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San Joaquin Valley

BUSINESS FORECAST

Emerging Trends in the Valley's Economy

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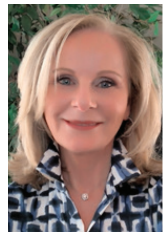
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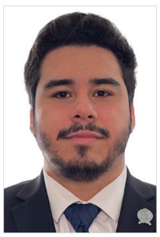
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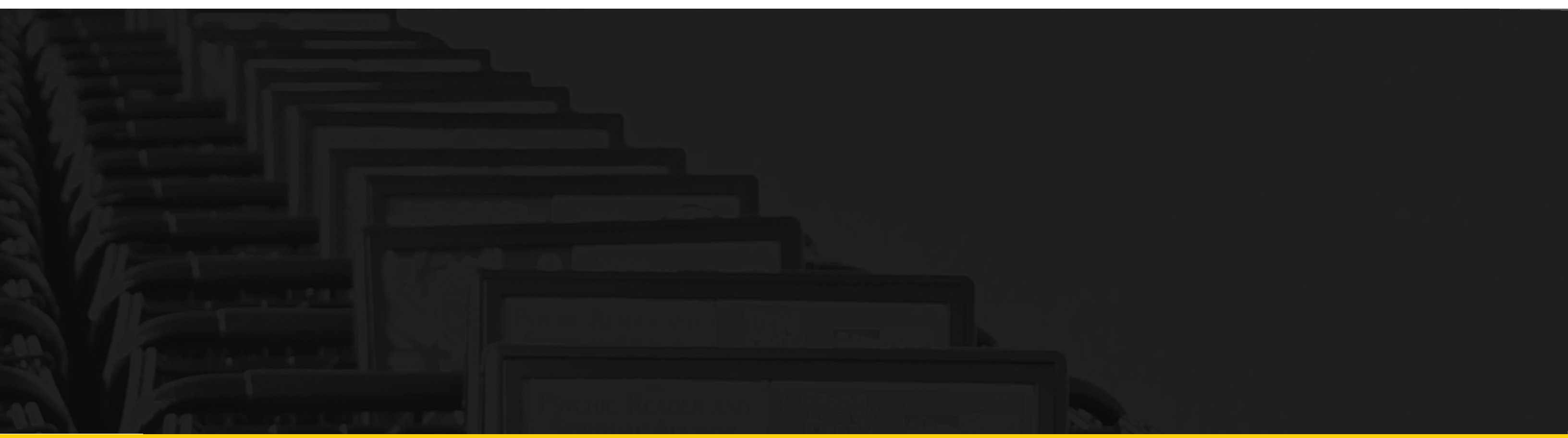


Executive Summary

As the San Joaquin Valley regional economy continued to reel from the COVID-19 pandemic, other factors — including the Ukraine-Russia conflict, the Federal Reserve's interest rate hikes and high inflation mainly driven by the oil prices — inhibited a faster recovery. Questions surrounding the number of interest rate hikes this year in addition to the conflict bring added uncertainty to the outlook.

The yield curve — a closely-watched and accurate predictor of recessions — on two-year bonds inverted a few times by March compared to 10-year bonds and marks the first inversion since 2019. The likelihood of a recession is higher than before given the increased worries that six rate hikes and the Federal Reserve's primary focus to lower inflation could steer the economy toward a hard landing. In this uncertain environment, we reiterate our earlier suggestions to switch from adjustable to fixed-rate borrowing while interest rates are still low, decrease debt exposure, refinance home mortgages and car loans and increase the composition of cash holdings by leveraging down.

After surpassing their averages, every category of employment in the Valley continued to revert to more normal, pre-pandemic growth rates. However, projections have been lowered in this updated report mainly because of impacts from Ukraine-Russia conflict and the Federal Reserve's rate hikes expected to occur in 2022. Every employment category except financial activities and government jobs continued to recover in the Valley's economy including information and wholesale trade employment. Farm-related Valley wholesale trade employment, which has been negatively affected by the drought, grew 1.01 percent in 2021. Education and health services employment grew 2.57 percent on route to catching the long-term benchmark growth of 3.20 percent. Financial activities employment declined by 0.98 percent in 2021, much less than it did in 2020. Government employment generally follows other categories with a lag. Government employment declined by 1.35 percent in 2021 but like the financial activities sector, the decline was much less than in 2020. For the first time since 2016, structurally problematic information employment increased by 3.36 percent.

Leisure and hospitality services, at an average annual rate of 16.1 percent, was the fastest growing category of employment in 2021, followed by trade, transportation and utilities employment growing by 6.63 percent. The third-fastest was retail services employment, posting 6.30 percent growth in 2021. Manufacturing employment grew 1.5 percent, the fastest pace since 2015. Valley construction employment grew 4.95 percent — more than four times the long-term benchmark rate of 1.16 percent. Given the changing policy variables to fight inflation, employment levels are expected to grow more slowly in 2023 than in 2022.

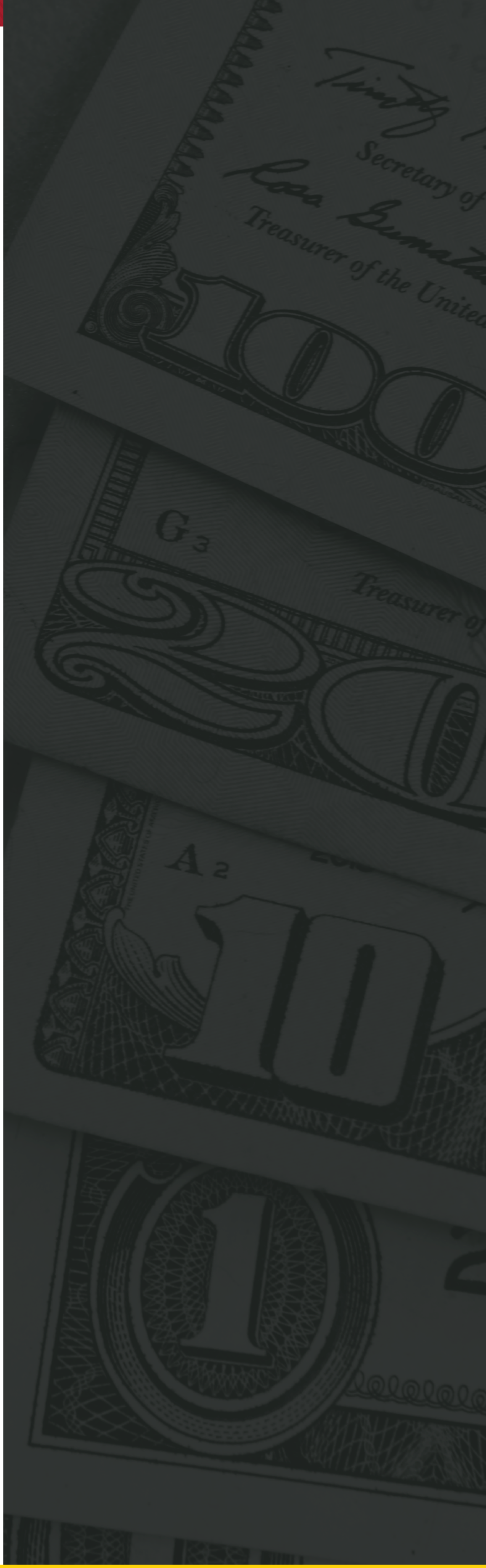
Valley building permits increased 19.67 percent in 2021. This is faster than the pace observed in 2020. Because of the extension of the Biden administration's relief package and the Federal Reserve's deployed tools to mitigate the negative effects of the pandemic, there were basically no foreclosures in 2021. Freddie Mac 30-year rates began to increasing with the first rate hike in the first quarter of 2022.

The average yearly inflation rate was 4.52 percent —more than twice the rate of the long-term benchmark rate of 2.45 percent. High inflation is likely to prevail through summer of 2022 because of the ban on Russian oil exports. Home values soared in 2021, registering a staggering 16.83 percent average yearly increase — more than three times the long-term benchmark growth of 5.60 percent. Although some of the increase is due to inflation, it appears that the housing market is now in a bubble. At this pace, home values are expected to go through a correction, particularly with other anticipated rate hikes this year. As was the case of the 2008 housing crisis, increasing interest rates to very high levels and very quickly could create an abrupt downward adjustment in the housing market.

Along with the high oil prices, wage-push inflation and inventory accumulation were other contributing factors causing high inflation. The rise in labor costs was passed on to consumers in the form of higher-priced consumer goods and services. Average weekly wages rose 4.78 percent in 2021, similar to the inflation rate. Given the abundance of job vacancies in the region, a tight labor market is likely to last through the summer.

Valley community bank total deposits grew 21.70 percent in 2021 — more than twice the long-term benchmark. However, net loans and leases growth, 4.86 percent in 2021, was significantly less than the growth in total deposits. The low growth in net loans and leases was the first since the 2008 Great Recession. This imbalance between total deposits and net loans and leases growth is concerning. Valley bank non-accruals trended upward in 2021 creating another concern for the coming months. Community bank assets in default 30 to 89 days and assets in default 90-plus days average was higher in 2021 than 2020. Non-accruals are projected to rise faster in the coming months. The Federal Reserve's focus to control inflation by implementing a series of rate hikes along with balance sheet reduction and tapering, inversion of the yield curve and exponential increases in home values increase the odds of a recession to 33 percent. Refinancing while interest rates are still low, moving into rental property as some circles recommend during peak levels, reducing leverage and increasing cash holdings are a few precautionary measures Valley businesses and residents can take.

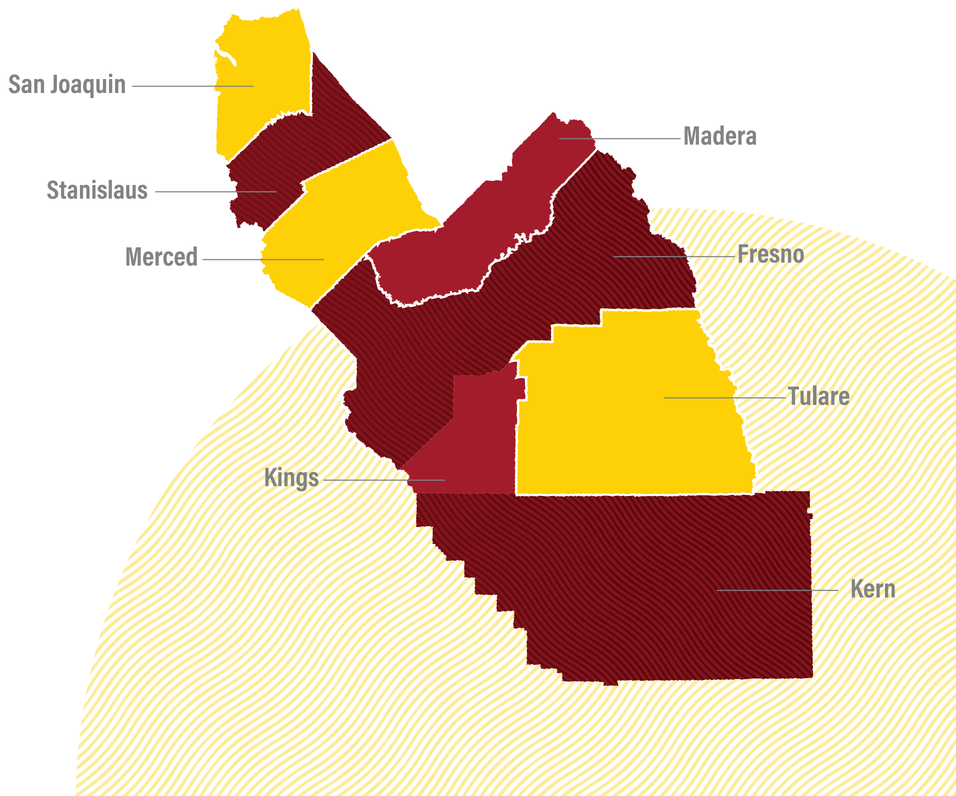
Introduction



Time series data spans from January 2001 to April 2022. Two-year medium-term forecasts are from July 2022 to July 2024. 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: Section B reports labor market conditions for the San Joaquin Valley; Section C reports region's real estate market based on eight metropolitan statistical areas of the Valley; Section D discusses prices and inflation; and Section E reports indicators from local banking and capital markets. Section F concludes.

San Joaquin Valley



Employment Indicators

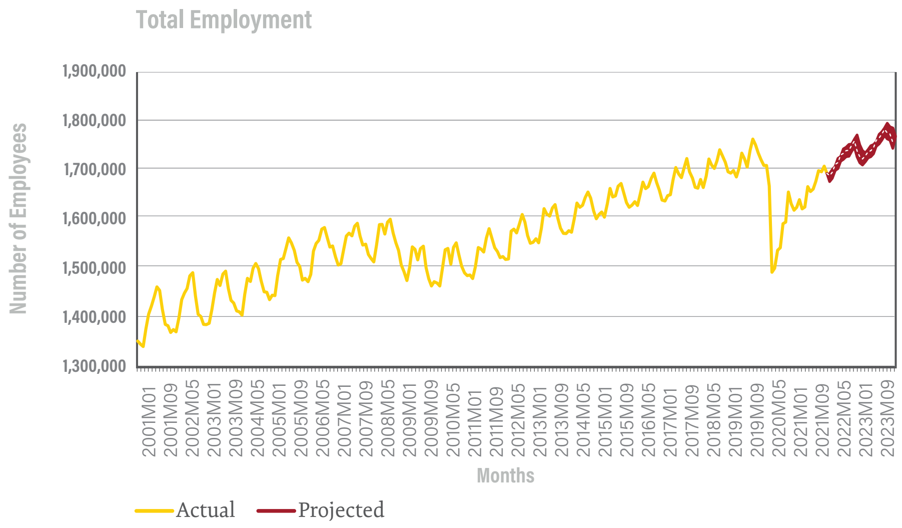
In 2021, total employment grew in all counties with the exception of Madera County, which posted a decline of 7.67 percent. Merced County total employment grew 3.99 percent, the fastest among the San Joaquin Valley's eight counties. Stanislaus County total employment grew the second fastest at 3.56 percent followed by San Joaquin County which grew 3.47 percent. Tulare County grew 3.21 percent in 2021. Fresno County grew 2.66 percent about the same rate as Kern County at 2.54 percent. Kings County reported 1.84 percent growth in 2021.

MERCED COUNTY TOTAL EMPLOYMENT GREW

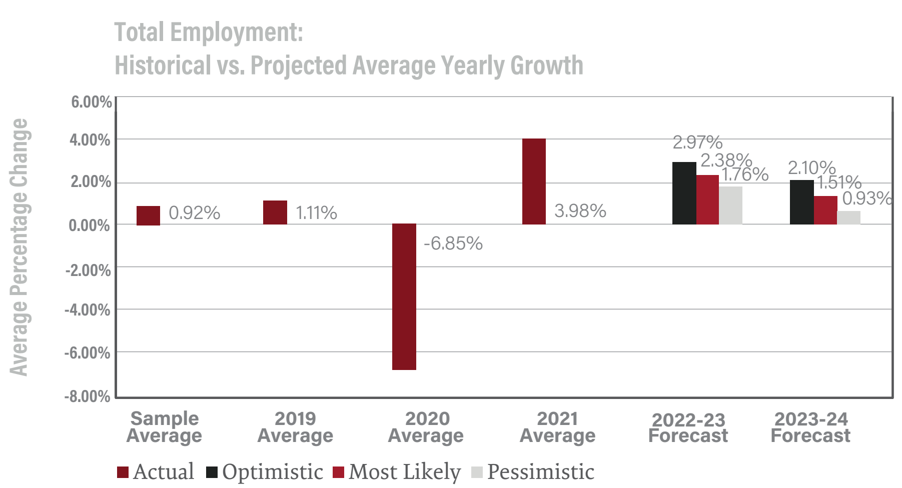
3.99%

THE FASTEST AMONG THE THE SAN JOAQUIN VALLEY'S EIGHT COUNTIES

All categories of employment with the exception of financial services employment and government employment grew in 2021. Even historically problematic information employment posted 3.36 percent growth in 2021. Government employment follows other categories with a lag and declined by 1.35 percent, but this was an improvement over 2020 in which decline was at 3.81 percent. Financial services employment declined 0.98 percent in 2021, but the decline was much less than 2020 at 3.83 percent. Farm-related Valley wholesale trade employment growth switched from negative to positive territory by posting 1.01 percent growth over the twelve-month period in 2021. Education and health services employment grew 2.57 percent, switching from negative to positive growth territory in 2021. Financial activities employment declined 0.98 percent in 2021 but the decline was less than the decline observed in 2020 at 3.83 percent. At 16.10 percent, leisure and hospitality services was the fastest growing category of employment in the Valley.



Valley total employment grew at an average annual rate of 3.98 percent in 2021. It will likely continue to stay below 1.8 million until the second half of 2024. Projections point to slower average growth of 2.38 percent in from the second half of 2022 to the first half of 2023 and 1.51 percent from the second half of 2023 to the first half of 2024, as several policy variables begin to reverse course.

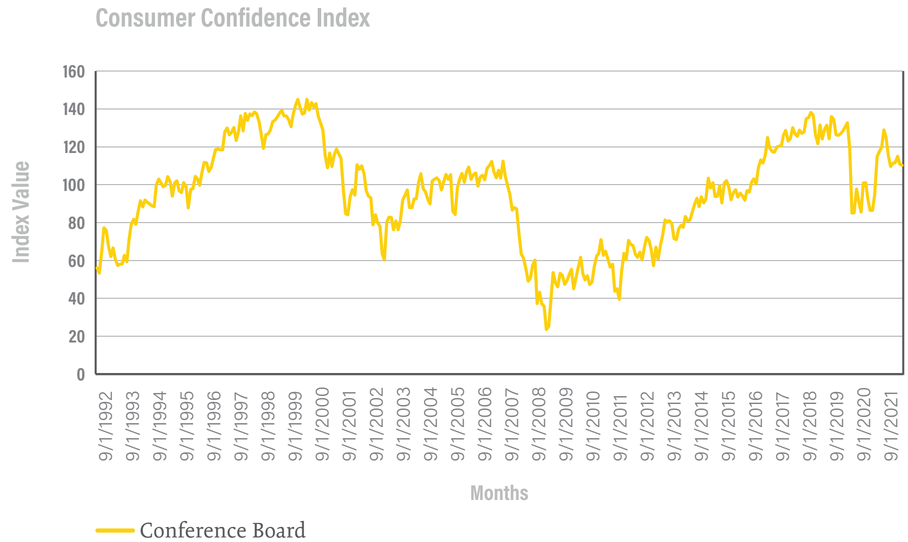


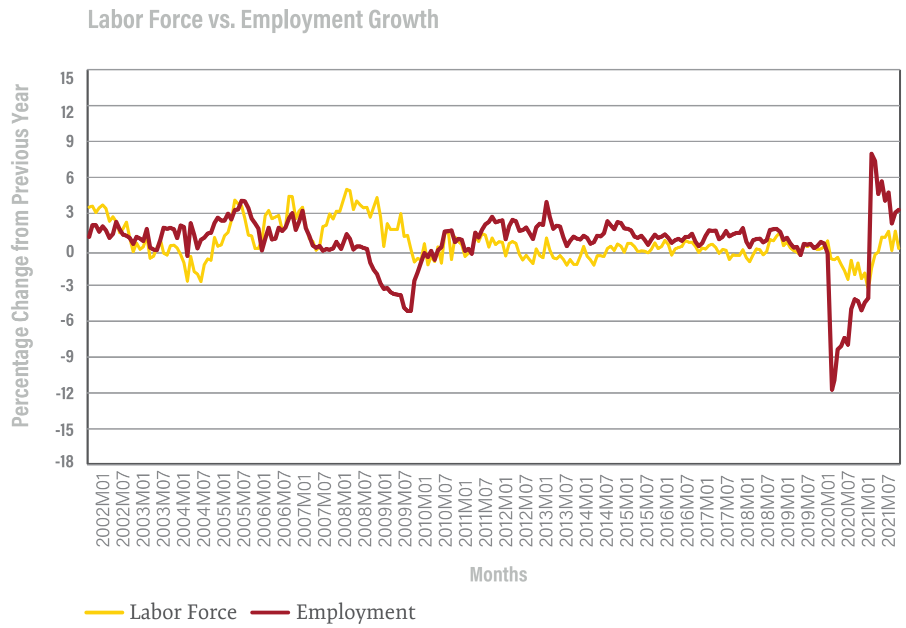
Concerns over workplace safety during the pandemic and the availability of unemployment compensation were the leading factors behind falling labor force numbers and participation. Consumer Confidence Index (CCI) is an important leading indicator predicting economic behavior. Activity continuously displayed an increasing pattern since the fourth quarter of 2020 and appeared to stabilize around a value of 120 points but recently declined to 110 due to the first of a series of interest rate hikes by the Federal Reserve and the ongoing Ukraine-Russia conflict. Confidence in consumer spending is not expected to rise in the coming months as additional rate hikes cool consumer spending. ▶

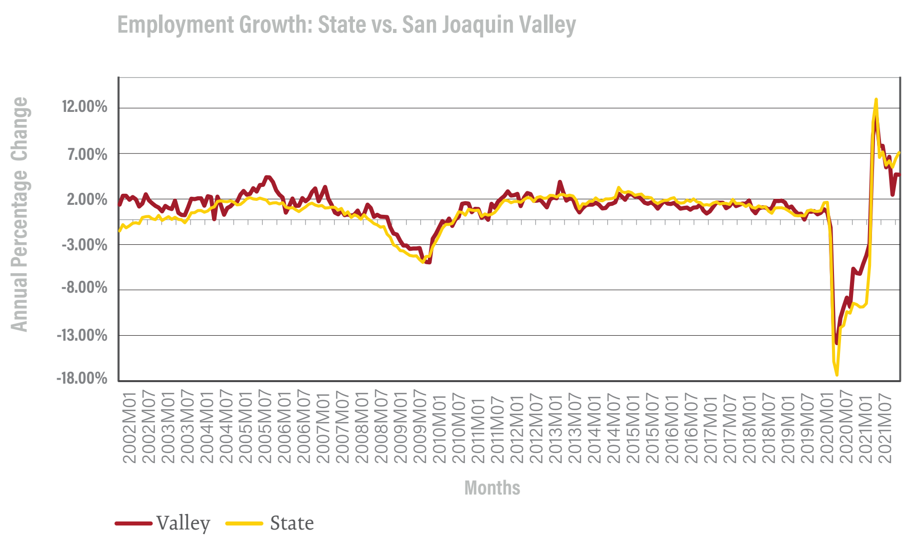
Labor force growth continues to lag significantly below employment growth, reflecting a strong labor market throughout the Valley. The tendency to switch directions in both series is now acting as a new leading indicator for our region and would serve as an additional cause of a recession concern. ▶

With the recovery well underway however, and our region being a growth area, employment growth in the San Joaquin Valley relative to California was expected to be faster. However, this pattern is not yet being observed, and the dynamics noted in the coming months will indicate whether we are nearing a recession.

ALL CATEGORIES OF EMPLOYMENT WITH THE EXCEPTION OF FINANCIAL SERVICES EMPLOYMENT AND GOVERNMENT EMPLOYMENT GREW IN 2021.



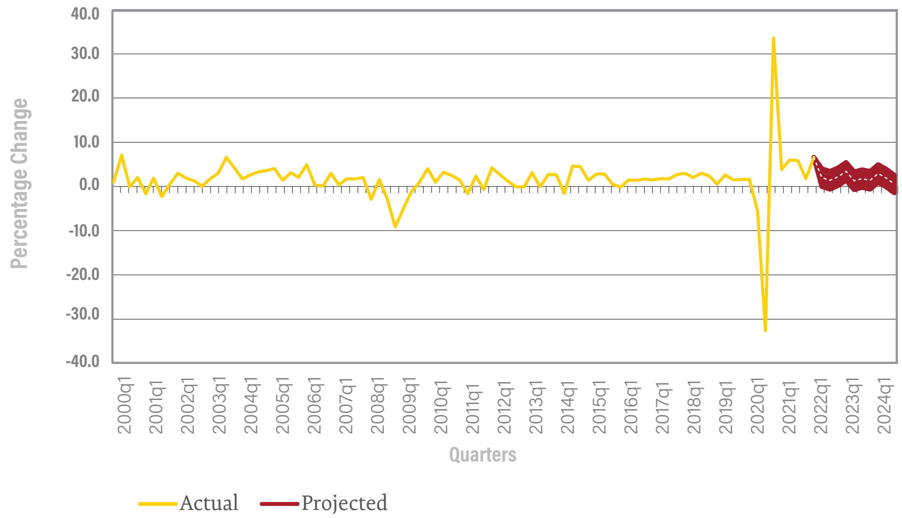




Employment Indicators

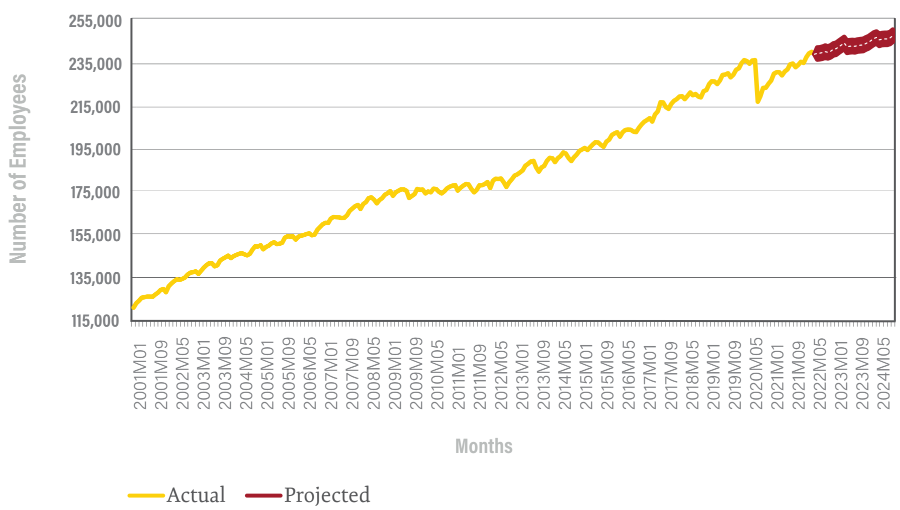
With the economy reeling from the pandemic, the latest growth numbers point to a pattern of more normal rate of real gross domestic product (GDP) growth. Noteworthy is the negative projected growth of the lower bound around the end of the first quarter of 2023 signaling a recession. There are already some immediate signs from leading indicators such as yield curve already inverting more than once.

U.S. Real GDP Annual Growth



Over the twelve-month period, education and health services employment, reported 2.57 percent growth switching from negative to positive territory in 2021. The long-term growth trend appears to catch the growth trend that existed before the pandemic. Delays in school openings and a priority placed on hiring healthcare workers due to COVID-19 caused a lag relative to other employment categories in the Valley.

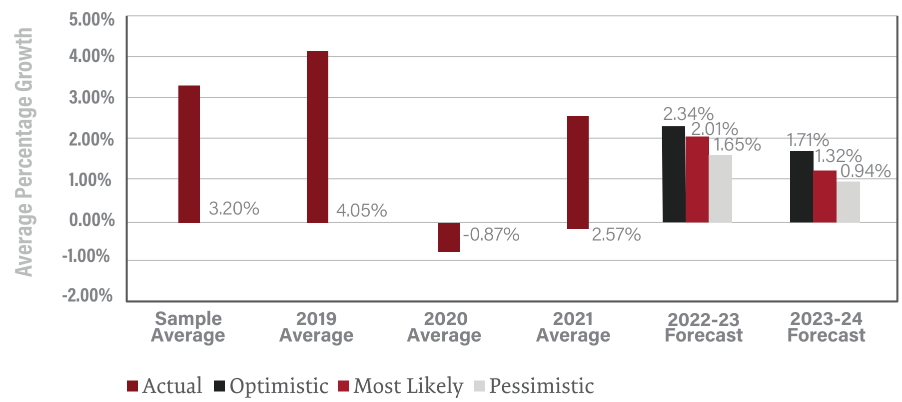
Education and Health Services Employment



OVER THE TWELVE-MONTH PERIOD, EDUCATION AND HEALTH SERVICES EMPLOYMENT, REPORTED 2.57 PERCENT GROWTH SWITCHING FROM NEGATIVE TO POSITIVE TERRITORY IN 2021.

At the current pace, employment levels in education and health services employment are projected to remain below 255,000 by the first half of 2024. As the regional economy continues to recover at rates less than the long-term benchmark rates of growth, employment in this category is expected grow at an average yearly rate of 2.01 percent from the second half of 2022 to the first half of 2023 and at 1.32 percent from the second half of 2023 to the first half of 2024.

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



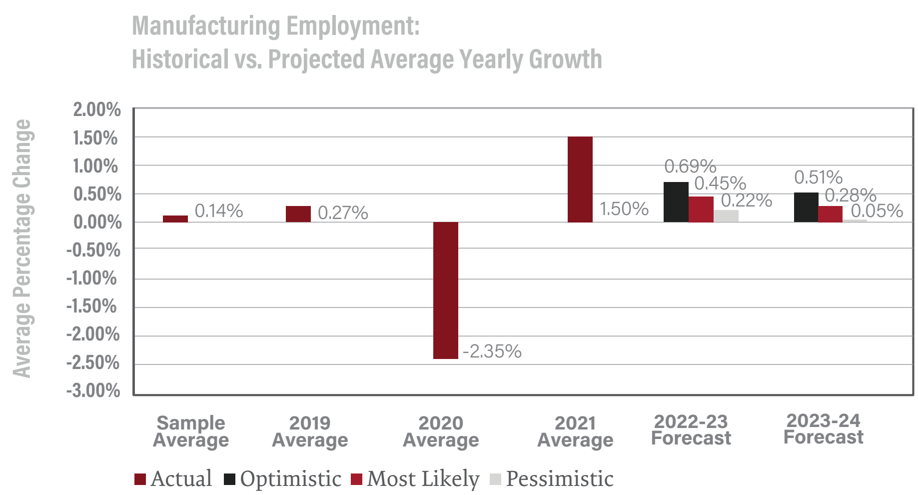
The manufacturing employment sector in the Valley grew 1.50 percent in 2021 — a significant improvement over the 2.35 percent decline in 2020. Even with a slower pace of growth, a seasonal spike in manufacturing employment will likely exceed 115,000 by the first half of 2024. Manufacturing employment long-term benchmark growth continues to remain in positive territory at an average yearly rate of 0.14 percent. ▶

Federal Reserve's six rate hikes in 2023 are expected to slow the pace of growth in manufacturing employment in the coming months. Given the housing market now being in a bubble, a correction in the coming months may further dampen growth in this category of employment. Projections point to slower average annual increase of 0.45 percent from the second half of 2022 to the first half of 2023 and 0.28 percent from the second half of 2023 to the first half of 2024. ▶

THE MANUFACTURING EMPLOYMENT SECTOR IN THE VALLEY GREW

1.50% IN 2021

After reaching an all-time high, the Purchasing Managers Index of Institute for Supply Management began to decline steadily because of anticipated rate hikes and the Ukraine-Russia conflict. Nevertheless, the index appears to stay above 50 points, indicating an expansion. With more scheduled increases in the Federal Funds rate, steep increases in this index as we saw in previous months are not expected. ▶



Employment Indicators

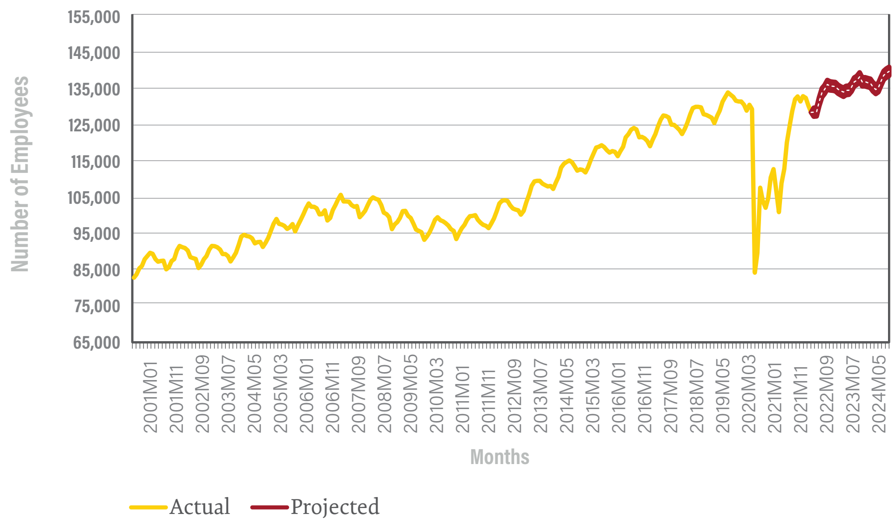
Leisure and hospitality services was one of the worst affected employment categories by the pandemic. However, as the economy reopened, leisure and hospitality services employment grew 16.10 percent in 2021 erasing losses observed in 2020. Employment levels are expected to exceed 135,000 by the first half of 2024. Had the pandemic not occurred, employment levels in this category in the Valley would have already exceeded 140,000. ▶

LEISURE AND HOSPITALITY SERVICES EMPLOYMENT GREW 16.10 PERCENT IN 2021 ERASING LOSSES OBSERVED IN 2020.

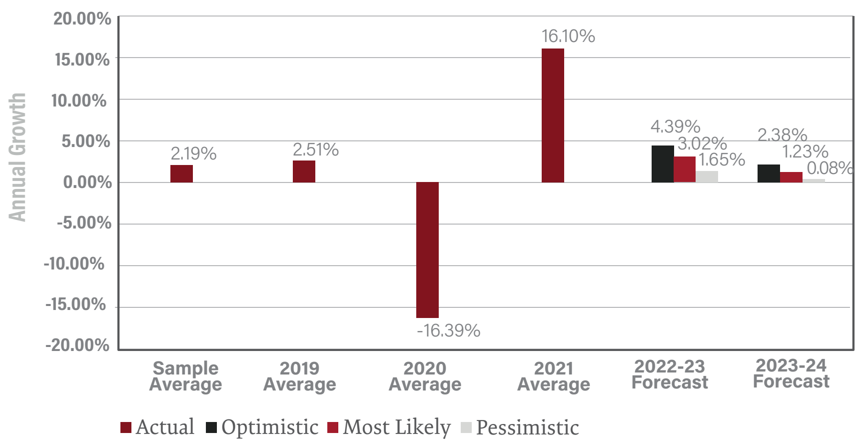
The long-term benchmark growth for leisure and hospitality services employment increased from 1.42 percent to 2.19 percent resulting from phenomenal growth in 2021. The growth in 2021 was a significant improvement considering that in this category alone, approximately 30,000 workers were laid off in 2020. Projections point to an average annual growth of 2.12 percent in the coming months.

Trade, transportation and utilities employment was the only category to post growth, even during the worst months of the pandemic. In 2021, the pace of growth increased to 6.63 percent becoming the Valley's second fastest growing employment category. At this relatively faster pace, this employment category is projected to reach 330,000 by the first half of 2024. ▶

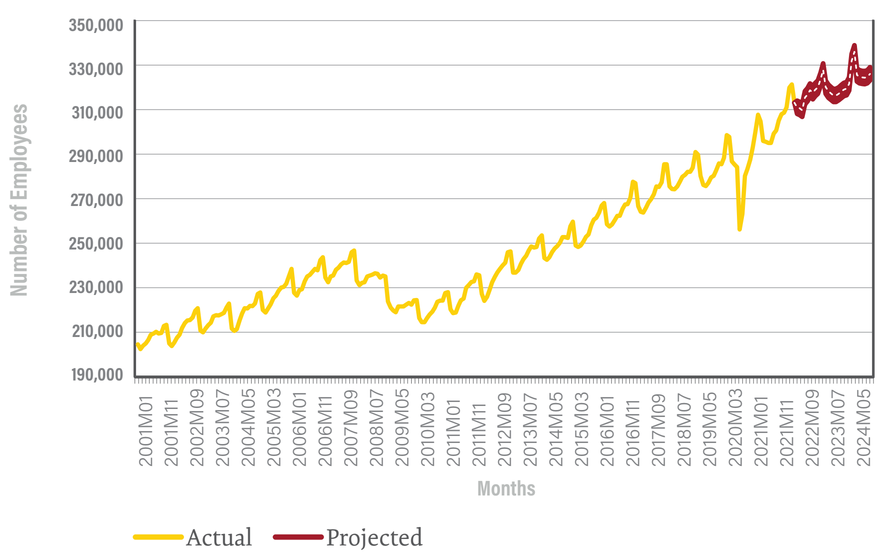
Leisure and Hospitality Services Employment



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



Trade, Transportation and Utilities Employment



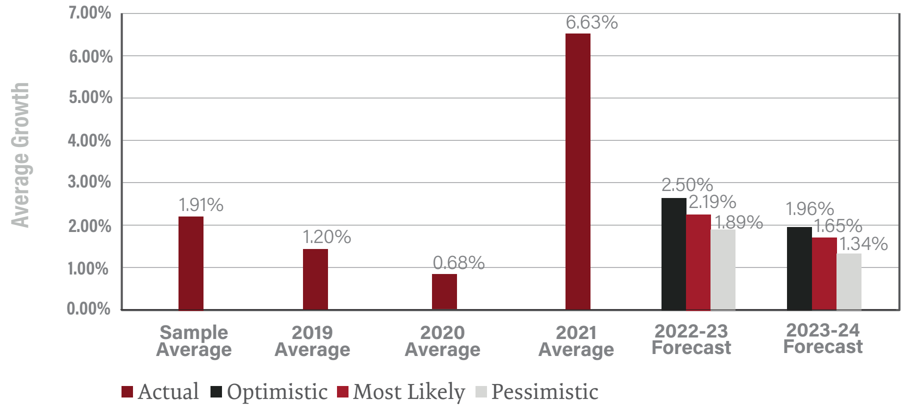
Trade, transportation and utilities employment is an essential sector, which explains its fast rebound from the pandemic. It was the only category that could not switch to a remote work environment since goods had to be physically transported from one location to other even with consumers' increase of online shopping. A shortage of truck drivers and other issues with logistics is likely to continue in the coming months. Trade, transportation and utilities employment is projected to grow in line with a more normal long-term benchmark rate. Projections point to an average yearly rate 1.92 percent in the two-year forecast interval. ▶

TRADE, TRANSPORTATION AND UTILITIES EMPLOYMENT IS AN ESSENTIAL SECTOR, WHICH EXPLAINS ITS FAST REBOUND FROM THE PANDEMIC.

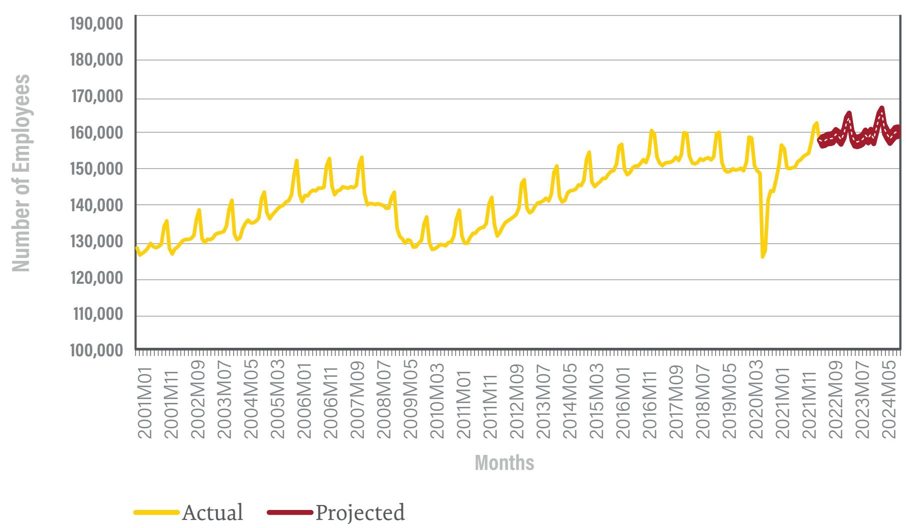
Retail trade employment's 6.30 percent comeback in 2021 was one of the fastest recorded among all other categories of employment in the Valley. This fast-paced growth erased the losses incurred in 2019 and 2020. Employment levels in this category are expected to exceed 160,000 by the first half of 2024. The seasonal pattern that was lost during the pandemic also resumed during the latter part of the recovery. ▶

The long-term benchmark growth increased from 0.81 percent to 0.93 percent resulting from the strong growth rate in 2021. Online shopping will likely continue to compete with retail trade employment in the Valley. Scheduled rate hikes will likely impact this category heavily in 2022. Projections point to 0.87 percent growth in the coming months consistent with more normal long-term benchmark growth rate of 0.93 percent. ▶

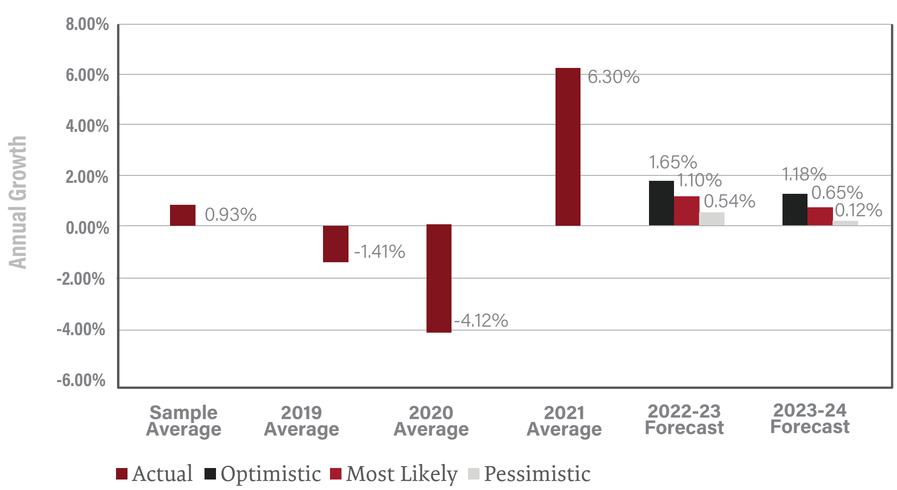
Trade, Transportation and Utilities Employment: Historical vs. Projected Average Yearly Growth



Retail Trade Employment



Retail Trade Employment: Historical vs. Projected Average Yearly Growth



Employment Indicators

Wholesale trade, a farm-related employment category, lost seasonal patterns due to drought and the pandemic. It appears to be track to slowly gain back seasonal patterns as the pandemic's impact continues. Funding obtained to build a new reservoir in Colusa County will undoubtedly help the Valley become more resilient to longer lasting drought years. Given the ongoing drought conditions, employment levels in the category are expected to stay below 48,000 in a the first half of 2024. ▶

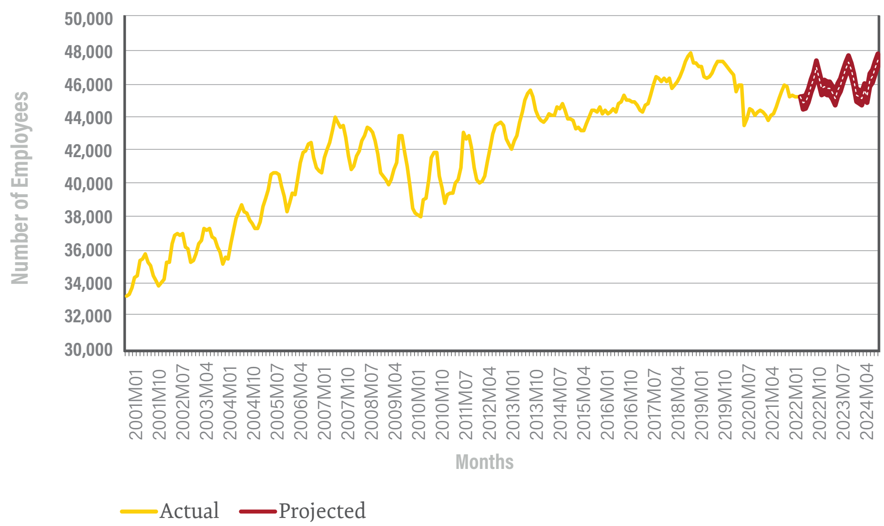
DESPITE THE DROUGHT, WHOLESALE TRADE EMPLOYMENT GREW

1.01%

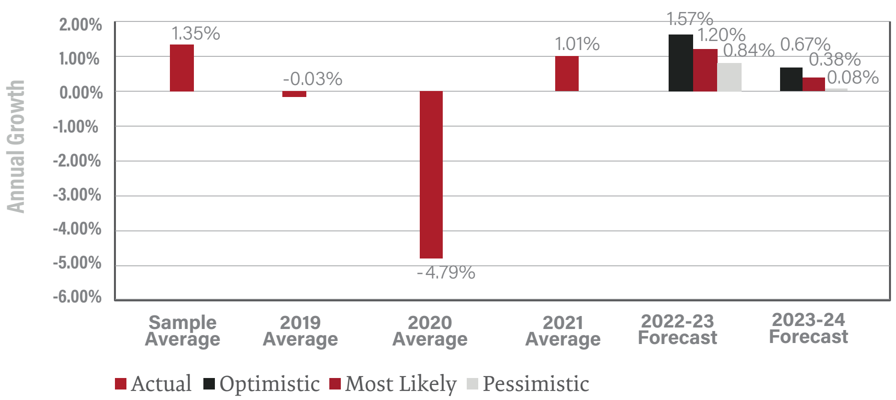
Despite the drought, wholesale trade employment in 2021 grew 1.01 percent, switching from negative to positive growth. However, all losses incurred in 2020 were not eliminated by the growth posted in 2021, creating a deficit about 3.79 percent growth still to materialize to make up for approximately 4,000 workers displaced because of the drought and pandemic. Projections point to 0.79 percent growth in the coming two-year interval. ▶

Valley information employment had been suffering since the end of the Great Recession but managed to grow 3.36 percent in 2021 even as the Valley reeled from the pandemic. However, the growth in 2021 was nowhere near the steep 18.96 percent decline in 2020 and 4.24 percent in 2019. Employment levels in this category will likely slightly exceed 8,500 by the first half of 2024. ▶

Wholesale Trade Employment



Wholesale Trade Employment:
Historical vs. Projected Average Yearly Growth

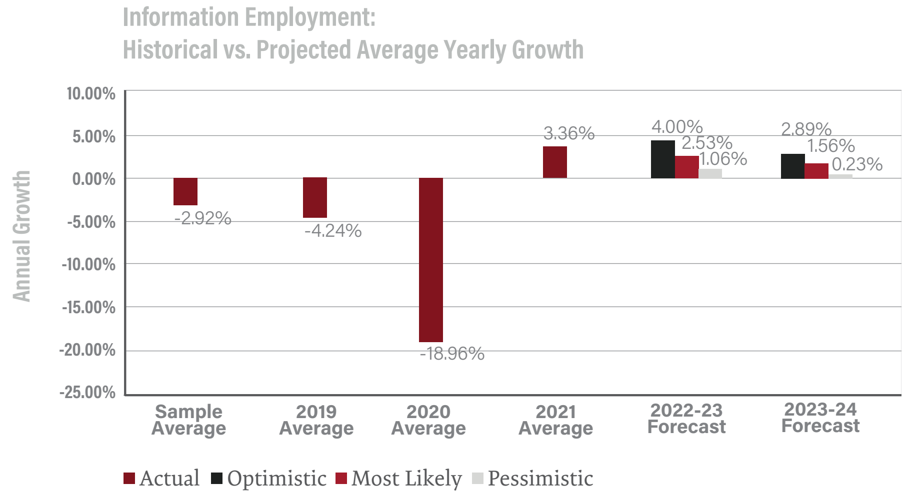


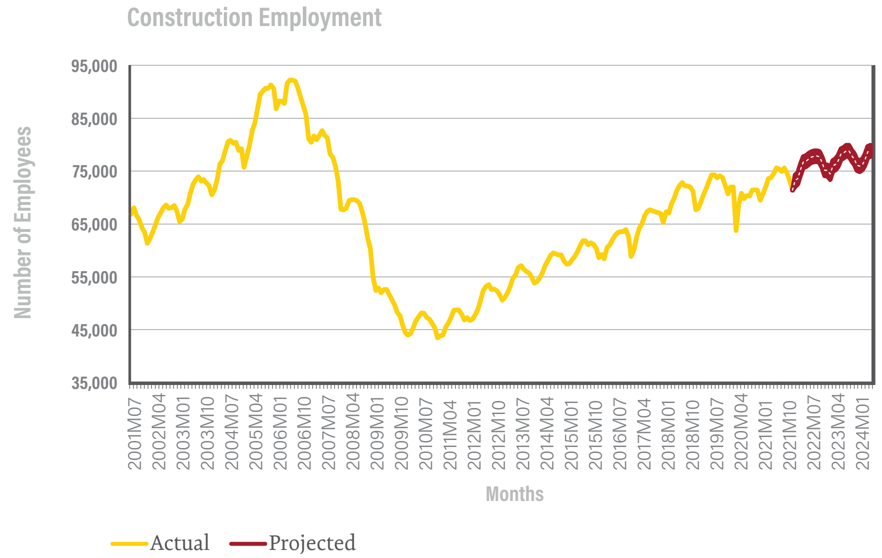
Information Employment

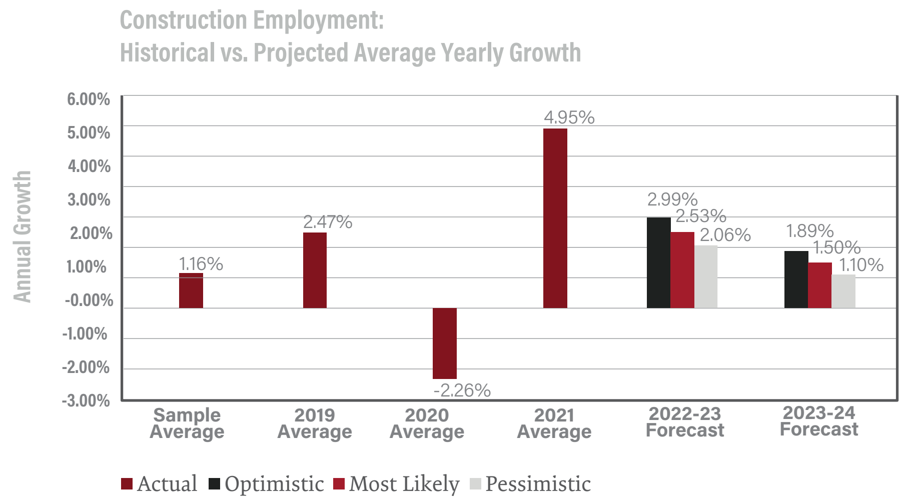
The long-term benchmark rate improved somewhat due to a slower decline — 2.92 percent in 2021 compared to 3.35 percent in 2020. The long-awaited switch in growth from negative to positive territory took place during the latter part of 2021. Employment in this category has been problematic over the years because of the increase of digital social media usage. Projections point to a continuation of this trend at an average yearly rate of 2.53 percent from the second half of 2022 to the first half of 2023 and 1.56 percent from the second half of 2023 to the first half of 2024. ▶

Seasonal variation in Valley construction employment was irregular during the pandemic but there appears to be clear return to the patterns that existed before the pandemic. Employment in this category grew 4.95 percent in 2021 — more than twice the decline observed in 2020. Increased construction activity can been seen in the Valley. Despite moving in the right direction, the inventory shortage is likely to last through the coming months. Many more homes must be built to address the Valley's housing problems.

Rate hikes will likely lower demand for housing in the Valley relative to the previous years when interest rates were at all-time lows. The high cost of materials used in construction due to inflation is another factor that will likely result in lower demand in the housing market. Higher interest rates in 2022 will likely lead to increasing number of foreclosures in the coming months. Projections point to an average annual growth of 2.01 percent in the two-year forecast interval. ▶







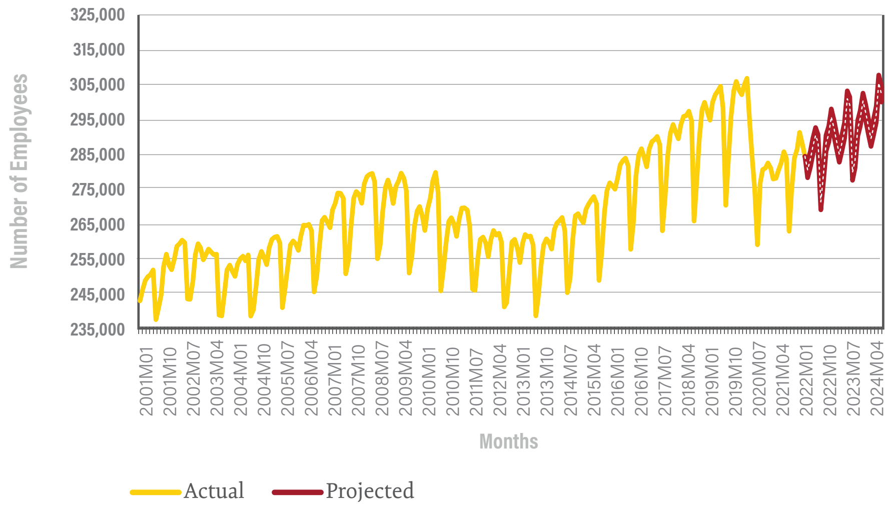
Government employment was one of two categories that declined in 2021. Employment growth in that category declined 1.35 percent. However, the decline in 2020 occurred at a faster pace at 3.81 percent. Recovery in this category arrives with a lag as it did in 2008 during the Great Recession. Even in a contractionary phase, the decline in government employment comes at a later stage than other employment categories.

GROWTH WILL LIKELY SWITCH TO POSITIVE TERRITORY IN 2022.

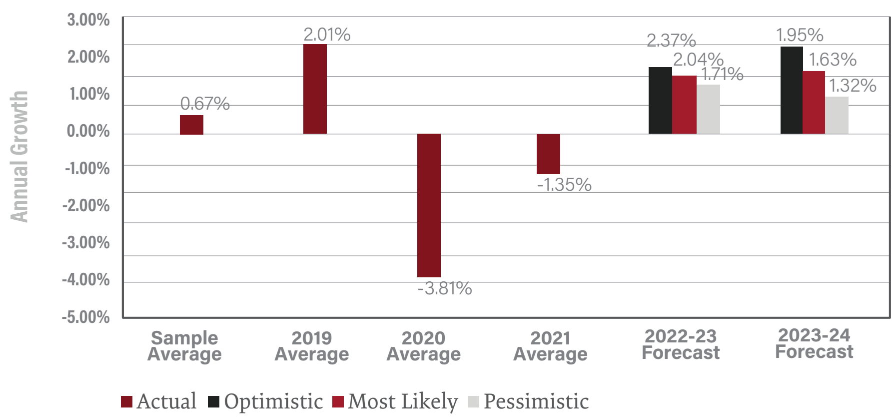
Not counting seasonal ups and downs, employment levels in this category will likely exceed 295,000 by the first half of 2024. Growth will likely switch to positive territory in 2022. The discrepancy of about 12,500 employees will remain during the upcoming months. Projections point to an average yearly growth of 2.04 percent from the second half of 2022 to the first half of 2023 and 1.63 percent from the second half of 2023 to the first half of 2024.

Valley financial activities employment was the other category that declined in 2021. Employment levels in this category declined 0.98 percent in 2021, slower than 3.83 percent decline in 2020. Employment in this category will likely remain below 43,000 by the second quarter of 2024.

Government Employment



Government Employment: Historical vs. Projected Average Yearly Growth

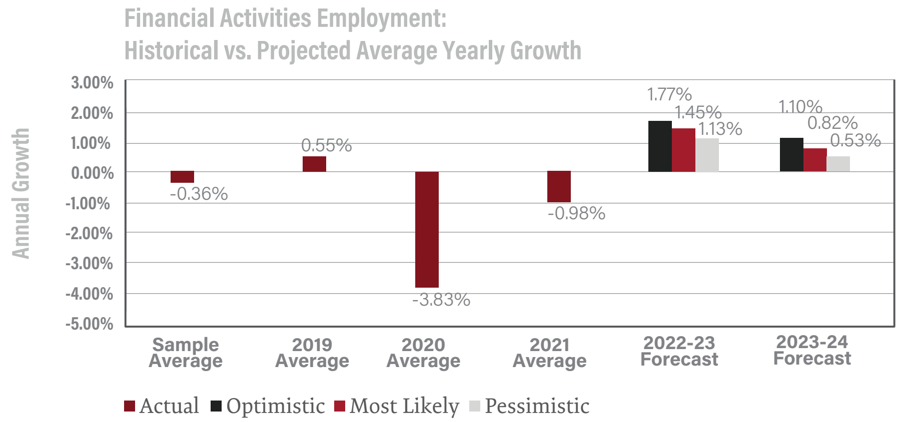


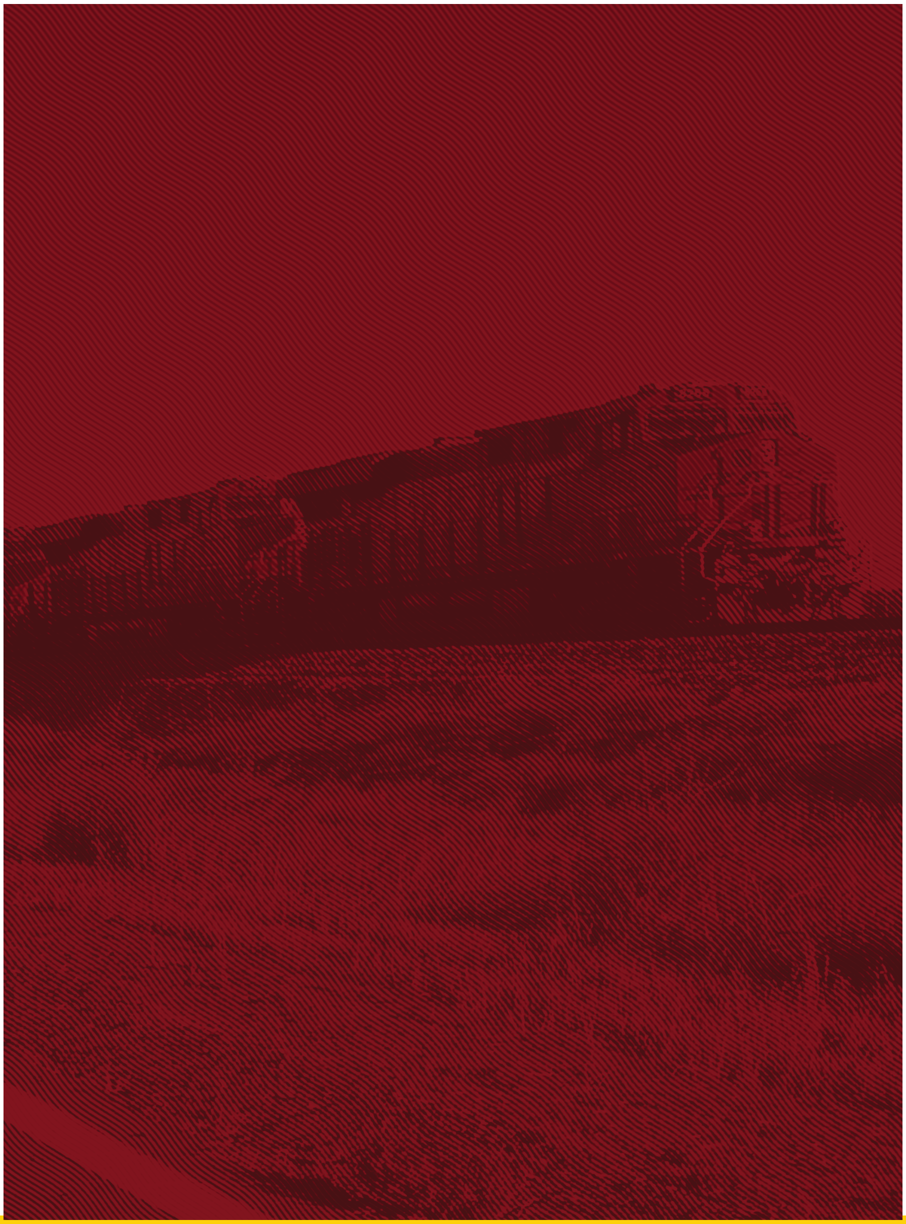
Financial Activities Employment

As more rate hikes occur in 2022, Valley banks' profitability will likely increase. The prevailing growth trend during the recovery appears to be flatter than the trend before the pandemic, suggesting that the discrepancy of about 2,000 employed is not likely to disappear anytime soon. Financial activities employment is projected to increase at an average yearly rate of 1.13 percent in the coming two-year interval. ▶

LOWERING DEBT EXPOSURE AND INCREASING CASH HOLDINGS, LOCKING INTEREST RATES EARLY ON LOANS, MOVING FROM FLEXIBLE TO FIXED RATE BORROWING AND REFINANCING WHILE INTEREST RATES ARE STILL LOW ARE A FEW WAYS BUSINESSES AND CONSUMERS CAN ACT EARLY TO PREPARE AGAINST A POTENTIAL CORRECTION.

Recovery will likely slow due to six rat hikes by the Federal Reserve in 2022, and there are now some indications of a recession. One of those signs is the more reliable leading indicator: the yield curve. The yield curve has already inverted a few times since late March, causing increased worry that six rate hikes may bring the economy to hard landing. Lowering debt exposure and increasing cash holdings, locking interest rates early on loans, moving from flexible to fixed rate borrowing and refinancing while interest rates are still low are a few ways businesses and consumers can act early to prepare against a potential correction.





Housing Sector

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

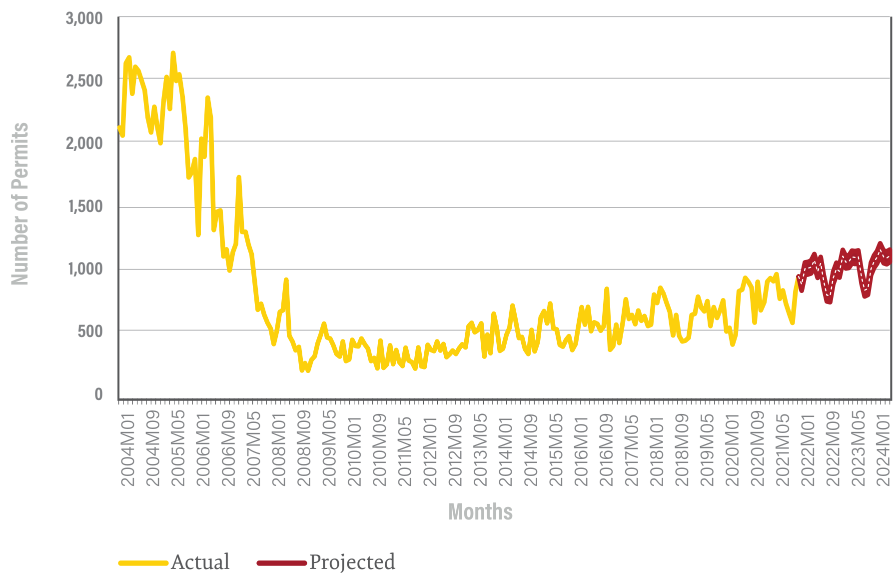
Building permits spiked 19.67 percent in 2021. The increase was greater than the previous year and about three times the long-term benchmark rate of 7.88 percent. In 2020, building permits increased 13.26 percent. At this pace, Valley building permits will likely exceed 1,250 per month by the first half of 2024.

With 2,781 permits, Fresno issued the most building permits in 2021, followed by Stockton with 2,599 and 1,942 in Bakersfield. Visalia issued 1,326 permits while Madera and Merced issued 1,026 and 128 housing permits respectively. Modesto issued 50 building permits. There were no housing permits issued in Hanford-Corcoran. Projections point to average annual growth of 14.84 percent from the second half 2022 to the first half of 2023 and 5.49 percent from the second half of 2023 to the first half of 2024.

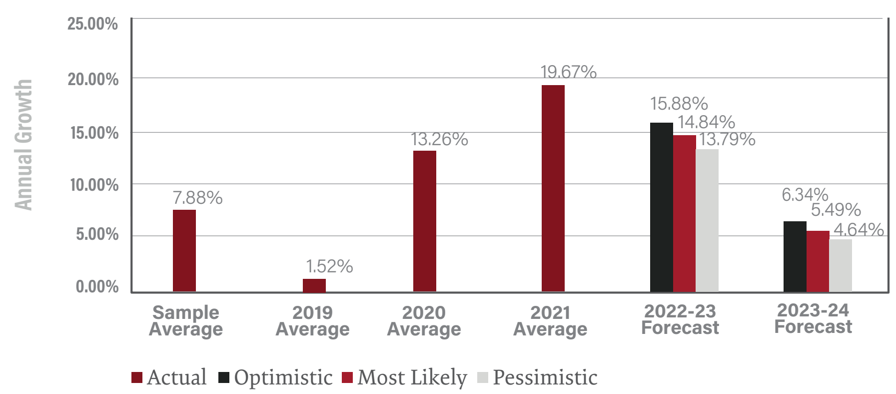
There were basically no foreclosures in California in 2021. Foreclosures started remained at the lowest levels they have ever been since 1999. Bank accruals, however, began to rise more notably. With the end of mortgage assistance in September 2021, a steep increase in foreclosures is expected in the coming two-year interval.

THERE WERE BASICALLY **NO FORECLOSURES IN CALIFORNIA IN 2021.**

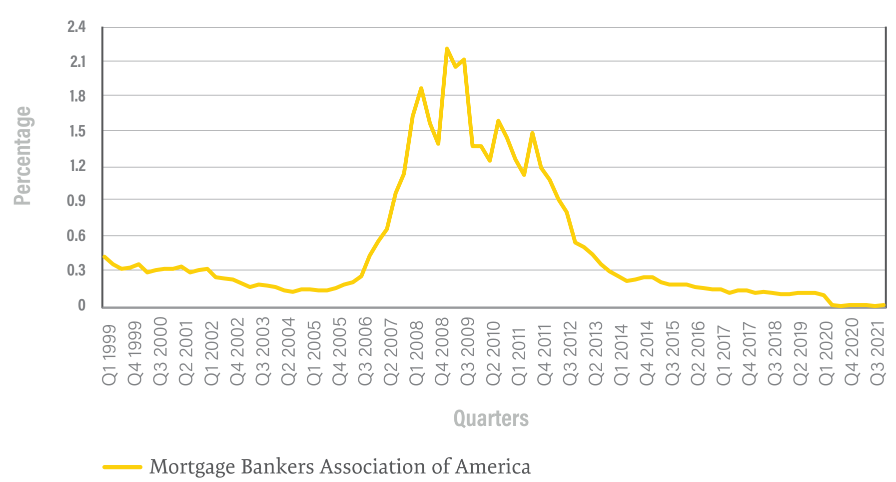
Single-Family Building Permits



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



Foreclosures Started in California

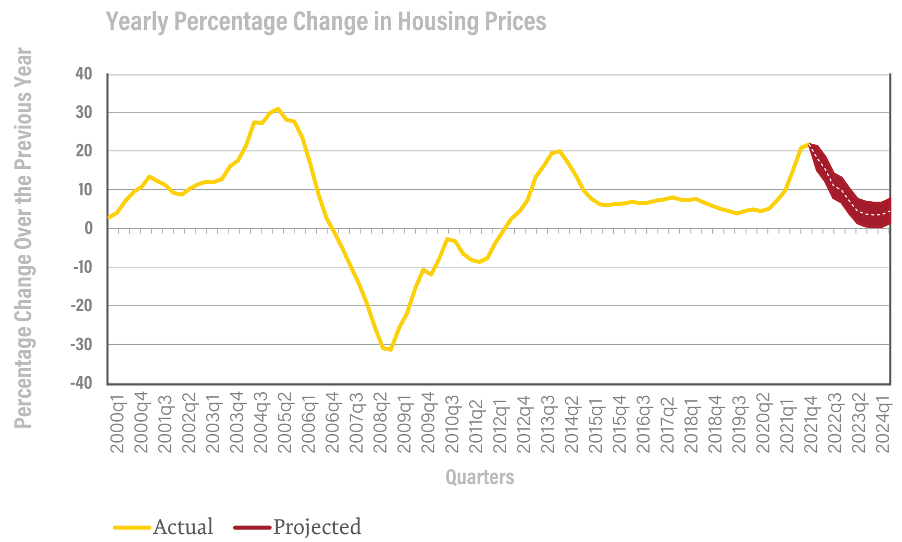


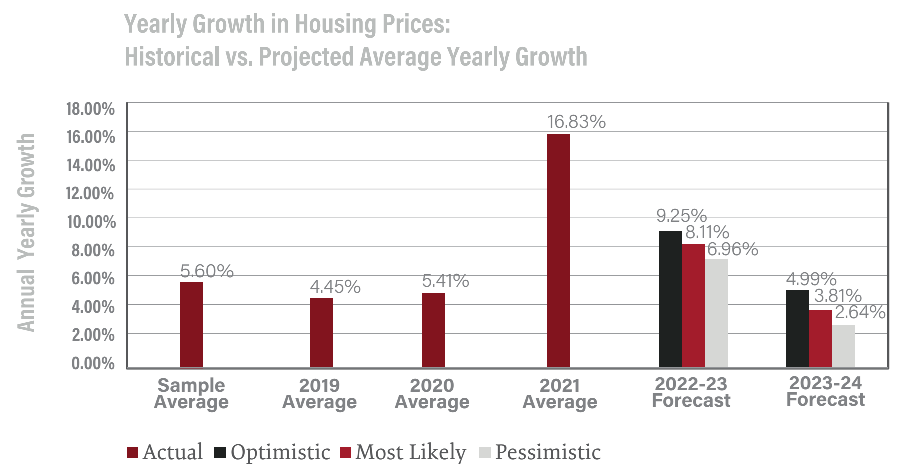
With the Federal Reserve's first rate hike in March 2022, long-term rates began to exhibit an upward trend. After reaching an all-time low of 2.68 percent in December 2020, 30-year interest rates began to increase gradually. The reading of the Freddie Mac 30-year rate at the end of the third quarter was above 3.5 percent. Long-term rates are likely to rise further in 2022 as the Federal Reserve implements six rate hikes. The Valley is more sensitive to rate hikes than the other parts of the nation. Even though national economic activity may not enter a recession, the Valley could very well tip into a regional recession. ▶

Valley home values registered a sharp 16.83 percent average annual increase in 2021. As rates continue to rise, home values will are expected to increase at much slower rates. Whether the dampening turns into a crisis will depend on how fast and how high interest rise. The sharp increase in home values now point to a bubble in the housing market. The increase in home values in 2021 was three times the long-term benchmark rate of 5.60. ▶

In 2021, home value appreciation was the fastest since the Great Recession. About 4.52 percent of the increase was due to inflation, corresponding to 12.31 percent real appreciation. Home values appreciated an additional 4 percent since November 2021 at a rate almost equal to the yearly benchmark appreciation in just over four months. Even in real terms, the appreciation was significant enough to remain a concern of a potential housing market correction, particularly if increasing rates do not bring the rate appreciation to more sustainable levels. ▶

The fastest increase in home values took place in Stockton, which reported 19.40 percent average annual increase in 2021. The second fastest increase in home values was in Merced at 17.78 followed by Modesto 17.47 percent. Visalia and Porterville came next at 16.19 percent, followed by 16.13 percent in Bakersville. Madera home prices increased 16.08 percent. Fresno and Hanford-Corcoran reported the slowest increase in home prices in 2021 at 16.03 percent and 15.49 percent respectively. Projections point to 8.11 percent increase from the second half of 2022 to the first half of 2023 and 3.81 percent increase from the second half of 2023 to the first half of 2024.





Inflation and Prices

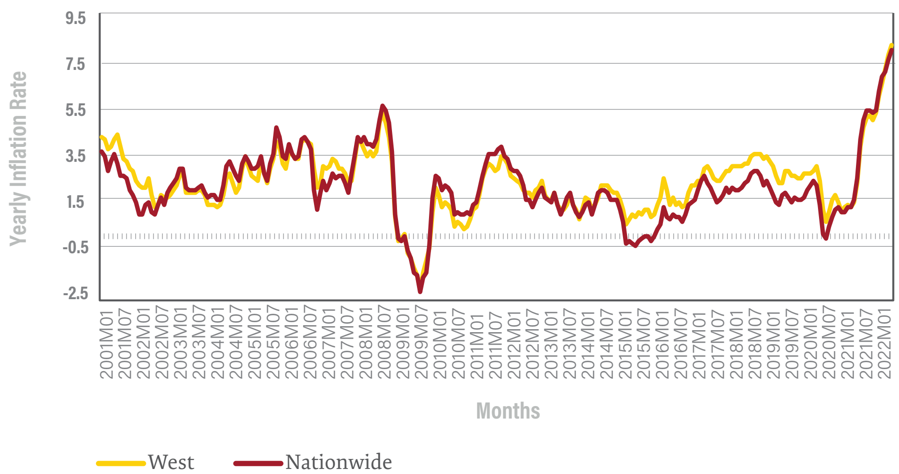
High inflation rates, mainly driven by the price of oil, is likely to last through the summer due to sanctions on Russian exports of oil resulting from Ukraine-Russia conflict. And increase in oil supply by a number of countries including our nation's strategic reserves will likely decrease the price of oil down from $130 a barrel but not to the more normal $65 dollars a barrel. Every time the price of oil has doubled in one year and persisted, a recession has occurred. Although the price of oil doubled during the first quarter of 2022, it did not persist and is about $112 dollars a barrel as of May. ▶

Historically, the inflation rate runs higher in our region than at the national level. The only time this pattern was reversed was during the Great Recession and its immediate aftermath. We are seeing a repeat of this phenomena whereby the rate of increase in overall price levels is slightly higher in our region than it is nationwide. However, there is a tendency for it to reverse in the past two months. This change in pattern during recessions acts as another reliable coincidental indicator for our region. ▶

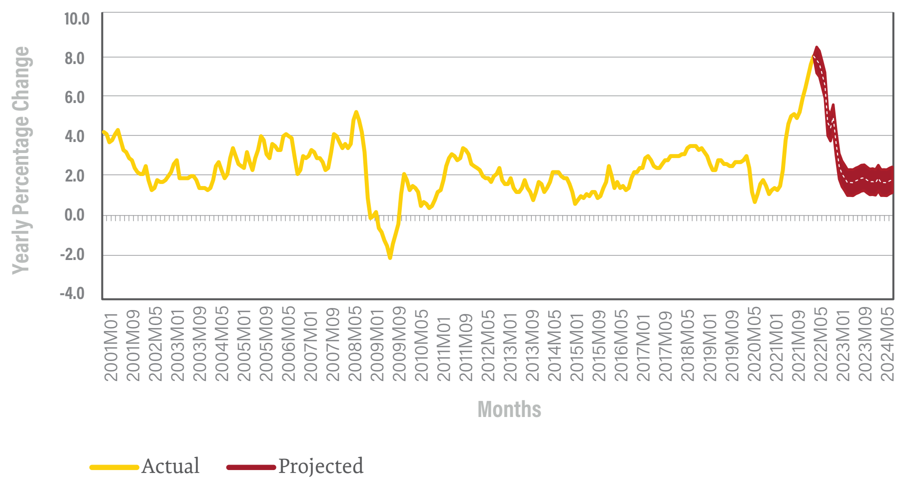
In 2021, the average yearly inflation was 4.52 percent — about twice the long-term benchmark rate of 2.45 percent. Besides cost-push factors such as the price of oil and high wages leading to a rise in labor costs resulting from a strong labor market, factors such as costs associated with inventory accumulation will play a role in high inflation that will persist into the summer months. ▶

Shortages observed in commodity markets being a significant factor driving prices up and an "now hiring" signs by employers throughout the Valley is indicative of prolonged recovery from the pandemic. Inflation rate projections for the Western region point to an average yearly increase of 2.83 percent in the first 12-month forecast interval and 1.87 percent in the second 12-month interval as the impact of rate hikes on the economy is more readily felt.

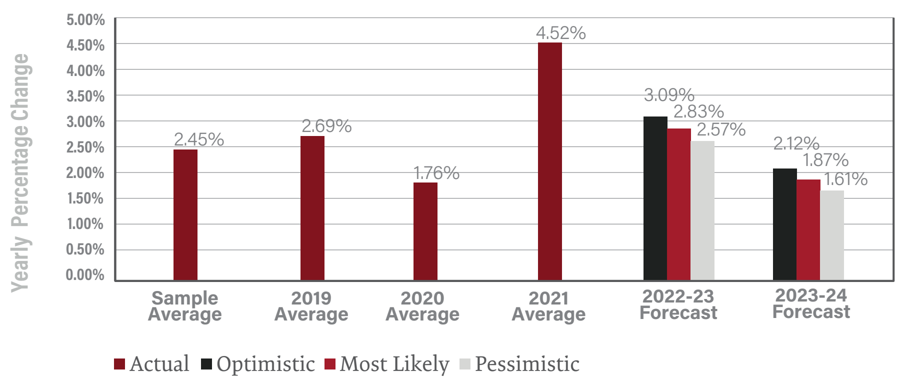
Inflation Rate: Nationwide vs. West



U.S. West Inflation Rate



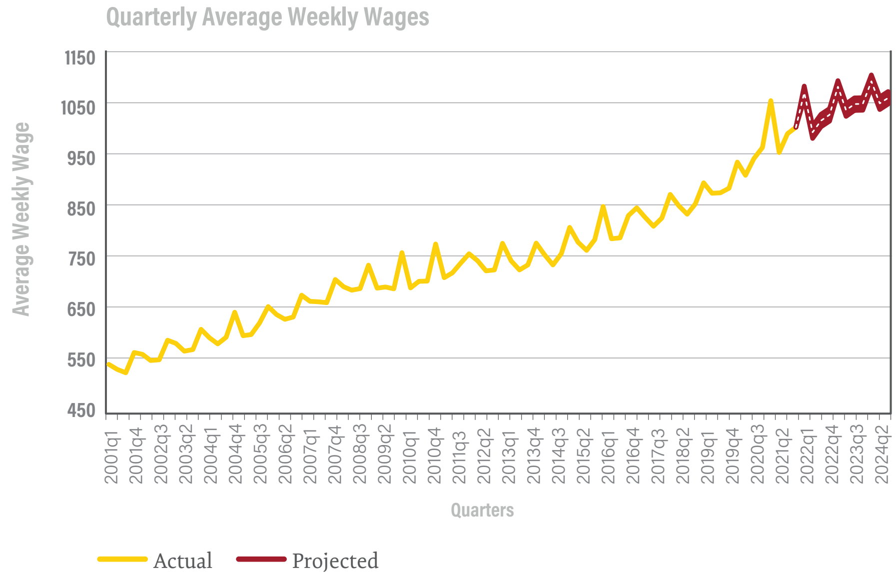
U.S. West Inflation Rate:
Historical vs. Projected Average Yearly Growth

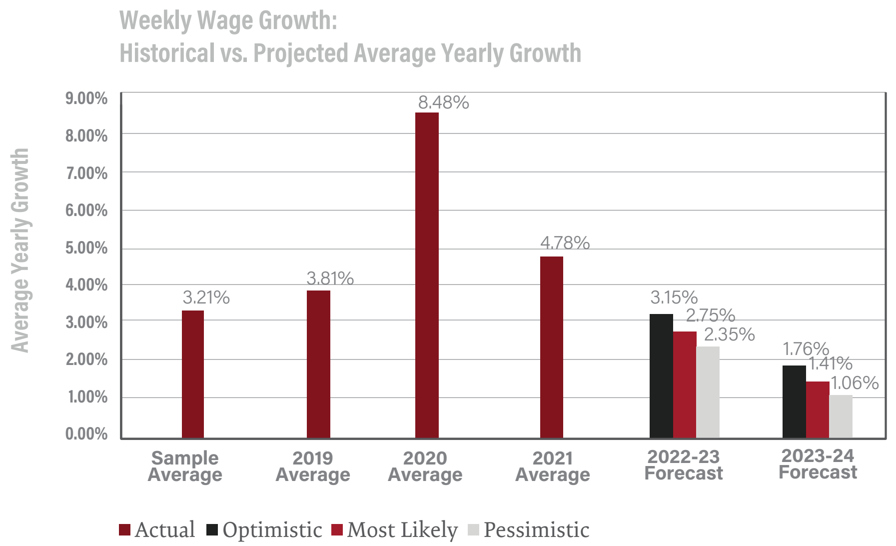


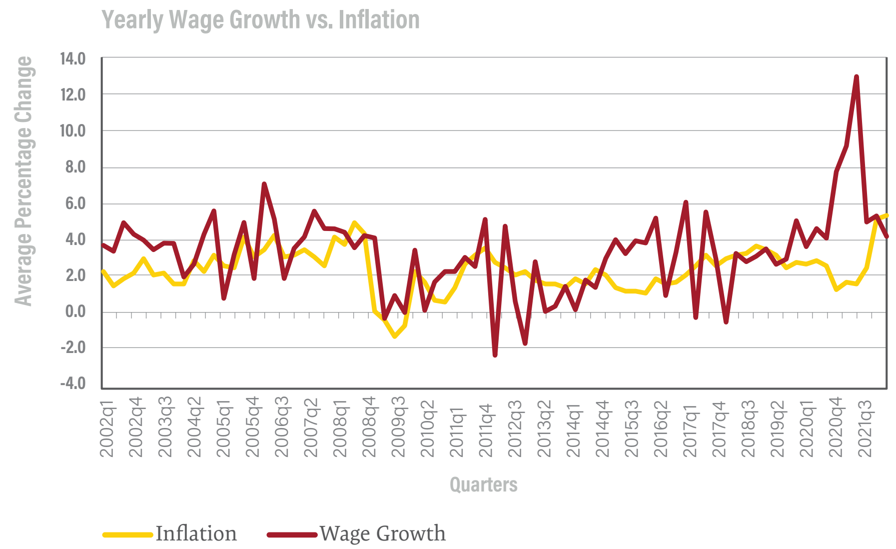
The most interesting development that took place during the early months of the recovery was the yearly change in average weekly wages. Due to labor market shortages, average weekly wages in the Valley rose 8.48 percent in 2020 and 4.78 percent in 2021. This sharp rise in wages was due to reluctance of workers to return to work. As the recovery continues, wages are likely grow at slower speeds as more workers begin to fill vacancies, particularly in the unskilled employment categories such as leisure and hospitality services and retail trade employment.

The reservation wage of a typical worker in the Valley — the amount wages must be at to go back to work — increased by nearly three times the long-term benchmark rate of 3.21 percent during 2020. Average weekly wages in the Valley will likely exceed $1,050 by the first half of 2024. Projections point to an average yearly increase of 2.75 percent from the second half of 2022 to the first half of 2023 and 1.41 percent from the second half of 2023 to the first half of 2024.

In 2021, the average rate of inflation stood at 4.52 percent. During the same time, average weekly wages rose 4.78 percent, keeping purchasing power constant in 2021. In 2020, the rate of inflation was 1.76 percent while the increase in average weekly wages was 8.48 percent, corresponding to a significant gain in purchasing power of 6.72 percent — an all-time high gain in purchasing power since 2001. In the coming months, average weekly wages are expected to increase at a slower pace than the rate of inflation, corresponding with a loss in purchasing power.





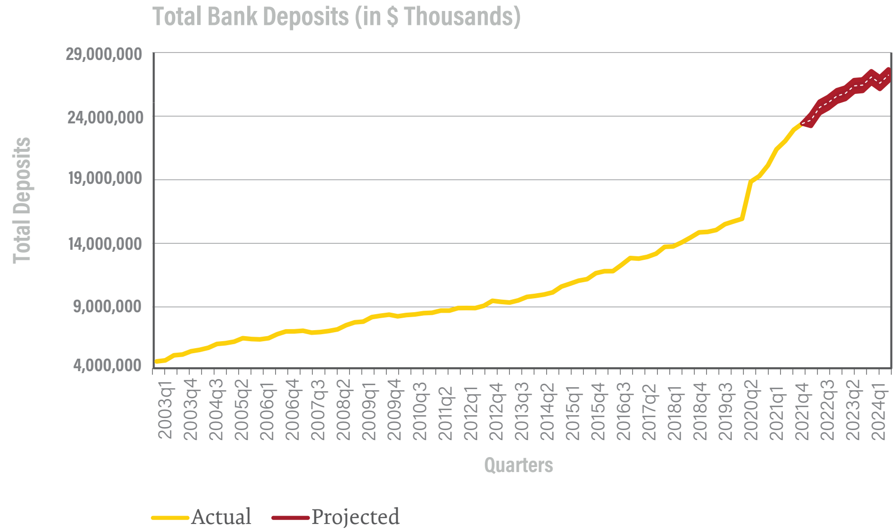


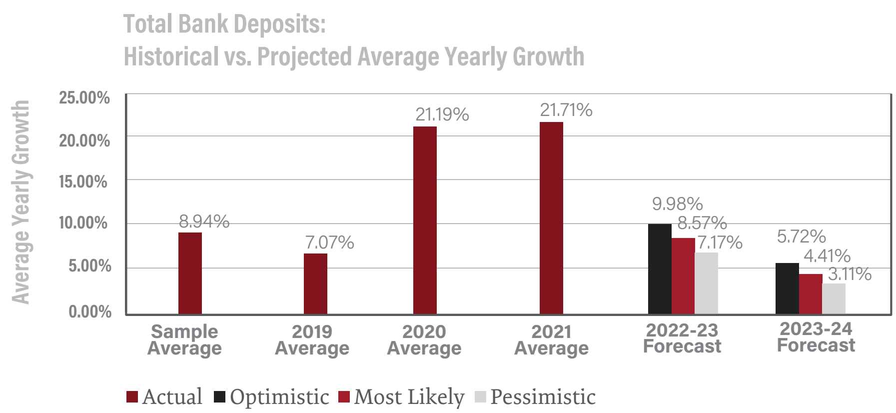
Banking and Capital Markets

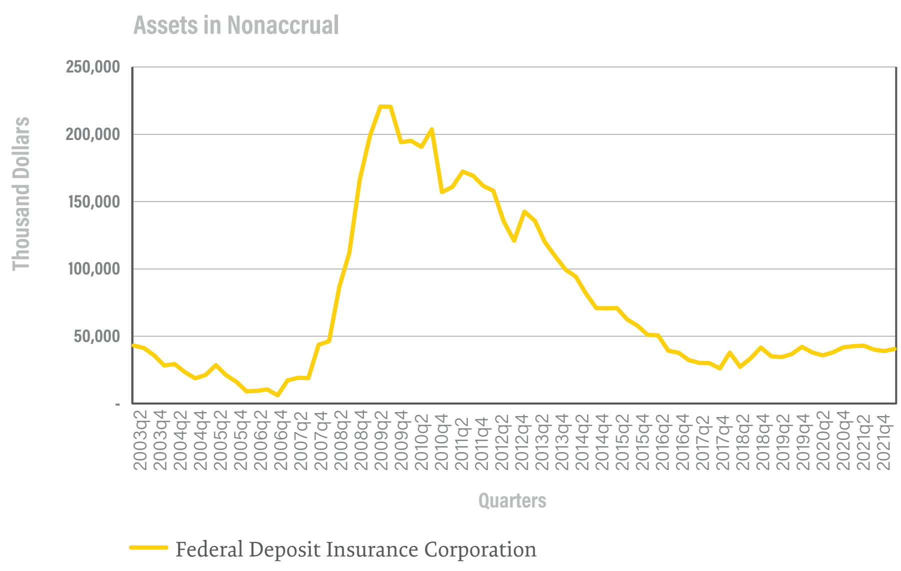
Valley community bank total deposits and net loans and leases as well as bank accruals began displaying different dynamics as the expectation of interest rates reversing course in 2022 became the prevailing sentiment in 2021's fourth quarter. Valley total bank deposits spiked 21.71 percent in 2021 and 21.19 percent in 2020. When compared with the long-term benchmark rate of 8.94 percent, the magnitude of the increase resulting from Federal Reserve intervention during the pandemic becomes apparent. Despite being flooded with cash, banks did not extend loans at the same pace as the increase in deposits. The main reasons behind the imbalance were the default risk being very high and interest being very low in 2021. Community bank deposits in the Valley are projected to increase at an average annual rate 8.57 percent from the second half of 2022 to the first half of 2023 and 4.41 percent from the second half of 2023 to the first half of 2024 as the Federal Reserve slowly begins to deflate balance sheet in addition to rate hikes.

Bank assets in non-accrual have begun to trend more visibly upward from the third quarter of 2021. With the end of mortgage forbearance programs in September 2021, the pace of non-accruals will likely rise faster. The rise in interest rates make it harder for Valley residents to pay their mortgages and meet other financial obligations.

VALLEY TOTAL BANK DEPOSITS SPIKED 21.71 PERCENT IN 2021 AND 21.19 PERCENT IN 2020.





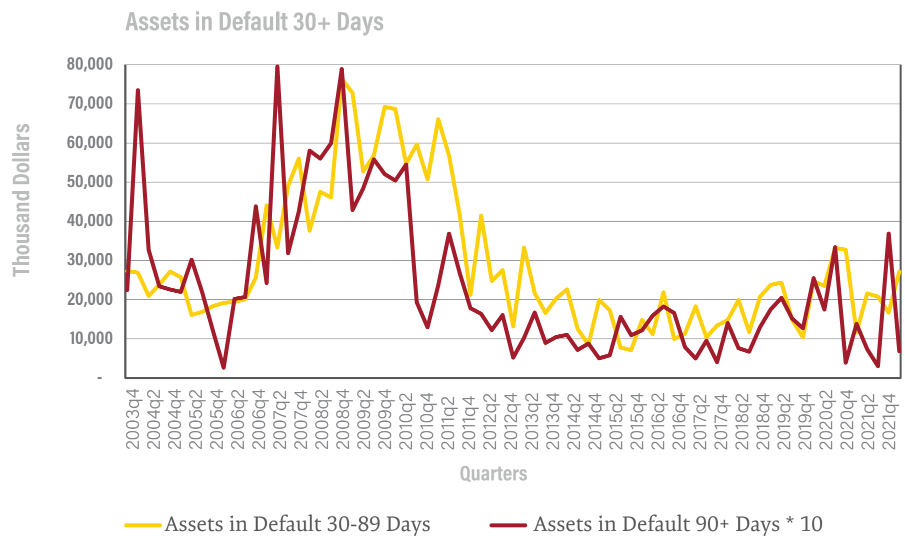


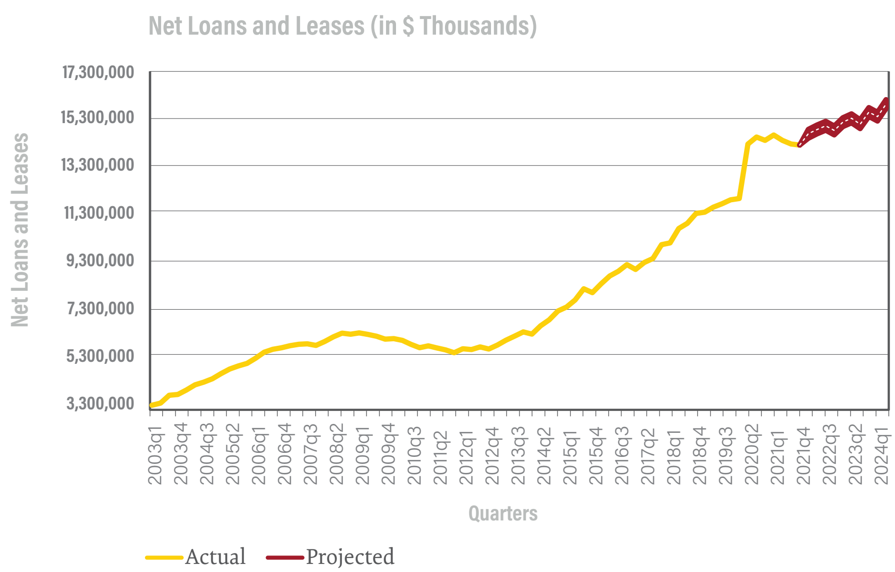
The pattern observed in bank assets in default 30-to-89 days and assets in default 30-to-89 days is now consistent but not at the same speed as the pace observed in non-accruals. The two series are exhibiting slower movement than the latter. Given the first rate hike took place in March 2022 with five more to follow, the two series will likely increase at faster rates in the coming months. ▶

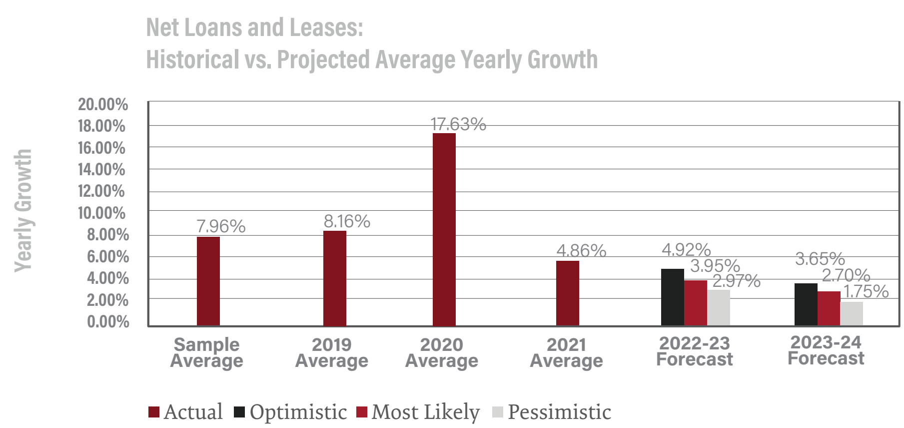
Community bank net loans increased 4.86 percent in 2021. During the last two quarters of 2021, basically very few loans were extended. The rate of increase was about one third the increase in 2020, highlighting significant decreases on the part of community banks in loans extension. The rate hikes in 2022 may change that outlook in the coming months as higher interest rates correspond to increased interest earnings and profitability from new loans. ▶

With the increasing interest rates, balance sheet reduction and tapering on the part of the Federal Reserve, the economy's trajectory will likely change in the next two-year period. Projections point to net loans and leases increasing at an average yearly rate of 3.95 percent and 2.70 percent in the first and second twelve-month forecast horizons respectively. ▶

Both community bank deposits and net loans and leases will likely grow more in line with their historical benchmark rates as the Federal Reserve begins to fight inflation more aggressively.







Concluding Remarks

Given the change in stance of monetary policy, our projections point to slower growth in the next two years. The yield curve inverting for the first time since 2019 was a telling sign of increasing odds of a recession occurring in 2022. Currently, there is a 33 percent chance of a recession. Our projections point to a recession that could last 12 to 18 months. Oil prices doubling in one year and persisting is another leading indicator of an oncoming recession. While the price of oil doubled to $130 per barrel in the first quarter of 2022, it did not persist at that level.

Given the six interest rate hikes scheduled for 2022, Valley total employment is expected to grow at a slower rate of 1.94 percent in the next two years. During 2021, total employment in all counties except Madera County. Employment grew the fastest in Merced County, followed by Stanislaus and San Joaquin counties. The fourth fastest growth occurred in Tulare County

followed by Fresno and Kern counties. Kings County grew the slowest in 2021.

Structurally problematic, information employment grew for the first time since the third quarter of 2018. The fastest growing category of employment was leisure and hospitality services employment followed by trade and transportation, and retail trade. Financial activities along with government employment declined in 2021, but the decline for both was slower than it was in 2020. Education and health services employment grew faster during the latter part of 2021 due to delays in the opening of schools. Despite the drought, farm-related wholesale employment grew in 2021.

Home values increased by approximately three times the long-term benchmark rate in 2021, bringing worries of a housing market bubble. While there are no immediate signs, the speed of tapering and rate hikes may trigger a correction if homeowners panic and attempt to sell their homes all at once. After the Federal Reserve's first interest rate hike in March 2022, the number pending home sales decreased considerably relative to previous months. As such, it is increasingly important to keep an eye on those variables reversing course and to be prepared for a potential correction in the housing market and elsewhere. Therefore, lowering debt exposure, moving into cash, to switching from adjustable rates, refinancing while interest rates are still low and even moving into rental property, as some seminal economists suggest, are a few precautionary steps Valley residents can take.

Because of the ban on Russian oil exports due to its conflict with Ukraine, high inflation rates driven by the price of oil are likely to prevail through the summer. Valley average weekly wages rose by approximately the same rate as inflation in 2021. Accordingly, there was no change in Valley consumers' purchasing power in 2021.

Although Valley community bank total deposits increased significantly, the increase in net loans and leases was much slower. This discrepancy meant community banks did not extend loans in 2021 relative to previous years. Valley community bank assets in non-accrual began to trend upwards steeply in 2021 and are more likely to increase as rates rise. Community bank assets in default 30-to-89 days and assets in default 90-plus days displayed a slower increase than non-accruals. The two series will likely rise in a pattern similar to non-accruals due to rising rates triggering defaults in the coming months.

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