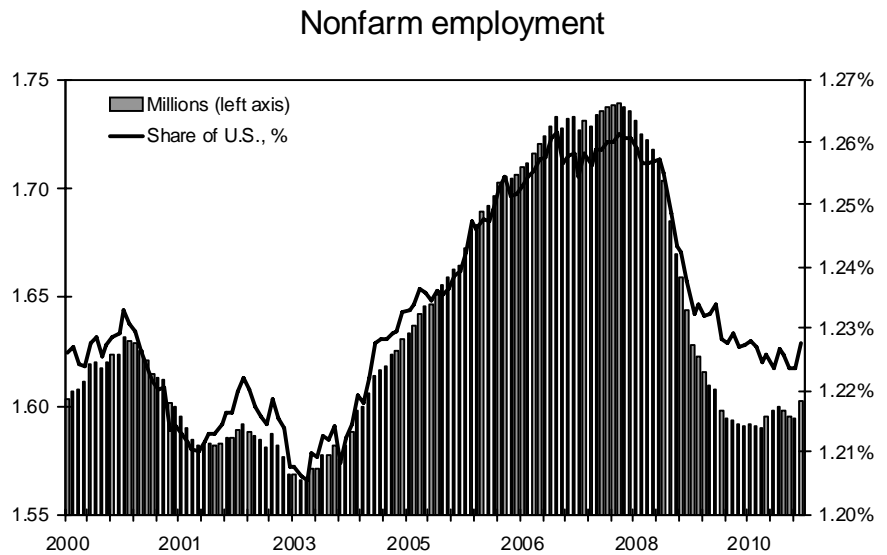


ECONOMIC PERFORMANCE AND OUTLOOK

Recent Performance

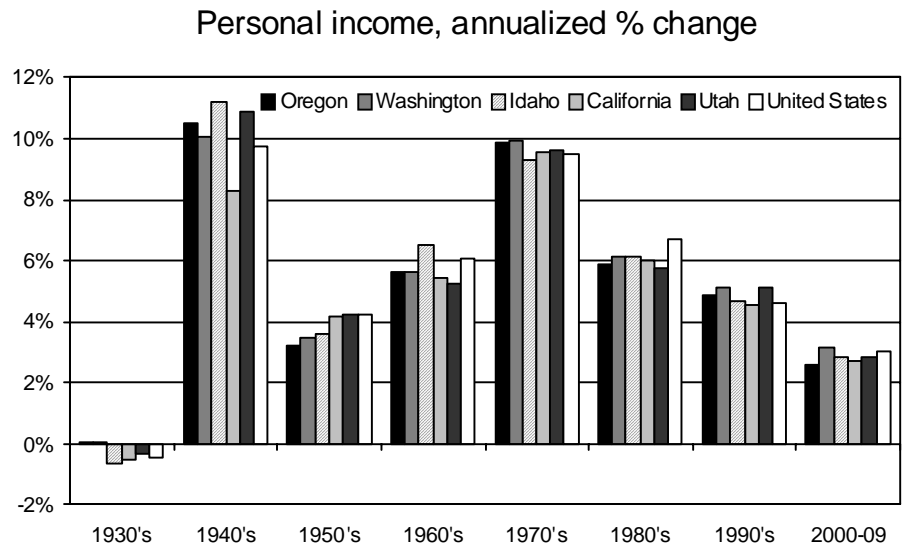
- As of fall 2010, the number of nonfarm jobs in Oregon was the same as when the decade began. Labor markets in other states have not fared any better. Although job growth over the decade as a whole has matched that seen elsewhere, employment in Oregon has gone through relatively large swings—similar to the state’s typical experience during past business cycles. Large local job gains during the middle of the decade were sandwiched between two relatively severe downturns that fully offset them (see Figure 1).

Figure 1: No Job Gains this Decade



- Per capita personal income grew at a modest 2.6 percent annual rate between 2000 and 2009. Adjusting for inflation reduces these income gains by half. The 1930’s is the only decade on record when income gains were slower (see Figure 2). Oregon’s income gains of recent years have lagged behind those seen in all neighboring states.
- The recession that began at the end of 2007 was particularly painful. By mid-2009, employment in Oregon had fallen by more

Figure 2: Disappointing Income Growth

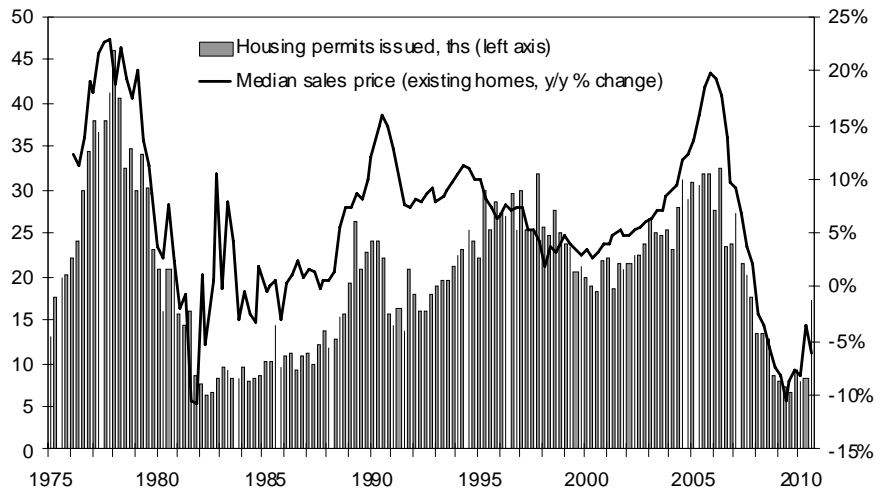


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than 8 percent from its pre-recession peak level. Of all the downturns on record, only the 1980 recession was harder on the local labor market. At that time, statewide employment fell by nearly 12 percent.

- Oregon’s severe recession and lackluster recovery have been characterized by a credit crunch among many of its firms together with sharp corrections in the state’s largest housing markets. Residential construction activity and house price appreciation have fallen to levels not seen since the timber industry restructured during the early 1980’s (see Figure 3).

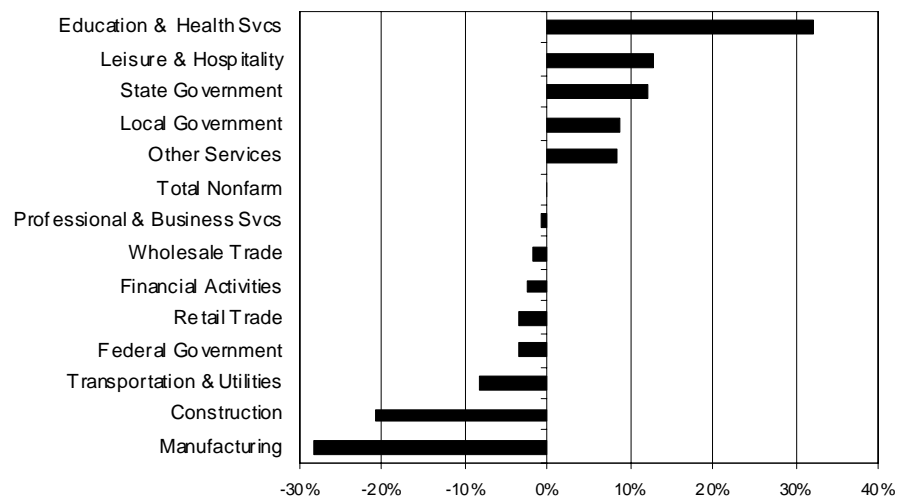
Figure 3: Housing Hits Bottom



- Across Oregon’s industries, local manufacturing firms have suffered through the largest net job reductions over the decade. Sharp recessionary job losses exacerbated the long-run structural decline of domestic manufacturing operations, resulting in a 28 percent employment decline in the industry. Despite these large losses, Oregon’s manufacturing payrolls have performed better than those elsewhere in the U.S. Nationwide, manufacturing employment has fallen by 33 percent this decade with old-line textile and vehicle operations in the Midwest and South being hit harder than Oregon’s relatively diverse and modern mix of producers (see Figure 4).

Figure 4: Expanding & Contracting Industries

Employment, percent change Jan 2000 to Oct 2010

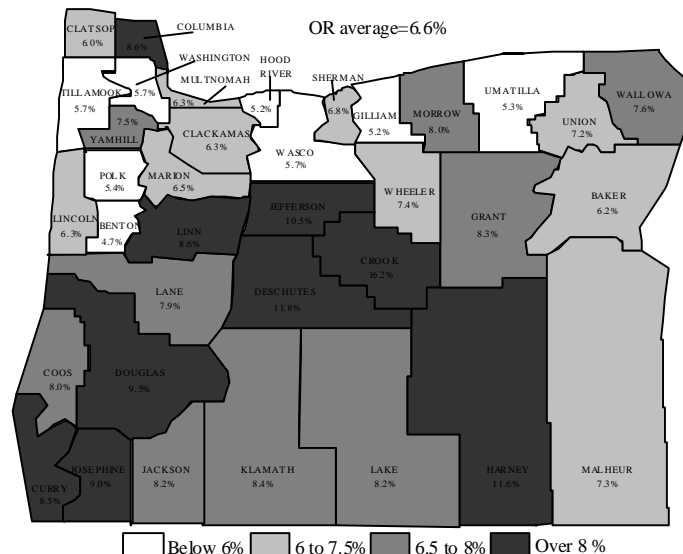


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- In addition to manufacturing operations, construction firms have also suffered from extreme job losses during the most recent business cycle, which has been characterized by imbalances in residential and commercial real estate markets. Over the decade as a whole, the number of construction jobs has fallen by 21 percent statewide. Relative to its 2007 peak level, construction employment has fallen by 37 percent.
- In general, consumer-oriented service industries and retailers for which demand is tied to population growth have fared the best over the decade. In particular, employment in education and health services has risen by 32 percent. Demand growth in education and health firms can largely be tied to demographic shifts. The baby-boom population cohort is spending an increasing amount on health services while their children are now enrolling in colleges and universities en masse.
- Although not as successful as health and education firms, most of Oregon’s consumer service industries also added jobs during the decade. Employment among leisure and hospitality firms has risen by 13 percent. Wealth losses, a weaker dollar and the terror attacks of 2001 have resulted in a larger share of entertainment budgets being spent close to home.
- Statewide, the unemployment rate more than doubled over two years from a low of 5 percent in May 2007 to 11.6 percent in May 2009. The regional pattern of job losses across the state largely matches the pattern of weakness in housing markets. Labor market conditions deteriorated the most in Central and Southern Oregon where housing corrections were most severe. In particular, the unemployment rates in Deschutes and Crook counties more than tripled during the downturn (Figure 5). Labor markets have typically held up better in counties with smaller housing bubbles and those with a large degree of exposure to agriculture. As such, many of the top performing labor markets are located in Eastern Oregon. Within the Willamette Valley, Benton and Polk counties saw the smallest increases in unemployment.

Figure 5: Rise in Joblessness Across Regions

Unemployment rate: Percentage point increase trough to peak



Source: Oregon Employment Department

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Outlook

Key Assumptions

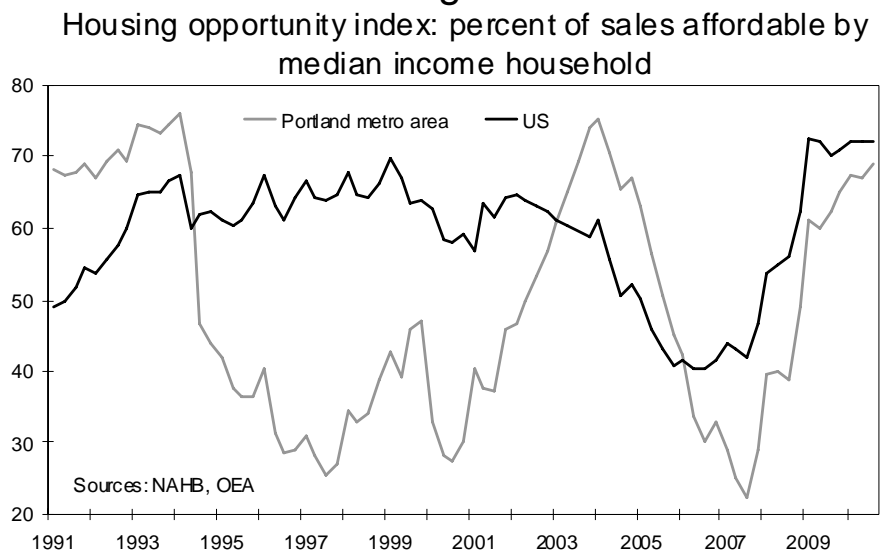
- Technically, economic recovery began in both Oregon and the U.S. as a whole during the summer of 2009. At that time, growth in output and consumption resumed, and mass layoff announcements became rare. Despite these improvements, the economy is still growing beneath its potential more than one year into the recovery, with significant job gains yet to materialize.
- As is usually the case in the aftermath of financial crises, the current economic recovery is expected to be a slow one by historical standards. Demand growth among interest rate-sensitive industries such as housing, vehicles and other durable goods often lead the way during rapid economic recoveries. This time around, relatively little boost is expected while consumers make long overdue corrections to their savings behavior, and the housing sector returns to balance.
- Consumers will not lead during the recovery. Instead, exports and business investment will fuel demand growth. Among the first industries likely to come back are professional and business services, health care services, technology manufacturing and retail trade.
- The housing sector will remain weak well into the economic expansion, and will do little to fuel growth going forward. That said, housing is no longer creating the same headwind as in recent years. Residential permitting and construction activity have likely hit bottom, as has the volume of home sales. However, house prices still have some room to fall. Prices will remain soft until excess inventories of homes are worked off. Despite a slow pace of homebuilding, inventories remain stubbornly high due largely to a growing supply of foreclosed, bank-owned, and other distressed property sales.
- In addition to housing-related industries, state and local governments will represent a drag on growth going forward. It takes several months for changing economic conditions to be fully reflected in government finances. With tax revenues still depressed, and the aid to states and localities associated with federal fiscal stimulus programs now being phased out, further contractionary state and local spending and tax policies will be required going forward.
- The impact of federal fiscal and monetary policies on the economic outlook is mixed. Federal fiscal policies are providing a decreasing amount of support to private sector growth. Federal home buying incentives and hiring of 2010 Census workers are now a thing of the past, and stimulus spending associated with the American Recovery and Reinvestment Act will fade over the next few months. While fiscal policy is no longer supporting growth, monetary policy remains very accommodating, with real interest rates near 0 percent and a second round of quantitative easing underway.
- Growth in the global economy and favorable terms of trade will help fuel U.S. exports. Exports to Asia are of particular importance to Oregon's producers. With developing countries in Asia expected to maintain above-average rates of growth, and the dollar expected to depreciate vis-à-vis the Chinese yuan, trade will continue to support the recovery going forward.

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Oregon Outlook

- Oregon's economic recovery will persist, albeit at a painfully slow rate. Job gains will remain below trend through most of 2011. After next year, trend-like job growth on the order of 2 percent per year is expected throughout the medium term. Under these assumptions, total employment will not return to its pre-recession peak level until late 2014.
- In keeping with the outlook for employment, personal income gains will remain below trend for several more months. In 2012 and beyond, personal income will grow at annual rates between 4 percent and 6 percent, matching what has been seen during past expansions.
- Oregon's industrial structure and ties to rapidly growing Asian markets position the state to join in the nationwide economic recovery. The recovery will be led by business investment and export growth. Many of Oregon's firms produce investment goods and other business inputs rather than serving consumer demand. Examples include Oregon's technology manufacturers, metal makers and commodity firms, transportation equipment producers, utilities, and its warehousing and transport firms.
- Although Oregon's labor market recovery will be a slow one relative to past business cycles, once the state gets back on its feet, it is expected to grow faster than the national average over the extended forecast horizon. Oregon's primary long-run growth advantage remains its healthy migration trends. Oregon is expected to continue to enjoy above-average population gains, including an ample flow of skilled labor to supply its growth industries.
- Oregon can be expected to attract many migrants from other states as job opportunities become more plentiful. In particular, Oregon has traditionally netted thousands of households from California whenever the local unemployment rate is lower than California's, as it is now. Oregon's relatively affordable housing remains a draw for migrants. During the peak of the housing boom, only 22 percent of houses sold in the Portland metropolitan area could be afforded by a household earning the median income level. Now, nearly 70 percent of houses sold in the area are affordable for the typical household (see Figure 6).

Figure 6: Housing Is Affordable Once Again



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Risks

- Oregon's economic recovery remains fragile, and there is a significant risk that the state will slip back into recession before job growth becomes self-sustaining. Firms have remained lean following the return of sales growth. As a result, most have seen strong growth in profits for several months. Despite widespread profitability, many firms remain unwilling or unable to expand their operations through investment or hiring. In part, small businesses are having difficulty getting access to credit. Small businesses depend on small regional banks, many of which are still repairing their balance sheets and therefore remain unwilling to lend.
- Oregon's ties to foreign markets also put it at risk. In the near term, Oregon's relatively small amount of exposure to Europe provides some degree of protection from the currency risks facing the euro zone. Longer-term, Oregon faces a good deal of risk associated with the overvalued Chinese currency and future Asian demand conditions. The local impact of the Asian financial crisis during the 1990's highlights this risk, with Oregon now even more closely tied to Asia than it was at that time.
- The performance of the housing sector remains a downside risk to the outlook. Until the wave of foreclosures plays itself out, and housing inventories return to normal, the potential for further wealth losses exists.
- A persistent lack of job opportunities puts Oregon's healthy migration trends at risk. In addition to jobs, migrants care about a wide range of factors including the quality of school systems, public safety operations and the overall cost of living. As such, any tax increases or reductions in public services that result from state and local budget problems threaten to deter migrants. Also, a lack of household mobility due to dysfunctional housing markets further threatens future population gains.
- Following the economic recovery, the reemergence of inflation poses a risk to growth. The unprecedented amount of monetary and fiscal stimulus seen in recent years will generate upward pressure on prices going forward. If these policies are combined with growth in aggregate demand and wages, inflation will once again become a significant threat.

DEMOGRAPHIC CHANGE

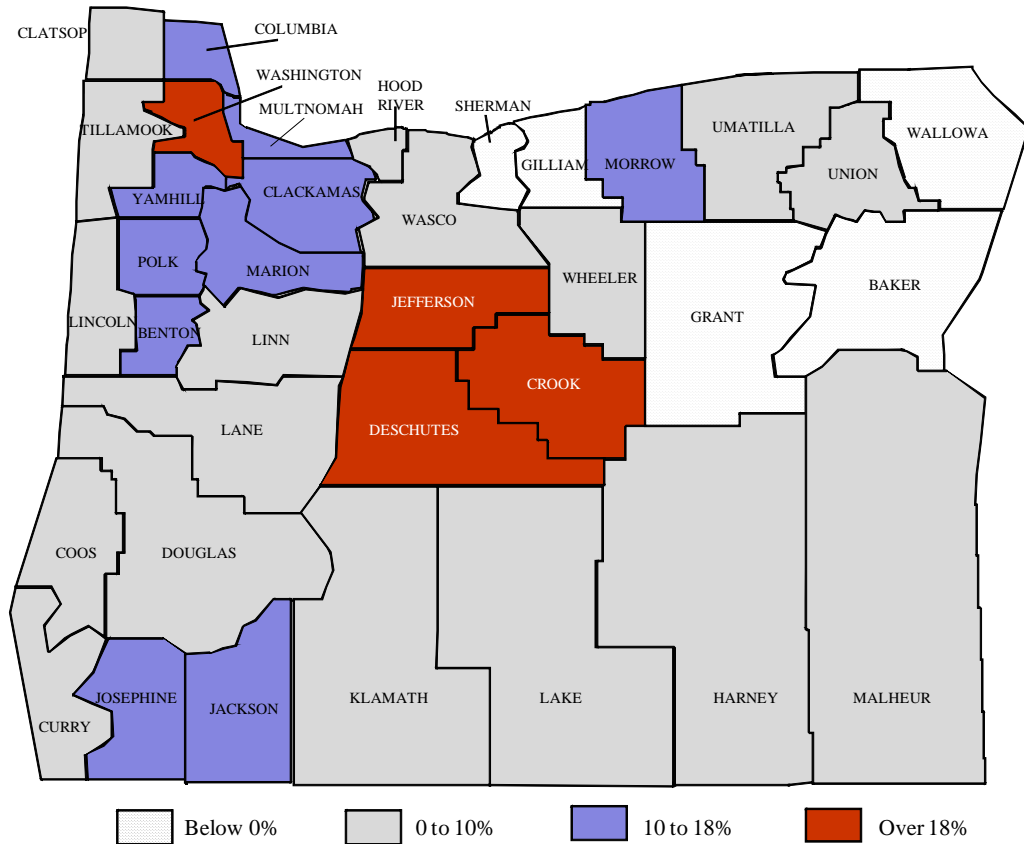
- Oregon's population reached 3.844 million on July 1, 2010, as estimated by Population Research Center of Portland State University. This is an increase of nearly 423,000 or 12.4 percent since the 2000 Census. Oregon's population growth between 2000 and 2009 was 13th highest in the nation. However, with the exception of California, Oregon's growth rate was still slower than its neighboring states. Over a long run, Oregon has retained a distinction of major destination for migrants in the United States. During the 2000 to 2009 period, nearly 68 percent of the population growth in Oregon was due to net in-migration. Oregon's population growth changes with its economic and employment outlook. Economic slowdown associated with recent recession has caused slow population growth. Population growth in the near future is expected to continue the path of slow growth in sync with the slow pace of economic recovery. Its population is expected to reach 4.142 million in 2017 with an annual rate of growth hovering around 1.1 percent.

Geographic Variations

- Figure 7 shows population growth by county between April 1, 2000, and July 1, 2010. Overall state growth was 12.4 percent during this period. However, there are large variations by region and county. High growth counties (exceeding 18 percent increase) in order of magnitude were Deschutes, Crook, Jefferson, and Washington. All three central Oregon counties experienced very rapid population growth. The moderately growing counties (between 10 and 18 percent increase) were Jackson, Morrow, Yamhill, Clackamas, Marion, Columbia, Benton, Polk, Multnomah, and Josephine. The slow growing counties (between zero and 10 percent increase) were Linn, Lane, Tillamook, Hood River, Clatsop, Douglas, Klamath, Union, Umatilla, Wheeler, Wasco, Lake, Harney, Malheur, Lincoln, Coos, and Curry. Five counties losing population (negative growth) were Gilliam, Baker, Wallowa, Grant, and Sherman. Population growth by county reflects the local economic environment. The differential population growth rates will have real geo-political consequences when 2010 Census results are released for legislative redistricting.

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Figure 7: County Population Growth, April 1, 2000 – July 1, 2010
(Oregon: 12.4 percent)



Sources: U.S. Bureau of Census 2000, and Population Research Center, Portland State University 2010 (preliminary)

Change in Age Structure

Figure 8 shows that population growth differs by age group with budgetary implications.

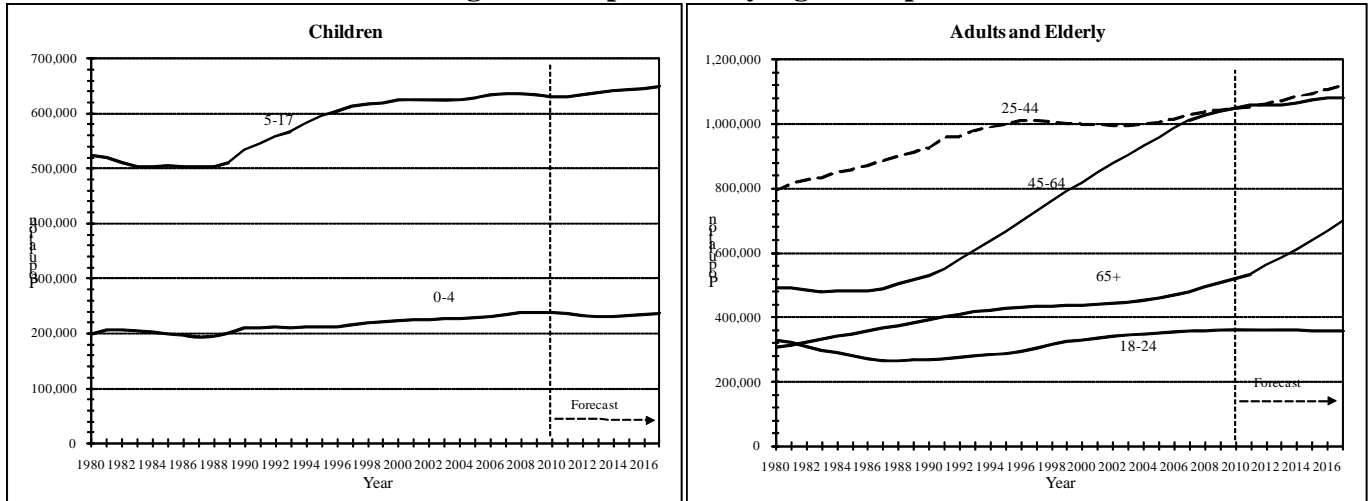
Children

- **Under five years:** The size of this age group directly affects demand for childcare, Head Start, and Temporary Assistance for Needy Families (TANF). Between 2011 and 2013 the number of children under age five will decline by 2.4 percent due to the recent decline in the annual number of births associated with an increasing tendency towards smaller family-size and slowdown in the net immigration of children and young adults at the early stage of family formation.
- **School Age:** This age group drives demand for K-12 public school enrollment. Nearly 90 percent of five to 17 year-olds are enrolled in public schools. After growing rapidly during the early 1990's, population growth in this age group has slowed for nearly a decade. After about four years of negative growth, the growth in the number of school-age children will turn positive starting in 2011. However, the percentage increase will remain well below the state's overall population rate of change. Between 2011 and 2013, the number of school-age children is expected to grow by 1.4 percent. During

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economic hardship the public schools feel added pressure when parents cannot afford private school expenses.

Figure 8: Population by Age Groups



Adults

- **Ages 18 to 24:** This age group drives demand for post-secondary education and entry-level jobs. Nearly three-fourths of all undergraduate students in Oregon public universities are 18 to 24 years old. However, college enrollment in Oregon has increased at a much faster rate than the 18-24 age population due to the lack of competing employment opportunities. Also, males in this age group are the criminally “at risk” population with the highest arrest rate of all adults. Consequently, population increase in this age group can raise demand for prison and jail beds and probation services. The growth in this population group, however, has slowed and will continue to taper off to negative territory as the “baby-boom-echo” cohort exits this age group. Between 2011 and 2013, this population will remain virtually unchanged.
- **Ages 25 to 64:** Working-age adults comprise 55 percent of the total population. The nature of this group is heavily influenced by baby-boomers. The working-age population is the major contributor to the state’s tax revenue and puts very little direct pressure on state services. However, younger adults need entry-level jobs and older adults require continued training in a changing technological environment. All of them, especially young adults, need affordable housing, childcare, and schools for their young children. Overall, this population group will grow by 1 percent between 2011 and 2013, with older working age adults 45 to 64 remaining unchanged as the early baby-boomers mature out of this age category.

Elderly

- Since 1950, Oregon’s elderly (ages 65 and over) have more than tripled, while the total population has nearly doubled. Growth in this group was slow until 2004, largely due to the depression era birth-cohort reaching retirement age. However, the trend has already started to reverse and will continue its faster pace

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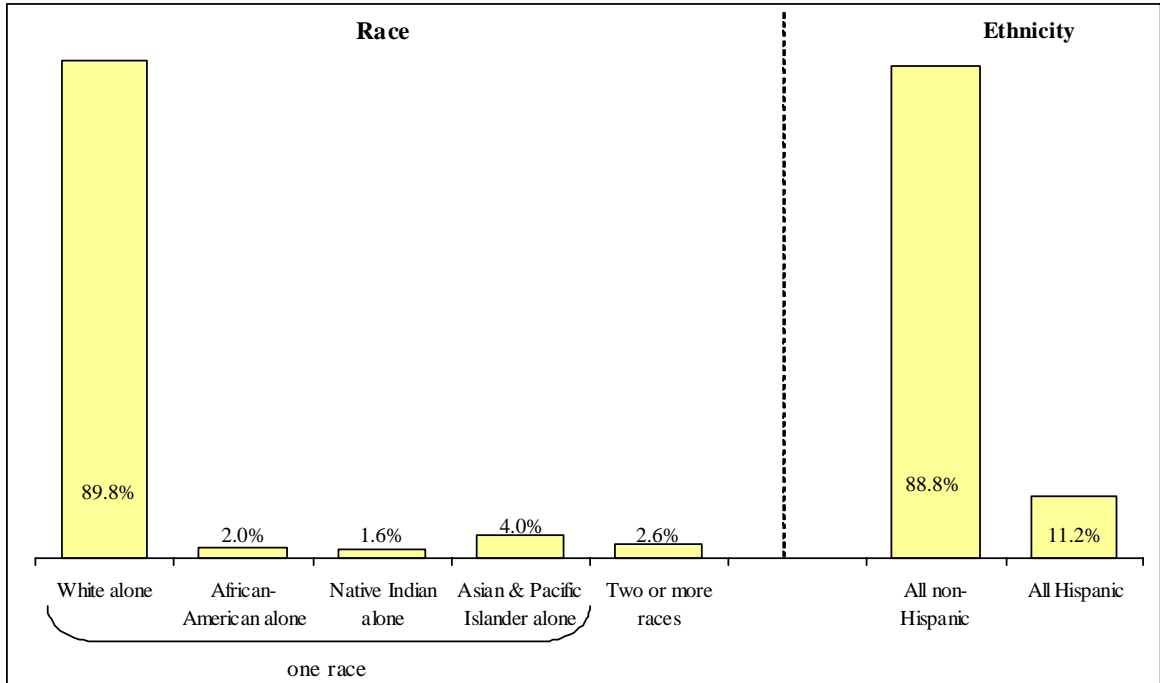
of growth. Beginning in 2011, this population group will consistently exceed four percent annual growth rate. Between 2011 and 2013, the number of young elderly (aged 65 to 74) will increase by 15.1 percent as the early baby boomers enter this age group, far exceeding the state's overall growth rate and at the fastest pace of all age groups. During the same period, the number of oldest elderly (85 plus) will increase by 3.9 percent. The number of persons aged 75-84 has just transitioned from a period of negative growth to slow but steady growth. The young elderly require relatively little government assistance, while persons aged 85 and over tend to require more public assistance. Many members of the senior population require health care, pension support, and special housing. They are highly dependent on state long-term care services. Different age groups of elderly population will manifest the effects of people born during the depression era and baby-boom period.

Race and Ethnic Composition

- Oregon has become more racially and ethnically diverse. A more diverse population entails meeting the needs of increasing racial and ethnic minorities. Oregon's population is overwhelmingly White. The Census Bureau estimated 89.8 percent of Oregon's population as of the White racial group in 2009. However, only 79.6 percent were non-Hispanic White in 2009, down from 83.9 percent in 2000 Census. Each of the other racial categories accounted for less than four percent of the population. Between April 1, 2000, and July 1, 2009, the Asian population grew by 37.2 percent and the African-American or Black racial group increased by 34 percent, much faster than 9.9 percent growth of the White population.
- The Hispanic or Latino ethnic group, which can be of any race, reached 11.2 percent of Oregon's population in 2009. This ethnic group has been increasing very rapidly. The Hispanic population increased from 112,707 in 1990 to 275,314 in 2000 Census. This ethnic group had grown to 428,469 in 2009. Between April 1, 2000, and July 1, 2009, the Hispanic population increased by 55.6 percent whereas the non-Hispanic population increased by 8.0 percent.

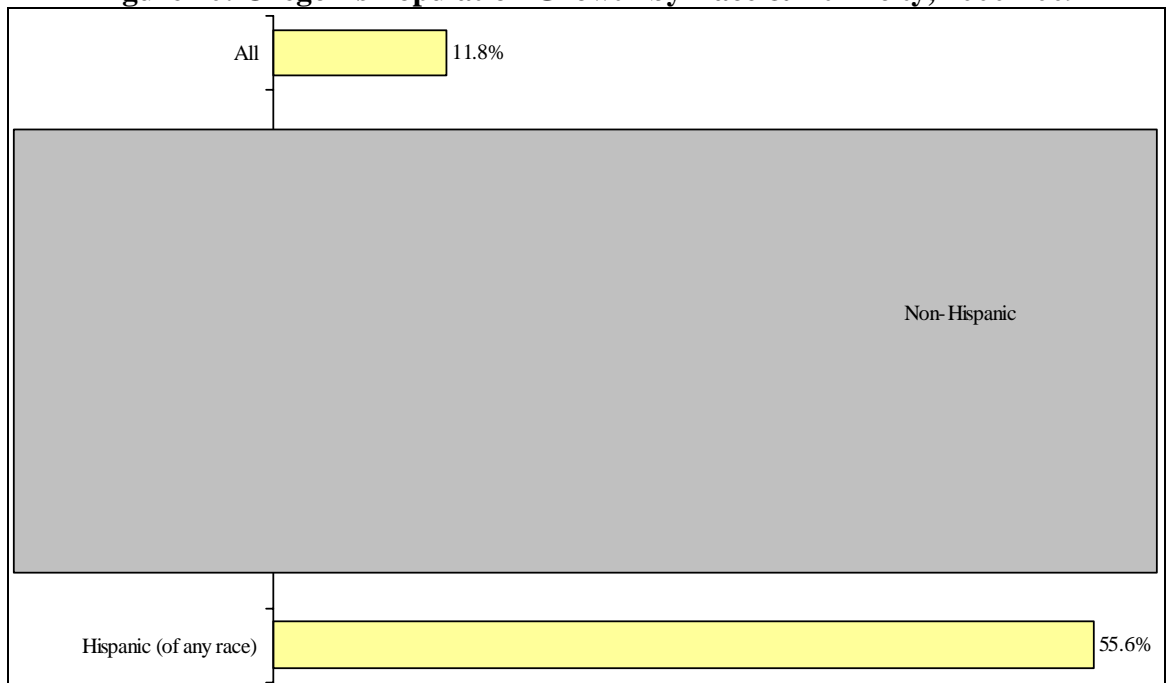
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Figure 9: Population by Race and Ethnicity, 2009



Source: U.S. Bureau of Census.

Figure 10: Oregon's Population Growth by Race & Ethnicity, 2000-2009



Source: U.S. Bureau of Census.