

EXECUTIVE SUMMARY

December 2011

Oregon Economic Forecast

Oregon's economic expansion has been put at risk by external factors – most notably the sovereign debt crisis and unfolding recession in Europe. Although the outlook is uncertain, the local recovery is playing out according to script so far. Oregon is growing, due in large part to healthy gains in business investment and exports. Even so, the economic expansion continues to be a disappointing one by historical standards. Spending and hiring will remain constrained for some time as households repair their balance sheets and governments make do with fewer resources.

Taken as a whole, the labor market is slowly returning to health, although many of Oregon's rural communities and low-income households have yet to share in the fruit of the economic recovery. Gradual improvement has persisted across a laundry list of labor market indicators (including the rate of hiring, hours worked per employee, claims for unemployment insurance, layoff announcements, labor force participation, the duration of unemployment and the number of help wanted listings).

If Europe's banking problems remain primarily a regional issue and do not short circuit the global flow of credit, Oregon's expansion, such as it is, can be expected to persist. Being home to a relatively small banking industry, and having few direct trade links with Europe, Oregon's economy has relatively little exposure to Europe's woes. Even so, given Europe's size and the depth of its financial problems, the threat of a renewed global recession is uncomfortably high.

Although the bulk of the current economic data points toward continued growth, the downside risks are not only mounting but coming more into focus. Most U.S. forecasters place the probability of a near term U.S. recession at or near 40 percent; with a slow and uneven recovery still being the base case. Similarly, the Office of Economic Analysis is not forecasting a recession for the Oregon economy. Nevertheless, contingency planning remains a must.

Recent Trends

Employment in Oregon in both the second and third quarters was essentially flat following a very strong start to 2011. The recent weakness can largely be attributed to public sector cuts as the private sector continues to add jobs. Overall, job growth is up 1.5 percent on the year, which ranks 13th across states.

After a rocky start in the first quarter of 2010, the private sector has added jobs each of the past six quarters, for a total increase of 36,900, or 2.8 percent. In the third quarter there were notable job increases reported in construction, computer and electronic products, information, education and health services and leisure and hospitality services. Some of the weakest private sector industries were natural resources and mining, wood products, transportation equipment, food processing and retail trade. Budget shortfalls have caught up with the public sector, with declines in all three government levels, notably local education.

Even with mounting concerns abroad (e.g. European debt issues and Chinese inflation), the U.S. economy continues to chug along, leading to more demand for Oregon's firms. As expected, investment and exports are leading the statewide expansion. Encouragingly, consumer spending remains stubbornly strong and the public sector drag has decreased the past two quarters. Nevertheless, overall employment growth remains slow, with governments and housing-related industries unlikely to add a significant number of workers any time soon.

OEA forecasts an employment increase of 0.6 percent in the fourth quarter of 2011 and 1.4 percent in the first quarter of 2012. Job gains will remain subdued in 2012, improving at a 1.3 percent pace, following 1.5 percent gains in 2011.

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 growing pessimism and uncertainty felt among economic forecasters has yet to be reflected in Oregon's personal income tax collections. Personal income tax revenues have grown at double-digit rates for more than a year, and have shown few signs of slowing down so far this fall. Strength in personal income tax collections is more than making up for weakness in

corporate income tax collections and lottery transfers. Overall, Oregon's recent growth in tax revenues ranks among the top handful of states, with only energy producing regions faring better.

Heading into 2012, many of the factors supporting Oregon's strong revenue gains will go away. Not only has growth in employment and wages slowed, many nonwage forms of taxable income are weakening as well. The declines in stock prices and business income seen at the end of the summer will lead to less growth in taxable capital gains and bonuses this year. Also, 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, have been heavily tapped, and will weaken going forward.

Given these challenges, revenue growth is expected to be cut in half in the months ahead. Income tax collections are expected to increase by roughly \$600 million over the current biennium, matching the growth seen in fiscal year 2011 alone.

As such, the current outlook is only marginally more pessimistic than the September forecast. However, the risks to the outlook are clearly skewed to the downside. There is at least a one in three chance that the U.S. economy will slip back into recession, which would certainly drag Oregon's regional economy down with it. In such a scenario, the forecast for tax revenues would fall on the order of \$1 billion.

After the smoke clears, 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

Led by personal income tax collections, general fund revenues are posting large gains entering the 2011-13 biennium. Temporary factors will help support healthy growth in personal income tax collections in the near term, but growth in collections will lose a steam in the second half of the biennium. Corporate tax collections are now falling rapidly, with the boom in underlying corporate profits having come to an end.

Largely due to a weaker outlook for global demand, expected revenues for the 2011-13 biennium are somewhat weaker than what was predicted in the September 2011 forecast. The forecast for General Fund revenues for 2011-13 is now \$13,732 million. This represents a decrease of \$84.3 million (-0.6%) from the September 2011 forecast.

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Table R.1

2011-13 General Fund Forecast Summary					
(Millions)	2011 COS Forecast	September 2011 Forecast	December 2011 Forecast	Change from Prior Forecast	Change from COS Forecast
Structural Revenues					
Personal Income Tax	\$12,193.6	\$12,035.1	\$12,001.4	-\$33.7	-\$192.2
Corporate Income Tax	\$894.2	\$875.5	\$821.4	-\$54.2	-\$72.9
All Other Revenues	\$944.2	\$928.8	\$932.3	\$3.6	-\$11.9
Gross GF Revenues	\$14,032.0	\$13,839.4	\$13,755.1	-\$84.3	-\$276.9
Administrative Actions ¹	-\$23.1	-\$23.1	-\$23.1	\$0.0	\$0.0
Legislative Actions	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net Available Resources	\$14,008.9	\$13,816.3	\$13,731.9	-\$84.3	-\$276.9
Confidence Intervals					
67% Confidence	+/- 7.8%		\$1,068.0	\$12.69B to \$14.82B	
95% Confidence	+/- 15.5%		\$2,136.0	\$11.62B to \$15.89B	
1 Reflects cost of cashflow management actions, exclusive of internal borrowing.					

The forecast for the 2011-13 biennium is now \$277 million below the Close of Session forecast. Given the strong employment gains seen at the time, the Close of Session forecast was somewhat more optimistic than other recent forecasts produced before or since.

Personal Income Tax

Personal income tax collections were \$1,236 million for the first quarter of fiscal year 2012, \$28.9 million (2.0%) above the latest forecast. Compared to the year-ago level, total personal income tax collections were up 12.0% relative to a forecast of 9.8% growth. Table B.8 in Appendix B presents a comparison of actual and projected personal income tax revenues for the fourth quarter of fiscal year 2011.

Although personal income tax collections have been tracking ahead of projections for several months, the forecast for total personal income tax receipts during the current biennium was reduced by \$34 million from the September forecast. This small revision can be traced to weaker expectations for growth, and disappointing recent job counts.

Corporate Income Tax

Corporate income taxes equaled \$121 million for the first quarter of fiscal year 2012, \$12.0 million below the September forecast. Quarterly corporate receipts were 7.9% lower than figures from a year ago. Table B.8 in Appendix B presents a comparison of actual and projected corporate income tax revenues for the fourth quarter of fiscal year 2011.

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. The expectation for a sharp correction in

corporate income tax collections over the coming year has been built into recent forecasts. With collections tracking behind the forecast, and a weaker profit outlook, particularly among financial institutions, the decline in corporate income taxes is now expected to be more pronounced. As a result, the September outlook for 2011-13 was revised downward by \$54 million (6.2%).

Non-income Tax Sources of Revenue

All other revenues will total \$932 million for the biennium, an increase of \$4 million (0.4%) from the prior forecast. Downward revisions to the outlook for cigarette taxes and criminal fines and assessments were offset by a stronger outlook for court fees and a recently enacted bottle surcharge for alcohol.

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 2009-11		Forecast 2011-13		Forecast 2013-15		Forecast 2015-17		Forecast 2017-19		Forecast 2019-21	
	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg
Personal Income Taxes	10,467.2	3.7%	12,001.4	14.7%	13,689.5	14.1%	15,526.3	13.4%	17,306.3	11.5%	19,137.9	10.6%
Corporate Income Taxes	827.6	20.9%	821.4	-0.8%	1,070.0	30.3%	1,079.8	0.9%	1,092.3	1.2%	1,164.2	6.6%
All Others	318.2	-63.1%	932.3	193.0%	907.8	-2.6%	953.6	5.0%	1,011.7	6.1%	1,087.2	7.5%
Total General Fund	11,613.1	-0.2%	13,755.1	18.4%	15,667.3	13.9%	17,559.7	12.1%	19,410.3	10.5%	21,389.3	10.2%
<i>Kicker Distributions</i>	-		-		-		-		-		-	
Total Revenue	11,613.1	-8.7%	13,755.1	18.4%	15,667.3	13.9%	17,559.7	12.1%	19,410.3	10.5%	21,389.3	10.2%

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 \$15,667 million in 2013-15, an increase of 13.9% percent from the prior period, and \$265 million (1.7%) below the September forecast. In 2015-17, revenue growth will moderate to 12.1%, followed by 10.5% growth in 2017-19 and slower rates of around 10% to 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 September forecast, largely due to the downgraded outlook for global demand. Table B.2 in Appendix presents a more detailed look at the long-term General Fund revenue forecast.