

### Forecasting Economic Weather in 2008

January is usually the busiest month for bank economists, with so many outlook forums being held all over the place. Everyone wants to know what the New Year has in store, and this year is no exception. As a result, I am spending many nights in hotel rooms this month for speaking engagements.

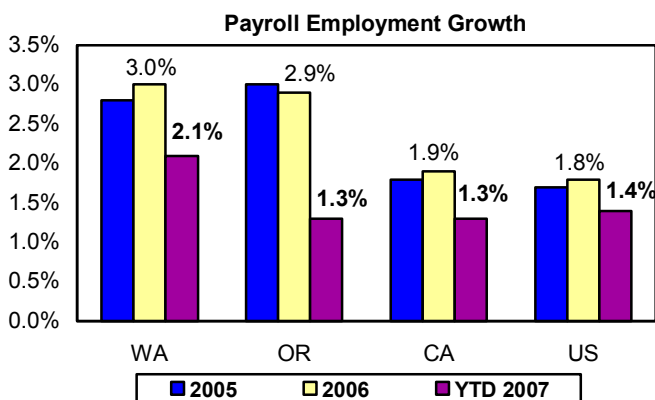
When I travel, I usually tune my hotel TV set to one of those financial news channels to stay abreast of the financial market and to catch economic data releases. That, unfortunately, often puts me in a sour mood. According to these channels, all sorts of economic calamities are about to happen, and it's depressing to hear about them over and over.

I concluded some time ago that it's not because newscasters and reporters necessarily think the U.S. economy will implode. The very data they quote do not support such a view. I believe they are after controversy, because that's what attracts viewers.

#### The Pacific Northwest remains an economic bright spot.

At these January economic forums, I offer my own forecast for the national or local economy. Unlike the financial reporters on TV, I prefer to deliver good news rather than bad. This can be accomplished quite easily as long as I stay within my home turf along the Pacific Coast, because the West is where growth is occurring right now.

In 2006, Washington ranked 6th and Oregon 7th among 50 states in terms of real Gross Domestic Product growth. The top honor went to Idaho, followed by Utah in second place. California ranked 13th. The Pacific Northwest was one of the brightest spots in the U.S. economy then. This fact did not change in 2007.



Percentage growth of nonfarm payroll employment.

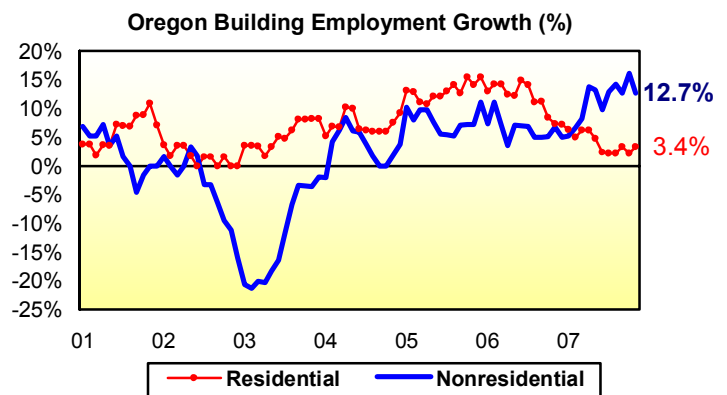
Year-to-date data are for the first eleven months of 2007 compared with the same period in 2006.  
Source: Bureau of Labor Statistics (BLS).

Still, after very strong economic performance in recent years, both Oregon and Washington show signs of slowing down. (See the preceding chart.) As of November 2007 (the latest month for which state-level employment data are available), year-to-date average employment growth was 2.1% in Washington and 1.3% in Oregon, compared with the corresponding 11-month period in 2006.

These rates are considerably lower than what both states achieved in 2005 and 2006. What changed since last year was that the building industry was no longer adding a large number of jobs to the Pacific Northwest economy.

#### The region's construction sector slows.

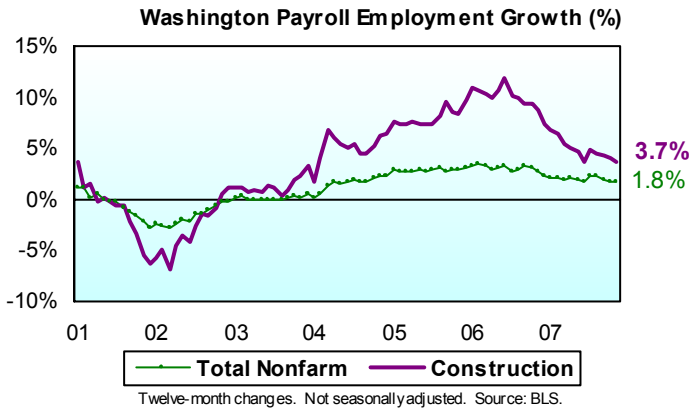
The deceleration was more pronounced in Oregon than in Washington. The November 2007 data show that construction employment in Oregon dropped 0.4% from a year earlier. While this decrease was small, it contrasts dramatically with the double-digit growth that the sector enjoyed between 2004 and 2006.



Twelve-month changes. Not seasonally adjusted. Source: BLS.

The end of the housing boom triggered this slowdown. The chart above shows that year-over-year growth of residential building employment dropped to 3.4% in November, while non-residential building employment increased 12.7%. In addition, manufacturing job losses in lumber and wood products, paper, and transportation equipment also pushed Oregon's job growth downward.

The chart on the next page indicates that construction job growth slowed in Washington, too, but not as much as in Oregon, California, or, for that matter, the entire country. In Washington, the sector expanded 3.7% in November 2007 from the same month in 2006, while California lost 3.7% of its construction jobs. Nationally, construction employment was down 2.9% over the same 12-month period. Washington was unique, with its swelling ranks of construction workers.



Washington is fortunate to have a few other industries that are performing well. One is the aerospace industry. Aerospace manufacturing had 7.1% more jobs in November 2007 than a year earlier. The Evergreen State gained 5,300 manufacturing jobs over the preceding twelve months, and this increase came almost entirely from the aerospace sector. Another industry that continues to expand is software publishing, which gained 2,400 jobs over the same period.

**Need an umbrella? How about an ark?**

Economic forecasts are like weather reports. They are just predictions, not facts. You ignore a forecast of rain at your own peril. By the same token, you believe a forecast at your own risk.

Using the meteorological analogy, the housing sector is currently an economic low pressure system, which can bring rain (a slowdown). Other industries adding jobs—such as aerospace in Washington—are high pressure systems, bringing more sunshine (continued growth) to the region. What kind of economic weather we have in 2008

will be determined by this interplay of low and high pressure systems.

I forecast partial cloud cover for Washington and an overcast sky for Oregon this year; the chance of rain (a recession) seems limited. We cannot, however, completely ignore the possibility of housing weaknesses developing into a tropical depression or even a hurricane.

Do pack your umbrella when you leave home—a little caution won’t hurt. At the same time, prepare for an upside and pack sunscreen, too. But as I see it, far too many people are currently building “arks” in anticipation of a deluge (especially about the U.S. economy). If the storm doesn’t come, those arks will look pretty silly sitting on the front lawn.

**Natural disasters seldom cause lasting damage.**

Talking about a great flood, the Pacific Northwest did in fact suffer much damage from a large storm in early December. Some communities were inundated with flood water, and portions of Interstate 5 became impassable.

For these communities affected, it must have been a horrific experience, and I pray for their quick return to normalcy. However, we can take some solace in knowing that, on a national and even a state level, natural disasters seldom cause discernable damage to the economy.

That’s because most economic activities that are put on hold during the disaster *will* eventually take place. Also, in the short run, clean-up and repair work heightens the activity level in affected areas. In the long run, a rebuilt and improved infrastructure can lead to greater efficiency.

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**Economic Forecast – January 2008**

UNITED STATES	2005	2006	2007	2008
Real GDP Growth (%)	<b>3.1</b>	<b>2.9</b>	2.3	2.7
Unemployment (%)	<b>5.1</b>	<b>4.6</b>	<b>4.6</b>	5.0
Payroll Employment	<b>1.7</b>	<b>1.9</b>	<b>1.3</b>	0.8
CPI Change (%)	<b>3.4</b>	<b>3.2</b>	2.8	2.4
Federal Funds Rate (%)	<b>3.2</b>	<b>5.0</b>	<b>5.1</b>	4.0
<b>OREGON</b>				
Employment Growth (%)	<b>3.0</b>	<b>3.0</b>	1.3	1.4
Personal Income Growth	<b>4.4</b>	<b>7.3</b>	6.2	5.3
<b>WASHINGTON</b>				
Employment Growth (%)	<b>2.8</b>	<b>3.0</b>	2.0	1.7
Personal Income Growth	<b>3.0</b>	<b>8.3</b>	6.6	6.0

**Bold: Actual.**

The information in this report is based on data available as of January 10, 2008, and has been obtained from sources believed to be reliable, but its accuracy, completeness, and interpretation are not guaranteed. We do not think it should necessarily be relied upon as the sole source of information and opinion.