STATE OF THE ECONOMY

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The United States and Oregon's economies have many of the marks bustling growth over the past year: output, employment, and hourly wages are up while unemployment and poverty are down. Nevertheless, there are some signs that growth is slowing: employment growth is leveling off and unemployment is stabilizing; home sales are slowing as is the construction of new housing. Factors such as trade disputes and rising interest rates may place drag on the economy, while increased investment under the Tax Cuts and Jobs Act are likely to provide a further boost over the next few years.

In Oregon, the gains in employment and incomes are doing little to improve the affordability of housing in the state. The Great Recession gutted the state's middle income households, while the net migration of higher income households are bidding up housing prices, especially in the Portland metropolitan area. In addition, implementation of Oregon's land use laws combined with local regulations discouraging housing construction have unnaturally restricted supply, resulting in what amounts to a housing shortage throughout the state.

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U.S. ECONOMY

The U.S. economy is performing well, with consistent growth enabling higher interest rates. Robust growth in over the past year has spurred job creation and helped to reduce unemployment rates to near-record lows. Wage growth has picked up recently, outpacing consumer price inflation. In turn, these factors are supporting growth in private consumption, which is encouraging firms to invest and hire yet more workers, stimulating GDP growth and putting upward pressure on consumer prices.

	2017	2018	Percent Change
Employment, thousands	146,963	149,500	1.7%
Unemployment rate	4.20%	3.70%	-.05%
Average hourly wage	$26.51	$27.25	2.8%
Consumer price index	246.39	251.99	2.3%
Gas price, per gallon	$2.645	$2.836	7.2%
Interest rate, 30-year mortgage	3.81%	4.63%	0.8%
New home sales	637,000	553,000	-13.2%
Existing home sales	5,370,000	5,150,000	-4.1%
Gross domestic product, trillions	$19.59	$20.66	5.5%
Federal debt as share of GDP	104.12%	103.35%	-0.8%

Table 1: U.S. Economic Metrics

Looking forward to 2019, rising trade barriers around the world are likely to weigh on business sentiment while higher interest rates may dampen U.S. consumer spending and slow growth in the housing market.

The renegotiation of the North American Free Trade Agreement (NAFTA) in late September—which has been rebranded as the United States Mexico Canada Agreement (USMCA) but is structurally similar to NAFTA—has eased some trade and inflation concerns. The deal must now be passed by legislatures in all three countries. Despite the Democratic gains in the U.S. House of Representatives, only the Senate approves treaties, so there is little risk of the approval process breaking down.

The Tax Cuts and Jobs Act has been a boon to consumer confidence, with consumer spending driving a large portion of GDP growth over the year. In general, economists see much of the potential stimulus from the tax cuts coming from changes in business taxation. However, less than a year in the new tax rules, increased investment is expected to occur over the next few years.

The U.S. Federal Reserve raised the benchmark federal funds rate in September and are expected to raise rates again in December. Consumers and businesses have so far shown resilience to moderately higher interest rates (Figure 1), although new and existing home sales have declined over the past year as mortgage interest rates have increased. In turn, as shown in Figure 2, housing starts over the past quarter have been below the 12-month moving average.

Rising interest rates and high costs associated with trade tensions and tariffs could harm residential and commercial real estate markets through increased construction costs as well as dampened demand. Offsetting these risks are increased employment and wages that would stimulate further demand for residential and commercial real estate.

U.S. ECONOMY

Figure 1: U.S. 30-year fixed rate mortgage rate, 2007-2018 (Freddie Mac)

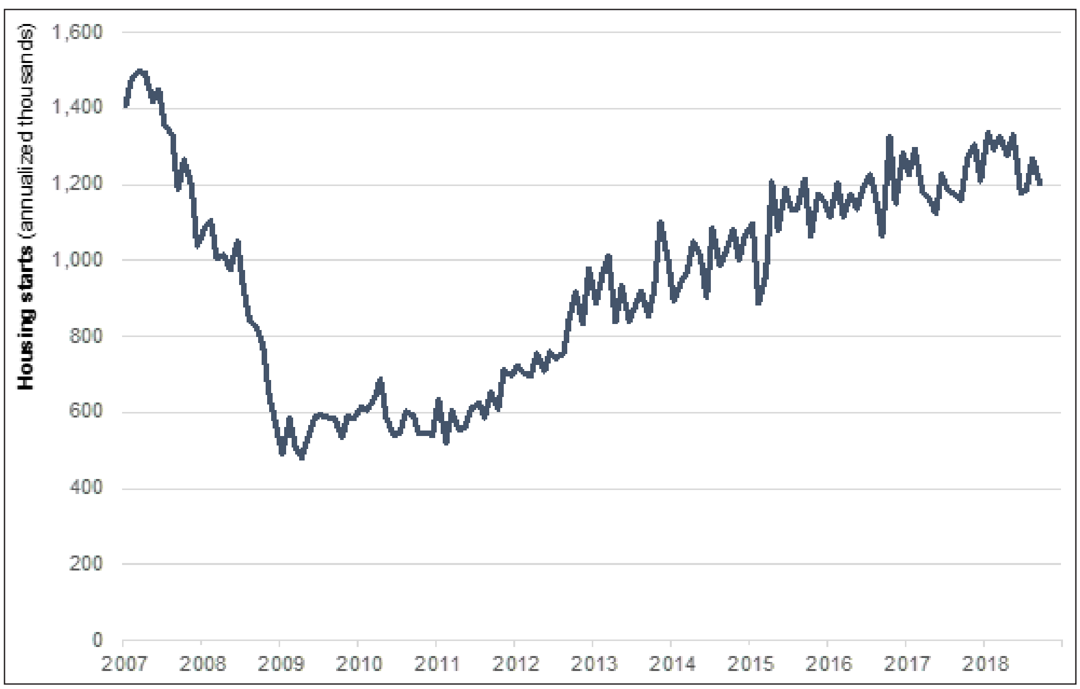

Figure 2: U.S. new privately owned housing units started, seasonally adjusted annual rate, 2007-2018 (U.S. Bureau of the Census and U.S. Department of Housing and Urban Development)

OREGON EMPLOYMENT, INCOMES AND HOUSING AFFORDABILITY

The U.S. and Oregon have seen robust employment growth over the past year, with unemployment at near all-time lows. Figure 3 shows that Oregon saw the biggest gains in employment over 2014 and 2015. As the state reaches full employment, Oregon job growth has more-or-less matched U.S. job growth since 2016. Oregon unemployment rate has flattened out at around 4.0 or 4.1 percent over the 18 months or so. This suggests that job growth has slowed to match population and labor force growth over this period.

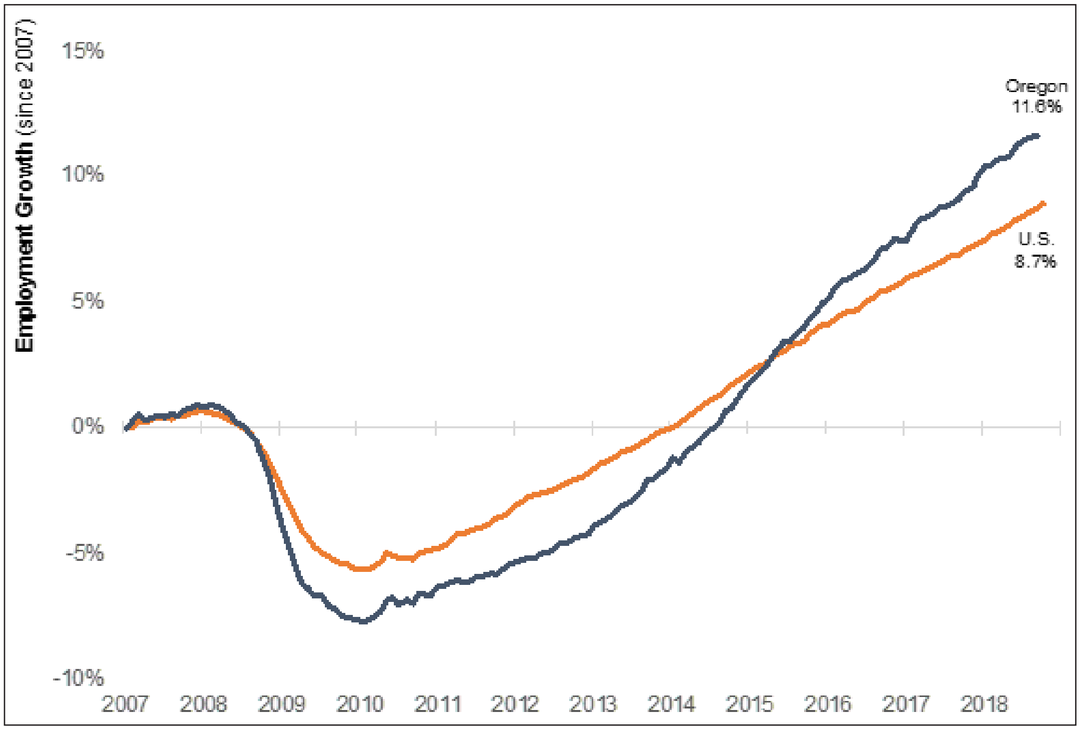

Figure 3: U.S. and Oregon employment growth, 2007-2018 (U.S. Bureau of Labor Statistics)

Middle wage jobs took the biggest hit in in the last recession, with a loss of more than 100,000 jobs, according to the Oregon Office of Economic Analysis. As shown in Figure 4, since the recession, high wage (e.g., professional and business services) and low wage (e.g., leisure and hospitality) jobs in Oregon have increased from pre-recession highs, while middle wage jobs (e.g., durable goods manufacturing) have declined throughout the state. With the steep decline—and slow recovery—of middle wage employment, Oregon household income inequality has worsened since 2007.

Figure 4 provides the Gini coefficient for Oregon from 2007 through 2017. The Gini coefficient is a widely used measure of income inequality. It ranges from zero (perfect equality in which every household receives equal income) to one (in which one household receives all income and every other household receives nothing). Prior to the recession, Oregon's Gini coefficient was 0.447. In the first year of the recession, the state's income inequality "improved" as high, middle, and low wage earns lost jobs. As the bottom dropped out of middle wage employment through 2009 and 2010, income inequality worsened. Middle wage employment stagnated through 2001-2014, further worsening income inequality.

It was during this period of rising income inequality that Oregon returned to pre-recession levels of in-migration. According to the Oregon Employment Department, and shown in Figure 5, approximately 87 percent of the state's population growth last year came from net migration. The combination of increasing net migration and sluggish production of new housing has led to an increase in housing prices, making home ownership unaffordable for a growing portion of the Oregon households.

OREGON EMPLOYMENT, INCOMES AND HOUSING AFFORDABILITY

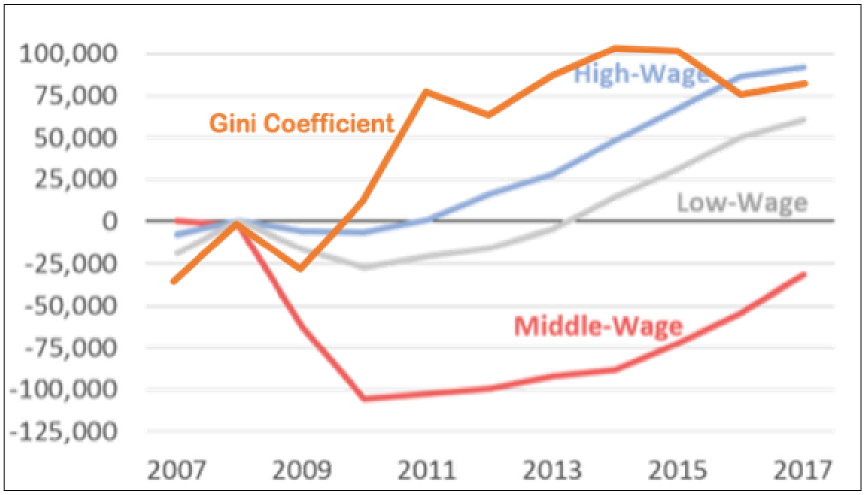

Figure 4: Oregon job polarization and household income inequality, Gini coefficient and employment change from pre-recession peak, 2007-2017 (U.S. Census Bureau; U.S. Bureau of Labor Statistics; Oregon Office of Economic Analysis. Gini coefficient range of 0.442-0.462.)

Indeed, it was also during this period of rising income inequality that Portland area housing prices began to grow faster than Portland area incomes, as shown in Figure 6. From 2011 through 2014, Portland area home prices increased by 24 percent while Portland area per capita personal income grew at half that rate. Since 2014, income have increased 15 percent while the Case-Shiller home price index increased 40 percent.

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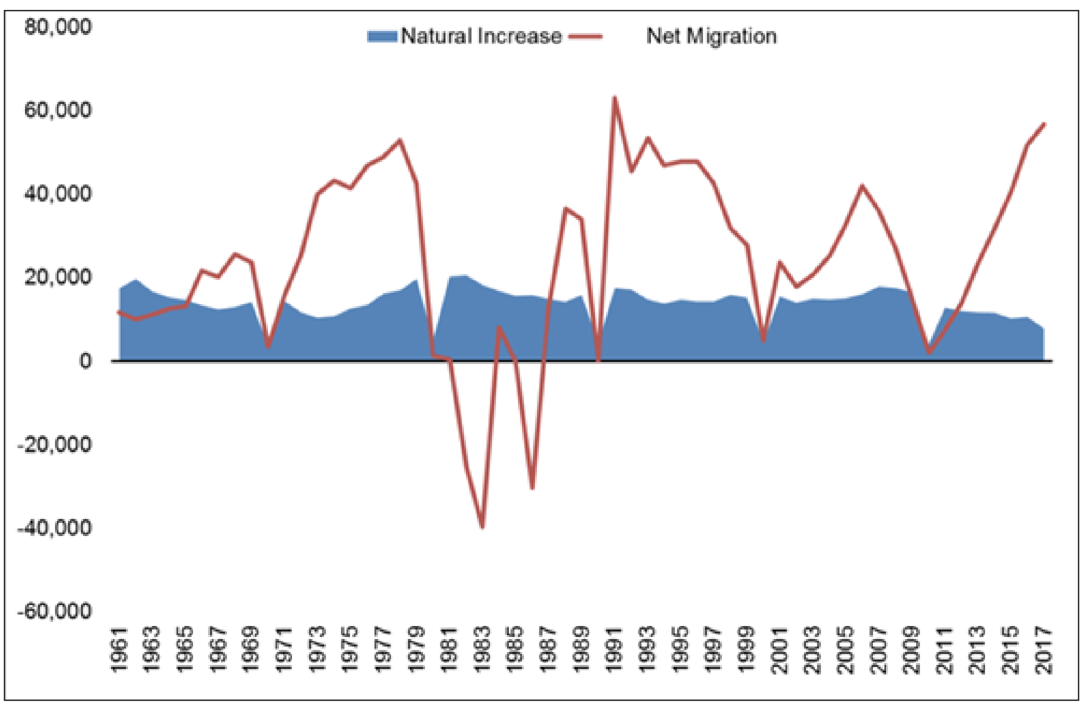

Figure 5: Oregon population growth, natural increase and net migration, 1961-2017 (Oregon Office of Economic Analysis)

OREGON EMPLOYMENT, INCOMES AND HOUSING AFFORDABILITY

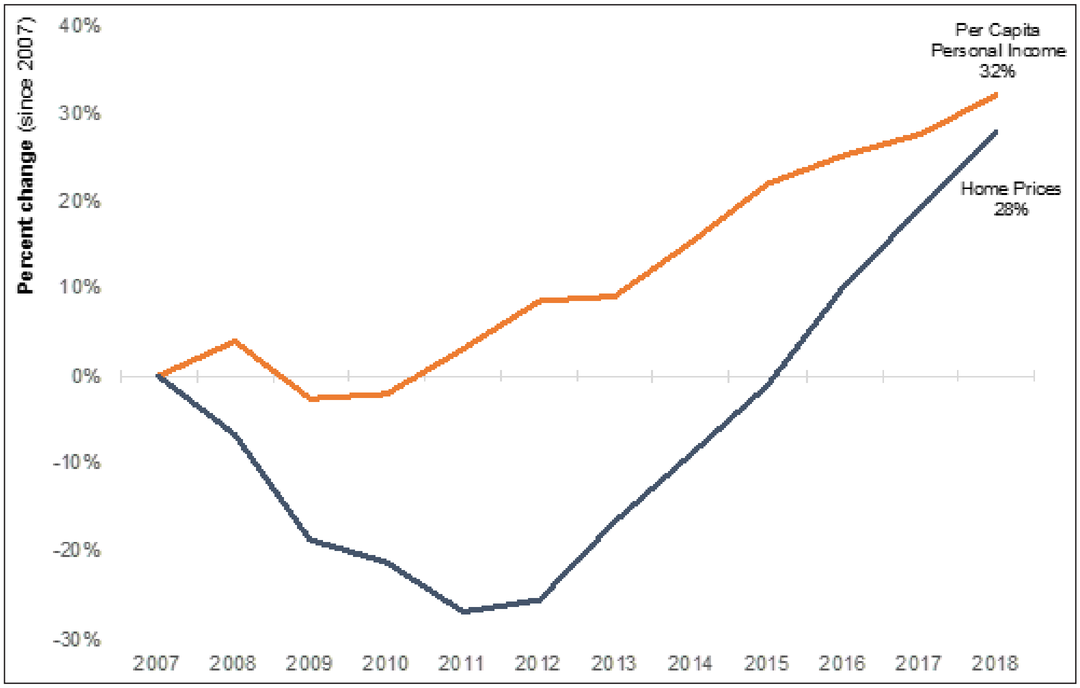

Figure 6: Portland area personal income and Case-Shiller home price index, 2007-2018 (U.S. Bureau of Economic Analysis; S&P Dow Jones)

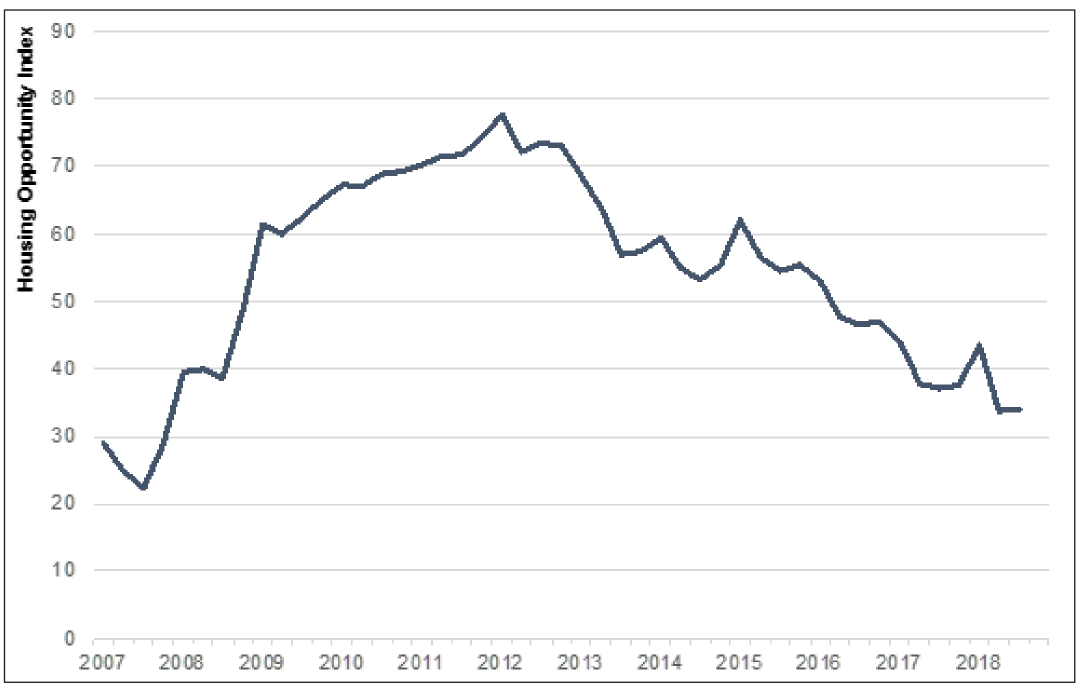

Figure 7: Portland area Housing Opportunity Index, 2007-2018 (National Association of Homebuilders and Wells Fargo. The Housing Opportunity Index measures the share of households for which monthly income is available for housing is at or above the monthly cost for the unit.)

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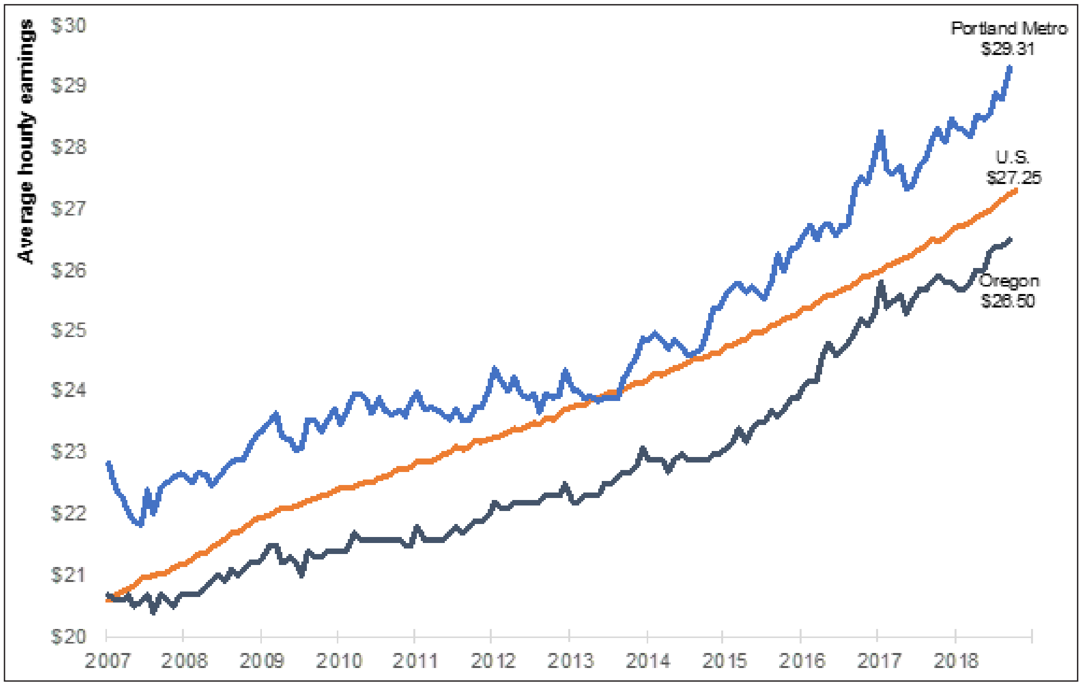

Figure 8: U.S., Oregon, and Portland metro average hourly earnings, 2007-2018 (Federal Reserve Bank of St. Louis and U.S. Bureau of Labor Statistics)

net migration. The combination of increasing net migration and sluggish production of new housing has led to an increase in housing prices, making home ownership unaffordable for a growing portion of the Oregon households.

The gap between income growth and housing costs is reflected in the NAHB/Wells Fargo Housing Opportunity Index, shown in Figure 7. Since the end of 2011, housing affordability has steadily declined. In the third quarter of 2018, only one-third of households have income available for housing that is at or above housing costs.

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Oregon's land use laws and local burdens on new construction of single-family homes have resulted an underproduction of housing units relative to population growth. The Oregon Business Plan estimates the state needs to produce 30,000 units a year in the foreseeable future to make up for previous years of underproduction. In contrast the Oregon Office of Economic Analysis forecasts fewer than 25,000 units per year through 2028. Potential inclusionary housing laws, rent controls, and property tax reforms are likely to further stifle production and reduce housing affordability in the Portland region and throughout the state. ■