I. ECONOMIC FORECAST

December 2011

This edition of the National Economic Review and Forecast contains excerpts from Nigel Gault, *U.S. Economy: Current Situation: Forecast Flash*, IHS Global Insight, October 2011. This publication summarizes Global Insight's baseline national forecast that OEA incorporates into the Oregon economic and revenue models. OEA summarizes the *Forecast Flash* and is our interpretation of this document. Any errors or misrepresentations are attributable to OEA.

A. National Economic Review and Forecast

Outlook Darker Despite Better Third-Quarter Growth

For the meantime, the U.S. economy is able to keep afloat despite the continued bad news from Europe. IHS Global Insight is now forecasting at least a mild recession in the Eurozone beginning in the fourth quarter. The impact will be felt in the U.S. by weakening exports, reducing corporate earnings and strengthening the U.S. dollar. The key question moving forward is whether or not European politicians can, and will, be able to ring-fence the issues and support European banks with sufficient financial firepower, given that a Greek default is all but inevitable in the next six months. Should the end result be a Greek exit from the Eurozone and broader contagion amongst Europe's peripheral countries, the likely outcome at home would be a U.S. recession. However, the baseline forecast is for the European response to be aggressive enough to stabilize financial markets and the U.S. avoids recession.

Third-Quarter Growth Improves; Fourth Quarter Looks Worse. Third-quarter GDP, based on incoming data, will show a sizable improvement over early 2011 growth. IHS Global Insight now expects 2.4% annualized growth, with the key being stronger business fixed investment, which is expected to grow 14.6% at an annual rate. While this is certainly encouraging, the pace is unlikely to be maintained in light of anemic consumer spending growth, continued depressed housing activity and an expected slowdown in export growth. The third quarterly likely began much stronger than it ended and the forecast for fourth-quarter growth is just 1.0%. 2012 growth is a modest improvement, however sluggish. The 2011 full year forecast increased to 1.7% however the 2012 forecast was revised down to 1.4%.

Recession or Not? IHS Global Insight maintains their weak growth outlook and avoiding a return to recession, however they place the recession probability at 40% due to weak momentum. Under such conditions, the U.S. economy remains vulnerable to shocks such as a worsening Eurozone crisis. Consumer spending is growing stronger than sentiment would suggest, while major business activity indexes are not in recessionary territory yet. A sharp drop in oil prices, a response to weakening global growth, will be a welcomed sign by consumers as IHS Global Insight expects gasoline prices to fall below $3.25/gallon by the holidays.

More Domestic Flashpoints Ahead. The fiscal-year 2012 continuing resolution expires November 18 and the threat of a government shutdown looms if spending details cannot be agreed upon. The congressional supercommittee is scheduled to present its budget proposal by

November 23. IHS Global Insight believes the supercommittee will be unable to reach agreement on a deal that would command general assent as the agreed upon "punishment" for not reaching a deal – severe spending cuts heavily concentrated in defense – is too far in the future, January 2013, to be effective. While neither of these developments should have the same impact that the debt ceiling debacle did, further public disenchantment with the political process may give another reason not to take economic risks by spending or hiring.

What Can Survive of the President's Jobs Proposal? The proposal, taken as whole package, is going nowhere, evidenced by the Senate vote on 10/12/12. The real question is what portions can survive Congress. The baseline assumes existing stimulus will be kept in place – the 2% payroll tax cut and extended unemployment benefits – but nothing more. The forecast for 2012 will be even worse if this does not happen.

Fed Will Do More, But Its Powers Are Limited. The Fed's prime ammunition has already been spent and it has undertaken a $400 billion "twist" operation to drive down long-term bond yields. Eventually, IHS Global Insight expects the Fed to implement a QE III similar in size to QE II ($600 billion). They do not believe either will much support to growth.

Figure N.1*

	Quarterly				Annual				
	2Q 11	**3Q 11**	**4Q 11**	**1Q 12**	**2010**	**2011**	**2012**	**2013**	**2014**
Real GDP (%, AR)	1.3	2.4	1.0	1.1	3.0	1.7	1.4	2.4	3.5
Federal Funds Rate	0.09	0.08	0.10	0.10	0.18	0.11	0.10	0.11	1.23
10 Year T-Bill	3.21	2.43	1.93	2.08	3.21	2.76	2.32	2.84	3.58
Oil Prices, WTI ($)	103	90	76	79	79	91	89	98	106
Consumer Price Index (Y/Y %)	3.3	3.8	2.9	1.9	1.6	3.0	1.3	1.9	2.3
Housing Starts (millions)	0.57	0.58	0.61	0.63	0.59	0.59	0.67	0.94	1.33
Consumer Sentiment (Univ. of Michigan)	72	60	63	64	72	67	69	77	79
Unemployment Rate (Percent)	9.1	9.1	9.3	9.3	9.6	9.1	9.3	9.1	8.4

*Figure N.1 was taken from Nigel Gault, *U.S. Economy: Current Situation: Forecast Flash*, IHS Global Insight, October 2011

Graph N.1

U.S. Economic History and Forecast

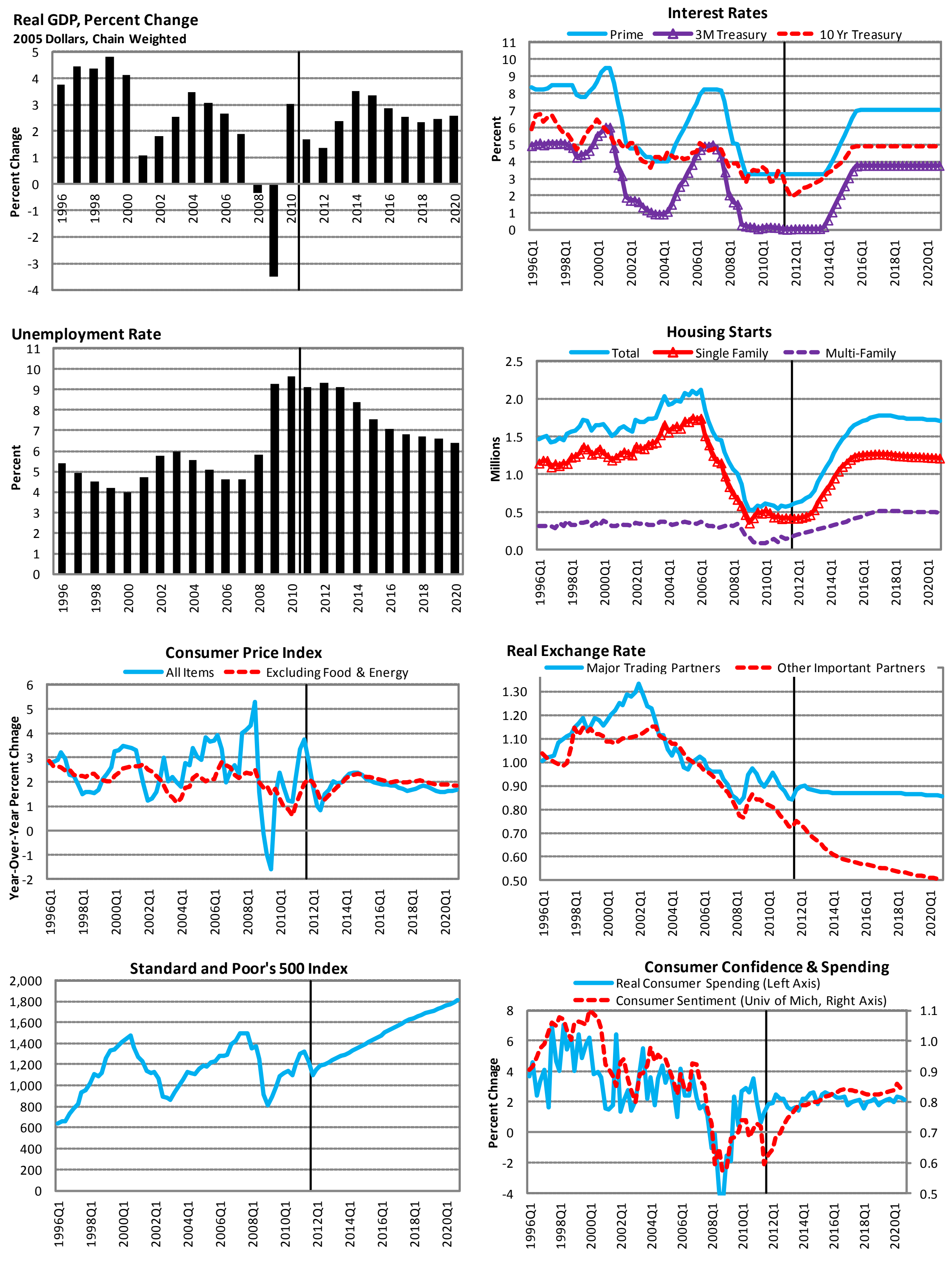

TABLE N. 1

U.S. Forecast Summary 2009-2017 (Oct 2011 U.S. Forecast, IHS Global Insight)

	Quarterly						Annual								
	2011:2	**2011:3**	**2011:4**	**2012:1**	**2012:2**	**2012:3**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
GDP (Bil of 2005 $) Chain Weight	13,272	13,350	13,382	13,420	13,464	13,511	12,703	13,088	13,308	13,491	13,810	14,298	14,779	15,200	15,586
% Ch	1.3	2.4	1.0	1.1	1.3	1.4	(3.5)	3.0	1.7	1.4	2.4	3.5	3.4	2.9	2.5
Personal Income (Bil of $)	12,993	13,043	13,151	13,280	13,389	13,495	11,930	12,374	13,008	13,442	13,904	14,627	15,417	16,199	16,933
% Ch	4.6	1.6	3.4	4.0	3.3	3.2	(4.3)	3.7	5.1	3.3	3.4	5.2	5.4	5.1	4.5
Nonagricultural Employment (Millions)	131.0	131.1	131.2	131.3	131.6	131.9	130.8	129.8	131.0	131.8	133.5	136.2	138.9	141.4	143.1
% Ch	1.4	0.4	0.1	0.3	1.0	1.0	(4.4)	(0.7)	0.9	0.6	1.3	2.0	2.0	1.7	1.2
Unemployment Rate	9.1	9.1	9.3	9.3	9.3	9.4	9.3	9.6	9.1	9.3	9.1	8.4	7.6	7.1	6.8
Point Change	0.2	0.0	0.1	0.0	0.0	0.0	3.5	0.4	(0.5)	0.2	(0.2)	(0.7)	(0.8)	(0.5)	(0.2)
Industrial Production Index (2007=100)	92.9	93.8	93.9	94.1	94.5	95.0	85.5	90.1	93.4	94.8	97.8	102.3	106.2	109.1	111.4
% Ch	0.5	4.1	0.3	0.9	1.7	2.2	(11.2)	5.3	3.6	1.6	3.2	4.6	3.8	2.7	2.2
Corporate Profits (Bil of $)	1,891	1,907	1,871	2,012	1,993	2,014	1,456	1,819	1,886	2,012	2,258	2,379	2,318	2,323	2,310
% Ch	2.9	3.4	(7.2)	33.8	(3.9)	4.4	7.0	25.0	3.7	6.7	12.2	5.3	(2.5)	0.2	(0.6)
Money Supply (M2) (Bil of $)	9,032	9,484	9,645	9,706	9,752	9,832	8,510	8,779	9,645	9,917	10,388	10,895	11,301	11,720	12,128
% Ch	6.6	21.6	6.9	2.5	1.9	3.3	5.0	3.2	9.9	2.8	4.7	4.9	3.7	3.7	3.5
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.23	6.27	7.00	7.00
% Ch	0.0	0.0	0.0	0.0	0.0	0.0	(36.1)	0.0	0.0	0.0	(0.0)	30.3	48.1	11.6	0.0
Consumer Price Index (1982-84=100)	224.5	226.2	225.8	226.4	226.8	228.1	214.5	218.1	224.7	227.6	232.0	237.3	242.4	246.9	251.2
% Ch	4.1	3.1	(0.8)	1.1	0.6	2.4	(0.3)	1.6	3.0	1.3	1.9	2.3	2.1	1.9	1.7
Federal Budget (unified) (Bil of $, Fed FY	(141.1)	(295.6)	(341.9)	(404.0)	(83.4)	(257.2)	(1,471.3)	(1,275.1)	(1,239.1)	(1,042.4)	(771.8)	(672.6)	(617.5)	(599.7)	(574.4)
Current Account Balance (Bil of $)	(472.0)	(420.5)	(376.0)	(364.1)	(395.7)	(421.9)	(376.6)	(470.9)	(436.7)	(401.1)	(402.2)	(422.6)	(463.5)	(443.0)	(390.5)
% Ch	(5.21)	(37.03)	(36.04)	(12.05)	39.37	29.34	(44.4)	25.1	(7.3)	(8.2)	0.3	5.1	9.7	(4.4)	(11.9)
Population (Millions)	313.46	314.21	314.97	315.73	316.49	317.26	307.84	310.83	313.84	316.88	319.94	323.04	326.16	329.30	332.46
% Ch	1.0	1.0	1.0	1.0	1.0	1.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0

TABLE N. 2

U.S. Forecast Change - (Current Forecast Oct 2011 vs. Last Forecast Jul 2011)

	Quarterly						Annual								
	2011:2	**2011:3**	**2011:4**	**2012:1**	**2012:2**	**2012:3**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
GDP (Bil of 2005 $) Chain Weight	13,272	13,350	13,382	13,420	13,464	13,511	12,703	13,088	13,308	13,491	13,810	14,298	14,779	15,200	15,586
% Change From Last Forecast	(1.7)	(2.0)	(2.5)	(2.8)	(3.0)	(3.2)	(1.4)	(1.2)	(2.0)	(3.1)	(3.5)	(3.3)	(3.3)	(3.6)	(3.8)
Personal Income (Bil of $)	12,993	13,043	13,151	13,280	13,389	13,495	11,930	12,374	13,008	13,442	13,904	14,627	15,417	16,199	16,933
% Change From Last Forecast	(0.5)	(1.3)	(1.5)	(0.7)	(0.9)	(1.1)	(2.0)	(1.3)	(1.0)	(1.0)	(1.7)	(2.3)	(2.6)	(3.1)	(3.6)
Nonagricultural Employment (Millions)	131.0	131.1	131.2	131.3	131.6	131.9	130.8	129.8	131.0	131.8	133.5	136.2	138.9	141.4	143.1
% Change From Last Forecast	(0.0)	(0.2)	(0.7)	(1.0)	(1.1)	(1.2)	0.0	0.0	(0.2)	(1.2)	(1.3)	(1.3)	(1.2)	(1.2)	(1.2)
Unemployment Rate	9.1	9.1	9.3	9.3	9.3	9.4	9.3	9.6	9.1	9.3	9.1	8.4	7.6	7.1	6.8
Point Change From Last Forecast	0.0	0.2	0.5	0.6	0.7	0.8	0.0	0.0	0.2	0.8	1.0	0.8	0.7	0.8	0.9
Industrial Production Index (2007=100)	92.9	93.8	93.9	94.1	94.5	95.0	85.5	90.1	93.4	94.8	97.8	102.3	106.2	109.1	111.4
% Change From Last Forecast	(0.2)	(0.5)	(1.2)	(2.0)	(2.1)	(2.2)	0.0	0.0	(0.4)	(2.1)	(2.0)	(1.2)	(1.0)	(1.4)	(1.9)
Corporate Profits (Bil of $)	1,891	1,907	1,871	2,012	1,993	2,014	1,456	1,819	1,886	2,012	2,258	2,379	2,318	2,323	2,310
% Change From Last Forecast	(2.3)	1.4	0.7	1.0	1.0	1.9	10.6	1.0	(0.9)	1.1	1.2	1.6	(0.1)	(1.1)	(2.0)
Money Supply (M2) (Bil of $)	9,032	9,484	9,645	9,706	9,752	9,832	8,510	8,779	9,645	9,917	10,388	10,895	11,301	11,720	12,128
% Change From Last Forecast	0.4	3.3	3.6	2.5	1.4	0.5	(0.0)	(0.1)	3.6	(0.4)	(2.0)	(2.0)	(2.7)	(3.7)	(4.9)
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.23	6.27	7.00	7.00
% Change From Last Forecast	0.0	0.0	0.0	0.0	0.0	(1.6)	0.0	0.0	0.0	(2.7)	(31.3)	(34.8)	(18.4)	(9.7)	(9.7)
Consumer Price Index (1982-84=100)	224.5	226.2	225.8	226.4	226.8	228.1	214.5	218.1	224.7	227.6	232.0	237.3	242.4	246.9	251.2
% Change From Last Forecast	0.0	0.4	(0.2)	(0.4)	(0.5)	(0.5)	0.0	0.0	0.0	(0.4)	(0.4)	(0.1)	(0.0)	(0.3)	(0.5)
Federal Budget (unified) (Bil of $, Fed FY	(141.1)	(295.6)	(341.9)	(404.0)	(83.4)	(257.2)	(1,471.3)	(1,275.1)	(1,239.1)	(1,042.4)	(771.8)	(672.6)	(617.5)	(599.7)	(574.4)
Current Account Balance (Bil of $)	(472.0)	(420.5)	(376.0)	(364.1)	(395.7)	(421.9)	(376.6)	(470.9)	(436.7)	(401.1)	(402.2)	(422.6)	(463.5)	(443.0)	(390.5)
% Change From Last Forecast	9.52	1.81	(22.65)	(21.61)	(15.37)	(11.43)	0.0	0.0	(3.3)	(14.4)	(10.8)	(10.7)	(3.4)	(9.5)	(13.7)
Population (Millions)	313.46	314.21	314.97	315.73	316.49	317.26	307.84	310.83	313.84	316.88	319.94	323.04	326.16	329.30	332.46
% Change From Last Forecast	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0