THE STATE OF THE ECONOMY

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Oregon is continuing to experience rapidly rapid growth as job gains and wage increases for Oregon workers are outpacing the national average. The June 2016 State of Oregon Economic and Revenue Forecast projects that the state's economy is quickly approaching full employment. Such a milestone has not occurred in Oregon since 2000. Additionally, underemployment, or those involuntarily working part-time in Oregon is back to pre-recession rates. Given the ongoing economic strength in Oregon, the economic outlook has been raised relative to recent forecasts. Economists working for the state project "full-throttle" rates of growth through the end of 2017. In addition to strong job growth, Oregon average wages are at their highest point since the early 1980s recession, with much of the improvement occurring in the past two to three years.

Oregon's revenue growth has been solid and aligned with expectations; Oregon's expected General Fund revenue sources in 2015-2017 are currently within 0.2 percent of the estimated General Fund revenue forecast projected at the end of the annual legislative session. However, reflecting national trends, corporate tax collections have decreased in recent months.

Corporate tax collections have started to contract in recent months. Nationwide, corporate profits are falling, largely due to rapid appreciation of the U.S. dollar, and struggles among energy firms and other commodity producers. However, the Oregon

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Office of Economic Analysis reports that Oregon corporate tax collections remain large relative to historical norms. Corporate tax revenues are expected to exceed the 2 percent kicker threshold by $10.4 million, generating a kicker amount of $32.3 million.

Due to the better-than-expected economic activity so far in 2016 and the likely limited impact of Brexit, the IMF global growth forecasts for 2016 and 2017 were both marked down by 0.1 percentage points relative to the April 2016 outlook, to 3.1 percent and 3.4 percent, respectively. The outlook worsens for advanced economies (down by 0.1 percentage points in 2016 and 0.2 percentage points in 2017) while it remains broadly unchanged for emerging market and developing economies.

The primary global financial impact from the Brexit vote will be short and medium term uncertainty as politicians have imperceptibly begun the increasingly lengthy and complex withdrawal process. However, the Global Bank Senior figures in both Great Britain and the European Union have both admitted they have only just begun preparing for a protracted negotiation with a timeline that continues to slip further and further out. Negotiations could easily slip so that formal, face-to-face talks on substance do not being until fall 2017 or even early 2018. However, the June 2019 European Parliament elections will be a key milestone for negotiations.

Table 1: Key Economic Indicators, Portland MSA, Oregon, and US Q2 2016

	Q2 2016/ Jun-15	Q1 2016/ Mar 2015	Q4 2015/ Dec 2015
GDP Growth (annualized)			
US	1.2%	0.8%	1.4%
Unemployment Rate			
US	4.90%	5.0%	5.0%
OR	4.80%	4.5%	5.5%
Portland MSA	4.9	4.2%	4.9%
Job Growth Rate (12-mo growth)			
US	1.7%	2.0%	2.0%
OR	3.5%	3.5%	3.2%
Portland MSA	3.1%	3.3%	3.1%
Inflation (12-mo unadjusted)			
US	1.00%	0.9%	0.7%
Interest Rates			
Federal Funds Rate	0.39%	0.4%	0.2%
10-Year Treasury	1.46%	1.9%	2.2%

Sources: BEA, BLS, Federal Reserve, Oregon Employment Department

GLOBAL TRENDS

In the United States, first-quarter growth was weaker than expected, triggering a downward revision of 0.2 percentage points to the 2016 IMF growth forecast. High-frequency indicators such as Standard & Poor's Corporation and Economic Cycle Research Institute (ECRI) point to a pick up in the second quarter and for the remainder of the year, consistent with fading headwinds from a strong U.S. dollar and lower energy sector investment.

Productivity growth in most advanced economies remained sluggish, and inflation was below target owing to slack and the effect of past declines in commodity prices. Indicators of real activity were somewhat stronger than expected in China, reflecting policy stimulus, as well as in Brazil and Russia, with some tentative signs of moderation in Brazil's deep downturn and stabilization in Russia following the rebound in oil prices.

The impact of Brexit is projected to be relatively limited for the United States, as lower long-term interest rates and a more gradual path of monetary policy normalization are expected to broadly offset larger corporate spreads, a stronger U.S. dollar, and some decline in confidence

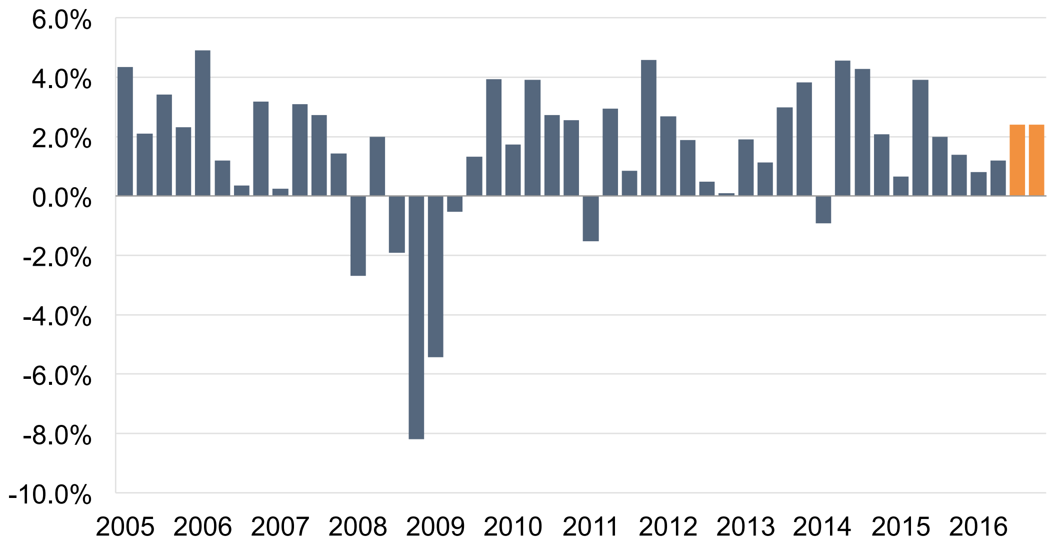
While global industrial activity and trade have been lackluster amid China's rebalancing and generally weak investment in commodity exporters, recent months have seen some pick-up due to stronger infrastructure investment in China and higher oil prices. This was projected in the IMF April World Economic Outlook forecast, in which upwardly revised forecasts of growth in China over the next two years. In China, the near-term outlook has improved due to recent policy support. Benchmark lending rates were cut five times in 2015, fiscal policy turned expansionary in the second half of the year, infrastructure spending picked up, and credit growth accelerated.

The Wall Street Journal recession odds forecast for July is at the highest point post-recession, with a 21 percent chance of an US recession within 12 months, up from a 15 percent projection in December 2015. Before Britain voted to leave the European Union last week, the majority of traders believed the Fed would raise interest rates at least once in 2016, according to Bloomberg data. Since Brexit, though, those odds have plummeted to almost zero. In fact, according to traders, the probability of a rate cut is now larger than a rate increase.

GDP/OUTPUT

Real gross domestic product increased at an annual rate of 1.2 percent in the second quarter of 2016, according to the advance estimate released by the Bureau of Economic Analysis. In the first quarter, the revised GDP figure was 0.8 percent. In previously published estimates, first-quarter GDP was estimated at 1.1 percent. The 0.3-percentage point downward revision to the percent change in first-quarter real GDP primarily reflected downward revisions to residential fixed investment, to private inventory investment, and to exports that were partly offset by upward revisions to nonresidential fixed investment, to PCE, to state and local government spending, to imports, and to federal government spending.

Figure 1: Gross Domestic Product, United States, Annualized Percent Change, 2005–2016 Q2



Source: Bureau of Economic Analysis (blue bars) and Wall Street Journal Economic Forecasting Survey (orange bars)

Overall, the Portland economy is strong, with a couple concerning data points that could impact future growth. The Portland job growth rate over the last 12 months of 2.8 percent is noticeably faster than the 1.7 percent for the United States. This growth rate is on par with many other western metro regions, such as Seattle, San Francisco and Denver.

Despite positive economic growth, two warning flags have appeared in the local data recently. First, manufacturing employment has stopped growing, while all other major industries continue to show impressive growth. State economists have also flagged a lack of job growth in the past 12 months for “Employment Services,” also known as “staffing services” or “temporary help.” This industry tends to be a leading indicator for the larger economy and is very sensitive to changes in the business cycle. However, with a 4.4 percent unemployment rate, it is possible that both industries have just stalled after so many years of strong growth.

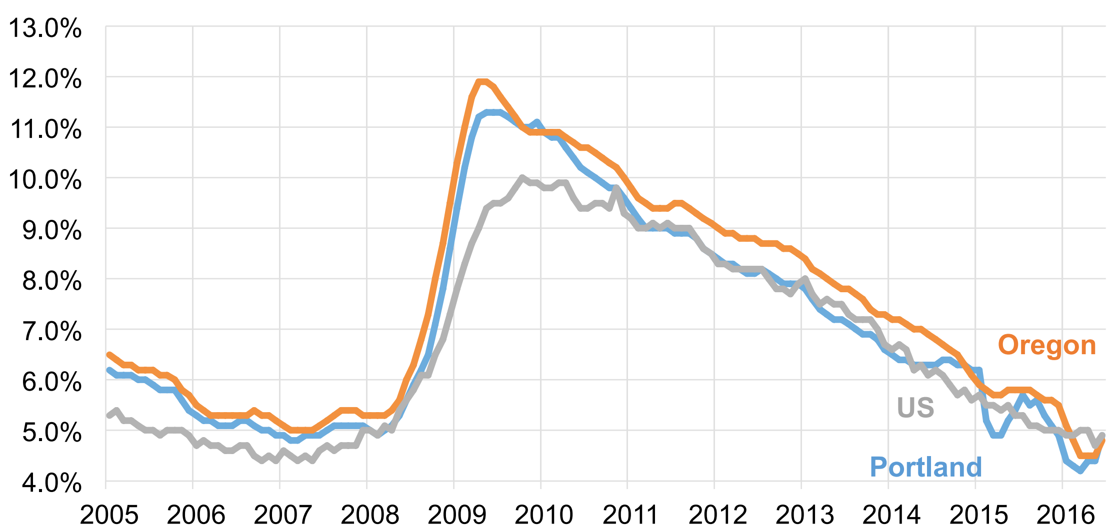
EMPLOYMENT

The Bureau of Labor Statistics (BLS) reported that total U.S. nonfarm employment increased by 287,000 in June and 442,000 for the quarter. This compares with growth of 228,000 in June 2015 and 752,000 for the first quarter of 2015. National unemployment figures remained steady at 4.9 percent, matching lows not seen since April 2008. The unemployment rate increased by 0.2 percentage point to 4.9 percent in June, and the number of unemployed persons increased by 347,000 to 7.8 million. These increases largely offset declines in May and brought both measures back in line with levels that had prevailed from August 2015 to April.

The unemployment rate for both Oregon and the Portland Metropolitan Statistical Area (MSA) increased to 4.8 percent and 4.9 percent respectively after historic first quarter lows primarily due to tightening manufacturing employment from the slumping US dollar, decreased corporate profits, and technology sector layoffs due to corporate restructuring. Despite these losses, state economists classify the state employment picture as “full-throttle,” and have dampened their projections of a recession occurring in the next year.

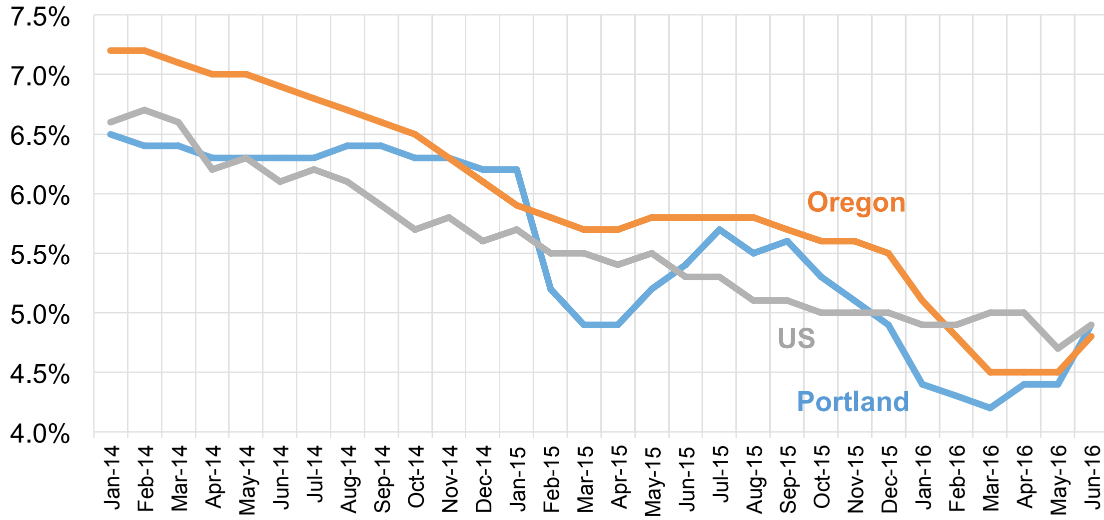
In positive news, construction is a strong growth market with one in seven new state jobs occurring in that industry. Construction added over 5,000 new jobs, with 8.9 percent growth rate. In the Portland market, construction jobs are fueled by rapid multi family building and recently escalating single family building with a projected year end output of 8,4042 single family units and 6,056 multi-family units.

Figure 2A: Unemployment Rate, Portland MSA, Oregon and United States, 2005-2016 Q2



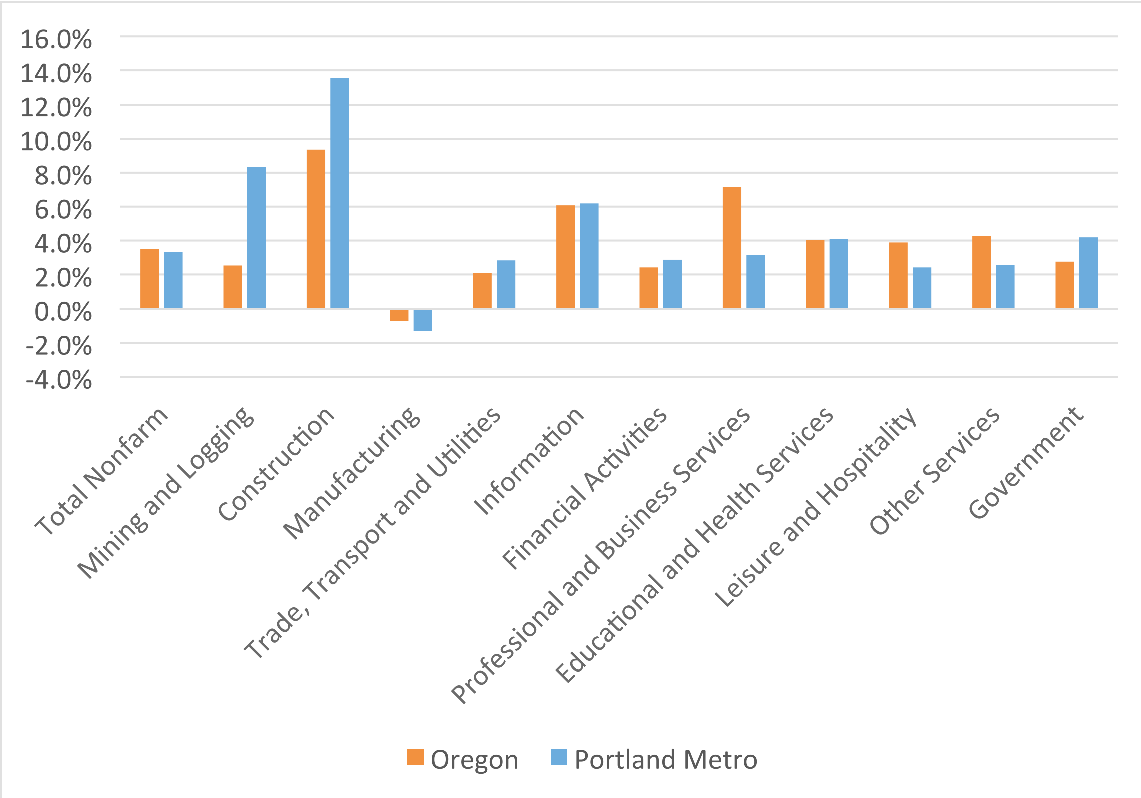
Source: Bureau of Labor Statistics

Figure 2B: Unemployment Rate, Portland MSA, Oregon and United States, Jan 2014-June 2016



Source: Bureau of Labor Statistics

Figure 3: Employment Growth Rate by Sector, Portland MSA and Oregon, 12 Months to June 2016



Source: Oregon Employment Department

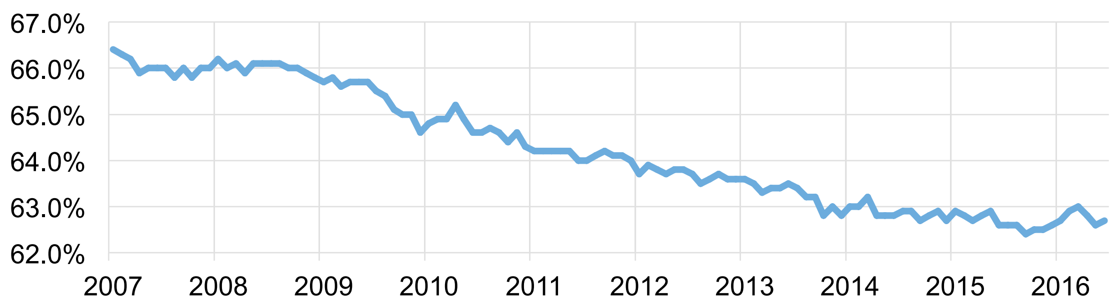
The job gains in 2015 and so far in 2016 are the best in the past two decades. Over the past two years the state has added 5,000 jobs every month, which translates into 3.5 percent growth on an annual basis. Such gains are stronger than the peak of the housing boom last decade. Only the mid-1990s boom saw comparable gains. At that time, employment gains were similar, nearly 5,000 per month, however growth rates were higher due to the smaller population and employment base.

Strong job gains have helped lead to relatively wage gains. According to Oregon's Office of Economic Analysis, "wages in Oregon are increasing at near double-digit rates, which is better than during the mid-2000s expansion but still below the 1990s gains. Average wages per worker are currently increasing 3-4 percent per year, which is faster than inflation of 1-2 percent per year. While national wage trends have just begun to accelerate in the past six to nine months, Oregon's have been strong for a couple years now."

Wage growth has been strong in the Portland MSA as well, and according to the Oregon Employment Department the metro area's hourly wage of over $19 is 14th highest among the 50 largest U.S. metro areas and 11 percent higher than the national average. As noted here the past few quarters, in the Portland MSA much of the growth in average wages has been driven by high-paying jobs, especially those in the software sector in Multnomah County.

Job growth in Oregon and Portland is expected to continue, driven by projected population growth and in-migration trends. However, the rate of growth is expected to moderate over the next two years. The Oregon Office of Economic Analysis expects job growth of 2.7 percent in 2016 and 2.6 percent in 2017, representing a slight downward revision from their prior forecast. This would translate to nearly 50,000 new jobs per year in the state over the next two years.

Figure 6: Labor Force Participation Rate, United States, 2007-2016 Q2



Source: Bureau of Labor Statistics

INFLATION

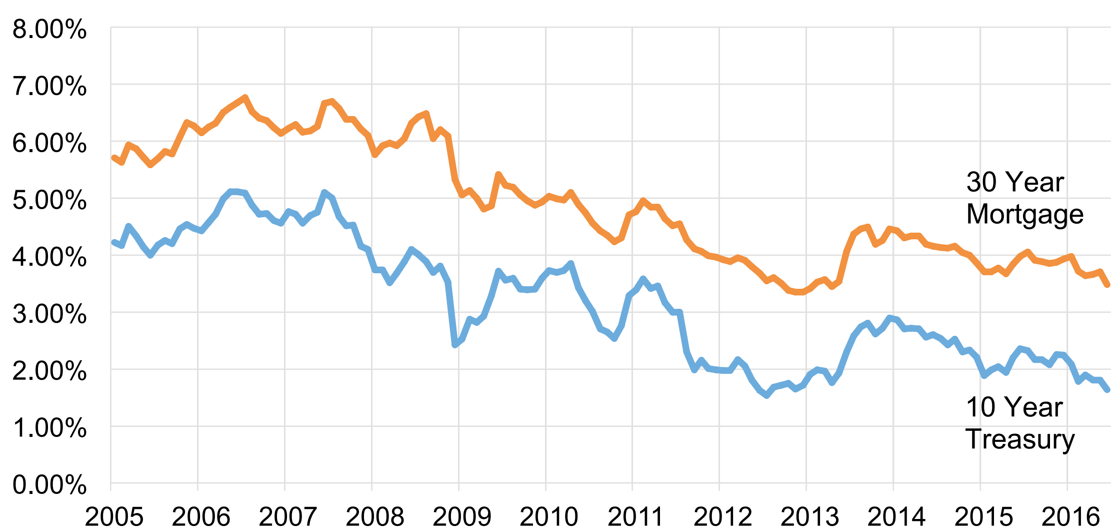
The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.2 percent in June on a seasonally adjusted basis, the U.S. Bureau of Labor Statistics. Over the last 12 months, the all items index rose 1.0 percent before seasonal adjustment. For the second consecutive month, increases in the indexes for energy and all items less food and energy more than offset a decline in the food index to result in the seasonally adjusted all items increase. The food index fell 0.1 percent, with the food at home index declining 0.3 percent. The energy index rose 1.3 percent, due mainly to a 3.3-percent increase in the gasoline index; the indexes for natural gas and electricity declined. The Wall Street Journal's Economic Forecasting Survey projects that the unadjusted 12-month CPI will increase by 1.8 percent in December 2016 and 2.2 percent in June 2017.

INTEREST RATES

Given the strong unemployment data, the Federal Reserve opted to maintain the fed funds target rate in a range of 0.25 percent to 0.50 percent at its June meeting. Brexit induced global uncertainty also factored into the Fed's decision, said Chair Janet Yellen. While the median forecast of Fed policymakers remained at two additional rate hikes in 2016, the number of officials who see just a single move rose to six from one since the previous poll in March. The 10-year Treasury and the 30-year mortgage rate both declined to 1.46 percent and 0.39 percent.

In China, stocks finished flat as investors gauged the pace of the country's economic growth. Returns for the April data disappointed investors following encouraging readings during the first quarter. Concerns resurfaced over how much stimulus the government would provide to sustain growth and the amount of debt on corporate balance sheets.

Figure 7: Treasury and Mortgage Rates, United States, 2005-2016 Q2



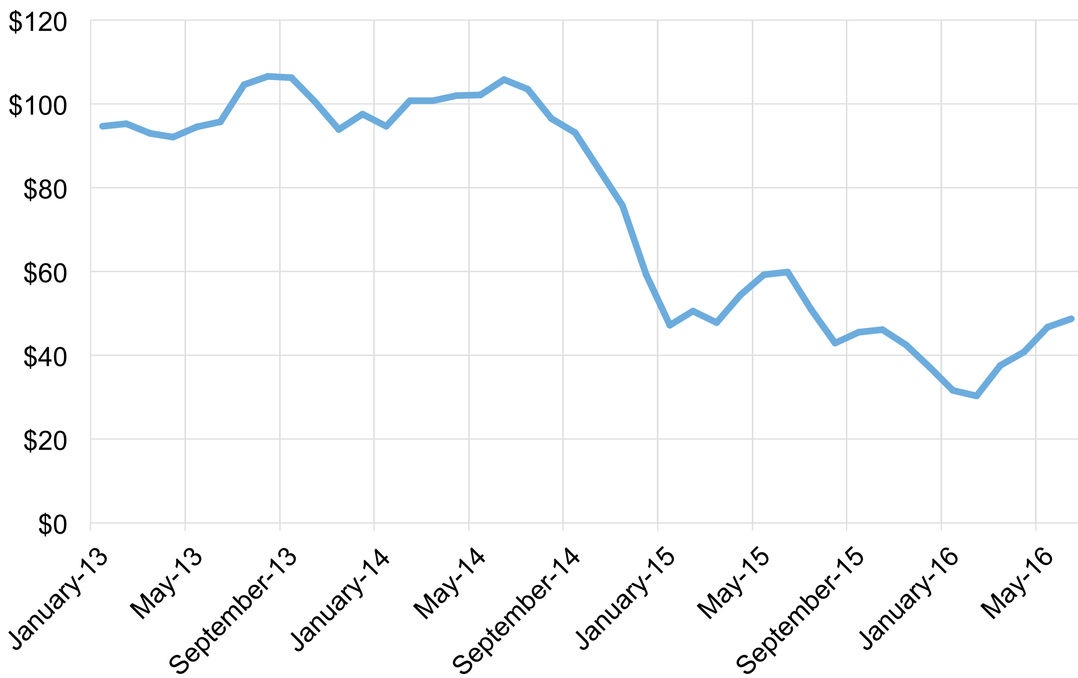
Source: Federal Reserve

CAPITAL MARKETS

Markets are dealing with political uncertainty from the fallout from Brexit but are assisted by prospects of a strengthening U.S. economy. Downside risks to global growth point to a U.S. Federal Reserve on hold. The U.S. economy grew far less than expected in the second quarter with inventories falling for the first time since 2011, but a surge in consumer spending pointed to underlying strength. Global stocks rose modestly in a volatile quarter marked by heightened concerns about threats to worldwide economic growth. Stocks initially dropped sharply after the June 23rd Brexit vote, but a strong bounce-back rally erased most of the losses. Rising oil prices fueled gains in the energy sector while consumer discretionary stocks declined. High-grade bonds, the U.S. dollar and gold rallied. The broad Standard & Poor's 500 Composite Index rose 2 percent; the Dow Jones Industrial Average also advanced 2 percent and the Nasdaq composite was flat. The quarter was characterized capital flight to established, safe sectors in light of global uncertainty. The telecommunication services and utilities sectors rose 7 percent, while consumer staples gained 5 percent. Information technology and consumer discretionary were the only sectors to post declines, losing 4 percent and 1 percent, respectively.

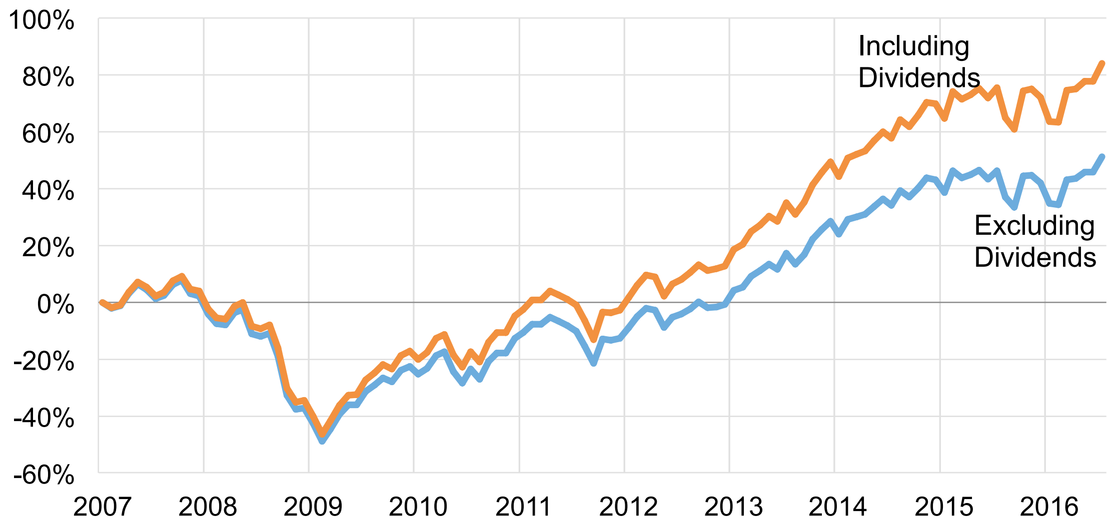
Declines in excess oil supply due to a slowdown in non-OPEC production and supply disruptions in Nigeria and Canada have helped recently increase oil prices and resulted in easing oil exporters' sovereign bond spreads from February-March highs. $48.76 in June, $46.71 in May and $40.75 in April. This could possible help the struggling oil production market in the United States.

Figure 8: Oil Price per Barrel (WTI Spot), 2013–2016 Q2



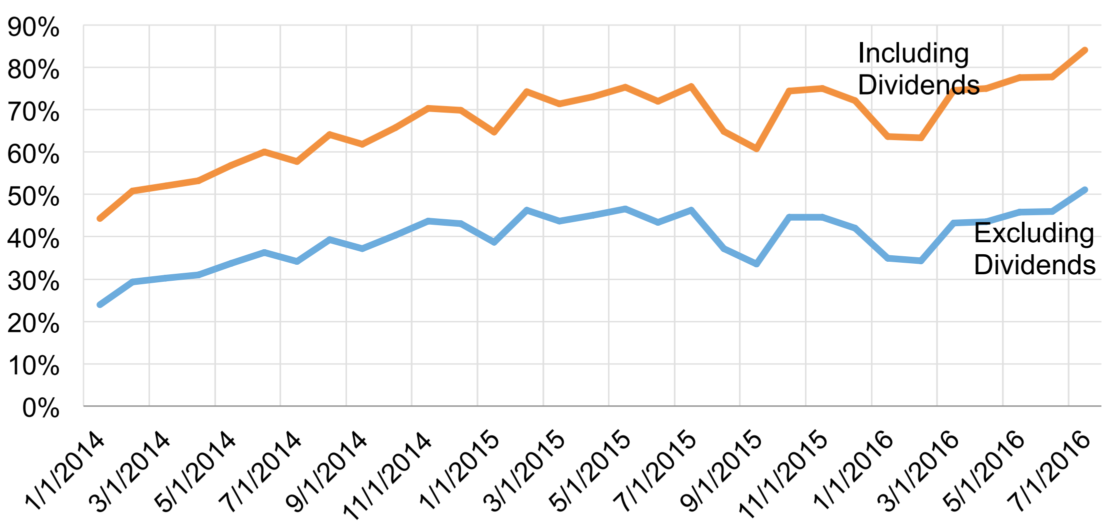
Source: US Energy Information Administration

Figure 9A: Standard & Poor's 500 Index, 2007–2016 Q2



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

Figure 9B: Standard & Poor's 500 Index, Jan 2014–July 2016



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

LOOKING AHEAD

Oregon and Portland's economies continued a strong economic performance in the second quarter with strong employment growth, however the dependence on manufacturing employment, which showed signs of slowing employment growth in the last quarter is concerning and could impact future growth projections.

As the U.S. economy enters the 84th month of expansion, including the longest string on monthly job gains on record, the outlook remains positive. The ongoing job gains and wage growth are pulling workers back into the economy and measures of slack, or underutilization, continue to improve. The U.S. economy is finally nearing full employment. ■