EXECUTIVE SUMMARY

May 2023

Inflationary economic booms have not traditionally ended well, meaning not without a recession. As such it is easy to be pessimistic about the outlook for the economy. Economic developments like last year’s goods recession, and the banking turmoil earlier this year add more fear to the outlook. However, a near-term recession is far from a slam dunk. The reasons include some nascent signs that inflation is cooling and the Federal Reserve is looking to pause its interest rate increases which limits the potential for overtightening. Furthermore, the economy is showing some signs of renewed strength as housing and manufacturing stabilize, and income growth is again outpacing inflation. All of these indicate a sudden stop in the economy in the short-term is unlikely. Part of forecasting is not just identifying the dynamics, but also the timing.

Our office’s baseline forecast calls for the economic soft landing and continued expansion. Even so, Oregon’s economy will slow noticeably in the upcoming 2023-25 biennium, however for good reasons. The recovery from the pandemic has been faster, and more inclusive than any in recent memory. With the economy operating at or near full employment, underlying gains in the labor market will be closely tied to demographics and population growth. To maintain even stronger economic growth in the years ahead Oregon will need to see faster population gains, and/or rely on business investment and capital to increase productivity. This cycle has been different in the sense Oregon ranks in the middle of the pack economically with income and productivity outpacing the typical state while jobs and population lag, the opposite pattern of decades past.

Available resources are expected to be up sharply relative to what was assumed in the March 2023 forecast, both in the near term and over the extended horizon. The upward revision in the outlook is based both on a stronger than expected tax filing season, as well as methodological changes made in light of fundamental shifts seen in recent years.

The tax filing season once again outstripped expectations, albeit modest ones. Revenue gains have cooled some, but it is clear that Oregon’s tax sources have become more effective than they were pre-pandemic.

One major factor has been the current inflationary environment. The vast majority of Oregon’s taxes are not adjusted to inflation and rise along with prices. With demand outstripping supply, businesses and consumers are paying premiums for their needs. This has translated into a wide range of taxable business and labor income, which has moved many filers into higher tax brackets. The new Corporate Activity Tax, Vehicle Privilege Tax, alcohol, and tobacco taxes have risen with inflation as well.

Inflationary dynamics have not been captured well by Oregon’s revenue models, given that this sort of environment has not existed since years before computerized models have. Oregon’s revenue models have also been refined to better account for fixed tax brackets and federal tax reform.

Qualitatively, there is not much difference between the updated revenue outlook, and what was predicted in March. After unsustainably high revenue collections over the past two years, tax revenues are expected to come back to earth over the next biennium, before returning to healthy growth thereafter.

Quantitatively, small differences in trajectory matter a lot, and compound over time. Taken together, the outlook for personal and corporate income taxes has risen by $1.5 to $2 billion over the forecast horizon due to the updated model methodology. The 2021-23 personal kicker is now estimated to be $5.5 billion, and the corporate kicker is now estimated to be $1.8 billion.