

FOR IMMEDIATE RELEASE

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Dear Clients, Friends and Neighbors,

In this, the 11th in the Q & A series, I'd like to discuss the frozen credit market and address reports predicting inflationary rates in the near future. Plus, I'd like to share my outlook for the financial services industry.

**Question: News over the past few weeks has been sprinkled with word that the recession may have bottomed out. Are the frozen credit markets showing signs of life and starting to thaw or is this just hype ?**

**Answer:** Our Fed Chairman made comments in the news two weeks ago that his data indicates we have reached bottom and that there are signs of rebound, however small they may be. Keep in mind that when the Fed Chairman makes a comment like this, he is looking at the national economy and is not focused on any one area within the country. This said, I think that overall there are indeed signs of life within our economy. The credit markets have loosened and loans are available. Interest rates for single family mortgages remain at historically low levels and housing on the low end of the market seems to be stabilized.

Looking at California and the Central Coast, we still have some work ahead of us. The state economy is a mess. California remains one of the most expensive states to live in and to operate a business within. We still see home prices on the high end falling and there is several months of inventory on the market. The Central Coast seemed to roll into this recession about six months behind the remainder of the state and it is my guess we will begin to see signs of recovery just a bit later than in other places in the country.

The good news, if you want to call it that, is that we did not see levels of unemployment rise in our area as did the rest of California and our home prices did not fall as far as other markets as well. Economically speaking, our Central Coast region has weathered this recession better than just about any other region of the country.

**Question: We have had 7 consecutive months of economic deflation but yet there are reports predicting inflationary rates in early 2010. How can this be?**

**Answer:** Inflation results from prolonged periods of low interest rates and rapid growth in the economy. For the past year, we have experienced historically low interest rates. Some read into these low interest rates that the economy will begin to grow and that rate of growth will be so rapid that inflation will result.

Just this week at the Federal Reserves Open Market meeting, the Fed opted to leave interest rates constant and signaled that inflation was not an immediate concern. Looking at the Fed Funds Futures market data, this prediction is supported in that Fed Funds interest rates are projected to remain below 1% for as long as nine months. What this also tells me is that the Fed has taken the position that getting this economy back on track is of greater importance than the threat of inflation at this point.

If the Fed were to raise interest rates now in order to prevent inflation, there is a good chance the economy would slip into a deeper and more prolonged recession. I would trust that the Fed will do most anything to prevent this from happening.

**Question: As a community bank president, what is your outlook for the financial services industry?**

**Answer:** This is a very complex question in that there are so many things happening at once. Congress is not only looking at regulatory reform, it is also looking at developing entirely new, even more far reaching, regulations which could significantly impact our ability to provide services to our clients in a cost effective manner.

Rules surrounding lending have changed and these changes will be around for some time to come. With the deflation in all asset values experienced over the past 18 months, borrowers are finding it more difficult to secure loans sufficiently large enough to finance growth. Couple this with lower sales and diminished cash flows, and you can see that many businesses are finding it difficult to meet credit obligations.

We, as community bankers, are doing all we can to support our clients; however, we operate within a strict regulatory environment and must exercise prudent safety and soundness guidelines in everything we do. Today, most of our clients are more interested in surviving this recession than making plans for rapid expansion. We no longer are seeing any speculation based on inflating real estate prices.

With all of the fundamental changes we have seen in the economy, at the end of the day, Heritage Oaks Bank remains a community bank dedicated to helping our community grow and prosper. We are looking for ways to help every one of our clients weather this economic storm and will be here for all of our clients as the economy rebounds.

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