Oregon Economic and Revenue Forecast

May 2013

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EXECUTIVE SUMMARY

May 2013

Oregon Economic Forecast

Current Conditions and Outlook

Oregon's economy continues to improve with each passing month and quarter, although the pace of improvement remains slow from a historical point of view. However, the rate of growth may now finally be picking up. Some of the major drags that have been weighing on Oregon's economic recovery are now being lifted, setting the stage for faster growth. Sentiment has improved among both businesses and households, with economic forecasters beginning to highlight upside risks to the outlook. With firms and workers having repaired much of the damage done to their balance sheets, many are in a position to spend should they remain confident about their future prospects.

So far during Oregon's recovery, private sector employment has expanded at approximately a 2 percent annualized rate, far below the 3.0-3.5 percent growth experienced in past expansions. Two primary reasons for this slower rate of growth have been large cutbacks among housing-related industries and government. As the housing rebound continues, and state and local governments stabilize, these two weights are being lifted. Furthermore, as these two sectors continue to improve, medium sized cities and rural areas of the state are beginning to take part in the expansion. With the housing market and public sector no longer holding us back, the baseline outlook calls for a pickup in job growth to 2.6 percent on an annualized basis over the next two years.

The housing rebound is now in full swing with sales, starts and prices all increasing at strong rates. New residential investment positively contributed to GDP growth in 2012 and in the first quarter of 2013, following 6 years of decline. Given the depth of the housing bust, the industry has at least two more years of strong growth before reaching even average levels of new construction. Moody's Analytics' chief economist, Mark Zandi, estimates that each new housing start supports 4.5 to 5 jobs in the economy from construction workers and real estate agents to concrete and cabinet makers. In Oregon, benefits also flow to wood product firms who gain from additional demand for building products.

Balance sheets for corporations remain very strong, particularly so for large businesses, but credit conditions are improving for small businesses as well. Household liabilities continue to decline and asset holdings continue to grow, putting consumers on a more solid footing. Stock markets are reaching all-time highs and home prices are rising briskly from recessionary lows. Even so, homeowners' equity remains a fraction of pre-recession levels, making a mortgage-financed spending boom unlikely. Given strong fundamentals, all signs point toward continued expansion. The Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters places the probability of a negative economic quarter at 15%. The Wall Street Journal's Economic Forecasting Survey similarly places the risk of recession over the next year at 15%. Survey respondents estimate the upside risks outweigh the downside risks 57% to 43%. One year ago, in May 2012, the same WSJ survey estimated the downside risks outweighed the upside risks by a 70% to 30% margin. While the average economic growth rate for 2013 has remained stable among forecasters, the risks have clearly shifted. Should the economy strengthen further than expected, job growth in Oregon will likewise exceed expectations.

Oregon's Employment Trends

Getting a handle on the health of Oregon's labor market is being somewhat complicated by technical issues within the underlying payroll jobs data. Technical issues aside, employment in Oregon continued to increase through the end of 2012 and into 2013, approximately in line with the gains seen at the U.S. level. While the gains continue to be slower than in previous expansions, they are gathering a little bit of steam and growth has picked up somewhat when compared with a year ago. In the past three quarters in Oregon, year-over-year employment has increased by 1.3 percent in the third quarter of 2012, 1.5 percent in the fourth quarter and 1.6 percent in the first quarter of 2013. Gains in the private sector are even stronger with the corresponding growth rates being 1.7 percent, 2.1 percent and 2.2 percent. Even with this pickup it still is not strong enough to bring the unemployment rate down quickly – at least not yet. The unemployment rate in the first quarter of the year was 8.3 percent, down 0.1 percentage points from the fourth quarter of 2012 and lower than the 8.9 percent unemployment rate in early 2012.

In terms of Oregon's regional labor markets, job growth is spreading beyond the Portland Metro in the past year, for the first time since the onset of recession. Even as the statewide numbers began to improve in early 2010, all counties outside the Portland metropolitan area lost jobs on net, however that has changed since the summer of 2012. In particular, Bend and Medford – the dual epicenter of the housing bubble in the state, and among the largest in the country – are both seeing strong employment gains in the past year. Based on the latest covered employment data (QCEW), jobs have rebounded nearly 5 percent in Medford and 5.5 percent in Bend. These employment gains are across nearly all industries and can be at least partially attributable to a pickup in construction activity and tourism. Additional jobs are being created in the Willamette Valley, Northern Coast and Northeast Oregon. Only the Southern Coast and Southeastern counties have yet to see sustained job gains. Even though there remains a long way to go before these local economies become healthy or approach what they once were in terms of job counts, the increasing geographic diversity of job creation is an encouraging sign.

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 to 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 and 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, actually negative, was during the 1980s 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 4.25 million in the year 2020 with an annual rate of growth of 1.03 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 73 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 coverage and 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 5.0 percent annual rate of growth due to the direct impact of the baby-boom generation entering the 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 1.4 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 of growth by 2012 and will remain at slow or below zero growth phase for several years. The size of this older working-age population will remain virtually unchanged at the beginning to the end of the decade. 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 1.2 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

Expectations for near-term General Fund revenue growth have become somewhat stronger since the last forecast. In recent months, both personal and corporate income tax collections have been coming in larger than was expected. In particular, the April tax filing season brought with it a big jump in personal income tax payments relative to last year.

Although the revenue forecast has become somewhat stronger in the near term, the overall flavor of the outlook has not changed. Along with underlying job growth, personal income taxes paid out of wages and salaries are expected to accelerate during the 2013-15 biennium.

Despite an improving economy, overall revenue growth will remain modest from an historical perspective. Underlying job gains, while improved, will not match the pace seen during previous periods of economic expansion. Also, personal income taxes based on investment income will grow slowly in the near term since many Oregonians cashed out gains in 2012 in anticipation of a scheduled federal tax rate increase. Tax revenue growth is expected to fall in between the rates Oregon has become accustomed to during past periods of economic expansion, and the slow gains we have seen in recent years.

Although the baseline revenue forecast has not changed significantly, risks to the forecast are becoming skewed to the upside. Despite a relatively weak long-term outlook, a year or two of strong growth remains possible. In particular, if Oregon's traditionally strong migration trends and labor force gains reappear, additional jobs and tax revenue can be expected.

The primary downside risk facing the near-term revenue forecast is the uncertain future of the nationwide economic expansion. Should federal government austerity or economic weakness abroad derail the U.S. economy, the expected growth in Oregon's tax collections will not materialize.

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 in the past.

2011-13 General Fund Revenue

A strong 2013 season of income tax collections has put General Fund revenues somewhat ahead of the Close of Session's relatively optimistic outlook. Both personal and corporate income tax collections are closely matching expectations. If not for large one-time deposits and changes to the tax system, revenue growth would have been indistinguishable from the Close of Session outlook.

Table R.1

2011-13 General Fund Forecast Summary

(Millions)	2011 COS Forecast	March 2013 Forecast	May 2013 Forecast	Change from Prior Forecast	Change from COS Forecast
Structural Revenues					
Personal Income Tax	$12,193.6	$12,044.9	$12,152.7	$107.8	-$40.9
Corporate Income Tax	$894.2	$898.3	$914.6	$16.3	$20.3
All Other Revenues	$944.2	$1,179.1	$1,181.2	$2.1	$237.0
Gross GF Revenues	$14,032.0	$14,122.2	$14,248.5	$126.2	$216.5
Offsets and Transfers	$0.0	-$12.0	-$12.0	$0.0	-$12.0
Administrative Actions[1]	-$23.1	-$4.4	-$4.4	$0.0	$18.7
Legislative Actions	$0.0	$0.0	$0.0	$0.0	$0.0
Net Available Resources	$14,008.9	$14,105.9	$14,232.1	$126.2	$223.3
Confidence Intervals					
67% Confidence	+/- **1.0%**		**$135.8**	**$14.11B to $14.38B**	
95% Confidence	+/- **1.9%**		**$271.7**	**$13.98B to $14.52B**	

1 Reflects cost of cashflow management actions, exclusive of internal borrowing.

The revenue outlook for the 2011-13 biennium has improved somewhat relative to the March 2013 forecast. The forecast for General Fund revenues for 2011-13 is now $14,248 million. This represents an increase of $126 million (+0.9%) from the March 2013 forecast.

The forecast for the 2011-13 biennium is now $216 million (+1.7%) above the Close of Session forecast. Most of the additional revenue can be traced to legislative actions taken during the February 2012 session.

Personal Income Tax

Personal income tax collections were $1,219 million for the third quarter of fiscal year 2013, $26.1 million (+2.2%) above the latest forecast. Compared to the year-ago level, total personal income tax collections grew by 7.5% relative to a forecast that called for 5.2% growth. Appendix B presents a comparison of actual and projected personal income tax revenues for the January-March quarter.

Personal income tax collections grew strongly during the April 2013 filing season as the 2012 gains seen in stock markets and across other investments were realized for tax purposes. In addition to asset appreciation, a considerable amount of taxable investment income has been generated by taxpayers choosing to cash in their assets ahead of federal tax increases in 2013. Due largely to this pulling forward of income, year-end personal income tax payments have come in more than 20% higher than last tax season.

Although the outlook for personal income taxes over the last six weeks of the biennium is an aggressive one, it remains possible (but not likely) that payments will still outstrip the forecast. Should Oregon collect $67 million (5.6%) more in personal income tax revenue than the current baseline calls for, the personal income tax kicker would come into play. This would require an increase in revenues of more than 30% relative to the last six weeks of fiscal 2012.

Corporate Excise Tax

Corporate excise tax collections equaled $92 million for the second quarter of fiscal year 2013, $12.3 million above the March forecast. Compared to one year ago, net corporate receipts were up 36.6% with the forecast calling for an 18.3% increase.

The rapid growth in corporate tax collections seen at the beginning of the year came to a sudden halt in April, leaving corporate collections very close to the kicker threshold (102% of the Close of Session forecast). The May outlook assumes that revenues will come in $2.7 million above the threshold, generating a kicker payment of $20.3 million.[1] Although a corporate kicker is incorporated into the baseline outlook, it is far from a sure thing. The Department of Revenue is working through a processing backlog of refunds due to be recorded before the end of the fiscal year. Should corporate revenues over the last six weeks of the biennium fail to match their level of last year (as they have in recent weeks), no kicker payment will be required.

[1] Voters approved reforms to the corporate kicker in November 2012, but these changes will not be in effect until biennium 2013-15.

Even before the recent surge in corporate tax collections, collections were very large from an historical perspective. Near-record corporate profits have yet to go away. Given that corporate tax collections and underlying profits are subject to boom-bust cycles, there is a considerable amount of downside risk to the outlook.

Nevertheless, strong growth is expected during the 2013-15 biennium, since Oregon's economy is expected to continue to grow, and corporate tax collections are sensitive to the business cycle. However, these growth rates, while large, will remain less than half of what has been seen during recent profit booms.

Other Sources of Revenue

All other General Fund revenues are expected to total $1,181.2 million for the 2011-13 biennium, an increase of $2.1 million relative to the March forecast. Only state court fees grew significantly faster than expected.

All other General Fund revenues are now expected to be $237 million larger than the Close of Session forecast. These additional revenues are included in the personal income tax kicker calculation. Much of the change relative to the Close of Session outlook can be traced to changes in policy. Reforms to liquor apportionment – continuation of the bottle surcharge – and judicial revenues – reclassifying some judicial revenues from Other Funds to General Fund – increased these other revenue sources. However, the February 2012 legislative session generated the largest change above and beyond the original Close of Session estimates. Unlike policy changes that take place during the full odd-year session, February adjustments are not netted out of the kicker calculation.

Extended General Fund Revenue Outlook

Table R.2 exhibits the long-run forecast for General Fund revenues through the 2021-23 biennium. Users should note that the potential for error in the forecast increases substantially the further ahead we look.

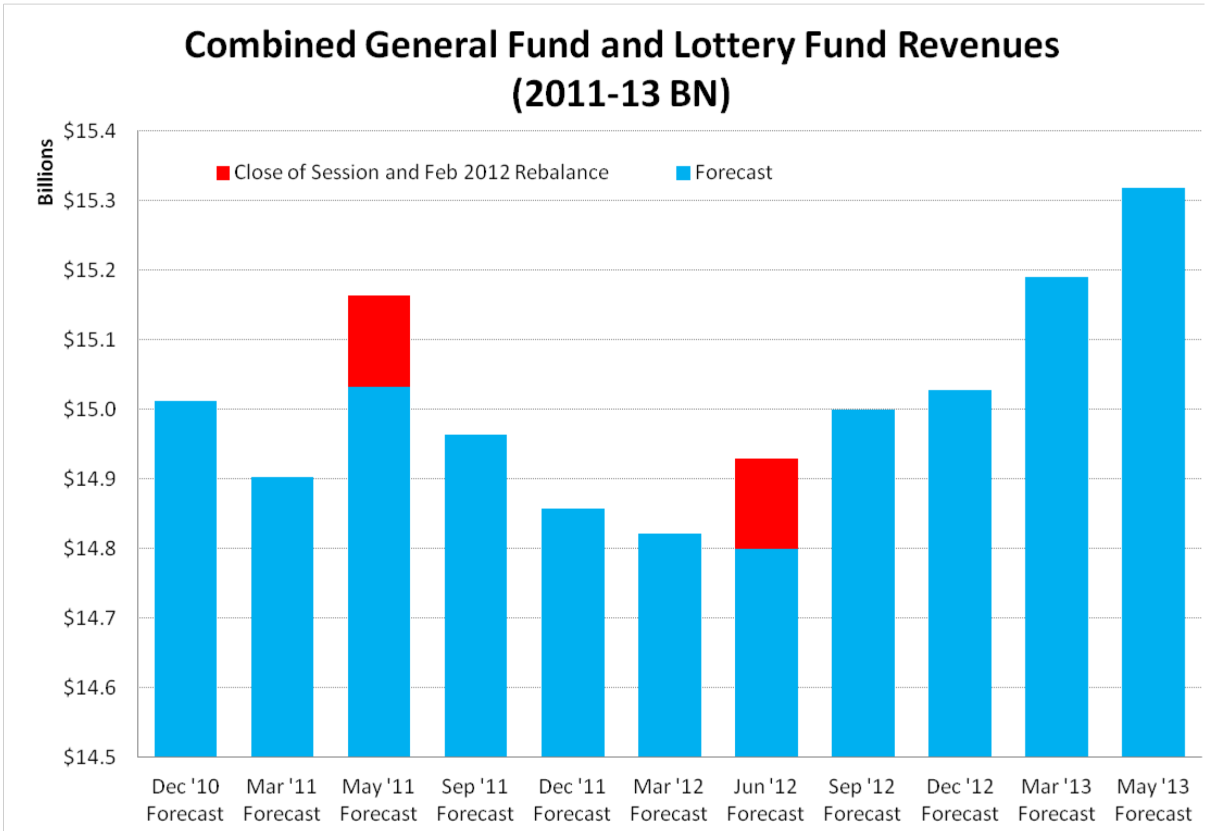
General Fund revenues will total $15,606 million in 2013-15, an increase of 9.5% percent from the prior period, and $161 million (+1.0%) above the March forecast. In 2015-17, revenue growth is expected to accelerate to 11.3%, followed by slower rates of 8.7% to 9.7% in subsequent biennia. The slowdown in long-run revenue growth is largely due to the impact of demographic changes and changes in savings behavior. Table B.2 in Appendix presents a more detailed look at the long-term General Fund revenue forecast.

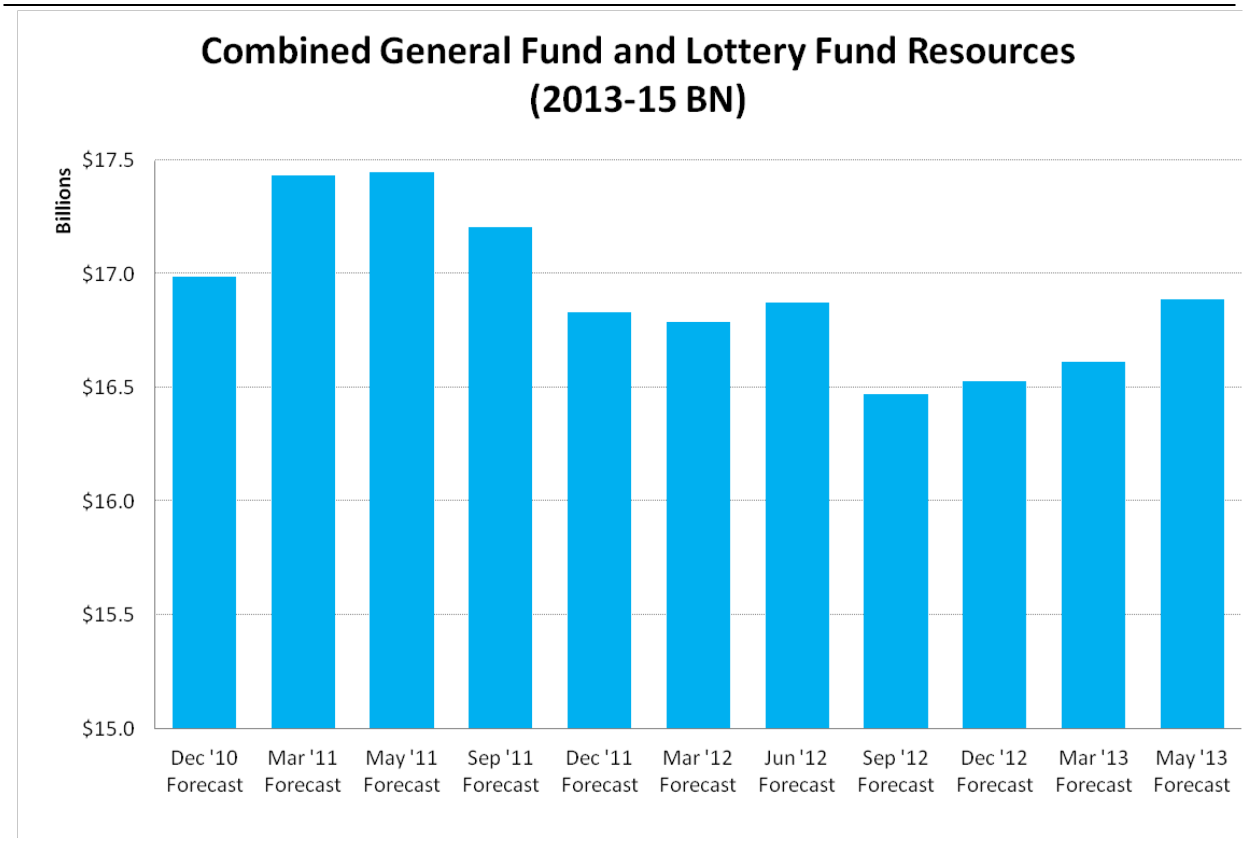
Table R.2

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

Revenue Source	Forecast 2011-13 Biennium	% Chg	Forecast 2013-15 Biennium	% Chg	Forecast 2015-17 Biennium	% Chg	Forecast 2017-19 Biennium	% Chg	Forecast 2019-21 Biennium	% Chg	Forecast 2021-23 Biennium	% Chg
Personal Income Taxes	12,152.7	16.1%	13,579.5	11.7%	15,312.8	12.8%	16,789.4	9.6%	18,497.0	10.2%	20,411.8	10.4%
Corporate Income Taxes	914.6	10.5%	1,036.6	13.3%	1,004.0	-3.1%	974.0	-3.0%	1,005.0	3.2%	1,096.7	9.1%
All Others	1,181.2	-3.7%	990.5	-16.1%	1,047.5	5.8%	1,116.2	6.6%	1,201.7	7.7%	1,277.2	6.3%
Gross General Fund	14,248.5	13.8%	15,606.5	9.5%	17,364.2	11.3%	18,879.6	8.7%	20,703.7	9.7%	22,785.7	10.1%
Offsets and Transfers	*(12.0)*		*(120.8)*		*(116.3)*		*(82.2)*		*(44.7)*		*(47.3)*	
Net Revenue	14,236.5	13.7%	15,485.7	8.8%	17,247.9	11.4%	18,797.4	9.0%	20,659.0	9.9%	22,738.3	10.1%

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


Combined General Fund and Lottery Fund Revenues
(2011-13 BN)
Billions
$15.4
$15.3
$15.2
$15.1
$15.0
$14.9
$14.8
$14.7
$14.6
$14.5
Close of Session and Feb 2012 Rebalance
Forecast
Dec '10 Forecast
Mar '11 Forecast
May '11 Forecast
Sep '11 Forecast
Dec '11 Forecast
Mar '12 Forecast
Jun '12 Forecast
Sep '12 Forecast
Dec '12 Forecast
Mar '13 Forecast
May '13 Forecast


Combined General Fund and Lottery Fund Resources
(2013-15 BN)
Billions
$17.5
$17.0
$16.5
$16.0
$15.5
$15.0
Dec '10 Forecast
Mar '11 Forecast
May '11 Forecast
Sep '11 Forecast
Dec '11 Forecast
Mar '12 Forecast
Jun '12 Forecast
Sep '12 Forecast
Dec '12 Forecast
Mar '13 Forecast
May '13 Forecast

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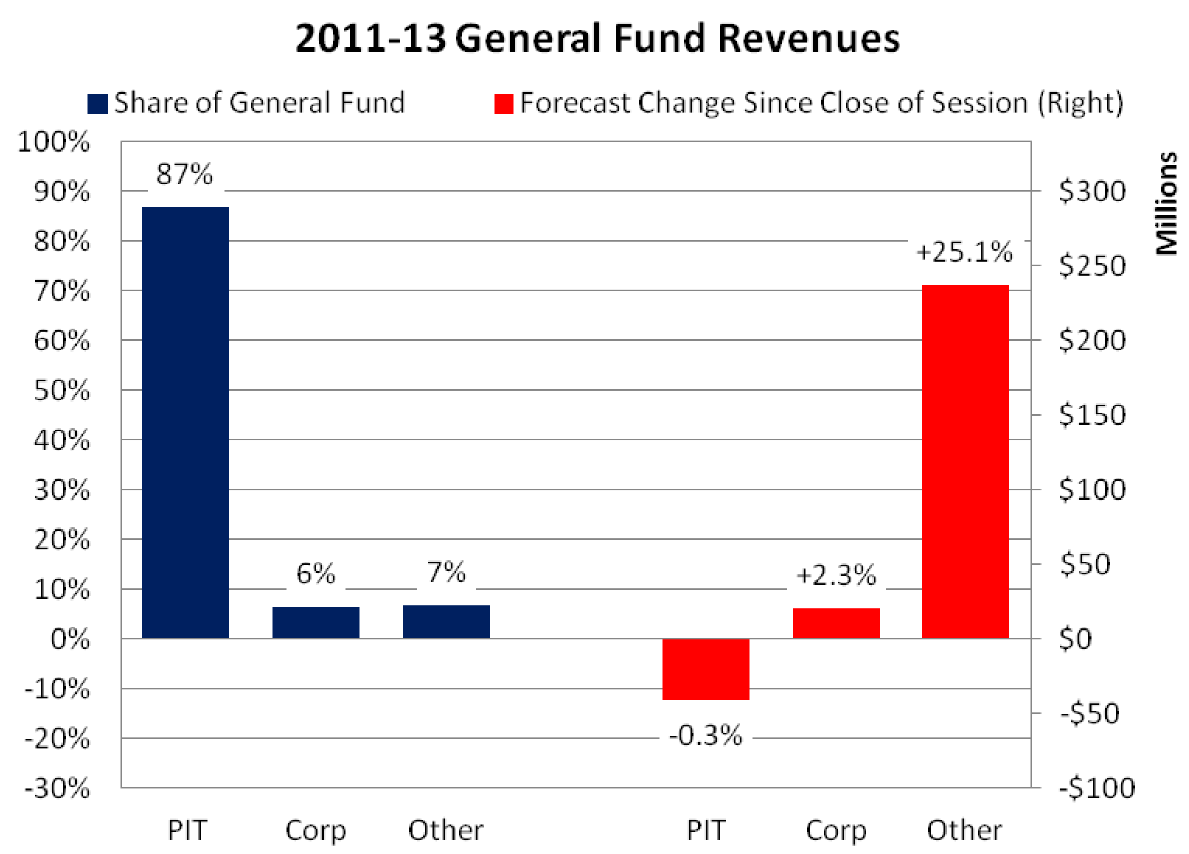
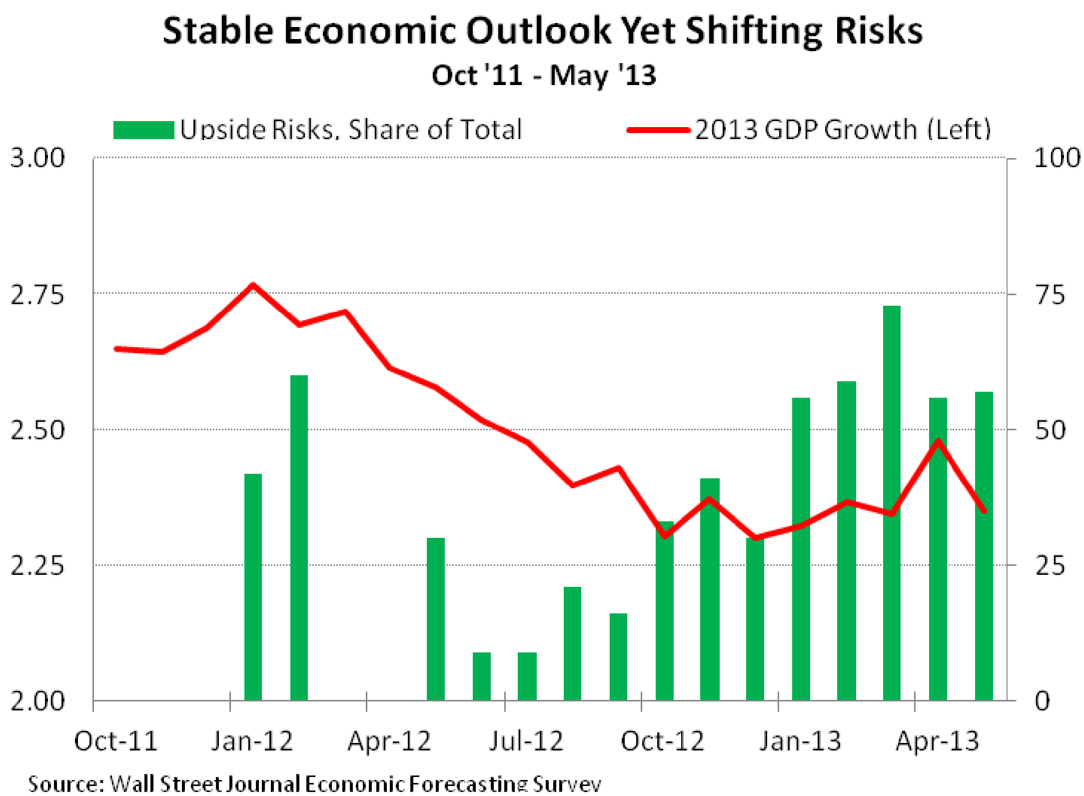
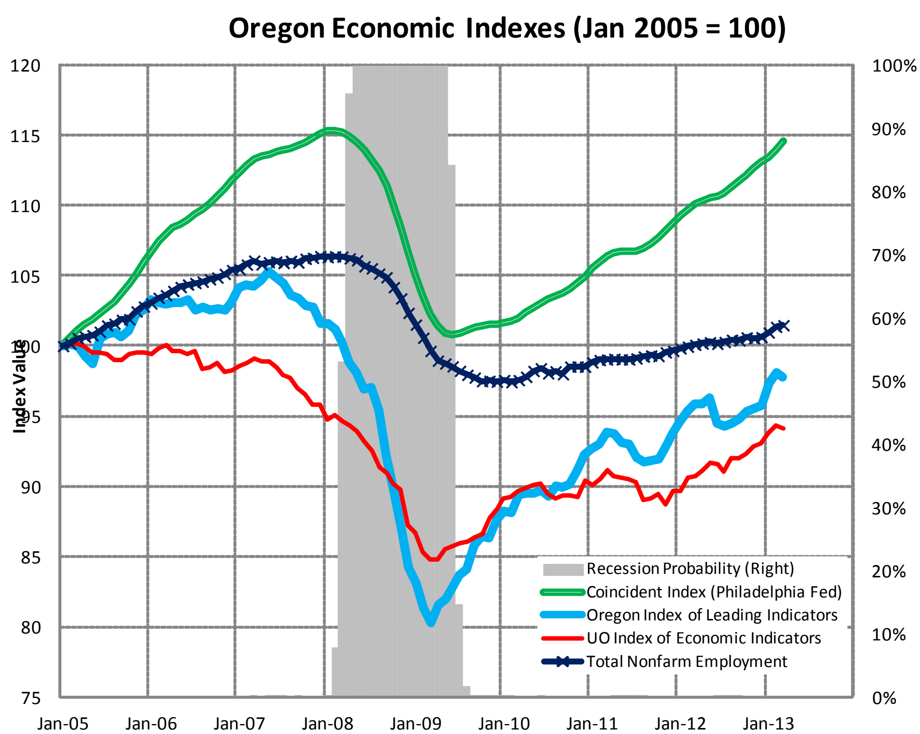




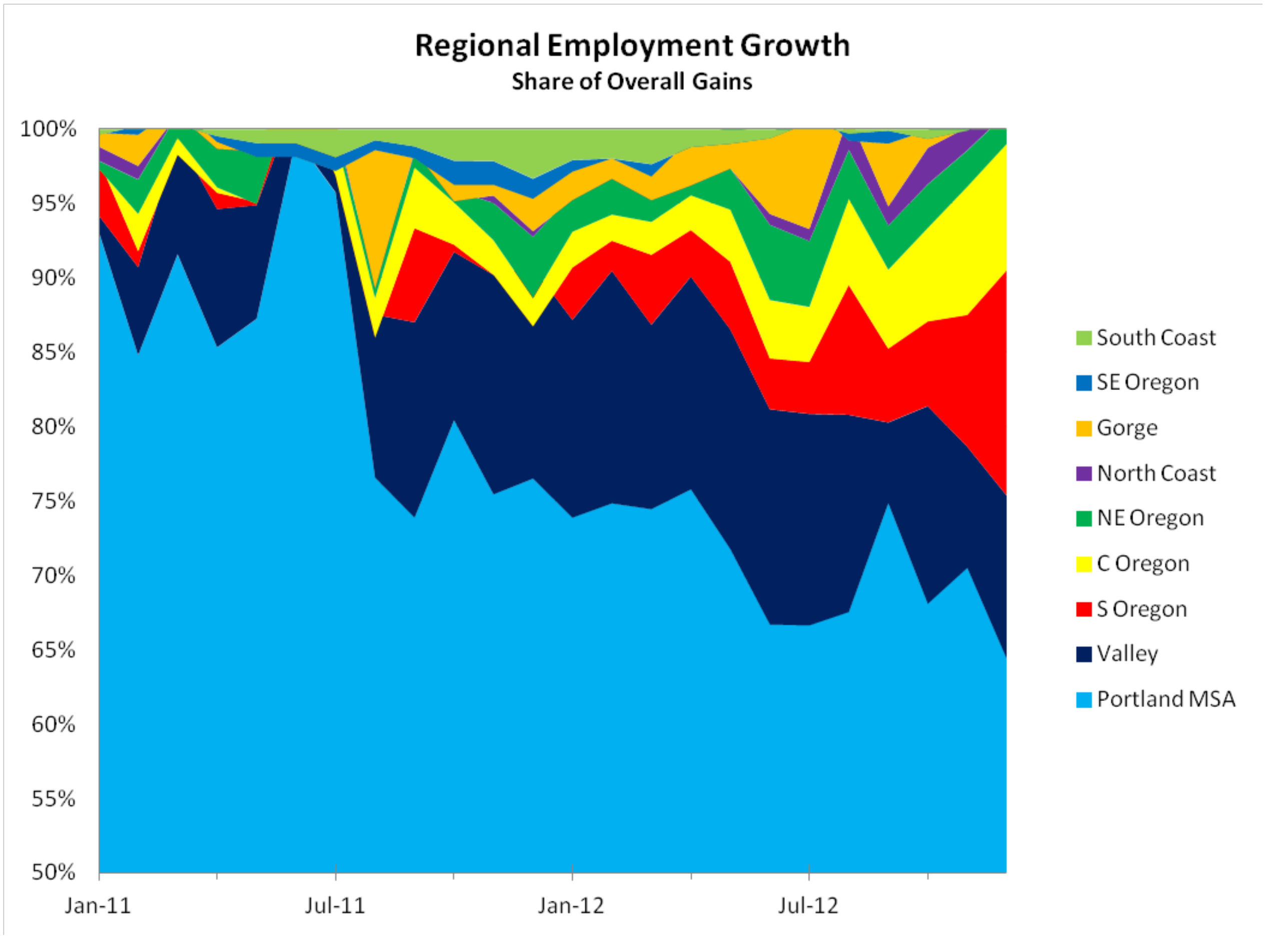


Individual Indicators

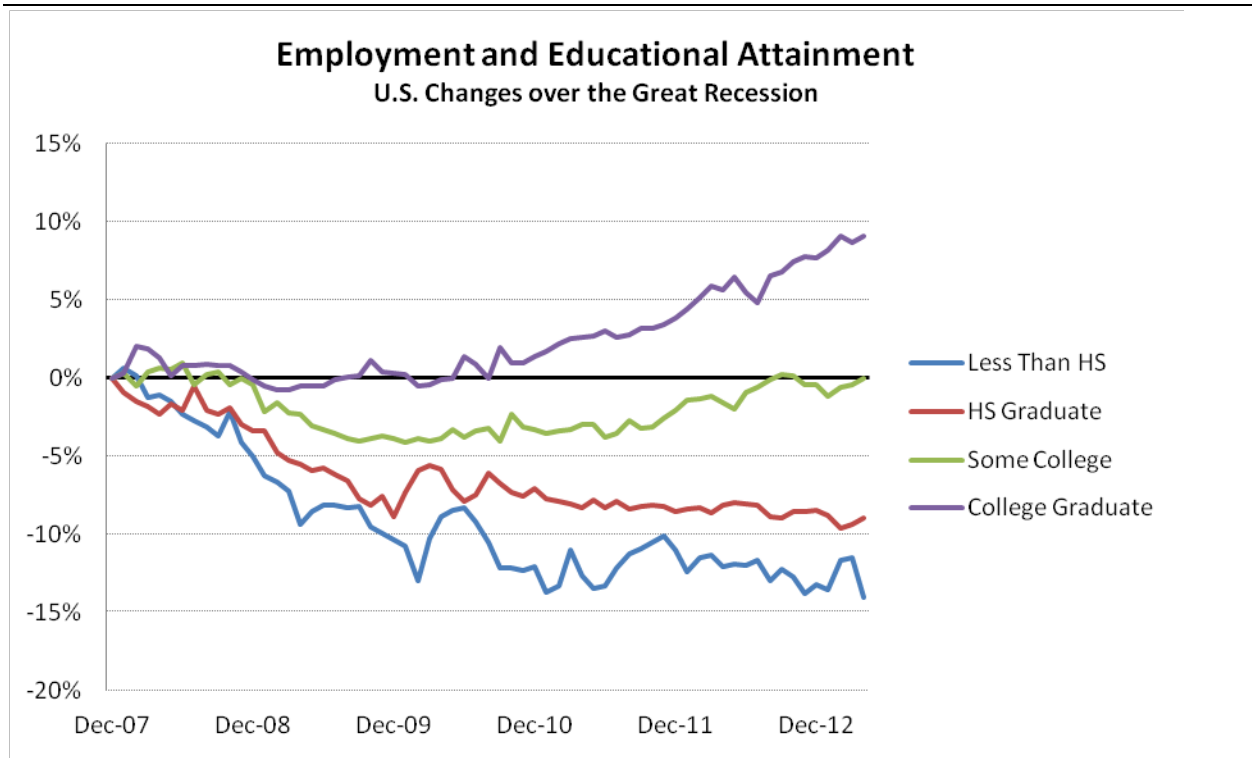
Sustained Improvement
Continued, Choppy Growth
Slowing or Slight Decline
No Improvement

OILI (OEA)
Industrial Production
Initial Unemployment Claims
Help Wanted Ads
Housing Permits
Air Freight Tonnage
Book-To-Bill Ratio
Consumer Sentiment
Purchasing Mangers Index
Withholding
Oregon Dollar Index
New Incorporations

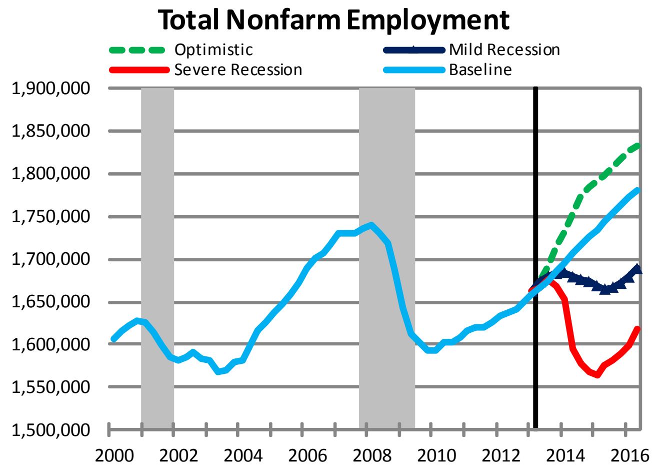
Univ Oregon Index
Housing Permits
Initial Unemployment Claims
Manufacturing Hrs Worked
Consumer Sentiment
Employment Services
Interest Rate Spread
Weight Distance Tax
Capital Goods Orders



Regional Employment Growth
Share of Overall Gains
100%
95%
90%
85%
80%
75%
70%
65%
60%
55%
50%
Jan-11
Jul-11
Jan-12
Jul-12
South Coast
SE Oregon
Gorge
North Coast
NE Oregon
C Oregon
S Oregon
Valley
Portland MSA

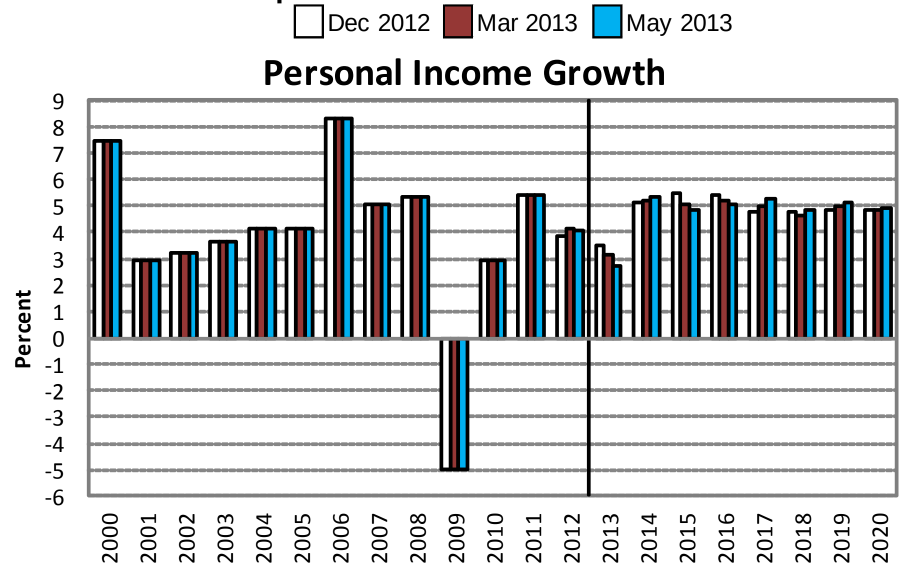


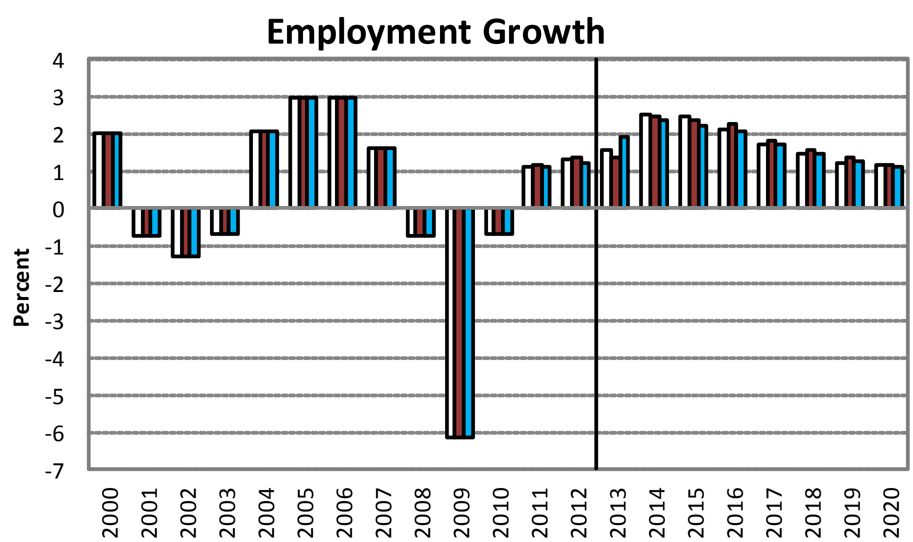
Employment and Educational Attainment
U.S. Changes over the Great Recession
15%
10%
5%
0%
-5%
-10%
-15%
-20%
Dec-07
Dec-08
Dec-09
Dec-10
Dec-11
Dec-12
Less Than HS
HS Graduate
Some College
College Graduate

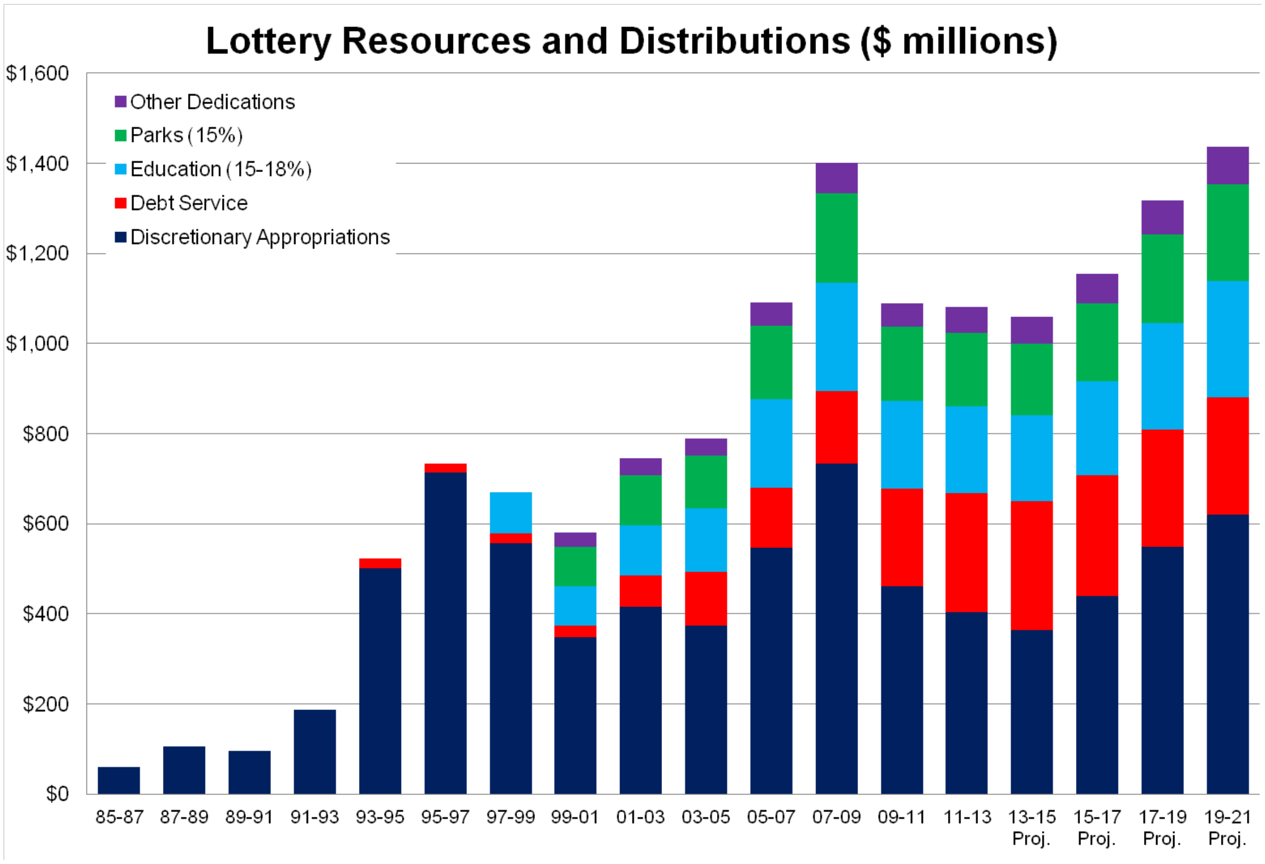


	2013	2014	2015	2015
Employment				
Baseline	1.9%	2.4%	2.2%	2.1%
Optimistic	2.7%	4.5%	2.4%	1.9%
Mild Recession	2.1%	0.2%	-0.6%	1.6%
Severe Recession	1.7%	-4.2%	-1.3%	2.9%
Personal Income				
Baseline	2.7%	5.3%	4.9%	5.1%
Optimistic	4.9%	8.0%	5.3%	4.8%
Mild Recession	2.8%	3.3%	2.3%	5.8%
Severe Recession	2.8%	-2.0%	1.4%	7.0%

Comparison of Last Three Forecasts







Oregon's Budgetary Reserves

(Millions)	2011-13 Biennium	2013-15 Biennium	2015-17 Biennium
Rainy Day Fund			
Beginning Balance	$10.4	$61.8	$263.7
Net Deposits[3]	$50.8	$199.9	$197.0
Interest	$0.6	$2.0	$18.2
Ending Balance[1]	$61.8	$263.7	$479.0
Education Stability Fund			
Beginning Balance	$5.1	$7.6	$187.9
Net Deposits	$184.8	$180.3	$197.2
Interest[2]	$0.6	$1.0	$13.5
Withdrawals	-$182.9	-$1.0	-$13.5
Ending Balance	$7.6	$187.9	$385.1
Total Reserves	$69.4	$451.6	$864.1
Percent of General Fund Revenues	0.5%	2.9%	5.0%