ECONOMIC OUTLOOK

Economic Summary

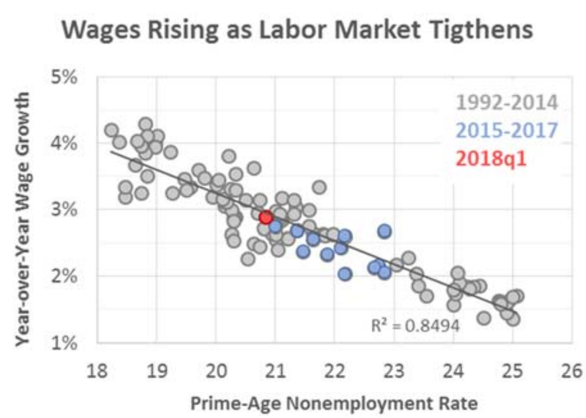
The U.S. economy continues to perform well. Economic growth remains above potential and job gains are strong enough to pull down the unemployment rate even as more individuals are looking for a job. Importantly, the business cycle is not yet waning and the near-term prospects for economic growth are good. The consensus of forecasters peg the probability of recession over the next year at just 15 percent. However, longer-run forecasts remain relatively muted, in part due to the impact of an aging population and the temporary provisions in the federal fiscal stimulus. From today's relatively strong cyclical vantage point, three real downside risks stand out. First is the Federal Reserve's tightening cycle, its response to the fiscal stimulus, and ability to engineer a soft landing for the economy. Second is the potential for deteriorating international relations creating a drag on overall economic growth. Third is the recent run-up in energy prices which crimp household budgets in the near-term. To date, actual constraints on growth appear to be minimal, but bear watching in a mature expansion.

In Oregon, the outlook remains bright as the economy continues to hit the sweet spot. Employment growth is enough to meet population gains and to absorb the workers coming back into the labor market. Wages are rising faster than in the typical state, as are household incomes. That said, growth is slower today than a few years ago as the regional economy transitions down to more sustainable rates. While housing affordability is set to improve in the coming years due to rising income and more new construction, the impact on household budgets and migration flows is a risk for the local economy. All told, the forecast calls for ongoing growth and there are no real worrisome signs seen in the Oregon data.

U.S. Economy

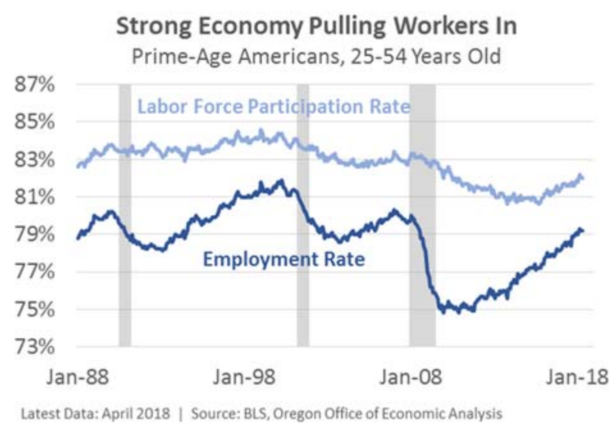
The current U.S. economic expansion turns nine years old next month, making it the second longest on record. Given the ongoing healthy data flow, more economists now forecast this expansion to eventually surpass the record-setting 1990s in length, which was exactly 10 years long. If anything, near-term risks to the outlook skew to the upside given the federal fiscal stimulus hitting the economy this year and next. However, the combination of rising interest rates and fiscal stimulus that is set to unwind in a couple of years has a growing chorus of forecasters more concerned over the medium term. Such a scenario is not a foregone conclusion as policymakers, the Federal Reserve in particular, can adjust course as needed. For now the outlook remains bright. There are no real worrisome sings seen in the data yet.

Even so, the economy is beginning to run into some supply side constraints. Chief among these issues is labor. Pick any standard measure and the labor market is tight – the unemployment rate, new claims for unemployment insurance, job openings, quits rate, and the like. However, inflation and wage growth is not yet as high as in past cycles. As such some economists are lamenting the death of the Phillips Curve, or the idea there is a tradeoff between unemployment and inflation (or wages). If the labor market is really tight, as many measures indicate, shouldn't we see faster wage growth?



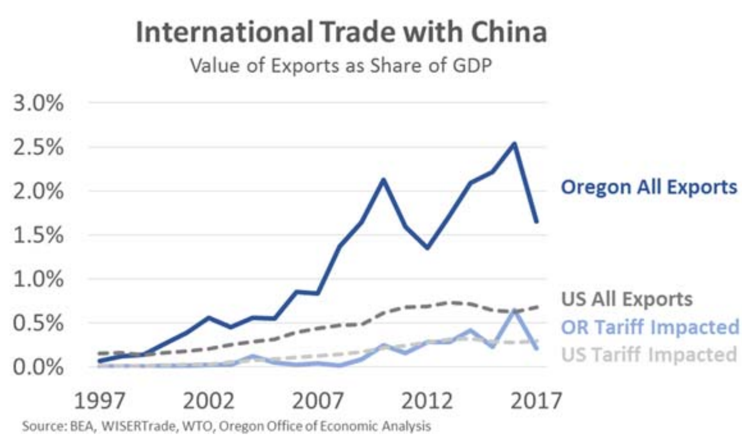
Data: ECI Private Wages | Source: BLS, Moody's Analytics, OR Office of Econ Analysis

One answer is that the unemployment rate likely overstates the strength, and tightness of the labor market today. An alternative measure that just looks at the share of prime working-age adults with a job continues to indicate there is room to run, and some slack remaining. So-called prime-age EPOP, for the employment to population ratio, remains a percentage point lower than prior to the Great Recession and a couple percentage points lower than the late 1990s. Using this measure of the labor market, or rather its opposite, the share of prime-age adults who are not working, shows the relationship between wage growth and slack remains strong. Wage growth in recent years is exactly what one would expect. That said, other factors identified in recent economic research like lower inflation expectations, slower productivity gains, monopsony power of firms, nominal wage rigidity, and fewer workers switching jobs are also impacting wage growth in recent years and over the long-term.



Most encouraging is the fact that the improving economy is drawing workers who were previously on the sidelines back into the labor market. The flows of those who one month say they are not actively looking for work but the next month have a job continue to be large. And labor force participation rates for working-age Americans continue to rise. The economy is seeing a labor force response. That said, labor is harder to find today than a few years ago. As detailed previously, there are at three large groups from which more workers may come in the future. These include those with self-reported disabilities being a barrier to work, stay-at-home moms of elementary school-age children, and teenagers and young adults enrolled in higher education, particularly two year programs.

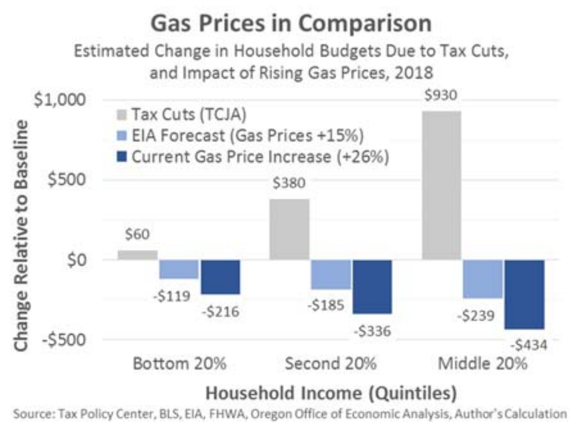
Another potential supply side constraint facing the economy, in large part due to federal policy proposals, is that of international relations. The U.S. is working to adjust terms of trade with both our closest neighbors in NAFTA in addition to proposing tariffs on some goods from China. Given that Oregon is more trade-dependent than the typical state, China is our number one destination for exports, and Canada is our number two destination, any substantial revisions to trade relations would impact the regional economy to a larger degree than the typical state. In fact, Oregon's trade exposure to China is among the largest in the nation. However, much of our direct trade reflects within firm shipments of high-tech goods that are not yet listed as targets of the proposed tariffs.



When examining the specific products that are targeted, Oregon's trade exposure to China is in-line with the typical state. Even this may overstate Oregon's direct exposure, due to data limitations. Right now, approximately half of the tariff-impacted exports from Oregon can be tied to automobiles and soybeans. Oregon is neither an auto manufacturing hub nor a major grower of soybeans. However both products do flow through the state on their way to the rest of the world. As such, should these exports decline there would still be a local impact due to the transportation aspects of loading and shipping products around the world.

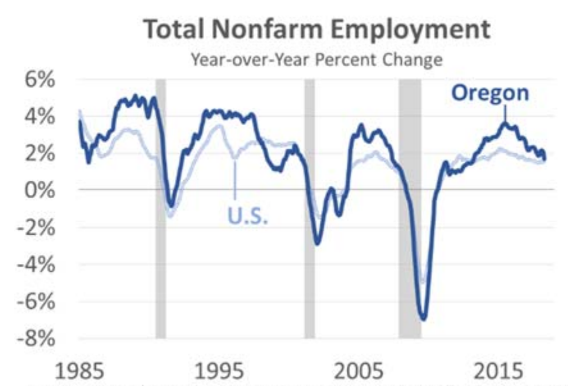
The good news is that the economy continues to expand and looks to have further room to run in the near-term. That said, while expansions do not die of old age, they do typically die due to mistakes and policies that slow or even snuff out growth. For the first time this expansion, a plausible recession scenario over the medium-term is beginning to come into focus. The heart of it lies in the fact that the federal stimulus unwinds in a couple years, moving from a new positive to a net drag on growth. Furthermore the Federal Reserve is in a tightening cycle and signals their intention to continue to raise interest rates. This combination of fiscal and monetary policy, at best, would slow growth. Provided the economy truly is near full employment and at capacity, slower growth is just what the doctored ordered to head off inflationary pressures and grow at a sustainable pace. However, engineering the so-called soft landing is very difficult in practice. Restrictive fiscal and monetary policy may be more likely to send the economy into recession. Of course this is far from a foregone conclusion. Policymakers, in particular the “data dependent” Fed, can adjust course as needed.

Besides the Federal Reserve raising interest rates, another common issue that can derail an economic expansion is an oil shock, or energy prices more broadly. Today, oil prices are rising quickly and are up around 50 percent relative to a year ago. Given the big increase in U.S. oil production in the past 15 years, rising prices are no longer just a drag on growth. In fact, some recent research indicates that high oil prices are now a positive of the U.S. economy overall due to wages and business investment in new mining equipment. That said, rising gas prices still crimp household budgets, slowing consumer spending for those in the middle and bottom part of the distribution in particular. To help put this impact in perspective, it is very likely that higher gas prices in 2018 are enough to wipe out any tax savings from the Tax Cut and Jobs Act for lower-income households. And these higher prices will likely negate a quarter to a half of the tax savings for middle-income households as well.



Oregon Economy

Oregon’s expansion continues to outperform the typical state due to our industrial structure and ability to attract and retain young, working-age households. That said, job growth continues to slow as the regional economy transitions down to more sustainable rates. This slowdown is not driven by one or two industries in particular, but is broad-based across nearly all sectors and all regions within the state. Encouragingly, job growth remain strong enough to keep up with population gains and to absorb the workers coming back into the labor market.



While the tight labor market continues to drive a virtuous economic cycle as local wage growth outpaces the typical state, like the U.S. overall, it is harder for businesses to find workers. This tight labor pool is due to both the cyclical strength of the economy, and due to rising Baby Boomer retirements. As such, these conditions are expected to remain until the next recession.

For firms looking to expand and growth with the economy, they must dig deeper into their resume stacks and hire candidates they may have previously passed over. During and after the Great Recession we know employers