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Dr. Gökçe Soydemir joined California State University, Stanislaus as the inaugural Foster Farms Endowed Professor of Business Economics in August 2011. Dr. Soydemir brings strong expertise and experience in business analysis and forecasting and has published extensively on applied econometrics, regional economics, financial forecasting, market analysis and international finance.

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This report relies on data gathered from third-party sources. The data has not been independently verified. While we believe these sources to be reliable, we make no warranties or representations of any kind as to the accuracy or completeness of the data. This report reflects the views and opinions of its author.

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Executive Summary

As the nationwide economic recovery began to take hold in the first quarter 2012, the San Joaquin Valley continued to lag behind. In cities such as Modesto and Turlock, sales tax receipts were on the rise and property tax collections displayed a stabilizing pattern. However, in other cities such as Stockton, conditions worsened due to ongoing effects of the housing-related crisis. Overall, however, gradual signs of the recovery felt nationwide began to appear in the Valley.

In particular, since September of 2011, total employment grew at a yearly average rate of 0.82%. Although miniscule, for the first time since the 2007-2009 recessionary period, the total employment yearly average growth rate climbed back into positive territory from declines of -3.7% and -0.2%, in 2009 and 2010 respectively. The northwest region, along with the U.S. economy, began registering lower inflation rates since September of 2011. The yearly inflation rate fell from 3.2 percent in September, 2011 to 2.6 percent by January, 2012. Average sales prices of new single-family houses declined at a much lower pace in the fourth quarter of 2011, displaying early signs of stabilization. A foreclosure relief program recently announced at the federal level is expected to keep excess inventories down in this region and to help stabilize housing prices. Foreclosure starts for the U.S. West continued to decline rapidly and are projected to exhibit a steeper decline once the foreclosure relief program begins to take effect in the Valley. However, the end of the foreclosure settlement reached by banks in early 2012 may temporarily interrupt this decline. Reaching its highest level in a year, consumer confidence began displaying more active spending patterns beginning from the first quarter of 2012, albeit experiencing a slight slowdown in March.

With job creation and housing market correction, the current sentiment of the public in general has now been marginally more upbeat. However, most jobs are not full time or full pay, contributing to frustration with the job market despite increases in job numbers generally above 120,000 per month nationwide. Adding to this sentiment is the lingering jobs deficit of 12 million that will require more time to eliminate even at the higher pace of job growth. Previously, job growth occurred only in some sectors. Beginning in 2012, job growth appears to be across the board, including very small gains in the construction sector. One exception is the public sector, where jobs continued to decline particularly in education. However, the federal job growth plan is expected to address this shortfall by allocating support funds for teachers.

An anticipated extension of unemployment benefits and cuts to payroll tax should help further job growth stimulation. Profit rates appear to be higher in 2012 than the previous year. Nationwide there was positive economic growth for ten quarters in a row and positive job growth twenty-two months in a row. The major exception occurred in state and local government-related jobs.

Yearly comparisons of incoming numbers reveal the recovery in the Valley is slowly taking hold, including financial and construction sectors. Most notably, the Valley economy began catching its long-term mean, showing slowly strengthening performance. Many analysts agree that we are approaching ever closer to a turning point in the housing market as builders slowly begin to construct new dwellings.

Continuing unrest in the Middle East and rising energy costs in the latter part of the first quarter of 2012 are renewing cost-push worries, but inflation continued to display a falling pattern. The average rate of the U.S. real GDP growth is expected to vary 2.4 to 2.8 percent as new jobs are added at a higher pace.

In all, the region's forecasts in the interval June 2012 to June 2014 point to an economy that is slowly gaining strength. Given the slow recovery underway, further easing of credit by the Federal Reserve is unlikely to occur. Locally, farm related employment exhibited fast job growth numbers. As the speed of recovery picks up nationwide, the Valley economy is projected to benefit from this expansion more so during the latter half of 2012 and extending into the first half of 2013.

Introduction

The purpose of this 2012 Midyear Update is to assess the forecasting accuracy of the November 2011 report and provide revised forecasts until June 2014 following the arrival of new numbers. The forecast percentage errors are reported in the appendix and reveal that our forecast errors remained below three percent, with the exception of manufacturing where the incoming numbers beat our forecasts by 4.5 percent but remained within an acceptable rate of five percent.

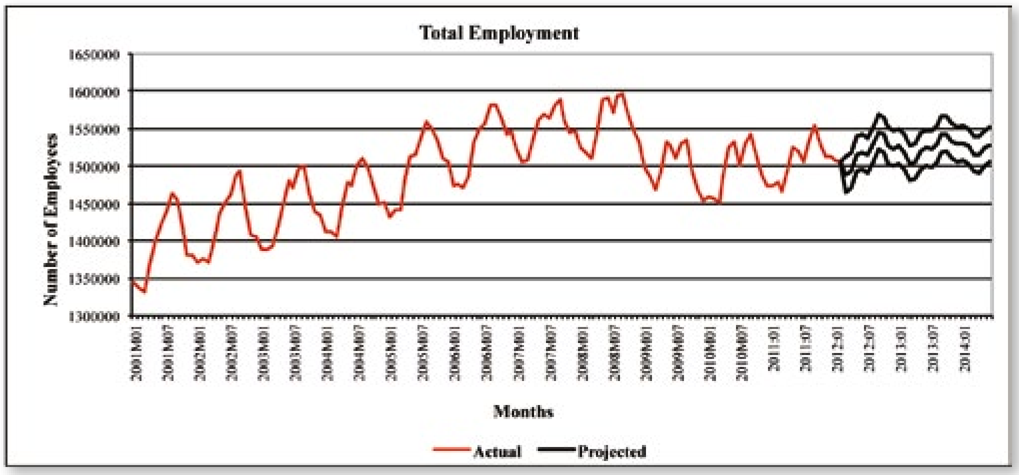
In this report, each mean forecast line extends through the first half of 2014 and is displayed with lower and upper statistical confidence bands. The actual values –realizations – are expected to fall within this range. Given the low percentage errors, the out-of-sample forecast accuracy appears to be in the range of 97 percent, thus mostly satisfactory.

The remainder of this Midyear Update Report is organized as follows. Section B provides a discussion of San Joaquin Valley labor market conditions and forecasts, Section C reports the region's housing market conditions, Section D reports prices and inflation, and Section E reports depositary institutions and capital markets. Section F provides a summary along with concluding remarks.

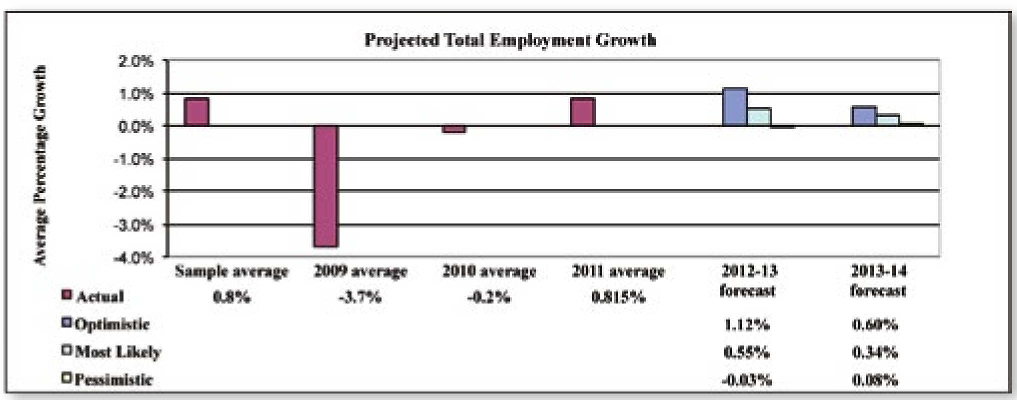
We thank the Valley community for providing valuable feedback on our inaugural report and hope to receive further comments and suggestions to incorporate into additional CSU Stanislaus forecasting reports in the future.

Employment Indicators

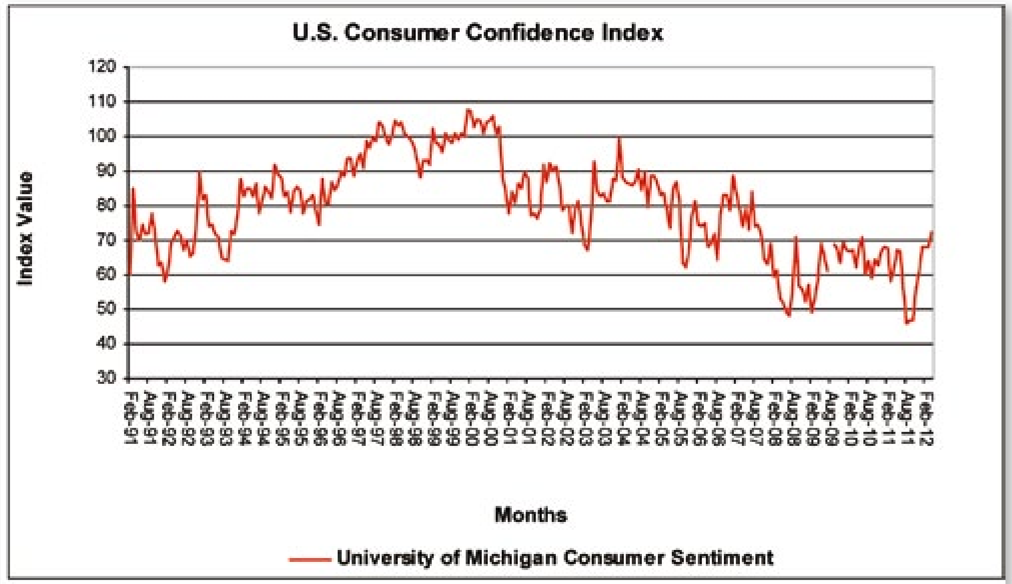
As projected in our previous report, the San Joaquin Valley annual average employment growth registered positive growth rate for the first time since 2007. This reading was based on a twelve-month period in 2011 at 0.82 percent. The switch to positive from negative growth rate occurred because Valley employment grew for the past four consecutive months after August 2011. Particularly, in November and December 2011, Valley employment grew more than three times its long-term average growth rate. These numbers reaffirm the view that recovery in the Valley, as nationally, is slowly beginning to take hold.



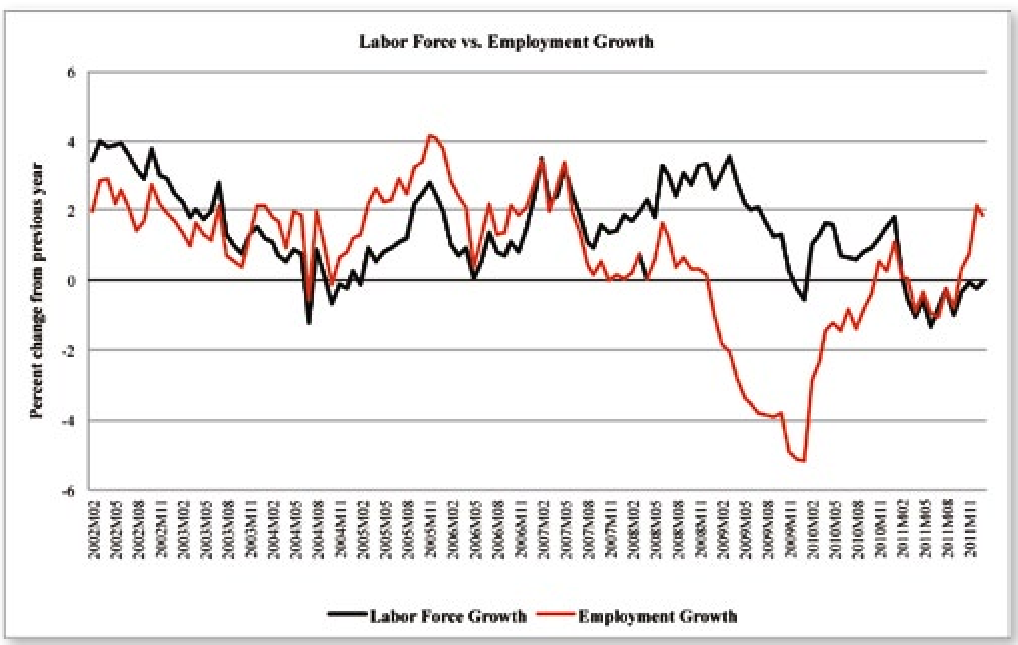
Based on the incoming numbers for the past three months, total employment forecasts for the Valley were of 99.32 percent accurate. The employment growth series is expected to gain traction gradually beginning the second quarter of 2012. From June 2012 to June 2014, yearly employment is expected to grow at an average rate of 0.45 percent.



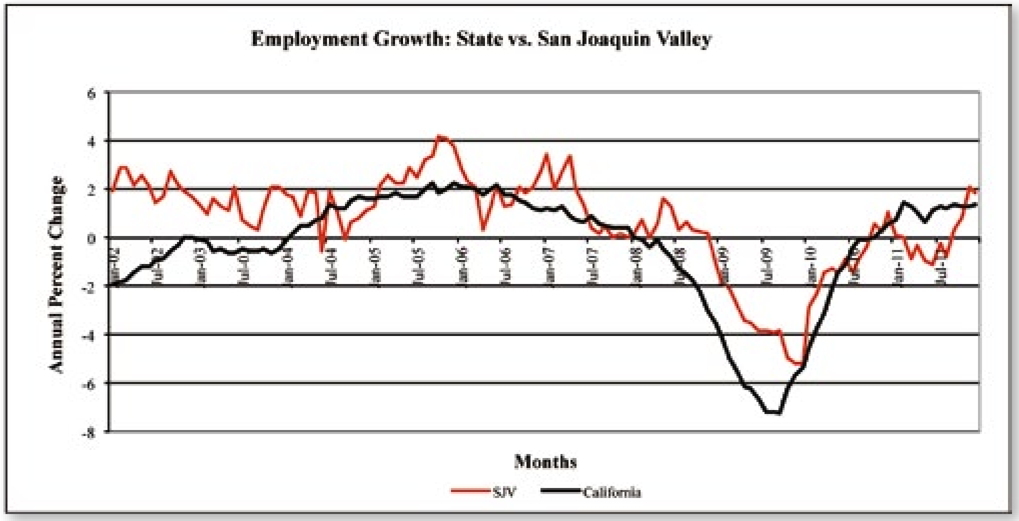
The driving engine of the U.S. economy – consumption expenditure – displayed a relatively more vibrant pattern from the last quarter of 2011 extending into the first quarter of 2012. The U.S. Consumer Confidence Index, a leading indicator, rose for five consecutive months, edging closer to its long-run mean after hitting a leading trough in July 2011. The significant improvement in consumer sentiment has resulted mainly from improving job growth numbers and optimism about income expectations. This consumption activity and job growth are now gradually contributing to a self-sustaining expansion where stronger job numbers stimulate consumption, which in turn results in further job creation. As such, the consumer confidence reading in the first quarter of 2012 was the highest in a year.



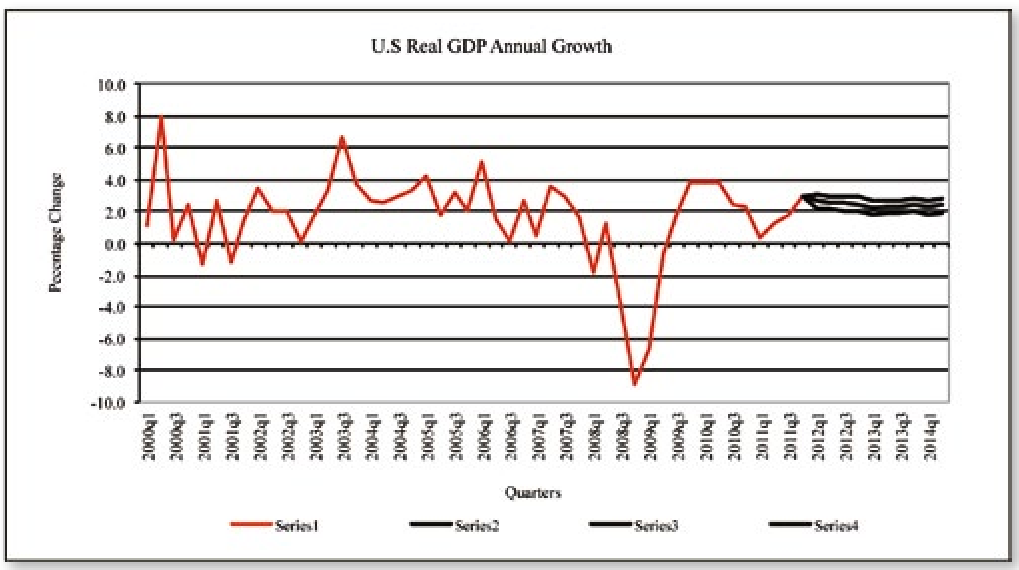
San Joaquin Valley labor force and employment growth continue to progress at almost equal rates since January 2011. This pattern is unlike the pattern that existed since April 2007 whereby, due to an influx of population in the Valley, labor force growth greatly exceeded employment growth. The head-to-head patterns of growth are consistent with the view that the influx of population has declined significantly since the 2007-2009 recession. The spike in employment growth greatly exceeding labor force growth in the latter part of the sample may indicate a new structural pattern. If so, it becomes ever apparent that the Valley is gaining traction in terms of job creation and economic performance.



Employment growth in the Valley historically has been above California's employment growth, indicating a growing regional economy. In the latter part of the sample however, the Valley's employment grew less than the state, suggesting the recovery is taking place first in the coastal region. Since November 2011, employment growth again began to exceed that of California, perhaps suggesting that the recovery is beginning to spill over to the inland region. In particular, annual employment growth in November and December 2011 for the Valley reached 2.1 and 1.8 percent, while for California as a whole was at 1.3 and 1.4 percent. We expect this pattern of Valley employment to grow faster than California's from the latter part of 2012 extending into 2013 as the economic recovery slowly begins to gain strength in the two economically segmented regions of California. It is worth noting that, once again, in the last quarter of 2011 Valley employment growth began to outpace California's employment growth, consistent with the historical pattern.

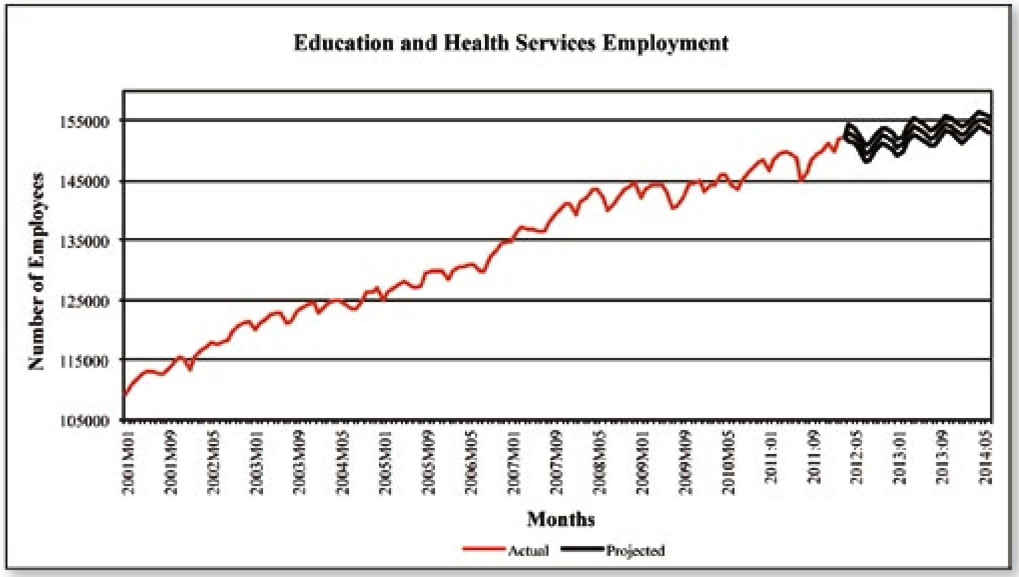


The U.S. real GDP grew at an average rate of 1.62 percent in 2011. The 3 percent growth in the last quarter was welcoming news and above the growth of 2.1 percent projected by many economists. In 2011, the U.S. economy performed significantly below the ten year average rate of about two percent, with the exception of the last quarter.

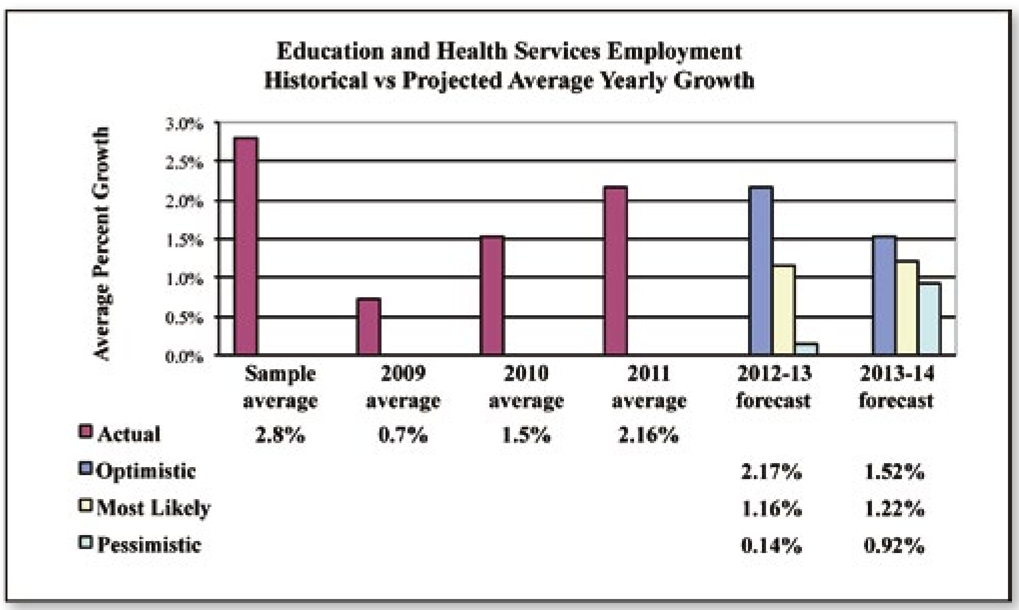


In 2012, the U.S. economy is likely to fluctuate around this long run rate, at an average growth of 2.4 percent. In 2013, the real GDP is projected to grow at 2.32 percent, with an overall average growth of 2.48 percent in the forecasting interval. As the recovery slowly gains strength, the Valley economy is expected to perform slightly below this trend as long as employment growth continues to outpace the state's employment growth.

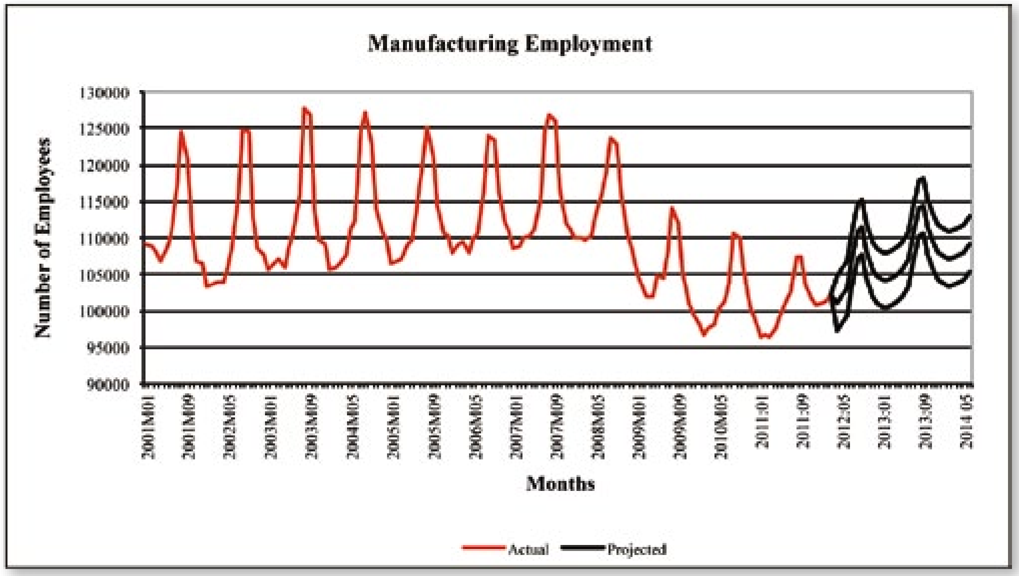
Historically, Valley education and health services employment displayed a relatively robust growth pattern. The series grew around one percent on a consistent basis even during the recessionary period of 2007-2009. Despite being lower than its long-term average growth rate of 2.8 percent, Valley education and health services employment managed to post positive growth rates in 2009 and 2010.



When compared to actual numbers, the series forecasts were 98.25 percent accurate. The same pattern is expected to extend into 2013 and 2014. Education and health services employment in the Valley is projected to grow at an average annual rate of 1.19 percent in the June 2012 to June 2014 forecast interval. This recovery is projected to be slow as it reverts back to its mean, but remain higher than its 2011 average.

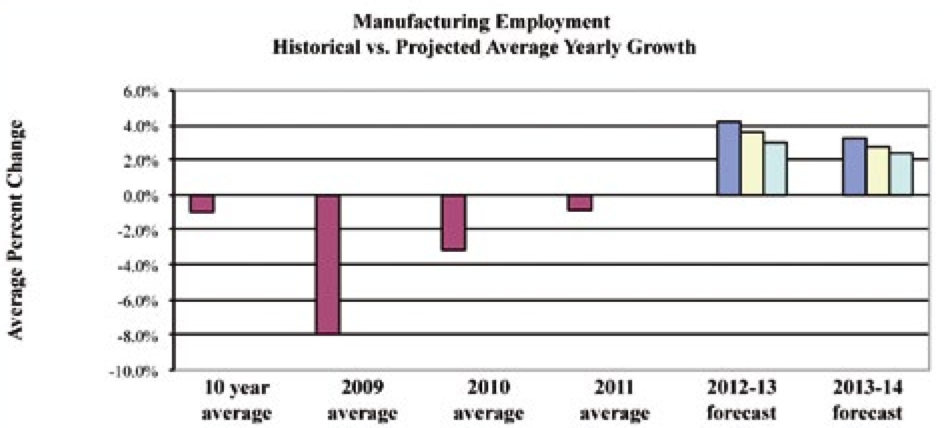


Valley manufacturing employment historically displays a much different pattern than education and health services employment, marked by heavy seasonal behavior and, more recently, displaying significant negative growth rates in 2009 and 2010. After the revision of historical data by the Bureau of Labor Statistics manufacturing employment posted an average yearly decline of -0.9 percent. This was mainly due to a slowdown in manufacturing employment in the last quarter of 2011 that also appeared to extend into the first quarter of 2012.



Manufacturing employment is projected to grow at an annual average rate of 3.2 percent from the first half of the June 2012 to June 2014 forecast interval, with seasonal peaks in August and troughs in January. Manufacturing activity is expected to be more vibrant with the actualization of “Project X” in Patterson and the expansion of Hilmar Cheese Company.

The Purchasing Managers Index (PMI), maintained by the Institute for Supply Management (ISM), and the ISM Manufacturing: New Orders Index, all manufacturing industries tracked at the national level, are two leading indicators that point to further expansion in this category by remaining consistently well above the minimum levels needed to signal expansion.

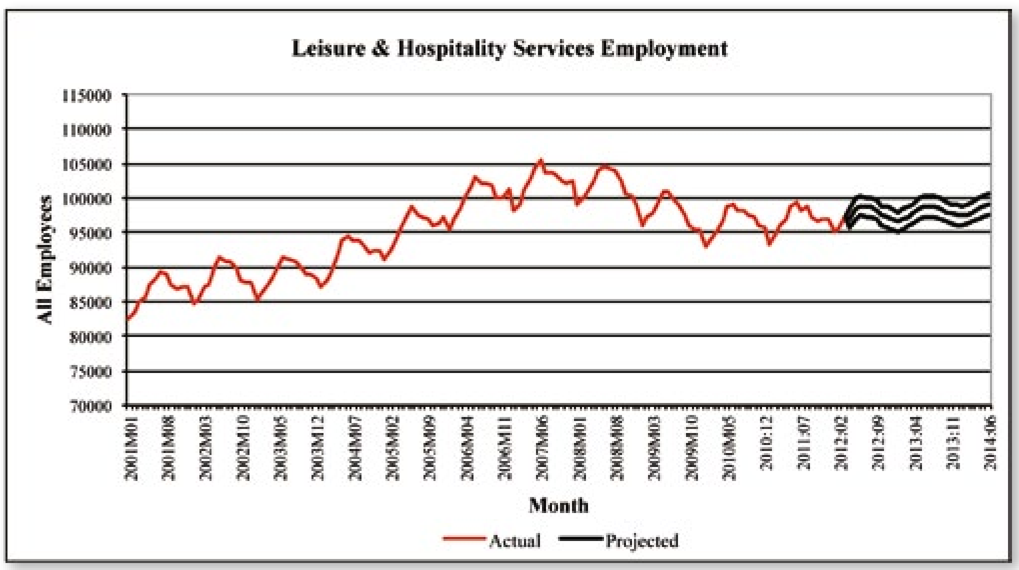


	10 year average	2009 average	2010 average	2011 average	2012-13 forecast	2013-14 forecast
Actual	-0.9%	-7.9%	-3.2%	-0.9%		
Optimistic					4.2%	3.2%
Most Likely					3.6%	2.8%
Pessimistic					3.0%	2.4%

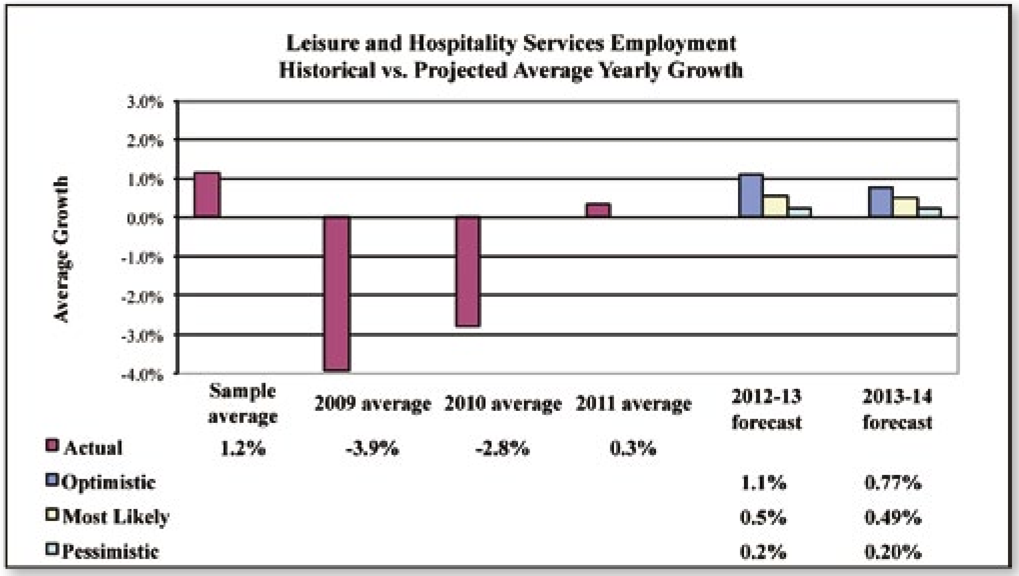
The PMI, a composite index of five "sub-indicators," is known historically for predicting the beginning and ending of recessions. New orders are on the rise beginning with the first half of 2011.

New orders for all manufacturing industries, in line with other leading indicators, point to expansion starting from the second half of 2011. By staying continuously above the index value of 50, the series points to a slowly strengthening economic recovery.

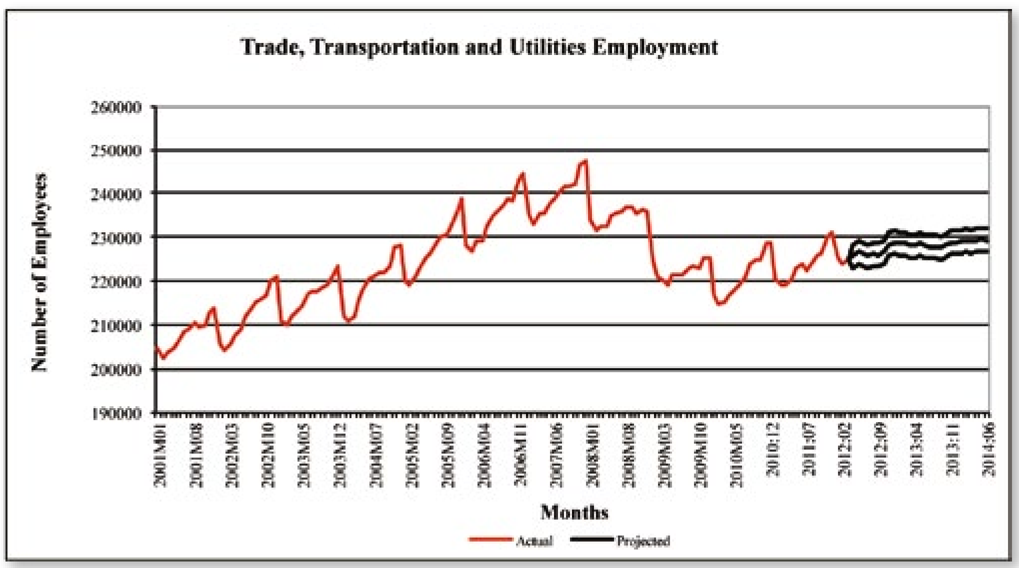
At 0.3 percent, Valley leisure and hospitality services average annual employment growth in 2011 stayed below its long-term growth of 1.2 percent. Construction of new hotels began benefiting local economies, such as those in Turlock and Fresno. As such, leisure and hospitality services appear to be recently re-discovered sectors in which the Valley economy has yet another comparative advantage. In 2009 and 2010 the growth rate was negative, at a highly pronounced rate of -3.9 and -2.8 percent. The dynamics of the series display a heavy seasonal pattern, peaking in the summer and declining in the winter. Recently however, seasonal peaks appear to outpace the troughs, showing accelerating signs of growth in the summer months.



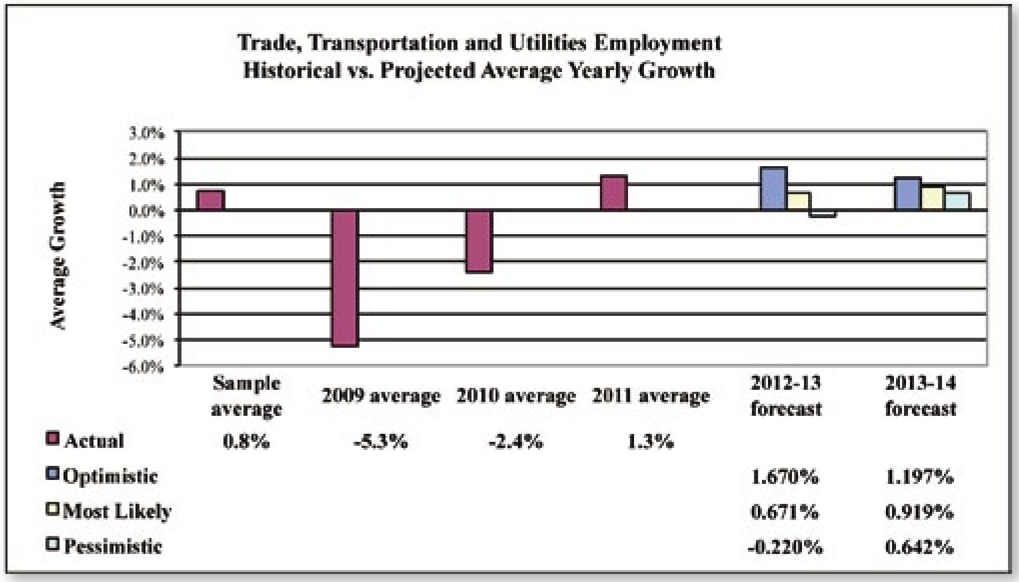
From the second half of 2012 to the first half of 2014, leisure and hospitality services employment is projected to grow at a yearly average rate of 0.7 percent, up from our earlier forecast of 0.5 percent a year. Under the optimistic scenario, where seasonal peaks continue to be more pronounced than troughs, the annual average growth is projected to reach as high as 1.19 percent.



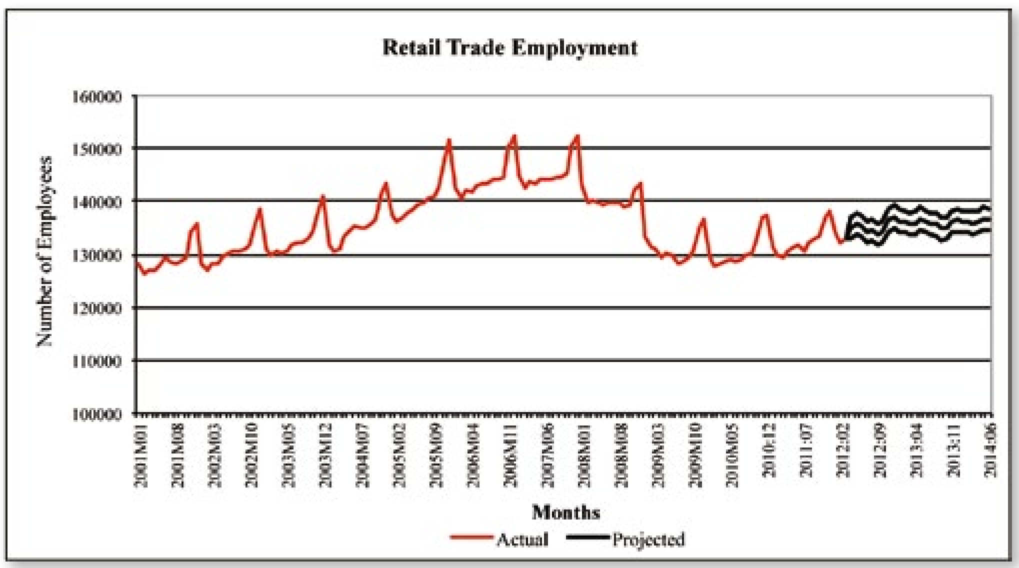
Strong performance in trade, transportation, and utilities employment in the last quarter of 2011 resulted in an increase of average yearly growth from 0.6 to 1.3 percent a year. Unlike 2009 and 2010, where the series posted significant negative declines, in 2011, trade, transportation, and utilities employment managed to post strong positive average yearly growth, well above its long-term average rate.



The Valley trade, transportation, and utilities employment is projected to grow at 0.8 percent from the second half of 2012 through the first half of 2014. The pace of recovery in this sector is expected to gain strength at a rate consistent with its long-term growth pattern of 0.8 percent.

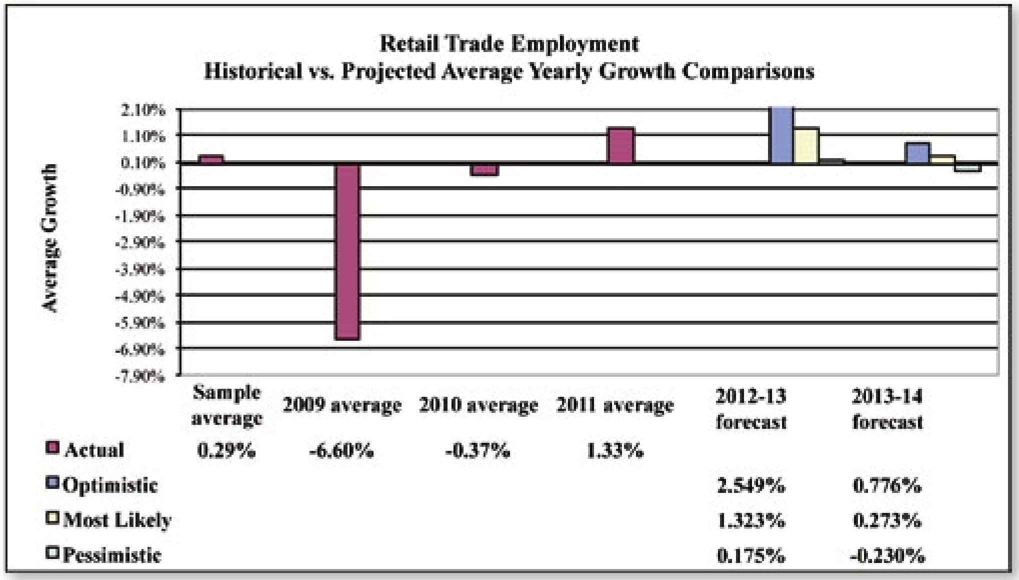


Apart from seasonal peaks each December, San Joaquin Valley retail trade employment had displayed a declining trend since the fourth quarter of 2007. However, beginning August 2009, the series exhibited a much slower decline, approaching a horizontal trend in 2010 and registering a turning point in 2011. The sample average of the series since 2001 stood at 0.29 percent. In the past two years, the series declined at a yearly average rate of -3.5 percent and in 2010 the yearly percentage change registered at -0.37 percent, reflecting recovering consumer confidence.

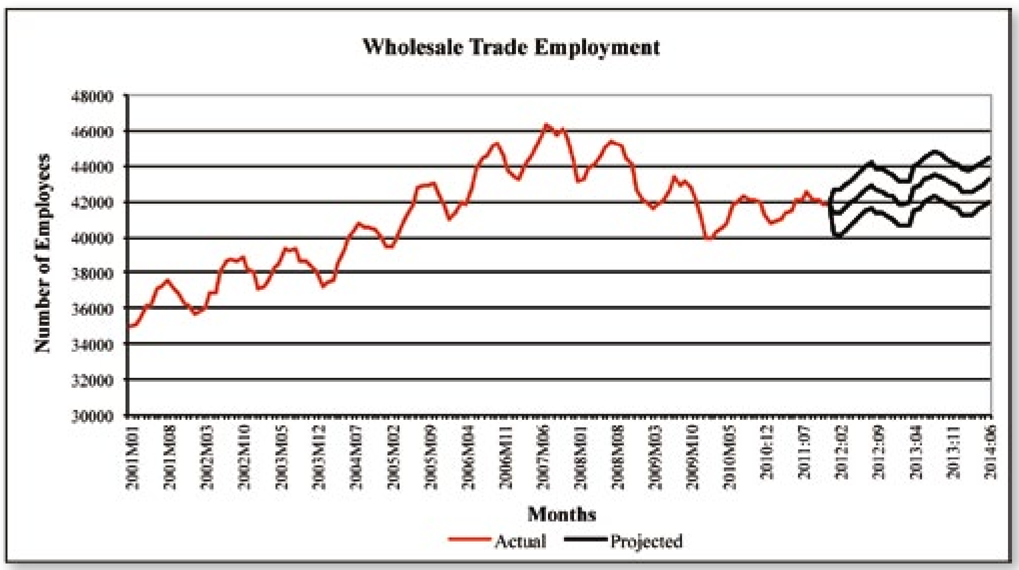


Over a ten-year period there has been very little growth in retail trade employment in the Valley. The series posted a very significant decline of -6.60 percent in 2009 . The flat trend since 2010 gave way to an expansion in 2011 at an average yearly rate of 1.3 percent. This expansion is projected to continue into 2012 and 2013 as the Valley economic recovery slowly gains strength.

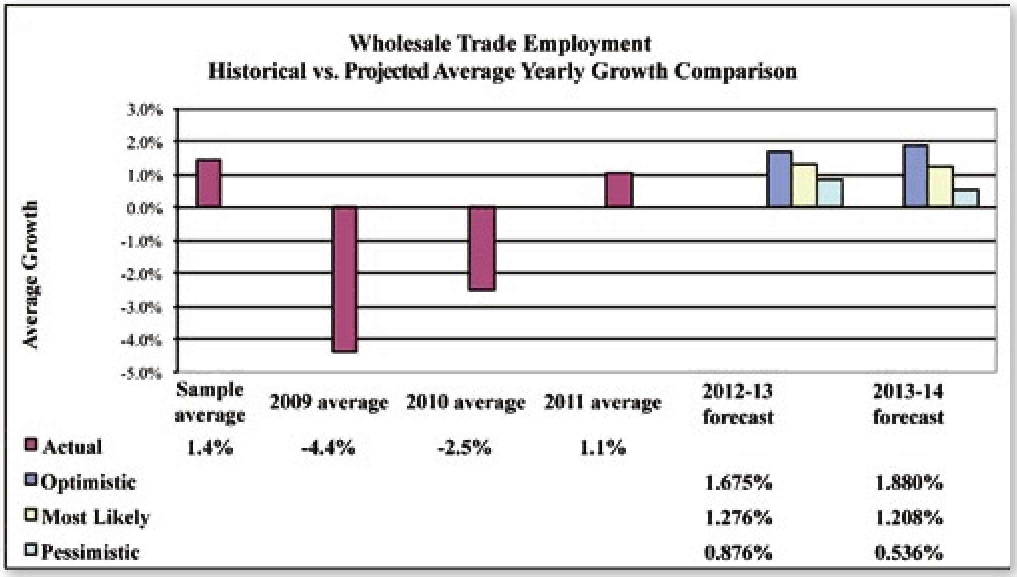
The average yearly rate of growth from the second half of 2012 to first half of 2014 is projected to hover around 0.8 percent, predicting a turning point in the latter part of 2012. Despite the low rate, the retail trade employment growth is expected to outpace its long-term average growth of 0.29 percent.



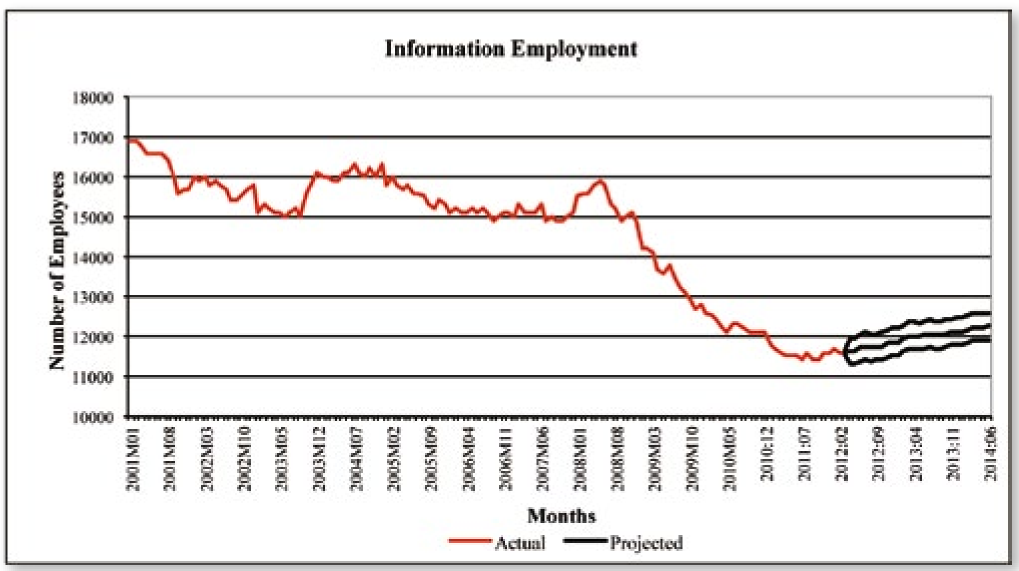
Year to year wholesale employment on average grew at 1.4 percent since 2001. After posting negative numbers in 2009 and 2010, the series quickly recovered, posting a 1.1 percent growth in 2011. This pattern is markedly different than retail sales employment, showing that the Valley wholesale trade sector is relatively strong compared to retail.



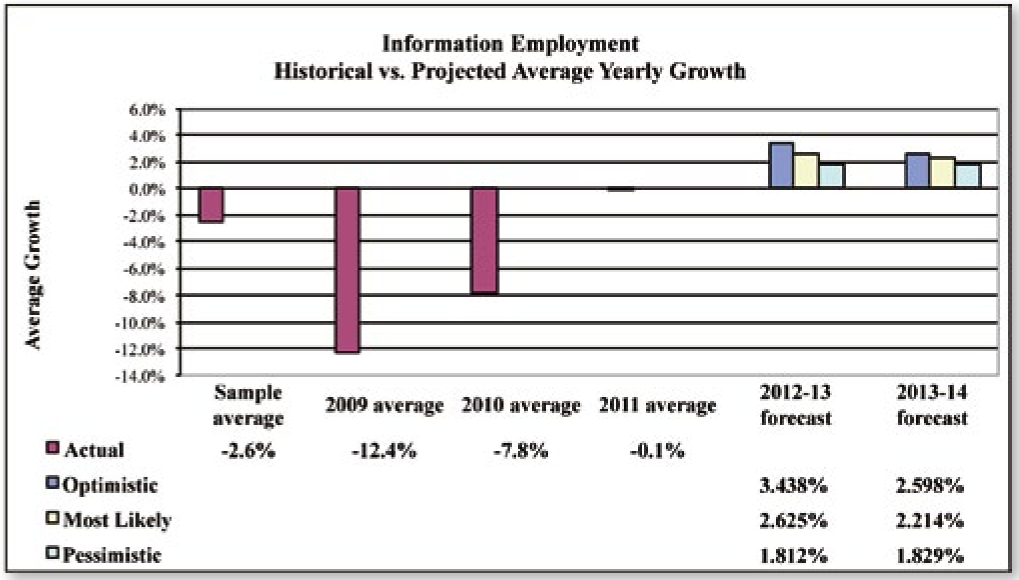
Once compared with recently arrived actual numbers, forecasts of wholesale trade employment were 99.31 percent accurate. In the interval between the second half of 2012 and first half of 2014, Valley wholesale employment is projected to grow at an annual average rate of 1.24 percent, slightly below its long-term rate of performance. Apart from seasonal variations in the summer and winter months, the series is projected to display a robust growth pattern.



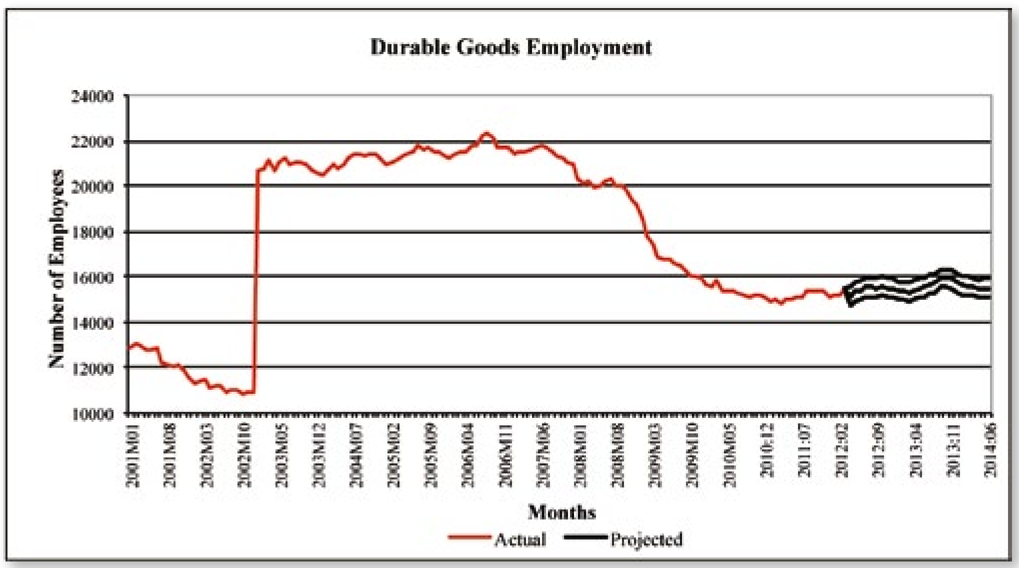
Valley information technology employment decreased at an average yearly rate of -2.6 percent over the ten year period since 2001. The decline accelerated in 2009 and 2010 at much higher rates of -12.4 and -7.8 percent, respectively. Information technology employment continued to post negative yearly growth of -0.1 percent in 2011. This improvement in growth numbers in 2011 relative to 2009 and 2010 may indicate that adjacent regional strength in this category is finally beginning to spill over to the Valley, as companies such as Amazon.com begin to consider the region's underutilized resources in land, labor, and capital more attractive for setting up establishments in cities such as Patterson.



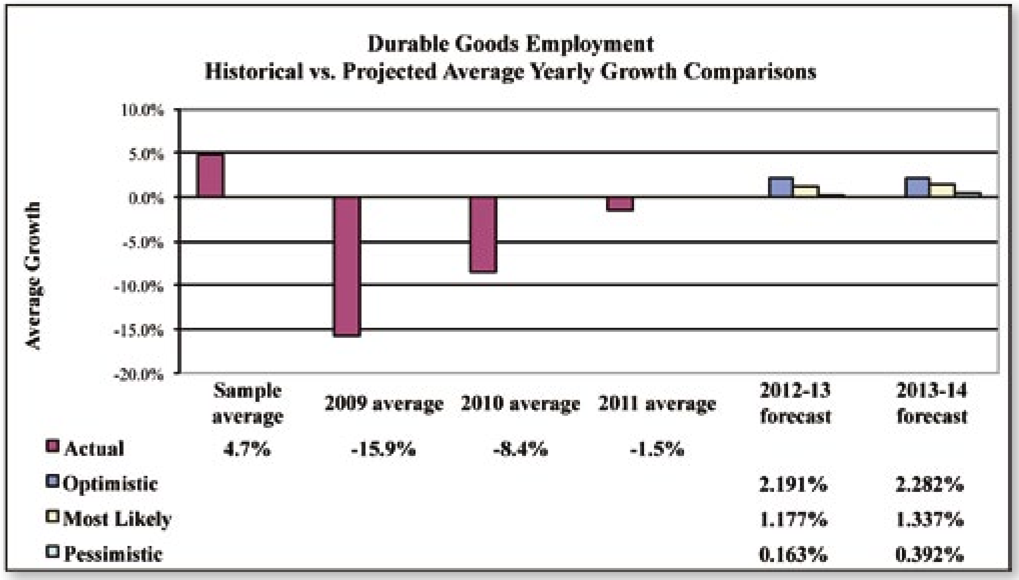
Information employment forecasts were 96 percent accurate based on actual numbers from the past three months. The turning point that occurred in the second half of 2010 appears to be sustained and is likely to continue into 2013 and 2014. In the forecast interval, Valley information employment is projected to continue this growth pattern at 2.63 and 2.21 percent in the first and second twelve-month forecast periods, as the economic recovery slowly begins to gain strength.



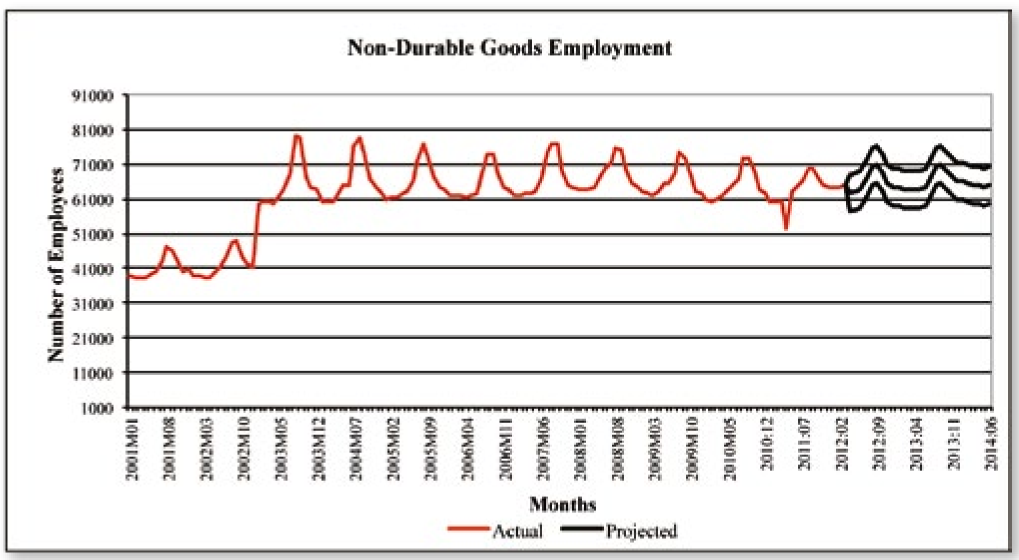
Durable goods employment decreased at -15.9 percent in 2009, followed by -8.4 percent in 2010, half the rate of 2009. The recovery continued roughly at the same pace in 2011, posting -1.5 percent annual decline. The 2002 spike in December is due most likely to a major employer locating in the area. Our projections point to a turning point in the first half of 2012.



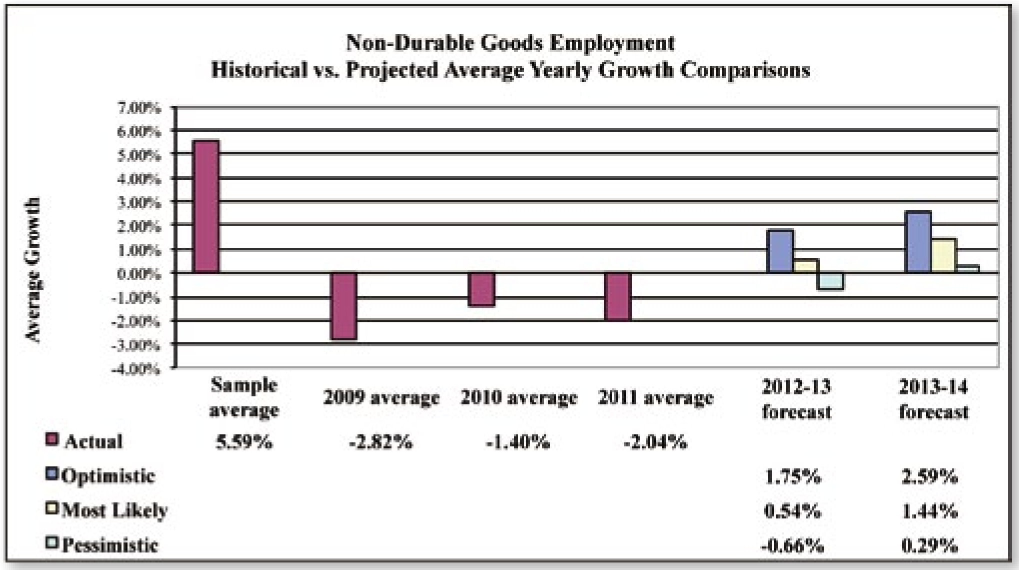
Durable goods employment projections were 99.47 percent accurate based on the incoming numbers from the last quarter of 2011 and the first quarter of 2012. From the second half of 2012 to first half of 2014, our projections point to an average annual growth rate of 1.26 percent. The projections in this sector therefore point to a milder recovery than the pattern observed in previous sectors.



Historically, San Joaquin Valley non-durable goods employment performs better than durable goods employment. In particular, non-durable goods employment displays a relatively robust pattern of growth marked by heavy deterministic components such as seasonal fluctuations, increasing in the summer and decreasing in the winter months.

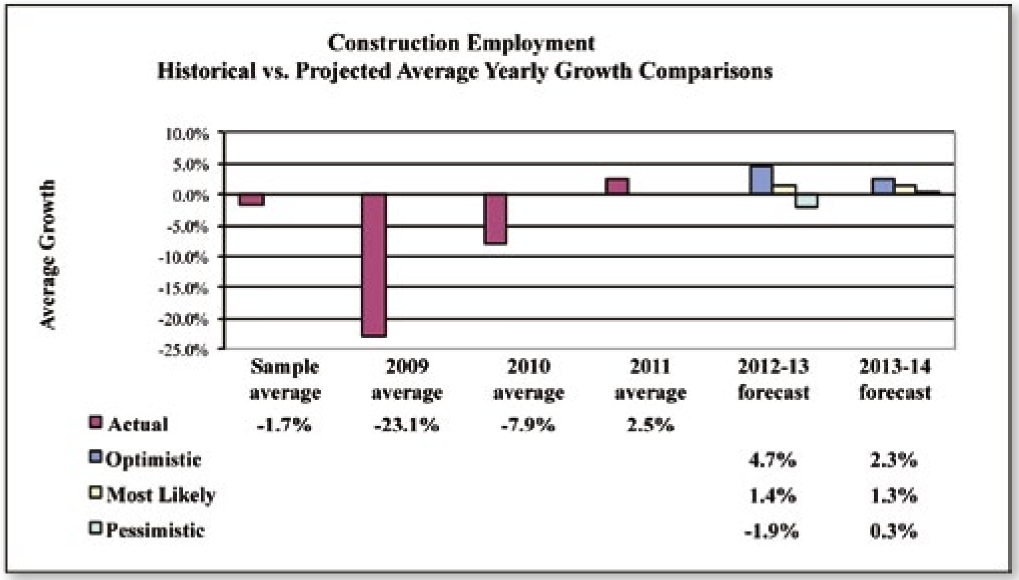


Non-durable goods employment forecasts were 98.96 percent accurate based on data received since February of 2012. Non-durable goods employment grew on average 5.59 percent a year since 2001. As in earlier indicators, the worst performance occurred in 2009 at -2.82 percent and the series has been struggling to recover since then, posting -1.40 and -2.04 percent growth in 2010 and 2011, respectively. In the forecasting interval, non-durable goods employment is projected to grow at a more dampened rate of 0.99 percent a year on average through the first half of 2014.

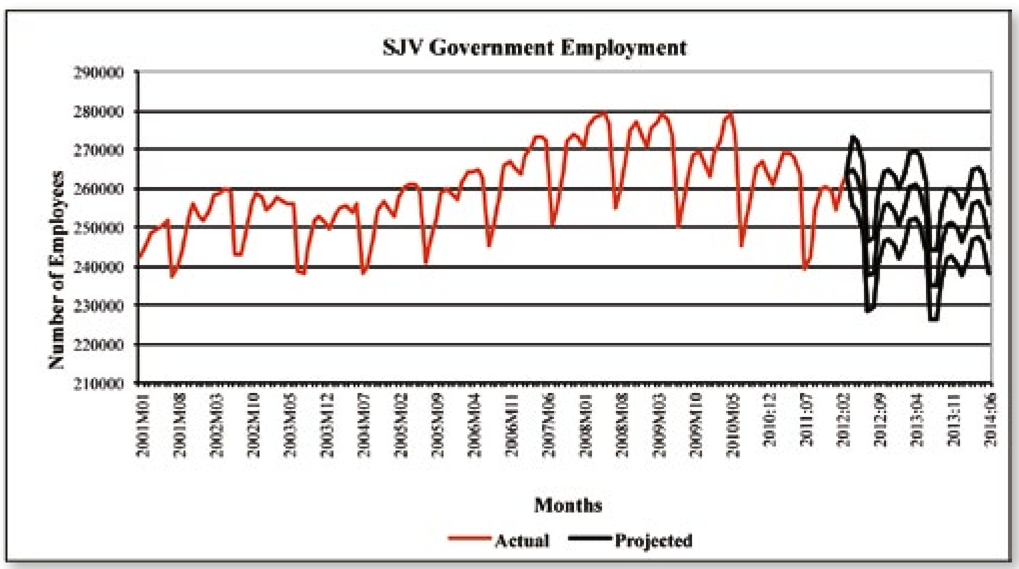


For the first time since the 2007-2009 recession, Valley construction employment ended its declining pattern and began leveling at about 30,000. Since 2001, construction employment decreased at -1.7 percent a year on average. Our projections show a turning point to occur in the latter part of 2012.

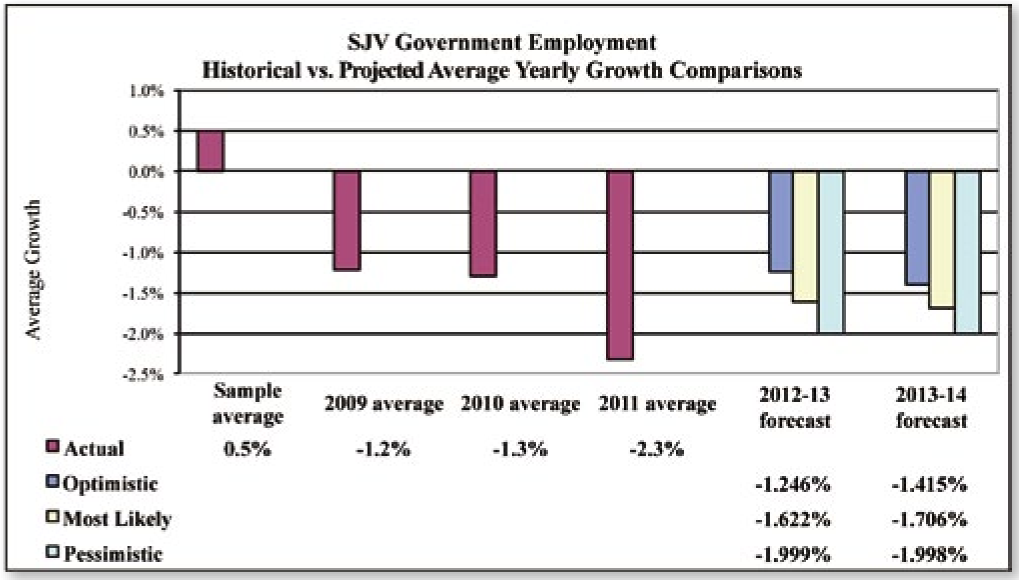
In 2009, construction employment declined at -23.1 percent, followed by a much less dramatic -7.9 percent decline in 2010. This recovery continued in 2011, posting an average positive growth rate of 2.5 percent. Despite being the worst performing series in the Valley for the past two years, construction employment began showing promising signs of halting its decline and beginning its recovery. As such, for the first time since the recession, construction employment growth is projected to post positive growth rates in the forecast interval. From the second half of 2012 through the first half of 2014, construction employment is projected to grow at a yearly average rate of 1.35 percent.



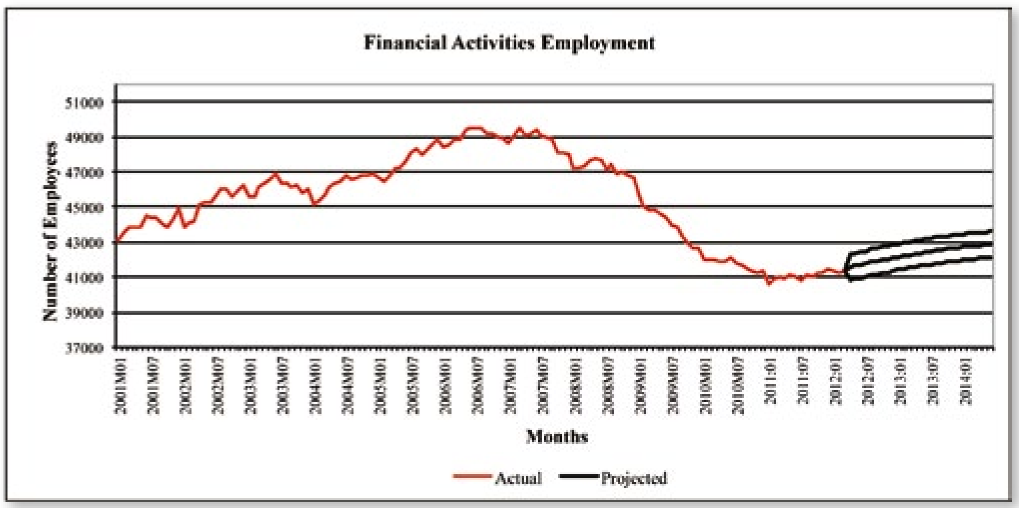
San Joaquin Valley government employment has suffered continuous declines since 2008. The dynamics of the series are different from other employment indicators; government employment failed to recover even in 2011. Despite average yearly growth of about 0.5 percent since 2001, in 2009 and 2010 government employment in the Valley fell at -1.2 and -1.3 percent, respectively. This is the only series that did not exhibit signs of recovery in 2011, posting even worse declines in that year of -2.3 percent. In addition, the series displays a unique seasonal pattern, reaching a peak in the spring and a trough in the summer months. Ongoing state budget cuts and mounting pressure on cities and counties to find alternative sources of funding took a serious toll on government services offered to the public.



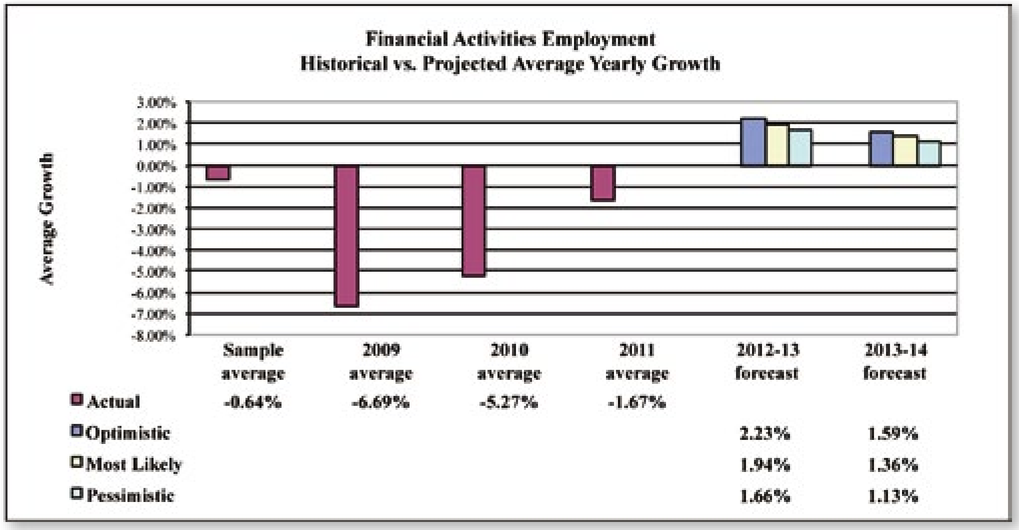
In the interval between the second half of 2012 and first half of 2014, government employment is projected to continue this downward slide. Consequently, public sector job losses and the resulting shortfall of teachers will continue to jeopardize the future of education in the State. However, a federal job growth plan is expected to address this shortfall by providing support funds for teachers. Another exception may be the public vote turning out to be in favor of a hike in sales tax in November 2012. Such remedial outcomes could predict a turning point in government employment series as early as the end of 2013.



Financial services long-term average yearly growth declined at an average yearly rate of -0.64 percent since 2001. Financial activities employment declined at a steady pace from July 2007 then hit a clear turning point in January 2011. After posting a negative growth rate well over five percent in 2009 and 2010, the series began quickly to recover in 2011 by posting a much lower rate of decline of -1.67 percent.



Our projections indicate the continuation of the recovery in the forecast period at an average yearly rate of 1.65 percent, along with a slight mean-reverting behavior beginning in the second half of 2013.

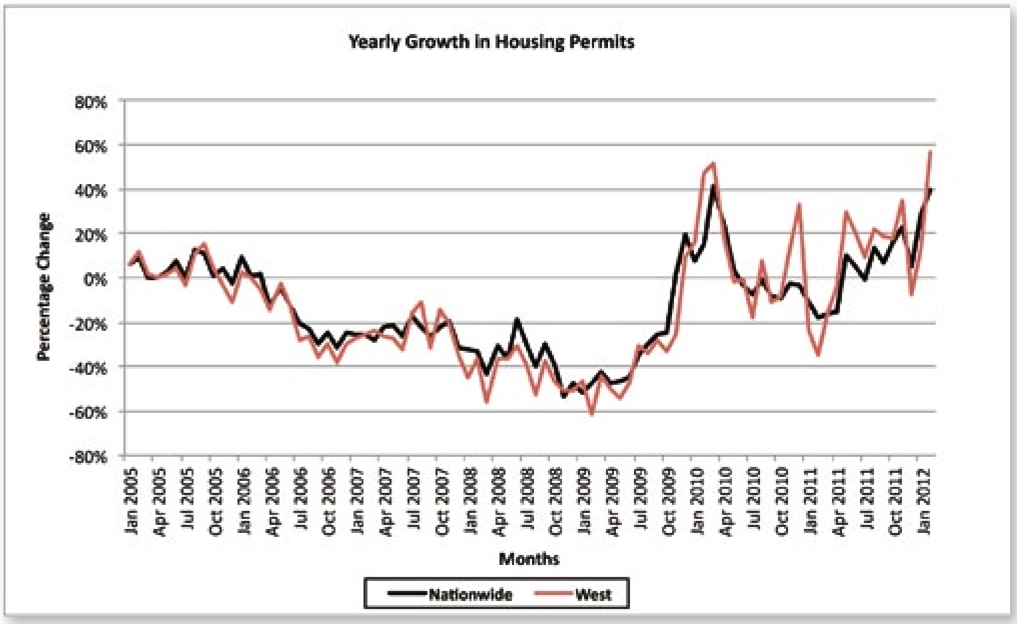


Unlike other employment indicators, financial services employment does not display seasonality, causing forecasts to appear smoother. Financial services forecasts were 99.23 percent accurate when compared with the actual numbers belonging to December 2011, and January and February 2012.

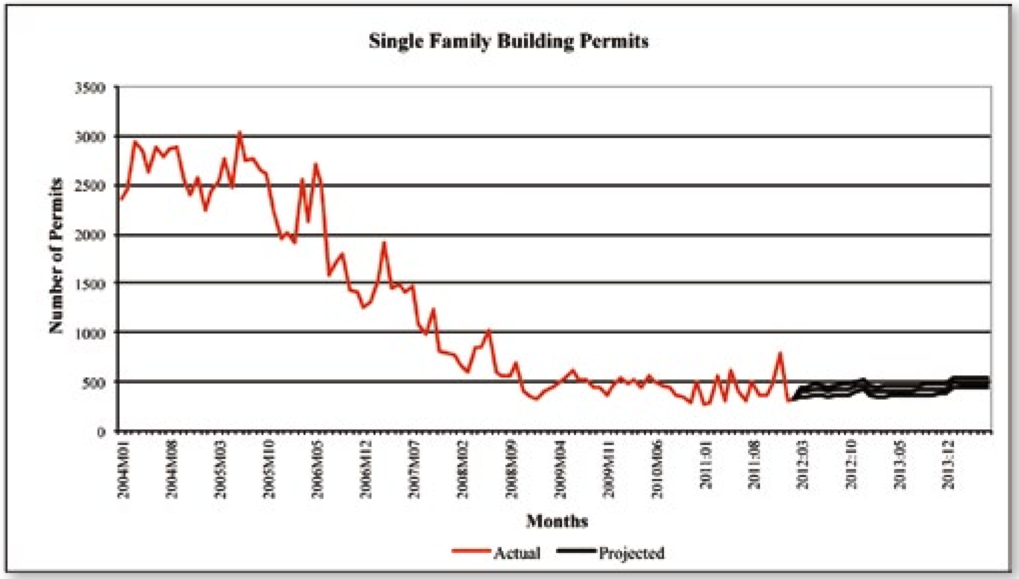
Household Sector

This report utilizes actual, rather than imputed, building permits. The data for the San Joaquin Valley are obtained from the U.S. Census Department. The total figure is obtained by summing values that belong to the eight major Metropolitan Statistical Areas (MSA) of San Joaquin Valley, as defined by the Bureau of Labor Statistics. During 2011, MSAs such as Fresno and Bakersfield reported building permits above 100 monthly, whereas Madera, Hanford, Modesto and Merced reported about 15 units a month. Stockton and Visalia MSAs reported values around 50 units per month in 2011.

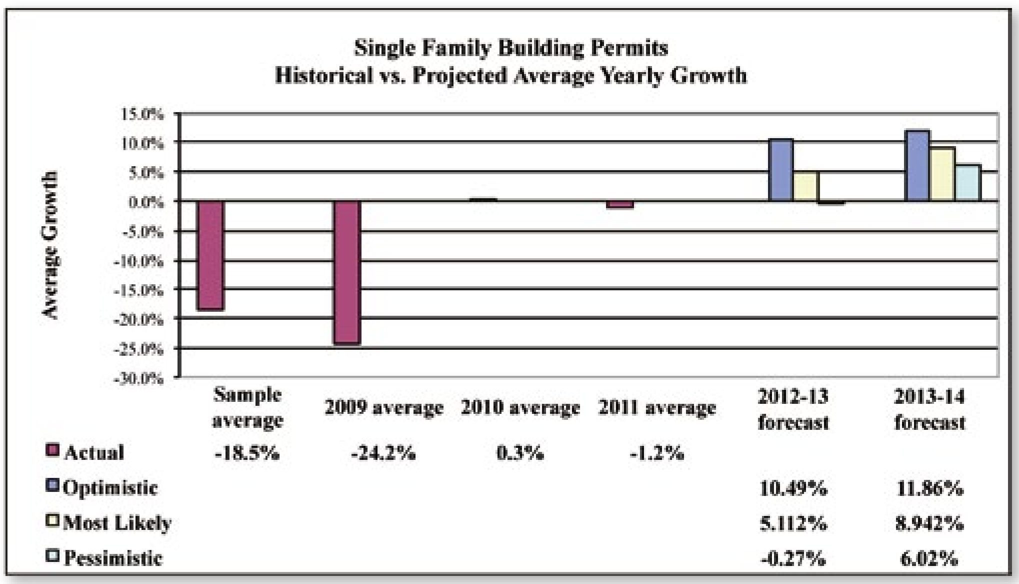
When yearly growth in housing permits from the Western region is compared with nationwide figures, it becomes clear that regional housing permits are now growing faster than the national average.



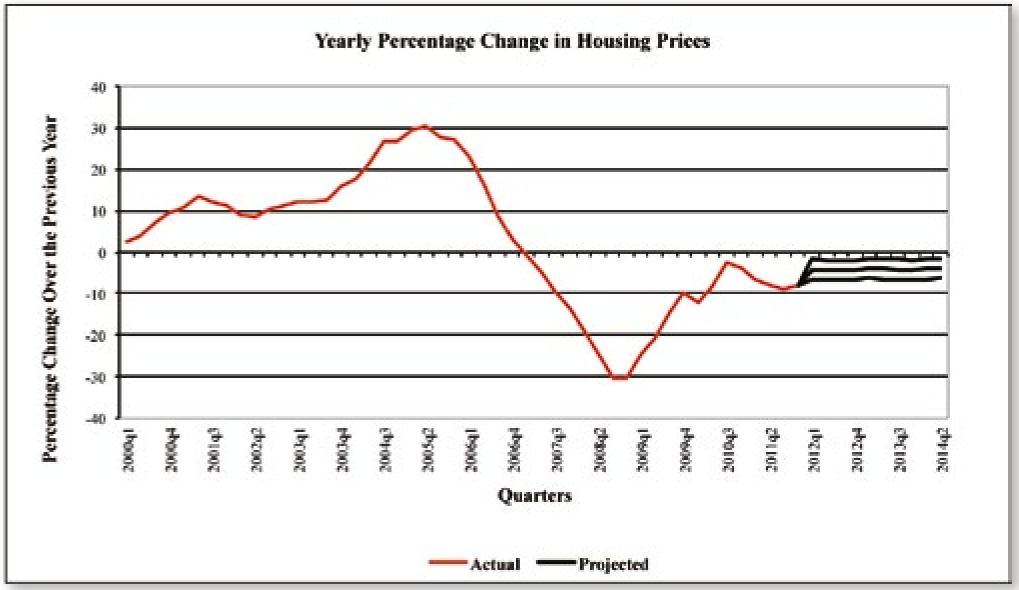
Since August of 2011, housing permits nationwide have grown at 18.9 percent. The Western region, however, has outpaced the nation, growing at 22.1 percent over the same interval. In 2009, housing permits declined at -60 percent. In 2010 and the first half of 2011, housing permit growth rates were near zero. These significantly high growth numbers in housing permits seem to suggest that the recovery in the housing sector is taking hold faster than many think.



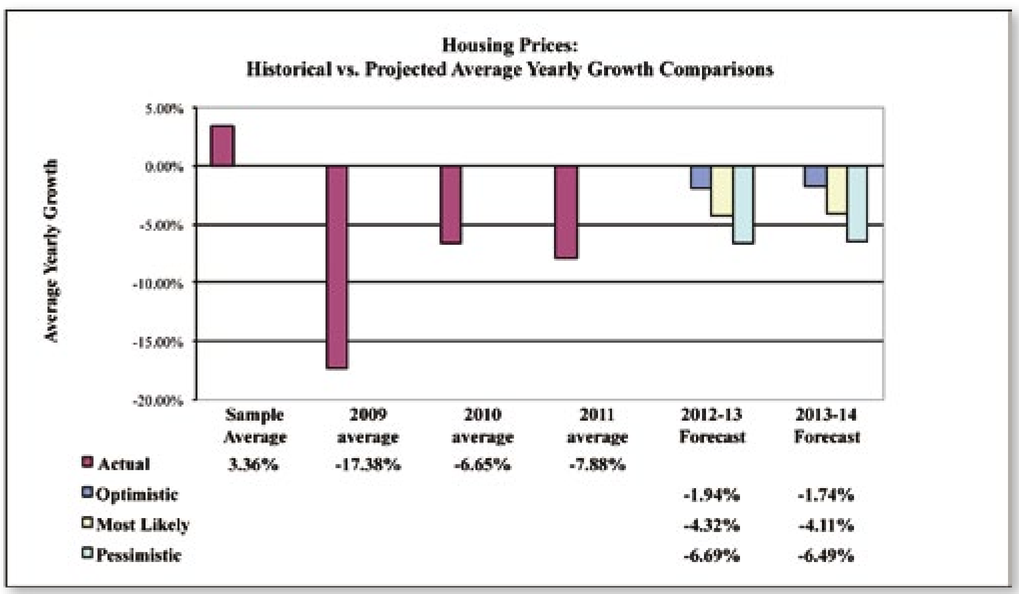
When actual, rather than imputed, values are taken into account, Valley housing permits declined at a yearly average rate of -18.5 percent since 2004. The worst decline occurred in 2009 at -24.2 percent. Surprisingly, housing permits in the Valley in 2010 posted a very weak positive growth at 0.3 percent, followed by another decline in 2011 at -1.2 percent. When compared with 2009, the growth rates in 2010 and 2011 suggest that the series became flat at about 500 per month entering into 2012. The growth rates in January and February 2012 were quite promising, at 8 and 13 percent respectively. The model predicts a turnaround in the first half of 2012 that is likely to improve in 2013 and 2014.



Building permits are projected to increase at 5.11 percent from the second half of 2012 the first half of 2013. From the second half of 2013 through the first half of 2014, the projected increase is 8.92 percent, in line with national and regional trends. Several other factors – such as major banks allowing mortgagers in difficulty to rent their houses instead of going to foreclosure, a faster pace of job growth, and the foreclosure relief program – are all expected to contribute to increased growth rates. The rental market is now more active than ever, contributing to a rise in rental prices in the Valley.



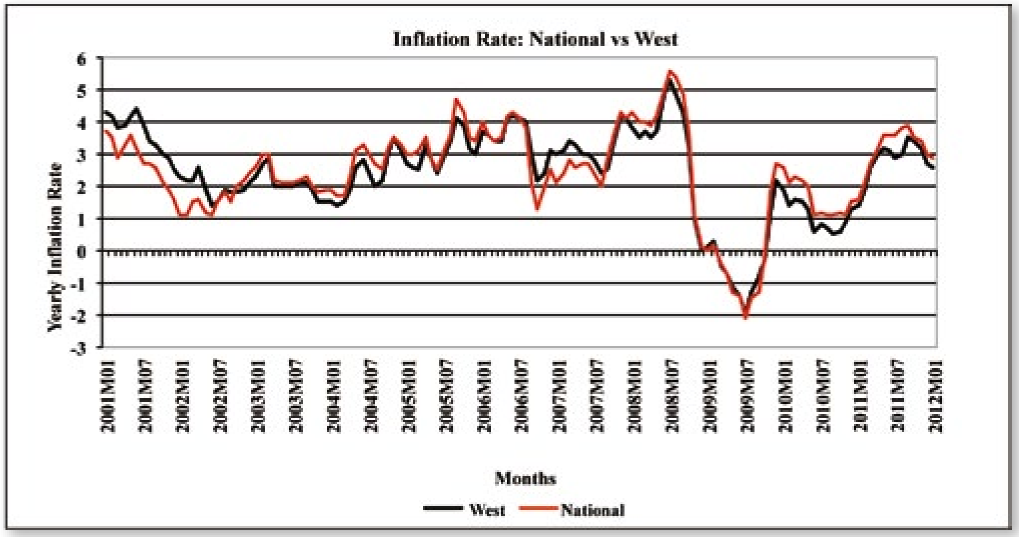
Housing prices in the Valley, despite the crisis of 2007-2009, rose at an average yearly rate of 3.36 percent since 2001. Given the historical annual inflation rate of 2.5 to 3.0 percent, housing pricing actually kept pace with the inflation rate over the years even under the devastating effects on home prices of the housing crisis. The foreclosure relief program put into effect in the first quarter of 2012 should contribute significantly to halting the fall in housing prices.



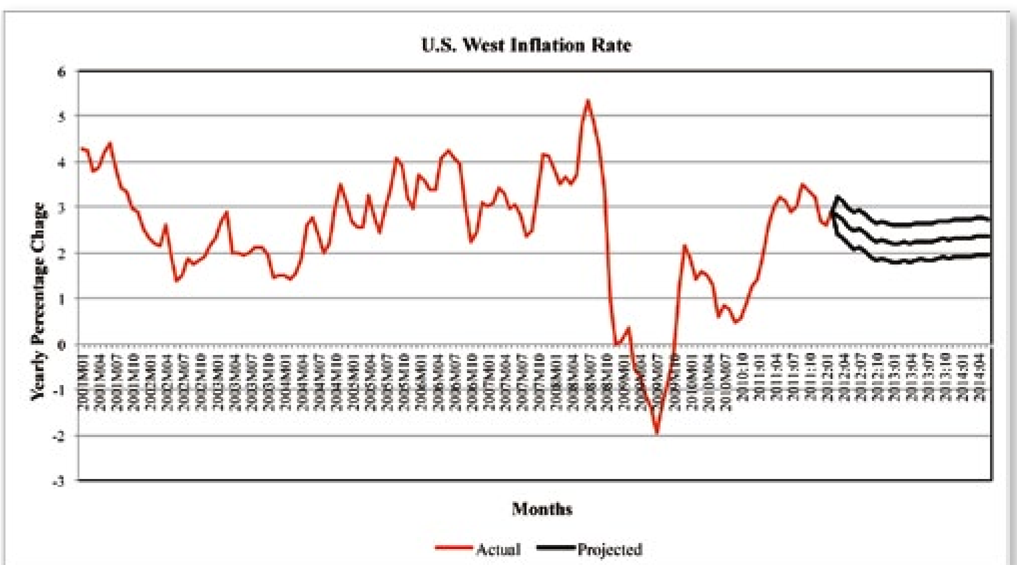
Our projections successfully predicted that housing prices would fall at a much slower rate than 2009. During 2009, housing prices fell at -17.38 percent, an unprecedented rate. During the forecast interval, between the second half of 2012 and the first half of 2013, the deceleration in housing prices appears to give way to a constant fall in housing prices at around -4 percent a year. After mid-2013, the fall in housing prices is optimistically projected to hover around zero percent, thus signaling price stabilization for the first time since the recession of 2007-2009.

Inflation and Prices

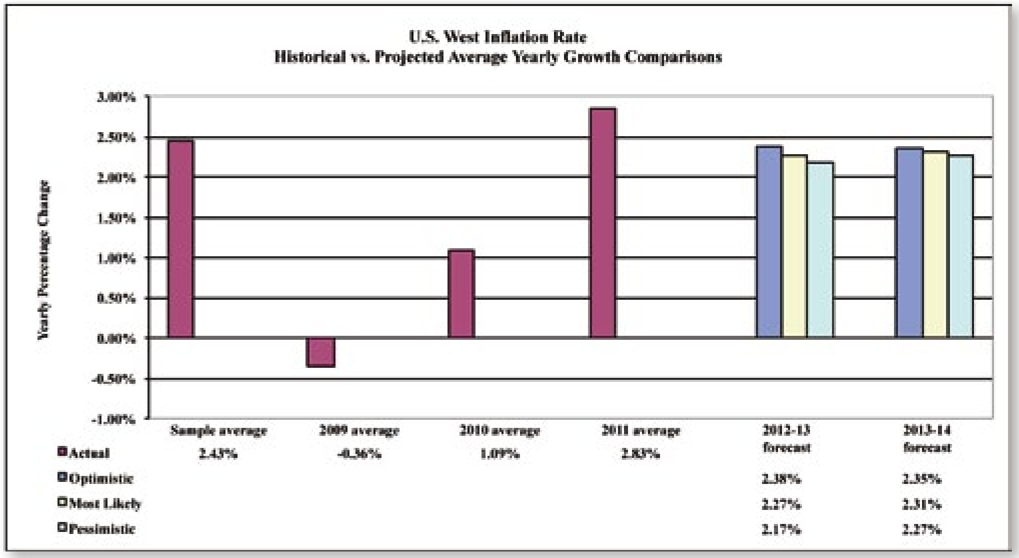
Despite higher inflationary expectations in 2011, there has been a downward trend in the inflation rate from September 2011 through February 2012. Further, inflation rates in the Western region once again fell more than the national average. Cost-push factors such as the recently observed blip in oil prices this past February put an end to this downward trend, causing the series to post a slight increase of 2.9% a year, which is projected to be temporary.



The Western region posted inflation rates lower than the nationwide average. These have prevailed since the beginning of 2010, mainly attributable to demand-pull factors in the region resulting from the lasting effects of the housing crisis and higher unemployment. The Consumer Price Index yearly inflation rate is projected to fall and oscillate around a lower value of 2.29 percent a year both in 2013 and 2014, provided that the Fed refrains from injecting more liquidity into the economy.

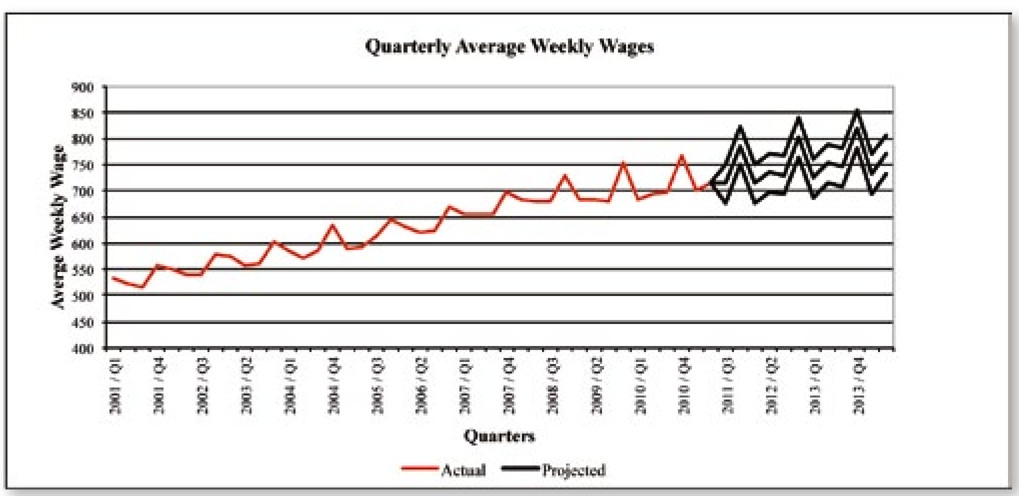


The projected decline in the inflation rate is expected to bring the long-term average inflation rate in the U.S. to 2.43 percent a year. One exception would be an over-heating economy in the projected interval. Although there are signs that the economy is picking up pace, the increase in traction is not strong enough at the present time to create concerns in that regard. In the forecasting intervals of July 2012 to June 2013 and July 2013 to June 2014 the inflation rate in the West region is projected to fluctuate around an average yearly value of 2.27 and 2.31 percent, respectively.

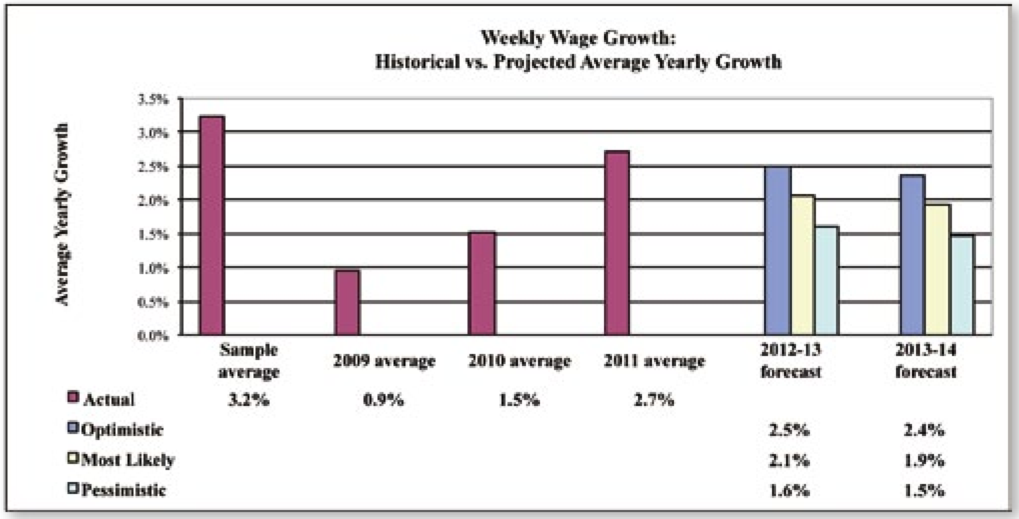


Because of the concerns about the European debt and the future credibility of the Euro, the dollar performed more strongly against other currencies than it did in the past. This in turn caused a worsening of the U.S. currency account. As the debt woes in Europe continue to exist well into the latter part of 2012 and 2013, the dollar is projected to remain strong against other currencies, including emerging market countries such as Mexico, as investors choose the dollar as a safer haven than the Euro.

Apart from seasonal volatility, Valley average weekly wages exhibited a stable upward trend beginning from 2009 and continuing to the end of 2011.



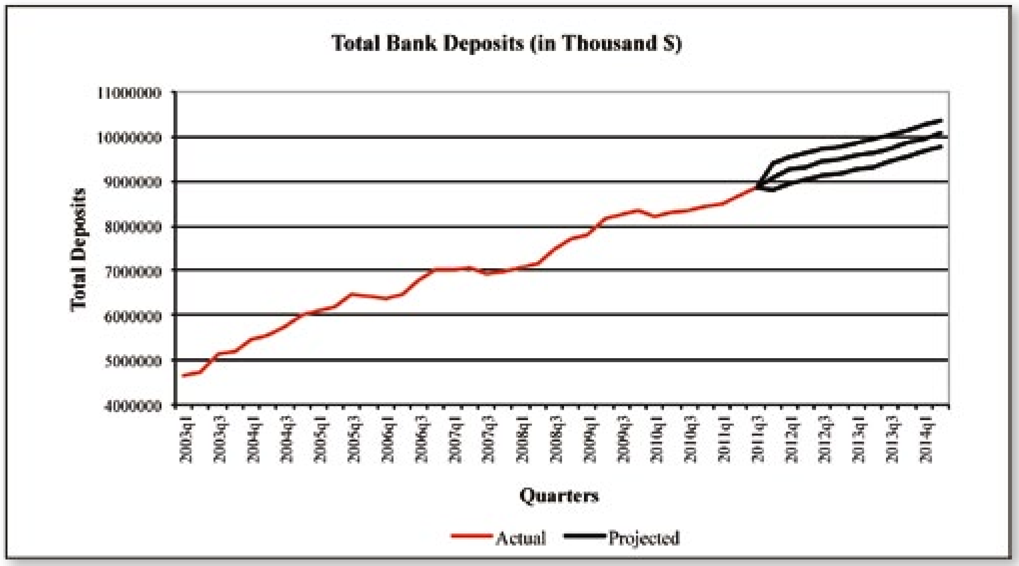
Valley weekly wage growth declined from 3.0 to 2.7 percent in 2011 as actual figures from the last quarter turned out to be less than the yearly average. This fall was consistent with the declining inflation rate over the same period. Still, long-term average yearly wage growth at 3.2 percent continued to remain above the 2.4 percent long-term value of inflation.



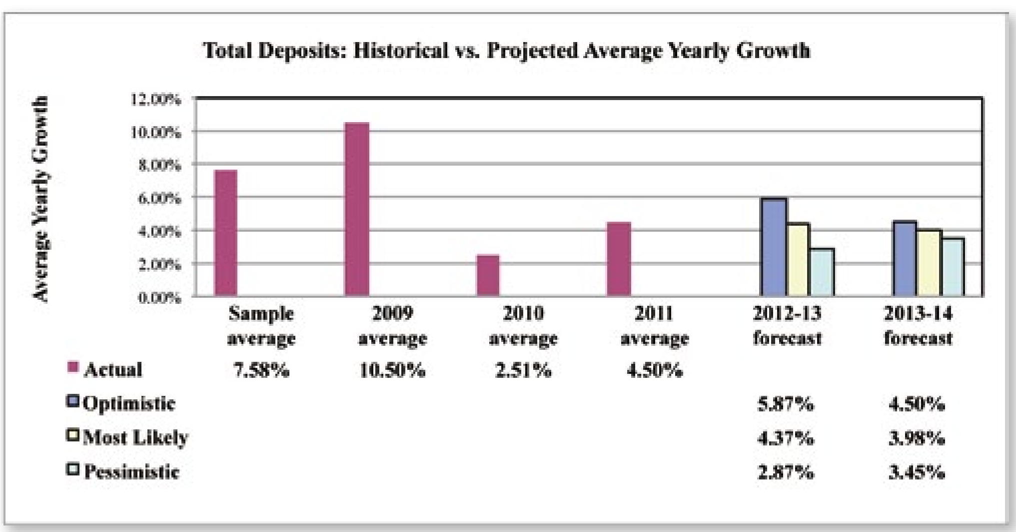
As inflation is projected to display a declining trend in the forecasting interval, so is the Valley weekly wage growth. Weekly wages are projected to grow at an average rate of two percent a year. Compared with the rest of the nation, weekly wages in the West region appear to approach the national average. This reverting behavior is not surprising, given the steady increases observed in wage growth in the years 2009, 2010, and 2011.

Banking and Capital Markets

With the recently announced foreclosure relief program and some banks implementing the new mortgage-to-rent option for homeowners on the brink of foreclosure, banks are now handling the pressures resulting from the prolonged housing slump more effectively. As the economy begins to pick up pace, causing the employment-consumption cycle to become a self-sustaining expansion, banks begin to feel positive effects in their balance sheets. The stock market – now oscillating around pre-crisis levels and becoming bullish starting from the early part of 2012 – is another positive sign for banks. As such, banks now are relatively more stable and self-sustaining. Total deposits in the Valley had increased continually since 2008, as banks were flooded with cash. But more recently, the upward trend became steeper due to the positive effects of the recent trends.

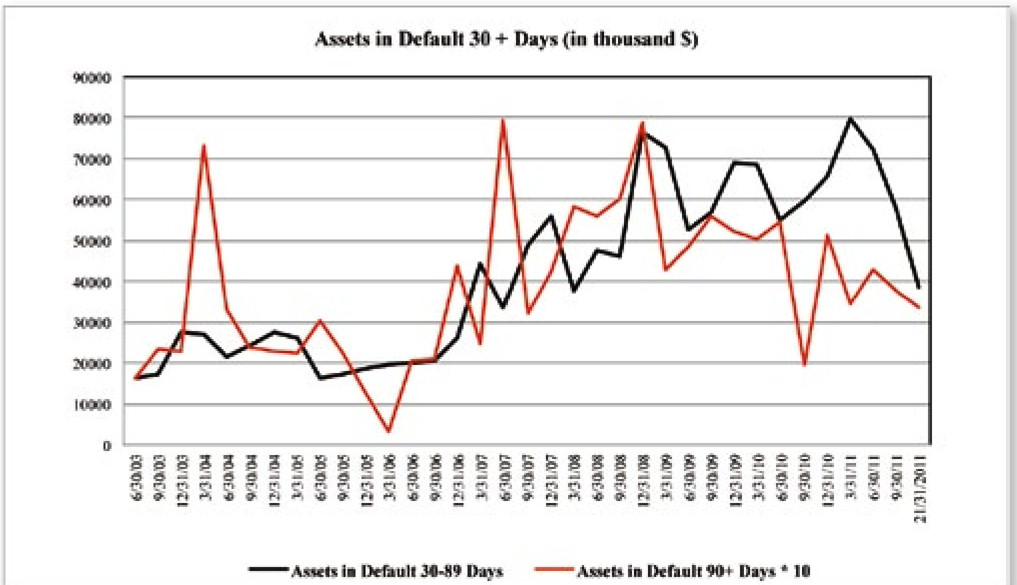


The pace of growth in Valley bank deposits increased steadily from 3.4 percent in the first quarter of 2011 to 5.9 percent in the fourth quarter of 2011. As economic recovery slowly gains strength and investors begin to move their funds from cash reserves back into the stock market, the pace of growth in bank deposits is projected to increase at a slower rate.



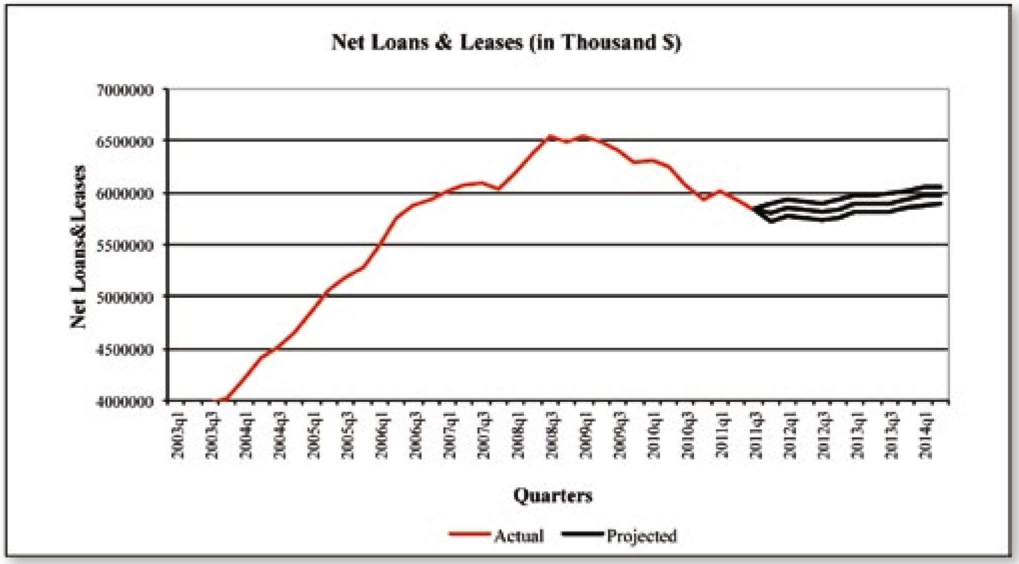
The year 2009 marked the worst year of the recession, during which the greatest flight to cash occurred. Since 2003, bank deposits in the Valley grew at the yearly average rate of 7.58 percent, a rate more representative of natural rate of growth in this indicator. From the second half of 2012 to first half of 2014, bank deposits are projected to grow at an average yearly rate of 4.17 percent as investors begin to withdraw their cash holdings and invest in risk-bearing assets to take advantage of higher returns resulting from a better performing economy.

San Joaquin Valley assets in default more than thirty days displayed a rising trend from the first quarter of 2006 to the first quarter of 2008, and have been decreasing since then. Assets in default 30-89 days peaked temporarily in the second quarter of 2011 but generally displayed a falling pattern in line with the overall trends in accruals.

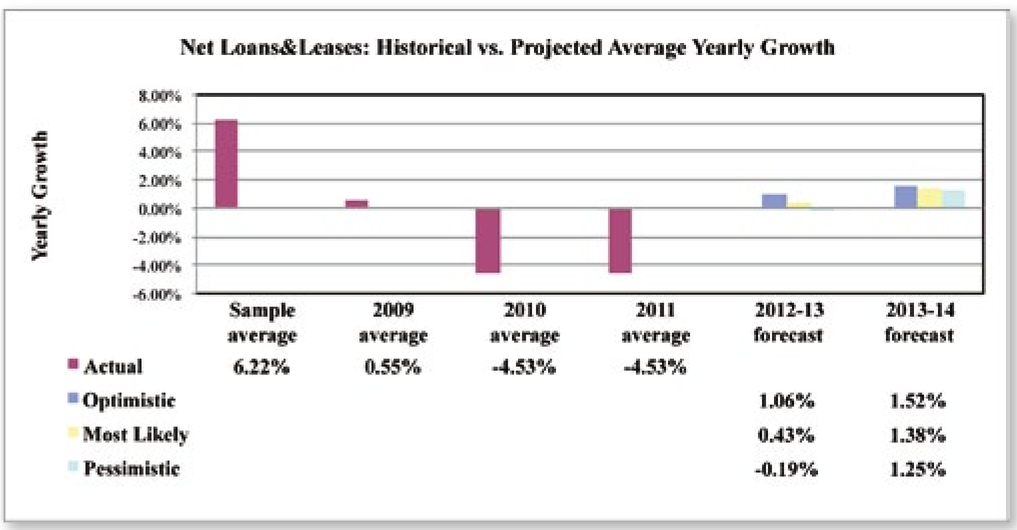


Assets in non-accrual status increased exponentially from the last quarter of 2006 to the second quarter of 2009 and have been displaying a flat trend since then. From the third quarter of 2011, however, the series appears to have begun displaying a pattern consistent with a decrease in non-accruals. It is worth noting that assets in non-accrual status may increase again, depending on the pace of foreclosures. In the forecast interval, foreclosures may display a temporarily increasing pattern as major banks stop holding back on new foreclosures following the new settlement reached in nearly all U.S. states.

Valley net loans and leases continued its decline in the latter part of 2011. The biggest decline occurred in the second quarter of 2011 at -5.0 percent, followed by a -3.7 percent in the third quarter. Despite its long-term average yearly increase of 6.22 percent since 2003, Valley net loans and leases have been in a steady decline since 2008.



The continued decline is unusual given the increases observed in Valley bank deposits. One would expect these deposits ultimately to be channeled back to the community in the form of increased extensions of loans and leases. However, one could also argue that newly introduced tougher regulation, consumers working on correcting their balance sheets, and depressed aggregate demand have caused net loans and leases to decrease over time.



As the economic recovery begins to take hold and employment-consumption activity begins to turn into self-sustaining expansion, the expectation would be for net loans and leases to begin increasing over time. In the forecasting interval, therefore, the model projects a turning point to occur and net loan and leases to begin increasing at an average rate of 0.90 percent a year.

Summary and Concluding Remarks

While occurring at a more modest pace than the nation, the recovery is beginning to take hold in the San Joaquin Valley. For the first time in four years and since the 2007-2009 recession, average yearly job creation in the San Joaquin Valley climbed back to a positive figure. This change of direction from negative to positive in four years is particularly noteworthy. In the recent past, such as in 2009 and 2010, the Valley posted average yearly job losses of -2.3 and -2.4 percent. Since 2001, the Valley average growth hovered around 0.7 percent a year. Although miniscule, there was net job creation of 0.82 percent in 2011. Adding to this momentum, Valley total employment was positive for the four consecutive months since September of 2011, with the largest growth occurring in the months of November and December at 2.11 and 1.85 percent respectively. These numbers may appear to be small, as is the case for employment indicators, but are quite significant when compared with long-term rates and their dispersion around the mean.

Areas such as construction, financials, and government employment continued to suffer in 2011. Despite a general improvement nationwide in government jobs, there was a significant decline in Valley government employment. Although less than previous years, durable goods employment also declined by -1.5 percent, financials by -1.67, and most notably government jobs fell by -2.3 percent in 2011. Wholesale, information, education, and health (of which 60 percent is private), leisure and hospitality, and trade, transportation and utilities employment, all did well and grew, posting positive job growth numbers in 2011. A slowdown in manufacturing, consistent with nationwide trends, also occurred in the Valley in the last few months of 2011.

In all, when compared with their long-term averages since 2001, these indicators show that the economic recovery is slowly gaining strength even here in the Valley. Job growth in the Valley, once again, began to outpace California's job growth in November and December of 2011.

Average sales prices of new single family houses continued to decline at a slower rate and are expected to stabilize by early 2014. Consumer confidence began rising and registered a one-year high in the first quarter of 2012. The current sentiment of the general public has been relatively more upbeat because of the perception that the economic recovery is now creating jobs and incomes. This in turn gradually leads to a self-sustaining expansion. However, it will take time, at an increase in job creation rate above 120,000 per month, to bring 12 million unemployed back to the levels consistent with the natural rate of unemployment.

The national stock market is now trading around the pre-crisis level. This in turn helps in creation of a bullish environment for investing. In the first quarter of 2012, the stock market had the best performance since 1998. However Europe's debt problems continue to worry investors. Industrial production index at home continues to point to a gradual recovery, but added to Europe's debt problems, a dramatic slowdown in China and India could bring back worries of a global recession.

In all, the region's forecasts in the June 2012 to June 2014 interval point to a recovery that is now slowly taking hold. The general perception of the public is that the worst happened in 2009 and is not very likely to happen again in the near term. The Valley economy has been slowly gaining strength since 2009. As the aftershocks cease to occur, the recovery that began to take hold in the last quarter of 2011 is projected to extend through the forecasting interval until the first half of 2014.

Appendix

Forecast Accuracy Table

	Percent Forecast Error	Accuracy	Turning Point
Total Employment	0.14%	99.86%	Yes
Real GDP	-13.83%	86.17%	Yes
Construction	-2.68%	97.32%	Yes
Durable Good	0.53%	99.47%	Yes
Education & Health	-1.75%	98.25%	Yes
Government	N/A	N/A	N/A
Financial Services	-0.77%	99.23%	No
Information	0.18%	99.82%	Yes
Leisure & Hospitality	-0.37%	99.63%	Yes
Manufacturing	4.03%	95.97%	Yes
Non-Durable Goods	1.04%	98.96%	Yes
Retail	0.15%	99.85%	Yes
Trade,Trans. & Util.	-1.10%	98.90%	Yes
Wholesale	0.69%	99.31%	Yes
Inflation	16.62%	83.38%	Yes
Quarterly Average Wage	0.99%	99.01%	Yes
Change in Housing Price	N/A	N/A	N/A
Net Loan/Leases	N/A	N/A	N/A
Housing Permits	N/A	N/A	N/A

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