

EXECUTIVE SUMMARY

May 2009

Oregon Economic Forecast

The first quarter of 2009 marks the fifth consecutive quarter of job losses. The annualized drop of 8.2 percent is the largest quarterly employment decline since the second quarter of 1980. The year-over-year (Y/Y) employment decline for the first quarter is 4.5 percent. Two quarters ago, the Y/Y employment decline was only 0.4 percent. The job loss decent has been extremely rapid the past two quarters.

For the U.S. economy, this recession is the deepest downturn post World War II. For Oregon, the projected job loss during this recession is the second largest downturn, only bested by the 1980-1982 recession periods. The unemployment rate for March 2009 reached 12.1 percent, matching the highest seasonally adjusted unemployment rate during the early 1980's recession. With more job losses likely this year, the unemployment rate will continue to rise.

In the first quarter of 2009, almost all sectors either continued to lose jobs or had slower employment growth. Only two broad job sectors gained jobs: educational and health services and government. Every manufacturing employment, except for food, sector had double digit job losses. The broader service sector continued to decline across most job categories. Health services continued to add jobs but at a much slower rate. Government job growth was barely positive.

“Hope springs eternal...” so wrote Alexander Pope in 1733. And as spring moves us out of the harshness of winter, signs that the U.S. recession may be coming to an end are slowly appearing. Although Paul Krugman warns us not to be too giddy, evidence of “green shoots” and “glimmers of hope” are making their way into the economic data.

The signs that Oregon's economic decline are coming to an end are harder to read. The March job drop was less than February but still over 10,000. The unemployment rate jumped a historical 1.4 percentage points from February to March; up to 12.1 percent to match the highest monthly rate during the early 1980's recession. The Philadelphia Federal Reserve Bank State Coincidence Indicator for Oregon was declining at faster rates since June 2008. February marked the first month that the decline has slowed, though the drop is still one of the largest in the data which goes back to January 1979. Some regions of Oregon are seeing housing inventory levels easing, though once again, they are still at very high levels. House price declines are either not as sharp or accelerating depending on the measure used and timeliness of the data. The bottom line, Oregon has less signals of seeing the end of this recession but should mirror the US business cycle.

OEA (Office of Economic Analysis – Oregon) forecasts a decline of 6.5 percent in total employment for the second quarter of 2009. The year average for 2009 is an employment decline of 5.3 percent. Job growth is negative at 0.7 percent in 2010 but with job gains starting in the second quarter through the end of the year. The Oregon economy does not see above 2 percent job growth until the first quarter of 2011.

The wood products industry is projected to lose jobs at a rate of -19.0 percent in 2009 and -2.2 percent in 2010 before a rebound of 6.7 percent growth in 2011.

The computer and electronic equipment sector is projected to loose jobs this year and the first quarter of 2010. This sector is projected to loose jobs at the rate of 13.7 percent in 2009, 4.4 percent in 2010, before adding jobs at 7.3 percent in 2011.

The recession has been especially harsh for the transportation equipment sector. Hard times will persist for this sector with job losses of 28.0 percent in 2009 and 5.0 percent in 2010 before growth of 3.4 percent returns in 2011.

The metals and machinery sector was one of the last manufacturing sectors to loose jobs as we entered this recession. This sector will reduce jobs by 14.6 percent in 2009 but return to positive growth of 1.8 percent in 2010 and 3.5 percent in 2011.

Employment in food processing is forecast to increase 0.4 percent in 2009, the only sector covered in the manufacturing sector projected to add jobs this year. Employment is expected to decline 5.3 percent in 2010 and remain flat in 2011.

Other nondurables, which includes paper and allied products, is projected to have job declines of 10.4 percent in 2009 and 3.9 percent in 2010 before adding jobs in 2011 at 2.1 percent.

Construction employment is projected to decrease annually by 18.3 percent in 2009, 9.0 percent in 2010, and 0.4 percent in 2011. These numbers would even be worse if not for the construction projects from the Federal and State stimulus packages.

Trade, transportation, and utilities sector employment will decrease by 6.5 percent during 2009 followed by increases of 0.5 percent growth in 2010 and 1.8 percent growth in 2011. Retail jobs are projected to decrease 6.2 percent in 2009 and increase 1.4 percent in 2010 and 2.0 percent in 2011.

The information sector, which includes traditional publishers such as newspapers and publishers of software, is being impacted from the slowing retail sector as advertising has decreased. This sector is expected to contract by 5.7 percent in 2009 and by 4.0 percent in 2010. Job growth should pick up in 2011 with growth of 3.6 percent.

The fragile stability of the financial sector came into stark awareness during the closing months of 2008. Financial activities are projected to lose jobs at 4.6 percent rate in 2009 with very mild growth of 0.6 percent in 2010. Growth continues in 2011 with job gains of 2.1 percent.

Professional and business services are projected to decline 7.0 percent in 2009, a slight drop of 0.4 percent in 2010, and return to positive growth of 7.3 percent in 2011.

Education and health services has generated jobs better than any other sector. But this recession is testing its ability to keep generating high job growth rates. Rather than sustain its plus three percent growth rate of past years, this sector's jobs will grow 2.9 percent in 2009, 2.8 percent in 2010, and 2.2 percent in 2011.

Leisure and Hospitality is projected to decline 4.2 percent in 2009, a slight decline of 0.3 percent in 2010, and grow 0.9 percent in 2011. Just as the retail sector has been hit by the decline in household discretionary spending, this sector is also feeling the loss of business and household customers.

The government sector will decline by 0.1 percent in 2009, 0.2 percent in 2010, and 0.4 percent in 2011.

Population growth will slow to 0.9 percent in 2009 increasing by 1.0 percent in 2010 and 1.2 percent in 2011.

Forecast Risks

The US economy is now in the deepest post WWII recession. Oregon is almost there with this recession starting to rival the 1980-1982 recessionary period. Our economies have experienced financial crises in the past, but the breadth of this one is the worst since the Great Depression.

When you hear the phrase “we are in uncharted waters”, we are reminded that our policy makers are not quite sure what to do. “Uncharted waters” means we have no map to either lead us out of this mess or even know where we are. We do know not to repeat the policy prescriptions during the Great Depression. But the policies for the Great Recession are largely untried with little or no track record.

As with our last quarterly forecast, there are both negative and positive risks going forward. The economic situation could get worse or start to turn just as government stimuli kick in and create a robust recovery. The return of the financial sector to some form of normalcy will be key to ending this recession.

We will continue to monitor and recognize the potential impacts of risk factors on the Oregon economy. We have identified the major risks now facing the Oregon economy in the list below:

- *Contagion of the credit crunch and financial market instability.* With the freezing up of credit markets, broad based borrowing and lending is very expensive or non-existent. Consumer spending has been greatly curtailed and the stock market has lost 40 percent of its value in 2008, though the stock market has almost regained its losses during 2009. Some signs of credit easing are appearing. If the credit markets do not return soon to some sort of state of normalcy, the current recession could be much deeper and longer than presently projected. Oregon will suffer the consequences along with the rest of the nation.
- *Prolonged housing market instability.* Generally, analysts believe that the housing market has yet to hit bottom, at least in terms of price declines. Though Oregon has been hit hard through this downturn, Oregon’s housing market is relatively better off compared to California, Nevada, Florida, and Arizona. Coupled with the recessionary state of the economy, the rise in mortgage rates and heightened credit standards will keep demand for housing relatively low. Rather than the correction of the housing bubble further hurting the Oregon housing market, it will be the deepening recession that causes further home price declines and rising foreclosures. Unlike many parts of the economy, there is an upside risk here as well. If the recession is over sooner than forecasted, Oregon’s housing market should revive better than the states who experienced the greater housing market bubbles.

- *The relative effectiveness of nearly-global government stimulus.* The level of government response to the current recession has never been greater. Furthermore, the coordination of central bank actions throughout the world was similarly unprecedented. While the intent was for significant stabilization and growth, it is unknown if these will come to pass. Federal Reserve, US Treasury, and the federal stimulus package may lift this economy out of recession sooner than projected.
- *The return of federal timber payments to Oregon counties.* Included in the federal bailout was a provision to reinstate federal timber payments for four years. Oregon counties will receive \$254 million, down from the previous \$282 million level and will be phased out over the four year window. While this temporary reinstatement helps cover short term budgets for Oregon counties, finding or replacing this dwindling revenue source will be imperative as any loss of public services could have adverse impacts on economic activity.
- *The extent of the global downturn triggered by the U.S. slowdown.* The U.S. economy has been an important engine of growth for the global economy. As the U.S. economic woes continue, the whole world is being to feel the impact. First, European economic growth slowed considerably, even contracting in places. Then Asian economies began slowing due to their large exposure, via trade, to the U.S. economy. China is a top importer of Oregon products and any slowing of the Chinese economy will adversely impact Oregon exports. To the extent that Oregon major trading partners take longer to recovery compared to the US economy, this could extend the downturn in Oregon.
- *Appreciation of the U.S. dollar.* Along with slowing foreign economies, the recent appreciation of the U.S. dollar has slowed exports from U.S. producers. This is also true for Oregon exports. The extent of the impact from the U.S. dollar may not be as great for Oregon given the expected appreciation of the Chinese Yuan, one of Oregon's major trading partners. Still, the risk is present for a slowing of exports.
- *National and regional energy prices.* The over 60 percent drop in oil prices is bringing relieve to both businesses and households. The near term outlook is also for lower regional prices for natural gas and electricity. This comes at a welcomed time when businesses are looking for cost savings. The benefit from lower energy prices is most likely short-lived as the underlying demand drivers will return once the world economies rebound from this recession.
- *Geopolitical risks.* Uncertainty still abounds in Iraq. Tensions with Iran and heightened security risks weigh on businesses and consumers. Disruptions in travel, oil supplies, and consumer confidence could be severe. The drop in business activity could deepen if this uncertainty persists or if the transition out of the Iraq war goes badly for the U.S. The eventual winding down of military expenses will not greatly impact Oregon. There is also an upside risk that the transition will go more smoothly than anticipated, and stability in the Mideast will provide a stronger than forecasted stimulus to the economy.
- *H1N1 flu.* The "Swine" flu pandemic is still unknown. The disruption to the economy of Mexico has been severe, but other economies so far have not been greatly impacted. Indications to date are for mild disruption and nothing approaching the devastation of the Spanish Flu of 1918-19.

- *Initiatives, referendums, and referrals.* Generally, the ballot box brings a number of unknowns that could have sweeping impacts on the Oregon economy.

Demographic Forecast

Oregon's estimated population on July 1, 2008 reached 3,791,075. That was an increase of 1.2 percent over the 2007 population. The growth has slowed down since the highs of 2005 through 2007 when it exceeded 1.5 percent on average. Overall, population change since 2000 is much lower than the rate of growth of well over 2.0 percent during the early 1990s. As a result of recent economic downturn, Oregon's population is expected to grow at a slower pace in the near future. Based on the current forecast, Oregon's population will reach 4.106 million in the year 2015 with an annual rate of growth of 1.14 percent between 2008 and 2015.

Oregon's economic condition heavily influences the state's population growth. Its economy determines the ability to retain local work force as well as attract job seekers from other states and beyond. As Oregon's total fertility rate remains below the replacement level and deaths continue to rise due to ageing population, long-term growth comes from net in-migration. Working-age adults come to Oregon as long as we have good economic and employment situations. During the 1980s that included a major recession and a net loss of population, net migration contributed to 22 percent of the population change. On the other extreme, net migration accounted for 73 percent of the population change during the booming 1990s. This share of migration declined to 57 percent in 2002. As a sign of slow to modest economic gain, the net migration will account for 49 to 64 percent of the population change in the near future. Although economy and employment situation in Oregon look bleak, migration situation is not expected to replicate the early 1980s pattern. Potential Oregon out-migrants have no better place to go since other states are also in the same boat in terms of economy and employment.

Growth in all age groups will show the effects of the baby-boom and their echo generations during the period of 2008-2015. It will also reflect demographics impacted by the depression era birth cohort combined with diminished migration of the working age population and elderly retirees. After a period of slow growth in the past, the elderly population (65+) growth has picked up in pace and will surge as the baby-boom generation starts to enter this age group. The average annual growth of the elderly population will be nearly 3.8 percent during the forecast horizon as the boomers continue to enter retirement age. The youngest elderly (aged 65-74) will grow at an extremely fast pace due to the direct impact of the baby-boom generation entering retirement age. The elderly aged 75-84 will continue to shrink in numbers until 2009, as the depression era birth-cohort will dominate this group. The oldest elderly (aged 85+) will continue to grow at a moderately high rate due to the combination of cohort change, continued positive net migration, and improving longevity. However, the annual growth rate will continue to taper off as the depression era small birth cohort transitions from the younger age group.

As the baby-boom generation matures, the once fast-paced growth of population aged 45-64 will gradually taper to near 0 percent rate by 2012. The young adult population (aged 18-24) will grow at an average of 0.1 percent annually, considerably slower than the rate averaging 1.1 percent experienced between 2000 and 2008. Although the slow growth of college-age population tend to ease the pressure on public spending on college education, college enrollment typically goes up during the time of high unemployment and scarcity of well paying jobs when even the older population flock back to college to better position themselves in a tough job market. Compared to other non-elderly age groups, children under the age of five show a higher rate of growth after a slow growth period in the recent past. However, the growth rate for the children will remain below the

overall population growth rate resulting in lesser demand for child care services and pre-Kindergarten program. The K-12 population (aged 5-17) will show very slow growth which will translate into slow growth in school enrollments. This population will actually decline in the near future. The 25-44 age group population has reversed the several year trend of decline. The decline was mainly due to the exiting baby-boom cohort. This age group has seen positive growth starting in the year 2003 and will approach 1.2 percent annual growth by the year 2011.

Revenue Forecast

The forecast for General Fund revenues for the 2007-09 biennium is \$11,757.9 million, a decrease of \$260.6 million from the March 2008 forecast. The decrease is concentrated in personal income taxes, as expectations for income tax receipts related to both capital gains and business income continued to slide rapidly through April. Corporate income tax receipts have exhibited similar weakness. Including the beginning balance of \$1,436.7 million, total available resources amount to \$12,833.2 million, a decline of \$1,305.7 million from the Close of Session forecast.

After adjustments for several new laws related to expenditure cuts and revenue increases, the May projections result in a negative ending balance of \$351.3 million for the 2007-09 biennium. The protracted slowdown will push still further downward relative to the March forecast in the 2009-11 biennium. The forecast for total General Fund revenue during 2009-11 was reduced by \$532.5 million relative to March.

Projected lottery earnings for 2007-09 will total \$1,326.9 million, an increase of \$9.7 million from the prior forecast. Though coming in slightly ahead of the March forecast, the dramatic decline in lottery sales through the winter has continued, with weekly video lottery sales down more than 20 percent on a year-over-year basis. Including the beginning balance and other earnings, total available resources equal \$1,400.2 million. Total projected resources have increased \$8 million from the Close of 2007 Session.

Lottery earnings are expected to fall 14.3 percent to \$1,137.1 million for the 2009-11 biennium. In addition to the expected impact of the smoking restrictions and slow economic growth, the weak growth is the result of an absence of administrative savings for the biennium, compared with \$102.7 million in the current biennium. In spite of the increased transfer rate, video lottery earnings will decrease 7.1 percent, while traditional products will decline 7 percent. Not including any administrative savings that may accrue during the biennium, total available resources will amount to \$1,141.8 million.