With the seeking of emergency authorization for COVID-19 oral medications, and with vaccine booster shots now being widely administered, key economic indicators - including falling interest rates, easy monetary policy, and low tax rates - are beginning to reverse course. Though the Federal Reserve announced no rate hikes for 2022, long-term rates have begun to rise. In addition, home values in the Valley registered a whopping 14.43 percent increase in the second quarter of 2021. Given the structurally disadvantaged position of our region’s economy and the ongoing drought, the consequent combined impact on the Valley most certainly will be disproportionate to the rest of the country. The data suggests no immediate downturn in economic activity, but it is important to note that the future course of the economy will very much depend on how fast and how high interest rates rise. A sudden panic of homeowners rushing to sell all at once may bring about a sudden correction in the housing market, which would greatly impact the Valley.

Every category of employment in the Valley continued to recover with the exception of government employment, which posted the same decline as in the previous year - 3.91 percent in 2020 and 3.92 percent in 2021. Despite recovering from the previous year, a few categories continued to post declining rates, albeit at slower paces. Farm-related Valley wholesale trade employment, negatively affected by the drought, declined at an average yearly rate of 1.13 percent in 2021, less than the 2020 decline of 4.75 percent. Education and health services employment declined at a slower rate of 0.16 percent in 2021, compared to 0.76 percent decline in 2020. Another category of employment that declined less than the previous year was financial activities employment, which posted a decline of 4.09 percent in 2020 and 2.43 percent in 2021. Structurally problematic information employment declined 9.12 percent in 2021, still notably less than the 19.06 percent decline in 2020.

Retail trade, at an average annual rate of 5.93 percent, was the fastest-growing category of employment in 2021, followed by trade, transportation and utilities employment growing at 5.56 percent. The third-fastest was leisure and hospitality services employment, posting 4.62 percent growth in 2021. Manufacturing employment grew 2.05 percent in 2021, its fastest pace since 2015. Among the categories that switched from negative to positive territory, Valley construction employment grew the slowest at 1.99 percent in 2021, still a significant jump back from a decline of 3.01 percent in 2020. Despite an increase in employment growth projections for 2022, changing policy variables should compel employment levels to grow at a much slower rate in 2023.

Valley building permits increased at a phenomenal rate of 35.65 percent in 2021. This is similar to the pace observed in 2018 and it reflects the supply side trying to catch up with the excess demand caused by a shortage of inventory. Because of the extension of the Biden administration’s relief package and the Federal Reserve’s continued deployed tools to mitigate the negative effects of the pandemic, there were basically no foreclosures in 2021 - similar to 2020. Freddie Mac 30-year rates continued to fall in the third quarter of 2021, after the Federal Reserve’s signal of no rate hikes through 2022. Because of the rising price of oil and wages along with increased demand and liquidity injection, the yearly inflation rate increased very significantly in 2021 and is likely to stay high through the first quarter of 2022. Home values continued to increase in 2020, registering a 5.42 percent average yearly increase – outpacing the long-term benchmark growth of 5.07 percent. The increase in home values was much greater in 2021 than 2020 but some of it was due to inflation. Controlling for inflation, real growth in home values was a bit lower, yet still very significant. Home values are expected to grow at much slower rates in the coming months, particularly in real terms. As in the case of the previous housing crisis of 2008, an increase in interest rates to very high levels and at very fast rates may very well mean another correction. Homeowners looking at nominal growth rates may panic and try to sell all at once in an attempt to take advantage of home value appreciations, triggering a another significant correction in the housing market. It is therefore important to watch the rate of increase in the Federal Funds rate along with the pace of change in home values closely as we move forward.

To fight the negative effects of the pandemic, tremendous liquidity was injected into the economy both in 2021 and 2020. However, the Federal Reserve clearly signal that tapering began in November. Liquidity injection was an important factor behind the very high inflation rates of the past two quarters. Another reason was wage inflation, a result of a labor shortage that pressured employers to create monetary incentives for people to return to work. The rise in labor costs was passed on to consumers in the form of higher prices for goods and services.
Average weekly wages rose 4.93 percent in 2021, still very fast but not as fast as the rate observed in 2020 at 8.48 percent, the fastest increase since the report began tracking this indicator. Bottlenecks in supply chain as a cost-push factor was another main cause of high inflation. The average yearly inflation rate during 2021 was 3.66 percent, corresponding to a real wage increase of 1.27 percent.

President Biden’s stimulus plan and the Federal Reserve’s continued intervention again spurred bank activity in 2021. Valley total deposits grew 25.71 percent in 2021, which was a faster rate than the 21.19 percent rate observed in 2020 and just shy of three times the long-term benchmark rate of 8.68 percent. Net loans and leases grew 11.36 percent in 2021, slower than the 17.63 percent growth in 2020. Valley net loans growth fell significantly below the rate of growth in bank deposits, indicating the community banks did not extend loans as they did in pre-pandemic years. Valley bank non-accruals began to trend more significantly upward, relative to 2020, creating a serious concern for the coming months. Community bank assets in default 30-to-89 days and assets in default 90-plus days also displayed a steepening trend as banks continued to keep a tab on unpaid loans. As relief programs such as eviction moratoriums end, non-accruals are projected to rise much faster in the coming months. Data does not point to any immediate significant downturn in economic activity, but rising yields, Federal Reserve tapering, steep increases in home values and tax increases may be triggers of an oncoming correction. As a precaution, Valley residents and business should consider refinancing while interest rates are still low, moving into rental property, reducing leverage and increasing cash holdings.

This report examines data from January 2001 to October 2021. Two-year medium-term forecasts are from November 2021 to December 2023. 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.
**Total employment grew in all counties except Kings County in 2021.** However, Kings County is on the way to posting significantly positive average yearly growth numbers beginning from December 2021 as the incoming growth numbers begin to outweigh the negative rates reported earlier in the year. Merced County total employment grew 3.56 percent, the fastest among the eight counties of the San Joaquin Valley. Stanislaus County total employment grew the third fastest at 3.04 percent. Fresno County grew 1.98 percent, followed by Kern County at 1.84 percent. Tulare County reported 1.48 percent growth in 2021. Growth numbers for all counties switched from declining rates in the negative territory to growing in the positive territory beginning in April 2021, and employment levels have been growing steadily since then. Overshooting followed by undershooting is a regular phenomenon of any series trying to find steady rate of growth following a significant economic impact.

### Merced County Total Employment Grew

3.56%

All categories of employment, with the exception of government employment, are clearly in recovery phases but some have not yet begun to report positive growth. The historically problematic sector of information employment reported a decline of 9.12 percent in 2021, but even this was an improvement over the faster decline of 19.06 percent during the worst months of the pandemic in 2020. Government employment declined at a near-identical rate in 2021 at 3.92 percent as it did in 2020 at 3.91 percent. A few other categories continued to post declining rates, albeit slower than the previous year. Farm-related Valley wholesale trade employment, negatively affected by the drought, declined at an average yearly rate of 1.13 percent in 2021, slower than the 4.75 percent decline in 2020. Education and health services employment declined at a slower rate of 0.16 percent in 2021 compared to a 0.76 percent decline in 2020.

### Financial impacts

Financial activities employment was yet another category that declined less in 2021, at 2.43 percent, than in 2020, at 4.09 percent. Average yearly growth in Valley total employment grew 3.84 percent in 2021. Valley total employment will likely continue to stay below 1,800,000 through 2023. Projections point to an average growth of 3.51 percent in 2022 and slower growth of 0.88 percent in 2023 as several policy variables are expected to reverse course.

### MERCED COUNTY TOTAL EMPLOYMENT GREW

3.56%

### Education and health services employment

- Average yearly growth in education and health services employment declined at a slower rate of 0.16 percent in 2021 compared to a 0.76 percent decline in 2020.

### Farm-related Valley wholesale trade employment

- Average yearly growth in farm-related Valley wholesale trade employment declined at an average yearly rate of 1.13 percent in 2021, slower than the 4.75 percent decline in 2020.

### Financial activities employment

- Average yearly growth in financial activities employment declined at a slower rate of 2.43 percent in 2021, than in 2020, at 4.09 percent.

### Average yearly growth in Valley total employment

- Average yearly growth in Valley total employment grew 3.84 percent in 2021. Valley total employment will likely continue to stay below 1,800,000 through 2023. Projections point to an average growth of 3.51 percent in 2022 and slower growth of 0.88 percent in 2023 as several policy variables are expected to reverse course.
The Consumer Confidence Index, an important leading indicator of upcoming economic activity, has continuously displayed an increasing pattern since the fourth quarter of 2020 and now appears to have stabilized around a value of 120. As the Covid-19 pill becomes publicly available in the second half of 2022, confidence in consumer spending should continue to rise.

With the pandemic recovery taking hold, labor force and employment growth both are in positive territory. However, labor force growth lags significantly behind employment growth due to low labor force participation rates. A similar pattern, at a much-lower scale, of employment growth exceeding labor force growth was observed at the end of the 2008 recession. The tendency to switch directions in both series is now acting as a new leading indicator for our region.

All categories of employment, with the exception of government employment, are clearly in recovery phases but some have not yet begun to report positive growth.

Just as in the in 2008 recession, statewide employment growth fell below the employment growth of the Valley during the pandemic. But with the recovery well underway, employment growth of the state now exceeds the Valley employment growth. This pattern during the recovery is different than the pattern observed after the 2008 recession, perhaps reflecting the negative effects of the ongoing drought impacting the Valley to a greater degree than the rest of the state.
Following the sudden pandemic-related decline of more than 30 percent, real gross domestic product overshot the mean at the start of the recovery, then quickly rebounded at roughly the same rate. The latest growth numbers point to a pattern of return to the steady state growth of about 3 percent. With the recovery taking hold in 2021, real GDP is projected to grow at 2.65 percent in 2022 and at a significantly slower rate of 0.51 percent in 2023 as the impact from reversing course begins to intensify.

AT THE CURRENT PACE OF RECOVERY, EMPLOYMENT LEVELS IN EDUCATION AND HEALTH SERVICES ARE PROJECTED TO EXCEED 235,000 BY THE END OF 2023.

Noteworthy is the negative projected real GDP growth of the lower bound around the end of the first quarter of 2023. Even though there are no immediate signs, a series of quick rate hikes that reach above a 6 percent threshold may trigger a housing correction led by a panic of homeowners rushing to sell all at once.

Education and health services employment reported a decline of 0.16 percent in 2021, but the decline was slower than the previous year’s decline of 0.79 percent. Delays in school openings and unrelated healthcare centers undoubtedly had an impact on the relatively slower recovery in this category.

At the current pace of recovery, employment levels in education and health services are projected to exceed 235,000 by the end of 2023. Projections point to a switch from negative to positive territory and faster growth in the coming months. As the Valley’s economy continues to recover, employment in this category is expected grow at an average yearly rate of 1.22 percent in 2022 before slowing to 1.07 percent in 2023.
Valley manufacturing employment grew 2.05 percent in 2021, a significant improvement over the decline of 2.04 percent in 2020. At this new pace, the seasonal spike level of manufacturing employment will likely exceed 115,000 by the end of 2023. The manufacturing employment long-term benchmark growth rate remains in positive territory as the recovery of the Valley economy intensifies in 2021.

### Valley Manufacturing Employment Grew 2.05% in 2021

Manufacturing employment in the state and nation had been struggling before the pandemic, just as it did in the Valley. With the new infrastructure plan taking hold, the effect of new investments is expected to contribute to faster growth in this category. Projections point to an average annual increase of 0.96 percent in 2022 and 0.19 percent in 2023.

The Institute of Supply Management’s Purchasing Managers Index reached an all-time high value of 65 in March 2021. Since then, the index appears to have reverted to its mean, reflecting the strong confidence of consumers, who now can make plans into the future - as opposed the months when the effects of the pandemic were worse. The index value is now around 60, with any value above 50 considered a signal of expansion.
Leisure and hospitality services employment has been one of the worst-affected categories of employment during the pandemic because of the dominance of unskilled workers earning minimum wage. Leisure and hospitality services employment grew 4.62 percent in 2021, a very significant improvement after falling 17.18 percent in 2020. Employment levels are expected to exceed 125,000 by the end of 2023, but the discrepancy resulting from the pandemic most likely will continue beyond 2023.

**LEISURE AND HOSPITALITY SERVICES EMPLOYMENT GREW 4.62 PERCENT IN 2021**

The long-term benchmark growth rate for leisure and hospitality services employment increased to 1.42 percent after factoring in the growth in 2021. The remaining discrepancy in employment levels will likely be around 5,000 by the end of 2021, which still would be a significant improvement. In this category alone, about 30,000 workers were laid off in 2020. Projections point to an average annual growth of 9.57 percent in 2022 and 2.34 percent in 2023.

The only category to post growth during the worst months of the pandemic was trade, transportation and utilities employment. In 2021, the growth intensified to 5.56 percent, becoming one of the fastest-growing categories of employment in the Valley. Further, this category of employment was the quickest to recover, exceeding the pace of growth in construction employment. At this rate, and with supply chain issues, trade, transportation and utilities employment is projected to exceed 310,000 by the of 2023.
Trade, transportation and utilities is an essential sector when explaining the fast rebound from the pandemic. In particular, this was the only category that could not switch to remote work environments, since goods had to be physically transported from one location to other, especially as consumers switched to online purchasing. A shortage of truck drivers and other logistical issues has created bottlenecks that will last well into 2022. Trade, transportation and utilities employment is projected to grow at an average yearly rate of 2.32 percent in 2022 and slow to a 1.79 percent growth in 2023.

TRADE, TRANSPORTATION AND UTILITIES IS AN ESSENTIAL SECTOR WHEN EXPLAINING THE FAST REBOUND FROM THE PANDEMIC.

Retail trade employment suffered a huge loss during the worst months of the pandemic, but the 5.93 percent comeback in 2021 was the fastest among all categories. Employment in this category is expected to exceed 160,000 by the end of 2023. Initially, retail trade employment was slow to recover from the pandemic but in 2021 pace of growth picked up very significantly, even surpassing the growth rates observed in strong categories such as trade, transportation and utilities employment and construction employment.

The long-term benchmark growth increased to 0.81 percent on momentum created by the strong growth rates in 2021. However, competition from online shopping continues to hurt retail trade employment in the Valley. Factoring the impact of online shopping, projections point to 2.30 percent growth in 2022 and 0.99 percent in 2023 as the effects of tapering and rate increases take their toll on consumer spending.
Worsening drought conditions took a toll on wholesale trade employment in 2021, causing it to perform below retail trade employment. To fight the adverse effects of drought and climate change the Valley must increase its water storage to make the region more resilient to longer-lasting droughts. Given these ongoing drought conditions, employment levels in the category are expected to stay below 47,000 through the end of 2023.

THE DECLINE IN INFORMATION EMPLOYMENT IN 2021 WAS 9.12%}

Primarily because of the drought and the pandemic, the seasonal pattern observed in prior years was not observed in 2021. Wholesale trade employment in the Valley declined by 1.13 percent, a slower decline when compared to the 4.75 percent drop in 2020. Projections point to 1.48 percent growth in 2022 and 0.65 percent growth in 2023. Because of the drought, however, the discrepancy of about 2,000 workers will likely not disappear during the forecast interval.

Information employment nationally, statewide and in the Valley had been declining long before the pandemic. The use of social media and consumers’ changing digital media preferences are the main causes of this decline. The decline in information employment in 2021 was 9.12 percent, compared to 19.06 percent the previous year. The decline slowed in 2021 but was roughly twice the rate observed in 2019. Employment levels in this category will likely stay below 8,500 through the end of 2023.
The long-term benchmark decline fell further, to 3.35 percent, or about one-third of the decline in 2021. Because the declines in 2020 and 2021 were extreme – multifold of the long-term benchmark rate – a switch from negative to positive territory is expected in the coming months. Projections point to average yearly growth of 3.20 percent in 2022 and 1.66 percent in 2023. Given the historical declining pattern prevailing since 2008, the growth in 2023 might very well occur closer to the lower bound of 0.28 percent.

Construction employment bounced back quickly in the initial stages of the pandemic, but in later months grew at rates more in line with the long-term benchmark rate. Employment in this category grew 1.99 percent in 2021, rebounding from a 3.01 percent decline in 2020. Increased construction activity is easily visible to the eye in the Valley. However, the inventory shortage is likely to last for some time, as the number of homes being built in the Valley is not close to what is necessary to satisfy the demand.

THE HUGE SPIKE IN BUILDING PERMITS IN 2021 SERVES AS A LEADING INDICATOR THAT MORE HOMES WILL BE BUILT.

Low interest rates were another factor contributing to increased demand for housing in the Valley, as was an emerging trend – Bay Area residents relocating to more sparsely populated areas. The huge spike in building permits in 2021 serves as a leading indicator that more homes will be built. Projections point to an average annual growth of 2.82 percent in 2022, then a fall to 1.23 percent in 2023 as tapering and rising rates begin to take effect.
Government employment was the only category of employment that did not improve from the previous year, declining 3.92 percent in 2021 – nearly matching the 3.91 percent decline observed in 2020. Recovery in this category comes with a lag, as it did during the 2008 recession. During a contractionary phase, the decline in this category also comes at a later stage than the declines in all other categories of employment.

**Government Employment: Historical vs. Projected Average Yearly Growth**

<table>
<thead>
<tr>
<th></th>
<th>Sample Average</th>
<th>2019 Average</th>
<th>2020 Average</th>
<th>2021 Average</th>
<th>2022 Forecast</th>
<th>2023 Forecast</th>
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</thead>
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<tr>
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<td>-3.91%</td>
<td>-3.92%</td>
<td>1.88%</td>
<td>-3.92%</td>
<td>1.23%</td>
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<tr>
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<td></td>
<td></td>
<td>1.30%</td>
<td>-3.92%</td>
<td>1.75%</td>
</tr>
<tr>
<td>Most Likely</td>
<td>1.88%</td>
<td></td>
<td></td>
<td>2.06%</td>
<td>-3.92%</td>
<td>2.56%</td>
</tr>
<tr>
<td>Pessimistic</td>
<td>-3.92%</td>
<td>-3.92%</td>
<td>-3.92%</td>
<td>1.59%</td>
<td>-3.92%</td>
<td>1.30%</td>
</tr>
</tbody>
</table>

Government employment was the only category of employment that did not improve from the previous year, declining 3.92 percent in 2021 – nearly matching the 3.91 percent decline observed in 2020. Recovery in this category comes with a lag, as it did during the 2008 recession. During a contractionary phase, the decline in this category also comes at a later stage than the declines in all other categories of employment.

**NOT COUNTING THE SEASONAL UPS AND DOWNS, GOVERNMENT EMPLOYMENT LEVELS WILL LIKELY REACH 295,000 BY THE END OF 2023.**

Not counting the seasonal ups and downs, government employment levels will likely reach 295,000 by the end of 2023. The discrepancy of about 12,500 employees will not likely be filled during the two-year ahead forecast interval. Projections point to an average yearly growth of 1.59 percent in 2022 and a lagged positive response of 1.06 percent in 2023.

Valley financial activities employment continued to improve, even as growth did not switch from negative to positive territory. Employment levels in this category continued to decline in 2021 but at a slower pace than the year before. Employment in this category will likely reach 42,000 in the fourth quarter of 2023.

In the coming months, as interest rates begin to increase, Valley banks’ profitability also will increase. As interest rates fell during the pandemic, Valley banks extended fewer loans, reacting to very high default risks and interest rates too low to generate profit. Financial activities employment is projected to increase at an average yearly rate of 2.22 percent in 2022 and 1.24 percent in 2023.
Recovery seems to be well underway and is steady, based on the incoming data. However, many important policy variables – such as easy monetary policy and falling interest rates – will be reversing course in the coming months. While the projections are upbeat in 2022, slower growth should prevail in 2023 due to a changing business environment. Though there are no immediate signs of a downturn, it is important to watch incoming data to take necessary positions and be prepared before the impact of such reversing of course begins to be felt on our economy. Consumer credit grew more slowly than in previous months, limiting the ability of consumers to spend and eventually lowering their spending power. To prepare for an oncoming correction, it would be prudent for businesses and consumers to lower debt exposure, increase cash holdings, lock interest rates early on loans and move from flexible to fixed-rate borrowing.

**RECOVERY SEEMS TO BE WELL UNDERWAY AND IS STEADY, BASED ON THE INCOMING DATA.**
The eight Metropolitan Statistical Areas (MSAs) of 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 aggregated data from these MSAs constitute the total single-family building permits in the Valley.

Housing permits spiked 35.65 percent in 2021, an increase more than four times the long-term benchmark rate of 8.22 percent. Even during the pandemic, building permits increased 13.26 percent. Next year’s building permit totals will likely be lower due to the spike in 2021. In any case, the building permit data points to highly increased activity in home building in the Valley. At this strong pace, Valley housing permits will most likely exceed 1,000 per month by the second half of 2022.

With 2,020 permits, Fresno kept the lead in issuing the most housing permits in 2021, followed by 1,749 in Stockton and 1,351 in Bakersfield. Visalia issued 927 permits in 2020, while Madera and Merced issued 778 and 93, respectively. Modesto issued 26 building permits, while no housing permits were issued in Hanford-Corcoran.

Projections point to average annual growth of 17.60 percent in 2022 and 3.76 percent in 2023, as the effects of tapering and rate hikes begin to take hold on the housing sector.

Because of the Federal Reserve’s continued intervention in 2021, the foreclosures started series in California fell further, to all-time lows, and became virtually nonexistent. Thus, this series remains at the lowest levels since 1999. Bank accruals, however, began to rise sharply in 2021, as they did in 2020. With the ending of mortgage assistance in September, 2021, a sharp increase in foreclosures is expected in the coming two-year period.
Other than a temporary spike in April, 2021, long-term interest rates kept falling. Falling rates kept borrowing costs very low, but home values increased sharply. The refinancing activity of homeowners who could afford to do so was very active in 2021. When interest rates reverse course, in concert with other important variables – such as low tax rates – it undoubtedly will have a dampening effect on the housing sector. Whether this dampening turns into a correction will very much depend on how fast and how high interest rates rise. Home values continued to increase but the pace intensified in 2021. Home values in the Valley rose 12.19 percent in 2021 – more than twice the rate of the 5.38 percent observed in 2020.

Home value appreciation in 2021 was the fastest since 2014. About 3.66 percent of this increase was due to inflation, corresponding to 8.93 percent real appreciation. Even in real terms, however, the appreciation was significant enough to create the concern of a potential correction in the housing market, particularly if such high rates of appreciation do not retreat to more sustainable rates. The fastest increase in home values took place in Stockton, which reported a 13.92 percent average annual increase in 2021. The second fastest increase in home values was in Modesto at 13.03, followed by Merced at 12.50 percent. Madera came next at 12.02 percent, followed by 11.92 percent in Visalia and Porterville. Fresno home prices increased 11.67 percent. Fresno and Hanford-Corcoran reported the slowest increase in home prices in 2020 at 11.26 percent and 11.19 percent, respectively. Projections point to a 6.38 percent increase in 2022 and a 3.94 percent increase in 2023.
As the pandemic recovery intensified, enormous liquidity injections in the economy began to take their toll on the rate of inflation, and these high inflation rates are likely to stay with us through the first quarter of 2022.

As was the case following the 2008 recession, the overall price level has risen during the recovery from 2020 faster nationwide than for our region, a reverse of historic performance. This change in pattern during recessions and immediately after recovery acts as another reliable coincidental indicator for our region.

The rate of inflation began to come in at rates above 5 percent following the second quarter of 2021. In 2021, the average yearly inflation was 3.66 percent, well above the long-term benchmark rate of 2.34 percent. The high price of oil acts as a cost-push factor, driving prices higher. Another cost-push factor is high labor costs, which have begun to increase well in advance of the rate of inflation in the early months of recovery.

Inflation remains mainly anchored to the price of oil. However, excess demand conditions and shortages observed in commodity markets is another significant factor driving prices up from the demand-pull side. Projections of the rate of inflation for the Western region point to an average yearly increase of 2.81 in 2022 and 1.87 percent as the tapering intensifies and rates rise in 2023.
We had reported in our previous report that perhaps the most interesting development during the early months of the recovery was the yearly change in average weekly wages. Wages normally fall during recessions. However, average weekly wages in the Valley rose 8.48 percent in 2020, another characteristic that made this recession unique. This sharp rise in wages was due to the reluctance of workers afraid for many reasons – including the fear of catching the virus - to return to work and the amount of available unemployment compensation.

The reservation wage of a typical Valley worker (the amount the average employee would require to return to work) increased about three times the long-term benchmark rate of 3.21 percent during 2021. Slower increases will likely occur following the first quarter of 2021. Average weekly wages in the Valley will likely exceed $1,050 by the end of 2023. Projections point to an average yearly increase of 2.77 in 2022 and 1.58 percent in 2023.

During 2021, the average rate of inflation stood at 3.66 percent. During the same time, average weekly wages rose 4.93 percent, corresponding to a gain in purchasing power of 1.27 percent. In 2020, the rate of inflation was 1.76 percent while the increase in average weekly wages was 8.48 percent, corresponding to a gain in purchasing power of 6.72 percent – the largest gain since 2001. In the coming months, however, average weekly wages will likely be increasing at a slower pace than the rate of inflation, thus decreasing purchasing power.
The continued interventions in the economy to fight the impacts of the pandemic resulted in tremendous liquidity injections, which were reflected in bank deposits and net loans and leases as well as bank accruals. Valley total bank deposits spiked 25.71 percent in 2021 and 21.19 percent in 2020. When these are compared with the long-term benchmark rate of 8.68 percent one can understand the magnitude of the increase resulting from the Federal Reserve intervention. Yet despite the banks being flooded with cash, they do not appear be extending loans at the same pace as the increase in deposits because of a high default risk and low interest rates. Community bank deposits in the Valley will likely increase at rates in line with their historic rates as tapering resumes and interest rates rise. Valley total bank deposits are projected to increase at an average annual rate of 5.58 percent in 2022 and 4.49 percent in 2023 as the Federal Reserve slowly begins to deflate the balance sheet.

**Valley Total Bank Deposits Are Projected To Increase At An Average Annual Rate Of 5.58% In 2022**

Bank assets in non-accrual have begun to trend more visibly upward in 2021. With the end of mortgage forbearance programs and other support in September of 2021, the pace of non-accruals will likely rise at a faster rate. The rise in interest rates will make it more difficult for Valley residents to meet their mortgages and other financial obligations. The anticipated increases in taxes also will contribute to a decrease in the disposable income that fuels consumer spending and savings.
The pattern observed in bank assets in default 90-plus days is not yet consistent with the pattern observed in bank assets in non-accrual. The two series are exhibiting a flatter trend when viewed against the steep trend observed in bank non-accruals. The two series will likely increase at much faster rates in the coming months as the Federal Reserve begins to gradually decrease the balance sheet and resorts to a series of rate hikes to control inflation.

Community bank net loans and leases increased 11.36 percent in 2021. The rate of increase was less than the 17.63 percent increase in 2020, pointing to further cuts on the part of community banks to issue loans. It means banks are increasingly choosing to sit on cash rather than extend more loans. The expected increase in interest rates may change this picture in the coming months as higher interest rates correspond to increased bank profitability.

The economic stimulus plan, indeed, delivered much-needed assistance to fight-off the impact of the pandemic on the economy. Had the plan not been implemented, the effect of the pandemic on the economy would be much more devastating. But with the end of assistance programs and easy monetary policy and with falling rates reversing course, the trajectory of the economy will likely change in the next two years.

Community bank deposits and net loans and leases both are likely to grow more in line with their historical benchmark rates as the Federal Reserve begins to deflate the balance sheet to tame inflation. Projections point to net loans and leases increasing at an average yearly rate of 5.24 percent in 2022 and 4.07 in 2023.
Incoming data points to a recovery that is now well underway. With the seeking of emergency authorization for COVID-19 oral medications, and with vaccine booster shots poised to be publicly available in the second half of 2021, we are quickly moving away from the pandemic’s hold on the economy. However, easy monetary policy and falling interest rates will be reversing courses and change the trajectory of the economy. Much will depend on how fast and how high interest rates rise following the tapering activity by the Federal Reserve.

Valley total employment will likely grow at an overall average rate of 3.51 percent in 2022, followed by slower growth of 0.88 percent in 2023. During 2021, total employment in all counties grew, with the exception of Kings County. Merced County employment grew the fastest, with Madera and San Joaquin counties tying for second place. Fourth-fastest growth occurred in Stanislaus County while Kern and Fresno counties took fifth and sixth place, followed by Tulare.

Information employment continued to decline at the fastest rate of all sectors in 2021, but these declines were occurring long before the pandemic hit. The information employment rate of decline was much slower than the decline in 2020. The fastest-growing category of employment was retail trade, followed by trade, transportation and utilities employment. The leisure and hospitality services category grew the third-fastest while manufacturing and construction employment were the fourth- and fifth-fastest growing categories. Financial activities employment declined in 2021, but the decline was slower than that of 2020. Government employment posted the same decline in 2021 as in the previous showing. Education and health services employment grew the slowest in 2021, due to delays in school-openings and with healthcare workers primarily assigned to fighting the pandemic. Because of the worsening drought, farm-related wholesale employment declined in 2021.

Home values posted very significant increases in 2021, bringing back worries of a correction in the housing market. While there are no immediate signs of this happening, tapering and rate hikes may trigger a crisis if homeowners panic and attempt to sell their homes all at once, an action that would significantly depress home values. It is important for homeowners to keep an eye on the variables as they reverse course and to prepare for a potential correction by lowering debt exposure, moving into cash, locking-in fixed interest rates by moving from flexible rates while interest rates are still low, and even selling homes and moving into rental property.
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