THE STATE OF THE ECONOMY

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Following data revisions, the economy continues to grow steadily, but slowly, in line with expectations. Gross domestic product has increased, interest rates remain low, and the unemployment rate has continued to decrease while labor force participation has also decreased. Economists continue to affirm that there is low risk of recession on the horizon.

After a seemingly slow start to the year, the United States economy has been stronger in the second quarter, with a seasonally adjusted annualized growth rate of 4.0 percent. This is in contrast to the first quarter, which saw a shrinking of 2.1 percent, however, this was largely attributed to a severe winter and inventory overhang from the end of 2013.

Unemployment continued to improve in the second quarter, decreasing from 6.7 percent to 6.1 percent. According to Federal Reserve Chairwoman, Janet Yellen, there is still much room to improve, as millions of these workers have part-time jobs but want full-time work while others have stopped looking for work. Overall consensus, however, is that the job market is improving.

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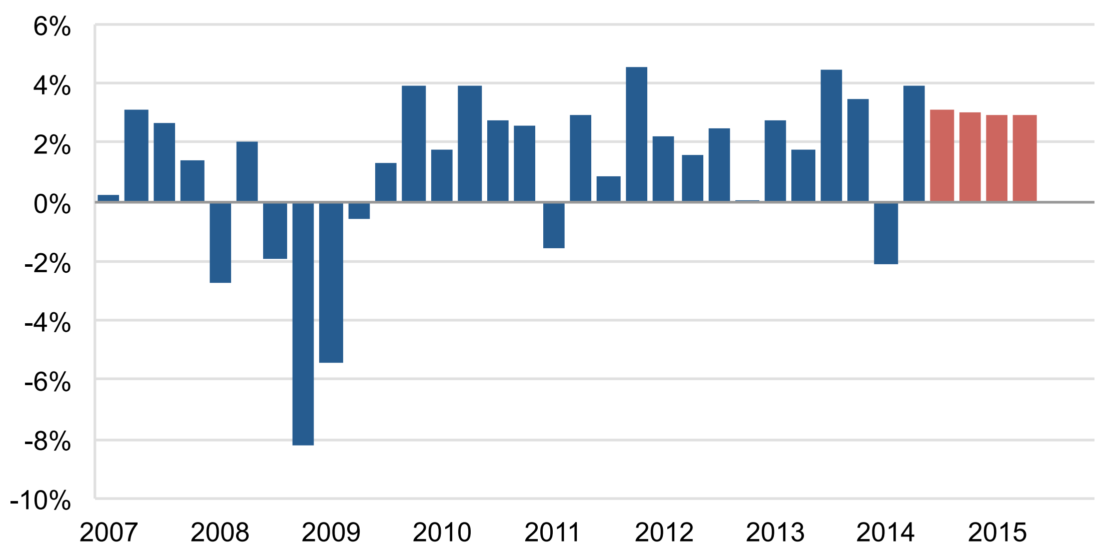
THE WORLD ECONOMY

The International Monetary Fund reports in their July update that global growth is still relatively strong for 2014 with slightly higher projections for 2015. The world economy is projected to grow by 3.4 percent, which reflects a downward revision of 0.3 percent from earlier projections. Nevertheless, the IMF projections 4 percent growth in 2015.

A large portion of world economic growth is expected to be from emerging markets. Emerging markets are projected to grow 4.6 percent, while advanced economies are expected to grow at 1.8 percent in 2014, with smaller increases projected in 2015. Many emerging economies are vulnerable to a decrease in capital investment, due to perceived or actual instability.

In China, in order to prevent a real estate bubble, officials have tapered credit growth, leading to a slight decrease in domestic demand for the world's second largest economy. According to the Wall Street Journal, the decrease in economic growth is pressuring local governments to spend their budgets quickly, and has led Chinese authorities to support policy measures that accelerate fiscal and infrastructure investment, tax relief for small and medium businesses, and lower reserve ratio requirements. The projected growth for 2014 is 7.4 percent and is expected slow slightly to 7.1 percent as the Chinese economy becomes more consumer-driven rather than export-driven.

Figure 1: Gross Domestic Product, United States, Annualized Percent Change, 2007–2015



Source: Bureau of Economic Analysis and Wall Street Journal Economic Forecasting Survey

THE UNITED STATES ECONOMY

Coming out of the first quarter with negative growth in GDP, the United States Bureau of Economic Analysis reports a relatively strong second quarter, with a growth rate of 4.0 percent (Figure 1), following the first quarter's decline of 2.1 percent. This increase primarily reflects an increase in personal consumption expenditures, private inventory investment, exports, nonresidential and residential fixed investment, and state and local government spending.

While the stronger second quarter shows positive signs, economists believe that 2014 will be another "disappointing" year for growth, according to the Wall Street Journal's survey. There appear to be no overwhelmingly positive changes on the horizon, and several potential downside risks, one being the Fed's tapering, which would lead to higher real rates.

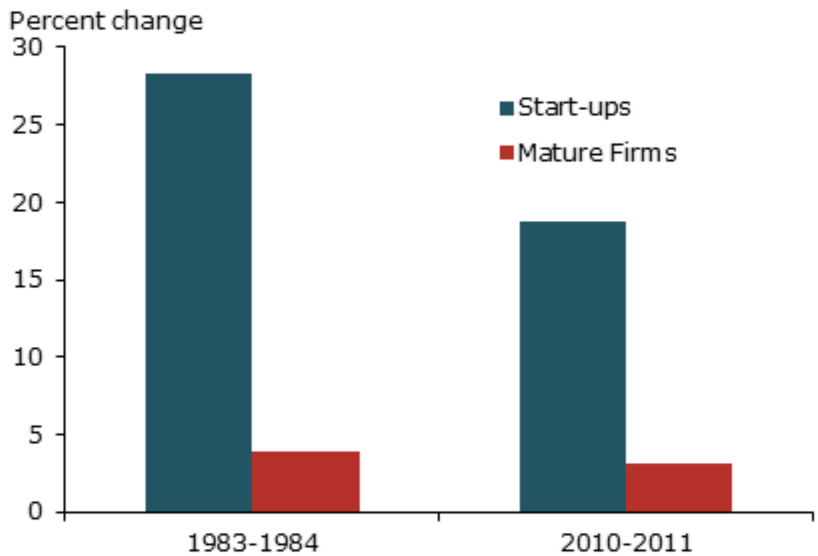
In addition to the increase in GDP, unemployment decreased from 6.7 percent to 6.1 percent in the second quarter, with 288,000 nonfarm payroll jobs added in June alone.

Industry sectors with the most absolute growth in jobs were:

- Professional and Business Services (+67,000); employment growth in this industry averaged 53,000 per month over the prior 12 months;
- Retail Trade (+40,000); employment growth in this industry averaged 26,000 per month over the prior 12 months;
- Food Service and Drinking Places (+33,000); and has increased by 314,000 over the past year;
- Health Care (+21,000); with a trend up in ambulatory health care services.

There was also modest growth in jobs in Transportation and Warehousing, Financial activities, and Manufacturing.

Figure 2: Net Growth Rates: Start-ups and Mature Firms

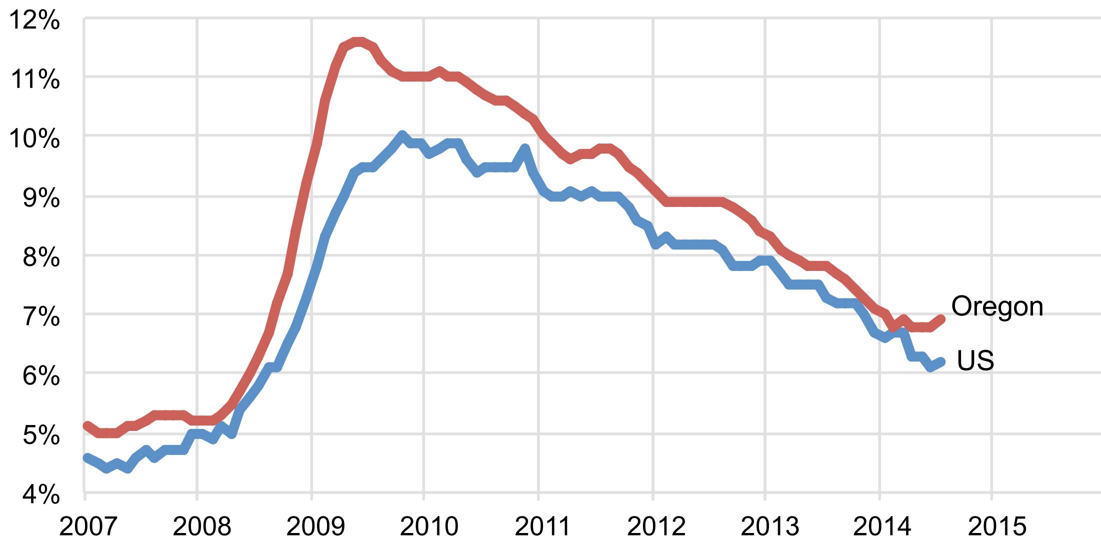


Source: Federal Reserve Bank San Francisco, BDS and calculations by Laderman and Leduc.

In analyzing the five years it has taken the job market to reach its pre-recession peak in terms of number of jobs, authors at the Federal Reserve Bank of San Francisco point out how start-ups can affect job growth rates. Historically, one of the major contributors to job creation is the flourishing of start-ups within the economy, as mature enterprises often have comparably slow job growth. The difference in growth rate is shown in Figure 2, with start-ups growing 15-20 percent faster than mature firms. However, unlike the years following the 1981-1982 recession, the growth in start-ups following the Great Recession was almost 10 percent less than the previous recovery. According to the San Francisco Fed, one potential issue could have been financing, as small business owners no longer had the same level of home equity to fund their growth and were faced with more stringent credit quality criteria. It should be noted that this is a reflective of a generally sluggish economy, and not a cause of the slower job growth.

While job growth has been steady, and unemployment low at 6.1 percent (Figure **3**), Fed chair Yellen warns that "the Fed can't put too much weight on the unemployment rate because slack in the labor market remains hidden in other forms." She goes on to reference the 7.5 million workers who work part-time but want full-time work, as well as the increasing number of people who have either retired or stopped job-searching.

Figure 3: Unemployment Rate, Oregon and United States, 2007-2015



Source: Bureau of Labor Statistics

In looking at the job growth that has occurred, and comparing it with the relatively less impressive GDP growth and inflation, the Wall Street Journal suggests a reason for this: workforce productivity is not growing very fast. On the other hand, it has been argued this is may signal an improving employment outlook. With lower productivity, employers will eventually need to hire more workers to increase output.

The New York Times suggests that the biggest factor holding back the economy has been slow wage growth. With more people out of work, there is less need to retain or attract employees with higher wages, therefore helping to reign in consumer spending, limiting housing choices and contributing across the board to a lack of aggregate demand.

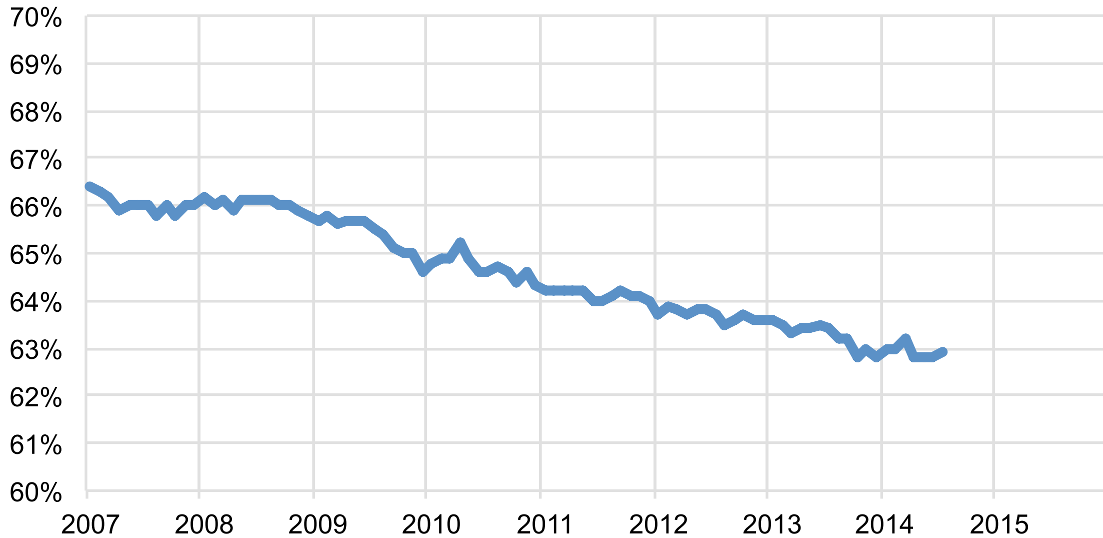
While the unemployment rate has continued to go down, the labor force participation rate has also been decreasing. Thus, the improving unemployment rate has not been entirely due to job growth, but because there are fewer people looking for jobs. Behind this decline is a complicated mystery, but could be a host of reasons, some of which are discouraged workers, baby boomers going into early retirement, double earner households becoming single earner households, the Affordable Care Act reducing the need for employment to provide healthcare.

In May 2014, the U.S. saw the highest level of inflation since October 2012, at an unadjusted 2.6 percent (

Figure 5), or 1.8 percent for seasonal adjustments from a year earlier. According to Yellen, the current June adjusted inflation of 1.2 percent is still below the

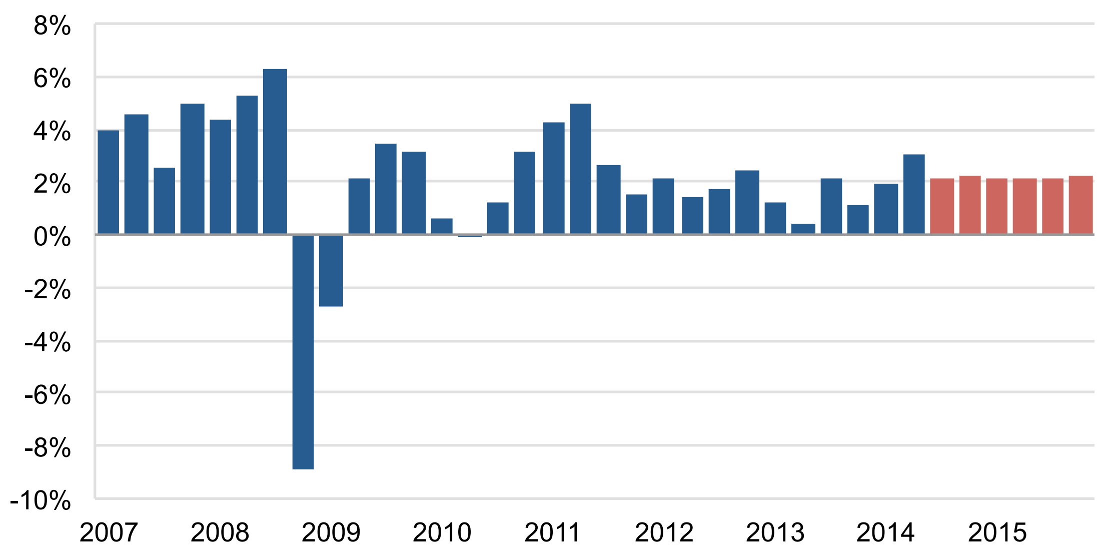
2.0 percent objective by the Fed, but this is much higher than in the first quarter. Fed officials still do not anticipate a large uptick in inflation in the near future.

Figure 4: Labor Force Participation Rate, United States



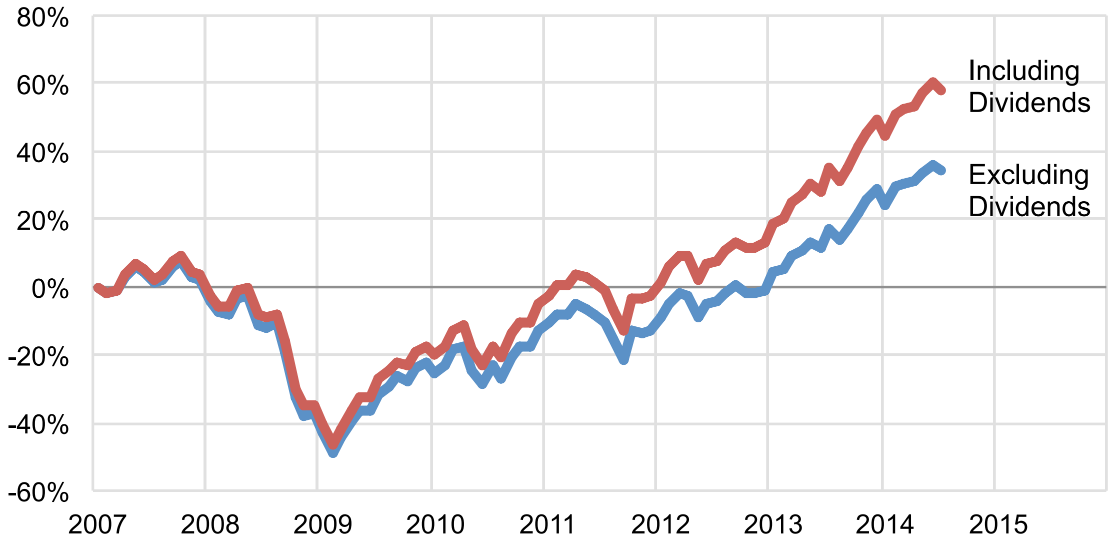
Source: Bureau of Labor Statistics

Figure 5: Inflation, Annual Change in Consumer Price Index, United States, 2007–2015



Source: United States Bureau of Labor Statistics and Wall Street Journal Economic Forecasting Survey

Figure 6: Standard & Poor's 500 Index, 2007–2014



Source: S&P Dow Jones Indices, McGraw Hill Financial

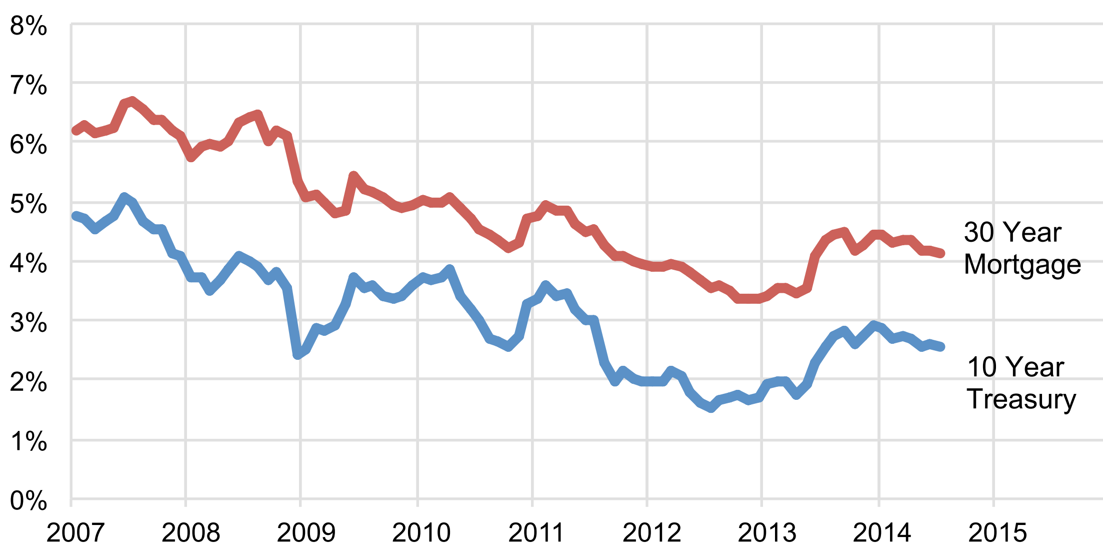
The U.S. Stock Market has continued to get stronger, with the second quarter increase much higher than the previous change in the last quarter. The Wall Street Journal reports a current second quarter increase in revenue for S&P 500 companies of 4.3 percent over the previous year, and a 7.7 percent increase in earnings, showing the fastest growth since the fourth quarter of 2013. With fixed-income yields at record lows, it is not surprising that share prices have benefitted as investors scramble for higher yields.

From

Figure **6**, it is clear much of the gains in equities has been from increasing dividends. Since 2007, the S&P 500 has grown by 34 percent. Including dividends, S&P 500 stocks have delivered a 58 percent return since 2007.

As was announced in April, the Fed decreased its monthly bond purchases to $45 billion from its previous $85 billion, with its monthly mortgage bond purchases now at $20 billion and its Treasury purchases at $25 billion. Yield rates for both 10-year Treasury bonds (2.60 percent) and conventional mortgages (4.16 percent) have dropped slightly in response, instead of rising as is expected. This is a bit of a mystery to economists, but may represent the flight of overseas investors to a relatively safe investment in the United States. While most Fed officials still do not expect interest rates to rise until 2015, the quantitative easing that has been flushing the economy with money is likely to come to end in October.

Figure 7: 10 Year U.S. Treasuries vs. Conventional 30-Year Mortgages, 2007–2014



Source: Federal Reserve Bank

Figure 8: Spread Between 10 Year U.S. Treasuries and Conventional 30-Year Mortgages, 2007–2014

Source: Federal Reserve Bank

OREGON AND THE PORTLAND AREA

The state of Oregon has continued to experience the economic acceleration in 2014 as it had in 2013. Avoiding some of the weather-related problems that slowed the economy in early 2014, the Oregon job market is at its highest level since 2006, according to the Oregon Office of Economic Analysis, with two main drivers in job growth of housing and government. These two sectors historically show job growth when the economy comes out of a recession, but were absent in the earlier stages of the recovery. This has likely increased job growth rates with these sectors “catching up.”

The OEA continues to forecast a decrease in unemployment, a steady population growth rate of 1.1 percent, and an increase in in wages and salaries in the next couple years.

In looking over the last year, the sectors of nonfarm employment that have shown the most growth are educational and health services (11.3 percent), construction (5.7 percent), professional and business services (4.7 percent) and manufacturing (2.5 percent). As is indicated in Figure , 3.8 percent of the growth in Construction in in June 2014 alone, bringing an additional 3,800 jobs as a result of the housing recovery.

In addition to Oregon’s job growth, the Bureau of Labor Statistics reports that Oregon’s unemployment rate has remained largely stable in the second quarter in the 6.9 percent range.

Figure 9: Oregon Job Growth, Nonfarm Payroll Employment, Seasonally Adjusted (thousands)

				Change From		% Change From	
	Jun-14	May-14	Jun-13	May-14	Jun-13	May-14	Jun-13
Mining and Logging	7.8	7.8	7.7	0.0	0.1	0.0%	1.3%
Construction	78.2	74.4	74.0	3.8	4.2	5.1%	5.7%
Manufacturing	179.2	178.1	174.9	1.1	4.3	0.6%	2.5%
Trade, Transport and Utilities	324.0	323.7	318.1	0.3	5.9	0.1%	1.9%
Financial Activities	91.2	91.4	91.4	-0.2	-0.2	-0.2%	-0.2%
Professional and Business Services	213.8	214.9	209.1	-1.1	4.7	-0.5%	2.2%
Educational and Health Services	252.1	248.6	240.8	3.5	11.3	1.4%	4.7%
Leisure and Hospitality	181.1	182.2	176.9	-1.1	4.2	-0.6%	2.4%
Other Services	59.8	59.5	57.9	0.3	1.9	0.5%	3.3%
Government	289.7	291.2	288.1	-1.5	1.6	-0.5%	0.6%
Total	1,710.10	1,714.40	1,670.70	-4.3	39.4	-0.3%	2.4%

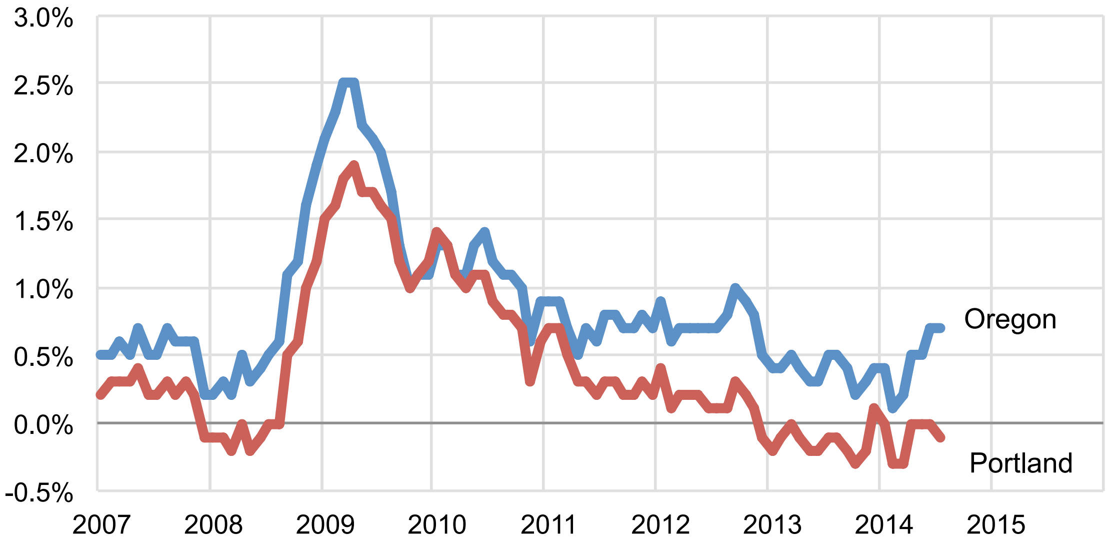
Source: Oregon Employment Department

Figure 10: Portland-Vancouver-Hillsboro MSA, Nonfarm Payroll Employment, Not Seasonally Adjusted

	Feb 2014		March 2014		April 2014		May 2014		June 2014	
Total Non-farm Employment	1,043,000		1,049,700		1,061,800		1,068,200		1,073,900	
Unemployment rate	6.4%		6.4%		6.3%		6.3%		6.1%	
Mining and Logging	900	0.0%	900	0.0%	900	0.0%	1,000	11.1%	1,000	0.0%
Construction	50,800	-0.2%	52,000	2.4%	55,300	6.3%	55,300	0.0%	56,200	1.6%
Manufacturing	116,000	0.5%	116,600	0.5%	118,500	1.6%	118,500	0.0%	119,300	0.7%
Trade, Transportation, & Utilities	194,900	-0.5%	194,300	-0.3%	195,900	0.8%	197,600	0.9%	198,800	0.6%
Information	22,700	-0.4%	22,900	0.9%	22,600	-1.3%	22,700	0.4%	23,000	1.3%
Financial Activities	62,600	0.6%	63,100	0.8%	63,400	0.5%	63,900	0.8%	64,400	0.8%
Professional & Business Services	153,100	0.4%	154,000	0.6%	158,000	2.6%	158,200	0.1%	159,500	0.8%
Educational & Health Services	154,200	2.1%	155,900	1.1%	157,900	1.3%	156,900	-0.6%	154,600	-1.5%
Leisure and Hospitality	103,200	-0.4%	105,000	1.7%	105,600	0.6%	107,800	2.1%	109,300	1.4%
Other Services	37,700	2.2%	37,600	-0.3%	37,100	-1.3%	37,500	1.1%	38,300	2.1%
Government	146,900	0.6%	147,400	0.3%	147,700	0.2%	148,800	0.7%	149,500	0.5%

Source: Oregon Employment Department

Figure 11: Unemployment Rate, Oregon and Portland Metropolitan Area vs. United States



Source: Bureau of Labor Statistics and Oregon Employment Department

In looking closer at the Portland-Vancouver-Hillsboro MSA, there has been robust employment growth of 2.9 percent over the last 12 months, far surpassing the national growth. Since March, the sectors that have brought the highest number of jobs are Leisure and Hospitality (+3,700), Trade, Transportation, & Utilities (+2,900), and Government (+1,800).

With the exception of a short time in 2008, Oregon and Portland's unemployment rate have typically trended above the national rate since 1998, that is, until December 2012, when the Portland-Vancouver-Hillsboro MSA rate fell. It has since been with equal to or lower than the national rate, with no exception in June 2014, when it ties with the national rate at 6.1 percent, a drop of 0.3 percent since March.

The Portland-Vancouver-Hillsboro MSA has typically trended above the national average, with Oregon's rate even higher. However, since December 2012, the MSA unemployment rate has remained equal or lower than the national average at 6.1 percent, dropping slightly since the previous quarter.

CONCLUSION

Overall, the national and local economy is not showing drastic signs of improvement nor further recession, and instead continues to grow steadily. Interest rates are low, unemployment rate is a little lower, GDP is expected to grow slightly, with no overwhelmingly positive changes in the near future. ■