THE STATE OF THE ECONOMY

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The global economy and the United States economy continue to grow moderately. In the United States, GDP increased very little, with increased but moderate growth projections, unemployment has dropped further, interest rates and the price of oil remain low, although the latter has increased since fall 2014. Job growth continues, although wage growth lags, and inflation is almost non-existent. There seems to be a slight improvement of the fundamentals nationally, while regionally and locally, Oregon and Portland MSA are showing strong signs of market health.

THE WORLD ECONOMY

The International Monetary Fund projects global growth at a moderate 3.5 percent in 2015. This April World Economic Outlook echoes its January forecast, and follows a 2014 global growth of 3.4 percent.

In advanced economies, potential growth of output is expected to increase slightly from the average of 1.3 percent during 2008-2014, to 1.6 percent during 2015-2020. This can be contrasted with emerging economies, which is expected to have a slower projected growth of potential output, moving from 6.5 percent to 5.2 percent over the same time period. The decrease is largely due to lower productivity growth as technological gaps between advanced and emerging economies get narrower. Prior to the crisis, the output growth of emerging markets was over-stated

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as much of it was due to structural transformation and the expansion of global and regional value chains. As commercial infrastructure becomes more commonplace in these emerging markets, their growth rate slows to a more sustainable and fundamentally sound rate. In contrast, much of the advanced economies had already experienced exceptional growth due to innovation in information technology. Prior to the crisis, the output growth rate of these advanced economies had already started declining. In analyzing potential output growth, it is largely affected by the growth of the working-age population, changes in the labor force participation rate, and the productivity and investment of capital.

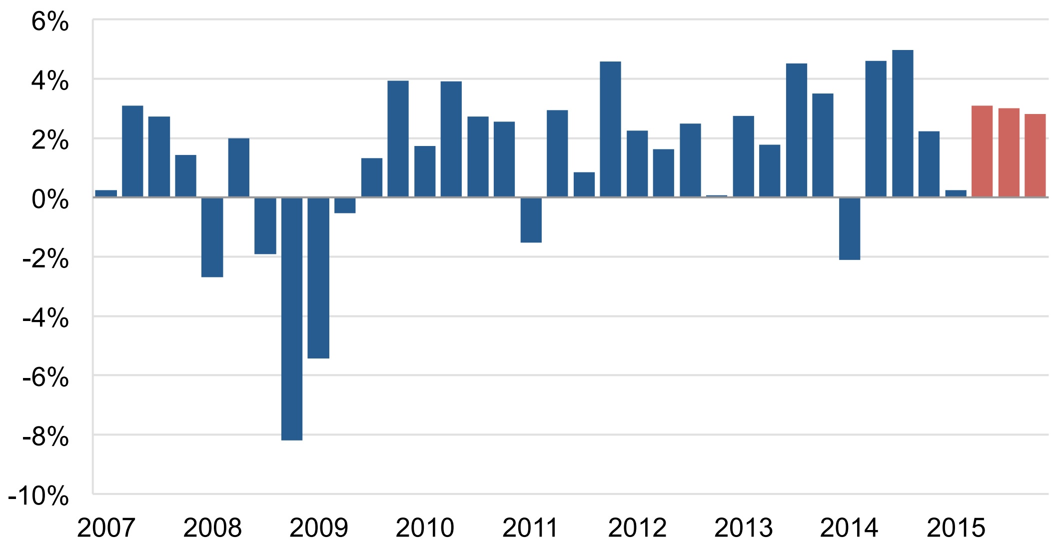
Oil prices continue to be low. While the price has increased by almost 30 percent since its recent low, which saw the largest drop since 2009, the price is still only at 60 percent of its 2014 high. This will provide an economic boost for oil importers, but will obviously dampen growth for exporters. As the Economist points out, the number of rigs drilling for oil in the U.S. has fallen by half since October 2014. While that reflects a loss of about 800 rigs, hydraulic fracturing (fracking) has surprisingly not slowed. As a costlier extraction method relative to conventional drilling, it was expected that the unconventional method of fracking would be unable to compete in the face of lower oil prices. However, frackers have been able to cut costs, due to the falling price in labor, steel and other inputs. With the cost improvements and productivity improvements in fracking, coupled with its gaining share of the capital investment in the United States, American oil production is still growing and is likely to continue. As the IMF mentions, Saudi Arabia has stated openly that it will not cut production, leaving some to argue that this strategy is aimed at pushing such higher cost extraction activities out of the market. In addition to the environmental concerns that accompany fracking, this minor shift in the source of our oil has other consequences. As local economist Bill Conerly suggests, “the collapse of actual oil drilling will have repercussions in a broader swath of the economy,” a good example being the steel industry. As rig counts decrease, so do steel shipments, reflecting the importance of oil drilling in steel demand, albeit not the only one. He notes that we should be on the lookout for other regions and sectors to understand more of the effects of cheap oil.

THE UNITED STATES ECONOMY

Growth in the United States has been “energetic”, the IMF suggests, especially when compared with the diverging trajectories of the other major economies, which are showing weaker recovery. Despite a low 0.2 percent annualized first quarter GDP growth rate, as evidenced in Figure 1, GDP has shown strong growth over the last year, with consumption being the main engine of growth. As has been previously stated, this low growth rate in the beginning of 2015 is likely due to the cold weather, which kept Americans at home instead of in the shops. But another likely culprit is the stronger U.S. dollar, which affects the revenues that companies receive from abroad. According to the Economist, of third of revenues from companies in the S&P 500 index come from abroad, corporate profits fell by 1.6 percent in the fourth quarter of 2014, and were 6.4 percent lower than in the same quarter of 2013.

Nevertheless, Washington Street Journal's survey of economists continues to forecast a GDP growth rate of approximately 3 percent in coming 2015 quarters.

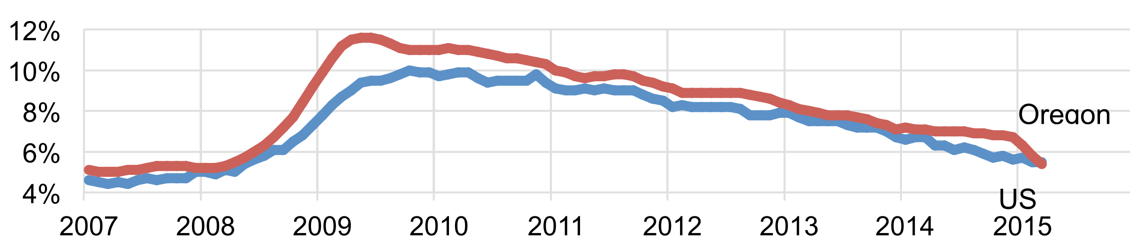
Figure 1: Gross Domestic Product, United States, Annualized Percent Change, 2007–2015



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

As the Bureau of Labor Statistics (BLS) states, unemployment in the U.S. continues to stay low at 5.5 percent (Figure 2), with an average trailing twelve month rate of 5.9 percent, and the number of unemployed persons was 8.6 million. In the first quarter of 2015, total nonfarm payroll employment increased by approximately 560,000 as of March, with a relative increase in professional and business services, health care, and retail trade, and mining losing jobs. Twelve-month job growth is 2.2 percent, however, as the Economist points out, many of these new jobs are low-wage professions such as retail, and many of the current jobs are not full-time.

Figure 2: Unemployment Rate, Oregon and United States, 2007-2015

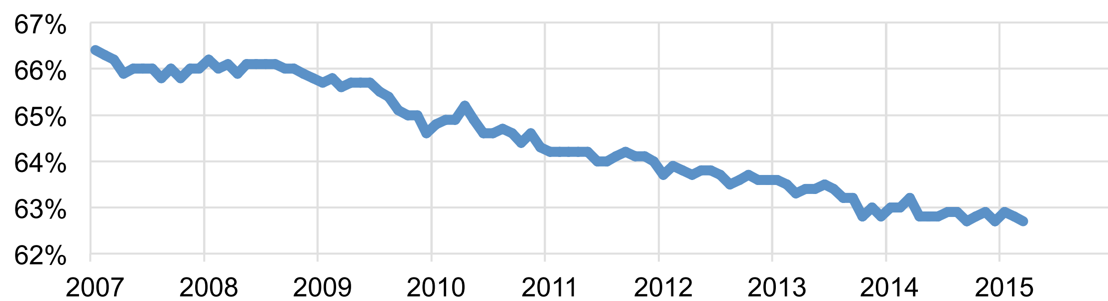


Source: Bureau of Labor Statistics

While the unemployment rate has continued to drop, the labor force participation rate has also continued to decrease to 62.7 percent, the lowest level since 1977, when there was a smaller share of women in the workforce (Figure 3). Over the last several years, many have been asking: Why is the participation rate decreasing? What are the drivers? The most common answers are: the increasing number of baby boomers who retired early upon losing employment, young people staying in higher education longer, delaying their entrance into the labor force, and people who were experiencing longer term unemployment and had dropped out of the labor force.

Perhaps the most important reason to look behind the 62.7 percent, is to know what could happen with wage growth in the future. When the economy improves further, who will come back into the labor force? BLS data shows that wage growth has increased slightly, but as the Economist points out, that may entice those out of the labor force to compete for jobs, having a negative effect on wage growth. Add this to the fact that the number of full-time jobs is lower and the number of part-time jobs is higher than before the recession hit. Conclusion: there is still slack in the market and we may not see substantial wage growth in the near future.

Figure 3: Labor Force Participation Rate, United States



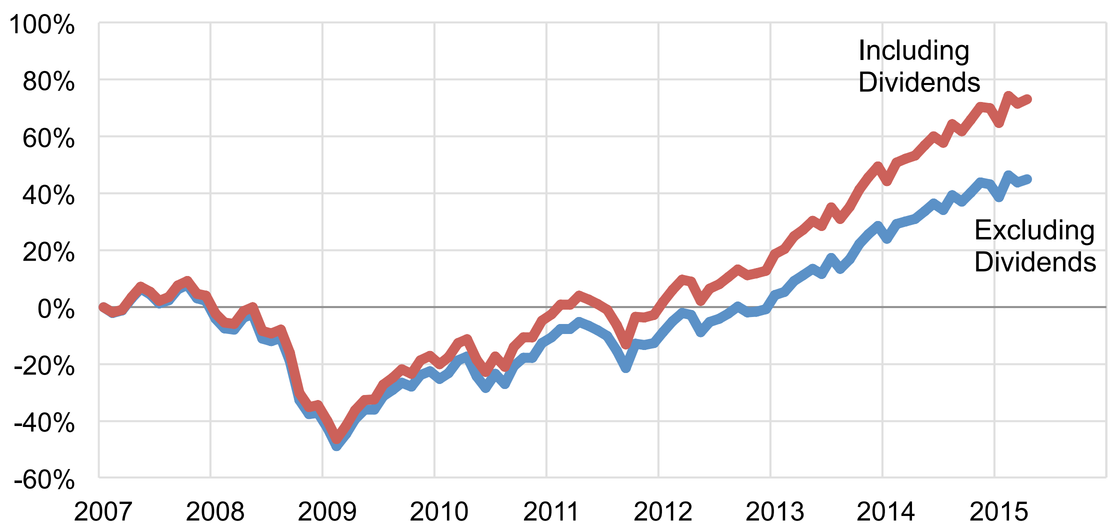
Source: Bureau of Labor Statistics

Inflation continues to be mildly positive, but consistently low. The seasonally adjusted month-over-month Consumer Price Index continues to hover just above zero, at 0.2 percent in both February and March, following slight deflation from November to January. The BLS also reports the unadjusted CPI has decreased since March 2014.

Dialing into the CPI, there were increases in the energy and shelter sectors, the former with major contributors being gasoline and fuel oil, and the latter evidenced by our booming national multifamily markets. There was also a noteworthy 1.2 percent increase in used cars and trucks, which has a twelve-month change of negative 1.3 percent. This is contrasted with a decline in food, and very low growth in all other sectors.

Since the end of Quantitative Easing in October 2014, the Federal Reserve no longer flushed the economy with money from their asset purchases, which had likely contributed to a higher rate of inflation during their QE days. Now, with inflation barely above zero, there is still a long way to go to reach the Federal Reserve's objectives: 2.0 percent inflation and maximum employment. Reaching these goals will influence the timing of Federal Reserve's liftoff of policy interest rates, which is expected to occur in the third quarter of this year, according to the IMF. Because the market has been showing resistance to growth in both GDP and inflation, many think it is unlikely that they will raise interest rates this June, as had previously been thought. However, as the Federal Reserve anticipates its next monetary policy moves, former chairman Paul Volcker has announced a plan to reshape the Federal Reserve itself. As the Economist reports, Volcker has assembled a group of people to reshape the financial institution with a focus on improving effectiveness and accountability of regulators, by merging agencies and separating powers. As the article states, it is likely that many in D.C. will be unhappy with limiting governmental power in the financial world.

Figure 4: Standard & Poor's 500 Index, 2007–2015



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

The U.S. Stock Market has continued to grow in the first quarter, with the S&P 500 (Figure 4) and NASDAQ Composite indices hitting record highs in February and April of this year. While this is impressive growth, surpassing the pre-recession peaks, many investors think the value of shares are being "propped up by lack of decent alternatives", as the Economist points outs. Bonds are overvalued and cash yields zero, or less in period of deflation. Concerns surrounding the global market's inflated value are illustrated in the earnings per share. While the global market has grown 10 percent since it 2007 high, earnings per share are essentially flat. In the

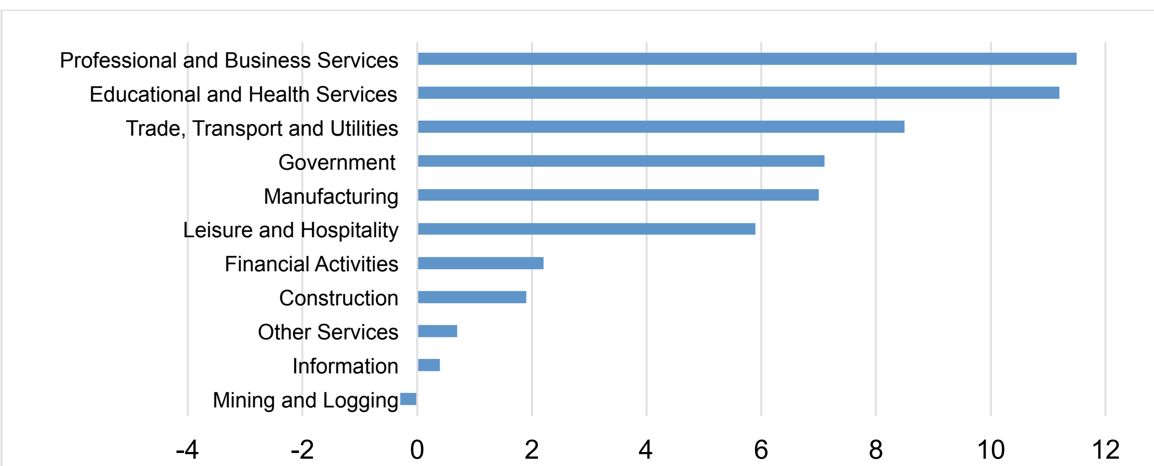
U.S. Stock Market, the market is 35 percent above its 2007 high, but earnings per share are up only 20 percent. As the article articulates, companies have squeezed higher margins out of these revenues, and investors are paying more for the value of these future cash flows, or the market is trading at a higher PE.

OREGON AND THE PORTLAND AREA

The state of Oregon has continued to show a strong pace of growth throughout 2014 in jobs, wages, and labor force participation and is expected to continue in 2015. The Oregon Office of Economic Analysis economic report further states that the labor market is not back to full employment, but outlines that there is still slack in the job market attributed to a participation gap, a lower underemployment gap and an even lower unemployment gap. The report concludes that Oregon is approximately halfway back to full employment.

Oregon's unemployment rate has dropped from 6.7 percent in December to 5.4 percent in March, a decrease in 1.3 percent in one quarter. While this is an impressive decrease, the number of jobs has also increased by 3.3 percent in the last 12 months, with sectors in Figure 5 showing the most number of jobs added.

Figure 5: Oregon Job Growth over last 12 months, Nonfarm Payroll Employment, Seasonally Adjusted (1,000's)



Source: Oregon Employment Department

In addition to an increase in the number of jobs, wages in Oregon are increasing at nearly 7 percent per year, on par with the mid-2000s expansion, with an average wages growth per worker of 3 percent, slightly above the rates of inflation. This has not had much of an impact on real wage growth, but expectations are that real wages will pick up further in the future.

The Portland Metropolitan Region unemployment rate has continued to decrease over the first quarter, with a March rate of 5.2 percent. Employment growth was up by 2.9 percent from the previous March, with the highest growth rates in the Professional Services, Manufacturing, Trade and Transport, and Education, and a decline in Construction (a 2.0 percent decline). 1,091 jobs were added in March. Portland's unemployment rate continues to decrease at the same rate as Oregon's, relative to the national unemployment rate.

CONCLUSION

Overall, there is modest growth in the global economy, and the national economy is growing only slightly with incredibly low inflation and interest rates. Neither is expected to increase much soon. There is slight job growth coupled with a lower unemployment rate, but only a minor wage growth, a potentially over-valued stock market, fueled by a lack of comparable alternatives. Despite the uncertainty with the national economy, Oregon and Portland's local economies are showing healthy fundamentals and a continued positive trajectory. ■