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San Joaquin Valley

BUSINESS FORECAST

EMERGING TRENDS IN THE VALLEY'S ECONOMY

Stanislaus State

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SAN JOAQUIN VALLEY BUSINESS FORECAST 2020

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Gökçe Soydemir, Ph.D.

Stanislaus State
One University Circle
Turlock, CA 95382

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Contributors

Faculty

Gökçe Soydemir, Ph.D.
Foster Farms Endowed Professor of Business Economics

Tomas Gomez-Arias, Ph.D.
Dean, College of Business Administration

Annhenrie Campbell, Ph.D.
Professor, Accounting and Finance

David Lindsay, Ph.D.
Professor, Accounting and Finance

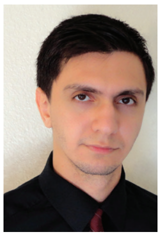
Katrina Kidd
Director, MBA Programs

College of Business Administration Staff

Diamelle Abalos
Administrative Support Coordinator

Carmen Garcia
Administrative Analyst

Student Assistants



Abdulla Mammadsoy

Noah Wells

David Yohanan

Communications and Public Affairs

Rosalee Rush
Senior Associate Vice President for Communications, Marketing and Media Relations

Kristina Stamper
Director for Communications and Creative Services

Steve Caballero
Senior Graphic Designer

Mandeep Khaira
Senior Web and Electronic Communications Developer

Executive Summary

As predicted in our last report, the economic recovery began in the second half of 2020, with a slowing pace in the latter part of the third quarter that reflected the rising number of COVID-19 infections. The spread of the virus continues to be the result of relaxed adherence to social distancing measures – particularly a reluctance in mask-wearing, contact tracing difficulties, pandemic fatigue and the delays in public availability of vaccines currently in trial phases. If the reluctance to wear masks is an indication of the nation's willingness to be vaccinated, the recovery process may even last longer, which in turn will place additional burden on an already-distressed economy.

While the projections in our last report accurately captured the scope of recovery in sectors such as construction, a few categories such as retail trade employment were over-forecast. As projected, the leisure and hospitality services category of employment was affected the most, with a decline of 20.87 percent, while education and health services employment and financial activities employment were affected the least, with declines of 1.82 and 1.10 percent, respectively. Because we are mostly a farm-related economy that employs a relatively significant number of essential workers, employment declines in the San Joaquin Valley were less then statewide declines in 2020.

Wholesale trade employment declined 5.95 percent in 2020 while the decline in information employment accelerated to 9.99 percent and government employment declined 1.96 percent. Construction employment declined 2.21 percent, but was the sector quickest to recover from the initial shock of the pandemic. Naturally, no category of employment reported growth in 2020. The projections point to a more gradual recovery in the coming months, with the pace of recovery expected to accelerate in the second 12-month interval.

The quick recovery in construction employment was reflected in Valley building permits in 2020. Building permits registered a 12.52 percent increase, following a very trivial increase of 1.52 percent in 2019. Due to the CARES Act and the Federal Reserve's deployed tools (relief program) to mitigate the effect, the foreclosures-started series continued to exhibit a flat pattern. However, given the pattern in Valley bank accruals, the foreclosures-started indicator most likely will display a rising trend in the coming months. Freddie Mac 30-year rates fell below 3 percent, an all-time low dating back to 1993, when regional indicators began to be tracked. The current long-term rates are much lower than those that prevailed during the 2008 recession. Surprisingly, home values kept increasing in 2020, primarily due to relief effort interventions of the Federal Reserve, a development in stark contrast to falling home values in the previous recession. Home values in the Valley grew at an average yearly rate of 4.61 percent in 2020, trailing the long-term benchmark growth of 5.05 percent.

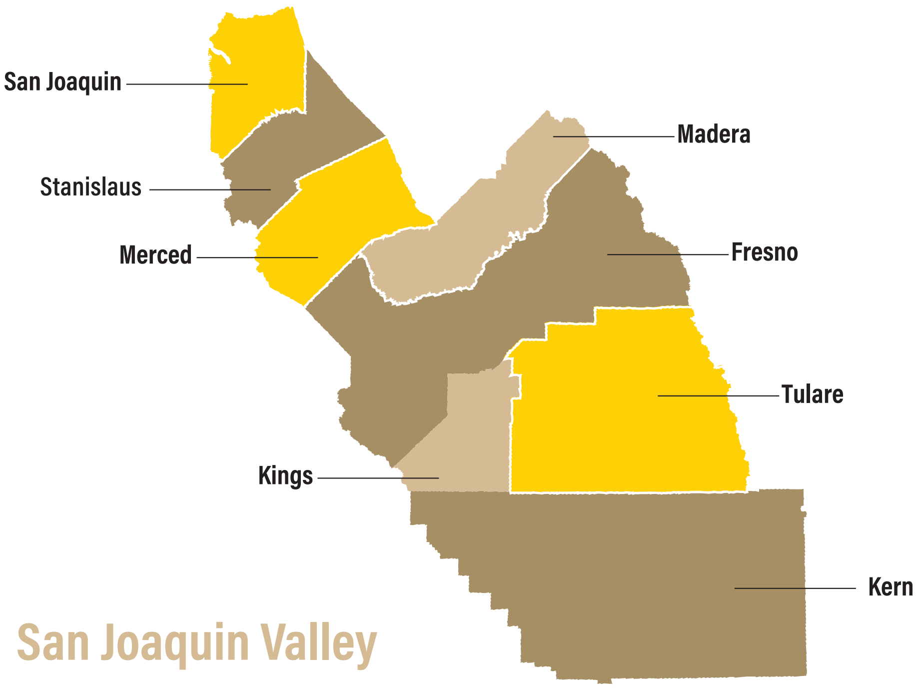
In July, along with the start of the recovery, the yearly inflation rate began to rise very gradually, freeing itself from the deflationary phase by posting an average annual rate of 1.89 percent. However, the yearly inflation rate in 2020 was still less than the typical rate of 2.31 percent. Wage growth in the Valley did not differ much from the rate of inflation in 2020, but displayed a falling trend with respect to previous years, as expected during recessions.

The impacts of the CARES Act and the Federal Reserve's intervention was reflected in bank activity, as Valley total deposits grew 16.10 percent in 2020, roughly twice the long-term benchmark rate. Net loans and leases grew 13.51 percent, slightly less than twice the long-term benchmark rate. Net loans growth trailed the growth in bank deposits, indicating the community banks cut back in extending loans relative to previous months. Valley bank non-accruals did not change much from previous months, again, a result of the relief programs, but is expected to steeply trend upwards in the coming months. Perhaps the most important indicators of this year's report were that community bank assets in default 30-to-89 days and assets in default 90-plus days began trending sharply upward as banks kept a tab on unpaid loans. In the coming months, these two indicators will likely steepen further both regionally and nationally. This is a cause for significant concern for the Valley and for the national economy if the recovery lingers longer as a result of issues such as low vaccination rates.

Introduction

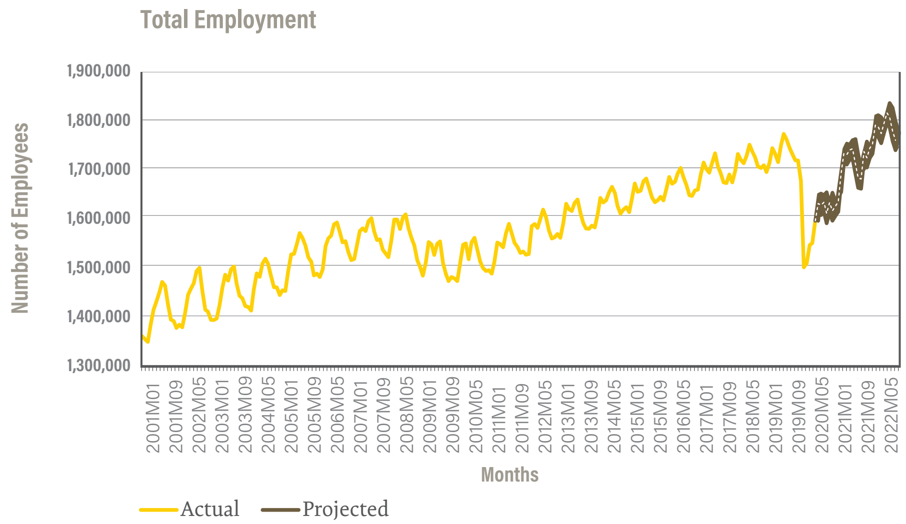
This report examines data from January 2001 to October 2020. Two-year medium-term forecasts are from November 2020 to December 2022. Forecasting a range rather than a point provides a more realistic assessment of likely future values. When actual numbers fall within the upper and lower forecast bands, the forecast becomes accurate.

The remainder of this report is structured as follows: labor market conditions for the San Joaquin Valley; a look at the real estate market in the eight metropolitan statistical areas of the Valley; a discussion of prices and inflation; an examination of indicators from local banking and capital markets; and a conclusion.



Employment Indicators

The pandemic had an across-the-board impact on all counties' total employment indicators, albeit with differing rates of decline. Kern County employment declined at an average yearly rate of 8.89 percent, the fastest rate among the eight counties of the Valley. Tulare County employment declined 8.06 percent, followed by Stanislaus County at 7.51 percent. San Joaquin County employment declined 7.24 percent, while Merced County employment declined 6.68 percent. The slowest decline in total employment occurred in Madera County at 4.27 percent, followed by Fresno County at 5.39 and Kings County at 5.90 percent.



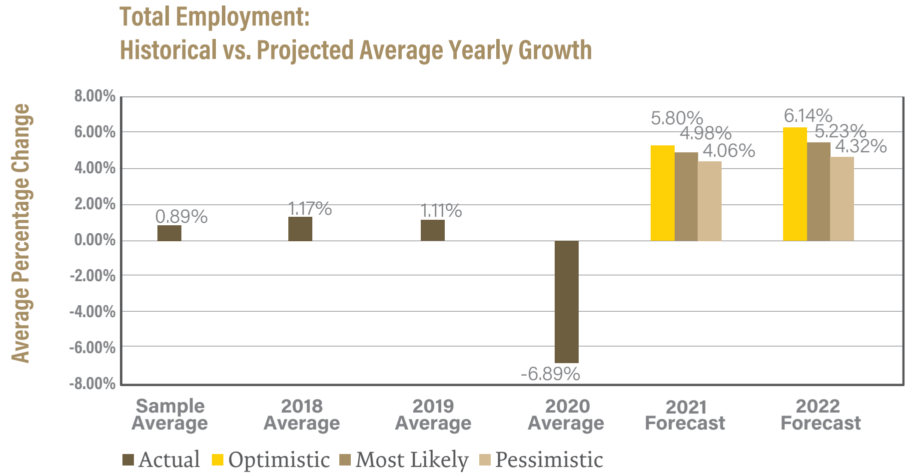
20.87%

DECLINE IN LEISURE AND HOSPITALITY EMPLOYMENT AS A RESULT OF THE PANDEMIC'S IMPACT

As projected, the leisure and hospitality services category of employment was affected the most, showing a decline of 20.87 percent, while education and health services employment and financial activities employment were affected the least with declines of 1.82 and 1.10 percent, respectively. Because the Valley is primarily a farm-related economy that employs a relatively significant number of essential workers, employment declines in the Valley were less than that of the state overall in 2020.

The Valley's wholesale trade employment declined 5.95 percent in 2020. Decline in information employment accelerated to 9.99 percent, while government employment declined 1.96 percent. Construction employment declined 2.21 percent but was the quickest to recover from the pandemic.

Average annual growth in Valley total employment declined at 6.89 percent in 2020, spiking at 12.51 percent in April and 13.60 percent in May. Valley total employment will likely stay below 1,800,000 in the coming two-year period, in line with a recovering economy. The trend line is likely to steepen relative to preceding years as the series reverts to its mean. Undoubtedly, the Coronavirus Aid, Relief and Economic Security (CARES) Act and the Federal Reserve's all-deployed tools (relief program) mitigated the effect of the pandemic, but more needs to be done to speed up the recovery. Projections point to an average employment growth in the Valley of 4.98 percent in 2021 and a faster pace, 5.23 percent, in 2022.

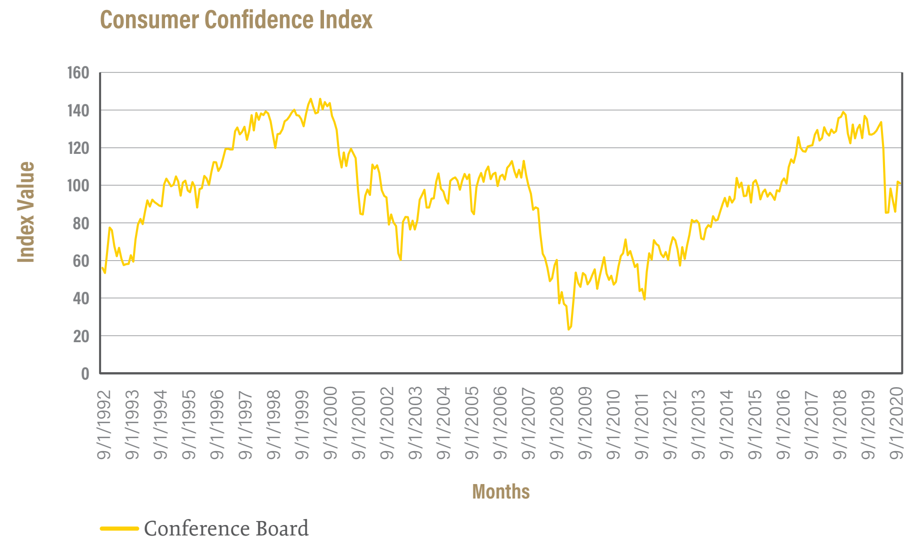


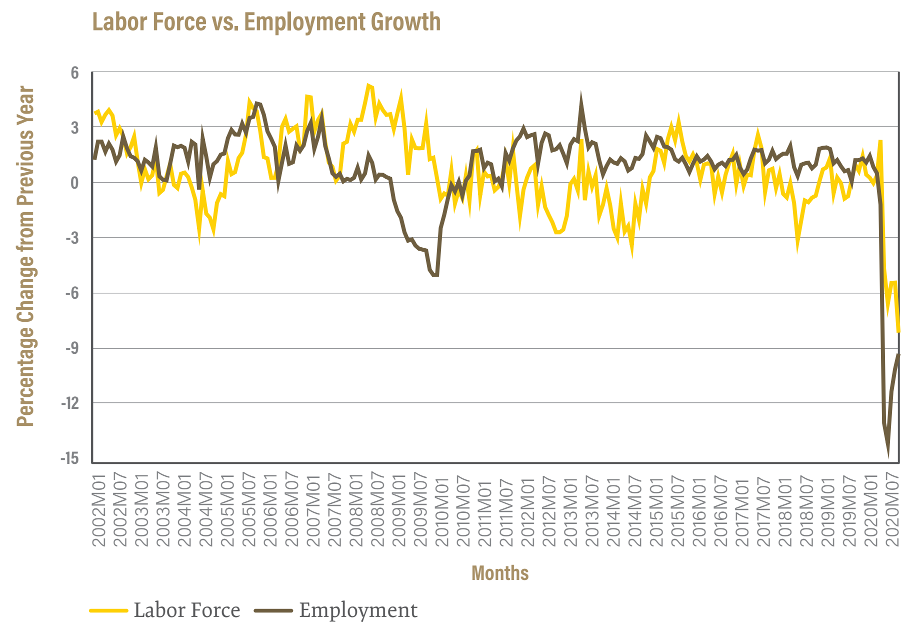
The Consumer Confidence Index (CCI) is an important leading indicator for predicting economic behavior in the upcoming months, and that index fell drastically – by about 40 index points – before stabilizing in the second half of 2020. The steady upward trend gave way to a flat trend with a slight upward tick in September of 2020, but sales of certain consumer items, including durable goods, increased at the end of the third quarter.

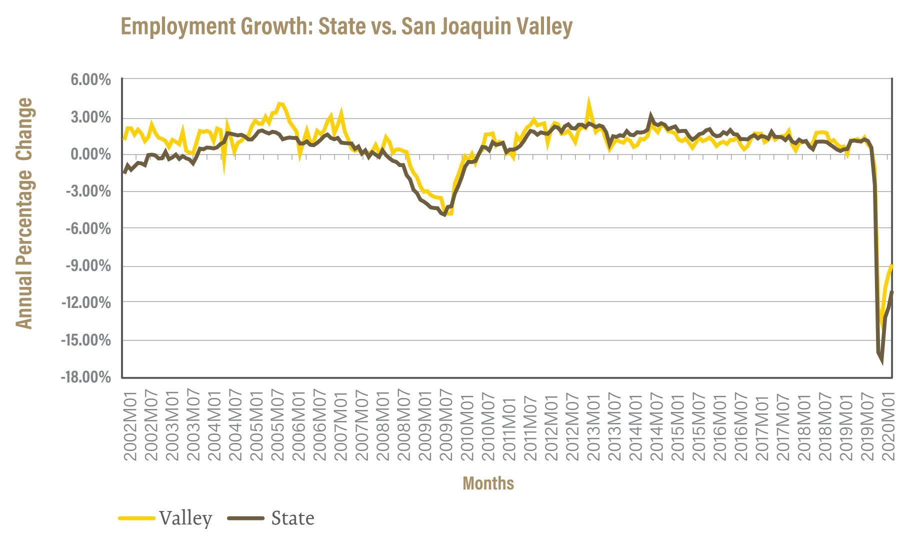
The decline in labor force numbers in 2020 is indicative of falling labor force participation rates in the Valley. As in the previous recessionary years, labor force growth is staying above employment growth. In a positive sign, however, the chart lines are on their way to cross, signaling a path to total recovery. We had indicated in our previous report that if Valley labor force growth exceeds employment growth in the zcoming months, it would be an additional sign of an oncoming recession. The change in pattern involving the two series indeed acted as an early warning signal for the current and 2008 recession.

VALLEY EMPLOYMENT GROWTH ROSE ABOVE STATE EMPLOYMENT GROWTH DURING RECOVERY PERIOD IN THE SECOND HALF OF 2020

During the recovery period that began in the second half of 2020, Valley employment growth rose above state employment growth. That same pattern was present in the 2008 recession, making it another indicator of oncoming recessions. At the trough of the recession in May 2020, Valley employment declined as much as 16.67 percent, while state employment declined by 13.5 percent in the same month.







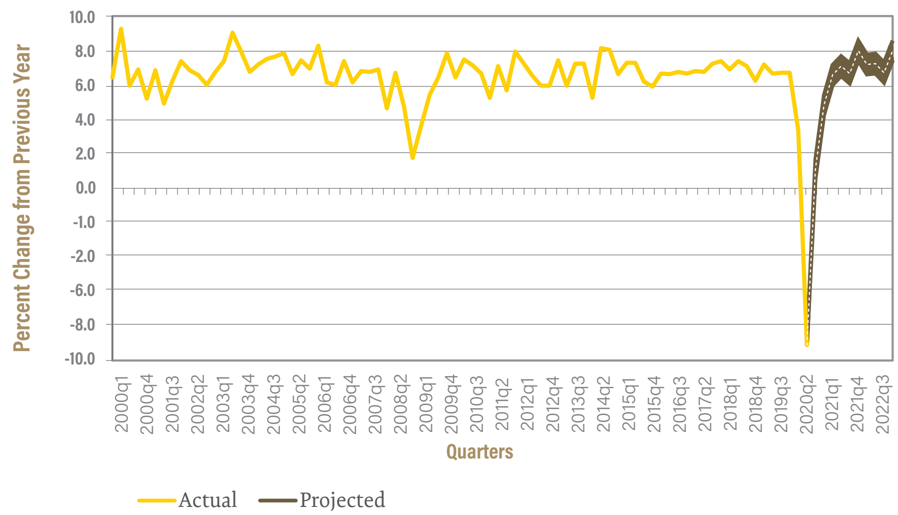
Employment Indicators

The yield curve, as a leading indicator, has predicted recessions seven times in the past, and indeed in 2019 the yield curve inverted once again. The slowing-down indicators also were present in other leading indicators, such as the CCI, the Purchasing Managers' Index and the new export orders index. Even prior to the pandemic, these leading indicators pointed toward negative real GDP growth in the second quarter of 2020. Because of their predictive accuracy, it now becomes increasingly important for the Valley business community to closely track these leading indicators. Real GDP is projected to grow at an average annual rate of 2.87 percent in 2021 and 3.3 percent in 2022.

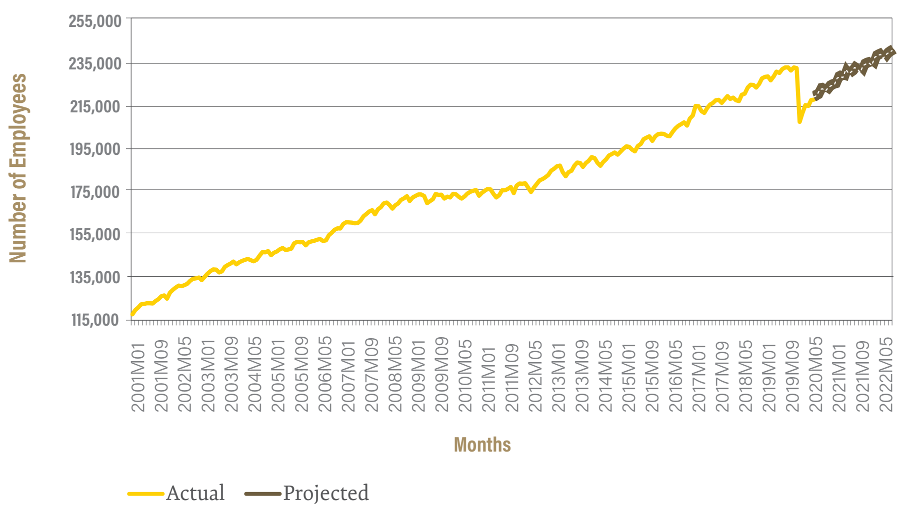
Historically, education and health employment services has been the most robust category of employment in the Valley. However, the pandemic triggered an exception to this claim, as employment in this category fell sharply – from 235,000 to 208,900 – in April 2020. Non-essential health care-related offices and schools closed, leading to a decline in education and health services employment at levels not seen before or even during the 2008 recession.

At the slower recovery pace, employment in education and health services is not projected to exceed 235,000 prior to the second half of 2022. In 2020, education and health services employment declined by 1.82 percent, still a smaller loss than many other categories of employment in the Valley. Projections point to slower growth as the regional economy continues to recover, reaching an average annual growth of 2.88 percent in 2021 and 3.67 percent in 2022.

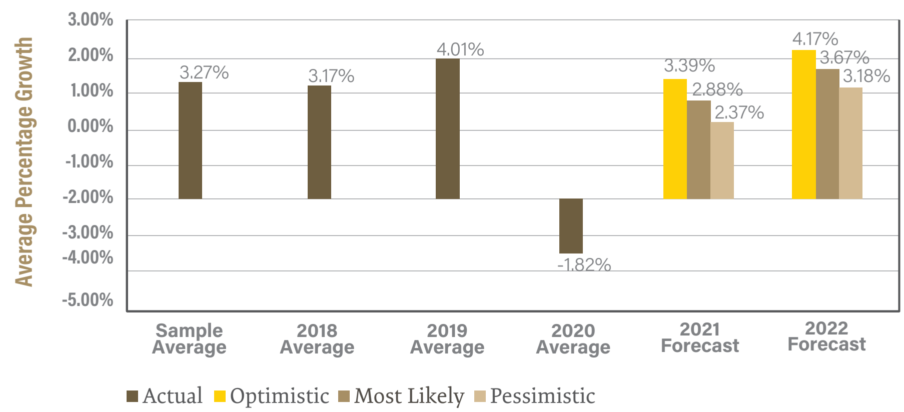
U.S. Real GDP Annual Growth



Education and Health Services Employment



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



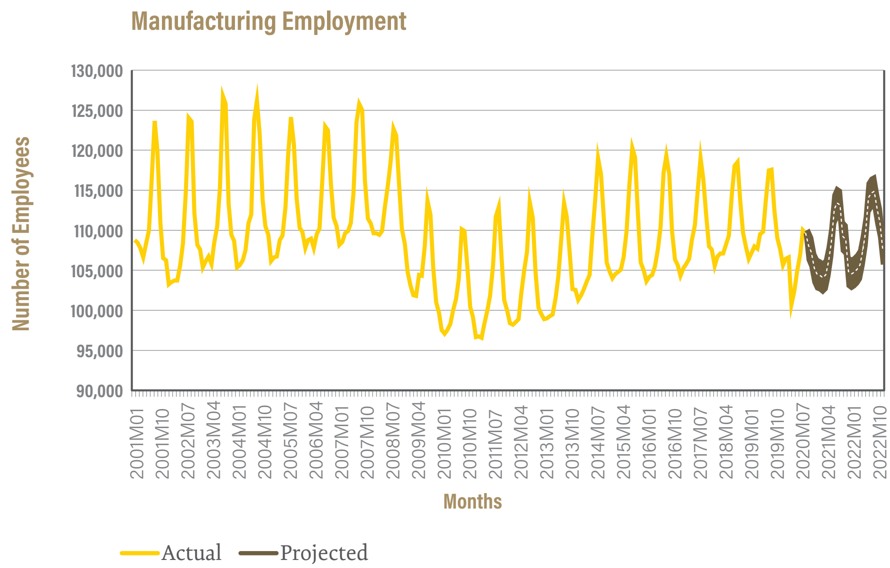
Manufacturing employment already had slowed significantly before the pandemic, but the addition of COVID-19 spurred a 4.08 percent decline in this category in 2020. The recovery in this category likely will be slower than in other categories of employment in the Valley. At this slower pace, manufacturing employment likely will stay below 115,000 until the second half of 2022.

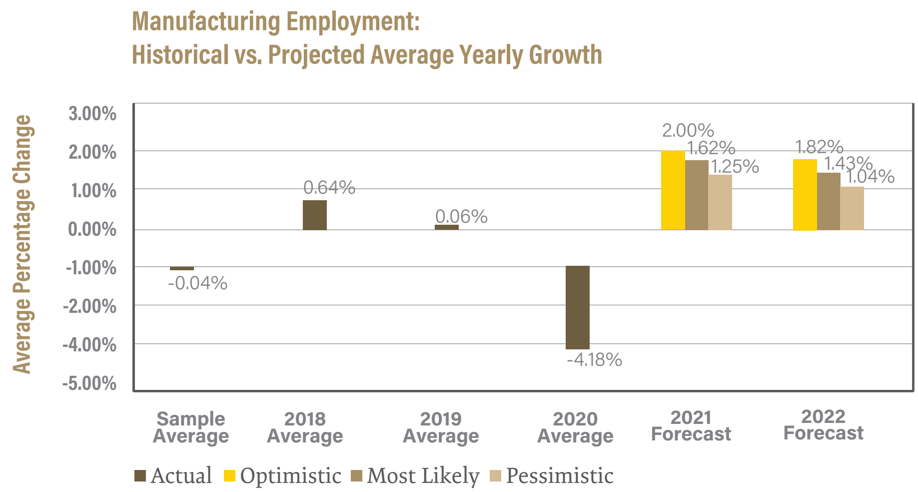
4.18 %

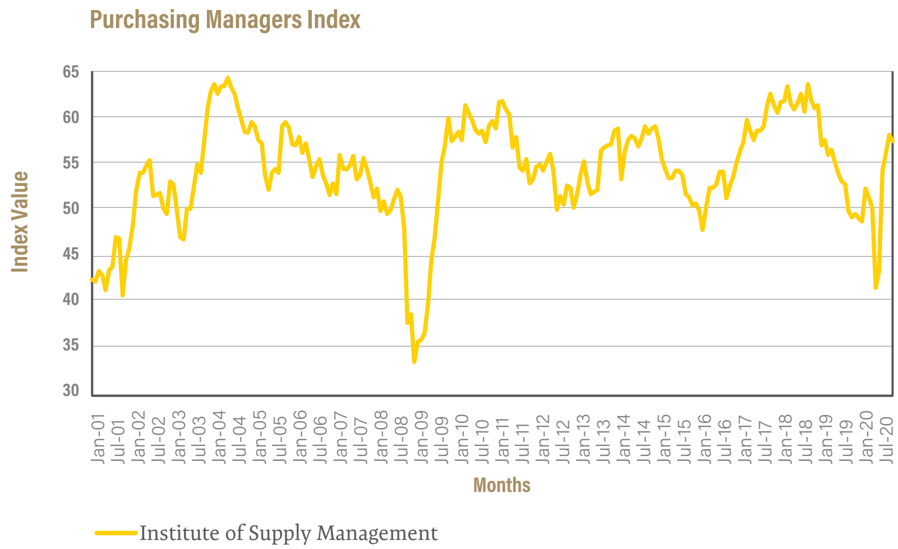
DECLINE IN MANUFACTURING JOBS WAS COMPOUNDED BY THE ADDITION OF COVID-19

Manufacturing employment's struggling performance can be assessed relative to the long-term benchmark rate of -0.04 percent. The slow rate of growth in the past two years of 0.64 percent and 0.06 percent, respectively, is another indication that manufacturing employment was slowing prior to the pandemic. Manufacturing employment also had been slowing nationwide. Projections point to an average annual increase of 1.62 percent in 2021 and 1.43 percent in 2022.

After hitting a low value of 41.5 on April of 2020, the Purchasing Managers Index of the Institute for Supply Management exhibited a very steep recovery, quickly surpassing 50 points. A reading above 50 points signals an expansion. As an important leading indicator, the index now stands at 55.4 points, signaling a continuation of the economic recovery that began in the second half of 2020.

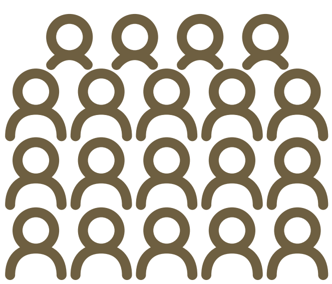






The pandemic had the most severe effect on the Valley's leisure and hospitality services employment, a category dominated by unskilled workers earning minimum wage. These often-marginalized workers were hit hard by the recession, resulting in layoffs in very large numbers. Leisure and hospitality services employment is expected to remain below 130,000 by the first half of 2022. Since these are the levels that prevailed in 2019, we are expecting no new net gains until after 2022. ▶

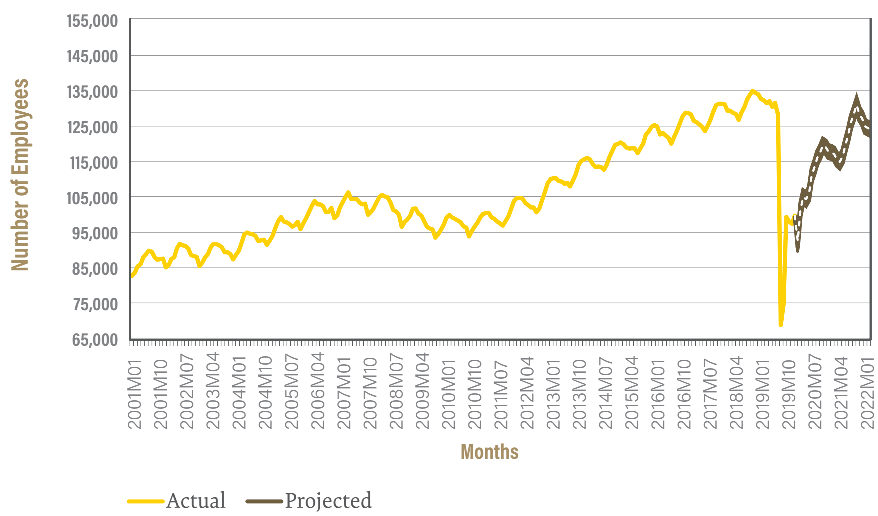
The long-term benchmark growth for leisure and hospitality services employment fell drastically, from 2.51 percent in 2019 to 1.50 percent in 2020. The unprecedented decline of 20.87 percent in this category is a multiple of the declines observed in other categories of employment. Roughly, 60,000 jobs were lost in this category alone, and – again – these are some of our most vulnerable workers. Projections point to an average annual growth of 16.28 percent in 2021 and 8.07 percent in 2022. ▶



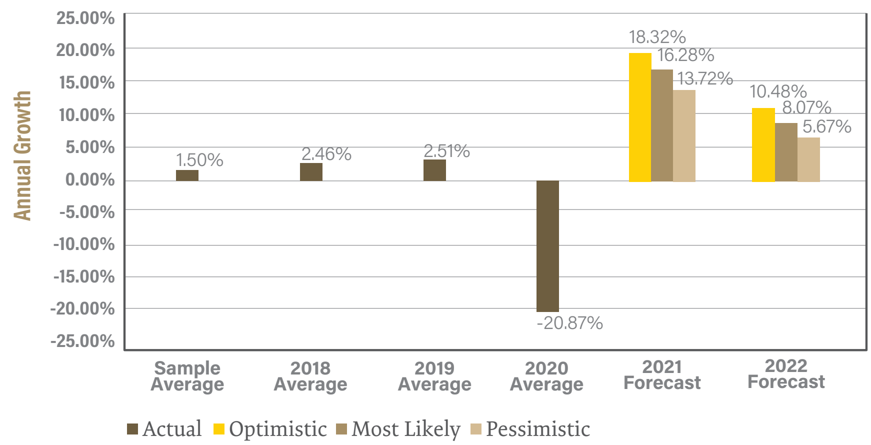
60,00 LEISURE AND HOSPITATLITY SERVICES JOBS WERE LOST

Trade, transportation and utilities ▶ employment fell 4.28 percent in the first half of 2020. The job losses amounted to 45,700 by April, but employment in this category was quick to come back. It registered an increase to 271,900 job and a net loss of 24,900 by the end of September 2020. At this pace, trade, transportation and utilities employment is projected to reach 310,000 by the second half of 2022.

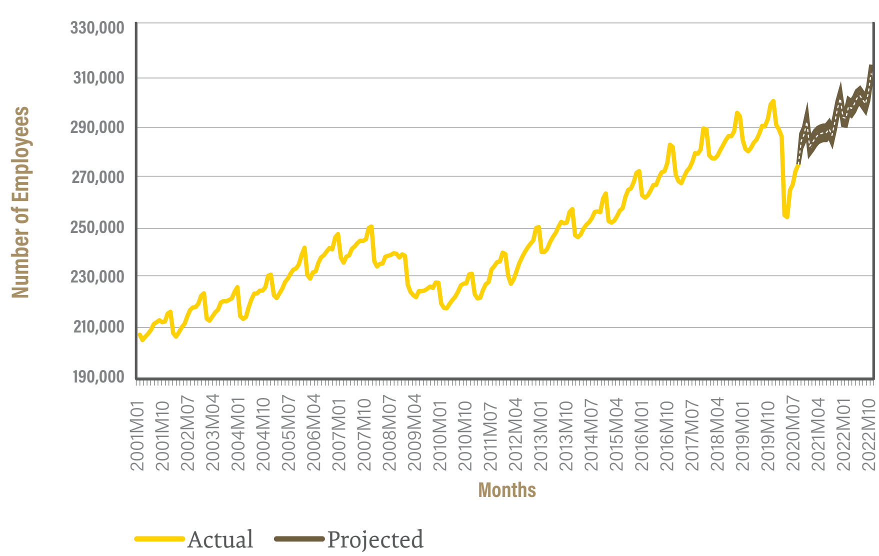
Leisure and Hospitality Services Employment



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



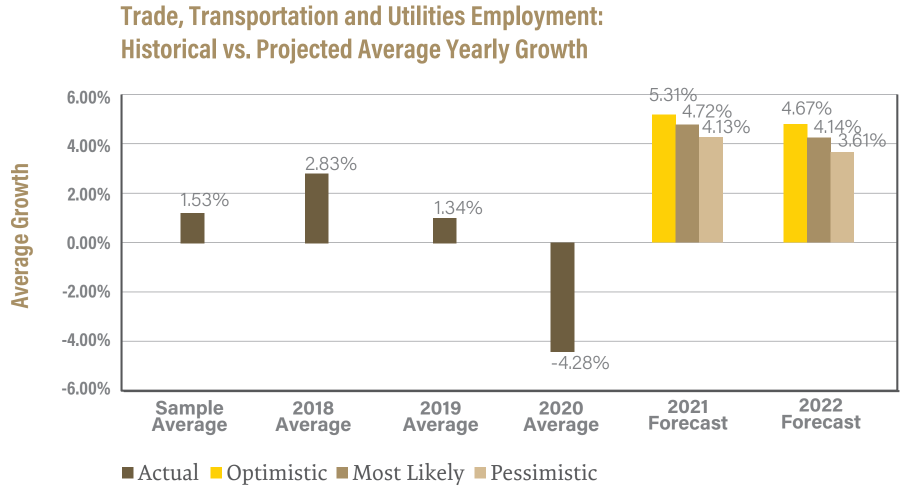
Trade, Transportation and Utilities Employment

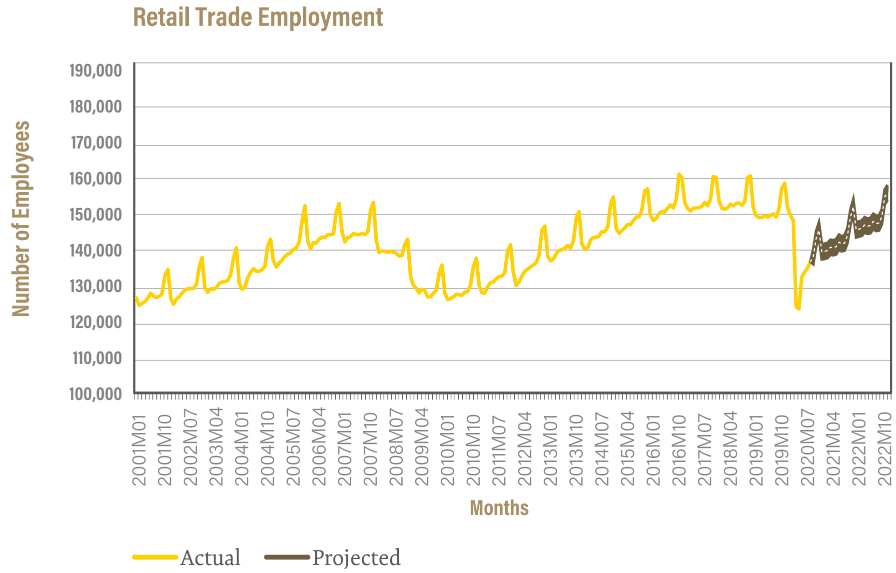


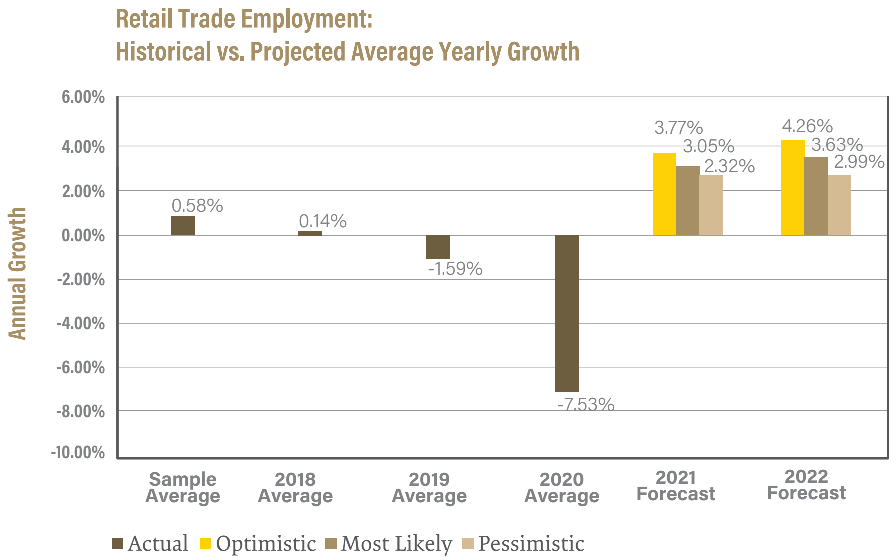
Trade, transportation and utilities is considered to be an essential sector, which explains the reasoning behind the speedy comeback. Before the pandemic, even during slowing months of 2019, employment growth was relatively vibrant. The rate of growth at 1.34 percent in 2019 was about the same rate as the long-term benchmark rate of 1.53 percent. Projections point to an increase in trade, transportation and utilities employment at an average yearly rate of 4.72 percent in 2021 and 6.12 percent in 2022.

Retail trade employment was another category hit significantly harder than other categories of employment in the Valley. As in the leisure and hospitality services sector, the retail trade sector is dominated by unskilled workers earning minimum wage. Consequently, these workers suffer the most during recessions, and 31,300 retail jobs were lost by April 2020. Retail trade employment is slow to recover from the pandemic compared with other categories. At this slower pace, retail trade employment will most likely stay below 160,000 to the end of 2022.

Retail trade employment growth had been gradually slowing before the pandemic, at a rate faster than other categories of Valley employment. In 2019, retail trade employment registered the first decline, 1.59 percent, for the first time since the recession. This was mainly due to economic slowdown prior to recession but also due to competition from increasing online consumption activity. In 2020, retail trade employment declined at an average yearly rate of 7.53 percent. Projections point to 3.05 percent average annual increase in 2021 followed by 3.63 percent growth in 2022.







Employment Indicators

The decline in wholesale trade employment was less than retail trade employment in 2020. Valley wholesale trade employment declined by 4,700 through May 2020, but has been coming back gradually, restoring 3,700 jobs by September 2020 and showing no signs of slowing. At this pace, wholesale trade employment is likely to exceed 50,000 by the end of 2022. ▶

WHOLESALE TRADE JOBS WILL LIKELY EXCEED

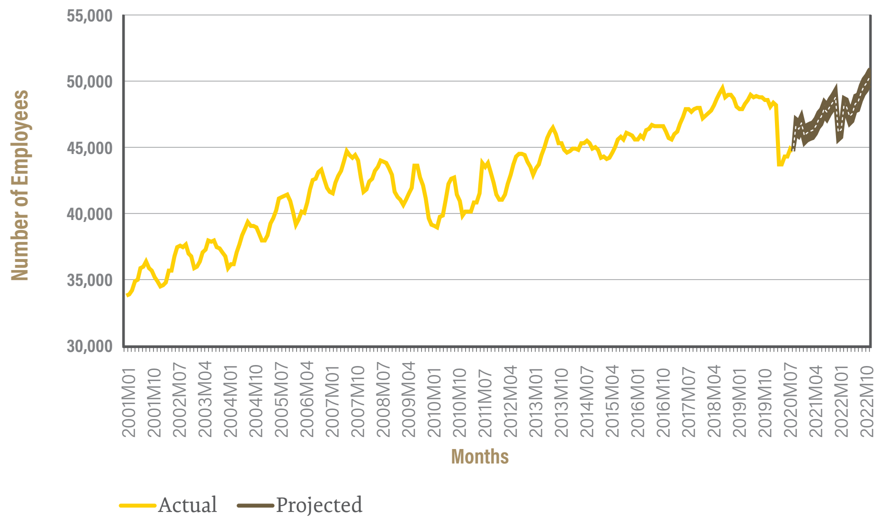
50,000

BY THE END OF 2022

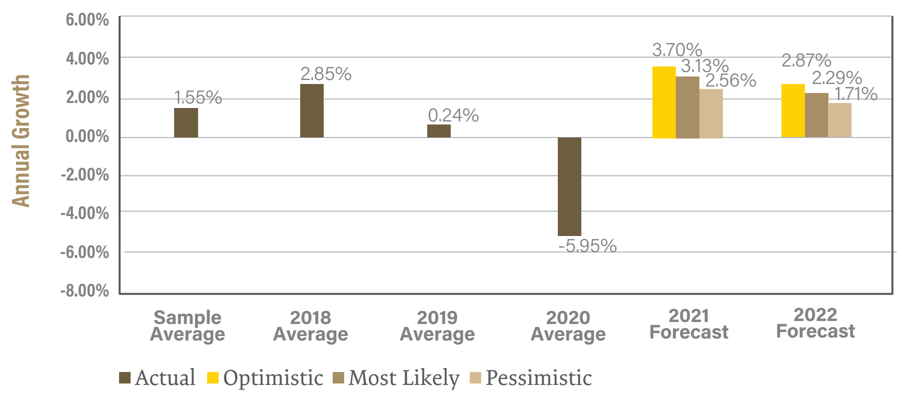
Wholesale trade employment had been slowing considerably in 2019, even before the pandemic, posting very slow growth of 0.24 percent against the long-term benchmark growth rate of 1.55 percent. The average ▶ annual decline in this category of employment was 5.95 percent in 2020, reaching as high as 10.12 percent in May 2020. Unlike retail trade, projections point to robust recovery in this category of employment, at an average annual growth of 3.13 percent in 2021 and 2.29 percent in 2022.

Valley information employment had been the worst-performing category of employment both in the Valley and the nation for the past couple years, and the decline was exacerbated by the pandemic. At the peak of COVID-19's impact, information employment lost 1,000 jobs, and unlike other categories of employment, a recovery is yet to occur in information services employment. ▶

Wholesale Trade Employment



Wholesale Trade Employment: Historical vs. Projected Average Yearly Growth



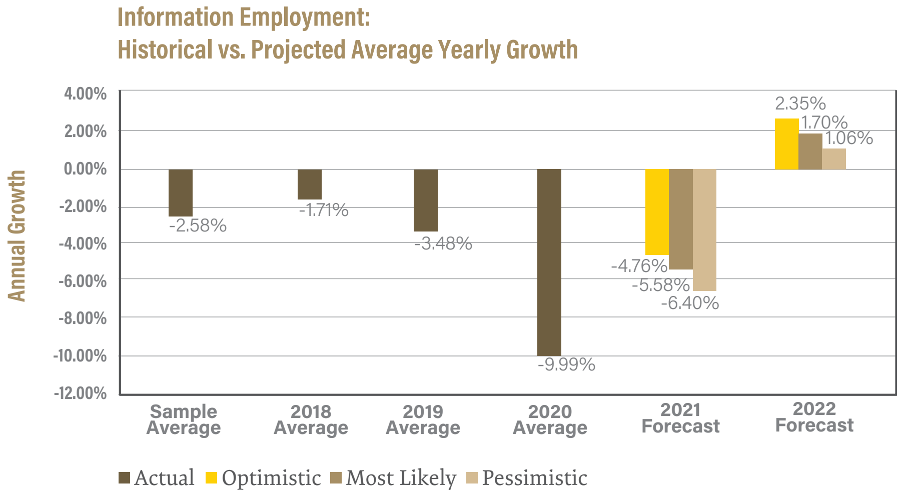
Information Employment

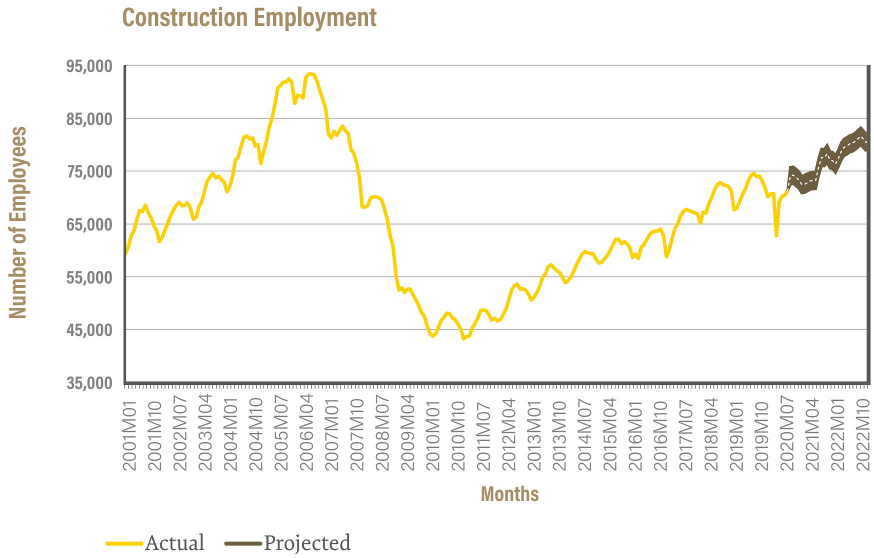
Employment in this category is projected to remain below 9,000 in the next two years. In 2018 and 2019, information employment posted accelerating declines of 1.71 and 3.48 percent, respectively. The decline in 2020 was 9.99 percent, or about four times the long-term benchmark rate of negative 2.58 percent. Projections point to a slower decline of 5.58 percent in 2021 and an increase of 1.70 percent in 2022, signaling a switch in growth from negative to positive territory. ▶

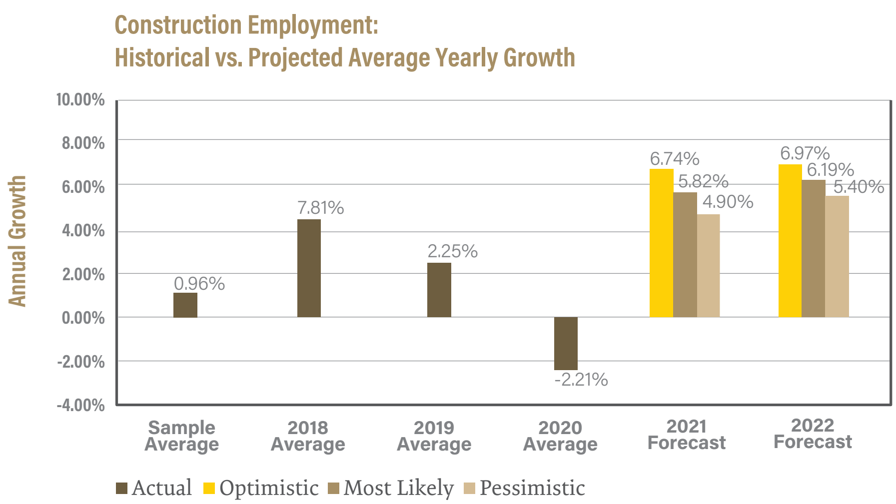
PROJECTIONS POINT TO A SLOWER DECLINE IN INFORMATION EMPLOYMENT IN 2021 AND AN INCREASE THE FOLLOWING YEAR

Construction was the first category of employment to show recovery from ▶ the pandemic's devastating impact in 2020. Construction employment was a slowing sector in pre-pandemic years, but still had been growing above the long-term benchmark rate. The average yearly growth rate in 2018 was 7.81 percent, followed by a slower growth of 2.25 percent, yet both posted a faster rate than the 0.96 percent benchmark. Construction employment declined 2.21 percent in 2020.

Construction employment fell from 69,700 in March 2020 to a lowest level of 62,000 in April 2020. However, by August 2020, employment in this category fully recovered and climbed back to the slightly higher level of 70,000 employees, erasing all of the previous job losses in the category. Projections point to an average annual growth of 5.82 percent in 2021 and to slightly faster growth of 6.19 percent in 2022. ▶







Unlike other employment categories, government employment in the Valley grew faster in 2019 than the growth in the preceding year. Government employment is another lagging variable, recovering later than other employment categories after a contraction and slowing later than most other categories after an expansionary phase of the business cycle. Government employment is projected to exceed 305,000 by the second half of 2022.

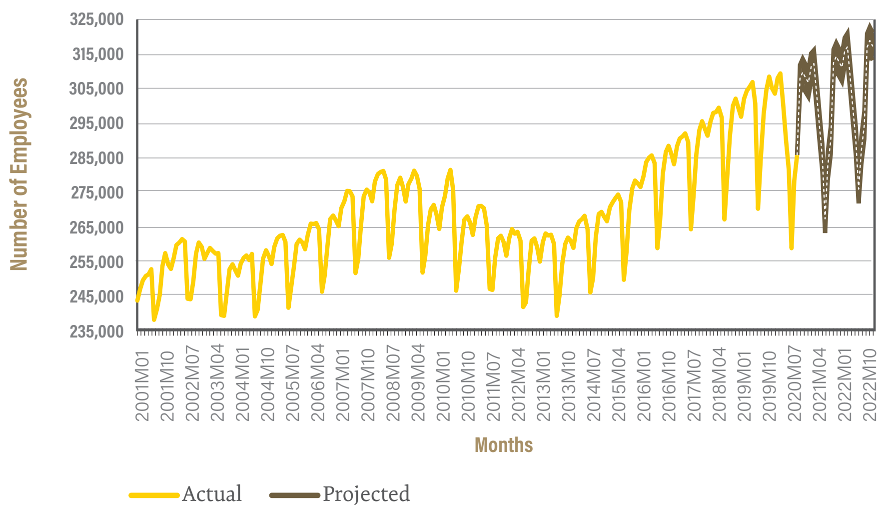
305,000

PROJECTED TOTAL OF VALLEY GOVERNMENT JOBS BY THE SECOND HALF OF 2022

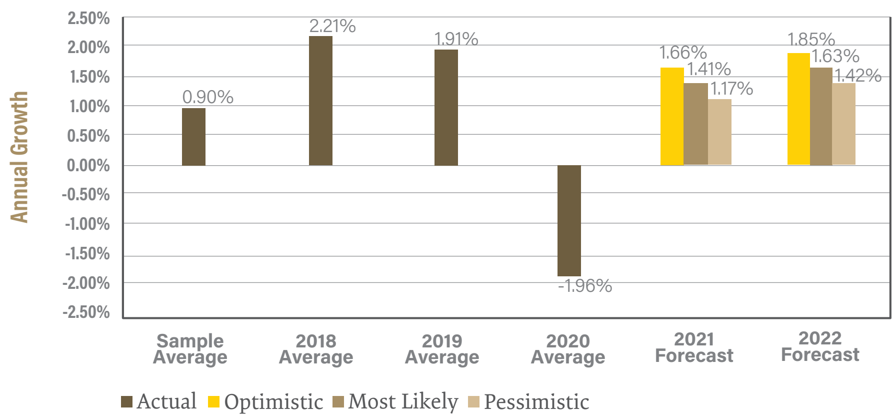
As expected, government employment's decline during the first half of 2020 came with a lag of about two months. Employment levels in this category fell by 22,000 in a single month – from 279,300 in May to 257,300 in June. Government employment was one of those categories quick to bounce back from the abrupt fall, and by September jobs in this sector had reached 283,500, pointing to a full recovery. However, government employment levels likely will not exceed 315,000 in the two years ahead. Projections point to an average yearly growth of 1.41 percent in 2021 and 1.63 percent on 2022.

Valley financial activities employment has been another category affected less than other categories. Housing activity was relatively active in 2020 after a brief pause, explaining the observed dynamic. Nevertheless, employment levels in this category of employment fell from 43,400 in March 2020 to 41,000 in May. Since then, financial activities employment has been on a robust recovery pattern.

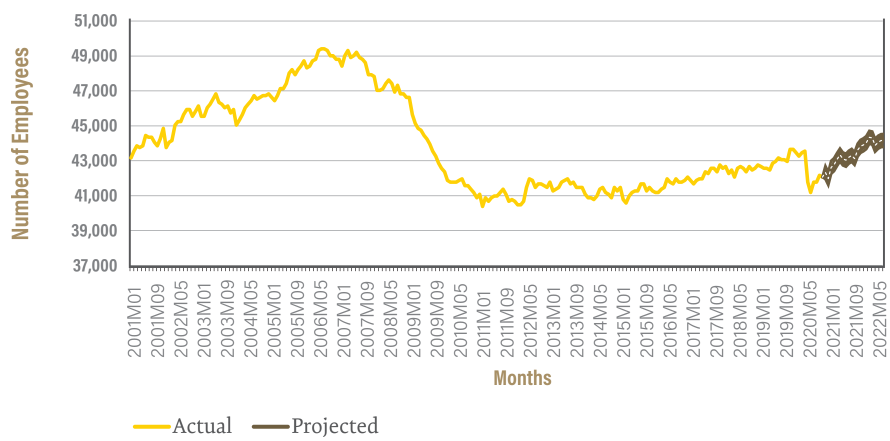
Government Employment



Government Employment: Historical vs. Projected Average Yearly Growth

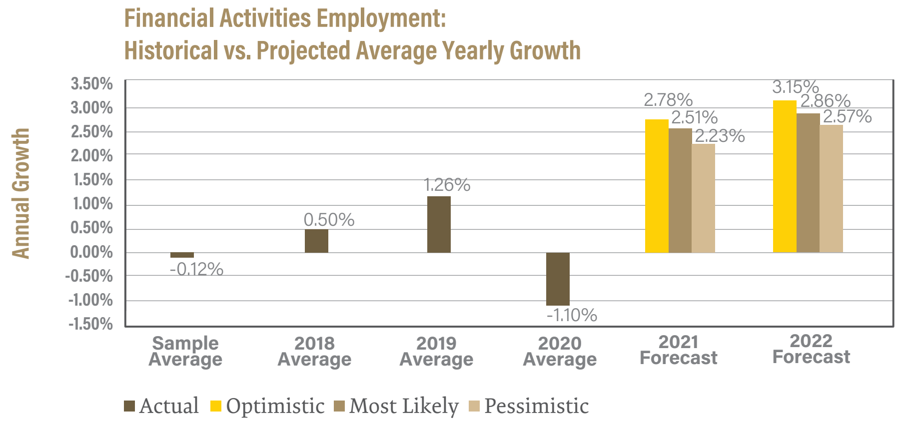


Financial Activities Employment



Financial activities employment declined by 1.10 percent in 2020. The September 2020 reading for financial activities employment was 41,900, pointing to partial recovery and a net loss of 1,500 jobs. Employment levels in this category likely will reach 44,000 in the second half of 2022. Financial activities employment is projected to increase at an average yearly rate of 2.51 percent in 2021 and 2.86 percent in 2022.

Consistent with our earlier projections not related to the pandemic, the Valley economy entered a recessionary phase in the second quarter of 2020. The trajectory of the economy changed to a path of recovery after the pandemic, despite being at a slower pace than originally predicted. While some categories of employment, such as construction, has almost fully recovered, other categories, such as leisure and hospitality services, appear to be slower to recover.



Housing Sector

The San Joaquin Valley's eight Metropolitan Statistical Areas (MSAs) are Fresno, Bakersfield-Delano, Hanford-Corcoran, Madera-Chowchilla, Merced, Modesto, Stockton and Visalia-Porterville. The aggregate data from these eight MSAs are compiled to create the total of single-family building permits issued in the Valley.

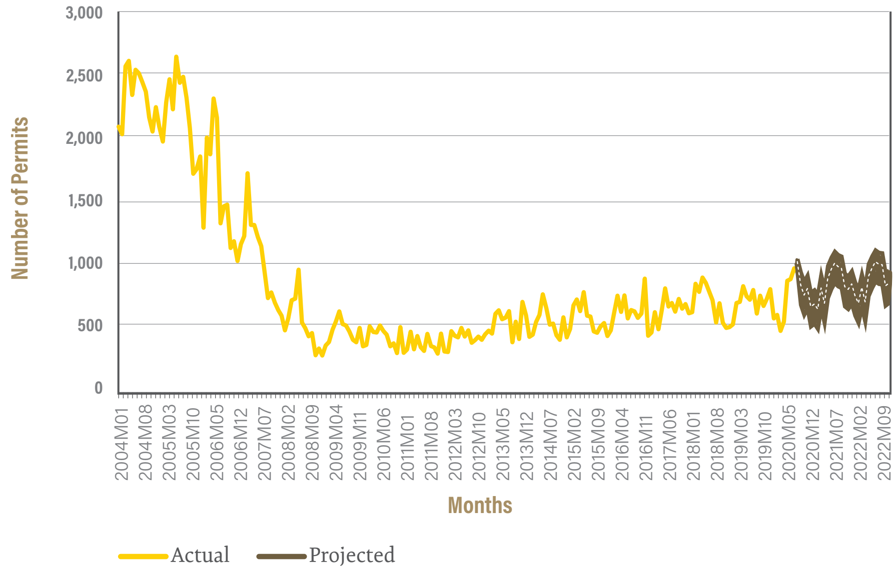
The housing sector was one of the quickest to recover from the economic effect of the pandemic. As such, building permits exhibited an increasing pattern during the recessionary months and rose 1.5 percent in 2020. Part of this was a statistical phenomenon, due to a very low reading of 12.52 percent the previous year. Valley housing permits will most likely oscillate around 700 permits per month in the next two-year interval.

"THE HOUSING SECTOR WAS ONE OF THE QUICKEST TO RECOVER FROM THE ECONOMIC EFFECT OF THE PANDEMIC."

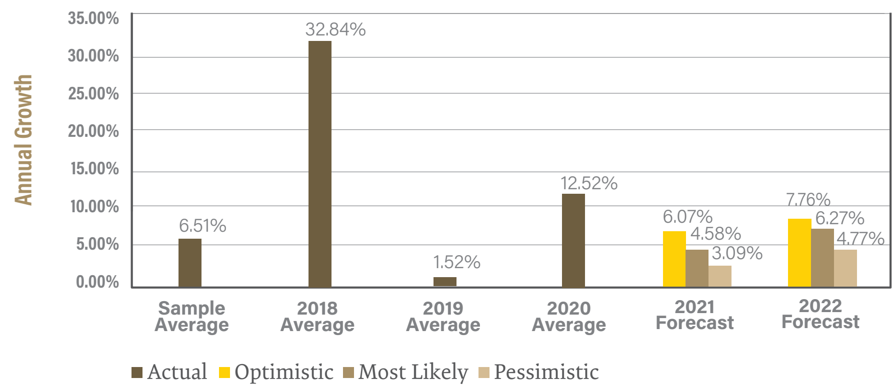
With 1,996 permits, Fresno issued the most housing permits in 2020, followed by 1,490 by Stockton and 1,277 by Bakersfield. Visalia issued 1,007, while Madera and Merced issued 561 and 129 housing permits, respectively. Modesto issued 21 building permits. There were no housing permits issued in Hanford-Corcoran. Projections point to average annual growth of 4.58 percent in 2021 and 6.27 percent in 2022.

Because of the Federal Reserve's intervention to relieve the economic damage of the COVID-19 pandemic, foreclosures started series in California remains flat. However, bank accruals tell a different story. Accruals have risen sharply in 2020 but are not yet reflected in foreclosure activity due to ongoing relief effort programs. A sharp increase in foreclosures is expected in the coming months, surpassing those of the previous years, as these protections come to an end.

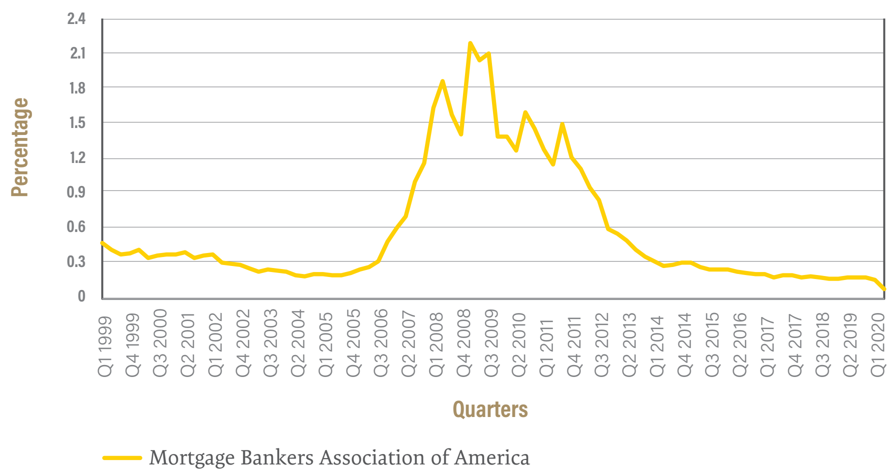
Single-Family Building Permits



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



Foreclosure Starts in California



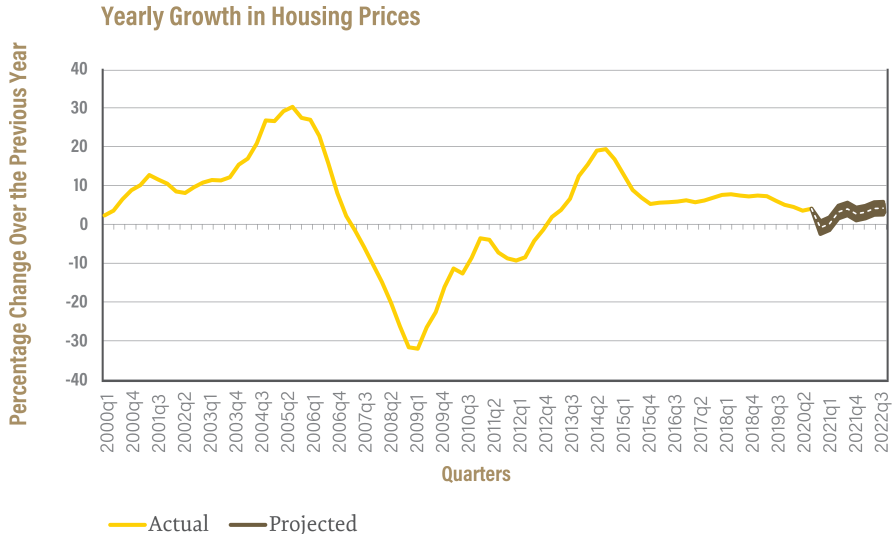
One common characteristic of all recessions, including 2020, is falling interest rates, but the magnitude of this most recent fall exceeded that of the 2008 recession. The reading of the Freddie Mac 30-year rate from September 2020 was 2.89 percent, an indication that long-term interest rates have fallen to all time lows in 2020 and are likely to stay at below 3 percent in the coming months.

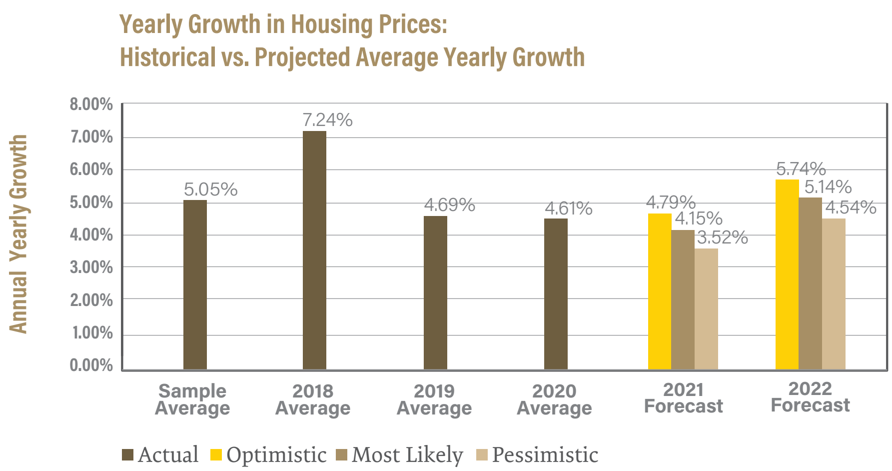
During the Great Depression of the 1930s home prices declined more than 10 percent, and home values also fell considerably during the 2008 housing crisis. Surprisingly, given this history, home values continued to increase in the Valley in 2020 – at 4.61 percent, or roughly at the same rate as the long-term benchmark rate of 5.05 percent. This can be largely attributed to the successful intervention on the part of the Federal Reserve to avert the impact of the crisis initiated by the pandemic.

IN 2020, HOME VALUES CONTINUED TO INCREASE IN THE VALLEY BY 4.61%

The fastest increase in home values took place in Bakersfield, which reported a 5.54 percent average annual increase in 2020. The second fastest increase in home values was in Visalia at 5.12 percent, followed by 4.85 percent in Modesto. Fresno home prices increased 4.56 percent while Hanford's home prices rose by 4.83 percent. Stockton reported the slowest increase in home prices in 2020 at 3.44 percent.

Building permits likely will continue to increase in the months ahead due to the construction sector's quick recovery, and long-term interest rates being at all-time lows. There is renewed demand from Bay Area residents who now choose to l ive in more-isolated places – intending to minimize new risks such as the pandemic. This additional demand is likely to intensify the Valley's low inventory situation. Housing values will likely continue to increase at rates more consistent with the long-term benchmark rates.





Inflation and Prices

Another common characteristic of all recessions is deflation, and 2020 was not an exception. Price levels in the West remained above the national average, even during the recession.

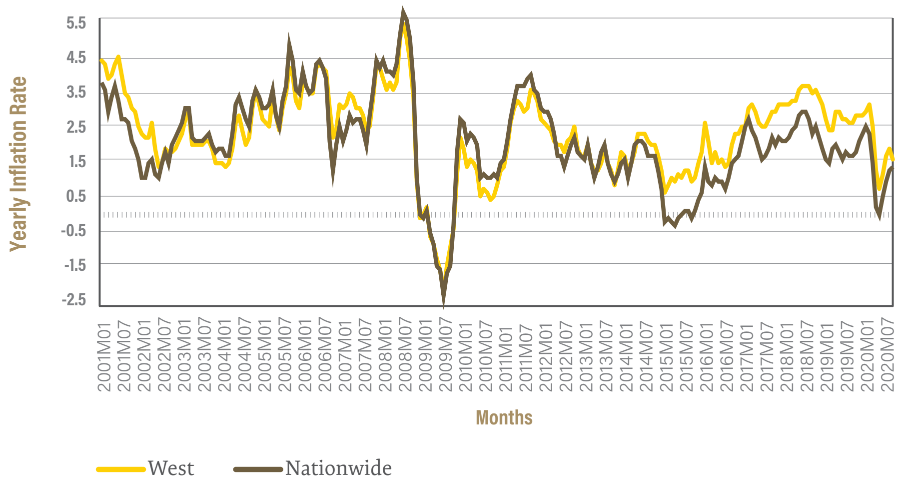
IN THE WEST, PRICE LEVELS REMAINED ABOVE THE NATIONAL AVERAGE DURING THE RECESSION

However, the discrepancy between the two series decreased considerably in 2020, due to deflationary pressures. This discrepancy had emerged in 2014 and continued to increase gradually. The two series had overlapped in the 2008 recession, indicative of prices falling at a faster rate in the West during recessions. The difference in pattern now serves as another reliable coincidental indicator for our region.

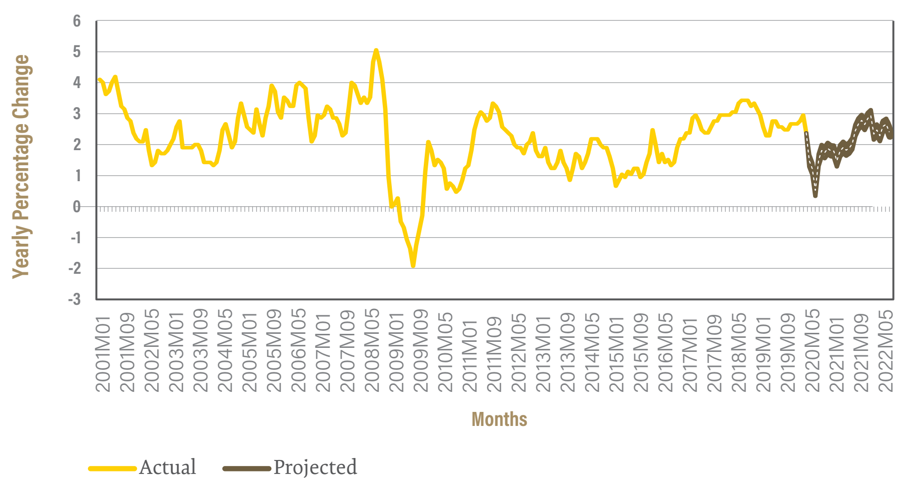
INFLATION RATES HAVE BEEN FALLING SINCE 2018

The rate of inflation has been falling since 2018, which registered 3.35 percent, followed by 2.69 percent in 2019. But 2020's rate of inflation was 1.89 percent, considerably lower than the historical rate of 2.31 percent. After hitting a bottom on May 2020, the overall price level has been slow to recover. The yearly rate of inflation registered 1.92 percent on August 2020, followed by 1.63 percent a month later.

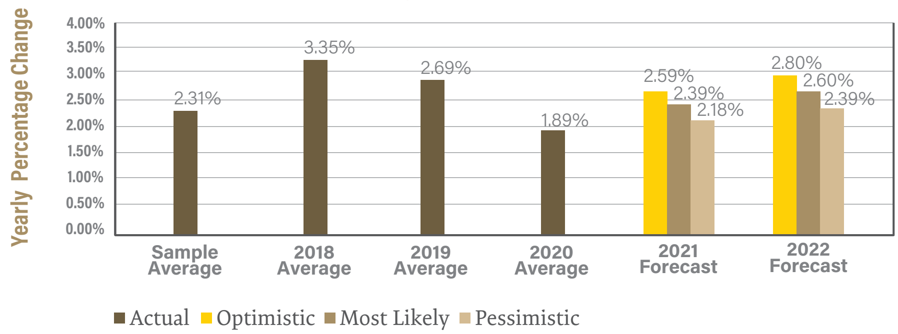
Inflation Rate: Nationwide vs. West



U.S. West Inflation Rate



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



Another important factor that keeps prices low from the cost-push side is the price of oil, which has been remaining at relatively low values for several months. The price of oil was declining even before demand was curtailed by the COVID-19 pandemic and low demand continued in the second half of 2020. Projections of the rate of inflation for the West point to an average yearly increase of 2.39 percent in 2021 and 2.60 percent in 2022.

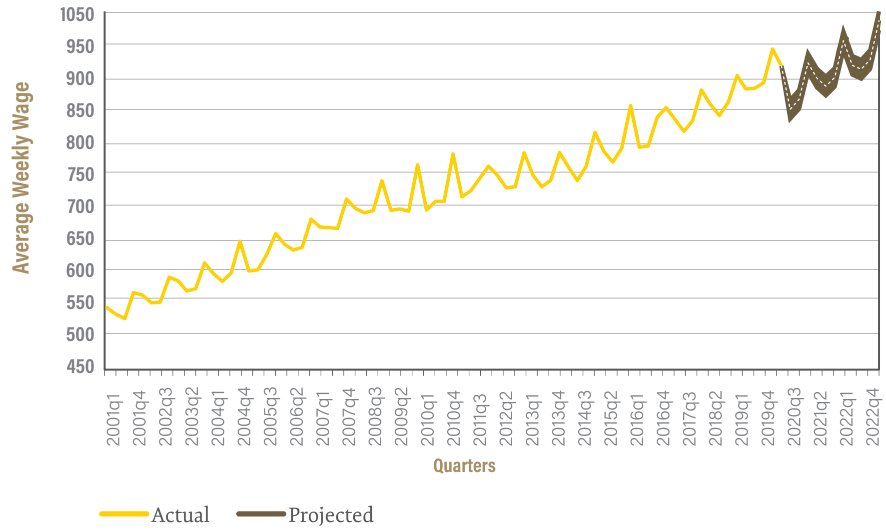
2.41%

THE AVERAGE WEEKLY WAGE INCREASE IN 2021

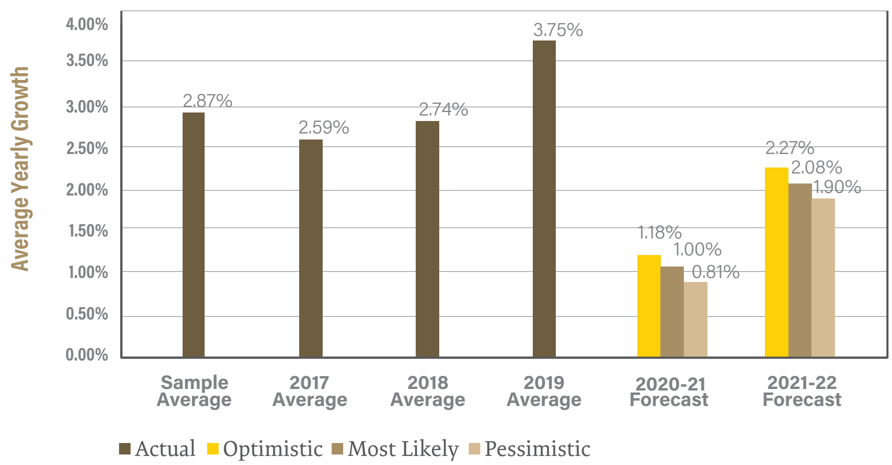
Average weekly wages rose 3.75 percent in 2019, about 1 percent higher than the rate of 2.74 percent in 2018. Since the inflation rate was 2.69 percent, there was an increased purchasing power of the Valley consumer by 1.12 percent in 2019. All prices fall during recessions, and wages as a price of labor, also fell in 2020. Projections point to a slower increase in the coming months in line with an economy coming out of a recession. At this pace, average weekly wages in the Valley will likely exceed $950 by the fourth quarter of 2022.

High unemployment rates mean low wages. In the recession following the COVID-19 pandemic, wages fell sharply together with the overall price level. However, with a rate of inflation of 1.89 percent and a wage increase of 0.68 percent, the purchasing power of the average consumer has declined during 2020. Projections point to an increase in average weekly wages at an annual rate of 2.47 percent in 2021 and 2.88 percent in 2022.

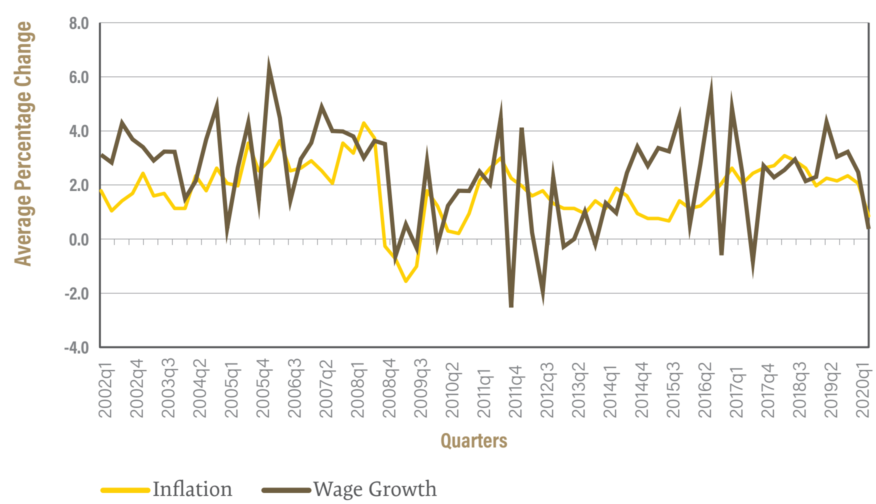
Quarterly Average Weekly Wages



Weekly Wage Growth:
Historical vs. Projected Average Yearly Growth



Yearly Wage Growth vs. Inflation



Consistent with other indicators, Valley community bank deposits and net loans and leases in 2019 grew slower than the two preceding years.

SPIKE IN TOTAL BANK DEPOSITS IN 2020

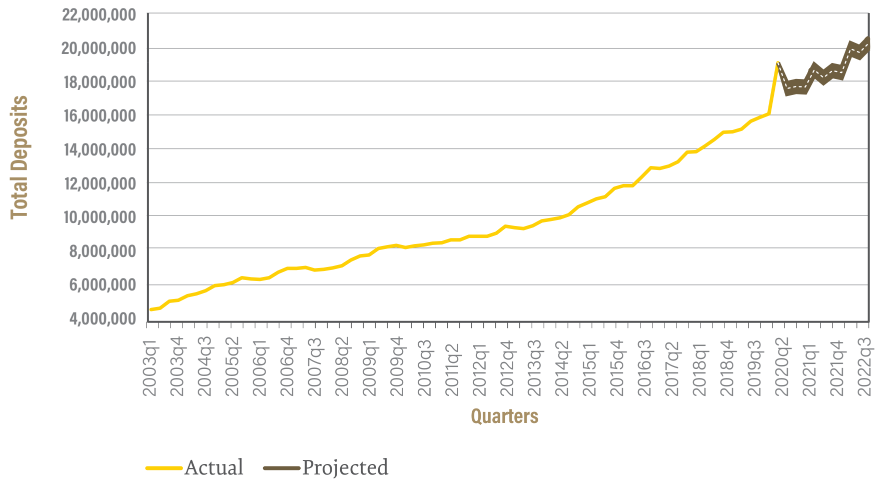
25.26%

Valley total bank deposits spiked 25.26 percent in 2020 as a result of fiscal and monetary policy interventions to alleviate the economic impact of the COVID-19 pandemic. Community bank deposits in the Valley will likely increase at rates in line with their historical rates, at an average annual rate of 4.09 percent in 2021 and 6.97 percent in 2022.

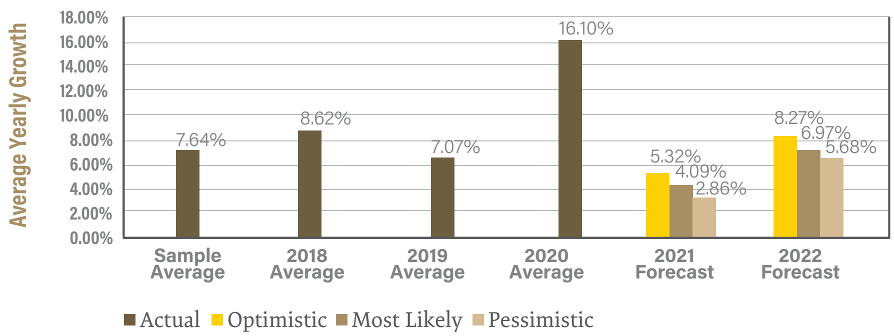
A SHARP INCREASE IN BANK ASSETS IN NON-ACCRUAL WILL LIKELY OCCUR IN THE COMING MONTHS AS BANKS BEGIN TO ADJUST THEIR BOOKS

Bank assets in non-accrual have not yet begun to increase sharply, largely in due to CARES Act and the Federal Reserve's actions, which have aided banks helping residents who have lost their jobs or are in financial distress due to the COVID-19 pandemic. There will likely be a sharp increase in bank assets in non-accrual in the coming months as banks begin to adjust their books.

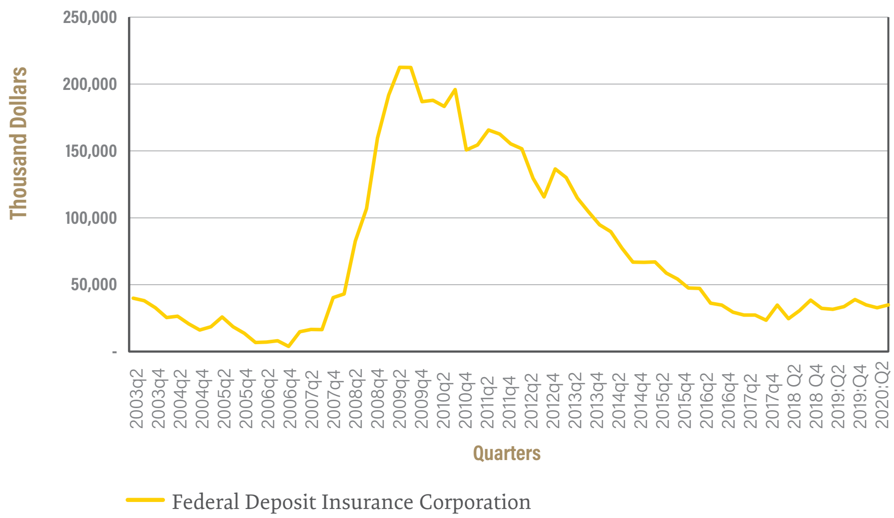
Total Bank Deposits (in $ Thousands)



Total Bank Deposits:
Historical vs. Projected Average Yearly Growth



Assets in Nonaccrual



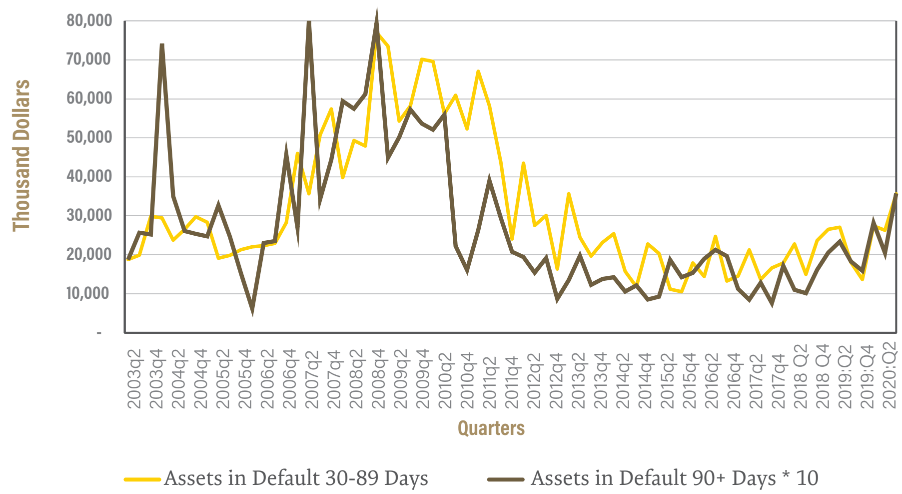
A pattern inconsistent with assets in ▶ non-accrual is now being observed within the series of assets in default 30 to 89 days. Unlike assets in non-accrual, assets in default 30 to 89 days are displaying a sharp upward trend. The assets in default 90-plus days have also been sharply trending upward in the first and second quarters of 2020. Assets in default 90-plus days appears to have a parallel trend to assets in default 30 to 89 days as banks keep a tab on the accumulating unpaid loans. Both series will likely continue their steep increase in the months ahead due to a more gradual economic recovery.

A SIGNIFICANT INCREASE IN COMMUNITY BANK NET LOANS AND LEASES IS INDICATIVE OF THEIR EFFORTS TO ASSIST VALLEY RESIDENTS

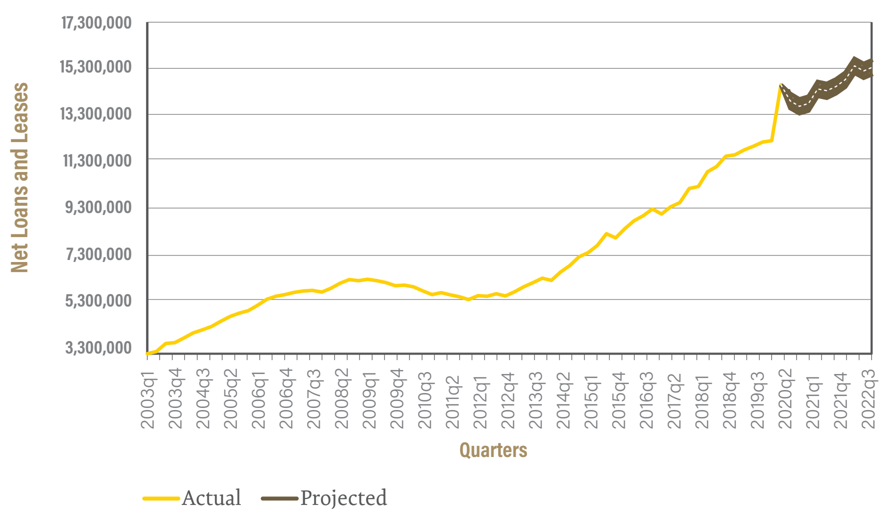
Consistent with bank deposits, ▶ community bank net loans and leases also grew significantly in 2020. Net loans and leases registered a 22.15 percent increase in the second quarter of 2020 alone. Such a pattern in net loans and leases is indicative of community banks continuing to assist Valley residents who are unemployed or in financial distress.

Because of the CARES Act and Federal Reserve's interventions, both Valley ▶ community bank deposits and net loans and leases and bank deposits increased at faster rates in 2020 than 2019. Bank deposits increased at 16.10 percent in 2020 – roughly twice the rate of increase in 2019's 7.07 percent. Net loans and leases increased 13.51 percent in 2020, still faster than the 2019 rate of 8.16 percent but not at a slower pace than the as the increase in bank deposits.

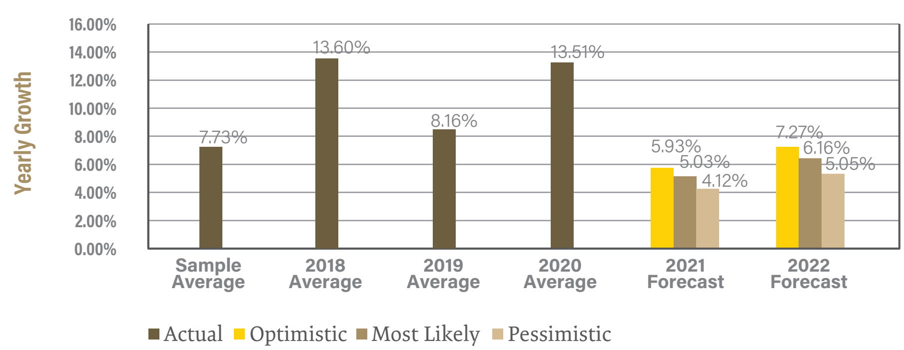
Assets in Default 30+ Days



Net Loans and Leases (in $ Thousands)



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



Economic recovery from the COVID-19 pandemic began in the second half of 2020. However, pace slowed in the months of August and September due to difficulties with wearing face masks, establishing contact tracing and pandemic fatigue. If there is a similar difficulty in willingness to get vaccinated, the recovery may slow further.

At the peak of the economic damage from COVID-19, which occurred spring 2020, Valley total employment declined at an average yearly rate of 12.51 percent in April and 13.60 percent in May. Kern County employment declined the fastest among the eight Valley counties. Tulare County employment declined the second fastest followed by Stanislaus County, San Joaquin County and Merced County respectively. Fresno County and Kings County were the sixth- and seventh-fastest declining counties in total employment. The slowest decline in total employment occurred in Madera.

As projected, the leisure and hospitality services category of employment was affected the most, while education and health services employment and financial activities employment were affected the least. Construction employment was the quickest to recover from the recession. Because we are mostly a farm-related economy, employing a relatively significant number of essential workers, employment declines in the Valley were less than that of the state in 2020.

Unlike the previous recessions, housing values continued to climb in 2020, due largely to the CARES Act and the Federal Reserve employing all of the tools to mitigate the economic impact of the COVID-19 pandemic. Consequently, building permits continued to increase at a very gradual pace in 2020.

Recession meant falling prices and wages in 2020. However, overall price levels began to increase gradually in August and September. The rate of inflation will likely increase in the coming months but remain below the long-term benchmark rate. The rate of inflation also should stay behind wage growth in the coming months, improving over time the purchasing power of the Valley consumer.

Both Valley bank deposits and net loans and leases increased significantly in the second quarter of 2020 due to the CARES Act and mitigating actions of the Federal Reserve. There was basically no change in community bank assets in nonaccrual as banks have not yet reflected these in their books as a result of the relief programs in place. But in the coming months, this indicator is expected to trend upward sharply. Perhaps the most important indicators of this year's report were community bank assets in default 30 to 89 days and assets in default 90-plus days, which began trending upward very sharply as banks kept a tab on unpaid loans. In the coming months, these two indicators will likely steepen further, creating a cause for significant concern for the Valley and the nation.

In all, all regional and national indicators point to further recovery, albeit at a slower pace than initially predicted. It is important for Valley residents and business community to take the right precautions to increase the speed of recovery.

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