepen, causing unemployment rates to rise significantly. Both community bank deposits and net loans and leases are likely to grow less than their benchmark growth rates in the coming months, only to improve to the rates consistent with expansion in 2024. ▶

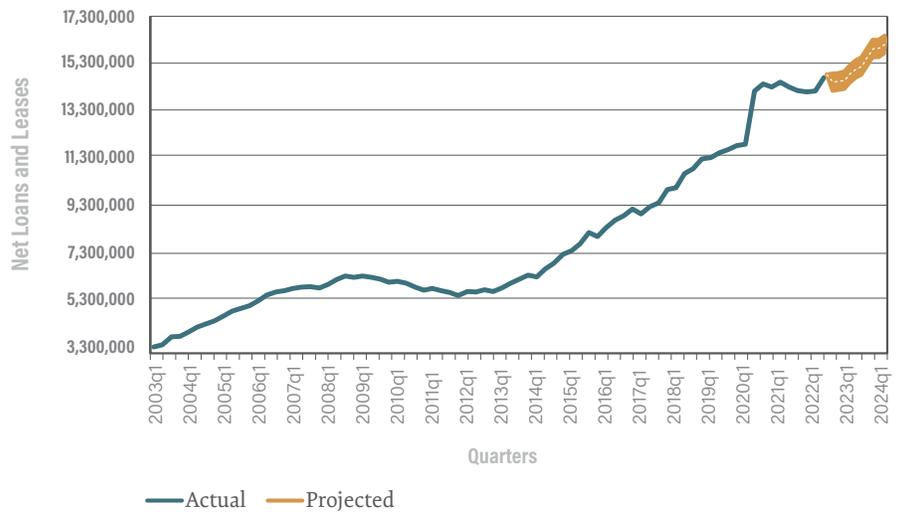
COMMUNITY BANKS BECAME MUCH STRICTER IN EXTENDING LOANS IN 2022 COMPARED TO 2021.

Assets in Default 30+ Days



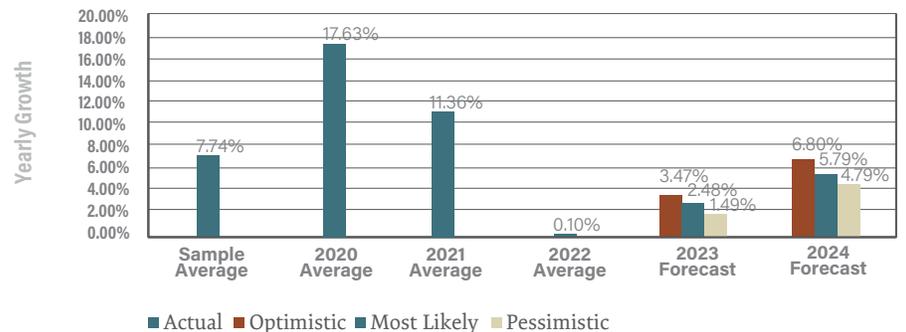
— Assets in Default 30-89 Days — Assets in Default 90+ Days * 10

Net Loans and Leases (in \$ Thousands)



— Actual — Projected

Net Loans and Leases: Historical vs. Projected Average Yearly Growth



Given the Federal Reserve's continuation of rate hikes, our projections point to slowing activity in the coming months. The Valley economy, along with the nation, has been in an official recession in the first and second quarters of 2022. However, during the same period, labor markets have been tight and unemployment rates incredibly low, therefore brightening the picture. With OPEC deciding to cut back oil production during its October 2022 meeting, high inflation driven by the price of oil may linger a bit longer.

Valley total employment is likely to decline in 2023 but will display some growth in 2024. In 2022, total employment in all counties grew at rates significantly higher than their respective benchmark growth rates. Fresno County reported the fastest growth, followed by Tulare County. Merced County registered the third fastest growth. Madera County was next in employment growth followed by San Joaquin County. Kings and Stanislaus counties were the remaining two counties that grew several times their typical growth rates.



The fastest-growing employment category was leisure and hospitality services, followed by information employment, a surprise since it is historically problematic in achieving sustained growth. Trade, transportation and utilities employment grew third fastest, followed by retail services employment. Manufacturing employment grew at the fourth fastest pace, followed by Valley construction employment. Education and health services employment displayed the once again robust behavior in 2022 and in prior years. Financial activities employment was the only category to report a decline in 2022, as it did in 2021 and 2020.

Home values increased 21.46 percent in 2022, bringing back worries of a housing market bubble. Any pull back will not likely be to the same degree seen during the 2008 recession simply because lenders are stricter in 2022 than the prior year, unemployment rates are still low and homeowners are holding on to their homes, indicating that any selling that takes place is likely due to a family event or is investment related. However, the double-digit increases seen in 2022 and 2021 are clearly not sustainable and a correction back to rates more in line with benchmark growth rates is expected.

Inflation is likely to decline at very gradual rates in the coming months but a fall to the Fed's target rate of 2 percent is not likely to occur in the very near future. Valley average weekly wages rose about 5 percent less than the inflation rate in 2022. Thus, there was a significant fall in purchasing power of the Valley consumer.

In 2022, Valley community bank total deposits increased about half the rate of the prior year. There was no growth whatsoever in Valley net loans and leases, reflecting the stricter stance of community banks in extending loans. Valley community bank assets in nonaccrual began trending more steeply in 2022 than in 2021 and are more likely to increase if unemployment rates significantly rise. Community bank assets in default 30 to 89 days and assets in default 90-plus days displayed a steeper increase in 2022 than previous years. There was a big spike in assets in default 90-plus days when at least one of the community banks reported a roughly ten-fold increase in the first and second quarters of 2022.

Given the economic landscape, it is increasingly important for Valley residents to leverage down, increase cash holdings, lock in fixed rates by switching from flexible rates and rent instead of purchase homes to protect their financial well-being in the coming months.

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