



Oregon Economic and Revenue Forecast **SUMMARY**

December 2008
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State of Oregon
Department of Administrative Services
Office of Economic Analysis

EXECUTIVE SUMMARY

December 2008

Oregon Economic Forecast

The past two quarters have now reported job losses. The third quarter job loss in Oregon is negative 0.9 percent at an annualized rate. On a year-over-year (Y/Y) basis, jobs decreased by 0.1 percent in the third quarter, the first Y/Y decline since the fourth quarter of 2003.

The third quarter job loss was spread across most employment sectors. In manufacturing, only metals and machinery managed to have positive job growth. In the service sector, private education and health services added jobs as did leisure and hospitality. Local government education lifted the government sector employment. All other sectors had some degree of job losses.

The housing market slump continued to impact employment sectors. Construction, wood products, and financial activities lost jobs. Consumer spending has slowed considerably impacting retail and wholesale employment sectors. Further detrimental employment impacts will likely stem from the turmoil in the financial markets. The economic environment is increasingly taking on the characteristics of a recession.

There is neither an official definition nor agency that declares a state, such as Oregon, to be in recession. Various measures do weigh in on this issue. The Federal Reserve Bank of Philadelphia's Coincident Index of economic activity for Oregon has been falling since its peak in February 2008. It is now down 2.8 percent from its peak. Moody's Economy.com Risk of Recession measure stands at 56 percent for Oregon. Only 11 states have a higher risk percentage than Oregon. The Oregon Index of Leading Indicators has been largely negative throughout 2007 and 2008 with more than half the components falling since October 2007. Oregon seasonally adjusted job growth, across most employment sectors, has now declined for two consecutive quarters, the second and third of 2008. While Oregon does not have an official agency that dates recessions, this office, the Office of Economic Analysis, believes that Oregon is in a recession.

OEA forecasts a decline of 3.2 percent in total employment for the fourth quarter of 2008. The first three quarters of 2009 are also projected to have drops in employment. The Oregon economy does not start to recover until the first half of 2010.

The wood products sector is projected to lose jobs at a rate of 7.5 percent in 2008 with a further decline of 7.0 percent in 2009. Looking forward the housing market will continue to correct itself through 2010 and wood products jobs will contract by 3.8 percent. As the housing market improves through late 2010 and into 2011, employment is expected to regain some of these lost jobs.

The computer and electronic equipment sector will see job declines of 5.0 percent in 2008 and 4.5 percent in 2009. Mild improvement is projected for late 2010 and into 2011, when job growth rebounds to 4.4 percent.

Employment in the transportation equipment industry will decline 9.4 percent in 2008, 8.9 percent in 2009 and 1.5 percent in 2010 before positive growth in 2011.

Construction employment is projected to fall by 8.3 percent in 2008 and 8.2 percent in 2009. As the housing market continues to correct itself into 2010, employment in this sector falls by 1.8 percent with a mild turnaround in 2011, when employment should turn positive with growth of 2.2 percent.

Trade, transportation, and utilities sector is projected to mildly add jobs at a rate of 0.06 percent in 2008, a decline of 1.9 percent in 2009, and moderate growth of 1.4 percent in 2010.

The information sector will reduce jobs by 1.3 percent in 2008, 3.4 percent in 2009, and grow 0.5 percent in 2010.

The financial sector will lose 2.3 percent of jobs in 2008, lose 1.2 percent in 2009, before recovering 1.2 percent employment in 2010.

Professional and business services will increase jobs by only 0.3 percent in 2008, continuing a slowing trend that started in 2007. With the economy slowing considerably, job growth will turn negative with a 3.1 percent decline in 2009 before rebounding to 2.6 percent growth in 2010.

Education and health services are surviving the downturn better than any other sector. Job growth will be 4.9 percent in 2008, 3.6 percent in 2009, and 2.4 percent in 2010.

Leisure and hospitality employment will increase 1.4 percent in 2008 due mainly to better numbers in the first quarter of the year. Jobs will decline 1.0 percent in 2009 with positive growth of 0.8 percent in 2010.

The government sector employment will increase by 2.6 percent in 2008, 0.6 percent in 2009, and 0.2 in 2010.

Population growth will slow but still be above the U.S. growth rate with rates of 1.2 percent in 2008, 1.1 percent in 2009, and 1.2 percent in 2010.

Forecast Risks

The US economy is no stranger to financial crises. If we only look at the past twenty-five years, there was the Savings and Loans bankruptcy in the mid-1980's, the largest one-day fall of the Dow Jones Industrial Average in 1987, the Asian Financial Crisis in the late 1990's with the collapse of Long-Term Capital Management, and the dot.com bubble bust of 2000. Each of these episodes in history was painful to varying degrees, but we survived and moved on. The nation and the world hold out hope that history will repeat itself and we will move on.

The depth and length of the current recession is very difficult to forecast. The current financial crisis appears to be of magnitude to the situation in the Great Depression. But unlike that time, governments around the world are moving swiftly to provide support to the financial system. Governments have undertaken these policies in various forms in the recent past, but nothing on the

grand scale we see today. In principle, the rescue packages should work. In practice, this is the first experiment of these theories.

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 since the start of the year. 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. Unlike many parts of the economy, there is an upside risk here as well. While Oregon did not have the same level of exposure to bad loans or to overbuilding as many places in the country, building permit and housing start data suggest that the industry in the state is correcting at least as fast as the country as a whole. Oregon's housing market may not decline longer than what is forecasted for the country.
- *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. Another fiscal stimulus package may be crafted late this year or early 2009. This may provide further help to the sagging economy.
- *Returning high energy prices.* Recently, slower demand for oil has caused the gas price spike to fade. However, the long-term growth of the developing world could cause demand to return, creating upward price pressures. We have already seen how high energy prices can slow consumer spending earlier this year. Given the weakened economic environment current being faced, a return to high gas prices would likely exacerbate the situation.
- *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. How long and how deep the impacts of the downturn will remain open ended questions.

- *Appreciation of the U.S. dollar.* Along with slowing foreign economies, the recent appreciation of the U.S. dollar is expected to slow exports from U.S. producers. This will also be 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.
- *A hard landing in China.* The Chinese economy has been growing very fast. Building construction and other business investments are largely responsible for this economic growth. Inflationary pressure remains strong but is subsiding. The central government's efforts to curb growth in early 2008 produced minimal success and the recent global downturn has produced sharp, negative effects. Limited experience in macro policymaking may result in an undesirable set of policy measures. A major slowdown in China will hurt most Asian economies, along with commodity-exporting countries, including Canada. Given that Canada and Asian countries are the major destinations of Oregon's manufacturing exports, the manufacturing sector would be negatively impacted.
- *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 drives of demand 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.
- *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, 2007 reached 3,745,455. That was an increase of 1.5 percent over the 2006 population. The growth between 2005 and 2007 was considerably higher than the 1.1 percent annual average growth rate between 2000 and 2005. 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 4.126 million in the year 2015 with an annual rate of growth of 1.2 percent between 2007 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, long-term growth comes from net immigration. Working-age adults come to Oregon as long as we have good economic and employment situations. The net migration during the 1980s, which included a major recession, 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 nearly 62 percent of the population change in the near future.

Growth in all age groups will show the effects of the baby-boom and their echo generations during the period of 2007-2015. It will also reflect demographics impacted by the depression era birth cohort combined with 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 annual growth of the elderly population will be nearly 3.7 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 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 nearly a 0 percent rate by 2012. The young adult population (aged 18-24) will grow at an average of 0.2 percent annually, considerably slower than the rate averaging 1.1 percent experienced between 2000 and 2007. This will ease the pressure on public spending on college education. 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. The K-12 population (aged 5-17) will show very slow growth which will translate into slow growth in school enrollments. 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 1.3 percent annual growth by the year 2011.

Revenue Forecast

The forecast for General Fund revenues for the 2007-09 biennium is \$12,731.6 million, a decrease of \$165.9 million from the September 2008 forecast. The decrease is concentrated in personal income taxes and is the result of the expectation of the current economic slowdown being more severe than previously anticipated.

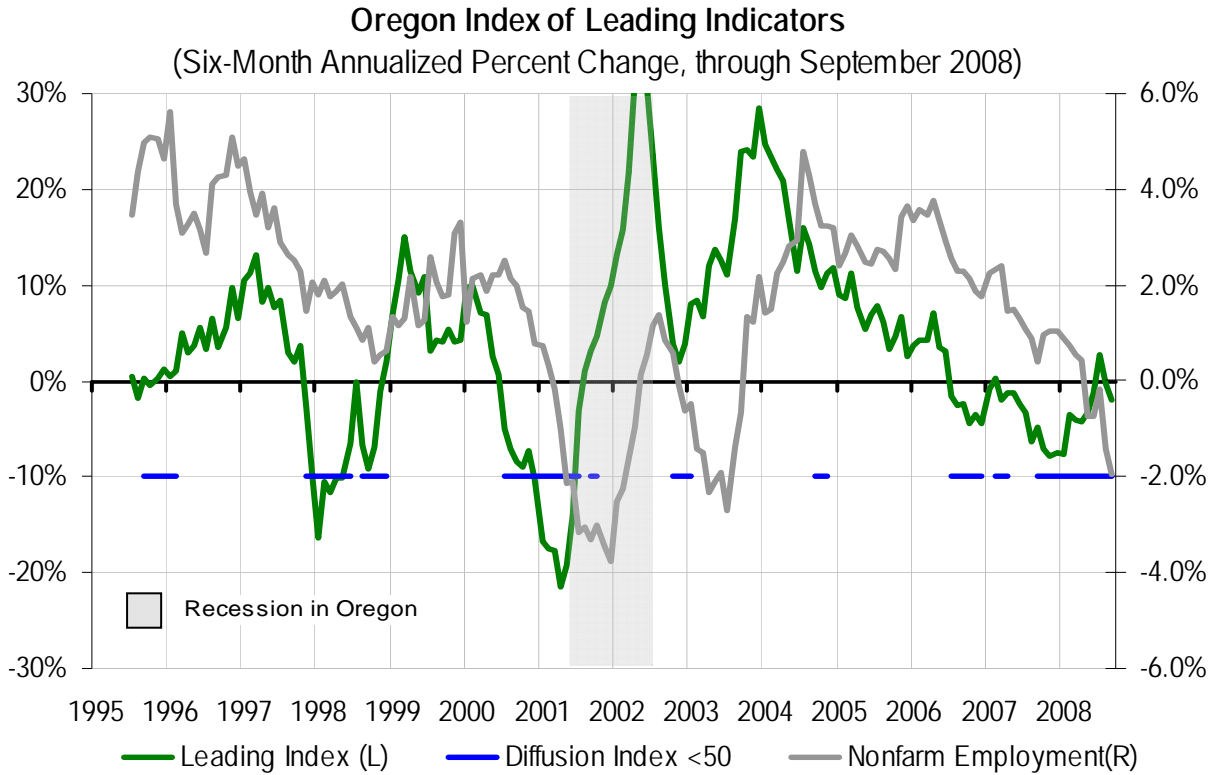
Total structural General Fund revenues will increase 6.8 percent to \$14,749.4 million in 2009-11. Personal income tax growth of 19.3 percent, which will raise collections to 13,104.8 million, is due largely to the \$1.084 billion kicker rebate distributed in the prior biennium. In addition, the sunset

of the Bush tax cuts in 2011 are expected to have a short-run positive impact on personal income taxes, particularly through capital gains realizations. Corporate income taxes will decline 7.2 percent to \$795.2 million, as the economic slowdown in 2008 and 2009 filters through to corporate income tax receipts. All other revenues will reach \$849.4 million, mildly below the prior biennium's level.

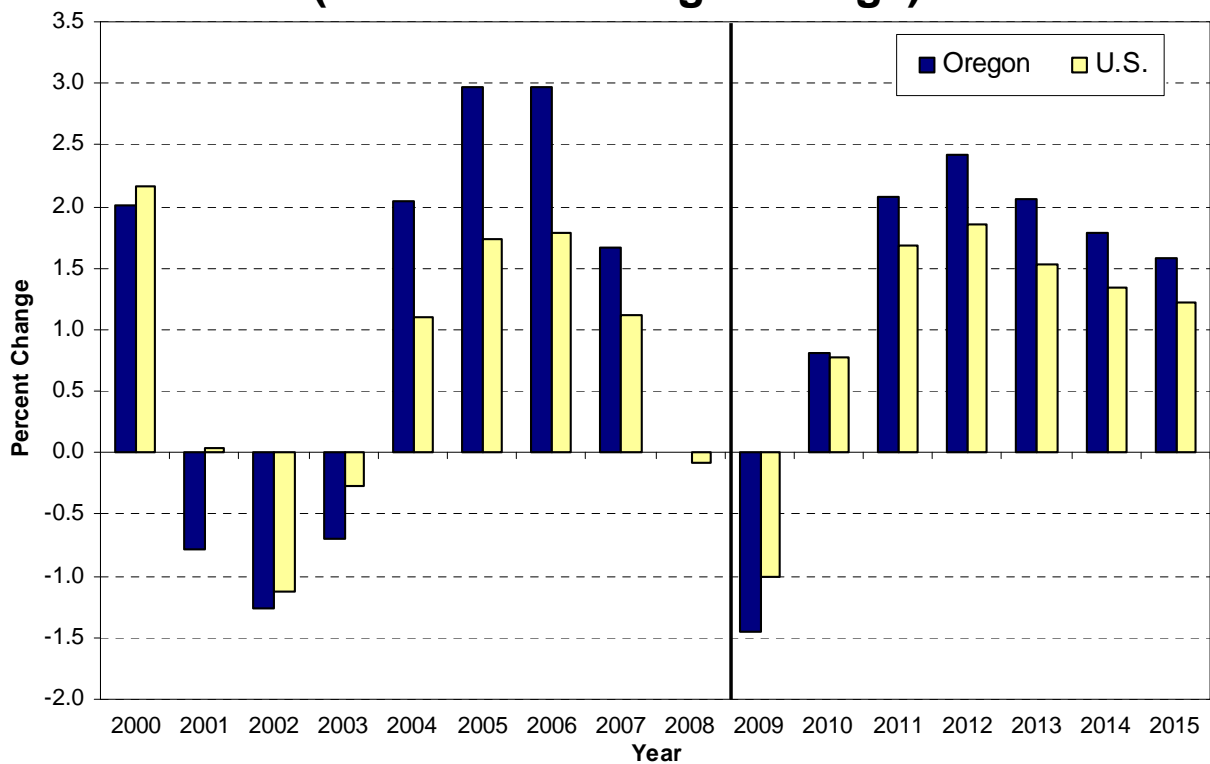
General Fund revenues will total \$16,955.7 million in 2011-13, an increase of 15 percent from the prior period. The growth is fueled primarily by a 15.2 percent increase in personal income tax collections to \$15,099.8 million. Corporate income taxes will reach \$981.1 million, while all other revenues will total \$874.7 million.

Projected lottery earnings will total \$1,324 million, a decrease of \$17.7 million from the prior forecast. Overall consumer spending has stalled, driving down expectations for lottery sales through the remainder of this biennium. Including the beginning balance and other earnings, total available resources equal \$1,402.1 million. Total projected resources have increased \$9.9 million from the Close of 2007 Session.

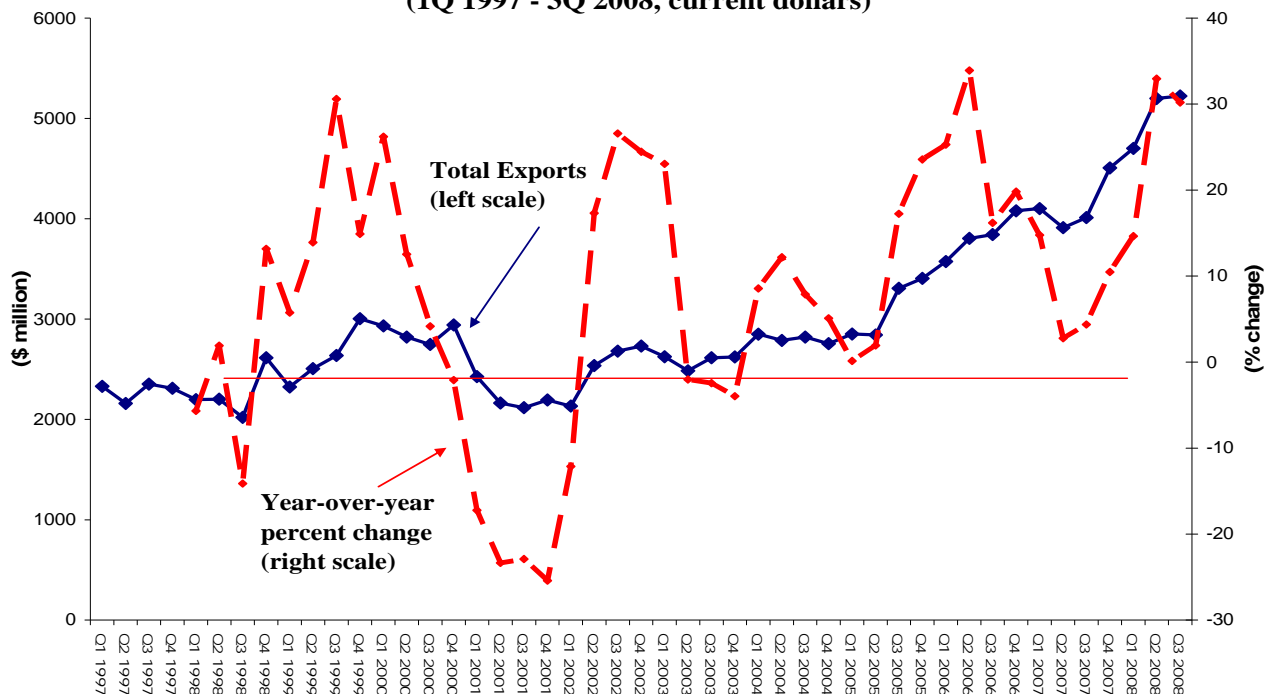
The extended outlook for lottery earnings includes a transfer rate pertaining to video lottery of 65.1 percent for sales beginning July 1, 2009, as opposed to the current rate of 62.4 percent. Lottery earnings are expected to fall one percent to \$1,311 million for the 2009-11 biennium. In addition to the expected impact of the smoking restrictions, the weak growth is the result of an absence of administrative savings for the biennium, compared with \$74.9 million in the current biennium. Buoyed by the increased transfer rate, video lottery earnings will increase six percent, while traditional products will decline four percent. Total available resources will amount to \$1,317.1 million.



Total Non-farm Employment (Annual Percentage Change)



Oregon's Total Exports
(1Q 1997 - 3Q 2008, current dollars)



Oregon December 2008 Forecast Comparison:

Alternative Scenarios

(Percent Change)

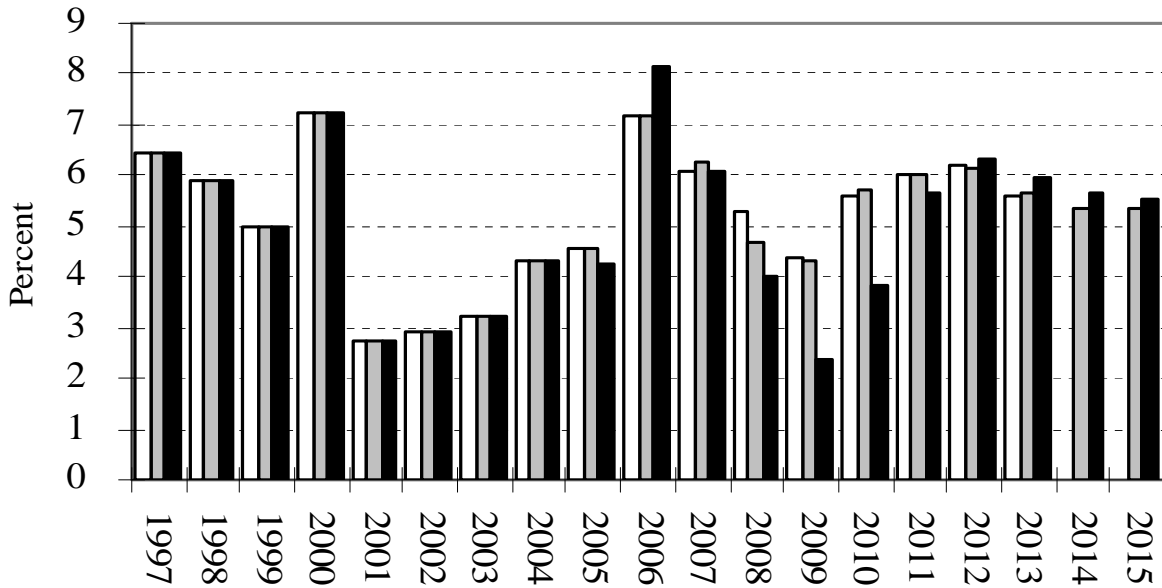
Employment	2008	2009	2010
Baseline	0.0	-1.5	0.8
Pessimistic	-0.1	-2.4	0.3
Optimistic	0.1	-0.7	1.2

Personal Income	2008	2009	2010
Baseline	4.0	2.4	3.9
Pessimistic	3.7	1.0	3.2
Optimistic	4.2	3.3	4.2

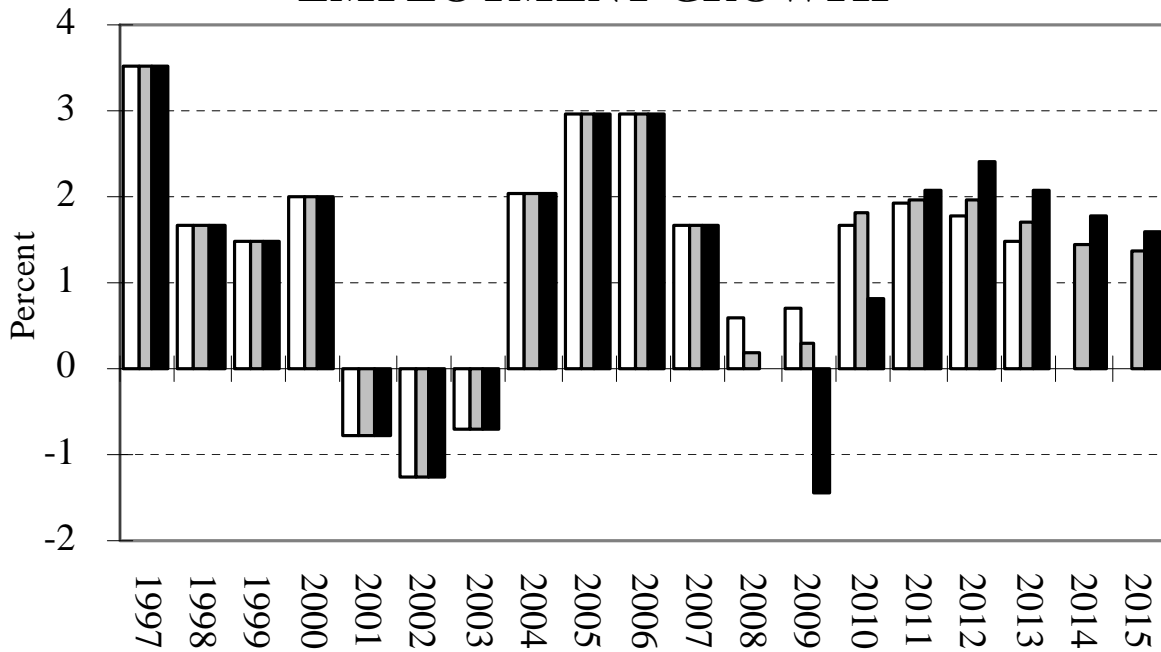
COMPARISON OF LAST THREE FORECASTS

June 2008
 Sep 2008
 Dec 2008

PERSONAL INCOME GROWTH



EMPLOYMENT GROWTH



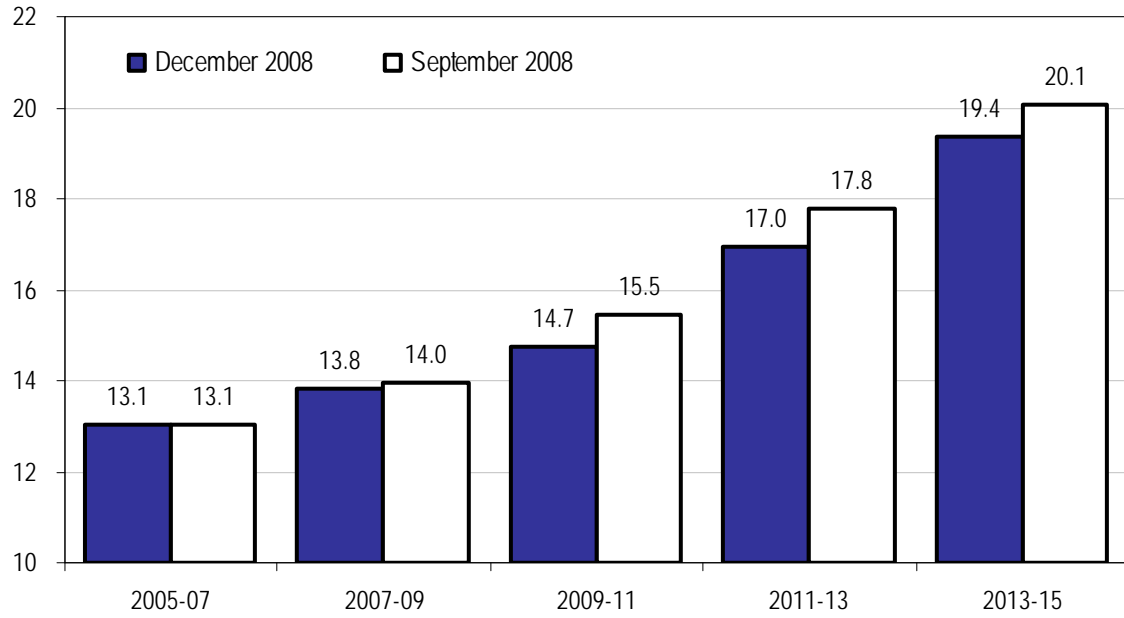
General Fund Resources

2007-09 Biennium

General Fund Resources (Millions)	September 2008 Forecast	December 2008 Forecast	Change from September	Change from COS 2007
Gross Personal Income Tax	12,227.3	12,066.7	(160.6)	(281.2)
Gross Corporate Income Tax ¹	857.3	857.3	-	(63.6)
Other Revenues ²	897.1	891.8	(5.3)	3.2
Gross GF Revenues³	\$13,981.7	\$13,815.8	(165.9)	(341.6)
Less Kicker Distributions	-\$1,084.2	-\$1,084.2	-	80.5
Net GF Revenues	\$12,897.5	\$12,731.6	(165.9)	(261.1)
Beginning Balance	\$1,436.7	\$1,436.7	-	(76.3)
Less Anticipated Administrative Actions ⁴	-\$42.1	-\$42.1	-	15.2
Less Legislatively-Adopted Actions ⁵	-\$319.3	-\$319.3	-	(9.9)
Net Available Resources	13,972.8	13,806.8	(165.9)	(332.1)
Proj. Expenditures ³	(13,949.0)	(13,949.0)	-	5.7
Ending Balance	23.8	(142.1)	(165.9)	(326.3)

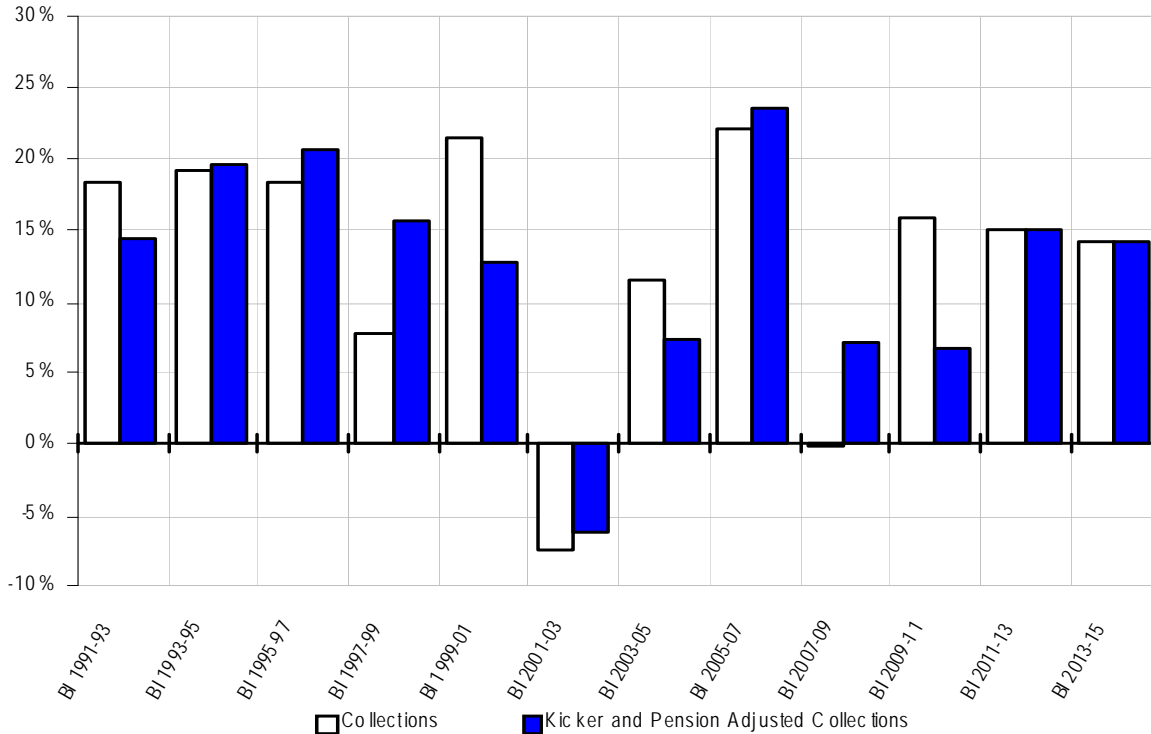
- Notes: 1 Corporate income tax figure includes Corporate Multistate taxes.
2 Other Revenues include Insurance, Cigarette, and Liquor taxes.
3 Excludes reductions due to kicker refund/credit distributions.
4 Represents costs associated with cashflow management actions, exclusive of internal borrowing.
5 Transfer of surplus 2005-07 corporate income tax revenues to the Oregon Rainy Day Fund.

Comparison of General Fund Resource Forecasts (\$Billions)



Biennia following 2009-11 do not include projected beginning balances

Biennial Growth in General Fund Revenue



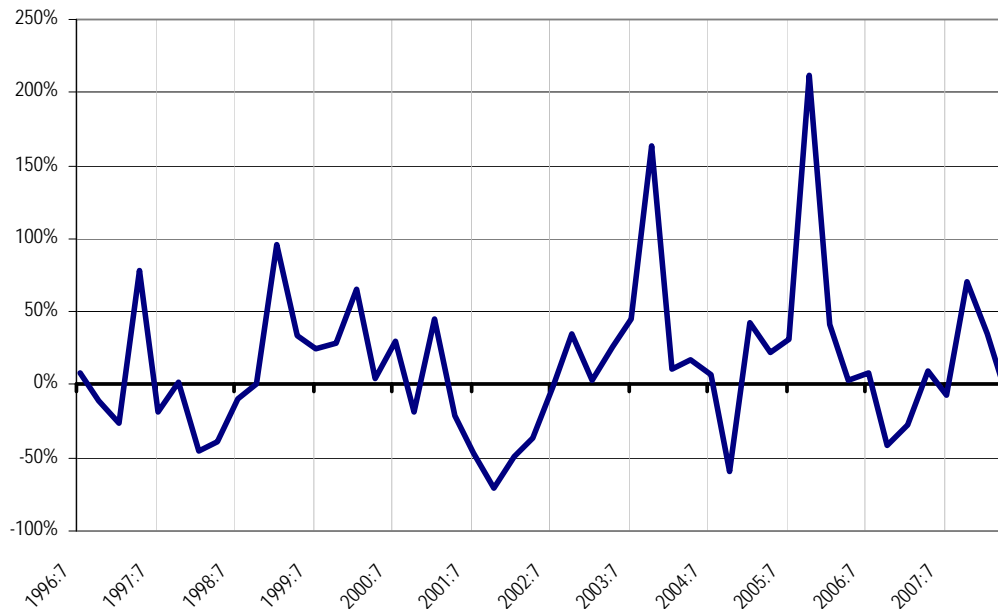
Oregon's Budgetary Reserves

(Millions)	Actuals through 6/31/2008	2007-09 Biennium	2009-11 Biennium
Rainy Day Fund			
Beginning Balance	\$0.0	\$0.0	\$340.5
Deposits	\$319.3	\$319.3	\$0.0
Interest	\$11.4	\$21.2	\$25.8
Triggered Withdrawals	\$0.0	\$0.0	\$0.0
Ending Balance¹	\$330.7	\$340.5	\$366.2
Education Stability Fund			
Beginning Balance	\$178.9	\$178.9	\$393.4
Deposits	\$112.1	\$214.5	\$157.1
Interest ²	\$10.3	\$17.9	\$35.9
Triggered Withdrawals	-\$9.6	-\$17.9	-\$35.9
Ending Balance	\$291.7	\$393.4	\$550.5
Total Reserves	\$622.4	\$733.9	\$916.7

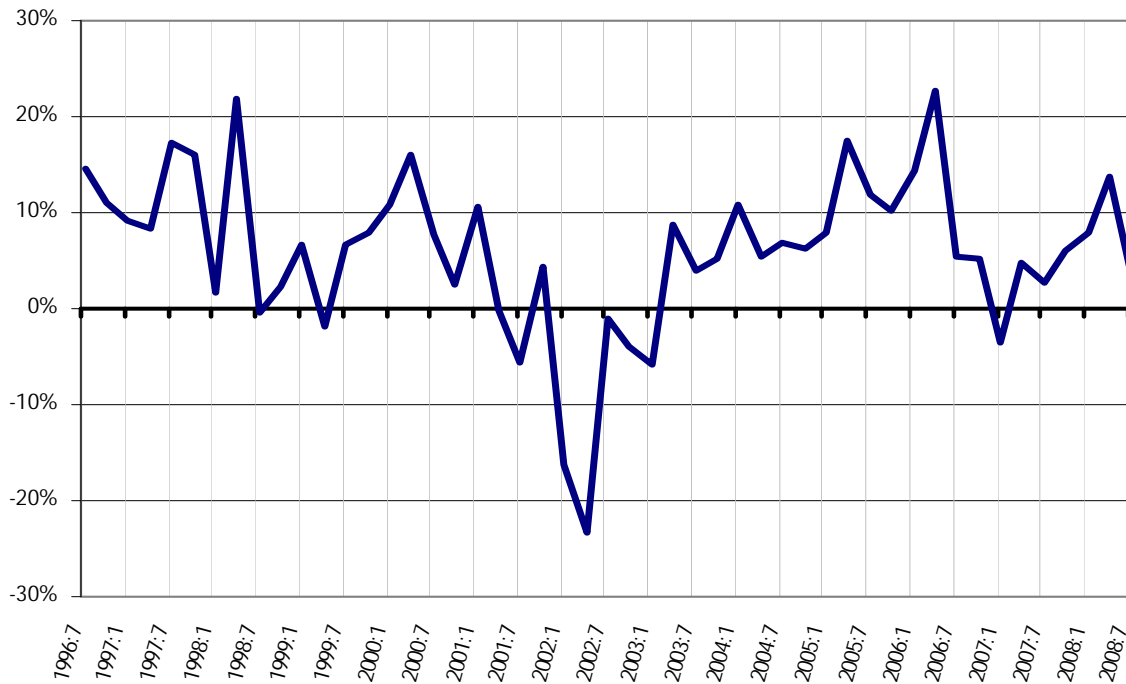
Footnotes:

1. Under current law, only 2/3rds of the beginning balance is available for withdrawal. Withdrawal subject to economic and financial triggers.
2. Education Stability Fund interest is distributed to the Oregon Education Fund (75%) and the State Scholarship Commission (25%).

Corporate Income Tax Collections (Quarterly, Year-over-year percent change)



Personal Income Tax Collections
(Quarterly, Year-over-year percent change)



Lottery Resources
(Millions of Dollars)
2007-09 Biennium

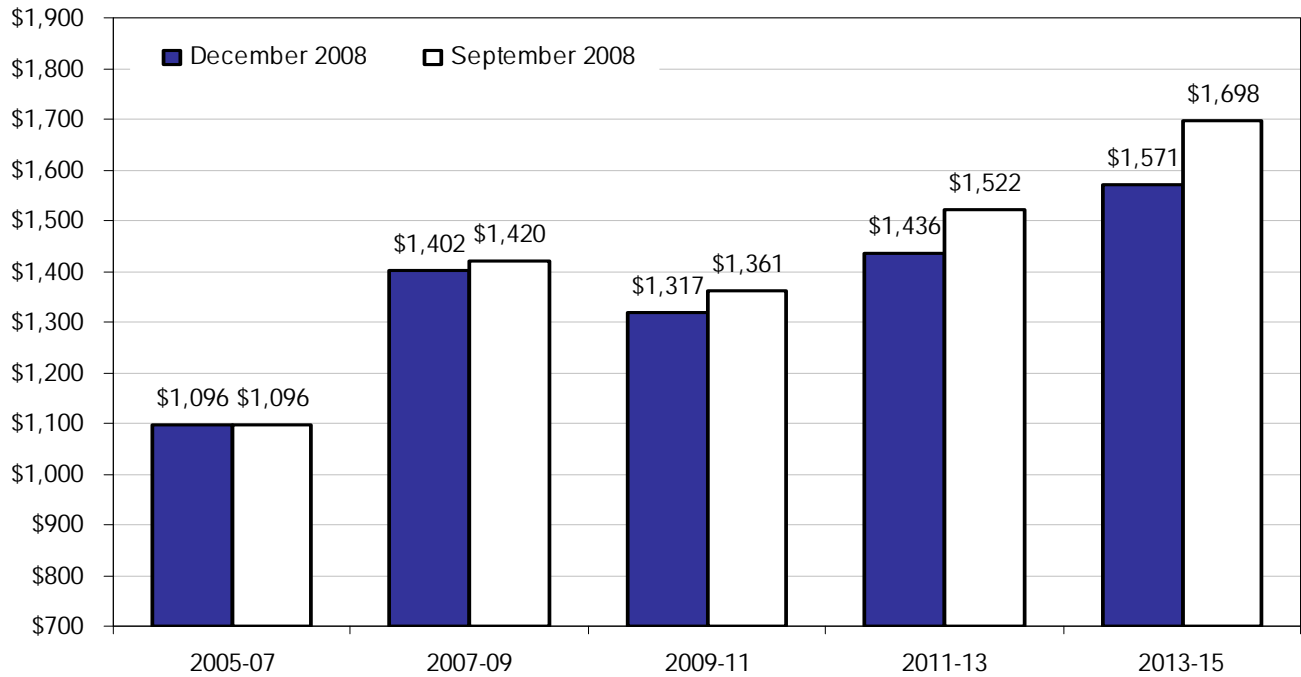
(Millions)	Sep 2008	Dec 2008	Change from Sep	
	Forecast	Forecast	Amount	Percent
Beginning Balance	\$64.1	\$64.1	-	0.0%
Earnings	\$1,267.0	\$1,249.1	(17.9)	-1.4%
Administrative Savings	\$74.7	\$74.9	0.2	
Other Resources ¹	\$14.1	\$14.1	-	0.0%
Total Resources	\$1,419.9	\$1,402.1	(17.7)	-1.2%
Allocations	1,406.0	1,398.8	(7.1)	-0.5%
Ending Balance	\$13.9	\$3.3	(10.6)	-76.1%

Note: Some totals may not foot due to rounding.

1. Includes interest earnings and reversions

2. Includes Education Stability Fund, Parks and Natural Resource Fund, and Debt Service.

LOTTERY LONG-TERM FORECAST



Biennia following 2009-11 do not include projected beginning balances

2 Percent Surplus Kicker History

Biennium	Tax Year	Personal		Corporate	
		Surplus / (Shortfall)	Credit Refund	Surplus / (Shortfall)	Credit
1979-81	1981	(141.0)	none	(25.1)	none
1981-83	1983	(115.2)	none	(109.9)	none
1983-85	1985	88.7	7.7%	13.4	10.6%
1985-87	1987	224.2	16.6%	6.8	6.2%
1987-89	1989	175.2	9.8%	36.2	19.7%
1989-91	1991	185.9	suspended	(23.0)	none
1991-93	1993	60.1	none*	17.9	suspended
1993-95	1994/5	162.8	6.3%	167.0	50.1%
1995-97	1996/7	431.5	14.4%	202.7	42.2%
1997-99	1997/8	167.3	4.6%	(68.6)	none
1999-01	2000	253.6	6.0%	(43.9)	none
2001-03	2002	(1,249.4)	none	(439.5)	none
2003-05	2004/5	(401.3)	none	101.0	36.0%
2005-07	2006	1,071.2	18.6%	344.1	suspended

Dollar figures in millions

*1991-93 personal surplus was less than 2%

Data Source: Legislative Revenue Office, Office of Economic Analysis