ECONOMIC OUTLOOK

Strong Underlying Outlook

Economic growth is surging as the pandemic wanes. Thanks to federal fiscal policy, consumers have higher incomes today than before COVID-19 hit. Now they are increasingly allowed to and feel comfortable resuming pandemic-restricted activities like going out to eat, on vacations, getting haircuts and the like. The outlook for near-term economic growth is the strongest in decades, if not generations. The consensus economic forecast for real GDP this year is 6-7%, which would be the largest increase since 1984’s “Morning in America.” Next year real GDP is forecasted to increase 4-5%. Such gains would bring the economy back to full employment much faster than in recent cycles. Growth slows thereafter as economic slack diminishes and gains are based on underlying productivity and the size of the labor force.

Oregon’s labor market is expected to return to full health during the upcoming 2021-23 biennium. With the strong near-term outlook for consumer spending, job growth is front-loaded such that the largest employment gains will occur this summer and fall. Total employment in Oregon will surpass pre-pandemic levels in late 2022 with the unemployment rate returning to 4 percent in 2023.

While a jobs hole remains in the labor market, the same cannot be said for household incomes. Currently incomes in Oregon are 20 percent higher than before COVID-19 hit, thanks in larger part due to the temporary federal measures put in place. Excluding the direct federal aid, incomes are back to pre-pandemic levels and expected to grow 6-7% this year and next. Income growth in the out years is forecasted to increase 5% per year.

However, with such a strong consensus near-term outlook, the risks do primarily lie to the downside. The risk is that supply cannot keep pace with demand. The path forward may be bumpier than expected, even if the trajectory is up. Already supply constraints have emerged in semiconductors, lumber, and rental cars to name a few. More bottlenecks are likely on the horizon. Furthermore, running through all of these issues is labor. Attracting and retaining workers is already much more challenging than expected given the economy went through a severe recession last year. There are a variety of simultaneous factors impacting the number of available workers including strong household finances, the virus itself, and lack of childcare or in-person schooling. While the temporary pandemic-related constraints will ease in the months ahead, the labor market is expected to remain tight for the foreseeable future in large part due to demographics and the large number of Baby Boomers retiring. Labor will remain a challenge for firms. But a tight labor market also works wonders for employees with strong wage gains and more plentiful job opportunities.

With the prospect of strong growth and near-term supply constraints, the possibility of an overheating economy has quickly replaced fears of a long-lasting, demand-driven recession like the past few cycles have been. Undoubtedly inflation will acceleration in the months ahead. Production costs are rising quickly in part due to
capacity constraints and bottlenecks. However these price pressures are coming off of a low base and are largely expected to be transitory. The Federal Reserve so far has indicated it will only become concerned should price pressures turn persistent. Given the overall economy is not at full employment, and generally strong wage growth is needed for persistent inflation, by definition the current bout of inflation is transitory.

**Economy Much Better Than Feared**

At the start of the pandemic, the economy experienced a massive recessionary shock. Large swaths of the economy were shut down to help slow the spread of COVID-19, a deadly, contagious virus. At the time, the biggest economic concerns related to the severe level of job losses and how they would affect household incomes, consumer spending and business closures. Since then, at nearly every turn, the economy has proved more resilient and performed better than feared.

Today the outlook is bright. Longer-run growth prospects show no real signs of permanent damage or economic scarring. Coming out of a recession, this is rather unusual and certainly different than the past two jobless recoveries. Following both the dotcom bust and the Great Recession, the overall trajectory of the economy was significantly lower than expected prior to each recession.

The strong federal policy response to the pandemic can be thanked for much of the better-than-feared economy. Not only did the Federal Reserve do as much as it could to stabilize the financial system, but the federal government also passed the $2.2 trillion CARES Act. When combined with the subsequent COVID-19 Economic Relief Bill ($900 billion) at the end of last year and the American Rescue Plan Act ($1.9 trillion) earlier this year, the fiscal response has more than filled the underlying hole in the economy. Most households and firms were able to keep their heads above water, limiting the financial downsides of the pandemic despite record-setting job losses.

As a result, total personal income in the economy today is higher than it was before the pandemic. Here in Oregon, direct federal aid in the form of recovery rebates ($12 billion), total unemployment insurance benefits ($12 billion), and paycheck protection program loans/grants ($10 billion) has help boost incomes to 20% above pre-pandemic levels. While the federal support is temporary, underlying income gains are ongoing. Excluding the direct federal aid shows total income in Oregon is back to pre-pandemic levels. The overall income trajectory of the current cycle is forecasted to be much more like the recovery in the 1980s or 1990s.
than the subdued, jobless recoveries in the 2000s and 2010s. Much of this growth is attributable to the strong underlying wage gains workers have continued to receive throughout the pandemic.

Many forms of consumer spending have been restricted by the pandemic, either formally through public health policies or informally through social norms and fear of the virus. Despite consumers’ best effort, they have been unable to spend as much ordering online as they typically go out to eat, on vacations, and getting their hair cut. Nationally, households have accumulated around $2.3 trillion in excess savings through March of this year. That’s the equivalent of around 15% of annual consumer spending. Here in Oregon financial institutions have seen substantial increases in deposits. Much of this savings is currently sitting in bank accounts, ready to be spent when the time comes.

Really that was the last major macroeconomic question, at least on the demand side. Would consumer spending roar back or would households only return slowly and more cautiously due to the pandemic? From an economywide perspective, there is no hesitancy. Consumer spending is rebounding strongly in the types of activities and services that have been impacted the most by the pandemic. The best real-time consumer spending data in Oregon are weekly video lottery sales. New records have been set the past couple of months. Consumers had the incomes, and so far this year they are clearly willing to spend.

With consumer spending growth expected to be strong, the risks of economic scarring in the form of business closures and permanent layoffs lessens considerably (See our office’s March 2021 forecast1 for more.) Importantly for the overall outlook, this increase in consumer spending on services will drive strong growth in the year ahead. Services like air travel, barbershops, hotels, nail salons, restaurants, and the like are labor intensive. These industries will need to staff back up quickly to meet consumer demand. This is the primary reason why job growth is front-loaded in the overall outlook.

Supply Constraints

Given the strong underlying drivers of growth, the question becomes just how fast can the economy actually grow? Already supply constraints are evident in semiconductors, lumber, and rental cars to name a few. Moving forward other short-term challenges of supply keeping pace with demand will emerge as well. Much of these constraints are expected to be temporary. Increased production and more efficient logistics will boost supply while higher prices and slower income growth as the federal aid runs out will cool demand somewhat. Better balance can be expected, although the path forward this year will likely be bumpier than expected.

Supply Side Constraints

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1 https://digital.osl.state.or.us/islandora/object/osl%3A964044
The good news is some classic supply constraints like energy costs and credit availability are not currently issues holding back economic growth. The current issues largely revolve around production capacity, getting goods to market, and labor availability.

**Industrial Production Capacity**

Currently, inventories are lean and demand is strong. Production needs to increase to meet the strong level of sales, which boosts overall economic growth. However many manufacturing sectors are already operating at or near capacity. They are constrained. To produce more, these industries need to invest in new plants and equipment, or add another shift. The overall economy reached this same point back in 2018-19 but the business investment never really materialized as the trade war dampened demand more than the corporate tax cuts boosted incentives. This was before the pandemic put all investment plans on hold.

Today, these constrained sectors are currently facing the same choice, which has macroeconomic implications. On one hand, sales are high. To meet this demand and chase market share, profits, and the like, they need to make big, long-term investments. On the other hand, it is somewhat questionable just how sustainable these level of sales will be given the temporary federal boost to incomes, and the pandemic shifting consumer spending out of services and into durable goods and eating at home.

The best economic outcome would be to see new investments in production, which boosts both near-term growth, and raises long-run potential GDP as the productive capacity of the economy increases. The worst economic outcome is production continues to be throttled due to capacity constraints and results in higher inflation but no real capacity increases.

The constrained industries, including those near capacity, represent a 40% larger share of Oregon’s economy than they do nationwide (11.8% of Oregon GDP vs 8.3% of U.S. GDP). During the pandemic, consumer demand for housing, technology, and food at home are through the roof. However, Oregon’s manufacturing employment has suffered more than in most states, even in these locally important sectors. This difference likely speaks to local firm or industry challenges rather than broader economic issues. Looking forward, the local outlook is mixed.

Food manufacturing is the brightest, and most surprising manufacturing development in Oregon in the past year. This is the only subsector where local employment is outperforming national employment since the pandemic hit. From a bigger perspective, Oregon has outperformed and gained national
market share in recent decades so this is not a complete surprise. However given a major bankruptcy a year ago, and the industry being a hotspot for COVID outbreaks, food manufacturing in Oregon was expected to take longer to recover. Thankfully, this has not been the case. The outlook has been revised upward as a result.

The good news for high-tech manufacturing is a rising tide appears to be lifting all boats. Local firms are doing well given strong business and consumer demand during the pandemic. Most encouragingly and despite manufacturing challenges in recent years, the state’s largest private employer, Intel, has announced plans for significant investments. Oregon is home to the firm’s most advanced operations and future generations of semiconductors are expected to be designed and the manufacturing process developed locally as well. In terms of the outlook, the sector is expected to continue to see ongoing investments and productivity gains which are very beneficial for the regional economy. However the industry has not been an employment growth sector in decades. Our office’s outlook calls for relatively stable employment counts in the years ahead. The outlook remains relatively unchanged.

Wood products and the timber industry more broadly enjoy very strong consumer demand. National market conditions, and underlying demographic demand for housing support future investments and increased production. However, these investments, should they materialize, are much more likely to occur in the South and not in the Pacific Northwest where ongoing log supply constraints remain a key issue to industry expansion.

Now, our office’s advisors indicate that log supply today is a little less of an issue in part due to salvage logging from last year’s wildfires, private landowners’ greater willingness to harvest at somewhat higher log prices, and fewer international log exports as local mills can better compete for raw logs given higher lumber prices. However if underlying harvest levels do not increase on a permanent basis, it is hard to support increased logging and milling operations in the region. Until these underlying dynamics change, our office’s outlook will continue to call for relatively steady employment counts for the industry, regardless of the broader market conditions.

Finally, aerospace and its regional supply chain that includes many metal and machinery manufacturers in the area remains a key subsector that has yet to emerge from the pandemic and recession. Local employment losses continue to mount in 2021. Overall demand for air travel is beginning to recover, which should soon put a floor
under the industry. Our office’s outlook has been revised down for both transportation equipment, and metals and machinery manufacturing in Oregon. There remains both upside and downside risks locally. To the upside, local employers could experience stronger demand and a faster pace of rehiring as the pandemic wanes. To the downside, following a lengthy shock to the industry, supply chains may get reworked, leaving local firms out of the loop.

**Labor Supply**

The most talked about constraint on the economy today is labor. Normally in the aftermath of a recession, firms have more workers to choose from when it comes to filling job openings. Unemployed workers greatly outnumber job vacancies. When workers are competing with one another to a greater degree to get a job, it can hold down wage growth. Once the labor market tightens, employers generally need to compete more by increasing wages or other perks to attract and retain workers.

The pandemic recession is different. These usual dynamics are either accelerated or gone. Firms are not responding as if there is a surplus of labor when it comes to hiring and expanding. In fact firms are advertising just as many, if not more job openings today as before COVID hit. Underlying wage growth remains roughly in-line with pre-COVID trends as well. A majority of Oregon employers (54%) are citing difficulty hiring workers, just as they have in recent years.

This recovery looks different because several simultaneous factors are constraining the supply of labor. These broadly fall under three categories: strong household finances, the pandemic itself, and other participation issues.

First, as discussed throughout this report, household finances are strong. Federal policy was explicitly designed to support households, and laid off workers in particular. The enhanced unemployment insurance benefits were to ensure impacted workers could afford to stay home and not be forced to take a job for financial reasons. The public health goal was so workers would not contract or spread the virus during a global pandemic.

Today, the average Oregonian on regular unemployment insurance is effectively receiving a 100% wage replacement thanks to the federal plus up of $300 per week. For the average leisure and hospitality worker the replacement rate is more like 134% of pre-pandemic earnings\(^2\). Given the policy was explicitly designed to

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\(^2\) In 2019 the average leisure and hospitality worker in Oregon earned $418 per week, while working 24.4 hours per week. This is equal to $17.14 per hour. Provided the worker qualified for unemployment insurance, their weekly benefit would be
reduce labor supply during a pandemic, it follows that the policy would continue to reduce labor supply during the recovery so long as the policy remained in place.

To be sure, enhanced UI is not the only factor at play and the labor market recovery remains in its early stages. But the combination of household recovery rebates and unemployment insurance benefits, which are both the same size in aggregate, work to improve household finances such that not all individuals or families need to work today for financial reasons, especially in light of the ongoing pandemic.

Second, labor supply is reduced due to the virus itself. Nationally the labor force participation rate is down 1.5 – 2 percentage points. Here in Oregon, 45,000 Oregonians indicated they were not searching for work in the first quarter of the year due to the pandemic. As vaccinations continue to increase, and COVID cases and deaths decline, the labor supply is expected to rebound as well. However this process is just underway in recent months. One potential concern is the sharp drop-off in vaccinations in the past month. Currently Oregon is right around 60% of the eligible population vaccinated.

Third, there remain other factors impacting the number of available workers in the economy. While not a significant contributor at the macro level, the lack of in-person schooling affects parents and households at the micro level. Some parents – moms in particular – are unable to work and make sure their kids are logged in and completing assignments and the like. Additionally the labor market is tight for demographic reasons. Annual retirements continue to be large due to the aging Baby Boomer cohort. The latest data indicates retirements increased early on in the pandemic due to job losses which were more severe for older workers. Compounding this issue is the fact that migration flows slow during recessions as job opportunities dry up. As fewer new residents arrived last year, the labor force grew at a slower rate than it would have during better economic times.

All told the labor market is tighter than one might think. Firms are looking to hire at a faster pace as the economy continues to reopen. Many of these businesses are concentrated in the high-contact, in-person sectors that have been the most impacted by the pandemic. They are all looking to rehire at the same time, creating increased competition for the same pool of labor. This is a complicating factor, especially in light of the labor supply challenges detailed above. Temporary frictions in finding and hiring workers are to be expected given the large scale shutdowns and reopenings experienced in the past year.

Looking forward, the pandemic-specific challenges and issues related to COVID fear and lack of in-person schooling will ease this fall. Enhanced unemployment insurance benefits will expire in a few months as well. The key question is what happens between now and then. At some point, declining COVID-related frictions, competition to hire workers, and relatively low unemployment will push to a market clearing wage that pulls more workers back into the labor force. How quickly any such changes occur is somewhat of an open question. Already these processes are underway, evident by the recent wage growth data.

$261 per week plus the federal $300 per week for a total of $561 per week. At 24.4 hours per week, that is the equivalent of $23.01 per hour, or 134% wage replacement. This does not factor in tips, which would lower the percentage somewhat.
The good news for firms is strong consumer demand means they can better afford to pay higher wages and pass along necessary cost increases to maintain profit margins. For workers the good news is wages tend to be sticky. That means the wage gains seen in the years leading up to the pandemic and so far during the pandemic will remain in place. Employers rarely cut wages outright and tend to reduce hours or lay off some workers when needing to cut costs.

In terms of the forecast, these underlying dynamics lead to an upward revision to the wage outlook in Oregon. While employment still has a ways to fully recover, the same cannot be said for wages. The increased bargaining power for workers today, given strong labor demand and a reduce labor supply, will lead to ongoing wage gains that are stronger than previously anticipated.

Note that the average wage increased at the beginning of the pandemic for compositional reasons. Most of the lost jobs were lower-paying service jobs, meaning the average wage for the jobs that remained was higher as a result. In the months ahead as these lower-wage service jobs come back, the average wage will decline some for the same compositional effects, but in reverse. That said the compositional changes will not fully offset. There has been a level up in the wage outlook due to current labor market conditions and the fact that wage gains are sticky.

Even so, such a forecast does not come without risks. Labor supply constraints in particular could disrupt the forecast for the upcoming 2021-23 biennium. Now, the outlook overall remains bright regardless, given the income and spending data. However the forecast does front-load much of the job growth. Should job gains in the next six months merely be good rather than exceptional, the overall trajectory throughout 2021-23 would be lower than anticipated.

Comparing the current May 2021 forecast (red line) with the December 2020 forecast (black dotted line), where job growth was not front-loaded, yields a noticeable difference. The slower-paced recovery seen in the December forecast has average employment over the entire 2021-23 biennium that is 2.7 percent lower than the current forecast. Aggregate wages under such a recovery would be 1.7 percent lower. The relatively smaller impact on wages is due to the ongoing average wage gains seen in recent months which would be expected to continue should labor supply remain a major constraint.

All told, even as the pandemic wanes and the economy returns to health, the labor market will remain tight for the foreseeable future. The pandemic-related issues will resolve themselves in the months ahead. However the underlying labor market will remain tight for demographic reasons. Employers will need to continue to cast a wider net, and dig deeper in their resume stack to attract and retain workers, just as they were doing pre-pandemic.
Federal Fiscal Policy

This forecast incorporates federal legislation that has already passed, like the American Rescue Plan Act (ARPA). It does not include any economic or revenue assumptions related to additional policy packages being discussed in Washington D.C. This would include both of the major infrastructure, and family plans that the Biden Administration has proposed. While the devil is always in the policy details, such packages, should they come to pass, would likely boost the economic outlook further. However in terms of the upcoming 2021-23 biennium the impact may be more muted as new programs usually take time to ramp up, and traditional infrastructure spending is spread out over years. That said, tax policy can result in immediate changes and a corresponding behavioral response by firms and households. Our office will adjust the outlook accordingly as federal policy changes.

In terms of explicit federal policies built into the forecast, two stand out. First, the substantial state and local government aid ($4.6 billion in Oregon between cities, counties, and the state) will improve public sector budgets. Our office’s employment forecast for local government has been raised modestly as a result. Local government employment is still down today largely due to pandemic-related restrictions to community centers, parks, schools, and the like. However those jobs will return later this year. The underlying boost from the federal aid is primarily in public administration.

The second major impact of federal policy is the direct income support in the form of recovery rebates, enhanced unemployment insurance, and the expanded Child Tax Credit (CTC).

In brief, the enhanced CTC will boost the average Oregon family’s after-tax income by $2,000\(^3\). For the typical family earning $85,000 per year this is a modest increase (2.6%) in income. However for families in poverty it represents a significant 5, 10, 15% or more increase. Researchers at Columbia University estimate the new CTC will reduce U.S. child poverty by 45% and by 46% here in Oregon.

In aggregate, total Oregonian personal income will increase $1 billion, and will lessen racial and ethnic income disparities as well. Today, families with BIPOC children earn 34% of total family income in the state. Such households will earn 41% of enhanced credit. This is for a few reasons. Younger generations are more diverse than older age cohorts, meaning young families – those receiving the CTC – are more diverse. Additionally younger families earn less income in part because one parent may not work in order to take care of kids, and those that do work earn lower wages because they are still relatively early in their careers. As such, the vast majority (~85%) of young families qualify for the enhanced

\(^3\) [https://oregoneconomicanalysis.com/2021/04/14/the-enhanced-child-tax-credit-in-oregon/](https://oregoneconomicanalysis.com/2021/04/14/the-enhanced-child-tax-credit-in-oregon/)
Overall these changes are not drastic, but boosting family-friendly policies do work to less racial and ethnic disparities.

Another change with the CTC this year is it will no longer be just a credit to claim on the tax return. The IRS will begin disbursing monthly payments to households, at $250 or $300 per month per child depending upon their age. The average family in Oregon will soon begin to receive $500 per month. A key policy challenge is reaching households that do not file tax returns. Nearly half of Oregon families in poverty do not file taxes. Ensuring all eligible households receive the payments is paramount, otherwise the projected declines in child poverty are unlikely to materialize.

While the CTC changes are for only this year, policymakers indicate they would like to extend them or even make them permanent. Should they last longer than one year, broader societal changes may result as well. For example, research shows that childhood poverty impacts outcomes of adults. A reduction in childhood poverty should result in better economic mobility and a stronger middle class in the years/generations ahead.

That said, one other potential impact may be labor force participation among parents. For many young families, one parent – usually the mom – works part-time to supplement income and also be able to be the primary caregiver for the household. With somewhat more generous benefits that are disbursed monthly rather than only once per year, some working parents may choose not to work as a result. Previous research has found this to be the case in other countries. Even so, new research on the reformed and expanded child credits in Canada in recent years find zero impact on labor supply among single moms. These potential differences – a small monthly boost to incomes allows one parent to stay home more versus the small monthly boost is not enough to allow an entire family to live off the CTC alone – make intuitive sense as well. Should the enhanced CTC last more than this year, monitoring program effectiveness and any potential economic and societal changes will be important.

**Inflation Risks**

Given the strong underlying drivers and an economy facing some supply side constraints, a key question is just how much will inflation rise in the months and years ahead. The baseline outlook is for a noticeable increase in prices as the economy continues to reopen and supply bottlenecks are alleviated. However these price pressures are expected to be temporary. The Federal Reserve is signaling they believe the same. Their underlying policy stance is basically that if the economy is not at full employment – loosely defined as the pre-pandemic labor market – then inflation will be transitory and not persistent.

The Federal Reserve has actively changed its policy and reaction function to the economy. No longer will the Fed raise interest rates on the prospect of higher inflation in the future. After undershooting their 2% inflation target for nearly the entire cycle last decade, the Fed is waiting until actual inflation rises above target on a sustained, or persistent basis.

The updated Federal Reserve policy framework also includes average inflation targeting, meaning if inflation is below target for a period of time, the Fed will allow above target inflation to offset and return to the long-run 2% trend. Today, core PCE – the Fed’s preferred inflation measure – is roughly 3% below target if measured from the start of the Great Recession. As such there remains
ample room in the absolute level of prices before the Federal Reserve is likely to really become worried about inflation. Currently the Federal Reserve is indicating they are not going to raise interest rates until 2023 or later. IHS Markit’s first fed funds rate hike is in mid-2024 in their forecast.

There are four main factors influencing inflation today. First, year-over-year inflation readings will be higher in the next few months due to so-called base effects. At the start of the pandemic, inflation slowed noticeably. That makes year-ago comparisons easier, leading to inflation readings a couple tenths of percentage point higher than the underlying momentum alone would suggest. These base effects will fade by late summer or early fall.

Second, building off the base effects is demand pull inflation. As consumers return to previously restricted activities, prices will rise as demand outstrips supply. Not all households can get on the same plane, or rent the same car on vacation this summer. Many of these impacted sectors saw prices sag due to the sharp drop in demand last year, and as prices reverse, they will push headline inflation higher as well. In just the past two months, a Reopening Basket of prices tied to vacations and in-person services increased 4 percent (27% annualized). Expectations are these sharp increases will slow once prices revert to longer-run trends.

Third, cost push inflation will likewise drive prices higher as supply chain bottlenecks occur. Cost push inflation is the result of higher costs of production that ultimately increase the final prices of goods and services. These linkages are far from 1:1 and historically producer prices are much more volatile than consumer prices. In part this is due to other managerial decisions made by firms, including changes in profit margins and other business operations. Recent quarterly results of publicly traded companies indicated profit margins increased so far during the pandemic. As such, should firms chose to do so, they can more easily absorb some of the increases in the cost of production, holding consumer prices steadier.

Fourth, the ultimate key to persistent inflation likely lies with wage growth. Even with employment far below pre-pandemic levels, fundamentally the labor market is tighter than one would think. Ongoing wage gains in the economy are broadly in-line with pre-pandemic trends and have not decelerated like in the past two cycle.

This dynamic gives forecasters pause, at least enough to acknowledge that some of the pieces are in place for higher rates of inflation than would otherwise be expected. Those pieces include supply constraints, large federal fiscal packages, tight labor, and a Federal Reserve that so far says all of these are transitory. That is, and should be the baseline outlook. However the risks are there for higher rates of inflation moving forward.

Modestly higher inflation (2.5-3%) is of no real concern, and would make up some of the persistent undershooting of the Fed’s inflation target last decade. The real economic risks lie with significantly higher inflation (>3 or 4%) as the Fed’s likely response is raising interest rates quickly to cool economic activity.
Historically such moves are more likely to tip the economy into recession than to engineer the so-called soft landing. For now, expectations are inflationary pressures will be transitory, with risks tilted toward the upside.

**Full Employment and Historical Disparities**

When economists talk about full employment, and a strong economy we are almost always referring to topline, or aggregate numbers. It is important to keep in mind that embedded within these historical periods of time when the economy was performing well are considerable disparities and inequities. Oregon’s trends here are not significantly different than the nation’s but are very evident when lifting the hood on socio-economic data. In particular, our office is especially concerned with three main types of disparities: racial and ethnic, geographic, and income.

**Racial and Ethnic Disparities**

Back in 2019, Oregon was experiencing the strongest economy it had seen in at least 20 years. However, large racial and ethnic disparities remained. The official poverty rate for white, not Hispanic Oregonians was 10.2%, for Asian Oregonians it was 11.8%, for Hispanic Oregonians it was 14.8%, and for Black Oregonians it was 25.2%. These disparities are among the smallest on record, as the economic gains from the decade long expansion were becoming more broadly shared. Even still, these disparities remained large.

A similar picture is seen when examining historical employment patterns. The first chart compares the share of prime-age Oregonians who have a job by race and ethnicity. Each is benchmarked to their white, not Hispanic peers. Over time, the share of Asian and Hispanic Oregonians with a job has risen and has recently matched their white, not Hispanic neighbors. However employment rates for Black, and American Indian and Alaska Native Oregonians remain considerably lower.

Some of these differences in employment can be explained by differences in educational attainment. Overall college graduates have higher rates of employment than do those with a high school diploma or less. Both Asian, and white, not Hispanic Oregonians have a larger share of college graduates than other racial or ethnic groups.

However educational attainment only explains part of the difference. Even after controlling for occupation, work experience, length of firm tenure, and the like, research finds a racial disparity in terms of wages and income. Another key factor impacting employment rates, especially among men, is incarceration. The share of prime-age Black, and American Indian and Alaska
Native men in Oregon that are incarcerated (technically in institutional group quarters in the Census data) is three or four times the rate of their white not Hispanic peers. This difference alone accounts for 26% of the overall Black-white employment gap, and 57% of the AIAN-white employment gap in 2019 in Oregon, based on the latest data.

Unfortunately, real-time economic data lacks good racial and ethnic breakdowns, in large part due to small sample sizes. What information is available – crunching that sample size data, examining the self-reported information for UI claims, etc – indicate that employment trends since the pandemic began are broadly similar across different racial and ethnic groups. None of the data indicates widening racial disparities, at least in terms of employment. That said, the best available information, including data on incomes and poverty, comes from the Census’ American Community Survey release each year. The 2020 data is scheduled for release on September 23rd. Our office will have updates in our December forecast release.

Even as we wait for the lagged Census numbers, it is important to keep in mind these historical disparities when our office talks about Oregon’s economy returning to full health during the upcoming 2021-23 biennium. Historically that may mean a 4% unemployment rate for white, not Hispanic Oregonians but a 12% unemployment rate for Black Oregonians, just like it did in 2019.

Geographic Disparities

Long-run economic growth is driven by productivity (investment) and the size of the labor force. Urban economies outperform rural ones in large part because they not only see faster rates of population (labor force) growth, but also experience higher rates of capital accumulation, be it physical, financial, human, or social in nature. Rural economies tend to have more natural capital, however it must be put to use to generate stronger economic growth.

While these long-run drivers remain in place, the pandemic has altered their patterns in the past year. To date, Oregon’s urban economies, particularly in the Willamette Valley, have suffered noticeably more than the state’s rural economies.

These patterns are not so much that rural areas are doing well so much as they are about urban areas doing poorly. Much of the declines seen in Portland, Salem, Corvallis, and Eugene can likely be tied to working from home, lack of in-person schooling, and lack of business travel. Urban cores rely upon daytime foot traffic from commuters, and demand for nightlife entertainment from both local residents and tourists. See our office’s December 2020 forecast for more on commercial districts and downtown Portland4.

In terms of the outlook, to date the urban-rural gap has not widened. However over the full cycle it may due to those stronger underlying drivers of growth. But for now rural economies have a year or two headstart on the

4 https://digital.osl.state.or.us/islandora/object/osl%3A957184
recovery given the low base from which urban areas are beginning to grow as the pandemic wanes and the economy reopens.

A key wildcard here for both urban cores and the housing market more broadly is working from home. Today, nearly 1 in 4 Oregonians with a job indicate they are continuing to telecommute due to the pandemic. While this is lower than a year ago, a sizable share of the workforce is still remote. The recent declines nationally are seen across all industries and major occupational groups. However the biggest declines are among the white collar, professional types. This shift is an indicator that workers are returning to the office, and expected to do so as the pandemic wanes. The open question is just how many will return on a full-time basis. It is likely that employees will continue to work from home a day or two a week, but even that leaves considerable gray area in terms of demand for office space, foot traffic to support ground floor retail and the lunch crowd propping up restaurants and food carts. These will continue to be important metrics to track in the months and years ahead.

**Income Inequality and Job Polarization**

Since the turn of the century, the biggest change and challenge in the labor market has been job polarization. These trends emerge when both low- and high-wage jobs grow quickly, while middle-wage jobs languish. The problems arise when traditionally well-paying middle-wage jobs disappear in recession and do not fully come back in expansion. In particular the loss of production (manufacturing) and office support occupations have really limited job opportunities and earnings for both men and women, particularly for those without college degrees. See our office’s 2013 report\(^5\) for a more comprehensive overview.

The pandemic recession is different. Low-wage service workers have borne the brunt of the lost jobs. Both food preparation, and personal care (barbershops and nail salons) lost nearly 20% of their jobs last year. Middle-wage jobs suffered an average recession instead of a severe one, while high-wage job growth slowed, but did not decline outright.

Given the middle-wage job outlook has called for only moderate gains during expansions, one of the more concerning parts to the COVID recession was that it hammered the low-wage jobs. A lot of times workers struggled to adjust when they lose their traditional, middle-wage job. While a few are able to land high-wage jobs, the vast majority end up taking a low-wage job, moving away in search of work, or dropping out of the labor force entirely. None of this is a good dynamic. However the concern last year was if there were also no low-wage job opportunities then even the existing meager options would dwindle further.

Thankfully, to date, this does not appear to be the case. Middle-wage jobs are not experiencing severe job losses, and even as low-wage jobs have, federal aid has largely kept workers and households financially afloat in the past year. The combination of strong incomes and pent-up demand means the overall recovery will be faster and more complete than previous cycles. The forecast calls for both low- and middle-wage jobs to fully recover as a result, at least overall. Some individual occupations and industries are unlikely to regain all their lost jobs, but the overall dynamics of this cycle are different.

Housing Supply and Affordability

Despite a severe recession a year ago, the housing outlook remains strong. Compared to past recessions, today’s decline in new construction activity is modest. Really only one segment of housing is weak – multifamily in the Portland region’s urban core – while everything is holding steady or growing.

Single Family

New single family construction continues to grow in every market. Strong consumer demand is driven by at least three major factors.

High-wage workers, and higher-income households are largely unaffected by the recession given the nature of the cycle. These households are primarily homeowners, many of which received thousands of dollars in recovery rebates which could help with the larger down payments needed in today’s market.

Record low interest rates at the end of 2020 allowed household budgets to stretch further in terms of home prices while keeping the monthly payment steady. Interest rates fell by one percentage point from late 2019 to late 2020, going from 3.7% to 2.7%. A one percent decline in rates offsets roughly a 13 percent increase in purchase price, while maintaining the same monthly mortgage payment. This means if a household was looking to buy a $400,000 home pre-pandemic, they could afford a $450,000 home during the pandemic.

While the nature of the cycle and record low interest rates are large factors in the strong homeownership demand in the past year, the biggest underlying driver in the years ahead are demographics. This decade, Millennials will fully age into their 30s and 40s. These are prime homebuyer ages. Today in Oregon, by one’s mid-30s households are 50/50 in terms of owners vs renters. Households in their early- or mid-40s are your traditional move-up buyers with young families. This demographic tailwind will remain in place for the foreseeable future, even as some of this demand was likely accelerated during the pandemic.
The biggest challenge today in single family is lack of inventory. The strong level of demand outstrips supply. This puts upward pressure on prices, particularly as it takes time for new developments to occur. That supply response is underway, particularly so in the suburban Portland markets and the state’s secondary metros – Albany, Bend, Eugene, Medford, and Salem.

Even so housing affordability is worsening in recent months. This is due to a few factors. There is the general supply and demand imbalance. Plus the cost of new construction is rising due to material prices like lumber setting records recently. And due to the increase in interest rates in recent months. While interest rates have settled in around 3% or so, this is still 30 or 40 bps higher than they were at the end of 2020.

All of these factors combined means housing affordability measured the monthly payment expense as share of income is now at the upper end of the historical range, provided we exclude the housing bubble from that range.

Speaking of bubble, there is increasing chatter that the housing market may be in another one. While identifying bubbles in real time can be challenging, there is no question that the current market is substantially different than the one from the mid-2000s.

In particular, even if buyers are overextending themselves a bit in part due to the belief home prices only go up, the macroeconomic implications today are much less dire. The credit quality of new mortgage loans has never been stronger. Any fallout from the housing market will not have the same spillover into the broader economy or financial system.

Even so, one key metric to watch on the bubble front is the differences in housing costs for owning and renting. At a fundamental level, housing is all about having a roof over your head. Households make the best choice for themselves given the various options and costs. But ultimately these costs for owning and renting should move together over time, which is what you see in the historical data even if they do differ at various points in time.

Today, given the run up in ownership costs due to higher interest rates and prices and the slower increases in rents during the pandemic, the price to rent ratio is getting near the upper end of the historical range, albeit a long way from where it was during the actual housing bubble.

What is the outlook from here? Traditionally when ownership costs rise like this and affordability worsens, overall consumer demand slows and price appreciation does as well. That is the pattern seen back in 2018 and 2019 when interest rates rose. While a similar pattern is likely underway today – weekly applications for
mortgages have slowed lately – there is the possibility it may take more time given the strong underlying housing drivers today. Should this occur, and affordability worsens further and the price to rent ratio diverges more, then the discussion can turn to whether there is a bubble forming again or not. However today that is far from clear. No doubt the sticker price of homes has risen considerably during the pandemic, however these gains are easily explained to date by higher incomes, strong demographics, and low interest rates.

**Multifamily**

The slowdown in new construction activity is entirely in multifamily in the Portland region. Construction of apartments in the state’s secondary metros hasn’t been this strong in aggregate since the mid-1990s.

Within the Portland region, there is a modest slowdown in apartments in the suburban markets, but not much. The bulk of the changes are seen in the urban core where a number of factors are in play.

First, there has been a lot of commercial real estate development in the urban core in recent years. In fact, 2020 saw a record number of new apartments come online for rent, barely edging out the previous record set in 2019. As such, new construction was set to slow given the development cycle even before the pandemic hit. Another complicating factor here is Portland’s inclusionary housing policy which created a larger pipeline of projects in recent years to get ahead of the policy being put in place.

Furthermore we know the pandemic flipped the urban economic calculus on its head. Suddenly the urban amenities of being close to work and entertainment options no longer were beneficial as these activities were restricted. Apartment dwellers and condo owners in the urban core were facing the dis-amenities of living downtown. All of this before the protests for racial justice and clashes of violence began last summer.

Given the underlying market dynamics of the urban core, rents have softened noticeably. Household formation and demand did slow during the pandemic, although research shows out-migration from the urban areas did not really occur except in Manhattan and San Francisco. Additionally supply continued to come on the market, leading to a rising vacancy rate, at least in the core. Suburban rents continued to rise, and vacancies remain low elsewhere in the state.

Overall with the cost of ownership outpacing renting so far in 2021, the calculus is flipping back to renting being a more prudent financial choice for many households. The apartment outlook is bright given underlying population growth and migration trends. As the pandemic wanes, the current urban dis-amenities will flip back to being benefits to living and working downtown.

One silver lining in the Portland apartment market is a bottom of new activity has likely been reached. While down 70 or 80 percent (!) from the years leading up to the pandemic, permit activity has strengthened
somewhat in recent months. That said, until the current vacancies fill up, and the benefits of living and working downtown return, expect low levels of new construction activity in the urban core.

The most encouraging news in the rental market today continues to be that the pandemic has not noticeably increased the number of struggling households. In large part this is likely due to the strong household finances thanks to the direct federal income support.

However what the pandemic, and various rental assistance programs and eviction moratoriums and the like, has done is brought these challenges more into the light. It is not so much that the pandemic increased them but rather that these issues have become more noticeable. They always exist.

For example, Oregon’s poverty rate in 2019 was 11.4%, the lowest in decades. However, the poverty rate for homeowners was 5.8% while for renters it was 21.5%. So when survey results show that 1 in 5 rental households worry about making next month’s rent, this is always the case, even during good economic times. In terms of the outlook, job opportunities have returning and wages are rising. These factors will help support household finances in the years ahead.

Bottom Line: The strength in single family construction statewide largely offsets the multifamily weakness in the Portland region. The biggest risk to the outlook remains an inadequate housing supply. Oregon will continue to need more new housing units, particularly as migration flows return, and the underlying demographics result in stronger rates of household formation.

A more complete summary of the Oregon economic outlook and forecast changes relative to the previous outlook are available as Table A.2 and A.3 in Appendix A.

Alternative Scenarios

The baseline forecast is our outlook of the most likely path for the Oregon economy. As with any forecast, however, many other scenarios are possible. While the pandemic is waning and the vaccines so far are working against the known variants, some risks do remain. The two alternative scenarios below are not the upper and lower bounds of these outcomes. These alternative scenarios are modeled on realistic assumptions that are somewhat more optimistic or pessimistic than the baseline. See page 20 for the General Fund revenue implications of these scenarios.

Optimistic Scenario – A Faster Recovery:

The underlying strength in income and consumer spending propel the economy to full health by early 2022, leading the overall cycle to more closely resemble the traditional recovery from a natural disaster. Inoculations continue to increase rapidly with the population reaching herd immunity this summer. Additional federal investments are made in public health, keeping another potential wave of cases this fall and winter at bay. The current supply constraints on the economy prove temporary with no large price pressures emerging. As the pandemic fades, labor supply accelerates allowing firms to hire and expand in an improving economy.
Pessimistic Scenario – A Double-Dip Recession:

Vaccinations crawl to a stop with the population not quite reaching herd immunity. Concerns over the virus remain, with a potential new wave of cases, hospitalizations, and deaths this fall and winter. The end result is consumers stay home to a greater degree and job gains are meagre until next spring when cases decline. Complicating matters is a lackluster federal policy response in order to support laid off workers and struggling households and firms this fall. More permanent damage accumulates in the form of business closures, slowing the pace of recovery. Oregon’s economy does not fully return to health until early 2025.