FORECAST OF OREGON’S ECONOMY IN 2013:
DISAPPOINTING BUT NOT DISASTROUS

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During a recent presentation that I made to the Roseburg Chamber of Commerce, I gave a one sentence summary of the forecast for Oregon’s economy in 2013: “We’re getting socks for Christmas.” It’s nice to get a present, but it’s not what we hoped for. What consensus there is among economists projects that Oregon and much of the U.S. will see some economic growth, but not the economic growth we hoped for.

Next year’s economy is projected to look much like this year’s—sluggish growth with a substantial risk of disruptions that could stall the recovery or send the economy back into recession. Businesses and households would benefit from planning for some of these risks by asking if they are prepared for:

• Increased taxes associated with the “fiscal cliff;”
• Federal spending cuts associated with the “fiscal cliff” (for businesses that rely on government contracting—remember federal cuts trickle down to the state and local level);

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• Another credit crunch in the event of a euro zone break up;
• Reduced demand for exports in the event of a significant slowdown in China’s economy.

Figure 2. “Uncertainty” will be 2013’s word of the year. One the one hand, economists are predicting about a 1-in-5 chance of another recession. At the same time, they predict a 1-in-4 chance that the economy will grow at a faster than average rate. What’s left is a fairly big chance of growth, but sluggish growth.

SLOW, BUT NOT NECESSARILY STEADY

Most economists are predicting relatively sluggish economic growth over the next year. Economists surveyed by the Wall Street Journal forecast growth of 2.4 percent next year. The Organization for Economic Cooperation and Development recently cut its forecast for the U.S. economy. The OECD predicts that even if the “Fiscal Cliff” is averted, the economy will grow 2.0 percent next year, which is down from the May forecast predicting 2.6 percent growth. On average, over the long run, U.S. economic growth has been about 3 percent a year, so the forecasters are projecting below-average growth.

Most economists surveyed by the Wall Street Journal do not expect see the U.S. falling into recession. On average, the economists put a 22 percent chance of another downturn hitting in the next year. The International Monetary Fund says that there is a 16 percent chance of a global slowdown. On the other hand, the Wall Street Journal economists say that there is a 28 percent chance that the economy will grow above 3 percent in 2013. These conflicting projections raise the big question: Will the economy tank or boom? The consensus seems to forecast sluggish growth with a significant number of economists saying that there are more downside risks facing the economy than there are upside opportunities.

Quite a few of the employment forecasts I’ve read have used the phrase, “disappointing, but not disastrous” to describe job growth over the next year. Most econo-
mists expect modest employment growth that barely keeps pace with population growth. Thus, the consensus seems to be that unemployment in the U.S. and Oregon will remain virtually unchanged in 2013.

One upside to a sluggish economy is relatively modest inflation and some reduced pressure on oil prices. Economists surveyed by the Wall Street Journal forecast inflation to be about 2.2 percent.

![Manufacturing emerged strong out of recession, but now appears to be losing momentum](image1)

Manufacturing emerged strong out of recession, but now appears to be losing momentum. Manufacturing came strong out of the recession, but has slowed over time, with some recent months hinting at the possibility of a contraction.

![Oregon housing starts are improving, but well below normal](image2)

Oregon housing starts are improving, but well below normal. Since about 1990—and with the exception of the housing boom—Oregon housing starts have been in the around the 20,000 a quarter range (with some big swings from year to year). Forecasts project that housing starts next year will be about the same as last year.

**MIXED MESSAGES FROM TWO MAJOR SECTORS**

Manufacturing took a big hit in the recession, but came back strong as the recovery began. Manufacturers found ways to boost output and margins. This can be seen in the increase in business profits and dividends since 2009. However, manufacturers have managed to make their gains with fewer employees, and it’s unclear whether this growth can be sustained. Earlier this year, the U.S. saw a small contraction in new orders in manufacturing. Right now, we’re in the uncomfortable position of trying to determine whether that small dip was just a “blip” or the hint of longer run slide in manufacturing.

The Oregon Office of Economic Analysis is somewhat optimistic about the state’s manufacturing sector. They point to a new expansion announced at Intel as well as improved market conditions for many wood product and metal firms as indicators that Oregon’s manufacturing sector is likely to improve over the next year or so.

The other part of the economy showing mixed messages has been the housing sector. In both the U.S. and Oregon, house prices are improving. At the same time, Oregon housing starts have slowly—almost imperceptibly—grown over the past few years. The Oregon Office of Economic Analysis projects 10,000 to 12,000 new hous-
ing starts a quarter over the next year. This is about half the number of housing starts that a “normal” Oregon economy has seen (meaning, if we ignore the housing boom and it’s subsequent bust). So, again, the forecast is disappointing, but not disastrous.

**A BRIGHT SPOT: BUSINESS INCOMES AND DIVIDENDS**

After a sizable hit during the recession, business incomes have improved and represent a bright spot in the economy. Corporate profits are increasing, incomes for smaller businesses are improving, and dividend-adjusted stock returns are positive.

Business incomes are measured by corporate profits, proprietor incomes, stock price appreciation and dividends. Corporate profits before taxes tend to be dominated by “big” businesses and C-corporations that must pay corporate income taxes, and they have rebounded quite strongly since the recession. Proprietors’ income is the payments to those who own non-corporate businesses, including sole proprietors and partners. These payments have risen since the recession, but not as rapidly as corporate profits. Finally, stock price returns measure the value of a company’s stock (either including or excluding dividend payments). When stock prices rise, that leads to more spending by consumers, either due to the increase in confidence or the extra income from dividends. Stock prices collapsed during the financial crisis and recession and have finally recovered to the level they were at the beginning of 2007. In fact, for stockholders, most of their gains came from improving dividends. Since 2007, dividend adjusted returns on stocks has been almost 30 percent. At first blush, this may seem like fairly strong growth. However, that amounts to an annual growth rate of just under 4.5 percent, which is well below the long run average return from stock market investing of approximately 8 percent a year (which is also the amount that the Oregon’s Public Employee Retirement System uses for its calculations).

![Figure 5. Corporate profits, usually associated with “big business,” saw a brief, but severe, dip during the recession. These profits quickly recovered after the recession. Proprietors’ income has seen slow, but steady, gains in recent years.](image1)

![Figure 6. Stock prices have had a wild ride over the past five years. If you fell asleep in January 2007 and woke up in October 2012, you’d think that nothing had happened to stock prices. Stock prices by themselves, do not tell the full story. Dividends have made a significant contribution to stock returns.](image2)
THINGS TO LOOK FOR ... AND PLAN FOR

As noted earlier, most economists are forecasting growth of the next year, but it will be sluggish growth. There are, however, many events that can cause all those forecasts to be thrown out the window.

The fast approaching “fiscal cliff”

As an economist, there is one prediction I can make with 100 percent certainty: By the end of this year, everyone will be sick of hearing the phrase “Fiscal Cliff.” The Fiscal Cliff is the combination of automatic tax increases and spending cuts that Congress wrote into the law earlier this year to avoid making a decision regarding the deficit prior to the election. In addition to the Fiscal Cliff, Congress and the Administration will have to take action on the federal debt ceiling sometime in the first half of the year.

The Congressional Budget Office calculates that the total effect of the Fiscal Cliff would be a 3.9 percent drop in economic growth. Remember, economists are projecting growth of only 2.4 percent to begin with. So, a drop of 3.9 percent means that the economy will contract and the U.S. will head into recession and drag the rest of the world with it. The International Monetary Fund has identified the Fiscal Cliff as one of the biggest threats to the global economy in the upcoming year.

Most commentators seem to agree that Congress and the President will do something about the Fiscal Cliff. At the same time, no one knows what that something will be or whether it pushes the cliff jumping back another year or two.

A Euro zone break up: Yes, it matters to Oregon

An external uncertainty to the American economy is the continued financial turmoil in Europe. Euro zone leaders have been struggling for more than two years to formulate a collective response to the zone’s debt crisis. Many of the region’s leaders are skeptical of continuing what they consider to be austerity measures. Italy, France, and Spain are now pressing for more radical measures to prop up the euro zone.

The Economist Intelligence Unit assigns a “moderate” risk of a euro zone break up. In particular, there is a substantial risk that Greece will withdraw from the Euro zone. The country is scheduled to complete an orderly debt default in March, but may fail to abide by the terms of its second EU-IMF loan, causing it to leave—or be ejected from—the euro zone. This could trigger a crisis among the remaining 16 member states, major central banks and key global institutions.

The break-up of the euro zone would massively destabilize the global economy. Weaker former members would default on their debts and their currencies would plummet. Funding costs and interest rates would soar. Banks globally would suffer large losses and a credit crunch would return as banks seek to bolster their balance sheets.
The U.S. would likely be seen as a “safe haven” by investors. The movement of funds from overseas would result in a stronger dollar, which would increase the price of our exports and weaken orders for U.S. manufactured goods.

The combination of tight credit and reduced demand for U.S. exports would negatively impact Oregon exporting businesses and those businesses in need of credit and has the potential to reverse the state’s fragile turnaround in manufacturing activity.

Can China keep growing?

The other external concern is the Chinese economy. China is the second largest economy in the world and the number one destination for Oregon exports. China’s economy has had a long run of double digit economic growth. However, since 2007, the country’s economy slowly has been losing steam. This year’s forecasted rate of 7.4 percent for China is the lowest growth rate in more than a decade.

China’s entry into the World Trade Organization in 2001 brought with it an export boom. Since then, China has grown to be the world’s largest exporter and accounts for more than 10 percent of the global market. With such a large share of the global market the room for further export expansion is limited. In addition, rising wages and a stronger yuan have also reduced China’s export competitiveness. On top of that, there appears to be growing evidence of a weakening of domestic demand as well.

As with predictions regarding the U.S. economy, economists have mixed forecast regarding China’s future growth. On the one hand, U.S. banking regulators have just required the biggest U.S. banks to “stress test” their balance sheets against a sharp slowdown in China. On the other hand, recent gains in industrial production, investment and retail sales picked hint that demand may be picking up again in China. The Fed’s stress test imagined a “sharp slowdown in economic activity in China that has substantial spillovers to activity in the rest of developing Asia,” according to the Fed. Under the Fed’s worst-case scenario, economic growth in developing Asian nations would slow down to 0.3 percent in the current quarter, compared with a base-line forecast of 7.4 percent growth. The Fed emphasized that the scenario was not a forecast but rather a hypothetical scenario.

The Economist Intelligence Unit says that a sharp slowdown in Chinese economic growth to 5 percent or so would have major implications for the global economy. A slowdown would likely lead to a drop in commodity prices and reduce demand for U.S. exports.

CONCLUSION

Next year’s economy is projected to look much like this year’s economy. Oregon and much of the U.S. can expect sluggish growth some substantial risk of disruptions that could derail the recovery and send the economy back into recession. Businesses
and households would benefit from planning for some of these risks by asking if they are prepared for

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At the same time, interest rates are currently at all-time lows. Although some are still finding some difficulty in getting credit, it would be advantageous to identify ways to obtain and lock-in to low interest rates while they are still low. ■