

## **B. International Review and Outlook**

### **Introduction**

After falling for the previous four quarters, GDP for the 30 country area covered by the Organization for Economic Cooperation and Development (OECD) stabilized in the second quarter of 2009. From the first quarter of 2009 to the second quarter, GDP fell only 0.002 percent following the first quarter decline of 2.1 percent (non-annualized rate.) Year-over-year, second quarter GDP in 2009 is 4.6 percent lower than in the same period in 2008. Within the OECD countries, there is substantial variation ranging from France, down 2.6 percent, to Japan, down 6.5 percent, with the United States falling between these figures at 3.9 percent.

Similar to global GDP, international trade has stabilized in the past few months and even shown modest improvements. The combination of high oil prices increasing transportation costs through much of 2008 followed by the worldwide financial crisis, crippled international trade. The ensuing global recession dealt a final blow as it destroyed what was left of consumer demand in the world's largest economies. This series of events over the past 18 months wrecked havoc on economic activity, especially in export-dependent countries such as Germany, Japan and South Korea. As a result, these countries experienced a much deeper economic contraction than less export-dependent countries. However, as consumer demand begins to stabilize, many export-heavy economies are beginning to grow again. For example, after contracting over 8 percent (peak-to-trough GDP), Japan's economy grew an annualized 3.7 percent in the second quarter, partially due to increased export demand, which improved 6.3 percent.

Due to the increasingly globalized supply chain, in which intermediate goods are constantly exported and imported across countries and regions over the course of the production process, export-dependent countries began experiencing the recession sooner and deeper than other advanced economies. Recent research out of Dartmouth College and the World Bank indicates that globalization of the supply chain increasingly amplifies economic fluctuations for manufacturing economies. During the 1960s and 1970s, a one percentage change in GDP resulted in trade changing by roughly two percent. In the 1990s, the measure increased to 3.4 percent and in the 2000s it is approximately 3.7 percent. One reason is that during recessions, purchases of goods decrease more than purchases of services. Services make up a larger percentage of GDP, while goods make up a larger percentage of trade. Additionally, businesses tend to source more locally during downturns due to trust and financing issues.

Furthermore, as consumer demand faltered, business drew down their existing inventories and did not place new orders with their manufacturers. Now, as consumer demand begins to stabilize, businesses have very lean inventories that need to be replenished. This inventory correction has increased GDP in large, net exporting countries already and is expected to do so in most other economies in the second half of 2009. Moving forward, two issues need to be addressed to sustain and fuel any economic recovery, no matter how feeble it may be. First, private consumer demand must stabilize and, ideally, increase. Public sector stimulus packages have increased short term demand; however

these packages are due to run out in the coming year or two. Second, in order to produce stable and sustainable economic growth, some international imbalances need to be corrected. Large, net exporters need to increase domestic demand in order to lessen exposure to economic fluctuations in the United States and much of continental Europe. Conversely, the economies of the United States and continental Europe need to increase savings and decrease consumption to rebalance their economies to ensure future economic growth.

### **Recent Developments and Outlook for Oregon Export Markets**

The Economist continues to purport that the Asian economies will have the first and strongest economic recoveries due to the inventory correction worldwide and increased domestic demand. South Korean consumer spending increased 14 percent on an annualized basis, partially due to increased low-income support and a large tax cut on automobile purchases, similar to the U.S.'s "Cash for Clunkers" program. Likewise, increased demand from China spurred an over 50 percent increase in exports in the second quarter. Additionally, many Asian countries' stimulus packages are larger than their western counterparts and will be sustained over a longer period as well. The added government demand in addition to efforts to increase private demand, should lead to a stronger economic recovery for much of Asia.

Japan's economy expanded for the first time in over a year in the second quarter. The 3.7 percent increase, on an annualized basis, follows the 11.7 percent decrease in the first quarter and 13.1 percent decrease in the fourth quarter of 2008. While the most recent GDP figures are certainly a sizable and positive development, Japan has experienced the worst economic contraction of any advanced economy. The second quarter increase only recouped roughly 10 percent of the economic activity lost over the prior year, and Japan's current GDP is approximately equal to its 2003 size. Consumer prices remained in the negative range for the first half of 2009, even after excluding food and energy, raising the expectations of another deflationary period for the country. On the bright side, industrial production increased nearly 40 percent quarter-over-quarter and many of the country's major automobile and electronic companies have performed well in recent months. For instance, Toyota recently revised upward the company's forecast for automobile sales in 2009, even prior to the implementation of the U.S.'s Cash for Clunkers program. Preliminary data from the program indicates the most popular company being Toyota and the number one vehicle of choice is the Toyota Corolla, slightly ahead of the Honda Civic, produced by another Japanese company. While the near term economic picture in Japan is improving, numerous long term issues remain. The unemployment rate is near the all-time high, the country has the largest debt to GDP ratio of advanced economies and the country is facing significant demographic constraints. The working age population is projected to shrink by 9 percent over the next decade, while the country is encouraging recent immigrants to return to their home countries. Overall, as a significant net exporter, Japan must work toward rebalancing its economy by relying less on foreign consumer demand and boosting domestic demand. However, the aforementioned issues provide difficult challenges for the country in the medium to long term.

China's economy expanded 7.9 percent, year-over-year, in the second quarter, which is a sizable increase relative to the 6.1 percent growth in the first quarter. Due to the recent positive data, many private forecasters have raised their forecasts for China's economy in the coming year. It is now believed that China will hit their government set target of full-year economic growth of 8 percent. It is widely cited that the Chinese economy needs to increase at 8 percent to incorporate the continued influx of rural migrants to the urban and manufacturing centers along the eastern seaboard and to avoid civil unrest. While China only reports GDP figures on a year-over-year basis, like most developing countries, it is estimated that on a quarter-over-quarter basis, the Chinese economy expanded 15-17 percent from the first quarter to the second quarter. This development has raised the probabilities that China will experience a V-shaped rebound after slowing in late 2008 and early 2009. The Shanghai stock market is up approximately 75 percent, partially a reflection of the easing lending practices of government-run banks. These banks issued two times the volume of loans in the first half of 2009 compared to the prior year as the government tries to boost domestic demand. The combined effect of the \$585 billion stimulus package and significant reduction in lending restrictions has propelled domestic consumption to increase substantially in recent months. From a global perspective, these practices are sorely needed to help rebalance the global economy. Increased domestic consumption for large net exporters, like China, will help stabilize its economic growth and allow countries running negative current accounts to boost their savings and investment rates. The largest immediate concern for the Chinese economy is the prospects of it overheating, either due to asset bubbles or high inflation. With low interest rates around the globe, investors are looking for new opportunities with high rates of return. The possibility exists that a continued influx of money into the Chinese economy may have dire effects in the future.

Europe, which has fared worse than many other regions in the world, is beginning to show improvements in a few countries, mainly Germany and France, while other countries continue to contract. This raises complicated issues of a two-track economy with myriad political bodies yet one shared currency in the 16 country Eurozone. Monetary independence has helped lessen the blow for some European countries, while major Eurozone economies like Spain and Italy would greatly benefit from being able devalue their currency given the fact these countries continue to contract. Overall, the Eurozone GDP fell 0.4 percent in the second quarter (annualized rate). This small contraction was a result of Germany and France's 1.2 percent expansion. As these two countries continue to grow and the Euro appreciates, the European Central Bank will begin tightening monetary policy. This tightening will undermine the other fragile economies within the Eurozone. Furthermore, the possible \$283 billion in bad loans that may need to be written off, according to the ECB, could hamper future economic growth. Elsewhere in Europe, the U.K. economy remains in recession through the second quarter, when it declined 3.1 percent (annualized rate). However, the Bank of England is now forecasting positive GDP growth for the second half of the year, after five consecutive quarters of decline.

While Canada largely missed the beginning of the Great Recession, a result of its sound banking system that avoided many of the perils of its U.S. counterparts, the economy has

now contracted 3.7 percent in the fourth quarter of 2008 and 5.4 percent in the first quarter of 2009 (annualized rates). It is expected that second quarter GDP numbers, when released, will show a further fall of 3.0 to 3.7 percent based on private forecasters' estimations. So far, the country has had the least severe recession in the advanced world, falling only a cumulative 2.3 percent through the first quarter. The recent declines are attributable to global consumer retrenchment and lower commodity prices for Canada's exports. Year-over-year in June, exports fell 33 percent and imports decreased 23 percent. The Bank of Canada is currently forecasting a 2.3 percent decline for full-year 2009 GDP with a strong rebound in 2010 at 3 percent. With positive quarterly growth expected in the third quarter, this recession would mark the shortest Canadian recession since 1957, at a length of only three quarters. With American consumers purchasing 80 percent of Canadian exports, the country will largely ebb and flow along with the U.S. moving forward.

Table I.1 shows Global Insight's (GI) country specific economic forecast as of July 10, 2009. It is the global forecast, GI cites some issues to watch to gauge future trends of the global economy. First, countries that aggressively fought to stabilize financial markets will recover sooner and stronger. Second, economic recovery will be uneven across the globe as some countries remain in recession while others have already begun to grow. Countries especially hit hard by credit bubbles will face protracted adjustments.

GI's July 2009 global forecast details the current global crises and issues facing the global economy as it will remain below potential growth through at least 2010. The resurgence in commodity prices is raising inflation concerns, however some of these gains are premature. Investors remain optimistic about future demand growth relative to current market conditions. GI expects downstream inflation to remain subdued for several years. It is good news that several major economies – Japan, Germany, China – have responded positively to the significant monetary and fiscal stimuli, but future growth may remain weak given lackadaisical external demand.

Table I.2 summarizes the Blue Chip Consensus forecast (August 2009) for Oregon's major export markets. It is

**Table I.1**

**Projected Growth Rates of Real GDP (Percent)**

As of 7/10/2009	(Average)			
	2008	2009	2010	2011-14
United States	1.1	-2.8	1.5	3.1
Canada	0.4	-2.3	2.3	3.2
Japan	-0.7	-6.8	0.9	2.8
Eurozone	0.6	-4.6	0.1	1.7
Mexico	1.4	-6.0	2.4	3.2
South America	4.9	-1.0	2.6	4.4
Asia except Japan	5.7	3.2	5.7	7.2
China	9.0	7.2	8.3	9.2
World	2.2	-2.6	2.0	3.8

Source: Global Insight, July 2009

**Table I.2**

**Projected Growth for Top U.S. Export Markets**

Ranked by \$ Value of U.S. Goods Exported	Oregon Exports 2008	Projected Change in Real GDP				
		Rank (\$ mil.)	2007	2008	2009	2010
Canada	1	2,801	2.7	0.5	-2.2	1.8
Mexico	8	748	3.3	1.3	-6.2	2.8
Japan	3	2,016	2.4	-0.7	-6.2	1.3
United Kingdom	13	338	3.0	0.8	-4.1	1.0
China	2	2,469	11.6	9.1	7.7	8.6
Germany	10	400	2.6	1.0	-5.7	1.0
South Korea	5	1,253	5.0	2.6	-2.3	2.8
Netherlands	11	396	3.5	1.8	-4.1	0.9
Taiwan	6	1,111	5.7	-0.7	-4.7	3.0
France	16	295	2.1	0.7	-2.8	1.0
Singapore	15	327	7.7	1.1	-5.4	3.5
Belgium	24	120	2.6	1.2	-3.3	0.7
Hong Kong	14	338	6.4	3.0	-4.0	3.0
Australia	12	345	4.0	2.1	-0.5	1.4
Brazil	17	283	5.7	5.3	-0.6	3.5
Eurozone			2.6	0.7	-4.4	0.8
U.S.			2.0	1.1	-2.6	2.3

Source: Blue Chip Economic Indicators, August 2009

Oregon Export Data: WISER, August 2009

consistent with the GI forecast shown in Table I.1, although more optimistic moving forward.

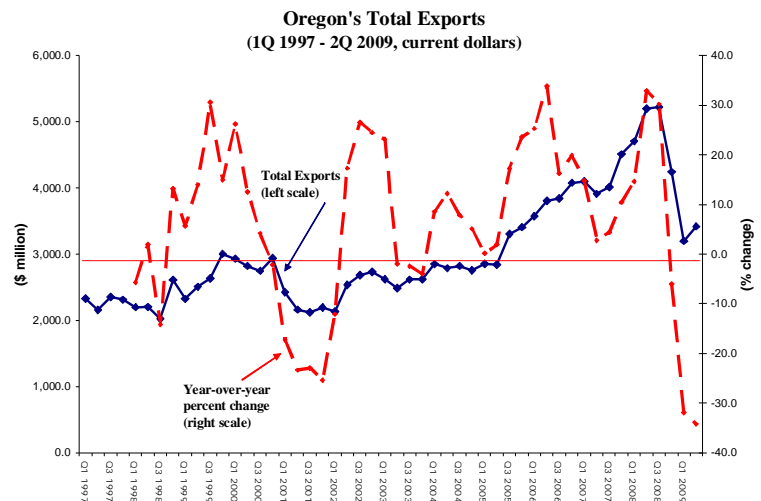
## Oregon Exports

U.S. exports continue to fall significantly through the second quarter of 2009. Exports are down 22.6 percent through the first half of the year, relative to 2008 and are at their lowest levels since the first quarter of 2006. The one bright spot is that exports have stopped declining on a monthly basis and remained relatively stable from March through June. Exports are expected to remain at depressed levels as long as the global economy continues to struggle and consumer demand is weak. The recent depreciation of the U.S. dollar will help exports as the flight to safety by investors has waned in recent months.

Just as Oregon saw stronger growth than the U.S. in recent years, Oregon is now experiencing an even deeper plunge. Through the second quarter of 2009, Oregon exports decreased 33.2 percent Y/Y. Monthly declines in April, May and June were 37.7 percent, 34.3 percent and 30.9 percent, respectively. In nominal terms, the \$3.4 billion in first quarter exports were the lowest since the quarter quarter of 2005 and represent a 6.8 percent increase Q/Q. The decline is broad-based as nearly every single industry's exports declined double digits from 2008 and the only major export industry to register gains being petroleum and coal products. Graph I.1 illustrates Oregon's total exports and the Y/Y percent change from 1997 through 2009.

Table I.3 shows Oregon's exports and growth rates by industry for the first half of 2009 (Y/Y). These are the top fifteen industries by export volume (in value). If the global economy remains sluggish, exports are expected to remain at low levels,

**Graph I.1**



**Table I.3**  
Oregon Exports by Industry  
(\$ millions, current prices)

	2008 Q2 YTD	2009 Q2 YTD	y/y % change	Share out of Total
Total All Industries	9,901.2	6,618.0	-33.2%	100.0%
Computer And Electronic Products	3,898.5	2,844.1	-27.0%	43.0%
Agricultural Products	1,660.3	946.4	-43.0%	14.3%
Machinery, Except Electrical	897.4	514.1	-42.7%	7.8%
Chemicals	493.5	459.1	-7.0%	6.9%
Transportation Equipment	796.3	363.2	-54.4%	5.5%
Primary Metal Manufacturing	376.0	248.5	-33.9%	3.8%
Waste And Scrap	315.0	191.0	-39.4%	2.9%
Food And Kindred Products	191.0	164.3	-14.0%	2.5%
Wood Products	247.6	139.9	-43.5%	2.1%
Miscellaneous Manufactured Commodities	160.4	129.8	-19.1%	2.0%
Paper	197.8	110.8	-44.0%	1.7%
Electrical Equipment, Appliances, And Component	114.1	94.2	-17.5%	1.4%
Fabricated Metal Products, Nesoi	143.6	91.5	-36.3%	1.4%
Petroleum And Coal Products	58.3	67.0	14.9%	1.0%
Plastics And Rubber Products	84.1	55.6	-33.9%	0.8%

Source: WISER, August 2009

however they are not expected to fall further from their current levels. The U.S. dollar still remains relatively strong compared to a year ago, but is expected to depreciate through the next year.

Y/Y growth is significantly negative for fourteen of the top fifteen export industries. Only petroleum and coal products managed to register positive growth – up over \$8.7 billion or 14.9 percent. The computer and electronics sector saw a steep plunge Y/Y in exports, recording a 27.0 percent decrease. Computer and electronics remain Oregon’s largest export market at 43.0 percent of total exports and on the bright side, exports in this major category increased over 30 percent Q/Q.

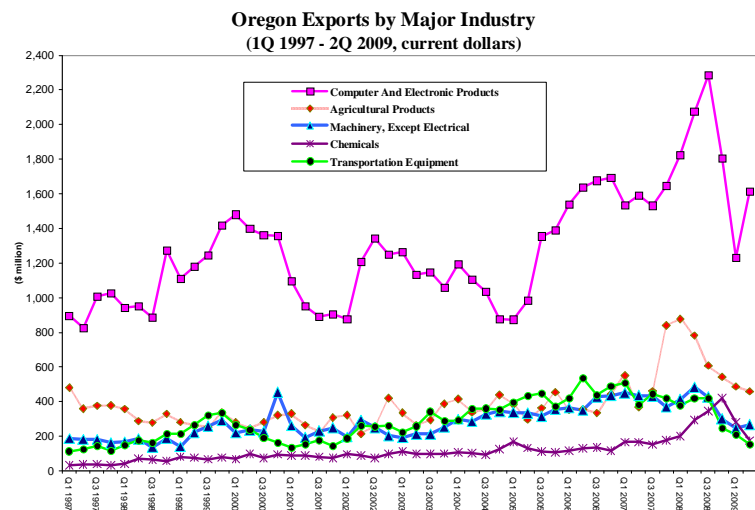
Agriculture, Machinery, Transportation Equipment, Wood Products and Paper all registered larger than 40 percent declines Y/Y, evidence of the global recession’s effect on a wide variety of industries. Similarly, Primary Metal Manufacturing, Waste and Scarp, Fabricated Metal Products and Plastics and Rubber Products all recorded declines larger than 30 percent Y/Y.

Graph I.2 illustrates quarterly exports by major industry since 1997. With a strong gain in the second quarter, computer and electronics have fallen to late-2007 levels; however they remain nearly twice as large as their dotcom recession level.

Agricultural exports, the beneficiary of the late 2007, early 2008 commodity boom, have decreased for five consecutive quarters and are now more in line with their long-run average of around \$400 million per quarter.

Table I.4 charts exports of Oregon products to major destinations. Out of the top fifteen export markets, only China and Costa Rica saw an increase in trade through the first half of 2009. Exports to China continue to increase substantially as its economy persists to outperform the other major economies in the world. Exports with all other major trading partner countries have fallen by more than 20 percent Y/Y in the first half of 2009.

**Graph I.2**



**Table I.4**

**Oregon Exports to Major Trading Partners**  
( \$ millions, current prices)

	2008 Q2 YTD	2009 Q2 YTD	y/y % change	Share out of Total
<b>Total All Countries</b>	<b>9,901.2</b>	<b>6,618.0</b>	<b>-33.2%</b>	<b>100.0%</b>
China (Mainland)	993.7	1,229.5	23.7%	18.6%
Canada	1,513.9	977.4	-35.4%	14.8%
Japan	1,089.7	689.3	-36.7%	10.4%
Malaysia	906.2	662.9	-26.9%	10.0%
Costa Rica	357.7	362.1	1.2%	5.5%
China (Taiwan)	574.5	348.0	-39.4%	5.3%
Korea, Republic Of	713.0	293.3	-58.9%	4.4%
Netherlands	213.2	190.9	-10.5%	2.9%
Germany	202.8	184.5	-9.1%	2.8%
Philippines	571.0	168.1	-70.6%	2.5%
Hong Kong	170.2	133.0	-21.8%	2.0%
United Kingdom	196.6	99.0	-49.6%	1.5%
Mexico	399.8	91.4	-77.2%	1.4%
France	158.7	85.7	-46.0%	1.3%
Singapore	181.7	71.9	-60.4%	1.1%

Source: WISER, August 2009

Graph I.3 shows the quarterly export trend for Oregon’s major markets since 1997. On a quarterly basis, exports to Canada, Japan and South Korea decreased while exports to China and Malaysia increased. From the graph, it is clear that mid-2008 saw sizable export growth to all major trading partners. Given this fact, trade data for the next few quarters will show significant declines Y/Y, relative to the previous boom. Exports to Canada have declined significantly after rising for most of the decade. Canada has historically been the number one market for Oregon exports, but China has now overtaken the top position for four consecutive quarters. These trends are expected to continue given the current state of the global economy and the relative robustness of the Chinese economy.

**Graph I.3**

