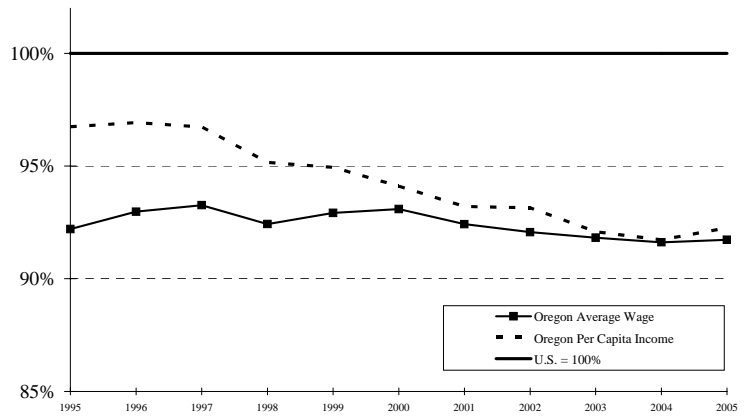


ECONOMIC PERFORMANCE AND OUTLOOK

Recent Performance

- Between 1995 and 2005, total nonfarm jobs in Oregon grew 15.8 percent, from 1.43 million to 1.66 million. Much of the growth in the 1990s was fueled by a boom in the high technology, construction, trade, and service sectors. A recession hit the state in 2001, triggering job losses for the next three years. A mild recovery started in the middle of 2003. The state enjoyed strong job gains in 2005 and 2006, outpacing the nation in terms of growth.
- Average wages grew 43.0 percent between 1995 and 2005. Despite gains in wages, Oregon was not able to close the gap against the nation during the same period (see Figure 1).

Figure 1: Oregon Per Capita Income and Average Wage as a Percent of the U.S., 1995-2005

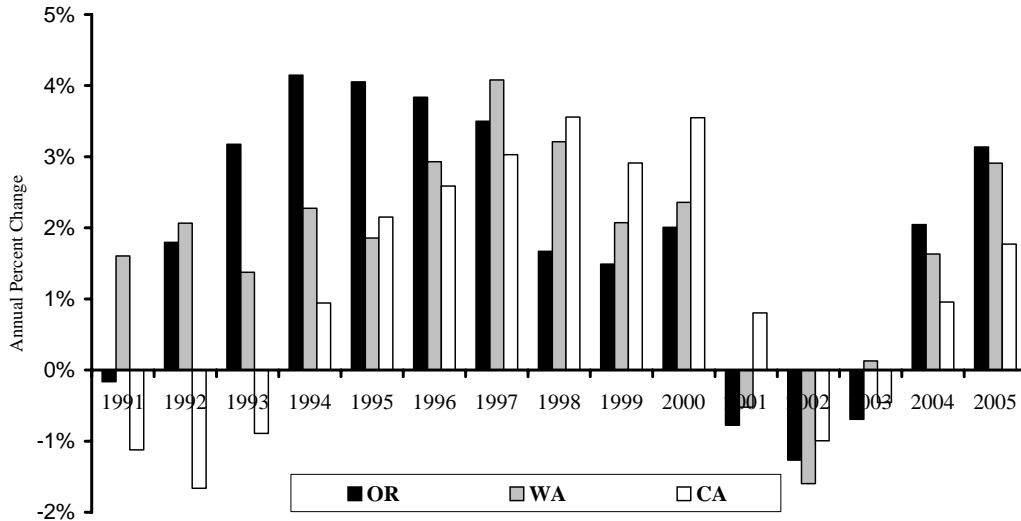


- Per capita income grew faster than the national per capita income in the 1990s. Relative to the nation, however, Oregon is now worse off than a decade ago due to a manufacturing slump during the Asian financial crisis, and the economic stagnation in the last recession. Oregon was hit hard during the last recession due to its high-tech dependence. Thanks to strong job gains in the past two years, Oregon's per capita income is again improving against the national average.
- Figure 2 shows the percent change in employment between 2000 and 2005. The last recession's impact is evident in many counties, including Multnomah and eastern Oregon counties. The counties with the highest job growth are Deschutes, Jackson, Coos, Curry, Josephine, and Morrow. After shedding jobs during the recession, many counties are rapidly gaining them back.
- The shift toward non-manufacturing and service industries has become more pronounced. In 1995, manufacturing employment's share of total employment was 14.5 percent. In 2006, it was 12.3 percent. Rapidly growing industries include professional and business services and health care services. The recent housing boom has led to strong growth in the construction, retail, and finance industries.
- Oregon has become tightly linked with its export markets. Canada is the largest export destination for Oregon products. In 2005, Asian countries made up four of the top five export destinations for Oregon products. As a consequence, Oregon's economy has fluctuated with the fortunes of the Asian economy. Figure 3 shows that Oregon sends a large portion of its exports to Asia. Major exports include semiconductors, transportation equipment, agricultural products, and machinery.

The Economic and Revenue Environment

- Oregon's job growth was negative for three consecutive years, starting in 2001. Between late 2000 and the middle of 2003, employment fell by as much as 4.0 percent, much worse than neighboring states. Since then, Oregon has seen very rapid job recovery. The state's employment surpassed its November 2000 pre-recession peak level in early 2005, and has grown at a 3.0 percent annual rate in the last two years. Oregon was hit harder than California and Washington during the recession. However, Oregon's growth exceeded these neighboring states in 2004 and 2005, as shown in Figure 4.

Figure 4: Employment Growth by States, 1991-2005



Data source: OEA, Other states - Global Insight

- Oregon's unemployment rate soared from just over 5.0 percent in late 2000 to a peak of 8.5 percent in the middle of 2003. Thanks to rapid job growth in the past couple of years, the unemployment rate eased to about 5.5 percent by late 2006, narrowing the gap against the nation.

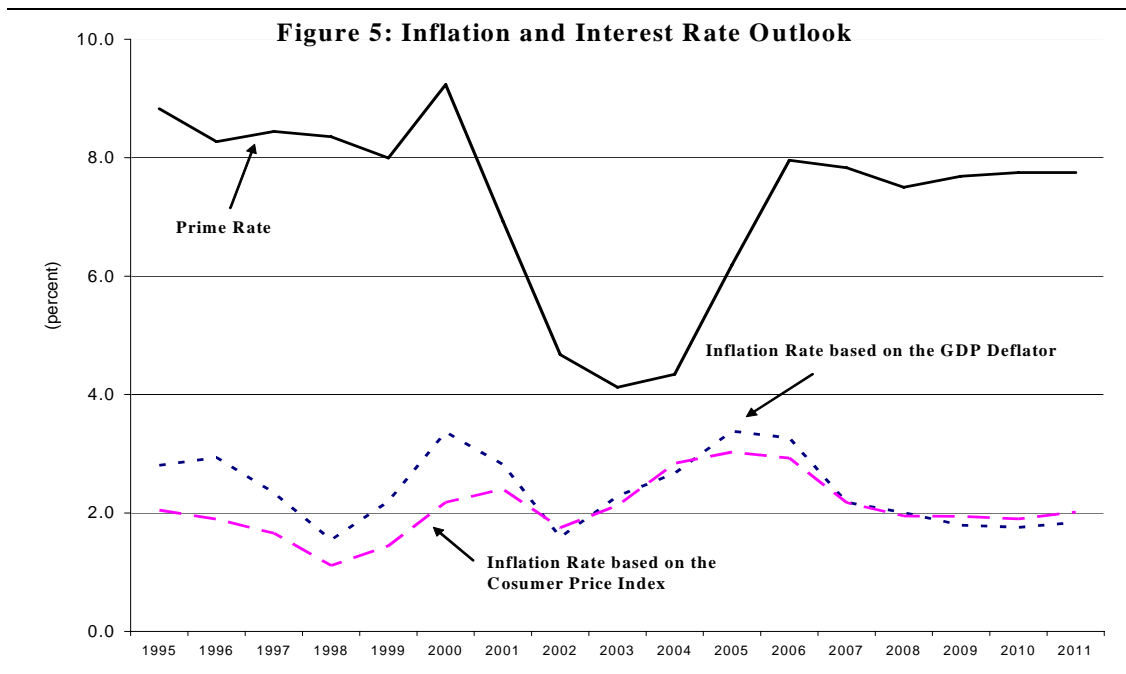
Outlook

Key Assumptions

- Currently, the U.S. economy is growing below potential. The construction and construction-related sectors are losing jobs. Consumers and the housing sector had supported economic expansion until recently. As consumers retrench and the housing sector goes through a long overdue correction, exports and business capital spending will take over as engines of growth.
- Uncertainty surrounds the U.S. economy in much of 2007. The U.S. economy is expected to be soft in 2007, continuing below trend growth. The economy will improve in 2008 to achieve a long-run average of 3.0 percent annual growth.

The Economic and Revenue Environment

- Growth in the global economy will help U.S. and Oregon exports. The economies of Asia and Europe are strong, and show increasing demand for imports. Manufacturing and agricultural industries will benefit from strong global markets.
- Energy prices are expected to stabilize, and moderate inflation is forecast through 2009. The consumer price index or CPI, used to measure cost of living increases, went up over 3.0 percent in 2006. It will grow 2.2 percent in 2007. The inflation rate will slightly decline in 2008 and 2009. The interest rate environment is still favorable. It appears that the Fed is done with rate increases for now. The market expects a series of rate cuts to boost the economy, starting in the middle of 2007.
- The housing markets in Oregon and the U.S. show signs of slowing, with growing inventories, declining sales of new and existing homes, and sharply lower building permits. The last item to join this group is price. While home price appreciation has continued in Oregon, some parts of the country have seen home prices drop. The expectation is for home prices to soften in most regions.
- Crude oil prices continue to hover around \$60 a barrel. While premiums due to geopolitical risks and associated speculation may have largely disappeared for now, the global supply is still tight, and demand is still growing, particularly from China and the rest of Asia. With OPEC constantly looking for ways to defend a certain price range, oil prices are not expected to move much in the short run. Additional moderation of prices, however, is expected if we go beyond the immediate future.



The Economic and Revenue Environment

Oregon Outlook

- The Oregon economy will continue to grow more moderately in the second half of 2006 and settle into milder growth in 2007. Along with the slowing U.S. economy, a soft patch in Oregon's economy is expected. Job growth will be 1.2 percent in 2007, substantially lower than in 2005 and 2006. Still, Oregon's job growth will outpace the nation during 2007-09.
- Personal income growth is strong in 2006. With a softening economy, personal income growth will moderate to 5.4 percent in 2007. A stronger growth rate will occur in 2008 and 2009 at 5.8 percent and 6.3 percent, respectively.

Risks

- With the national economy expected to slow in the latter part of this year and into 2007, the risks are higher from any disturbances that could throw the economy off track. The same two major drags, oil prices and a slowing housing market, could hurt the economy further when it is most susceptible. The recent drop in oil prices leaves the housing market as the major threat to the slowing economy. Despite good headline inflation numbers, inflation pressures still exist. The softening economy and falling oil prices will likely help ease inflation pressures. Any geopolitical disruptions during this time would be more harmful than when the economy is stronger.

DEMOGRAPHIC CHANGE

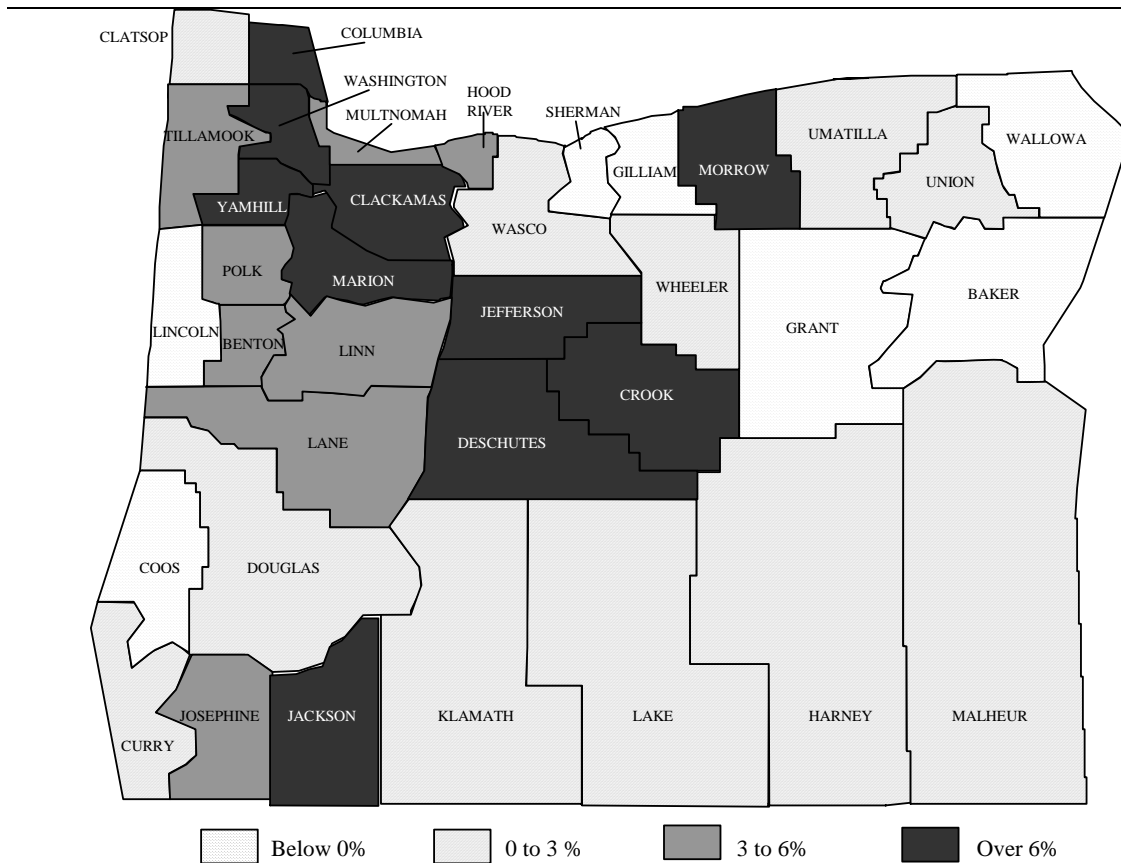
- The Census 2000 enumerated 3,421,399 persons in Oregon on April 1, 2000. This is an increase of 579,000 persons or 20.4 percent from the 1990 census. Oregon's intercensal growth rate was ranked 11th-highest in the nation. However, with the exception of California, Oregon's growth rate was still slower than its neighboring states. In tandem with Oregon's slowing economy, the population growth rate has slowed in recent years. Oregon's growth rate dropped to 14th in the nation and now lags behind all of its neighboring states. Oregon's estimated population for July 1, 2005, was 3.631 million, an increase of 6.4 percent from the benchmark 2000 Census. Its population is expected to reach 4.061 million in 2013, with an annual rate of growth hovering around 1.4 percent.

Regional Variations

- Figure 6 shows population growth by county between April 1, 2000 and July 1, 2005. Overall state growth was 6.4 percent during this period. The high-growth counties (exceeding 6.0 percent change) in order of magnitude were Deschutes, Crook, Washington, Morrow, Jefferson, Jackson, Clackamas, Yamhill, Columbia, and Marion. The moderately growing counties (between 3.0 and 6.0 percent growth) were Benton, Polk, Josephine, Multnomah, Lane, Linn, Tillamook, and Hood River. The slow growing counties (between 0 and 3.0 percent change) were Clatsop, Umatilla, Douglas, Klamath, Union, Lake, Harney, Wasco, Malheur, Curry, and Wheeler. Seven counties lost population (negative growth): Coos, Lincoln, Gilliam, Wallowa, Baker, Sherman, and Grant.

The Economic and Revenue Environment

Figure 6: County Population Growth, April 1, 2000 – July 1, 2005



Sources: U.S. Bureau of Census 2000, and Population Research Center, Portland State University 2005

Change in Age Structure

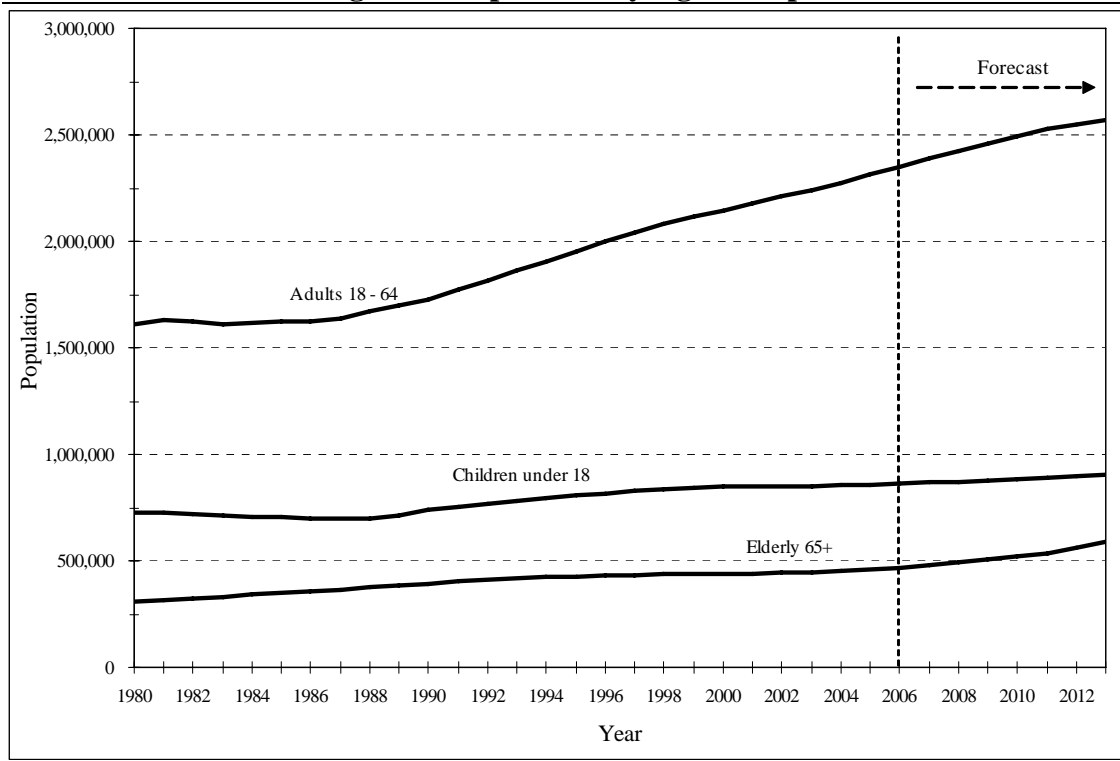
Figure 7 shows that population growth differs by age group.

Children

- Under five years: The size of this age group directly affects demand for childcare, Headstart, and Temporary Assistance for Needy Families (TANF). Between 2007 and 2009, the number of children under five years of age will grow more slowly than the state's overall population.
- School Age: This age group drives demand for K-12 public school enrollment. Nearly 92 percent of five to 17 year-olds are enrolled in public schools. After growing rapidly during the early 1990s, population growth in this age group has slowed for nearly a decade. As the children of the baby-boomers exit this group, the growth rate will continue to be slow. Between 2007 and 2009, the number of school-age children is expected to grow by 0.7 percent.

The Economic and Revenue Environment

Figure 7: Population by Age Groups



Adults

- Ages 18 to 24: This age group drives demand for post-secondary education and entry-level jobs. Nearly three-fourths of all undergraduate students in Oregon public universities are 18 to 24 years old. Also, males in this age group are the criminally “at risk” population, with the highest arrest rate of all adults. Consequently, increases in this age group can increase demand for prison and jail beds and probation services. The growth in this population group has slowed, but it will show a slight up-tick for a couple of years. This group will continue a slower pace of growth as the “baby-boom-echo” cohort exits this age group. Between 2007 and 2009, this population will grow by 2.4 percent.
- Ages 25 to 64: Working-age adults comprise nearly 54 percent of the total population. The nature of this group is heavily influenced by baby-boomers. The working-age population is the major contributor to the state’s tax revenue and puts very little direct pressure on state services. However, younger adults need entry-level jobs and older adults require continued training in a changing technological environment. All of them, especially young adults, need affordable housing, childcare, and schools for their young children. Overall, this population group will grow by 3.0 percent between 2007 and 2009.

Elderly

- Since 1950, Oregon’s elderly (ages 65 and over) have more than tripled, while the total population has nearly doubled. In recent years the overall growth in this group was slow, largely due to the Depression-era birth-cohort reaching retirement age. However, the trend has already started to reverse and will continue its faster pace of growth. Between 2007 and 2009, the number of young elderly (aged 65 to 74)

The Economic and Revenue Environment

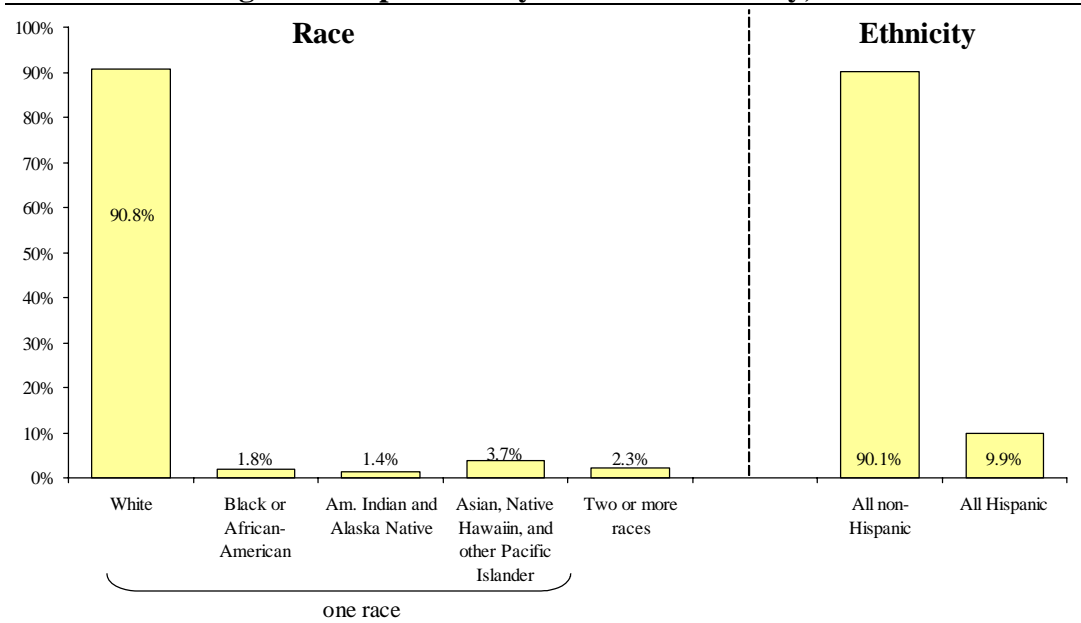
will increase by 10.7 percent, far out-pacing the state's overall growth rate and growing at the fastest pace of all age groups. The number of oldest elderly (85+) will increase at a fast pace of 5.5 percent. The number of persons aged 75-84 will actually see a decline. The young elderly require relatively little government assistance, while persons 85 and over tend to require more public assistance.

Race and Ethnic Composition

- Oregon has become more racially and ethnically diverse. A more diverse population entails meeting the needs of increasing racial and ethnic minorities. Oregon's population is overwhelmingly White. The Census Bureau estimates 90.8 percent of Oregon's population is of the White racial group. However, only 81.6 percent were non-Hispanic White. Each of the other racial categories accounted for less than 5.0 percent of the population. Between April 1, 2000 and July 1, 2005, the Asian population grew by 20.2 percent, and the African-American or Black racial group increased by 12.2 percent, much faster than the 5.7 percent growth of White population.
- The Hispanic or Latino ethnic group, which can be of any race, has reached 9.9 percent of Oregon's population. This ethnic group increased very rapidly. The Hispanic population increased from 112,707 in 1990 to 275,314 in 2000. This ethnic group has grown to 359,785 in 2005. Between April 1, 2000 and July 1, 2005, the Hispanic population increased by 30.7 percent, whereas the non-Hispanic population increased by 3.4 percent.

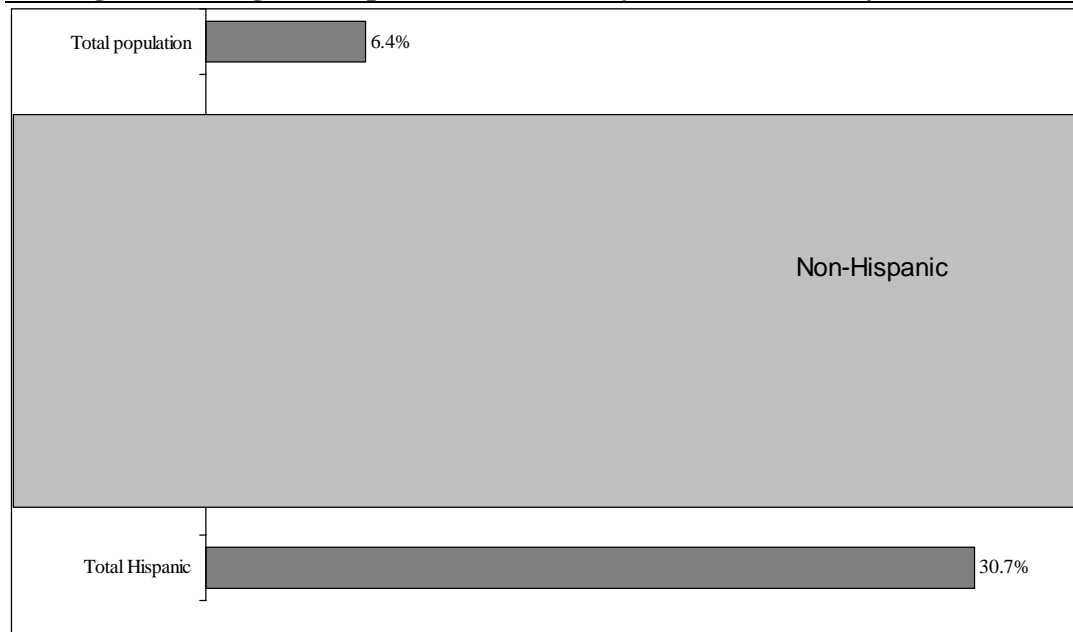
The Economic and Revenue Environment

Figure 8: Population by Race and Ethnicity, 2005



Source: U.S. Bureau of Census. 2005.

Figure 9: Oregon's Population Growth by Race & Ethnicity, 2000-2005



Source: U.S. Bureau of Census.