San Joaquin Valley

BUSINESS FORECAST

Emerging Trends in the Valley’s Economy
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SAN JOAQUIN VALLEY BUSINESS FORECAST 2023
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The slowdown in total employment growth intensified in the second quarter of 2023, leading to a noticeable decline in July — a first for the period — with a further decrease in August. This downturn is particularly concerning given that employment typically reaches a seasonal peak during these months. Indicators of an accelerating slowdown were observed in certain employment categories before the second quarter of 2022. This decline in total employment levels is expected to worsen in 2024. Currently, interest rates are at historic highs since 2000. It takes approximately six quarters for rate hikes to affect the economy, and we are approaching the period where their cumulative effects become most evident.

In the Valley, all employment categories except for retail and wholesale trade, as well as construction, experienced growth in 2023. Construction employment faced the sharpest decrease at -1.64 percent, with retail and wholesale trade also declining by 0.68 percent and 0.48 percent, respectively. Other categories saw their growth rates multiply compared to long-term benchmarks, though the rate of increase is slowing. Projections suggest that employment levels will drop in 2024, with a potential rebound in 2025. Education and health services employment, traditionally a strong performer, grew by 5.59 percent in 2023 — outpacing the previous year’s growth of 4.94 percent. Conversely, government employment expanded by only 2.83 percent in 2023, which lagged behind the 3.44 percent growth seen in the previous year.

One of the employment categories most vulnerable to changes in interest rates is leisure and hospitality services in the Valley, which grew by 5.05 percent in 2023. This rate was significantly slower than the previous year’s robust 13.63 percent growth, spurred by post-pandemic revenge travel. The increase was approximately 4 percent lower than in 2021. Despite the drop, leisure and hospitality employment still recorded the fastest growth among Valley sectors. In 2023, information sector employment growth was negligible at 0.64 percent, a decrease from 5.84 percent, and is anticipated to decline further in 2024. Growth in trade, transportation and utilities employment stagnated significantly in 2023, registering only 0.20 percent, down from 5.54 percent. This stagnation is a clear indicator of a slowing economy. Manufacturing employment grew by 2.86 percent in 2023, which is slower compared to the 4.62 percent growth in 2022. Employment levels are expected to decline in 2024, with the potential for only a partial recovery in 2025, barring any catastrophic regional conflicts.

After registering 12.30 percent growth in 2022, Valley building permits declined by 9.62 percent in 2023, reflecting a slowdown in the housing sector. Because workers mostly held on to their jobs in 2023, the region avoided foreclosures for now. Freddie Mac 30-year rates have reached a 22-year peak, last seen in 2001, with the rate of increase being the most rapid on record. The average inflation rate stood at 4.71 percent, persistently around 2 percent above the Federal Reserve's target rate. Inflation is showing signs of gradual decline, which could ultimately convert to a deflationary phase. Valley home values saw a modest increase of 1.88 percent in 2023, and they are likely on the path to experiencing a decline for the first time since the Great Recession. Although there is a significant inventory shortage, any market correction is expected to be short lived. However, a recalibration of home values is underway, likely influenced by the steep rise in long-term interest rates to the highest levels in decades.

Wage inflation, coupled with high gas prices, is the main culprit of persistent inflation in 2023. Average weekly wages increased by 6.01 percent in 2023, surpassing the overall price growth of 4.71 percent. This resulted in a real wage increase and a purchasing power gain of 2.79 percent in the Valley. However, projections indicate a trend toward lower wage growth rates in the next two years, with potential declines in the purchasing power of Valley consumers.

Total deposits at Valley community banks declined dramatically, from a growth of 10.10 percent in 2022 to just 0.92 percent in 2023. This substantial drop in deposit growth can be partly attributed to bank closures and mergers with banks outside the region. In contrast, net loans and leases experienced a rise of 9.54 percent in 2023, which was faster than the 4.90 percent increase in 2022. Such an imbalance between deposit growth and net loans and leases, like the scenario observed in 2008, raises concerns for sustained long-term growth. Community bank assets, both in the 30-to-89-day bracket and those over 90 days, remained unchanged in the first half of 2023 compared to the same period in 2022. Additionally, nonaccruals slightly decreased in the first half of 2023, as employment remained relatively stable with low but gradually increasing unemployment rates.

With interest rates reaching their highest in two decades, purchasing bonds is advisable. Over the next two years, interest rates are more likely to decrease rather than increase, given they are at the highest levels since 2000. To mitigate the impact of high rates on their economic circumstances, Valley residents might consider renting and delaying home purchases. Those who have borrowed at a high interest rate can consider switching from fixed to flexible rates to take advantage of future declining rates. Moreover, leveraging student loans to acquire new skills in the event of layoffs is another viable strategy, as higher skill levels generally reduce the risk of job displacement. For Valley businesses, maintaining a high cash reserve is a prudent safeguard against the effects of a contracting economy.
Time series data extends from January 2001 to September 2023. Medium-term forecasts, spanning a two-year period, are projected from October 2023 to December 2025. Employing a range for forecasting, as opposed to a single point estimate, offers a more realistic assessment of potential future values. The accuracy of the forecast is confirmed when actual figures align with the predicted upper and lower forecast bands.

The sections of this report are structured as follows: Section B analyzes labor market conditions in the San Joaquin Valley. Section C examines the region’s real estate market, focusing on eight metropolitan statistical areas. Trends in prices and inflation are reviewed in Section D, which Section E delves into indicators from local banking and capital markets. The report concludes with Section F.
Total employment growth came to a standstill, reporting a marginal increase of 0.45 percent in 2023, a significant slowdown from the previous year’s more robust growth of 5.05 percent. At this rate, a decline in Valley total employment in the coming months is expected, marking the first downturn since the Great Recession, excluding the exceptional pandemic years. Typically, Valley total employment reaches a seasonal peak in July and August. However, during these peak months, there was a consecutive decline in employment, with reductions at 0.94 percent and 1.39 percent in July and August, respectively. This downturn is another first since the recessionary period of 2008 and heightens concerns about an impending economic contraction.

In 2023, every county experienced employment growth. Fresno led with the fastest growth, followed by San Joaquin and Kern counties. Tulare was the fourth fastest-growing region, succeeded by Stanislaus and Kings counties. Merced and Madera counties reported the slowest growth in 2023. Despite overall growth in 2023, the rate of increases progressively declined each month, culminating in the first instances of decline in Merced and Stanislaus counties during July and August.

In 2023, all employment categories in the Valley, except for retail trade, wholesale trade and construction, grew. Construction employment saw the sharpest decline, followed by retail trade and wholesale trade. In other categories, growth was generally several times their respective long-term benchmark rates but at a decreasing pace. Education and health services employment, typically characterized by robust growth, increased faster than the previous year’s. On the other hand, government employment, a traditionally lagging growing sector, expanded at a slower rate than the previous year. Leisure and hospitality services employment in the Valley grew more slowly compared to the spike in the previous year when travel demand surged after the pandemic. However, this sector still achieved the fastest growth rate in the Valley. Trade, transportation and utilities employment growth stagnated in 2023, signaling a decelerating regional economy. Manufacturing employment’s growth rate was approximately half of that in 2022, further indicating an economic slowdown.

The average annual growth rate of total employment in the Valley was a mere 0.45 percent in 2023. Considering the growth rate was 5.85 percent in 2022, this significant drop in total employment is noteworthy and likely to lead to a decline in the coming months. Total employment in the Valley is projected to decrease to about 1.73 million in 2024 before rebounding in 2025. Projections suggest a 0.42 percent decline in 2024 and a growth of 0.57 percent in 2025, which is below the benchmark rate of 1.12 percent.
The Consumer Confidence Index, a crucial leading economic indicator, has been falling since 2021, stabilizing around a value of 100 during most of 2023. However, the recent drop in September aligns with other indicators in the economy, signaling an impending contraction. This decrease reflects consumers’ diminishing confidence in their spending patterns in the coming months compared to previous periods.

The growth rate of the labor force has intersected with the declining employment growth, exhibiting crossing patterns. In the coming months, it is likely that the labor force growth will surpass employment growth in the Valley, mirroring a pattern characteristic of a contracting economy, similar to what was seen during the recessionary period of 2008 and the pandemic months. Consistent with our predictions from previous reports, this crossing pattern appears to serve as a leading indicator of economic activity for the Valley’s economy.

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Employment growth is slowing for both the Valley and the state. However, this slowdown is more pronounced in the Valley. The region’s less diversified economy, with a higher proportion of unskilled labor, makes it particularly more susceptible to economic events such as rate hikes. Both the Valley and the state are now witnessing a shift from positive to negative territory in their employment growth series, signaling the first signs of a downturn in both regions.
An inverted yield curve and 10-year rates at their highest levels since 2007 are among several concerns suggesting a possible contraction in real Gross Domestic Product (GDP) growth. As noted in our previous reports, the impact on the job market is gradually unfolding, starting from the second half of 2023. Projections indicate a contraction in 2024, with a transition into an expansionary phase anticipated in 2025, as the Federal Reserve begins to lower rates in the coming months. If high rates persist for an extended period, the contraction phase may take longer.

Education and health services employment appears to be the least affected by changing economic conditions, displaying robust performance even during recessionary years. In 2023, employment in this category grew by 5.59 percent, outpacing the previous year’s growth of 4.94 percent. Considering this sector tends to lag behind other employment categories in the Valley, it is expected that growth in education and health services employment will likely start to slow down in the fourth quarter of 2024.

Education and health services employment appears to be the least affected by changing economic conditions, displaying robust performance even during recessionary years.

Employment levels in education and health services employment are projected to remain below 265,000 by the end of 2025. The skill requirements associated with jobs in this category render the sector more resilient to economic downturns. Projections indicate that employment in the sector will grow at an average annual rate of 3.38 percent in 2024, roughly in line with the benchmark growth rate, before decelerating to a slower pace of 2.34 percent in 2025.
In 2023, manufacturing employment in the Valley grew by 2.86 percent, about half of the 4.62 percent growth observed in 2022, but it remained above the long-term benchmark rate. Employment levels in this category are expected to stabilize at around 120,000 by the end of 2025. Considering the long-term benchmark growth rate for Valley manufacturing employment is 0.43 percent, the average yearly growth in 2023 was more than seven times this benchmark.

Given the intensifying slowdown in the overall economic activity, it is anticipated that growth in manufacturing employment will decelerate further in the coming months. Projections suggest an average annual growth rate of 0.78 percent in 2024, followed by a slight decline of 0.10 percent in 2025.

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The Institute of Supply Management’s (ISM) Purchasing Managers Index, an important leading indicator, has consistently fallen below the critical threshold of 50 points since the second half of 2022. An index value below 50 points typically suggests the economy is likely to contract. The ISM Purchasing Manager’s Index reached its lowest point in the first quarter of 2023. The subsequent upward trend in the index seems to be driven by concerns about a potential recession in 2024.
In 2023, leisure and hospitality services employment continued to be the fastest-growing employment category in the Valley despite an 8.58 percent decrease from the previous year. This category maintained the leading position in employment growth. Leisure and hospitality services employment increased by 5.05 percent in 2023, and is expected to continue slowing, likely remaining below 150,000 by the end of 2025.

Employing mostly unskilled workers, the leisure and hospitality services, along with the retail trade category, are the categories most sensitive to economic downturns. Following the pandemic, demand for travel and leisure increased considerably with some referring to this post-pandemic behavior as “revenge travel.” However, in 2023, as conditions slowly normalized, this demand began to wane. The decrease in demand was somewhat delayed but became evident following the rate hikes. Projections point to an average annual growth of 2.27 percent in 2024 for these sectors, followed by a slower growth rate of 1.10 percent in 2025.

It is projected that employment in trade, transportation and utilities will stay below 340,000 by the end of 2025.

Despite experiencing growth even during the pandemic years, employment in trade, transportation and utilities within the Valley began to slow in 2023. The pace of growth essentially came to a standstill, a marginal growth rate of 0.20 in 2023, a significant drop from the 5.54 percent growth seen in 2022. It is projected that employment in trade, transportation and utilities will stay below 340,000 by the end of 2025.
In 2023, rate hikes began to take their toll on trade, transportation and utilities employment in the Valley. The gradually slowing economy contributed to a reduction in the long-lasting shortage of truck drivers within this category. Trade, transportation, and utilities employment is projected to grow at a much slower rate than the benchmark growth pace of 2.10 percent. Specifically, it is expected to increase at an average yearly rate of 0.33 percent in 2024 and 0.62 percent in 2025.

In the Valley, retail trade employment experienced a decline of 0.68 percent in 2023, a downturn from the 1.84 percent growth observed in 2022. This decline was the first since the pandemic years and, given that retail trade employment is one of the sectors most sensitive to interest rate changes in the Valley, it was not surprising to see it as one of the first categories to post a decline. Employment levels in this category are anticipated to remain below 160,000 by the end of 2025.

**Trade, transportation, and utilities employment is projected to grow at a much slower rate than the benchmark growth pace of 2.10 percent.**

The long-term benchmark growth for retail trade employment fell slightly to 0.92 percent, a consequence of the decline experienced in 2023. With the impact of high interest rates being felt increasingly, retail trade employment is likely to decline at a faster pace in the coming months. Projections point to a decline of 1.03 percent in 2024, followed by a further decrease of 0.15 percent 2025.

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**Retail Trade Employment:**

- **Actual:**
- **Projected:**

The long-term benchmark growth for retail trade employment fell slightly to 0.92 percent, a consequence of the decline experienced in 2023. With the impact of high interest rates being felt increasingly, retail trade employment is likely to decline at a faster pace in the coming months. Projections point to a decline of 1.03 percent in 2024, followed by a further decrease of 0.15 percent 2025.
The Valley’s wholesale trade employment was another category to post a decline in 2023. This decrease of 0.48 percent followed a robust year in 2022, during which wholesale trade employment experienced a growth of 4.92 percent. Rate hikes were the main factor behind declining job numbers in this category. Employment levels in the wholesale trade category are expected to remain slightly below 48,000 by the end of 2025.

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Warehouse development appears to have plateaued, as evidenced by the decline for five consecutive months in 2023, marking the first such occurrence since the 2008 recession, not counting the anomaly of the pandemic years which had different underlying causes than the recent rate hikes. Projections point to a 0.54 percent decline in this category of employment in 2024, followed by a modest recovery with a growth of 0.42 percent in 2025.

Valley information employment declined continuously for many years before the pandemic. In 2023, employment in this category grew by 0.64 percent, a significant reduction from a very high growth rate of 5.82 percent in 2022. Post pandemic, the sector recovered about 1,000 employees and stabilized at a total employment figure of approximately 8,500 and has since maintained a steady level close to that number. In the coming months, employment in this category is expected to fall to about the 8,000 level.
The long-term benchmark rate roughly remained the same in 2023 given there was little growth in 2023. Information employment has suffered from an increased use of digitalization and social media, lowering demand for employment in this sector. Due to the specific skills required for employment in this category, it is not expected to be affected by rate hikes as some other categories, such as leisure and hospitality services. Projections point to a modest 0.34 percent growth in 2024, followed by a slightly higher growth rate of 0.91 percent growth in 2025.

Growth in construction employment had been slowing since the third quarter of 2022, with a noticeable decline that began in January 2023, marked by consecutive monthly decreases over an eight-month period. Excluding the pandemic years, the last time consecutive month-to-month declines were observed was in the third quarter of 2006. In 2023, employment in this category declined by 1.64 in 2023, a substantial drop from the 7.75 percent growth recorded in 2022, representing a decrease of approximately 9.39 percent.

Given 30-year interest rates hit 8 percent in the third quarter of 2023, the highest since 2000, employment in this category will decline further in the coming months. Construction employment will likely remain below 75,000 by the end of 2025 as the impact of high rates becomes more visible. Projections point to a 2.63 percent decline in 2024, followed by a slower decline of 1.46 percent in 2025.

Growth in construction employment had been slowing since the third quarter of 2022, with a noticeable decline that began in January 2023, marked by consecutive monthly decreases over an eight-month period.
Valley government employment generally responds to economic policy variables, such as rate hikes, later than other employment categories. Additionally, the impact on government employment tends to be less pronounced compared to other categories, such as retail trade. Consequently, government employment in the Valley grew 2.83 percent in 2023, which is slightly lower than the 3.44 percent growth observed in 2022. Notably, government employment makes up a significant portion of the Valley’s total employment, accounting for about 20 percent.

Government employment in the Valley is expected to remain below 310,000 over the next two years. A shortfall of approximately 15,000 employees, a remnant from the Great Recession, persists, along with an additional deficit of around 12,500 employees attributed to the pandemic years. Projections suggest an average annual growth rate of 1.58 percent in 2024, followed by a slightly higher growth rate of 1.72 percent in 2025.

The rise of digitalization and the increased use of online banking have significantly affected employment in the banking sector, leading to a negative long-benchmark rate of growth.

The rise of digitalization and the increased use of online banking have significantly affected employment in the banking sector, leading to a negative long-benchmark rate of growth. In 2023, growth in financial activities employment was minimal, registering at just 0.12 percent, a decrease from the 0.49 percent seen in 2022. Additionally, the closure and merger of some community banks in the Valley with banks outside the region have further contributed to the decline in employment within this category.
Employment in financial activities within the Valley is projected to remain below 42,000 by the end of 2025. The sector lost approximately 2,000 employees during the pandemic, which has not recovered post pandemic. Currently, employment in this category appears to be stabilizing around 41,000 employees, exhibiting a flat trend rather than the gradual upward slope observed before the pandemic. Projections indicate a decline of 0.47 percent in financial activities employment for 2024, followed by a shift to positive growth with a modest increase of 0.23 percent in 2025.

Long-term rates have reached a generational high. As a result, employment in certain categories began to decline as early as January 2023, while others experienced more pronounced slowdowns. Valley total employment saw consecutive declines during the typically robust seasonal peak months, heightening concerns about a potential economic contraction. At this pace, it is likely the Valley’s overall employment will continue to decline in 2024. As interest rates do not begin to decrease in 2024, the downward trend may extend into 2025. Interest rates will begin to fall in an aggressive pace in 2024, potentially leading to a resumption of growth in 2025.

Employment in financial activities within the Valley is projected to remain below 42,000 by the end of 2025.
The eight Metropolitan Statistical Areas (MSAs) defined by the Bureau of Labor Statistics that make up the San Joaquin Valley are Fresno, Bakersfield-Delano, Hanford-Corcoran, Madera-Chowchilla, Merced, Modesto, Stockton and Visalia-Porterville. The combined activity of these MSAs accounts for the total number of single-family building permits issued in the Valley.

In 2023, housing permits declined by 9.62 percent, a steep drop from the 12.30 percent growth observed in 2022. Given the situation with long-term interest rates and the contracting economy, Valley housing permits are projected to decline to an average of 700 per month by the end of 2025.

Fresno took the lead with 1,540 housing permits in 2023, while Bakersfield ranked second with 1,391 housing permits. Stockton, previously in the lead, dropped to third with 1,345 single-family building permits. In 2023, Madera surprised with 976 permits, followed by Visalia with 693 permits. Modesto and Hanford were next with 487 and 465 permits, respectively. Merced recorded the lowest number with 232 permits. Projections point to a further decline of 10.97 percent cent, in 2024, followed by a rebound of 6.41 percent in 2025, contingent on the Federal Reserve cutting rates. If rates remain unchanged, the impact on the housing market will experience a more pronounced impact.

It is still early for foreclosures to display a rising trend as declines in employment levels have only just begun.

Due to people holding on to their jobs, the series of foreclosures initiated remained at its lowest level ever in 2023, continuing the trend observed in 2022. It is still early for foreclosures to display a rising trend as declines in employment levels have only just begun. However, as the unemployment rate gradually increases, there will likely be an upward movement in the rate of foreclosures initiated.
As highlighted in our previous report, a particularly concerning indicator to watch is the 30-year fixed mortgage rate, which reached 8 percent in the third quarter of 2023, the highest rate since 2000. Not only are interest at a generational high, as evidenced by their steep upward trend, but the pace of this increase has been very quick, and unprecedented since the tracking of the series began in 1993. This drastic pattern underlines a key concern within the economy: the rates were increased too fast and to levels that are too high for sustained growth.

Valley home values increased by an average annual nominal rate of 1.88 percent. However, after adjusting for inflation, this translates to a real depreciation of 2.83 percent. As noted in our previous report, the double-digit increases observed previously were clearly not sustainable, and a reversion to the long-term benchmark rates is expected within the next two years. The steep decline from 21.61 percent in 2022 to 1.88 percent growth in 2023 is a clear indicator of a market correction.

For the first time in 2023, the increase in home values was less than the benchmark rate of 5.99 percent. Factors such as the shortage of housing inventory and homeowners opting to retain their properties—to avoid selling and then facing very high rates—have led to nominal appreciation in home values. However, given the well-defined downward trend, a decline in home values is expected in the coming months.
Hanford led the way with the fastest increase in home values in 2023, reporting a 3.17 percent increase, overtaking the reign of Madera MSA at 1.78 percent. Fresno followed with 1.49 percent appreciation, and Bakersfield experienced a growth of 1.23 percent. In Visalia and Merced, home values increased by 0.87 and 0.51 percent, respectively. For the first time since the recession, home values in Stockton and Modesto declined. Stockton experienced the steepest drop at 5.81 percent, while Modesto reported a decline of 1.77 percent, making these two MSAs the first to report declines in home values in 2023. If this trend continues, projections suggest a significant decline of 10.66 percent in 2024, followed by a more gradual decline of 2.47 percent in 2025.

Inflation generally registers higher in the western United States compared to the nationwide average, primarily due to the higher cost of living his higher in the region. However, during economic downturns, such as those experienced in 2008 and the pandemic years, there tends to be a convergence between the regional and national inflation rates. This pattern, emerging as a coincidental indicator since the first quarter of 2023, is becoming apparent again, signaling concerns of an economic contraction.

The inflation rate in 2023 decreased to roughly half of what it was in 2022, but the decline was not enough for the Federal Reserve to end its policy of rate hikes aimed at containing inflation. With a yearly average of 4.71 percent, inflation was still higher than the Federal Reserve’s targeted rate of 2 percent in 2023. However, this still represented a significant drop from the 8 percent rate recorded in the previous year. Ongoing geopolitical conflicts, along with the decision by OPEC+ and Russia to reduce oil production, are expected to continue exerting upward pressure on the inflation rate.

Inflation generally registers higher in the western United States compared to the nationwide average, primarily due to the higher cost of living his higher in the region.
Another factor that put upward pressure on the overall price level came from wages. Rate hikes implemented since the first quarter of 2023 appear to have had their intended effect of slowing the economy and curbing demand-pull inflation, albeit at a gradual pace. However, since the third quarter of 2023, there are more definitive signs of a contracting economy. Projections for the inflation rate in the Western region suggest an average yearly increase of 2.73 percent in 2024, which falls well within the Federal Reserve’s target range, and a further decrease to 2.52 percent in 2025. ▶

In the Valley, average weekly wages rose by 6.01 percent in 2023, up significantly from a modest 1.15 percent growth in 2022. This robust growth in wages, about twice the long-term benchmark rate of 3.23 percent, can be attributed to the resilience of the labor market, which remained strong despite the implementation of rate hikes. This high wage growth in 2023 served as another factor that kept inflation from decreasing more rapidly back to the Federal Reserve’s target rate of 2 percent. ▶

In 2023, the reservation wage, which is the minimum wage a worker in the Valley is willing to accept to return to work, increased as workers sought higher compensation. It is projected that the average weekly wages in the Valley will stay below $1,150 by the end of 2025. Projections point to an average yearly wage increase of 2.72 percent in 2024, followed by a smaller increase of 2.02 percent as the economy adjusts and inflation subsides in 2025. ▶

The average rate of inflation stood at 4.71 percent in 2023. During the same time, average weekly wages rose by 6.01 percent resulting in a gain in real wages and an increase in purchasing power of 1.30 percent. However, it is important to note that this gain in real wages did not fully compensate for the losses incurred during the preceding years.
The clear change in the dynamics of deposits and loans at Valley community bank deposits, which became apparent in the first half of 2023, persisted into the second half of the year. This change most likely resulted from Federal Reserve’s rate hikes, balance sheet reduction and tapering, which began in the first quarter of 2021.

Interestingly, there was virtually no growth in the total bank deposits in the Valley in 2023, a development that can be partly attributed to bank closures, mergers, acquisitions and the overhaul of the Federal Deposit Insurance Corporation’s (FDIC) online database. Remarkably, the growth rate in 2023 was notably low, standing at 0.97 percent, which is particularly striking compared to the 10.10 percent growth seen in the previous year. This significant drop in deposit growth rate is a point of concern, especially when contrasted with the benchmark growth rate of 8.73 percent, further fueling worries about an impending economic contraction. Looking ahead, projections suggest a growth rate below the benchmark at 7.78 percent in 2024, with an anticipated rebound to 8.83 percent in 2025.

The stability observed in foreclosures starts was mirrored by the lack of change in bank assets in nonaccrual, largely because most people held on to their jobs and the unemployment rate, despite its gradual increase, remained relatively low. However, this trend is likely to end in the coming months. As increases in unemployment become more significant, job displacement is expected to hamper the ability of individuals to meet their debt obligations. Additionally, long-term interest rates, which have been at their highest in 23 years, are also expected to contribute to an increase in default rates.

Looking ahead, projections suggest a growth rate below the benchmark at 7.78 percent in 2024, with an anticipated rebound to 8.83 percent in 2025.
Community bank assets in default, both in the 30 to 89 days and the 90 plus days categories, displayed a pattern similar to that of bank assets in nonaccrual. This trend was also consistent with foreclosures started series, reflecting the current dynamics of the unemployment rate. However, as declines in employment levels become more pronounced, these two series of bank defaults are also expected to trend upward. This increase will likely be exacerbated if long-term interest rates, like the 10-year rates currently nearing 5 percent, remain high and start to impact debt repayment capacities more significantly.

In contrast to the stagnant growth observed in community bank deposits, net loans and leases experienced a significant increase of 9.54 percent in 2023. This growth highlights a clear imbalance between deposits and lending, a discrepancy that had been present in prior years. The lack of growth in deposits presents a challenge: community banks cannot indefinitely extend loans without corresponding deposit growth. Eventually, such an imbalance could become unsustainable, potentially leading to great financial strain on banks. The growth rate of net loans and leases in 2023, at 9.54 percent, was notably higher than the previous year’s 4.90 percent growth and exceeded the long-term benchmark growth rate of 7.84 percent. This pattern stands in stark contrast to that of bank deposits, which, in 2023, grew at a rate lower than their long-term benchmark growth rate of 8.73 percent.

As the economy seems poised to enter a downturn as part of efforts to fight inflation, there is growing concern about the potential for this downturn to deepen. The rising unemployment rates are adding to these worries. Given the decline in economic activity, evidenced by various indicators including employment levels, both community bank deposits and net loans and leases are expected to grow at rates below their respective benchmark growth rates in the coming months. A series of reductions in interest rates will likely improve this situation, potentially aiding the economy to recover in 2025.
Considering the prevailing high interest rates as of the third quarter of 2023, there is an expectation of declining economic activity in the coming months. The Valley, in conjunction with the national trend, has been experiencing a downturn in employment levels across various categories of employment in 2023. Notably, total employment in the Valley began to decline during the typically robust months of July and August, which deviates from the norm of accelerated growth during these peak seasons. With the Federal Reserve’s change in course it is anticipated that total employment in the Valley will show signs of recovery in 2025.

In 2023, all counties experienced employment growth with Fresno leading the charge, followed by San Joaquin and Kern counties. Tulare ranked as the fourth fastest-growing region, succeeded by Stanislaus and Kings counties. Merced and Madera reported the most modest growth rates for the year. Despite the overall growth in 2023, the momentum of growth rates slowed progressively each month, culminating in the first instances of decline for both Merced and Stanislaus counties during July and August.

Despite a significant drop in growth in 2023, leisure and hospitality services remained the fastest-growing employment sector. All employment categories in the Valley experienced growth except for retail trade, wholesale trade, and construction in 2023. Construction employment faced the steepest decline, followed by retail and wholesale trade. Other sectors, while still growing, did so at a rate that was multiple times their respective long-term benchmark growth rates, albeit at a slowing pace. A high skills category, education and health services employment, typically characterized by robust expansion, grew at an accelerated rate compared to the previous year. Conversely, government employment, a traditionally lagging category, increased at a more modest rate than in the previous year. Trade, transportation and utilities sectors saw stagnant growth in 2023, a drop from the above-benchmark rates in prior years, signaling a slowing regional economy. Manufacturing employment growth was approximately half of what it was in 2022, further evidence of a slowing economy.

Home values increased by 1.88 percent, which is significantly lower than the previous year’s growth of 21.61 percent. At this rate, home values are expected to decline in the coming months. Homeowners are holding on to their properties, a decision likely influenced by the highest interest rates since 2000, as recorded in the third quarter of 2023. As noted in our previous report, the double-digit increases seen in previous years proved unsustainable, and 2023 saw a rate of home value appreciation that effectively resulted in a real loss when adjusted for the inflation rate. A reversion to the rates more in line with benchmark growth rates is expected.

The decision by Russia and OPEC+ to curtail oil production suggests that the overall price level, driven primarily by oil prices, is likely to continue to fall at a slow pace then switch to a deflationary phase. In the Valley, average weekly wages rose by 6.01 percent in 2023, yielding a net gain of 1.3 percent in the purchasing power of the Valley consumer, considering the average inflation rate of 4.71 percent for the year. Valley community bank’s total deposits saw negligible growth, while net loans and leases surged at a much higher rate, reflecting an imbalance between the two. Such an imbalance is unsustainable and is likely to correct before long. In 2023, Valley community bank nonaccrual assets growth remained consistent with previous years, as employment held steady and the unemployment rate rose only gradually. Default rates on community bank assets, ranging from 30 to 89 days and over 90 days, mirrored the static nature of nonaccrual assets.

In the first quarter of 2023, the economy exhibited mixed signals. However, it is now becoming evident that employment levels are on the decline amidst a progressively slowing economy. Valley residents may consider adopting a financially conservative stance by holding a larger cash reserve, delaying home purchases in favor of renting and contemplating a shift to flexible rates in 2024. Additionally, investing in bonds could be a prudent option, as interest rates are expected to decrease rather than increase, given that they are currently at a generational peak.
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