

## **EXECUTIVE SUMMARY**

**June 2012**

### **Oregon Economic Forecast**

#### *Current Conditions*

A chorus of indicators suggests that economic conditions are improving for many of Oregon's families and businesses. Unfortunately, the pace of improvement remains slower than what we have become accustomed to in past economic recoveries, and has not been shared across all communities.

Although recent gains have been broad-based across industries, they have not been broad-based across regions of the state. In general, communities that are located more than an hour's drive from the Columbia River are no better off now than they were when the nationwide recession ended two years ago.

#### *Outlook*

Oregon's economy can reasonably expect more of the same in the future. Most forward-looking data suggest that growth will continue. However, there is still ample reason to believe that this growth will remain disappointing from a historical perspective, with the statewide economy likely to struggle to pick up any further momentum.

The typical household still needs to save more, and spend less, of their income over the extended horizon. When less spending is combined with the broader effects of an aging baby-boom population cohort, Oregon and other states will face an uphill climb for many years to come.

What little acceleration that can be hoped for is tied to a long-awaited improvement in regional housing markets. Mortgage rates are very low, as are single-family house prices relative to apartment rents. Single-family housing markets are finally showing a weak pulse in many areas of the state.

House prices will remain depressed until most of the unwanted properties are purged from the balance sheets of lenders and underwater homeowners. Even so, improved housing investment, construction activity and spending on home furnishings represents the best hope for a speedier recovery.

The baseline (most likely) employment forecast remains essentially unchanged. Slow growth will continue to be the norm. Oregon is not expected to recover all of the jobs it has lost until the end of 2014—seven years after the recession began.

## *Risks*

There is little to suggest that a new recession is upon us. The possibility that Oregon will return to recession this summer is looking much less likely than it appeared a few months ago. Nevertheless, a considerable amount of uncertainty remains in the outlook since there is still plenty of time for the expansion to unwind before we reach the end of the biennium.

The primary downside risk currently on the radar is the ongoing production slowdown among some of Oregon's largest trading partners in Asia. With consumers needing to repair their household finances, Oregon's economic expansion has been led by business investment and exports, both of which would suffer greatly if Asian demand were to fade.

Even if the root cause of a future downturn turns out to be a financial crisis within the European Union, a primary channel through which problems would manifest themselves here in Oregon would be via a reduction in trade flows to and from Asia. Many of the Asian manufacturers we do business with cater to European clients. Furthermore, access to a healthy global credit market is a prerequisite for suppliers and transportation firms to operate.

## **Summary of Recent Trends**

Our office examines four main sources for labor market information: the monthly payroll employment survey, the monthly household employment survey, monthly withholding tax receipts and the quarterly census of employment and wages. Right now, three out of the four indicate solid economic improvement that is at least as strong as the national growth figures, while one shows essentially no improvement over the past fourteen months. That one bad indicator is the monthly payroll employment survey, which eventually will be revised to look like the others. Oregon's labor market is improving right along with the nation overall, if not a little bit faster.

After technical adjustments<sup>1</sup>, the data reveals a state that continues to expand slowly, adding slightly more than 15,000 jobs in the past year (0.9% through 2012q1), instead of a state that is stagnating, adding only 4,400 jobs in the past year (0.3%). Granted, the differences are small in percentage terms, yet important to understanding the lackluster expansion and interpreting recent events in light of our economic outlook.

In terms of industries, over the past year the job growth has been widespread with only wood products and government seeing declines. The largest gains have been in professional and business services and health services, which increased by approximately 5,400 and 4,300, respectively, from 2011q1 to 2012q1. Leisure and hospitality and retail trade each added 3,300 jobs over the past year. These four main sectors account for approximately 64 percent of all private sector gains, with total manufacturing accounting for another 19 percent, or 4,800 jobs. Within manufacturing, gains were led by durable goods, particularly metals and machinery. The public sector continues to lose jobs with the majority of the losses occurring in local education.

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<sup>1</sup> See the Oregon section for detailed information

Even with the majority of the economic data and news being positive, the forecast for economic growth – chiefly income and jobs – remains largely unchanged relative to recent forecasts. Substantial risks, concentrated to the downside, remain outstanding and may derail the fragile recovery. Even avoiding these downside risks, the rate of growth is still expected to remain average to slightly below average. OEA forecasts an employment increase of 1.0 percent in the second quarter of 2012 and 2.3 percent in the third quarter. Job gains will remain subdued in 2012, improving at a 1.4 percent pace overall, following 1.1 percent gains in 2011. The rate of growth will pick up in 2013 at 2.4 percent and 2014 at 2.3 percent however even these rates of growth are only slightly above Oregon’s long-run employment average of 2.2 percent.

### **Demographic Forecast**

Oregon’s population count on April 1, 2010 was 3,831,074. Oregon gained 409,550 persons between the years 2000 and 2010. The population growth during the decade of 2000 and 2010 was 12.0 percent, down from 20.4 percent growth from the previous decade. Oregon’s rankings in terms of decennial growth rate dropped from 11th between 1990-2000 to 18th between 2000-2010. Slow population growth during the most recent decade due to double recessions probably cost Oregon one additional seat in the U.S. House of Representatives. Actually, Oregon’s decennial population growth rate during the most recent decade was the second lowest since 1900. The slowest was during the 1980 when Oregon was hit hard by another recession. As a result of recent economic downturn and sluggish recovery, Oregon’s population is expected to continue a slow pace of growth in the near future. Based on the current forecast, Oregon’s population will reach 4.27 million in the year 2020 with an annual rate of growth of 1.1 percent between 2010 and 2020.

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 national and international labor market. As Oregon’s total fertility rate remains below the replacement level and deaths continue to rise due to ageing population, long-term growth comes mainly from net in-migration. Working-age adults come to Oregon as long as we have favorable economic and employment environments. During the 1980s, which included a major recession and a net loss of population, net migration 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 economy of 1990s. This share of migration to population change declined to 56 percent in 2002 and it was further down to 32 percent in 2010. As a sign of slow to modest economic gain, the ratio of net migration-to-population change will increase gradually and will reach 70 percent by the end of the forecast horizon. Although economy and employment situation in Oregon look stagnant at this time, migration situation is not expected to replicate the early 1980s pattern of negative net migration. Potential Oregon out-migrants have no better place to go since other states are also in the same boat in terms of economy and employment.

Age structure and its change affect employment, state revenue, and expenditure. Demographics are the major budget drivers, which are modified by policy choices on service delivery. Growth

in many age groups will show the effects of the baby-boom and their echo generations during the period of 2010-2020. It will also reflect demographics impacted by the depression era birth cohort combined with diminished migration of the working age population and elderly retirees. After a period of slow growth during the 1990s and early 2000s, the elderly population (65+) has picked up a faster pace of growth and will surge as the baby-boom generation continue to enter this age group. The average annual growth of the elderly population will be 3.9 percent during the forecast period as the boomers continue to enter retirement age. However, the youngest elderly (aged 65-74) will grow at an extremely fast pace during the forecast period, averaging 4.9 percent annual rate of growth due to the direct impact of the baby-boom generation entering retirement age. Reversing several years of shrinking population, the elderly aged 75-84 will start a positive growth as the effect of depression era birth-cohort will dissipate. A faster pace of growth of population in this age group will begin once the baby-boom generation starts to mature. The oldest elderly (aged 85+) will continue to grow at a moderately but steady rate due to the combination of cohort change, continued positive net migration, and improving longevity. The average annual rate of growth for this oldest elderly over the forecast horizon will be 1.6 percent.

As the baby-boom generation matures out of oldest working-age cohort combined with slowing net migration, the once fast-paced growth of population aged 45-64 will gradually taper off to below zero percent rate by 2012 and will remain at slow or below zero growth phase for several years. The size of this older working-age population will decline during the forecast horizon of 2010-2020. The 25-44 age group population is recovering from several years of declining and slow growing trend. The decline was mainly due to the exiting baby-boom cohort. This age group has seen positive growth starting in the year 2004 and will increase by 1.1 percent annual average rate during the forecast horizon. The young adult population (aged 18-24) will change only a little over the forecast period and remain virtually unchanged for most of the years into the future. Although the slow or stagnant growth of college-age population (age 18-24), in general, tend to ease the pressure on public spending on higher education, college enrollment typically goes up during the time of high unemployment and scarcity of well-paying jobs when even the older people flock back to college to better position themselves in a tough job market. The growth in K-12 population (aged 5-17) will remain low which will translate into slow growth in school enrollments. This school-age population has actually declined in size in recent years and will grow in the future at well below the state average. The growth rate for children under the age of five will remain below zero percent in the near future and will see positive growth only after 2013. Although the number of children under the age of five will decline slightly in the near future, the demand for child care services and pre-Kindergarten program will be additionally determined by the labor force participation and poverty rates of the parents. Overall, elderly population over age 65 will increase rapidly whereas population groups under age 65 will experience slow growth in the coming decade. Hence, based solely on demographics of Oregon, demand for public services geared towards children and young adults will likely to increase at a slower pace, whereas demand for elderly care and services will increase rapidly.

## Revenue Forecast

The peak filing season for personal income taxes came and went this year without any major April revenue surprises on either the upside or downside. The slow-growth year that was expected following the revenue boom seen in April 2011 largely came to pass, with personal income taxes coming in slightly below projections (-0.4%) over the peak tax season.

Although the overall magnitude of personal income tax collections closely met expectations, the pattern of growth did not. In general, personal income taxes levied on wages and salaries in the workplace came in somewhat stronger than expected, while collections flowing from taxable investment income were weaker than expected.

Always volatile corporate income tax collections closely matched the March forecast as well (+4.6%). Corporate income tax collections have stabilized in recent weeks, but remain down sharply relative to last year. The forecast calls for corporate tax collections to remain weak until fiscal year 2014.

Overall, revenue growth in fiscal year 2013 is expected to roughly match the modest gains seen in fiscal year 2012. Revenue growth is expected to accelerate somewhat during the 2013-15 biennium as the housing market begins to wake up, but gains will remain below historical norms.

Since the March forecast, combined general fund and lottery resources have been increased by \$107 million for the 2011-13 biennium. This increase reflects \$128 million in additional one-time transfers and other legislative changes associated with the 2012 Rebalance Plan. Excluding the impact of these legislative changes, combined general fund and lottery resources have been lowered by \$22 million (-0.1%) for the 2011-13 biennium.

Total resources have been lowered by \$20 million in the 2013-15 biennium, and by \$82 million in 2015-17. Longer term revenue losses are not the result of a weaker economy, but rather are due to more pessimistic expectations for taxable capital gains realizations and video lottery sales.

Revenue growth in Oregon and other states will face considerable downward pressure over the 10-year extended forecast horizon. As the baby boom population cohort works less and spends less, traditional state tax instruments such as personal income taxes and general sales taxes will become less effective, and revenue growth will fail to match the pace seen during recent periods of economic expansion.

## A. 2011-13 General Fund Revenues

Growth in general fund revenues slowed to a crawl at the beginning of 2012. Many workers received smaller bonus checks than last year, and there was considerably less investment income reported among high-income households. Corporate tax collections have been falling rapidly over the past year, with the boom in underlying corporate profits having come to an end. Also, video lottery sales have grown at only a snail's pace since the recession began.

Growth in collections will remain lackluster over the remainder of the biennium. Not only does job growth remain modest, many of the technical factors supporting Oregon's strong revenue gains in fiscal year 2011 have now gone away. Growth in personal income taxes will face downward pressure from policy changes, including a reduced 2012 income tax rate on high-income filers. Also, many households have depended on a wide range of alternative taxable income sources in recent years to help replace lost labor income. Some of these sources, including unemployment insurance payments and tax-deferred savings accounts such as IRAs,

**Table R.1**

### 2011-13 General Fund Forecast Summary

(Millions)	2011 COS Forecast	March 2012 Forecast	June 2012 Forecast	Change from Prior Forecast	Change from COS Forecast
<b>Structural Revenues</b>					
Personal Income Tax	\$12,193.6	\$11,969.2	\$11,919.9	-\$49.3	-\$273.7
Corporate Income Tax	\$894.2	\$812.6	\$814.5	\$1.9	-\$79.7
All Other Revenues	\$944.2	\$944.6	\$1,098.5	\$153.9	\$154.3
<b>Gross GF Revenues</b>	<b>\$14,032.0</b>	<b>\$13,726.5</b>	<b>\$13,832.9</b>	<b>\$106.5</b>	<b>-\$199.0</b>
Administrative Actions <sup>1</sup>	-\$23.1	-\$23.1	-\$14.1	\$9.1	\$9.1
Legislative Actions	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<b>Net Available Resources</b>	<b>\$14,008.9</b>	<b>\$13,703.3</b>	<b>\$13,818.9</b>	<b>\$115.5</b>	<b>-\$190.0</b>
<b>Confidence Intervals</b>					
67% Confidence	+/- 5.2%		<b>\$719.3</b>	<b>\$13.11B to \$14.55B</b>	
95% Confidence	+/- 10.4%		<b>\$1,438.6</b>	<b>\$12.39B to \$15.27B</b>	

<sup>1</sup> Reflects cost of cashflow management actions, exclusive of internal borrowing.

have been heavily tapped, and will result in smaller tax collections going forward.

The revenue outlook for the 2011-13 biennium is somewhat stronger than what was predicted in the March 2012 forecast as a result of legislative actions taken during the February 2012 session. The forecast for General Fund revenues for 2011-13 is now \$13,819 million. This represents an increase of \$115.5 million (0.8%) from the March 2012 forecast.

The forecast for the 2011-13 biennium is now \$190 million below the Close of Session forecast. Given the strong employment gains seen in early 2011, the Close of Session forecast is somewhat more optimistic than other versions produced before or since. Nevertheless, given lackluster near-term expectations for revenue growth, a strong April 2013 tax season of collections would put us back on track with the Close of Session's optimistic outlook. If we see a boom similar to the last revenue cycle, the personal income tax kicker may yet come into play.

### *Personal Income Tax*

Personal income tax collections were \$1,348 million for the third quarter of fiscal year 2012, \$22.1 million (-1.9%) below the latest forecast. Compared to the year-ago level, total personal income tax collections fell by 1.6% relative to a forecast that called for 0.3% growth. This error can be traced to the timing of refund payments. With the expansion of electronic filing, refunds are getting paid out earlier and earlier each year. The shift was very pronounced this year, with first quarter refunds coming in \$55 million above expectations. However, it appears that this is a timing issue only, with refunds running roughly \$60 million below expectations in the current quarter. Table B.8 in Appendix B presents a comparison of actual and projected personal income tax revenues for the second quarter of fiscal year 2012.

Personal income tax collections over the April tax season as a whole will be \$40 million to \$50 million below forecast. This revision can largely be traced to disappointing final payments due to weak investment-related income. Taxable wages have remained encouragingly healthy throughout calendar year 2012.

### *Corporate Taxes*

Corporate excise taxes equaled \$64 million for the third quarter of fiscal year 2012, \$8.2 million above the March forecast. Compared to the year-ago level, total corporate receipts were down 12.0% relative to a forecast of a 23.2% decline. Table B.8 in Appendix B presents a comparison of actual and projected corporate income tax revenues for the third quarter of fiscal year 2012.

Corporate profits, and associated tax collections, are cooling off rapidly after reaching record highs. Profits and corporate tax collections are notoriously volatile, with collections often cut in half in the year immediately following profit booms. In January 2011, corporate taxes were growing at a 50% year-over-year pace. By December, they were falling at a 33% rate. The expectation for a sharp correction in corporate income tax collections has been built into recent forecasts. As such, collections are closely matching expectations, with the March outlook for 2011-13 being revised upward by \$1.9 million.

## Non-income Tax Sources of Revenue

All other revenues will total \$1,098.5 million for the biennium, an increase of \$154 million (16.3%) from the prior forecast. Most of this increase can be traced to \$128 million in one-time funds associated with the 2012 Rebalance Plan. Revisions were also large for state court fees and criminal fines, where the impacts of 2009-11 legislation are now appearing in the revenue data.

### B. Extended General Fund Revenue Outlook

Table R.2 exhibits the long-run forecast for General Fund revenues through the 2019-21 biennium. Users should note that the potential for error in the forecast increases substantially the further ahead we look.

**Table R.2**

**General Fund Revenue Forecast Summary (Millions of Dollars, Current Law)**

Revenue Source	Forecast		Forecast		Forecast		Forecast		Forecast		Forecast	
	2009-11 Biennium	% Chg	2011-13 Biennium	% Chg	2013-15 Biennium	% Chg	2015-17 Biennium	% Chg	2017-19 Biennium	% Chg	2019-21 Biennium	% Chg
Personal Income Taxes	10,467.2	3.7%	11,919.9	13.9%	13,636.4	14.4%	15,379.1	12.8%	17,056.6	10.9%	18,884.9	10.7%
Corporate Income Taxes	827.6	20.9%	814.5	-1.6%	1,098.0	34.8%	1,103.1	0.5%	1,085.8	-1.6%	1,137.4	4.8%
All Others	1,226.6	29.8%	1,098.5	-10.4%	943.8	-14.1%	1,001.5	6.1%	1,070.1	6.8%	1,155.8	8.0%
<b>Total General Fund</b>	<b>12,521.4</b>	<b>6.8%</b>	<b>13,832.9</b>	<b>10.5%</b>	<b>15,678.1</b>	<b>13.3%</b>	<b>17,483.7</b>	<b>11.5%</b>	<b>19,212.5</b>	<b>9.9%</b>	<b>21,178.1</b>	<b>10.2%</b>
<i>Kicker Distributions</i>	-		-		-		-		-		-	
<b>Total Revenue</b>	<b>12,521.4</b>	<b>-2.2%</b>	<b>13,832.9</b>	<b>10.5%</b>	<b>15,678.1</b>	<b>13.3%</b>	<b>17,483.7</b>	<b>11.5%</b>	<b>19,212.5</b>	<b>9.9%</b>	<b>21,178.1</b>	<b>10.2%</b>

Other taxes include General Fund portions of the Eastern Oregon Severance Tax, Western Oregon Severance Tax and Amusement Device Tax. Commercial Fish Licenses & Fees and Pari-mutual Receipts are included in Other Revenues

General Fund revenues will total \$15,678 million in 2013-15, an increase of 13.3% percent from the prior period, and \$2 million (0.0%) above the March forecast. In 2015-17, revenue growth will moderate to 11.5%, followed by slower rates of around 10% in subsequent biennia. The slowdown in long-run revenue growth is largely due to the impact of demographic changes.

Revenues in 2015-17 and beyond are expected to be smaller than in the March forecast, largely due to a downgraded outlook for capital gains and other taxable investment income. It is unlikely that capital gains will surge ahead to the same extent that was seen during the past two revenue cycles when many long-held assets were cashed in during the technology and housing booms. After consultation with the Revenue Forecast Advisors group, the assumed holding period for assets was lowered in the revenue model, leading to fewer taxable realizations of

capital gains over the extended forecast horizon. Table B.2 in Appendix presents a more detailed look at the long-term General Fund revenue forecast.