THE STATE OF THE ECONOMY

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The United States economy saw lackluster growth in the third quarter of 2013, following a sluggish first half of 2013. Initial reports, which were delayed because of the government shutdown, already indicated underwhelming growth, but were likely negatively affected by the 16 days in October that the government was closed. Early calculations reveal that as a result of the federal impasse, the uncertainty that had blanketed financial markets and the economy caused a slowing of economic expansion, but lasting reverberations still remain to be seen.

A report released by the White House Council of Economic Advisers (CEA) concludes that the "government shutdown took a huge bite out of economic growth—and that the impact will linger." Furthermore, the shutdown is attributed with reducing annual economic grown by 0.25 percent and costing an estimate of 120,000 jobs in just its first 12 days (the shutdown lasted for an additional four days). Other private sector analyses estimate that the shutdown reduced the annualized growth rate of GDP in the fourth quarter by anywhere from between 0.2 percentage point (as estimated by JP Morgan) to 0.6 percentage point (as estimated by Standard and Poor's).

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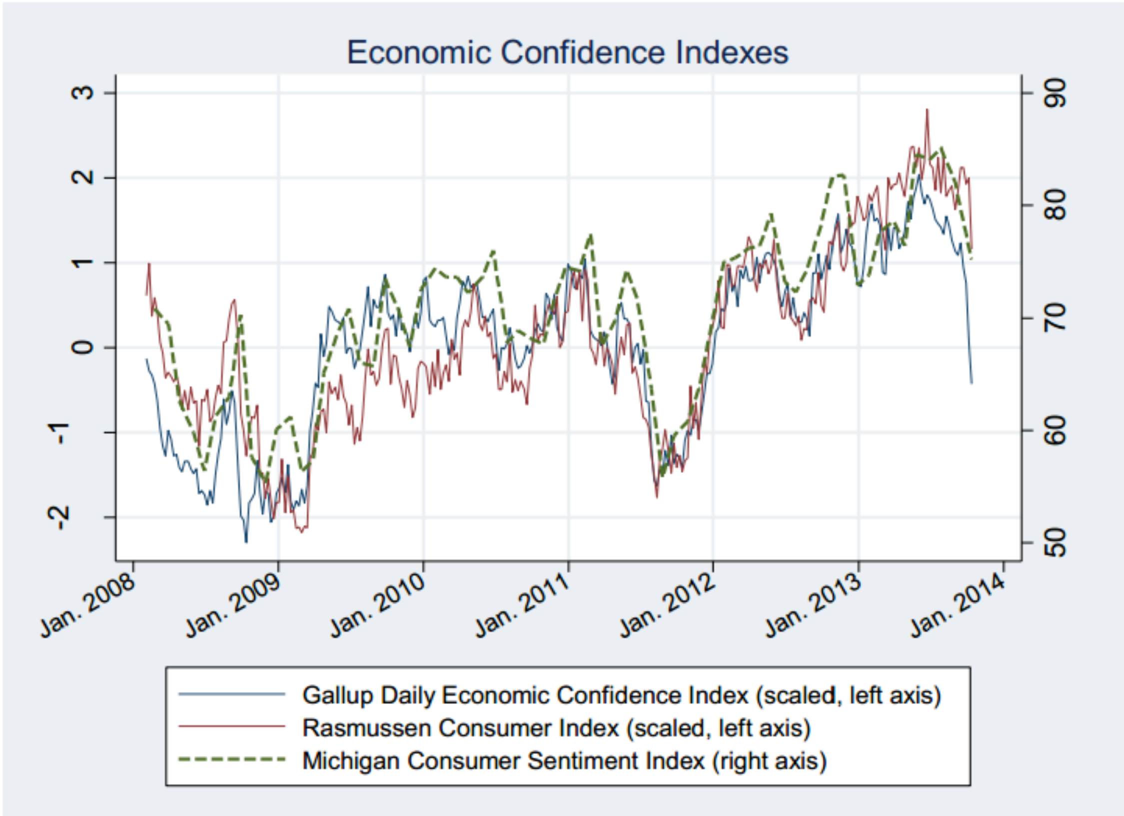
Figure 1: United States Consumer Confidence Chart



Source: White House Council of Economic Advisers October 2013

The shutdown purportedly not only withdrew government services, but rippled through the private sector and caused consumer confidence to be knocked down at the fastest pace since September 2008, when the recession was at its worst, as shown in Figure 1. According to the Wall Street Journal, however, economists believe this consumer sentiment to be short lived and should not have long-term effects on the economy.

In other news, J. P. Morgan came to a tentative agreement with the U.S. Justice Department to pay a record $13 billion to settle charges that J. P. Morgan and the two troubled banks (Bear Stearns and Washington Mutual) that it purchased during the financial crisis, sold fraudulent mortgage securities that contributed to the housing collapse. Of the settlement, $5.1 billion will go to resolve claims related to home loans and mortgage-backed securities sold to Fannie Mae and Freddie Mac, the Federal Housing Finance Agency announced.

The J. P. Morgan settlement comes at the heels of a jury finding Bank of America Corp. liable for fraud related to loans its Countrywide Financial Corp unit sold Fannie and Freddie between 2007 and 2008. According to the Wall Street Journal, the decision in this civil case marks the first time a bank has been found liable for fraud for its dealings during the mortgage boom. Bank of American bought Countrywide in 2008. The government argued that the program created bad loans by swapping out trained underwriters for less-qualified loan specialists, cutting the time it took to approve a loan and removing financial incentives to produce quality loans and replacing them with ones rewarding quickness.

Since 2008, financial firms have agreed to over $95 billion in mortgage-related penalties. Last year, in the National Mortgage Settlement, five American banks agreed to pay $32 billion to provide mortgage relief to homeowners, Bank of America agreed to pay $12.4 billion at that time.

These settlements reflect significant efforts by the Department of Justice and other federal and state governmental agencies to hold banks responsible for their involvement in causing the recent housing crisis. They intend to accomplish this by seeking billions in fines from banks, pursue criminal cases aggressively and mix penalties with consumer relief that helps homeowners who were harmed.

THE WORLD AND U.S. ECONOMY

The International Monetary Fund (IMF) projects that the world economy will grow by 2.9 percent this year and 3.6 percent in 2014. In recent years, emerging markets have been the drivers of world economic growth. While the growth of emerging market and developing economies is expected to remain strong, much of the pick up in economic expansion is expected to be driven by advanced economies.

The IMF reports that China's growth will decelerate slightly from 7.5 percent this year to 7.25 percent in 2014, as shown in Figure 2. Policymakers have refrained from stimulating activity amid concerns for financial stability and the need to support a more balanced and sustainable growth path. According to the IMF, growth in emerging market and developing economies is expected to remain strong at 4.5 percent to 5 percent in 2013–14, supported by solid domestic demand, recovering exports, and supportive fiscal, monetary and financial conditions. Commodity prices will continue to boost growth in many low-income countries, including those in sub-Saharan Africa. But economies in the Middle East and North Africa, Afghanistan, and Pakistan region will continue to struggle with difficult economic and political transitions."

Figure 2: IMF World Growth Projections, October 2013

			Projections		Difference from July '13 WEO Projections	
	2011	2012	2013	2014	2013	2014
World Output	3.9	3.2	2.9	3.6	-0.3	-0.2
Advanced Economies	1.7	1.5	1.2	2.0	0.0	0.0
United States	1.8	2.8	1.6	2.6	-0.1	-0.2
Euro Area	1.5	-0.6	-0.4	1.0	0.1	0.0
Germany	3.4	0.9	0.5	1.4	0.2	0.1
France	2.0	0.0	0.2	1.0	0.3	0.1
Italy	0.4	-2.4	-1.8	0.7	0.0	0.0
Spain	0.1	-1.6	-1.3	0.2	0.3	0.1
Japan	-0.6	2.0	2.0	1.2	-0.1	0.1
United Kingdom	1.1	0.2	1.4	1.9	0.5	0.4
Canada	2.5	1.7	1.6	2.2	-0.1	-0.1
Other Advanced Economies	3.2	1.9	2.3	3.1	0.0	-0.2
Emerging and Developing Economies	6.2	4.9	4.5	5.1	-0.5	-0.4
Central and Eastern Europe	5.4	1.4	2.3	2.7	0.2	-0.1
Commonwealth of Independent States	4.8	3.4	2.1	3.4	-0.7	-0.3
Russia	4.3	3.4	1.5	3.0	-1.0	-0.3
Excluding Russia	6.1	3.3	3.6	4.2	0.1	-0.1
Developing Asia	7.8	6.4	6.3	6.5	-0.6	-0.5
China	9.3	7.7	7.6	7.3	-0.2	-0.4
India	6.3	3.2	3.8	5.1	-1.8	-1.1
ASEAN-5*	4.5	6.2	5.0	5.4	-0.6	-0.3
Latin America and the Caribbean	4.6	2.9	2.7	3.1	-0.3	-0.3
Brazil	2.7	0.9	2.5	2.5	0.0	-0.7
Mexico	4.0	3.6	1.2	3.0	-1.7	-0.2
Middle East, North Africa, Afghanistan, and Pakistan	3.9	4.6	2.3	3.6	-0.7	-0.1
Sub-Saharan Africa	5.5	4.9	5.0	6.0	-0.2	0.1
South Africa	3.5	2.5	2.0	2.9	0.0	0.0

Source: International Monetary Fund, World Economic Outlook, October 2013.
*Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

Even the Euro Zone is seeing an improvement in business confidence, says the Economist. But, the IMF warns of nasty effects of policies in some of the world's biggest economies: like a government standoff in the United States, incomplete reform in Japan, and stagnation and high unemployment across the euro area.

Even so, there appears to be a silver lining to the dragging recession across the euro zone. Spain's economy grew for the first time in two years in the third quarter, according to the Spain's central bank. The National Statistics Institute in Madrid also reports that the jobless rate declined to 26 percent from 26.3 percent in the second quarter. Spain is the 4th largest economy in the euro zone. Foreign investments in the stock and bond markets have pushed the Ibex 35 index up 21 percent this year. But Javier Díaz-Giménez, of the IESE business school, is cited in the Economist warning "that the recovery is anemic, fragile and unlikely to create jobs. Average GDP growth of 1 percent, he points out, would not see Spain return to pre-recession levels until 2021."

In the United States, even before the government gridlock, economic indicators pointed towards a tepid third quarter. Economists had been hopeful that the second half of 2013 would bring a boost to the slower than anticipated first half. However, with the event of the government shutdown, this optimism has fizzled and annualize projections have yet again been adjusted down from their already moderate earlier forecasts for 2013. Figure 3 outlines the U.S. economic growth projections before the federal shutdown. Gross Domestic Product (GDP) in 2013 was projected to be 2.4 percent in the second quarter, but has been reduced to 1.6 percent. Still, GDP is expected to bounce back in 2014. The Economist writes that America will grow by 2.6 percent next year buoyed by rising household wealth and house prices, and by an easing of bank-lending conditions.

Figure 3: United States Annual Economic Growth, Actual and Forecast, 2012–2017

%	2012 [a]	2013 [b]	2014 [b]	2015 [b]	2016 [b]	2017 [b]
GDP	2.8	1.6	2.6	2.3	2.5	2.3
Private consumption	2.2	1.9	2.2	2.2	2.2	2.3
Government consumption	-1	-2.6	-0.9	-0.1	0	0.1
Gross fixed investment	8.3	5.3	8.5	6.5	6.5	6.4
Exports of goods & services	3.5	2.3	2.9	3.5	3.8	3.6
Imports of goods & services	2.2	1.3	3.4	3.6	4.3	5
Domestic demand	2.6	1.5	2.6	2.4	2.6	2.6
Agriculture	-3.7	2.1	2	2.5	2.9	2.9
Industry	3.2	2.5	2.8	3	2.5	2.4
Services	2	1.4	2.5	2.2	2.4	2.3

[a] Actual; [b] Forecasted

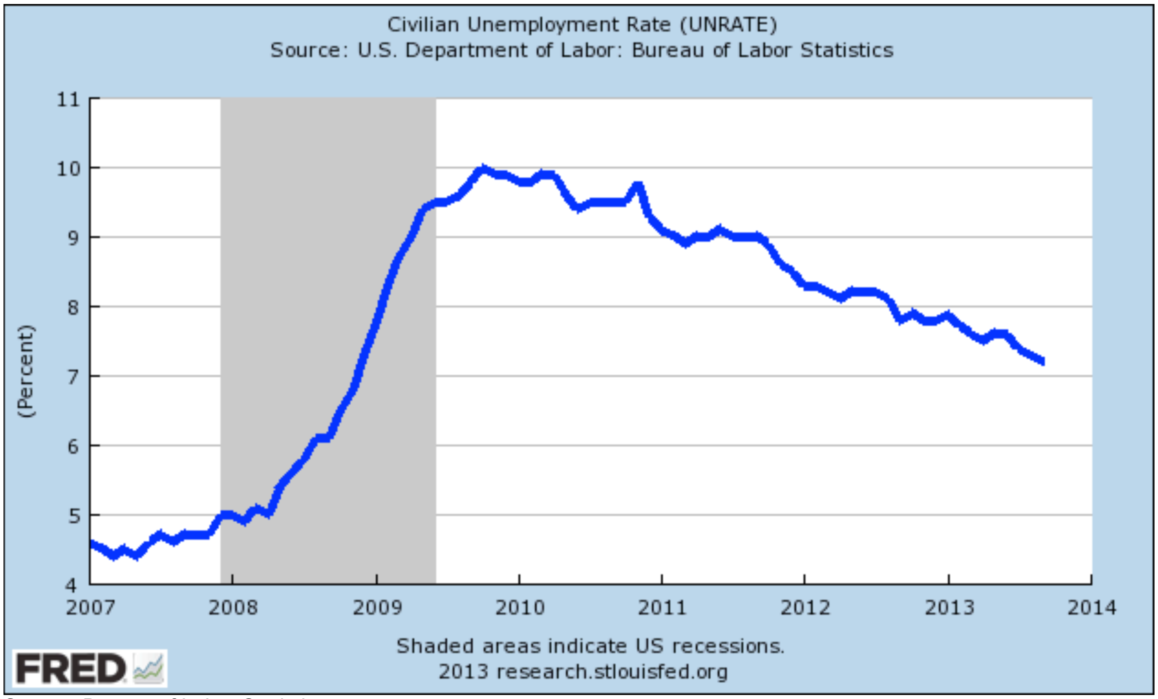
Source: Economist Intelligence Unit, September 2013

The United States' modest GDP growth is matched by sluggish employment growth that cannot keep pace with increases in population. The U.S. Bureau of Labor Statistics reports that the total nonfarm payroll employment increased by 148,000 in September 2013, down from August's increase of 193,000. Third quarter monthly job gains averaged 143,000, versus 182,000 in the second quarter and 207,000 in the first. Industry sectors that reported the most growth in September were:

- Professional and business services (+32,000); employment growth in this industry averaged 52,000 per month for the past year
- Transportation and warehousing (+23,000); most increase occurred in transit and ground passenger transportation (+18,000)
- Construction (+20,000); after showing little change over the prior 6 months, and,
- Wholesale trade (+16,000); added an average of 7,000 jobs per month for the past year.

Within the leisure and hospitality sector, employment in food services and drinking places was essentially unchanged over the month (-7,000) with job growth averaging 28,000 per month over the prior 12 months.

Figure 5: Unemployment Rate, United States

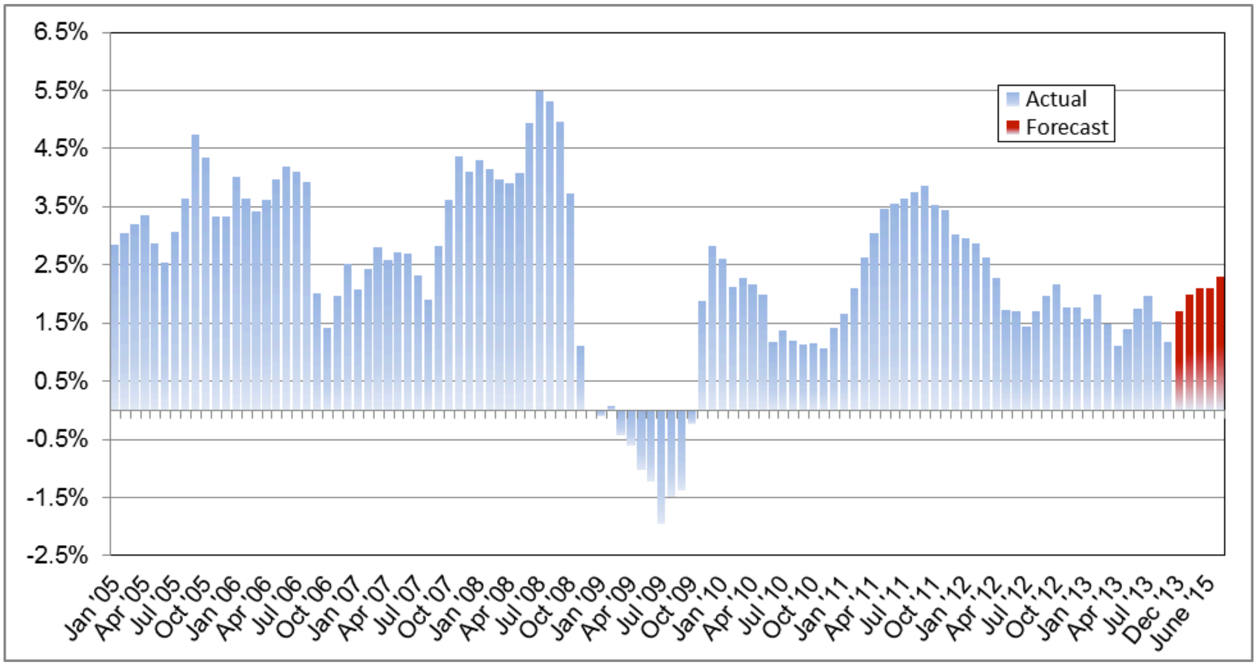


Source: Bureau of Labor Statistics

The U.S. unemployment rate continued on its downward trend, but has only declined 0.4 percent since June 2013, according to the Bureau of Labor Statistics. Since the depths of the recession, the unemployment rate has dropped gradually and by September 2013, stood roughly at 7.2 percent. While the decline in unemployment can been viewed as a sign of an improving economy, a portion of the decline in unemployment has been attributed to a large number of individuals leaving the work force.

Despite slow employment growth, consumer spending increased by 0.4 percent, while the inflation rate fell to 1.2 percent in September (Figure 6). The U.S. Bureau of Labor Statistics reported that the Consumer Price Index for All Urban Consumers (CPI-U) increased 0.2 percent in September on a seasonally adjusted basis. Over the last 12 months, the all items index increased 1.18 percent. The Wall Street Journal forecasts that inflation rates will stay below 2.5 percent through 2015.

Figure 6: United States Inflation Trend, Annual Change in Consumer Price Index



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

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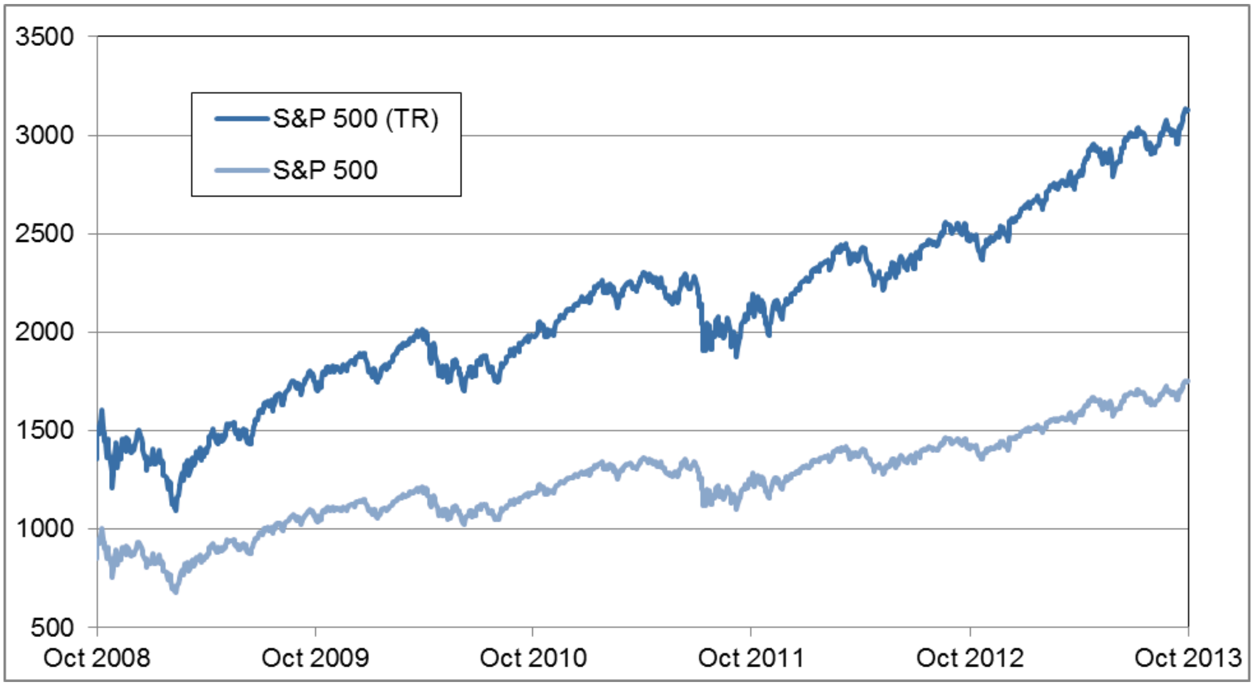
Standard & Poor's long-term outlook on the U.S. credit rating to remains as "stable" and the U.S. still holds an AA+ status—which is one notch below the AAA score that the U.S. held until 2011.

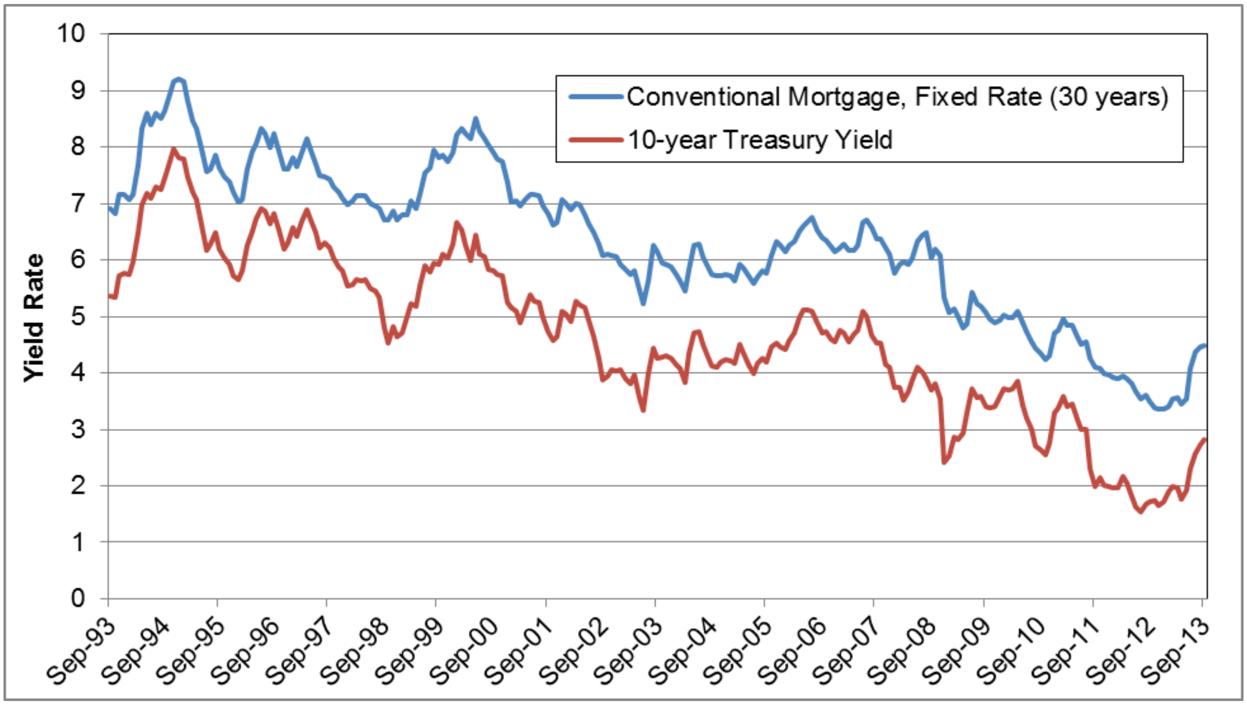
Figure 7: Standard & Poor's 500 stock index, 5-years



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

Stocks extended gains amid renewed expectations that the Federal Reserve will keep the easy money policy intact. The stock market continues to show gains from the severe dip that occurred in the early 2009 during the recession. The Standard & Poor's 500 stock index indicates a general upward trend since then. The S&P 500 closed at 1,763.31 and S&P Total Returns (which accounts for dividend reinvestment) stood at to 3,149.93 at the end of October, 2013. (Figure 7).

Figure 8: 10-year U.S. Treasuries vs. Conventional 30-year Mortgage Trends, 1993–2013



Source: Federal Reserve Bank

Since the second quarter of 2013, the Federal Reserve has been hinting that the tapering of the $85 billion-a-month bond buying program was nigh, as the economy showed signs of recovery. There has been no clear signal as to when the pullback will occur. Some forecasters anticipate that considering what happened in Washington recently, scaling back of the program will not begin until early 2014, but the Fed monetary policy will continue to be highly accommodative to the economic indicators.

Yields for the 10-year Treasury note increased from 2.58 percent in July to 2.81 percent in September. Mortgage rates, which are closely tied to 10-year Treasury yields, began climbing in the second quarter, as well. In April, the 30-year fixed rate was 3.45 percent. Conventional 30-year fixed rate mortgages rose from 4.37 percent in July to 4.49 percent in of September 2013.

The Fed had had concerns that the increase in mortgage rates would potentially harm the recovery of the housing market. Housing starts and home sales showed increases in August, but purchase mortgage applications have decreased as mortgage rates increased. As chances of reigning in the bond-buying program, an economic stimulus program that keeps U.S. interest rates close to zero, become unlikely, significant increase in yields of the 10-year Treasury note and conventional mortgages is not predicted for the rest of 2013.

Figure 9: Trade and U.S. dollar, October 2013

October, 2013	Trade balance		Current-Account Balance			Currency Units, per $		
	latest 12 months ($bn)		latest 12 months ($bn)		% of GDP	Oct 16th	year ago	% change
United States	-715.6	(Jul)	-412.9	(Q2)	-4.0	-	-	
China	+253.3	(Sep)	+42.3	(Q2)	-2.1	6.1	6.26	-2.6%
Australia	+12.4	(Aug)	-49.4	(Q2)	-2.9	1.05	0.97	8.2%
Japan	-86.8	(Aug)	+48.5	(Aug)	+1.1	98.9	78.9	25.3%
Canada	-9.7	(Aug)	-59.6	(Q2)	-3.3	1.03	0.99	4.0%
Sweden	+10.0	(Aug)	+32.0	(Q2)	+6.3	6.51	6.62	-1.7%
Switzerland	+26.5	(Aug)	+76.6	(Q2)	12.2	0.92	0.93	-1.1%
Britain	169.2	(Aug)	-102.1	(Q2)	-3.2	0.63	0.62	1.6%
Euro Area	+180.3	(Aug)	+257.4	(Jul)	+2.2	0.74	0.77	-3.9%
Germany	+246.9	(Aug)	+242.3	(Aug)	+6.8	0.74	0.77	-3.9%
Belgium	+10.6	(Aug)	-16.2	(Jun)	-0.9	0.74	0.77	-3.9%
France	-79.7	(Aug)	-49.1	(Aug)	-2.0	0.74	0.77	-3.9%
Netherlands	+59.5	(Aug)	+79.9	(Q2)	+10.6	0.74	0.77	-3.9%
Italy	+34.6	(Aug)	+12.3	(Aug)	+0.5	0.74	0.77	-3.9%
Spain	-22.1	(Jul)	+6.0	(Jul)	+0.8	0.74	0.77	-3.9%

Source: The Economist

Finally, the U.S. dollar continues to weaken in China and in the European Union. Although much of the euro area is still dragging in terms of recovery, the euro is expected to benefit as political uncertainty in the euro zone continues to dissipate and as positive signs of economic turnaround in Spain come to light, while fiscal wrangling is seen continuing in the U.S.

OREGON AND THE PORTLAND AREA

The Oregon Office of Economic Analysis (OEA) states that Oregon's economy is steadily improving, much like the rest of the nation with recent job growth in Oregon's private sector being faster than the national private-sector growth. The largest increase in nonfarm payroll employment (seasonally adjusted figures) since July 2013 were in Education and Health Services (+2,500), Manufacturing (+1,200), Leisure & Hospitality (+700), and Government (+700). From an annual perspective, the industries with the highest job growth from August 2012 are Leisure & Hospitality (+10,300), Professional and Business Services (+6,800), and Educational and Health Services (+6,500). Since August 2012, government employment shrunk by an estimated 6,000.

Figure 10: Oregon job growth, nonfarm payroll employment, seasonally adjusted, thousands

				Change From	
	Aug-13	Jul-13	Aug-12	Jul-13	Aug-12
Construction	71.0	70.5	69.3	0.5	1.7
Manufacturing	176.0	174.8	172.0	1.2	4.0
Trade, Transport and Utilities	321.4	322.0	316.0	-0.6	5.4
Financial Activities	89.2	90.5	90.2	-1.3	-1.0
Professional and Business Services	202.0	202.2	195.2	-0.2	6.8
Educational and Health Services	244.6	242.1	238.1	2.5	6.5
Leisure and Hospitality	180.7	180.0	170.4	0.7	10.3
Other Services	59.1	58.7	57.2	0.4	1.9
Government	285.1	284.4	291.4	0.7	-6.3
Total	1,670.70	1,666.20	1,640.00	4.5	30.7

Source: Oregon Employment Department

Between May to August, 2013, the industries with the majority of Portland-Vancouver-Hillsboro MSA employment growth were in Leisure and Hospitality (+5,700), Construction (+3,500), Manufacturing (+4,700) and Professional and Business Services (+4,100), as seen below in Figure 12.

Furthermore, the OEA reports that recent job growth in Oregon's private sector has been faster than national private-sector job growth. Job growth is expected to accelerate over the next two years, with the state expected to fully regain the nearly 150,000 jobs lost during the Great Recession by early 2015.

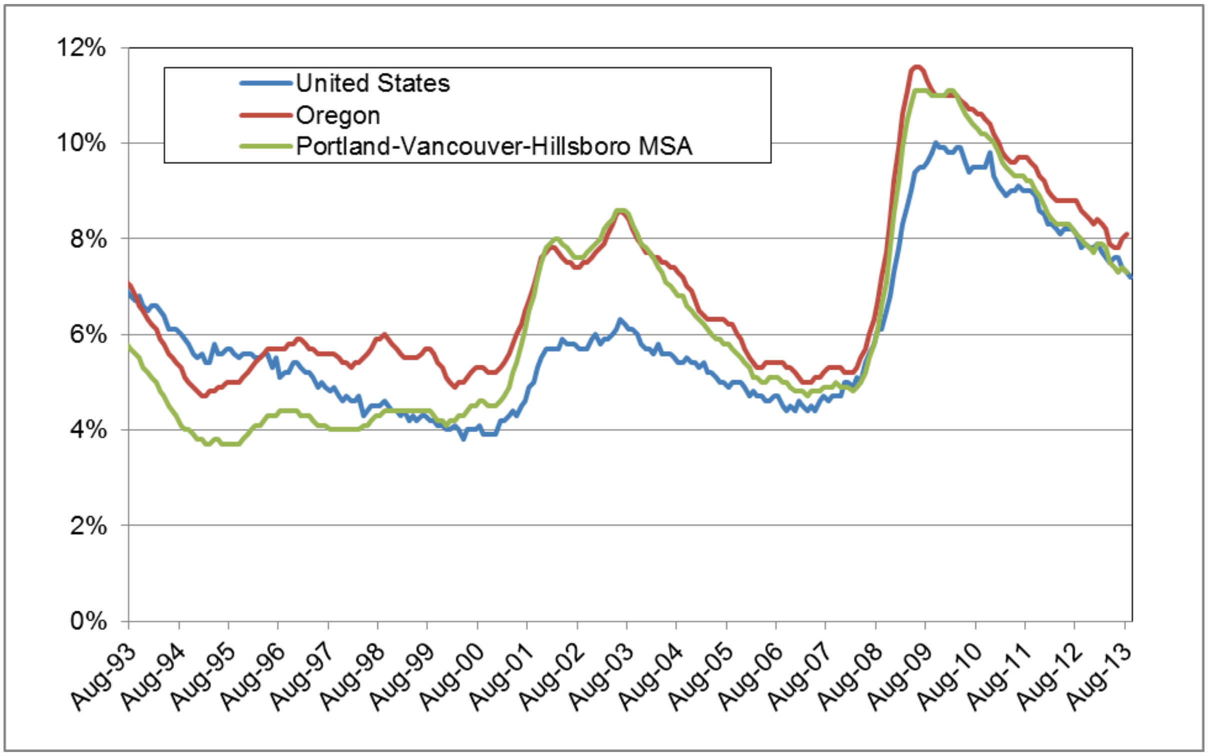
Figure 11: Portland-Vancouver-Hillsboro MSA, nonfarm payroll employment, not adjusted for seasonality

	May 2013		June 2013		July 2013		August 2013	
Total Non-farm Employment	1,034,200		1,040,700		1,030,400		1,030,800	
Unemployment rate	7.1%		7.6%		7.6%		7.1%	
Mining and Logging	1,000	0.0%	1,100	10.0%	1,100	0.0%	1,100	0.0%
Construction	48,800	3.4%	51,300	5.1%	53,100	3.5%	53,500	0.8%
Manufacturing	114,100	0.4%	115,800	1.5%	117,500	1.5%	117,900	0.3%
Trade, Transportation, & Utilities	196,800	1.4%	197,400	0.3%	199,000	0.8%	198,800	-0.1%
Information	23,600	1.7%	23,700	0.4%	24,000	1.3%	23,900	-0.4%
Financial Activities	64,500	0.3%	65,200	1.1%	64,400	-1.2%	63,500	-1.4%
Professional & Business Services	144,000	0.5%	145,500	1.0%	148,700	2.2%	148,100	-0.4%
Educational & Health Services	150,700	-0.3%	146,400	-2.9%	141,700	-3.2%	143,600	1.3%
Leisure and Hospitality	104,200	1.4%	107,800	3.5%	109,400	1.5%	109,900	0.5%
Other Services	37,500	0.8%	37,400	-0.3%	38,200	2.1%	38,800	1.6%
Government	149,000	0.6%	149,100	0.1%	133,300	-10.6%	131,700	-1.2%

Source: Oregon Employment Department

The region experienced a year-over-year employment gain of approximately 26,200 jobs from August 2012 to 2013. In percentage terms, the metro labor market expanded by 2.6 percent in the past 12 months.

Figure 12: Unemployment rate, national and local



Source: Bureau of Labor Statistics and Oregon Office of Economic Analysis

Oregon's unemployment rate typically treads above the national rate and in August was 8.1 percent, slightly higher than the national rate of 7.3 percent for the same month (Figure 12). Portland-Vancouver-Hillsboro MSA has observed persistent growth in employment in recent years and, although more volatile than both the national and state unemployment rates, had unemployment remain steady at 7.3 percent in August, which is equal to the national level on a seasonally adjusted basis.

In this improving economic climate with steady employment expansion and increasing consumption, the outlook for Oregon and the Portland metro region remain strong. ■