Business Forecast Report

2013

San Joaquin Valley

Volume 2, Issue 1

California State University | Stanislaus

MESSAGE FROM THE PRESIDENT

CSU Stanislaus is committed to supporting this region. Our roots here – the San Joaquin Valley and foothill communities – run deep. Most of our students are from here, and most of our graduates stay here. They make up a large portion of the region's educated workforce and have a huge impact on our economy. We strive to provide them with the high quality, cutting-edge education that they need to contribute to today's fast-moving world.

Our impact goes even beyond our graduates, however, as is apparent with this business forecast report, prepared by our Foster Farms Endowed Professor of Business Economics, Dr. Gökçe Soydemir. Dr. Soydemir uses industry data to identify trends and build forecast projections. His forecasts focus specifically on this region and its major industries. This focus provides area businesses with specific data and projections to assist them in their business planning. By supporting the these businesses, we contribute to the economic recovery and advancement of the entire region.

We are thankful to Foster Farms and the Foster family for their support. This business forecast report would not be possible without their commitment to this region and CSU Stanislaus.

Sincerely,

Joseph F. Sheley

BUSINESS FORECAST REPORT

2013

San Joaquin Valley

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Dr. Gökçe Soydemir

FOSTER FARMS ENDOWED PROFESSOR OF BUSINESS ECONOMICS

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.

Dr. Soydemir received his Ph.D. in Economics from Claremont Graduate School, Claremont, CA; an M. Phil. in International Finance from Glasgow University, Scotland, U.K.; and a Bachelor of Science in Economics from Middle East Technical University, Ankara, Turkey. He has several years of central banking experience co-constructing and forecasting large and medium scale macro-econometric models. In addition, he has conducted policy independent research on monetary economics.

Contents

Executive Summary ii
A~ Introduction iii
B~ Employment Indicators 1
C~ Household Sector 29
D~ Inflation and Prices 33
E~ Banking and Capital Markets 38
Summary and Concluding Remarks 43

The author would like to acknowledge the contributions of student assistants
Daniel Herrera and Benjamin Ross
in the preparation of this report.

Executive Summary

Despite fluctuating performance from one month to the next, the U.S. economy continued to grow at a gradual pace in 2012. In terms of job creation nationwide, California was the second after Texas in 2012. At the aggregate level, San Joaquin Valley employment grew by an average of 2.08 percent a year in the first eight months of 2012. The fastest job growth occurred San Joaquin and Kings counties at 4.38 and 4.18 percent respectively. All counties posted job growth at varying rates except Madera at -.2 percent decline. Overall, 2012 Valley employment growth was more than double its long run historical rate of .8 percent.

To quicken the national economic recovery, the Federal Reserve introduced phase three of Quantitative Easing (QE3) in September 2012. Open-ended QE3 is set to continue until unemployment significantly improves at the national level. Immediately following the QE3 announcement however, the spread between regular and TIPS treasury securities widened significantly reflecting increasing inflationary expectations for the long run.

The yearly inflation rate in the western region fell from 2.8 percent in 2011 to 2.1 percent by August 2012. Due to aggregate demand growing faster than the nation, inflation in the West exceeded that of the nation by .4 percent during this period. For the first time since the recessionary period of 2007-2009, average change in sales price of new single-family houses is projected to post a switch from negative to positive territory in 2013. The steep decline observed earlier in foreclosure starts for the West slowed considerably following the end of the foreclosure settlement reached by banks in early 2012 temporarily interrupting the downward pattern in foreclosures. However, foreclosures are projected to decrease further during the forecasting interval of 2013–2014. Slowly rising consumer confidence, in line with improved retail, consumption and construction spending jumped in September 2012 following QE3.

There was a slight decrease in Valley real wages in 2011 and 2012 when the average hourly wage growth fell behind the inflation rate in the region. The current sentiment of consumers and investors alike has improved following the new phase of quantitative easing. Valley jobs grew in all areas except the government sector in 2012. However, our projections point to an improvement in this employment category beginning in 2013. Slow growth was observed in information technology employment.

Most notably, the Valley economy began catching up to its long-term mean, showing slowly strengthening performance. Following a well-defined housing market turning point in the past year, builders slowly began constructing new dwellings. The unemployment rate is now below 8 percent nationally, and the U.S. real GDP is projected to grow more significantly in 2014 than 2013. As projected in our earlier reports, the natural rate of unemployment of 12 percent for the Valley and 6 percent for the nation is projected to be reached by early 2014.

In all, our analysis projects that the Valley economy in 2013 and 2014 is going to perform at more accelerated rates than in previous years for two main reasons. First, at the aggregate level in the Valley, incoming numbers in 2012 now point to employment growth that is well above previous years. Second, QE3 in September 2012 has increased medium-term expectations of consumers and businesses alike. Improved expectations as reflected in such leading indicators as consumer confidence and new orders indexes currently provide an added incremental effect on the future performance of the economy.

Introduction

The purpose of this year's forecast report is to provide forecasts from 2013 to the end of 2014 and inform the business community on the past, current and future trends of the Valley economy.

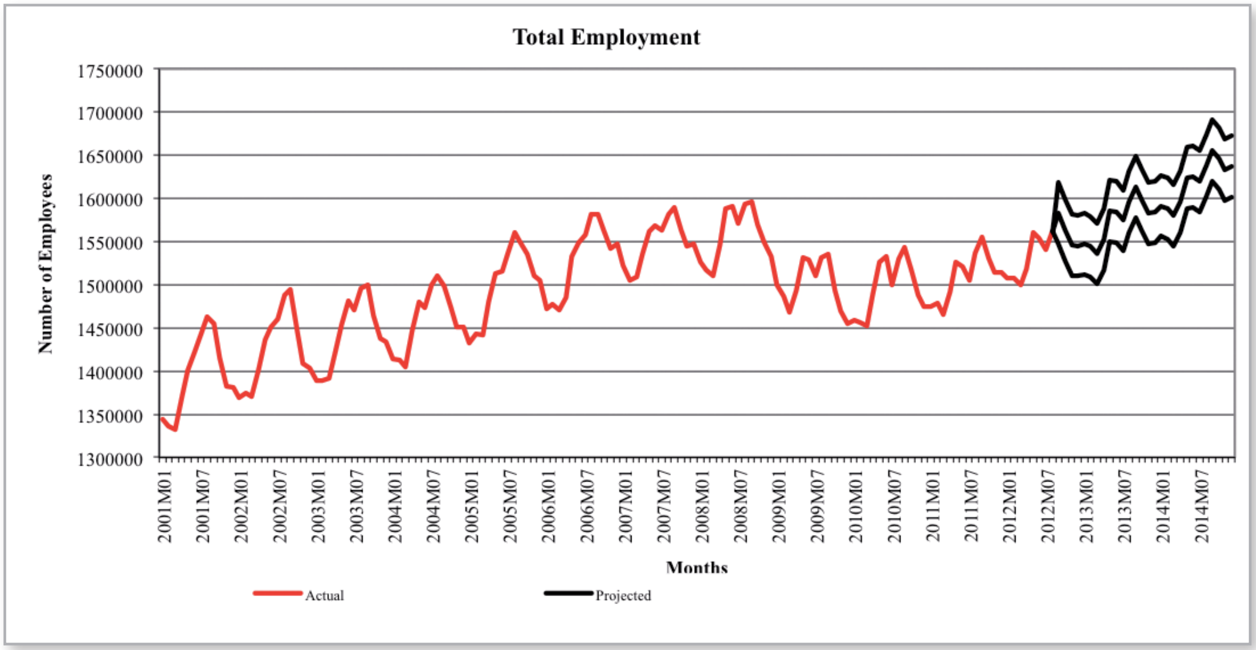
Each mean forecast line is displayed with lower and upper statistical confidence bands. The actual values – realizations – are expected to fall within this range. Given the low percentage errors, the out-of-sample forecast accuracy appears to be in the range of 94 percent. Forecasts are generated using actual numbers until August 2012, and the percentage changes in 2012 are based on the same month previous year.

The remainder of this 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.

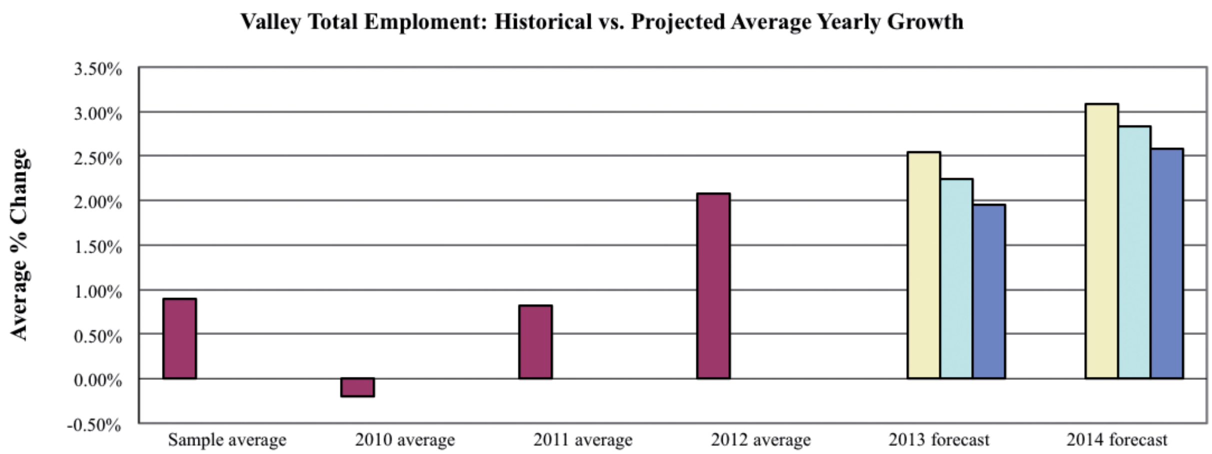
We thank the Valley community for providing valuable feedback throughout the year and hope to receive further suggestions to improve our future business forecast reports.

Employment Indicators

At the aggregate level, San Joaquin Valley annual average employment grew at 2.0 percent in the first eight months of 2012. However, not all counties grew the same. While San Joaquin and Kings counties grew above 4 percent over this period, Madera was the only one that had a negative growth of -.2 percent. Employment gains in Stanislaus and Merced counties were modest at .8 percent each.

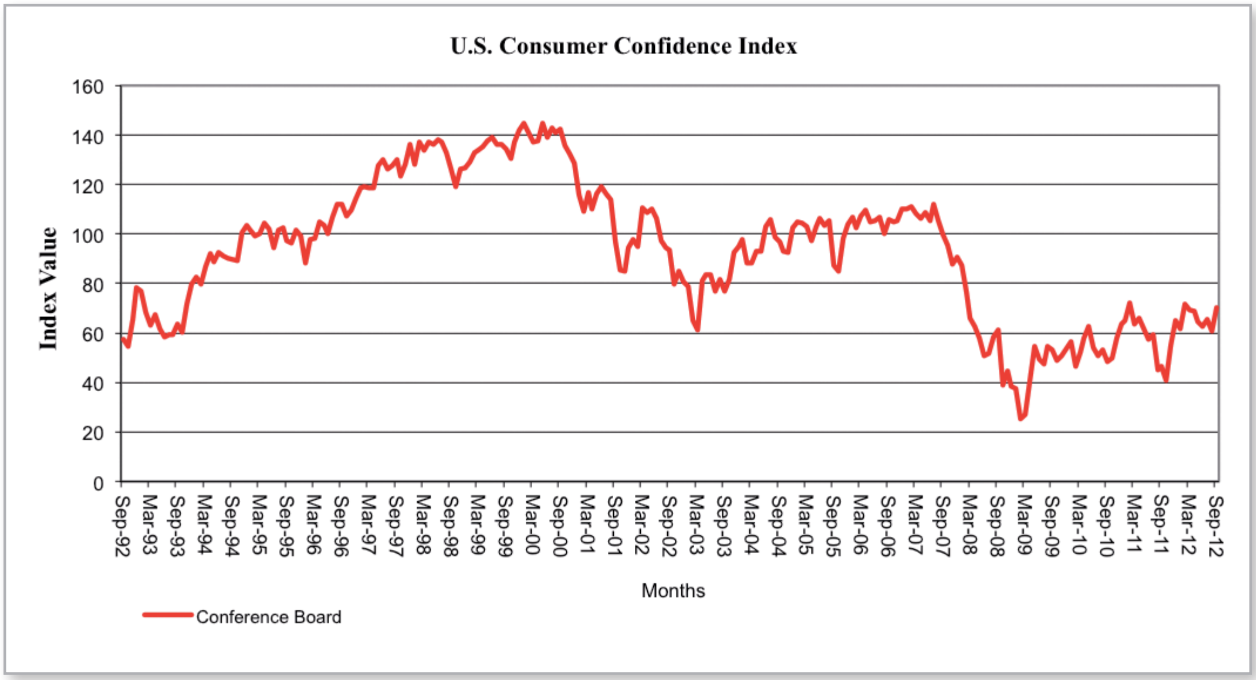


The trend since 2010, unlike the previous year, now appears to be relatively well defined and sustained approaching its structural pattern prior to the Great Recession. With improving numbers for the Valley at the aggregate level, long-term employment growth has increased from .7 percent to .9 percent. Valley employment grew by 2.08 percent in 2012, which was more than double its long-term rate of .9 percent. When compared to 2010 and 2011 growth rates, there appears to be a clear sign of sustained recovery since the recessionary period in 2007–2009. Our forecast predicts this recovery to continue into 2013 and 2014 at 2.25 and 2.83 percent, respectively, with a more pronounced pace in 2014 after the effects of QE3 begin to weigh in more heavily into the regional economy. Interestingly, average yearly growth in 2012 in total employment at 2.08 percent came close to the average yearly rate of growth in total employment that prevailed before the Great Recession at 2.18 percent.

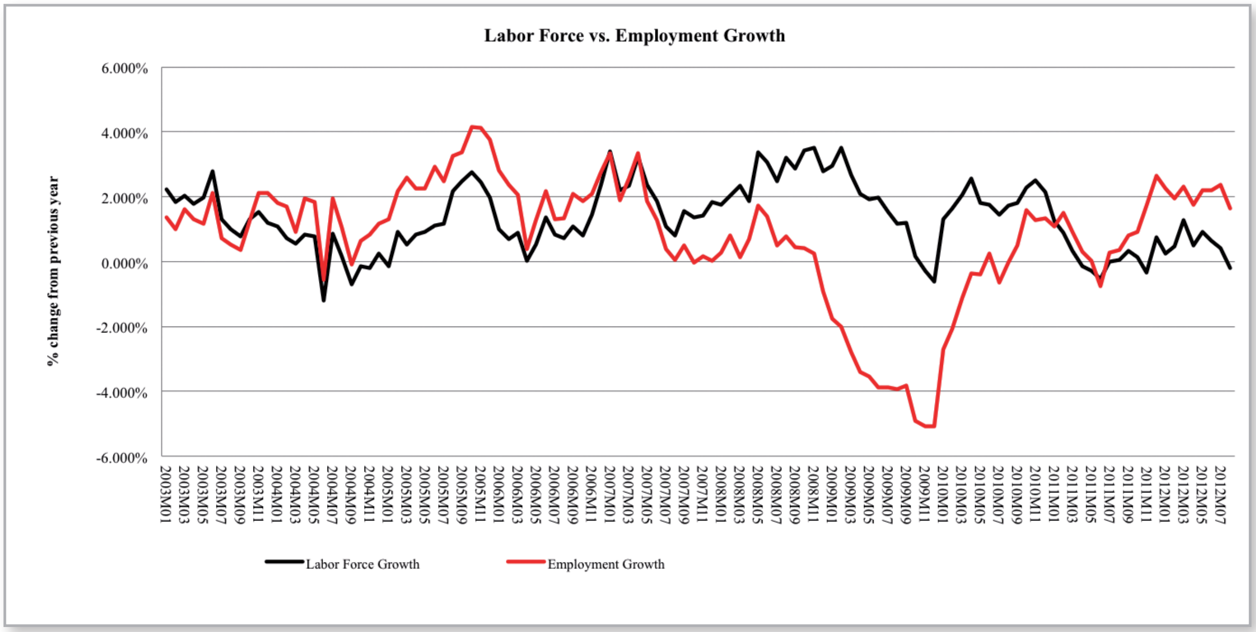


	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	0.89%	-0.19%	0.82%	2.08%		
Optimistic					2.54%	3.08%
Most Likely					2.25%	2.83%
Pessimistic					1.96%	2.58%

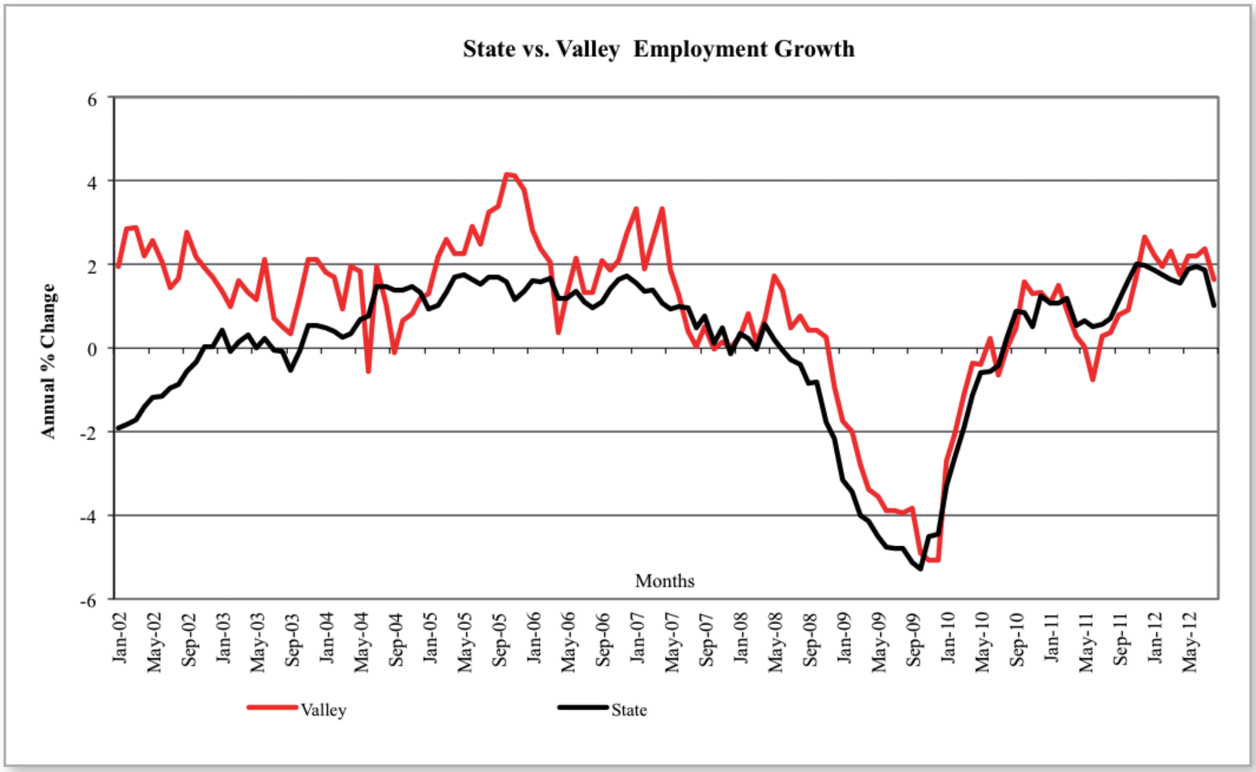
Consumption expenditure is what drives the U.S. economy. The Conference Board's Consumer Confidence Index is a relatively accurate leading indicator that foretells the path of the U.S. economy. The dynamics observed in the last two years appear to be very different exhibiting a sustained but gradual increase from that observed during and immediately before the onset of the Great Recession. During that period the series basically exhibited a free fall prompting some circles to issue a recession warning early on. The gradual increase in the series is suggestive of anticipated increases in consumption, which is further backed by positive retail sales data in 2012. Consumer confidence jumped to 70.2 in September as expectations became more confident following the announcement of QE3.



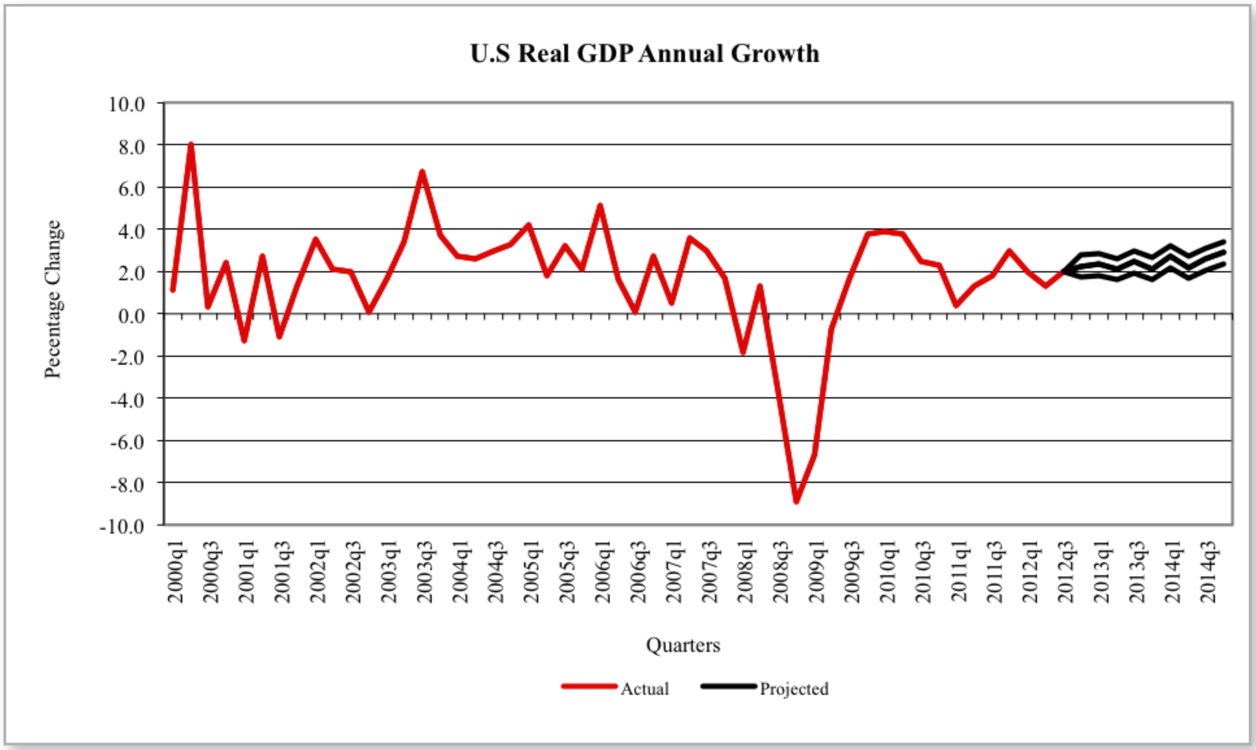
In line with its structural pattern, Valley labor force growth began to exceed employment growth in 2012. This pattern was reversed during the boom years and early recessionary period of 2007–2009, mainly due to influx of population to the Valley and the slow adjustment afterward. Since then, the influx of population has declined significantly, which has caused employment to grow faster than the labor force. This pattern is consistent with its historical behavior and is indicative of the Valley gaining traction in terms of job creation and economic performance.



Consistent with its structural pattern, Valley employment growth in 2012 was above that of California's employment growth. Historically, the abundance of relatively low-cost land, labor and capital provides greater opportunity for growth in the Valley than the rest of the state. The pattern was reversed at times however, during the 2007–2009 recessionary period when the Valley economy was hit hardest by the housing crisis.

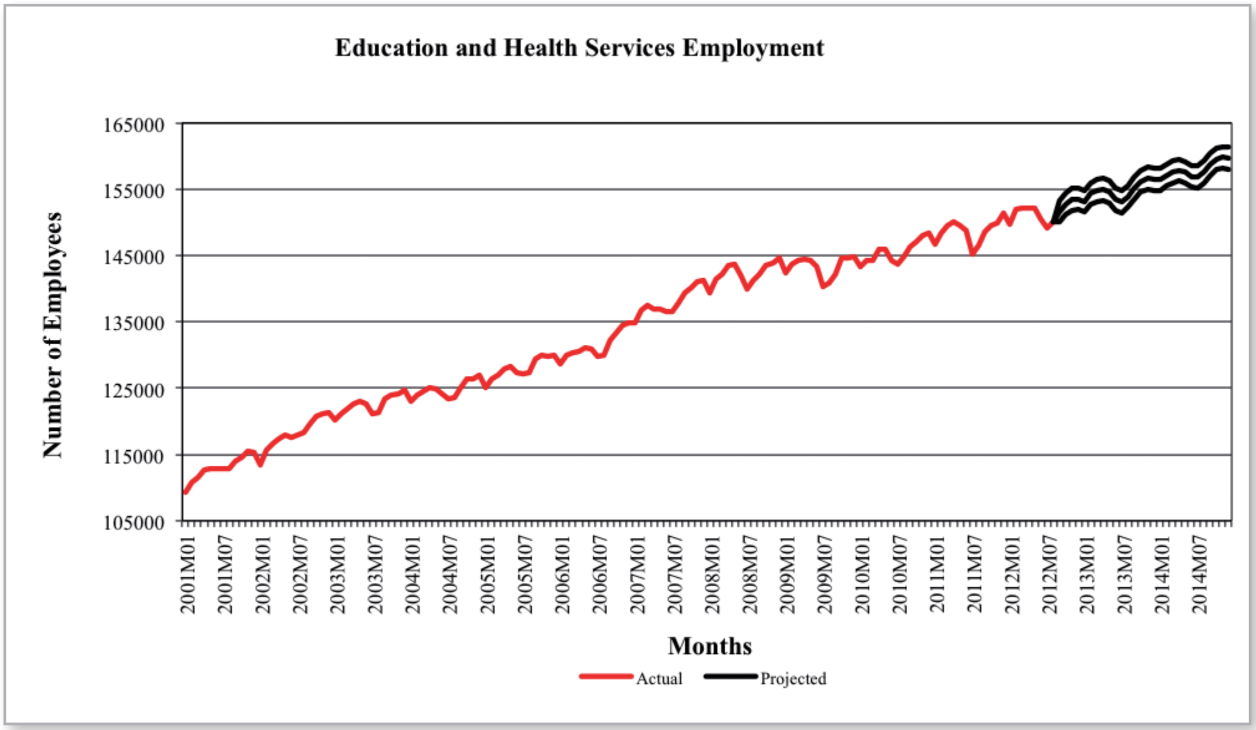


Although recovery first takes place in coastal regions, inland counties such as San Joaquin and Kings were quicker to catch up in recovery relative to Merced and Madera, which exhibited more of the bifurcation between coastal and inland California. Higher employment growth for the Valley is projected to continue into 2013 and 2014.

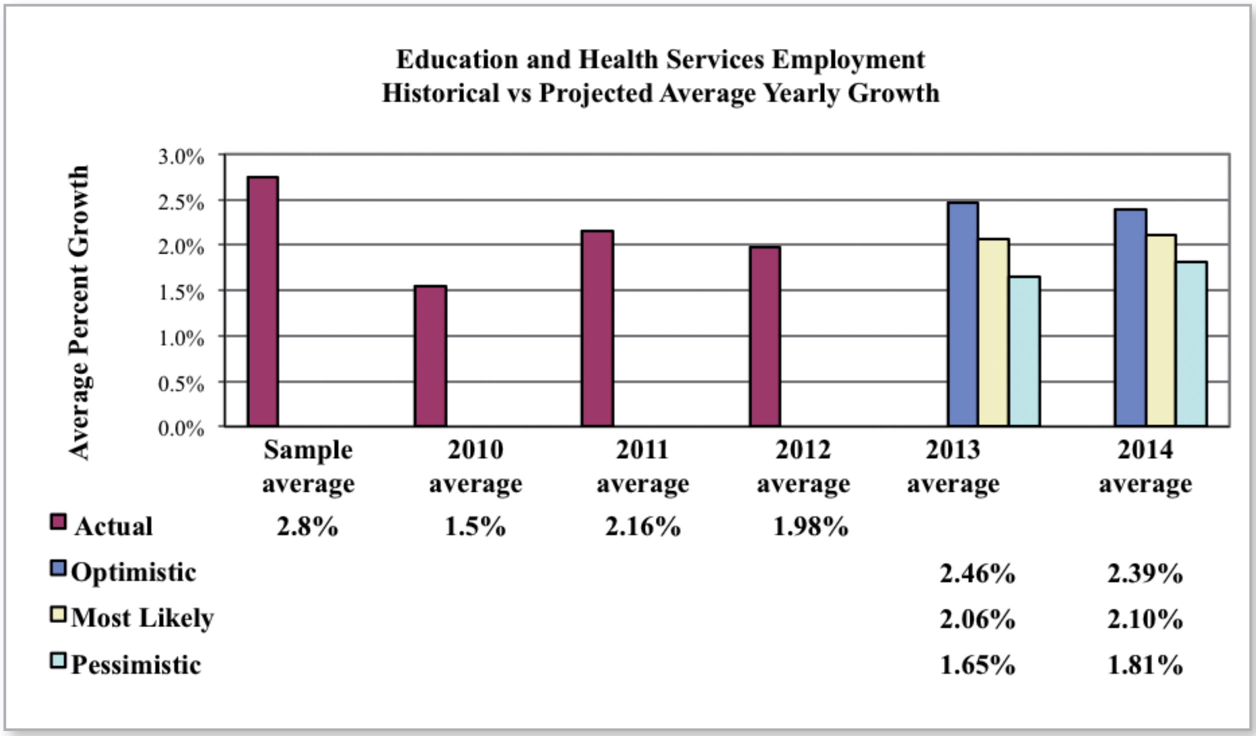


In the first, second and third quarters of 2012, the U.S. real gross domestic product (GDP) grew at 2.0, 1.3 and 2.0 percent respectively. Economic growth as measured by real GDP mostly oscillated around 2 percent. To bring unemployment down, at least 2 percent growth is needed in the U.S. economy, which convinced policymakers to announce Phase Three of quantitative easing to quicken the recovery.

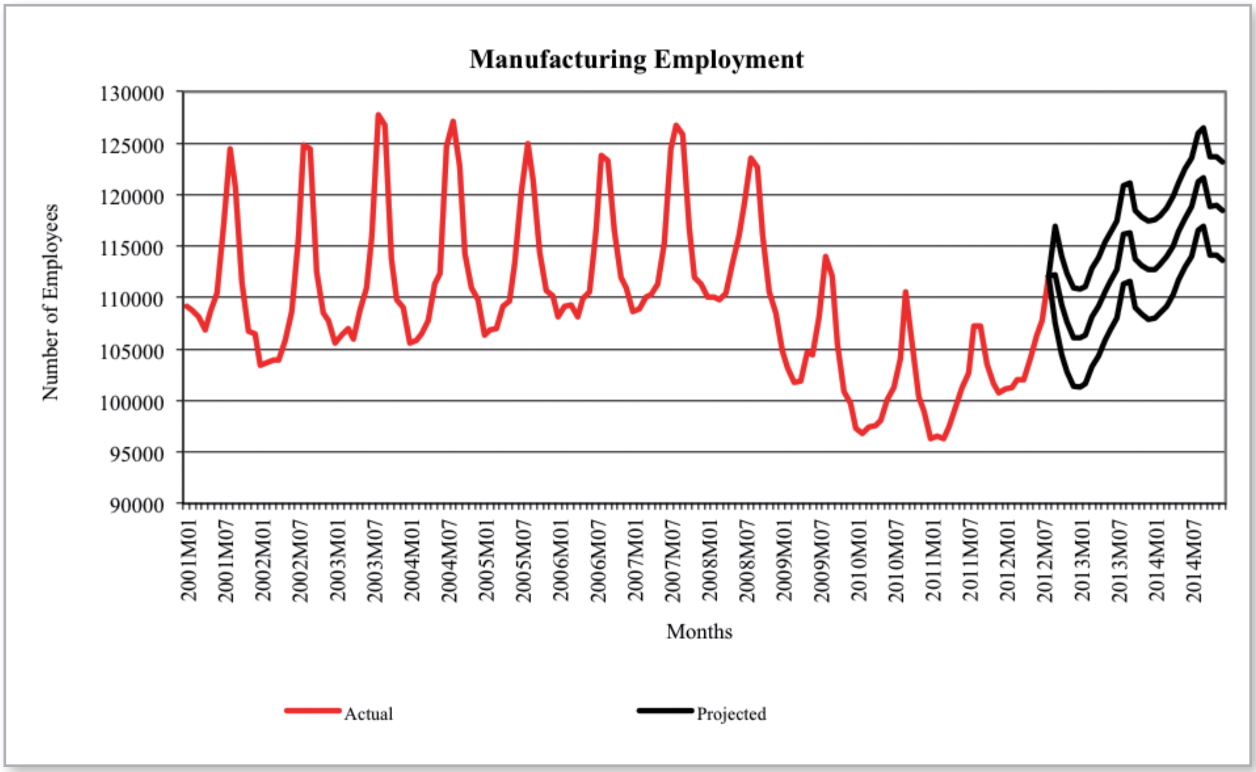
Real GDP is projected to grow at 2.3 and 2.6 percent in 2013 and 2014 with an overall average growth of 2.4 percent. As the effects of the QE3 begin to weigh in more heavily in the economy higher growth numbers are expected in 2014.



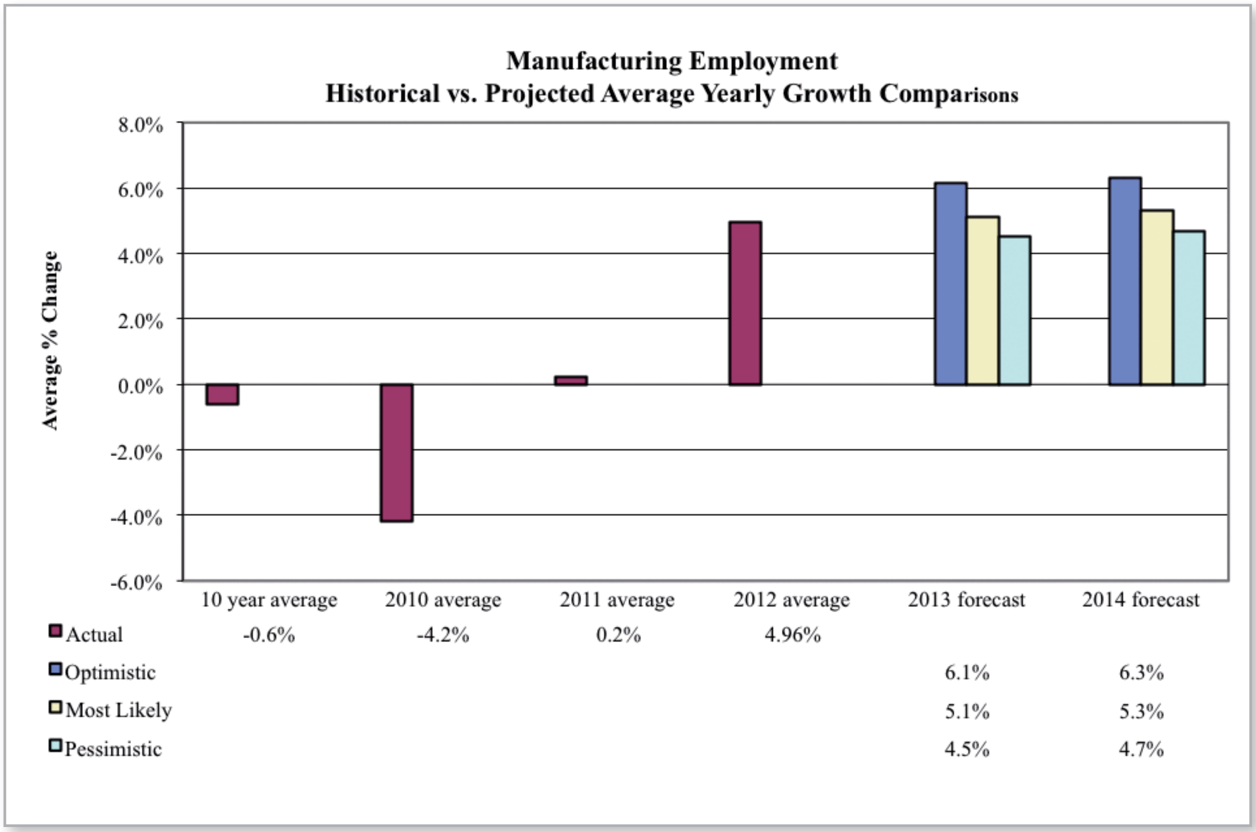
More than half of Valley education and health services employment is private sector. The series historically exhibits the most robust pattern displaying linear growth. Despite being lower than the long-term average growth rate of 2.8 percent, Valley education and health services employment managed to post positive growth rates in 2009 and 2010.



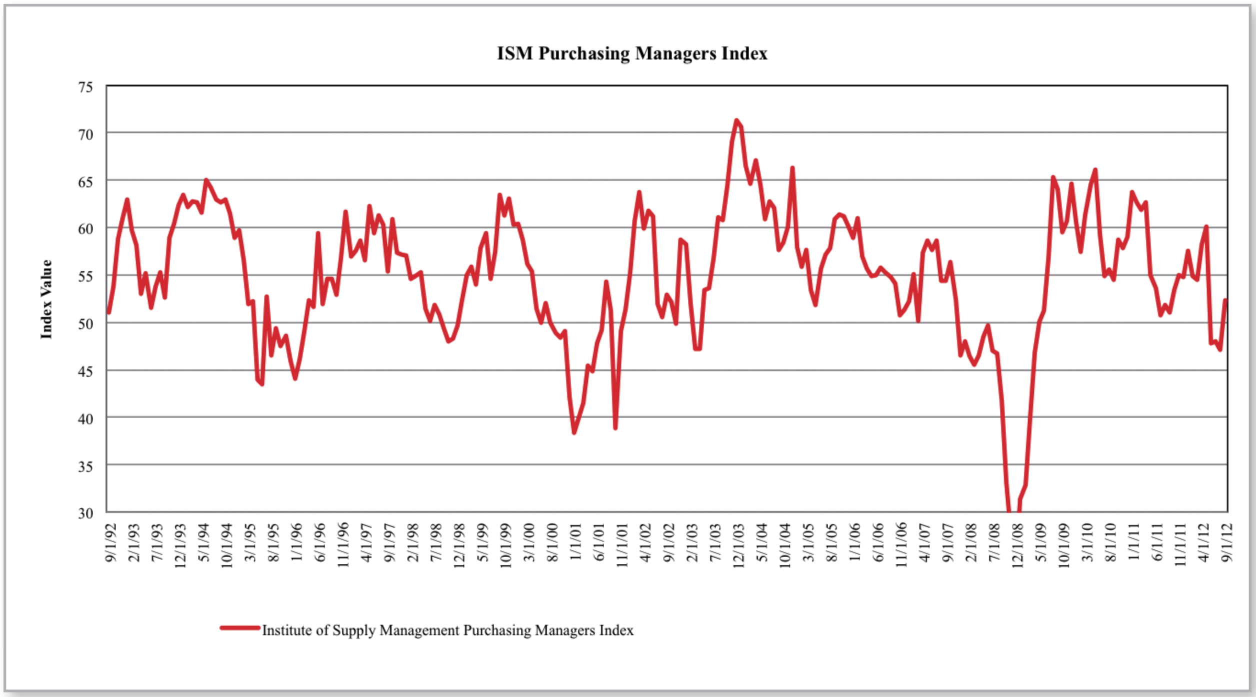
Valley education and health services employment is projected to continue along this robust pattern. Even during the recessionary 2007–2009 period, the series grew 1.0 percent a year indicating that this sector is not much affected by recessions. Education and health services employment in the Valley is projected to grow at an average annual rate of 2.08 percent in 2013 and 2014.



The contraction observed for manufacturing employment in 2009 and 2010 reversed itself in 2011 by growing .2 percent a year. In the first eight months of 2012, yearly average growth in Valley manufacturing employment reached 4.96 percent. Apart from heavy seasonal behavior, the new trend observed since 2010 appears to be steeper than the one observed structurally.

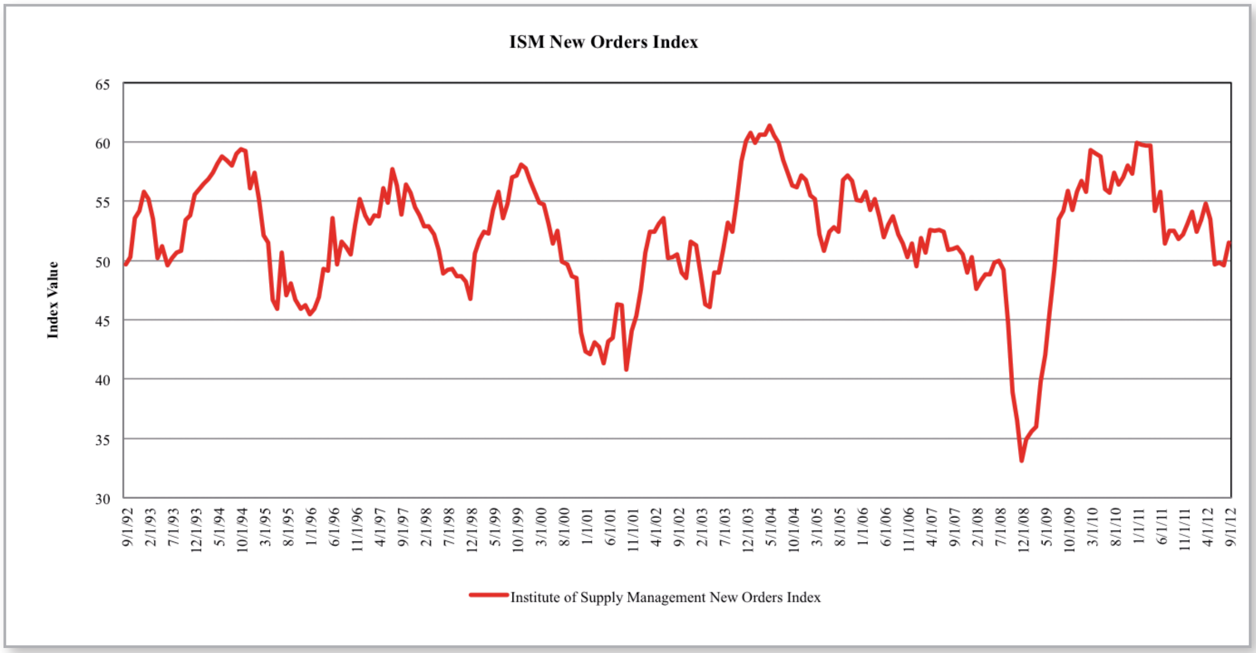


According to our forecasts, manufacturing employment is projected to grow at a yearly average rate of 5.2 percent in 2013 and 2014. Due to QE3, higher employment numbers are projected in 2014. Assuming that the global slowdown proves to be temporary, the actual numbers are more likely to fall within the optimistic range.



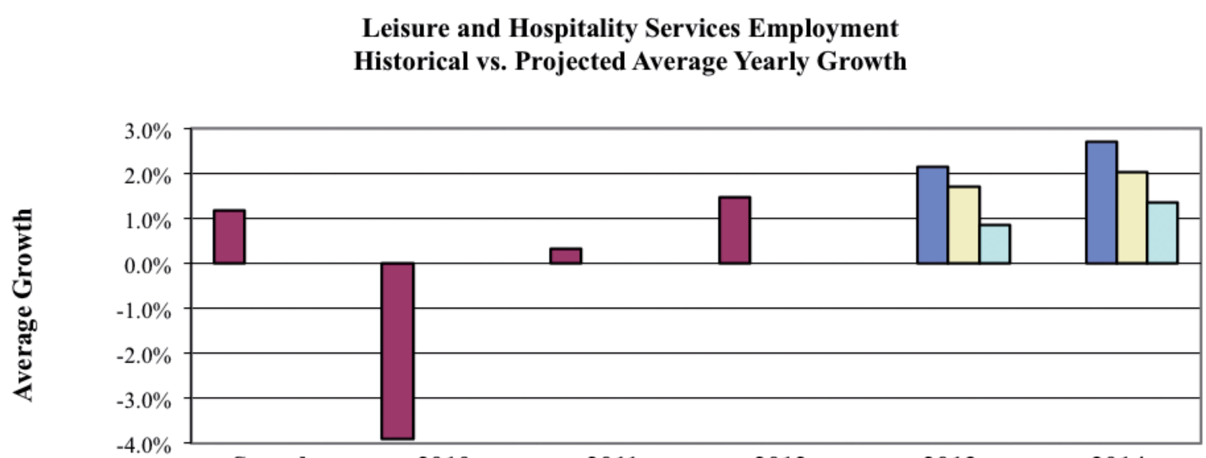
Two leading indicators in manufacturing employment nationwide are the Purchasing Managers Index (PMI) by the Institute for Supply Management (ISM), and the ISM Manufacturing, New Orders Index. Readings above 50 points to expansion in the national economy. These two indicators have fluctuated around 50 points in the first half of 2012, signaling weak manufacturing activity nationwide. The readings, in August and September 2012 were at 47.1 and 52.3 before and after the announcement of QE3. Manufacturing in the Valley does not appear to track this slower nationwide trend in growth according to the employment numbers published by the Bureau of Labor Statistics.

The PMI, a composite index of five "sub-indicators," predicts fairly accurately the beginning and ending of recessions. Its fluctuation around 50 points is indicative of slow expansion; however, with QE3, business sentiments are more likely to reflect expectations of quicker recovery.



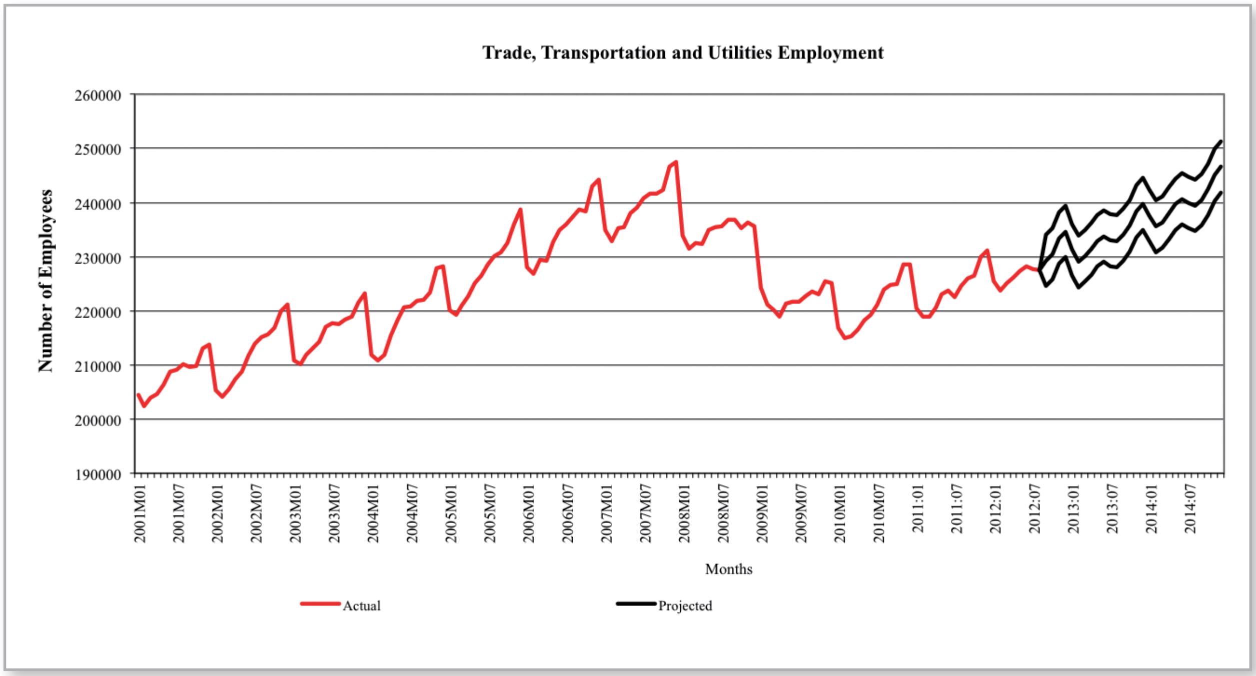
New orders for all manufacturing industries exhibit a pattern consistent with the PMI index. The new orders index has also oscillated around 50 points up until August 2012, suggestive of slow expansion. However, in September 2012, following the announcement of QE3, expectations were immediately revised causing a jump in the index value to 51.5. The holiday season along with Federal Reserve's intervention is leading to expectations of a higher reading for the new orders index in the upcoming months.

Leisure and hospitality services employment grew 1.3 percent in the first eight months of 2012. The yearly growth is now equal to the historical rate which has improved from .3 percent in 2011. Exhibiting heavy seasonal behavior in the summer and winter, leisure and hospitality services appears to be an area in the Valley for which there is ample opportunity for growth. Fully occupied parking lots of newly built hotels during the evening hours are a testament to increased demand in this sector.

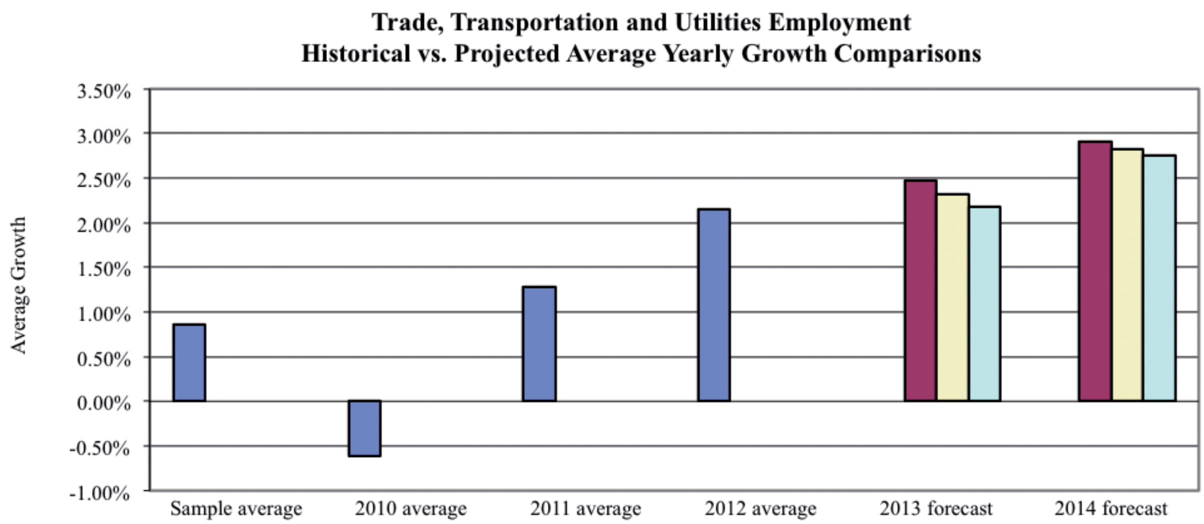


	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	1.2%	-3.9%	0.3%	1.47%		
Optimistic					2.13%	2.70%
Most Likely					1.70%	2.02%
Pessimistic					0.85%	1.34%

In 2013 and 2014, leisure and hospitality services employment is projected to grow at a yearly rate of 1.7 and 2.0 percent, respectively. As the seasonal peaks continue to be more pronounced than the troughs, the growth is projected to be higher in 2014. The long-term trend of the series is now almost parallel to the one that existed before the recessionary period of 2007–2009.

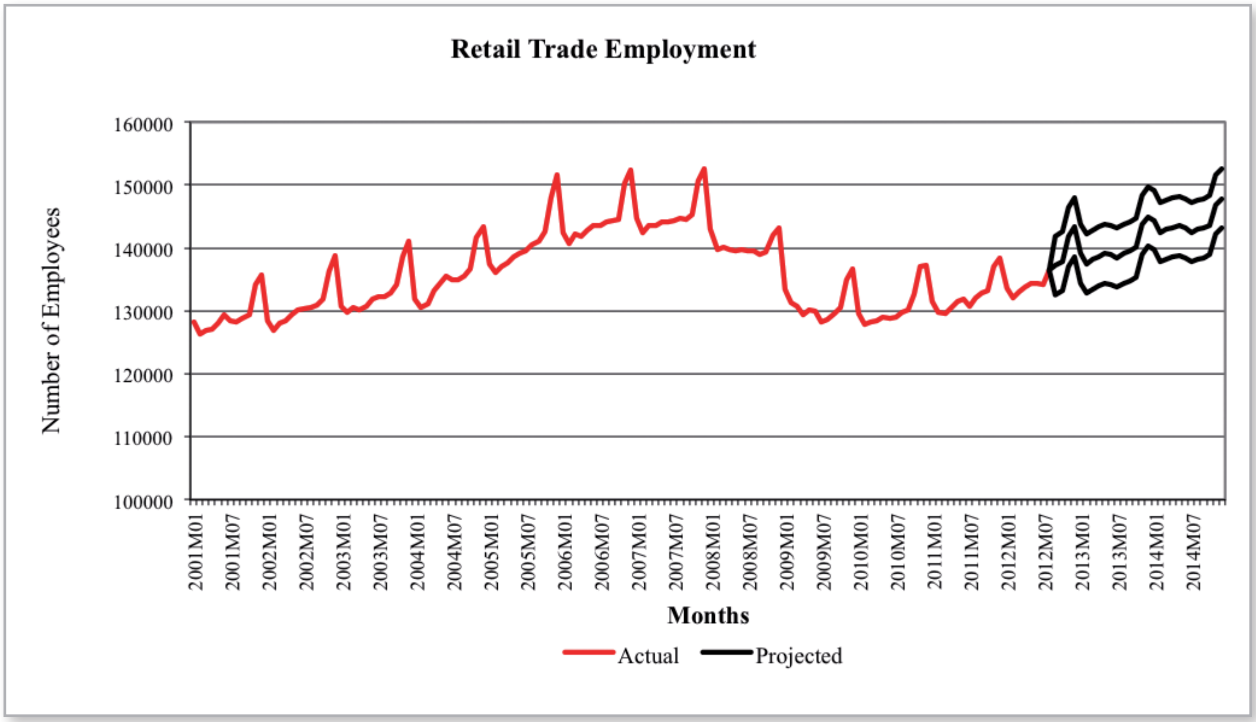


Valley trade, transportation and utilities employment grew 2.27 percent in 2012, a rate more than twice its typical long-term average rate of .86 percent. Growth in 2012 was also above 2011 growth of 1.28 percent. The trend since 2010 appears to be on the way to catch the structural counterpart observed in the pre-recession period. Similar to other farm-related sectors, the series peaks in November and troughs in January.

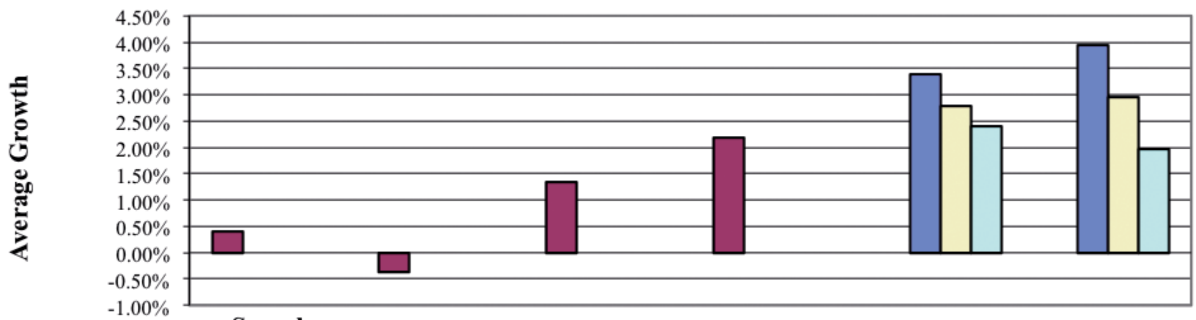


	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	0.86%	-0.62%	1.28%	2.15%		
Optimistic					2.47%	2.90%
Most Likely					2.32%	2.83%
Pessimistic					2.18%	2.75%

In 2013 and 2014, Valley trade, transportation and utilities employment is projected to grow 2.32 and 2.83 percent respectively. As the new trend continues to steepen and catch its structural pattern, 2014 yearly average growth rate is projected to be higher.

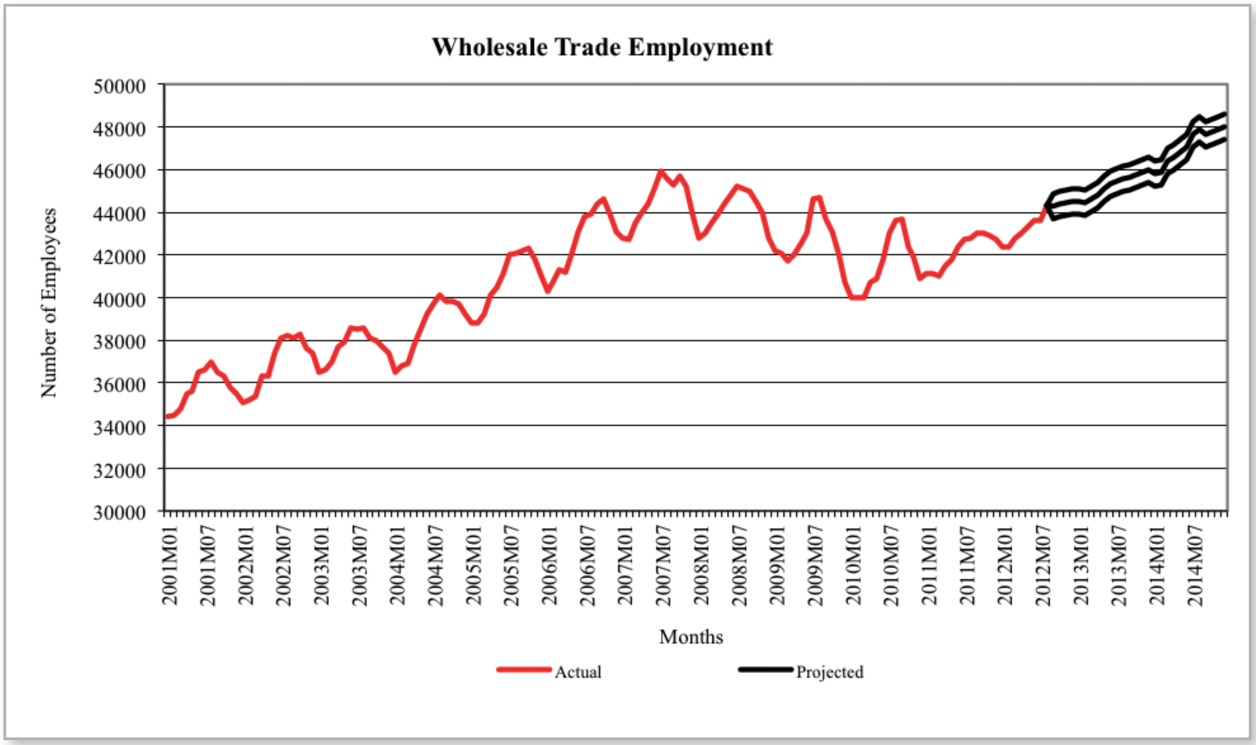


Valley retail trade employment grew 2.19 percent in 2012. When compared to its average historical rate of .40 percent a year, growth in 2012 appears to be quite significant. The declining pattern observed in the past years appears to have permanently reversed after reaching a turning point in early 2010. The quick recovery in this sector is expected to continue into 2013 and 2014.



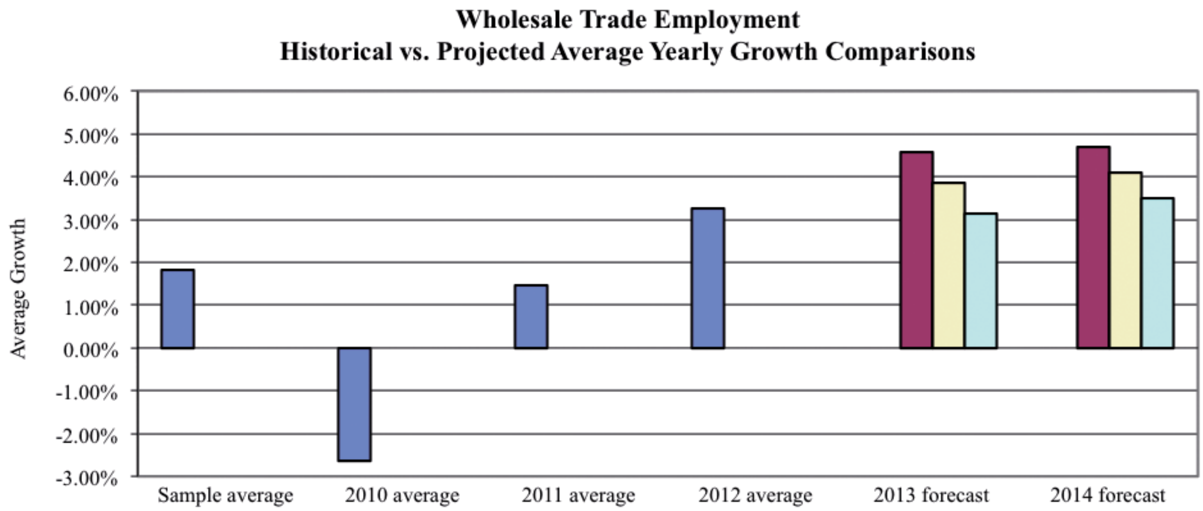
	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	0.40%	-0.37%	1.33%	2.19%		
Optimistic					3.389%	3.949%
Most Likely					2.797%	2.953%
Pessimistic					2.410%	1.957%

The rate of increase since 2009 in retail trade employment is roughly 1 percent a year. In the forecasting interval of 2013 and 2014, retail employment is projected to grow at an average yearly rate of 2.79 and 2.95 percent, respectively. The actual numbers from 2013 and 2014 are expected to fall between the optimistic and most likely interval given the model's tendency to produce more conservative numbers during the forecast horizon.



Unlike retail trade, wholesale trade employment yearly average historical growth rate over the previous decade was quite significant at 1.8 percent. Additionally, the eight-month 2012 growth of 3.27 percent was the best performance since 2007. While other sectors were struggling, wholesale trade employment quickly recovered beginning in 2011. The new linear trend observed since the Great Recession now almost parallels the one existing before 2007.

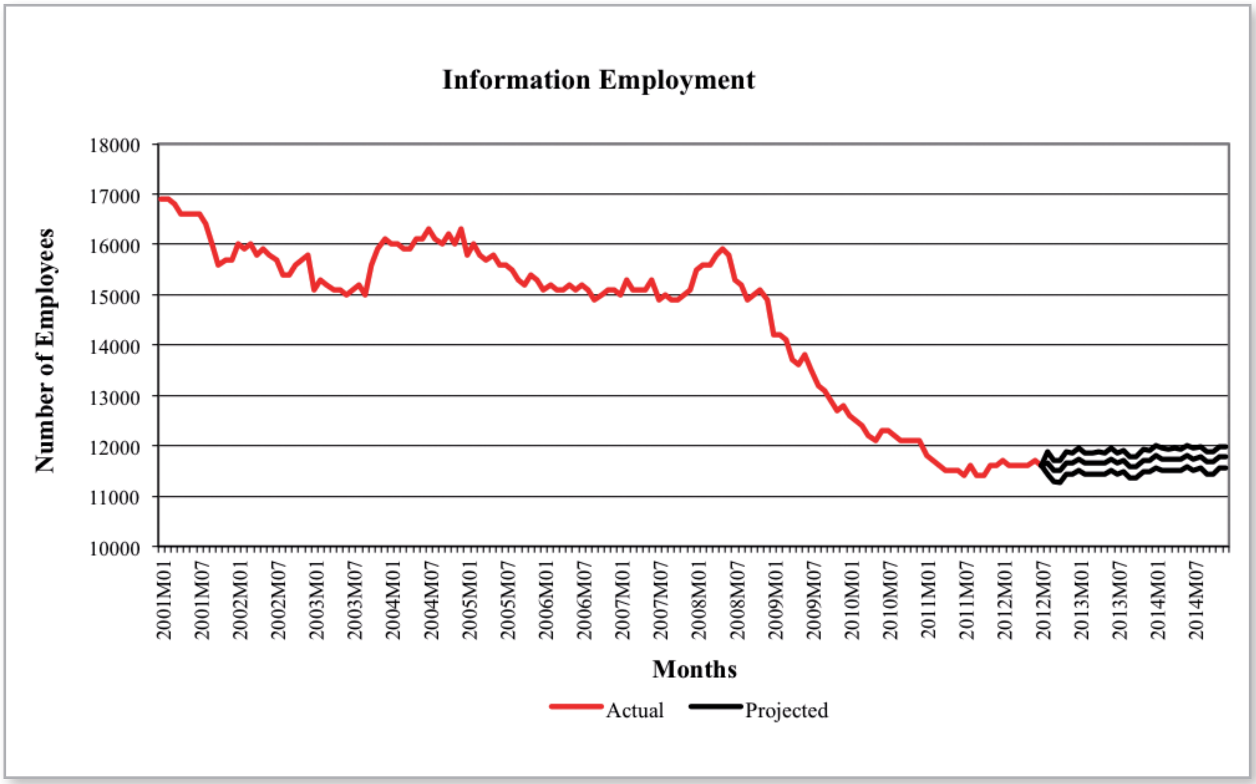
This marked recovery in wholesale trade employment is projected to extend well into 2013 and 2014 at 3.85 and 4.11 percent respectively. The wholesale trade sector is a farm-related sector in which the Valley has competitive advantage relative to retail trade.



	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	1.82%	-2.63%	1.47%	3.27%		
Optimistic					4.58%	4.71%
Most Likely					3.85%	4.10%
Pessimistic					3.13%	3.50%

This marked recovery in wholesale trade employment is projected to extend well into 2013 and 2014 at 3.85 and 4.11 percent, respectively. The wholesale trade sector is a farm-related sector in which the Valley has competitive advantage relative to retail trade.

Valley information technology employment suffered a contraction in 2009 and 2010. Unlike farm-related sectors information technology failed to recover quickly in 2012 posting an average yearly growth of only .50 percent. The recovery in this sector is projected to be slower relative to other sectors in 2013 and 2014.



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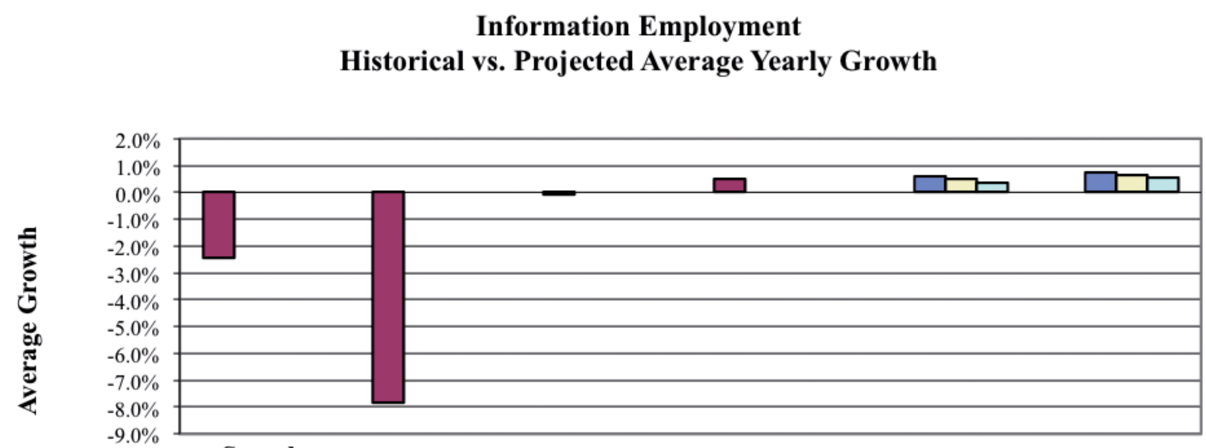
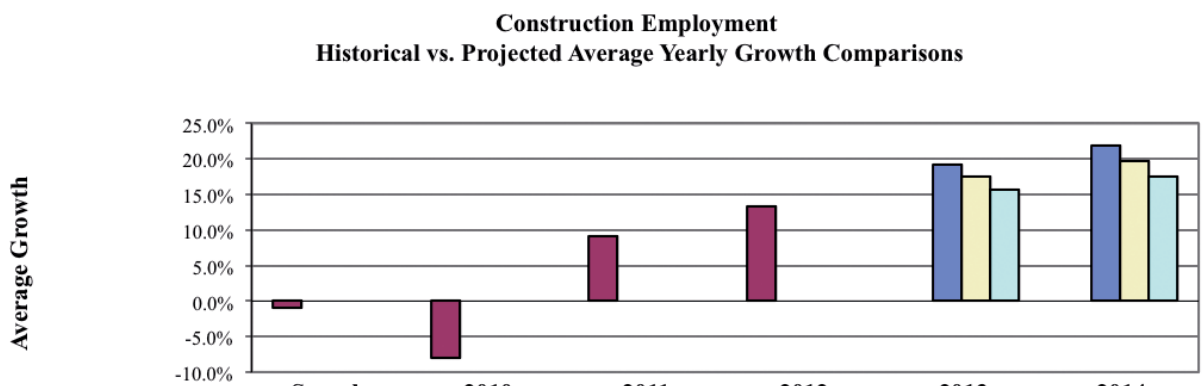


	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	-2.4%	-7.8%	-0.1%	0.50%		
Optimistic					0.613%	0.732%
Most Likely					0.491%	0.640%
Pessimistic					0.370%	0.548%

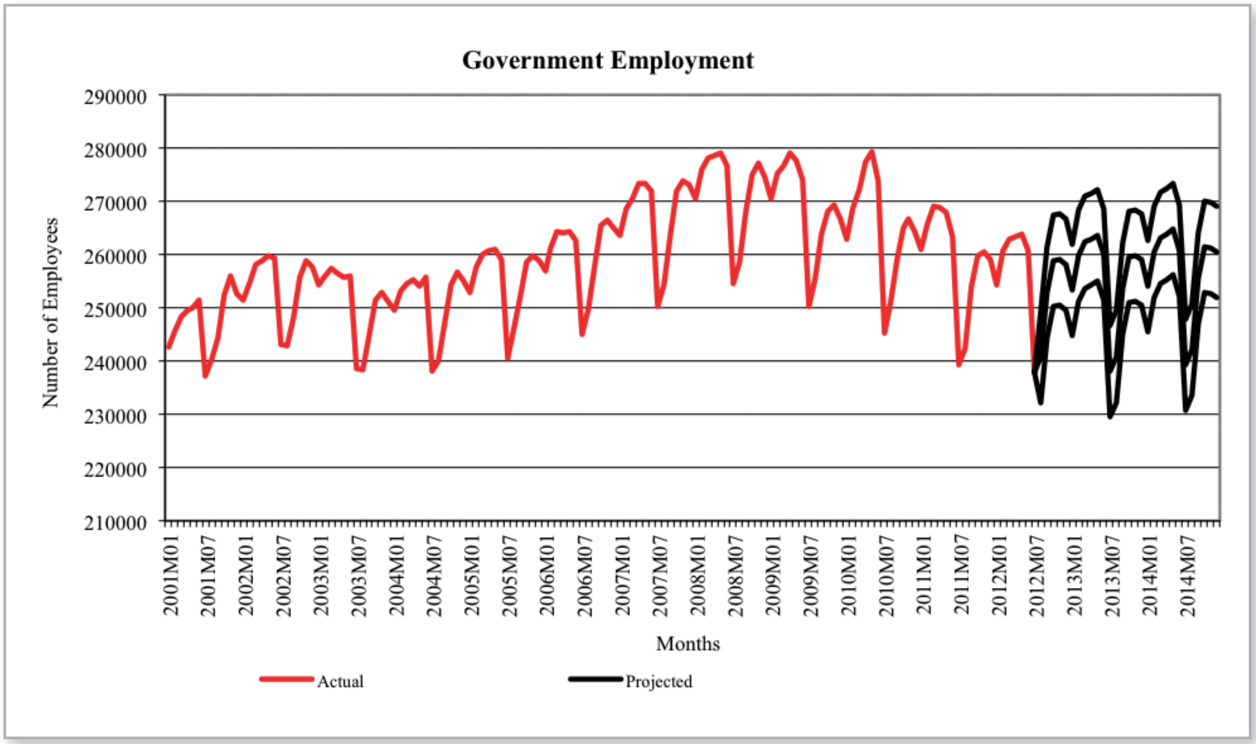
Information employment in the Valley registered a vague turning point occurring in the second half of 2010 and it is too early to tell whether it is of a sustained nature. The hyperbolic pattern observed in the recent past is likely to become slightly upward sloping in the coming months. Continuing on its relatively horizontal trend, information employment is projected to grow .49 and .64 percent a year in 2013 and 2014, respectively.

The 2012 performance of construction employment in the Valley was a positive surprise. The much-anticipated improvement in the construction sector occurred far earlier than generally expected, growing 13.4 percent over the first eight months of 2012. Back-to-back growth in construction employment in 2011 and 2012 now suggests that the turning point observed in 2010 is most likely a sustained one.

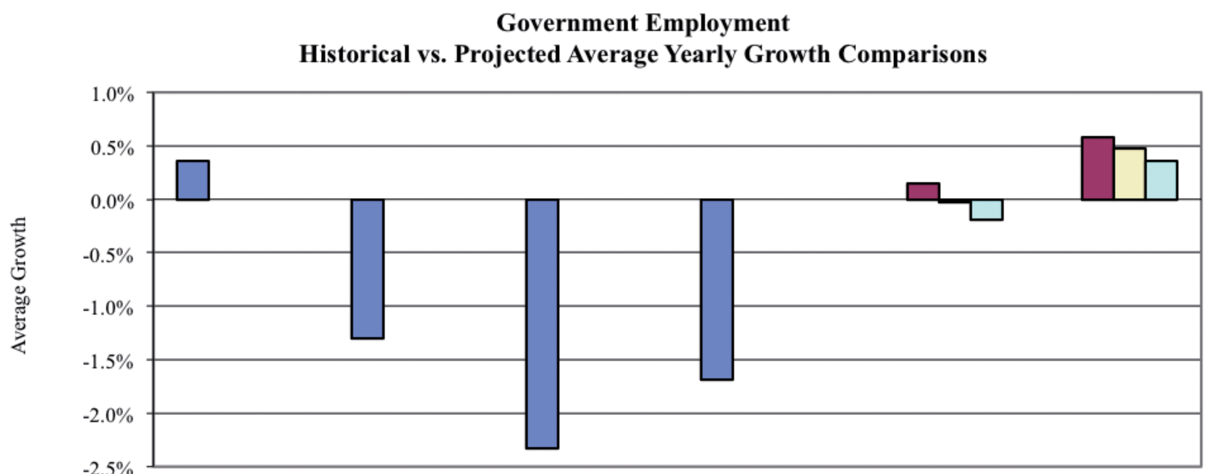


	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	-0.9%	-7.9%	9.1%	13.4%		
Optimistic					19.2%	21.9%
Most Likely					17.4%	19.7%
Pessimistic					15.6%	17.6%

Our 2012 accurate projection of continued growth in construction employment is now extended into 2013 and 2014. The average yearly growth in construction employment is projected to register at accelerated rates of 17.4 and 19.7 percent, respectively. The Federal Reserve's decision to buy mortgage-backed securities until unemployment approaches its natural rate contributes to the additional incremental improvement in this sector.

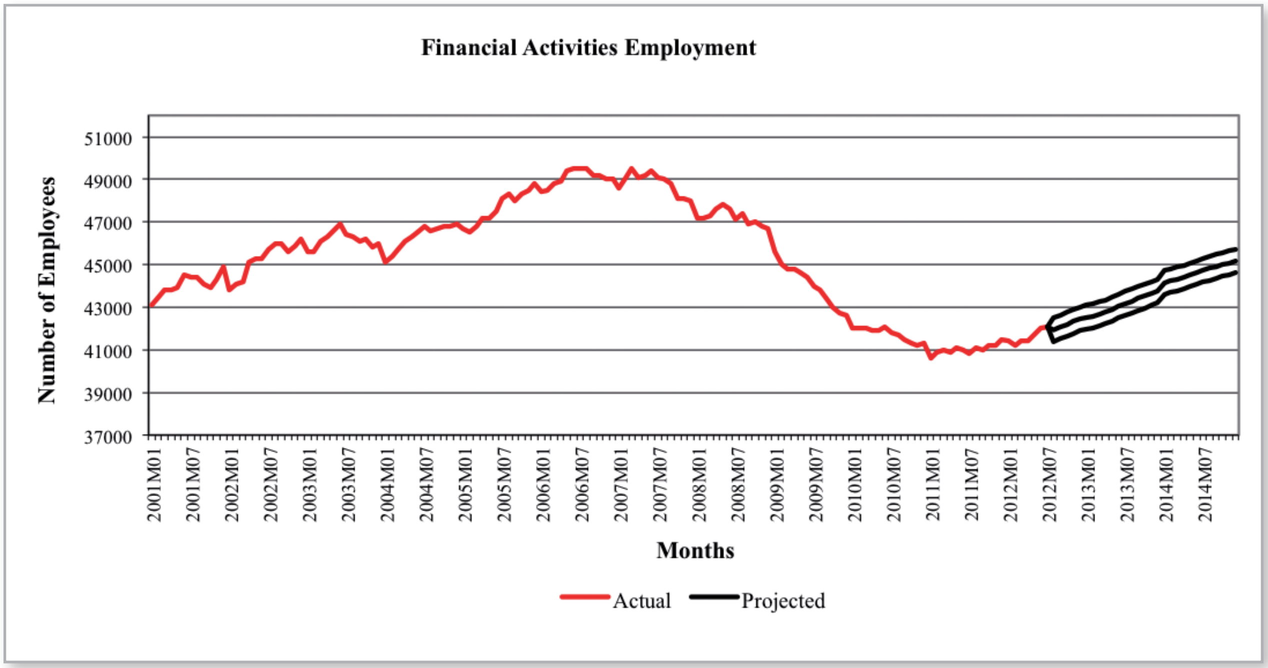


The Valley's worst-performing employment series in 2012 was government employment. Its 10-year rate, at .4 percent, declined after the incorporation of 2012 numbers. Before 2012, the 10-year historical average yearly growth stood at .50 percent. Government employment sustained consecutive declines in 2010, 2011 and 2012. Most notably, while other employment series were posting growth of several different rates, government employment was posting a decrease of -1.68 percent over the eight month period in 2012. This rate of decline was more than three times its then-historical rate of .50 percent, thus a very significant contraction.

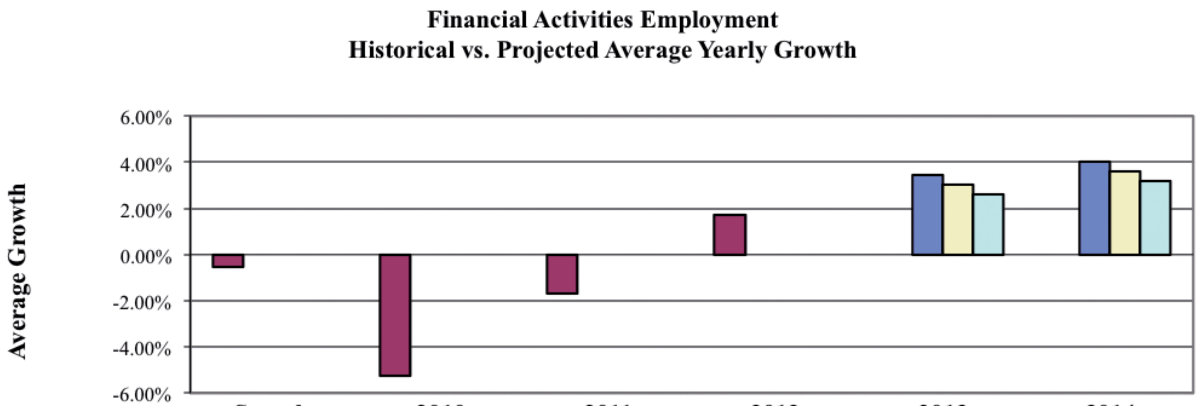


	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	0.4%	-1.3%	-2.3%	-1.68%		
Optimistic					0.145%	0.575%
Most Likely					-0.025%	0.469%
Pessimistic					-0.196%	0.363%

Despite continuous declines in the past three years, a turning point occurred in 2011, in line with our past projections. We project the worsening of government employment to slow down and register a much lower rate of contraction in 2013 at -.025 percent. In 2014, the average yearly rate of change is projected to enter into the positive territory at .46 percent, given the recovery occurring in other sectors in 2012 and the rate of growth change of about positive 1.0 percent since 2011.



The Valley financial services sector was another area in which employment growth suffered in 2010 and 2011. However, this trend was reversed in 2012, when the series posted 1.71 percent growth in the first eight months of the year. This fast pace of recovery was more than three times its steady state rate over the previous 10 years.



	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	-0.51%	-5.27%	-1.67%	1.71%		
Optimistic					3.44%	4.03%
Most Likely					3.02%	3.61%
Pessimistic					2.60%	3.18%

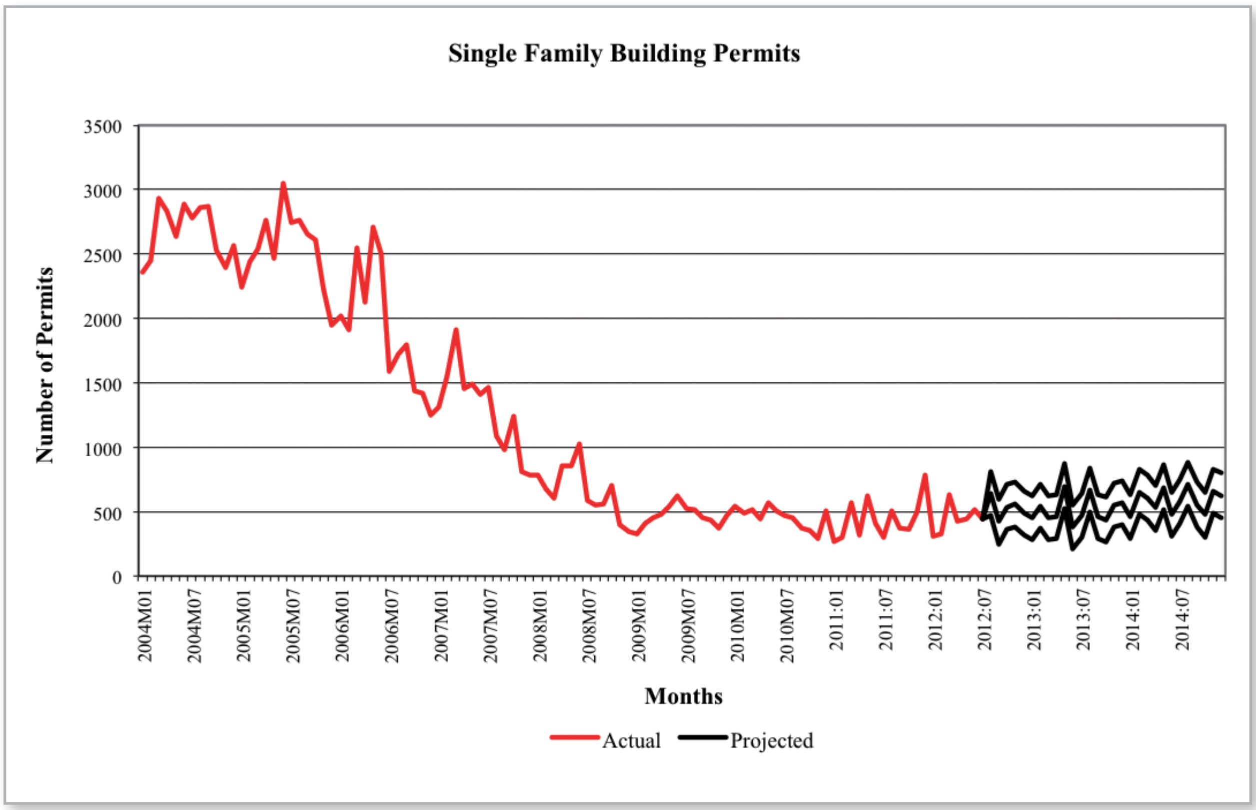
Financial services employment is projected to continue its fast pace of recovery into 2013 and 2014 at an average yearly rate of 3.02 and 3.61 percent, respectively. Financial institutions have indeed begun to quickly employ increasing numbers of personnel to speed up the lengthy processing of mortgages following the announcement of the Federal Reserve to purchase mortgage-backed securities and quicken the impact of the intervention on the economy.

Given the recent pace of recovery in financial services employment in 2012, this sector is no longer considered to be an area where jobs suffer in the Valley. Slower growth occurred in information technology employment. The only sectors in which the Valley suffers significantly in terms of job creation are now the government and information technology sectors. All other sectors were able to create jobs in the first eight months of 2012, albeit at varying speeds.

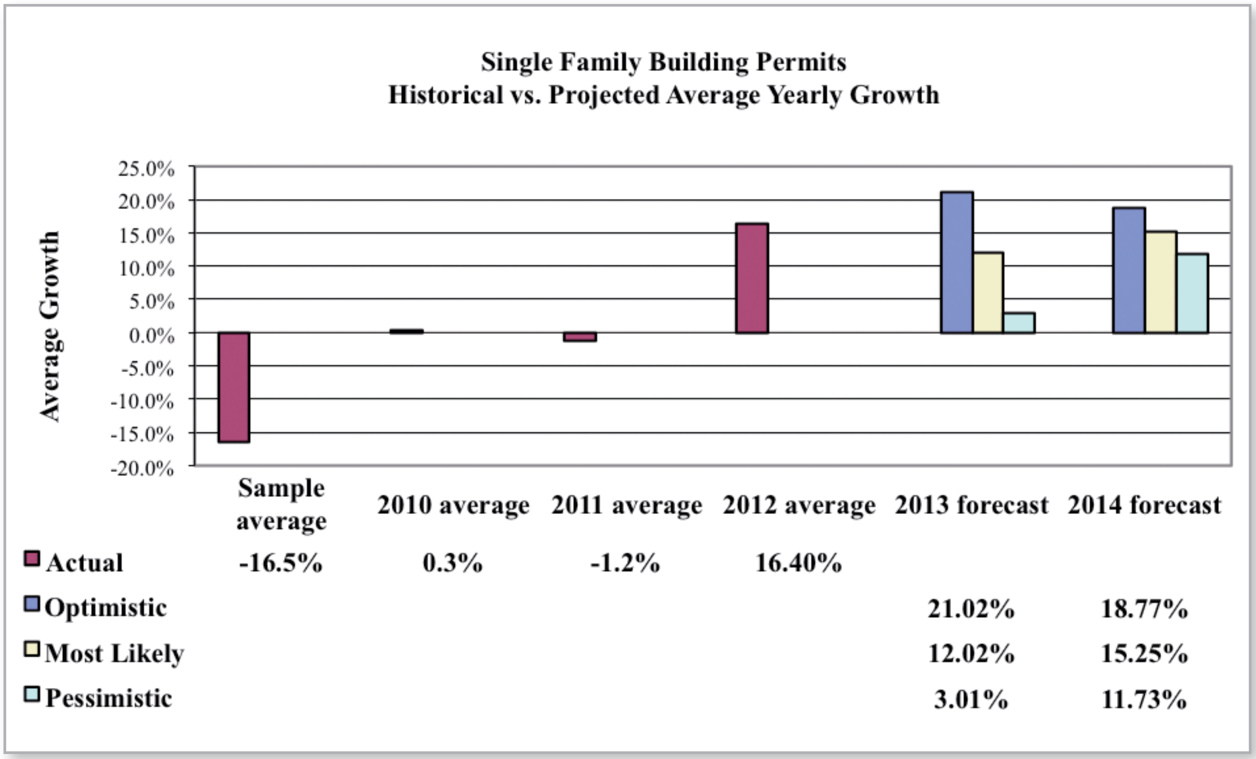
Household Sector

The actual building permits data for the San Joaquin Valley are obtained from the U.S. Census Bureau. The total figure is obtained by summing values that belong to the eight major Metropolitan Statistical Areas (MSA) of the San Joaquin Valley, as defined by the Bureau of Labor Statistics.

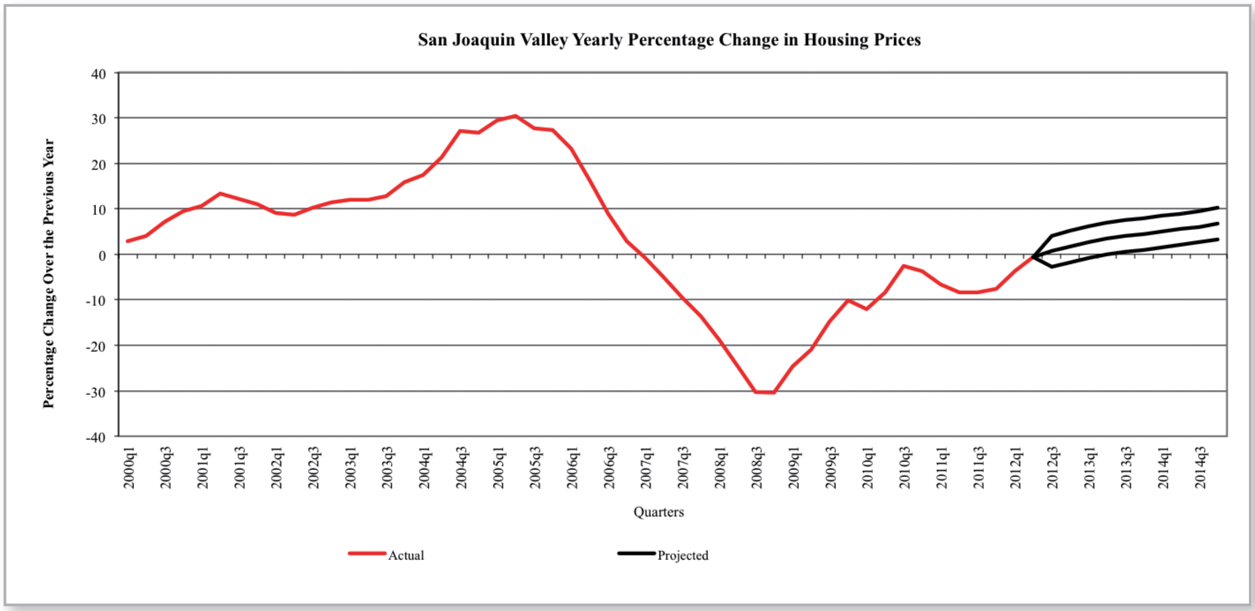
Due to the significant and lasting negative effects of the Great Recession, Valley building permits declined on average -16.5 percent over the last decade reaching as much as -60.0 percent during 2009 when the area economy was in a deep recession. Valley building permits registered a small recovery in 2010 of .3 percent that did not last into 2011, during which housing permits continued to decline -1.2 percent.



In 2012, Valley housing permits increased significantly by posting an average yearly increase of 16.40 percent. However, this number is projected to decrease slightly from its peak as the Valley enters the winter season during which construction activity recedes due to seasonal variation. The turning point observed in 2012, unlike 2010, is more likely to be permanent rather than temporary.



In the forecasting interval of 2013 and 2014, Valley building permits are projected to increase 12.01 and 15.24 percent, respectively. Better than expected performance of the construction sector in 2012 is projected to continue. The Federal Reserve's statement that QE3 will continue until unemployment is below 7 percent further supports the belief that housing recovery will continue at an accelerated rate into 2013 and 2014.

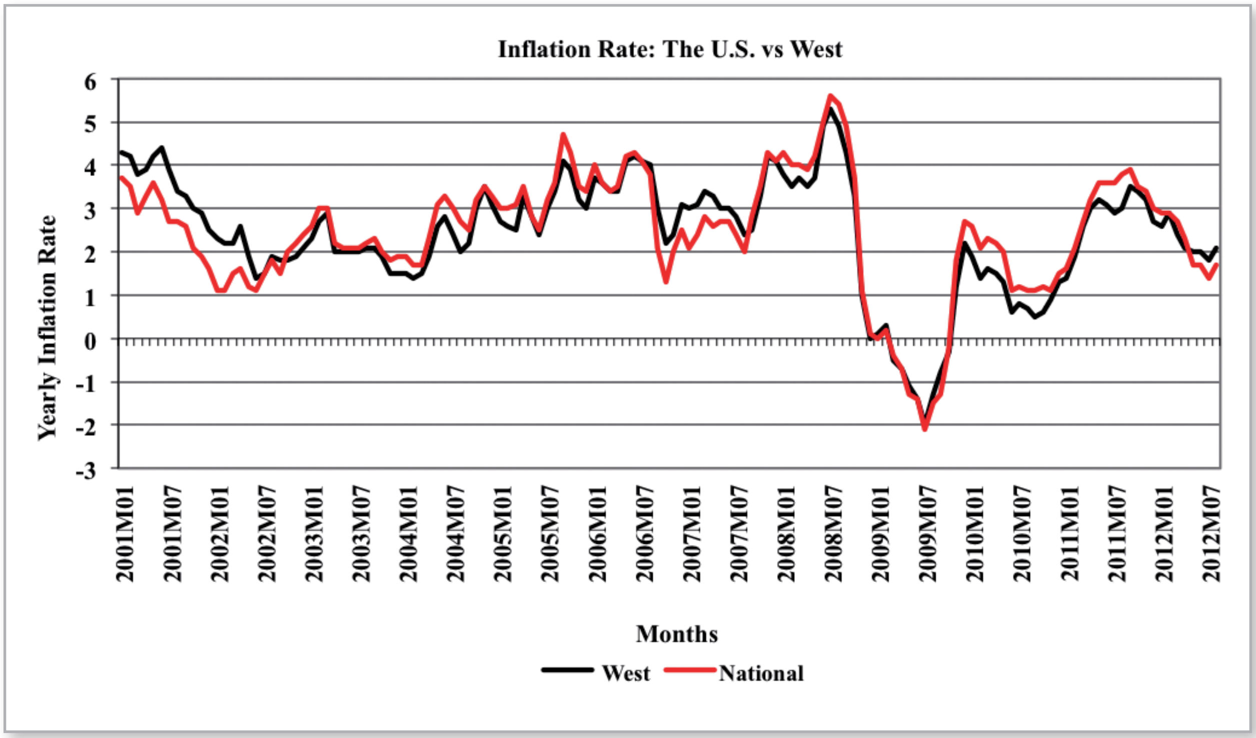


For the first time since the 2007–2009 recession, housing prices did not fall in the Valley based on the first eight months of 2012. After hitting a turning point in the third quarter of 2008, the fall in housing prices became less and less pronounced until reaching the horizontal axis of zero percent in the second quarter of 2012. This fast pace of improvement in housing prices from -30 percent in 2008 to 0 percent in 2012 is projected to continue into 2013 and 2014. This projection of better performance is based on the promising numbers arriving in 2012 and the Federal Reserve's implementation of QE3.

Despite the Great Recession, Valley housing prices rose at an average of 3.10 percent over the last decade. In the second quarter of 2012, the yearly rate of decline was as little as -.65 percent, indicative of price stabilization in the Valley. As aggregate demand picks up following QE3, the 2013 and 2014 recovery in Valley housing prices is projected to occur at a yearly accelerated pace of 3.67 and 5.83 percent.

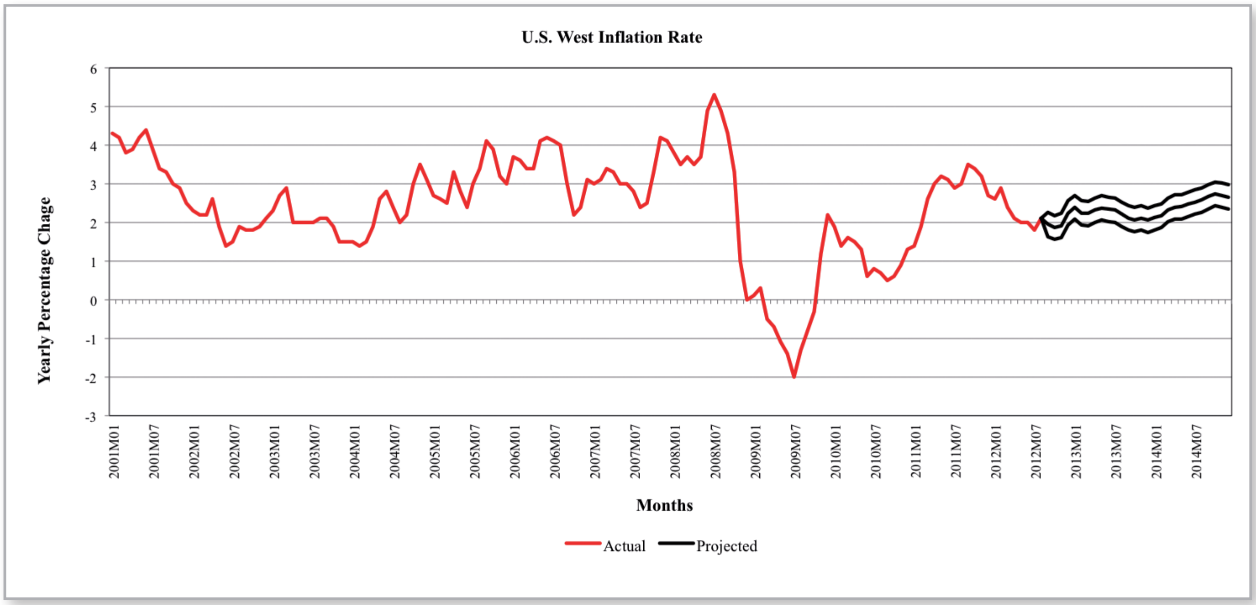
Inflation and Prices

The impact of previous Federal Reserve interventions of QE I and QE II did not have the anticipated impact of increasing inflation rates on the economy. While there may be cost push and demand pull factors that could have led to the increased inflationary expectations, the inflation rate remained around 2.24 percent a year in 2012, consistent with its typical behavior over the long term. Weak aggregate demand may have curtailed demand-pull factors while temporary increases in the price of oil were not sustained enough to bring about a permanent increase in cost push inflation.

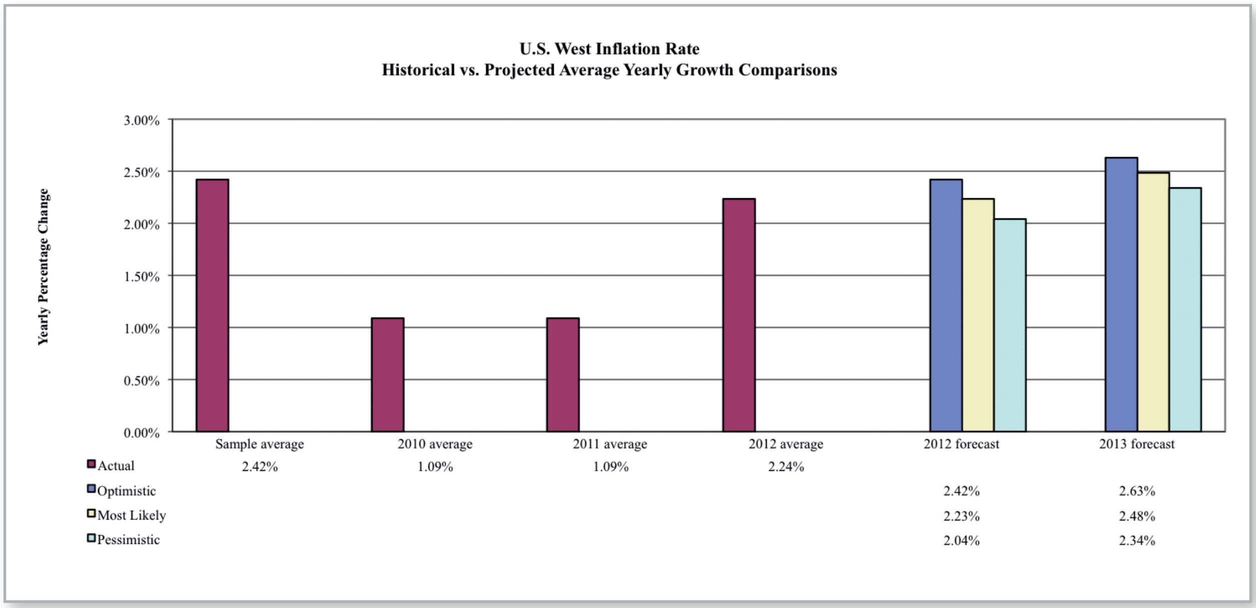


Because California was the second in the nation after Texas in job creation in 2012, aggregate demand growth was relatively higher for this region than the nation. Higher aggregate demand caused the inflation rate for the Western region to exceed that of the nation in 2012, a pattern that had not been observed in over a decade. The Western region had actually exhibited inflation rates lower than the nationwide average since the beginning of 2007. This was reversed in 2012 attributable mainly to demand-pull factors in the region.

The spread between regular and Treasury Inflation Protected Securities (TIPS) increased immediately after the QE3 announcement in September. This led inflationary pressures to once again form in the economy. However, given the negligible impact of the previous two interventions, the actual effect is anticipated to be minimal. It is also worth noting that the offset coefficient for the U.S. economy, the rate at which money printed in the U.S. flows abroad, is generally very high, which mitigates the inflationary effect on the domestic economy.

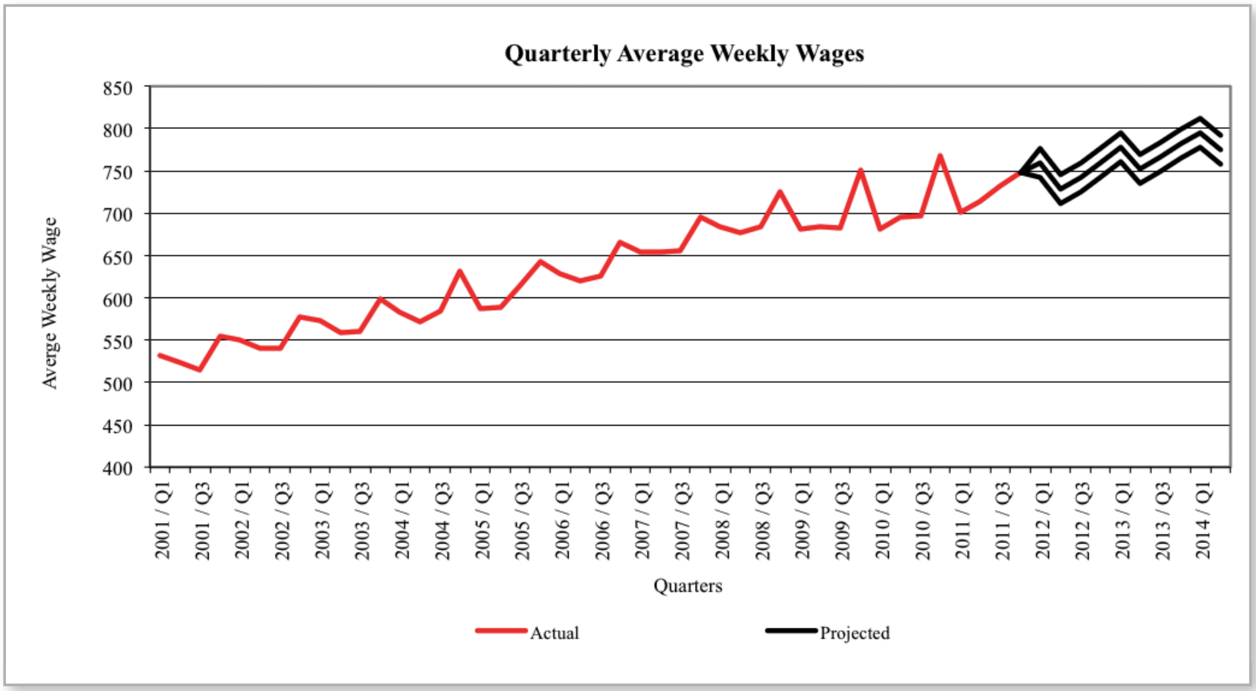


Despite temporary ups and downs, the inflation rate in the U.S. West is projected to hover around 2.23 and 2.48 percent in 2013 and 2014, respectively. Unless there is significant aggregate demand expansion that would switch a gradually recovering economy to a fast-recovering one, overheating the economy, inflation is projected to fluctuate around its long-term rate during the forecast interval, assuming the price of oil remains stable over the medium term.

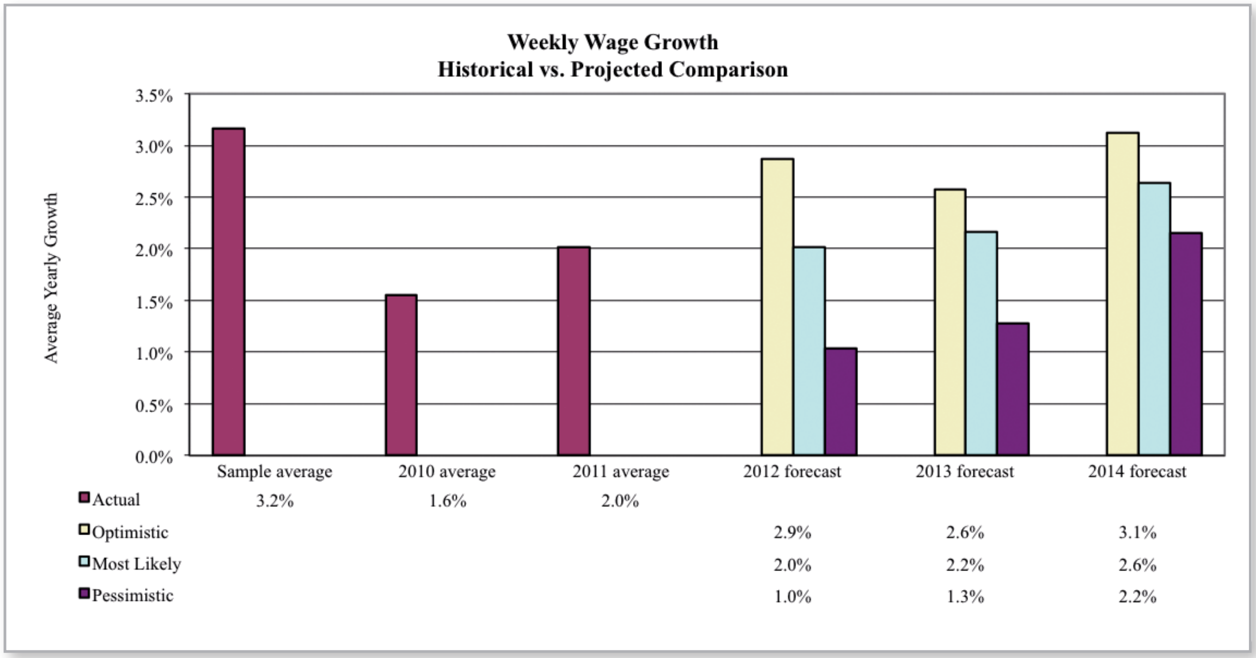


As the problems with European debt continue to linger into 2013 and 2014, the dollar is projected to remain relatively strong against the Euro. This increase in value against other currencies is causing U.S. imports to reach record levels and curtail exports, causing the trade deficit to worsen. It is also a sign of increased purchasing power on the part of U.S. consumers for imported goods, causing retail and consumer spending to be higher than the previous two years. QE3 is projected to dampen the appreciation against the Euro and other currencies in the world in 2013 and 2014.

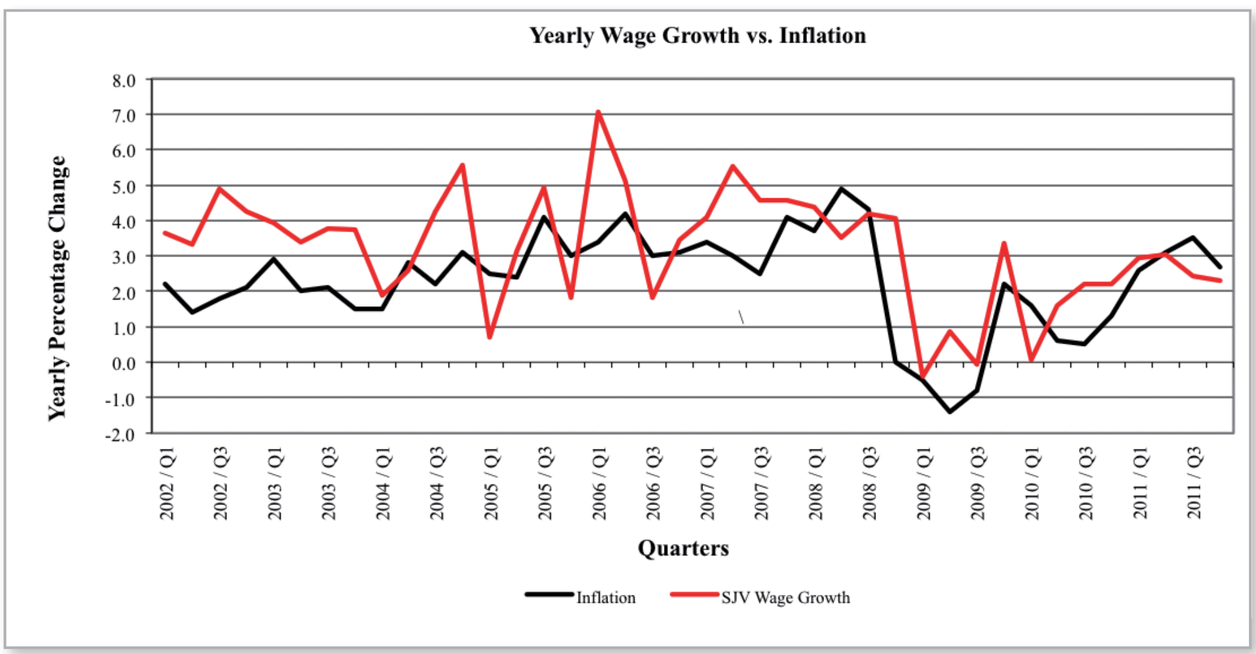
The long-term average rate of yearly increase in hourly wages in the valley since 2004 was 3.2 percent. In 2011, the average yearly wage increase equaled 2.0 percent, a rate less than its long-term rate.



At the time this report was being prepared, the Bureau of Labor Statistics reported wage data with a longer lag than employment indicators. Therefore, 2012 forecasts are included in this report. In the forecasting interval of 2012, 2013 and 2014 hourly wages are projected to increase at an average yearly rate of 2.0, 2.2, and 2.6 percent, respectively. The linear trend of hourly wages is projected to become flatter than the historical pattern in previous years due to lingering unemployment creating a surplus of labor, which puts a downward pressure on wages overall.

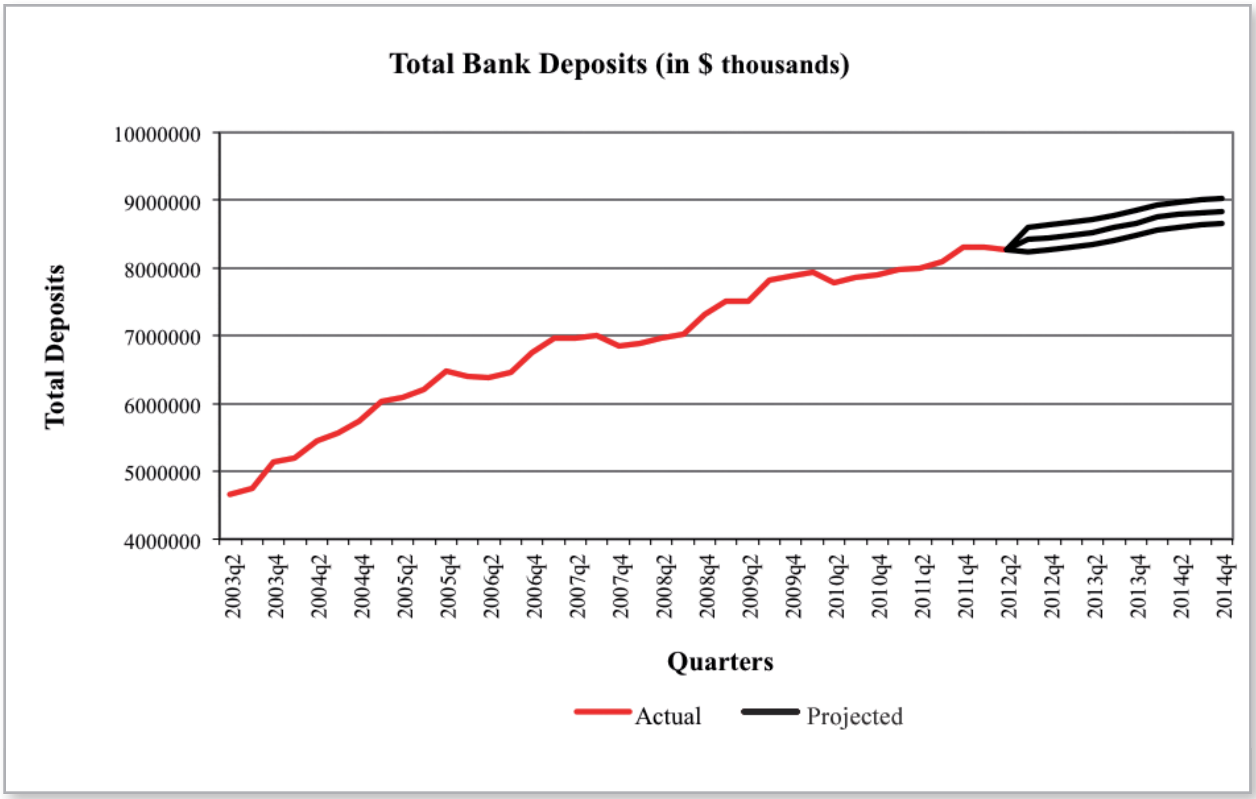


In 2011 inflation was higher than hourly wage growth, causing real wages to decline. This pattern was different than that observed structurally whereby wage growth has been generally higher than inflation. However, as inflation continues to display a falling trend, this discrepancy may not be permanent.

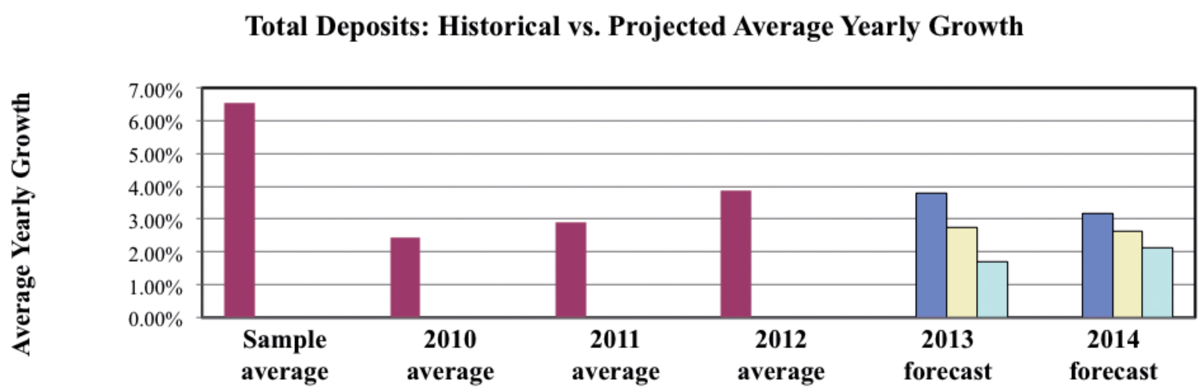


Banking and Capital Markets

Bank deposit data are retrieved from Federal Deposit Insurance Corporation (FDIC) and constitute aggregated data from regional and community banks excluding big banks. Bank deposits in the Valley continued to increase in 2012. Individuals, investors and businesses gradually have begun to pull their cash deposits and invest in risky assets such as stocks. The national stock market is performing above pre-crisis levels and now displays higher risk-adjusted returns for those investors who previously flocked to cash as a safe haven during the Great Recession.

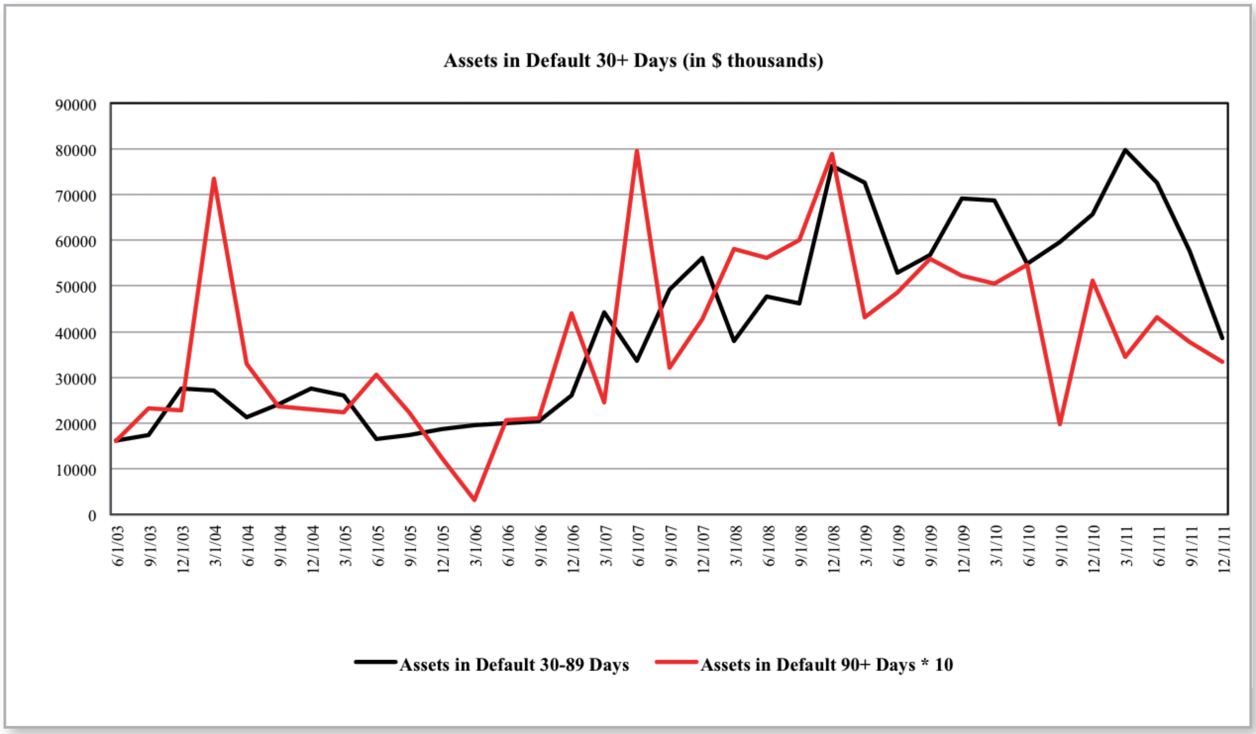


Valley total bank deposits increased at an average rate of 6.55 percent over the past decade. In 2012, in the first two quarters, Valley deposits increased at 3.86 percent, a higher pace than previous years. This expansion in total deposits is projected to continue into 2013 and 2014 at an average yearly rate of 2.74 and 2.64 percent, respectively. The slower rate of increase is anticipated as a greater number of investors choose to invest in risk-bearing assets to realize higher returns instead of holding their cash in low-interest or non-interest bearing bank deposits.

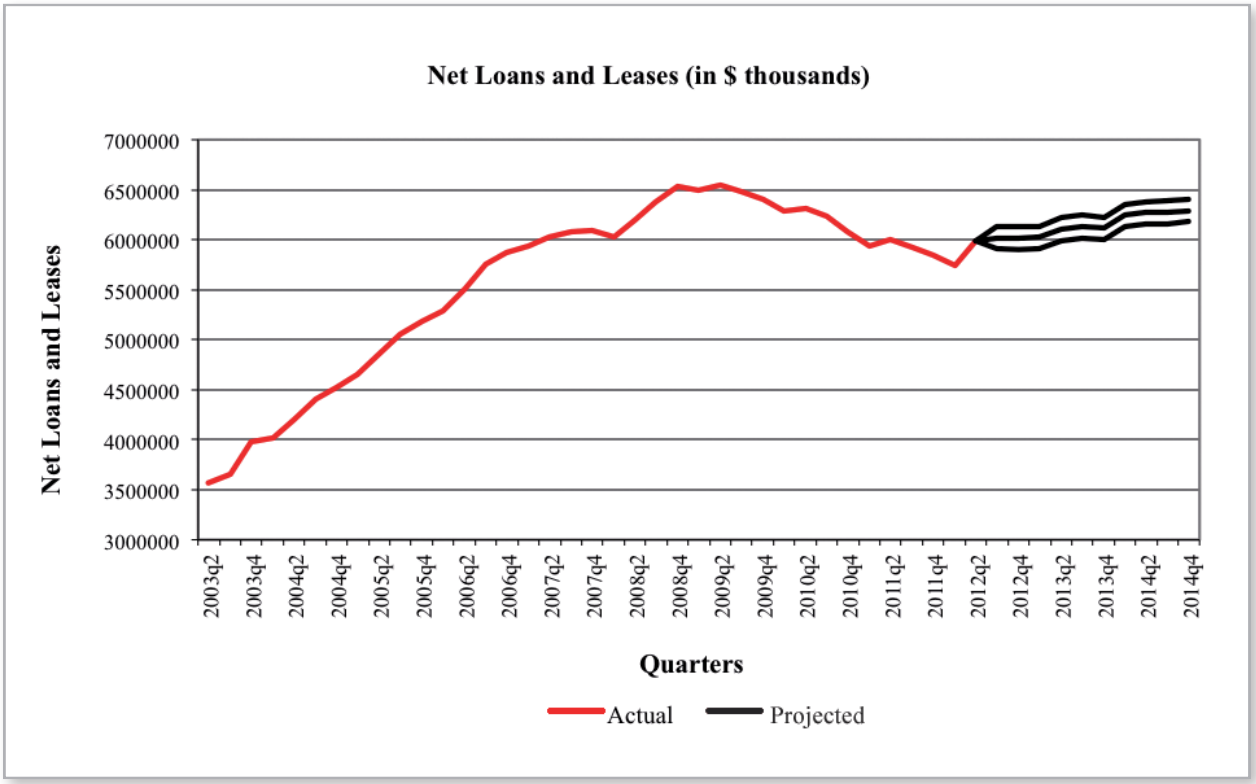


	Sample average	2010 average	2011 average	2012 average	2013 forecast	2014 forecast
Actual	6.55%	2.45%	2.91%	3.86%		
Optimistic					3.80%	3.17%
Most Likely					2.74%	2.64%
Pessimistic					1.68%	2.11%

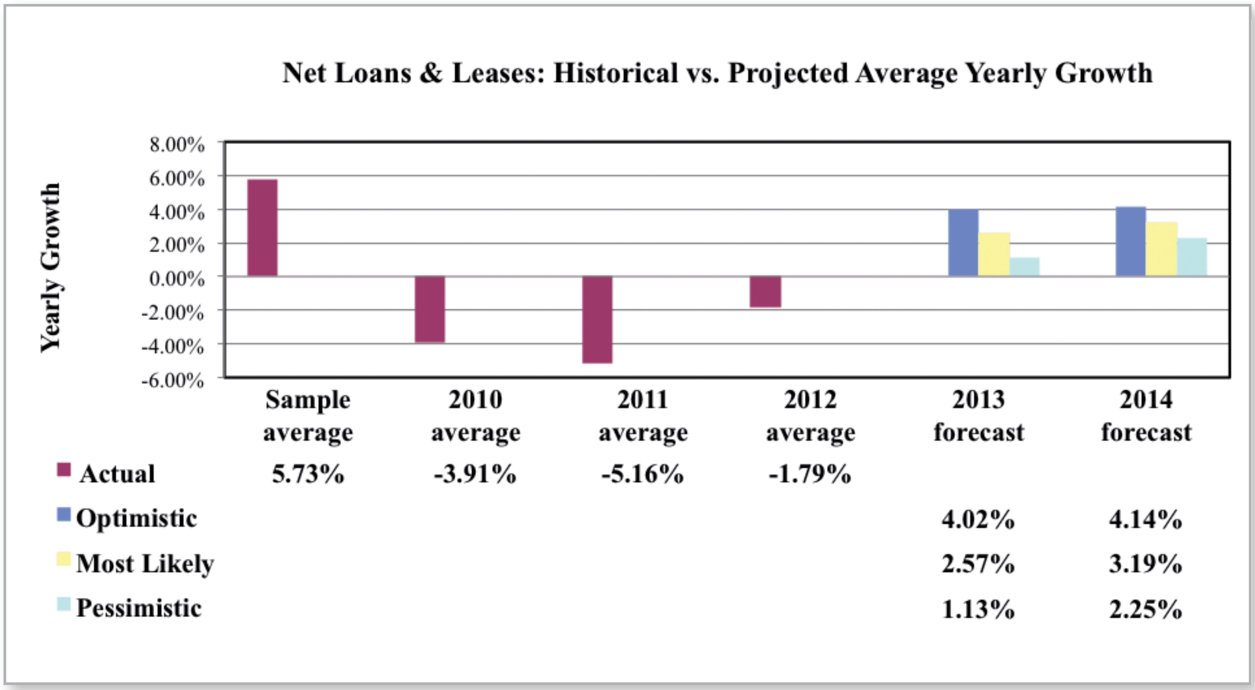
Data for Valley assets in default more than 30 days are reported by the FDIC. The data are reported with a longer lag than deposits and loans. Most recent data span until the end of 2011. Valley assets that are in accrual 90-plus days display a continuing declining trend that began after hitting a peak in the fourth quarter of 2008. Assets that are in accrual 30 to 89 days have leveled off temporarily since the fourth quarter of 2008 but then unexpectedly peaked in the third quarter and fell sharply in the last quarter of 2011. The overall pattern seems to be consistent with accruals decreasing since the recessionary period of 2007–2009.



Valley net loans and leases series halted its continued decline and posted an increase in the second quarter of 2012. Net loans and leases in the Valley had been falling steadily since the third quarter of 2008 even though total deposits were increasing. This new upward sloping pattern after hitting a turning point in mid-2012 is projected to be sustained rather than temporary. It is indicative of banks beginning to extend loans and consumers fixing their balance sheets and applying for loans and leases again for the first time since the Great Recession.



Net loans and leases in the Valley have increased 5.73 percent a year on average over the past decade. In 2010 and 2011, Valley net loans and leases decreased -3.91 and -5.16 percent a year, respectively. The yearly decrease in the first two quarters of 2012 was however much less at -1.72 percent. In the second quarter, the change became positive and is projected to continue into 2013 and 2014 in the positive territory at 2.57 and 3.19 percent.



The continued positive rate of change is attributed to performance exhibited in the first two quarters of 2012, the declining pattern of assets in default in the Valley, and the Federal Reserve's open-ended purchases of mortgage-backed securities.

Summary and Concluding Remarks

At the aggregate level, Valley total employment grew 2.08 percent – more than twice its long-term rate of .8 percent – in the first eight months of 2012. The increase in employment was not equal across all Valley counties. While San Joaquin, Fresno, Kings and Tulare county employment grew most, other counties such as Madera suffered a contraction. In Stanislaus, Kern and Merced counties, there was slight growth in employment equal to their long-term rates. It is well known that the Valley is bifurcated from the Coastal Region. However, given the 2012 performance, bifurcation appears to be less relevant for San Joaquin, Fresno, Kings and Tulare counties. California is now second in job creation in the nation after Texas and is beginning to pull the aggregate San Joaquin Valley up in job growth.

Two main factors contribute to the expectation of a better performance in 2013 and 2014. First is that the new 2012 numbers are registering higher growth rates than 2011 and 2010. Second is the Federal Reserve's open-ended intervention in the economy until unemployment falls below 7 percent. Consistent with the Federal Reserve's projections on the national economy, our forecasts point to higher economic growth in 2014 than 2013 as the lagged effects of QE3 weigh in more heavily on the regional economy.

Most notably, Valley construction employment and building permits grew in 2012 and growth is projected to continue in the forecasting interval. Wholesale, non-durables, information, education, as well as health, leisure and hospitality, and manufacturing employment grew well above their 2010 and 2011 growth rates. Weak growth was observed, however, in the information technology sector. All areas of employment improved in 2012 with the exception of the government sector. Government employment suffered a contraction of -1.68 percent in 2012 but is projected to register a turning point in 2013.

Average growth in the sales price of new single family homes is projected to become positive in 2013 after stabilizing in 2012. Foreclosures declined at a faster pace in the West than in the nation as a whole after leveling off temporarily and are projected to fall further in 2013 and 2014 as the Federal Reserve continues to buy mortgage-backed securities to quicken the economic recovery.

It is worth cautioning however that several simultaneously occurring potential developments not yet reflected in the incoming data may derail these projections. A significant economic slowdown in Brazil, Russia, India and China (BRIC), worsening of debt problems in the European Union, and an ineffective QE3 in the United States that fails to bring about a fall in the unemployment rate below 7 percent could cause the global economy to perform poorly in the forecasting interval. Escalation of the unrest in the Middle East could be another potential factor.

In all, based on the incoming data for the first eight months of 2012, the region's forecasts now point to better economic performance in 2013 and 2014. With QE3 and the federal approval of high-speed rail construction, some acceleration in growth is projected in 2014 relative to 2013. However, the natural rate of unemployment is projected to be attained in the Valley and nation no sooner than 2014.

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