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# Economic Forecast CONFERENCE 2012

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**J. Tayloe Washburn**

Washington Aerospace Partnership  
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## Maximizing Our Economic Potential

By Jeff Marcell



**Jeff Marcell**

Hiring at some of the Northwest's largest companies is expected to be strong in the coming months. The Boeing Company plans to hire 5,000+ annually for the next couple of years. Google's expansion brings with it 600+ jobs. Software firm HCL is adding another 400+ jobs. HTC Corp. hopes to add 100+. Amazon estimates bringing on 1,000 jobs this year alone.

These signs by no means guarantee that a full recovery will occur or that it will reach all areas of our community. But they do highlight a choice for our community: we can hope for better times or we can take action to grow our economy and take control of our economic future.

The economic downturn and struggle to recovery have impacted us all. Everyone is now focused on jobs, difficult budget decisions, and other economic issues. There are some of us, however, who focus on these matters every day and in every economic environment.

We are enterpriseSeattle.

Forty years ago, community leaders came together in another historic downturn to establish this public-private partnership. They knew that if the regional economy was to meet its full potential to create and maintain jobs for its citizens, they needed to create an organization dedicated to economic development. Their initial efforts have evolved into enterpriseSeattle.

The enterpriseSeattle team of industry cluster experts focuses on the key drivers of today's economy; industries competing globally in the knowledge-based economy. We are currently working with over 200 companies that are considering adding jobs in this region. Our organization is making deliberate speed to develop business accelerators, guide the performance of multiple Innovation Partnership Zones for the region, and create new economic development programs targeting emerging industries. Ensuring that these and other opportunities are pursued and the Seattle-King County business proposition is effectively delivered is critical to the region meeting its economic potential.

Our motivated Board of Directors and dedicated staff is internationally recognized for growing and sustaining the local economy. Under the organization's previous business plan, we assisted 60 companies that created and/or retained over 5,500 primary jobs in our region with a total impact of an estimated 9,000 jobs. enterpriseSeattle was able to make this impact because of the contributions of over 100 public and private sector partners.

We and our partners collectively implement strategic economic development plans to leverage the assets of our community as a whole. Our aim is to create sustainable economic growth to fulfill our region's potential. Our partners are leaders who fully understand the importance of a committed and sustained economic development effort. These leaders know that they increase the chances of success for their own businesses and organizations when they help to create a prosperous community for all. They are what make enterpriseSeattle the backbone of this region's economic development efforts.

If our community is to maximize its potential, we need your engagement in our efforts. enterpriseSeattle is launching an initiative that will update our strategic plan in 2012 and we want you to be involved in our work to grow our economy and create jobs. Please contact me at [jmarcell@enterpriseSeattle.org](mailto:jmarcell@enterpriseSeattle.org) or visit [www.enterpriseSeattle.org](http://www.enterpriseSeattle.org) to learn more about becoming a member of enterpriseSeattle.

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## Some encouraging news seen for local economy in 2012

By Cynthia Flash

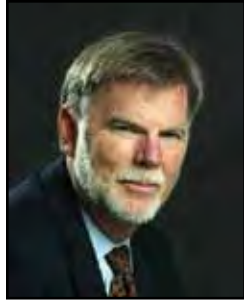
While the Puget Sound economy grew little in 2011, signs point to a better 2012, predicts local economist Dick Conway, publisher of "The Puget Sound Economic Forecaster" newsletter and a member of the Washington Governor's Council of Economic Advisors.

He cites several reasons to be more optimistic in the new year. They include:

**Boeing:** Big news occurred in December when Boeing and the machinists union signed a four-year labor contract that guarantees labor peace and puts the company on track to build more airplanes. With 75,000 employees, Boeing remains the region's largest private employer, impacting one out of every nine jobs. As part of the agreement, the union's 28,000 members will receive a generous pay package and a \$5,000 signing bonus. The contract also ensures that the 737 MAX will be built in Renton. Boeing has orders for 3,500 airplanes, which will keep the production lines going for seven years. Conway estimates the 737 MAX will require 2,000 to 3,000 additional local production workers. "The long-term outlook for Boeing has rarely looked better," he said.

**Jobs:** Boeing added 7,000 new jobs over the past year, helping the Puget Sound region to perform better than the nation during the recovery. Conway notes that between the first quarter of 2010 and the third quarter of 2011, the region regained 36,000 of the 141,000 jobs lost during the recession. This represented a 2.1 percent increase in total employment, 0.6 percentage points greater than the national gain over the same period. This is significant because the Puget Sound region suffered a deeper downturn than the nation.

**Retail sales and customer service:** An unexpectedly bright spot in the economy has been retail sales. "We thought consumers – who had built up debt and lost value in their homes – would continue to be a drag on the economy," Conway said. "The consumer sector is still holding things back, but not as much as we had expected, thanks to the rebound in the sales of automobiles, electronics, and other goods." Although final numbers are not in, holiday sales look good, perhaps up 5 percent or 6 percent locally. In addition, Consumer Reports ranked Costco, Microsoft, Amazon and REI among the top 10 national companies with the best consumer policies, something



Dick Conway

customers already know as they continue to buy from these retail heavyweights.

**Foreign exports:** Demand for U.S. foreign exports, which has been growing at 9 percent for three years, has been an exceptionally big help to the regional recovery because, on a per capita basis, Washington is the nation's top foreign exporter. In fact, one in four state jobs depend on foreign exports, which have been the fastest growing sector of the state economy for decades. Credit goes in large part to Boeing and Microsoft, which sell more than one-half of their products to other countries. Unlike Boeing, Microsoft has not added many jobs recently, but it did grant a substantial pay hike to its tech workers, putting more than \$500 million into the local economy.

That's the good news. But there are still obstacles in the way, Conway said. One thing to remember is that during the recession, the Puget Sound economy dug a relatively deep hole. Ironically, this was due to the fact that prior to the recession employment and population in the four-county region King, Pierce, Snohomish, and Kitsap counties had been growing at twice the national rate. Like elsewhere, this region had a housing bubble, fueled by speculative activities such as subprime lending. But the region's strong economy put the housing market on an even higher plane. Thus, when the housing bubble collapsed and the financial markets crashed, the region had farther to fall. During the recession, the Puget Sound region lost 7.6 percent of its employment (one out of every 13 jobs), while the nation lost only 6.2 percent.

Conway believes the housing market is stabilizing, despite reports that home prices continue to fall. He contends that the average home price has been a misleading indicator of home prices since it includes foreclosures and short sales. He believes prices on homes that are not in foreclosure have remained relatively constant since early 2009. "That's extremely important, because it means that there has been much less risk to

buying a house or making a home loan than most people think," he said. "In any event, we have seen signs of improvement in the housing market, including slow but steady gains in sales and building permits."

The biggest area of concern going forward involves state and local governments, which never completely recovered from the 2001-2003 recession, Conway said. "Things got better around 2007, but then tax revenues went into reverse and have been falling until only recently." Local governments have been protected somewhat because much of their revenue comes from property taxes. However, because

has one-fifth less per person to spend than it did in 2007. "The cuts in state expenditures are real," Conway said. For a time the state received financial support from the federal stimulus package, but that money is now gone.

Conway estimates that state and local governments will have to lay off people for another year or two, which will hinder the economy's recovery. He fears that cuts to education, infrastructure, and safety will have long-term implications for the state's economic development and quality of life. "We won't get back to anything like we had, even in 2007, until after 2020 and that's assuming reasonable growth," said Conway, who advocates overhauling the state's tax system.

### "The long-term outlook for Boeing has rarely looked better."

the state relies heavily on volatile sales taxes (especially taxes on new construction), its coffers have been hit hard by the economic downturn, Conway said.

Since 2007, state revenue and expenditures have dropped more than 20 percent, taking into account inflation and population growth. This means state government

"The economy is recovering, but the effects of the recession will linger for a long time, especially with regard to the role of state and local governments," he said.

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## WHEN IT MATTERS TO YOU IT MATTERS TO US



There's something special about Western Washington.  
It shows in the way we live, work and care for our families here.  
It shows when we gather together to make a difference  
in the community. We share your passion and your commitment.  
After all, this is our home too.



## Aerospace – Will Washington State Make the Grade?

By Crai S. Bower

In an economic era beset with intransigent labor v. management struggles, broken government and populist uprisings, the cooperation that produced one of the largest wins in Washington economic history is especially monumental, if not revolutionary. Not only did the Boeing machinist union and management team quietly forge a far reaching “win-win” contract extension, state, county and city governments worked intimately with industry aerospace leaders to confirm the region’s position as the world’s foremost aerospace manufacturing hub. The benefits of this collaboration enhance not just the area’s well established upper blue collar citizens but also boost educational institutions from kindergarten to the universities, civic infrastructure and cultural interests across the state.

This is not to say that building the 737 MAX is free from potential liability as the current workforce ages and a potential dearth of qualified machinists and engineers looms. However, comprehensive preparation for a robust future during a period of uncertain economic times fueled in part by a public’s dependence upon instant gratification serves as one example of how far the local aerospace model may reach. According to several experts, the blueprint for winning Boeing’s approval (and subsequent record 737 MAX \$19B jet order with Southwest Airlines) should serve as a rubric for other business communities, not only in Washington State, but also across the nation.

“We build better airplanes than anyone around the planet, from engineers to the machinists on the line to test pilots,” states Jeff Marcell, President and Chief Executive Officer of enterpriseSeattle, “but how do we best maximize this economy which impacts our communities across the spectrum?”

The King County Aerospace Alliance, led by county executive Dow Constantine and the Washington Aerospace Partnership (WAP), led by Governor Gregoire and industry leaders were formed to address this question and to best position Washington’s hundreds of aerospace companies in the intensely competitive bidding process for manufacture of the 737 MAX and future projects. The WAP hired Accenture to conduct the “Aerospace Competitiveness Study,” a candid appraisal of the state’s competitiveness individually and in comparison to primary



Students in Renton Technical College's Aerospace Assembly Mechanic Training Program. Photo courtesy of Renton Technical College.

competitors including Texas, South Carolina and Oklahoma, all states with far fewer business regulations and less compensated, i.e. costly, workforces.

Accenture’s Craig Gottlieb led the study. “When we looked at Washington compared to other states with aerospace capabilities, what stood out was, while the other states present a lower cost of doing business, Washington’s work force and the productivity of the work force. The well established supply chain also presented a clear advantage.”

Gottlieb’s team applauded the local community and technical colleges in training highly skilled, quality workers. The study also cited the vast network of existing Boeing and supplier facilities that support 737 MAX manufacturing investments. However, the Operations Management Consultant expressed concern about competitor states gaining on Washington’s highly skilled workforce through innovative STEM K-12 science and math programs, a threat exacerbated by recent deep cuts in Washington’s education funding, reductions more severe than in other states.

“The primary goal for Washington is to maintain its advantage,” Gottlieb continues. “Washington will never adopt the policies of other states to make it a cheaper investment. Yet workforce quality stands out. Because of this, investments in the present and future workforce are vital through apprentice and work investment programs from foundational matters like elementary math and science education to graduate school in engineering at the UW, as well as machinist skills at technical and two year colleges.”

The study called for several immediate actions: a strengthening of the state’s existing post-high school aerospace certification and apprenticeship programs; an increase in the number of high quality engineering graduates and expansion of aerospace-relevant research at UW and WSU; improvement in the readiness of current high school students to meet new work force needs; strengthening of the current manufacturing and research base by state tax credit extensions; and the continuation of the government’s role in developing positive relationships between government, Boeing, its suppliers and organized labor.

The study also recommended several actions within the next 12 to 24 months: increased student engagement and performance in math and science in grades K-8; creation of a position within the governor’s office to ensure and coordinate the ongoing support for the aerospace industry and its workforce; and work with national political representatives to fund and support workforce education for veterans and others.

“The challenge starts in kindergarten and continues all the way up,” observes J. Tayloe Washburn, co-chair of the Washington Aerospace Partnership. “We also need more focus on teacher training in science and math. If we invest strategically in putting elementary aerospace training curriculum into our grammar and middle schools, then kids can get machinist training in high school. Other kids will continue to UW and WSU for engineering degrees, so we need more space there as well.”

An attorney at Foster Pepper PLLC and a board member of the Seattle Chamber of Commerce, Washburn says he joined the Washington Aerospace Partnership because he saw an opportunity to increase the state’s education funding while improving the economy. “The reason I got into this was the recognition that at our local, county and state level we have less revenue, and we are making terrible cuts in education. But it seems just as obvious to me that if we create jobs, we reverse this trend. In this state, aerospace is the key to our growth. We have to recognize this.”

With the Aerospace Competitiveness Study in hand, the Washington Aerospace Partnership proposed several concrete funding initiatives to the legislature that included: a \$150,000 investment in two skills centers; a \$300,000 start-up grant to 12 high schools for aerospace assessment and manufacturing support; \$250,000 in start-up support for advanced aerospace related high school courses.

The proposed legislation agenda also includes: post-graduate credit in aerospace related courses; more rigorous teacher standards in science and math; \$1.5 million in start-up funds to form a Center for Aerospace Technology Innovation at UW and WSU; extension of the B&O tax credit until 2034; and \$7.6 million to support additional engineering students at UW and WSU.

“We’ve already convened meetings with several school district superintendents to determine how we can improve science and math in K-5 schools as well as with deans from the state’s universities and colleges with an eye on filling critical roles in the aging aerospace workforce,” states Marlena Sessions, Chief Executive Officer of the Workforce Development Council of Seattle-King County. “Being a very education oriented community, parents and students alike aspire to four year engineering degrees, but representatives from Boeing and their suppliers are telling us that there will be many great careers that require a two year degree, or less. By the numbers, 318 of the 360 different occupations inside Boeing require just a two year degree.”

“I had to be picked off the floor when we received the \$1M,” exclaimed Linda Lanham, President and Executive Director of the Aerospace Futures Alliance (AFA), whose organization received the

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# Boeing, labor accord fuels King County Aerospace Alliance

By King County Executive Dow Constantine

With The Boeing Company and the Aerospace Machinists reaching an historic five-year labor agreement to keep production of the 737 MAX right here in the Puget Sound region, we have the opportunity to both hasten economic recovery and expand our position as a world leader in aerospace.

The King County Aerospace Alliance (KCAA), a coalition of governments, business organizations, labor groups, and institutions of higher learning, has united to keep our region at the forefront of aerospace production. Though we build on a remarkable legacy, our work has just begun.

As we compete in a global economy, it is now more critical than ever to align our investments in education, workforce training, and transportation infrastructure, and to eliminate unnecessary time and cost of necessary regulation, to keep Washington State the best possible place in the world to build airplanes.

Boeing has achieved dramatically increased efficiency through the use of Lean principles throughout the manufacturing process. King County government is adopting the same approach. KCAA may be seen as a forum for applying an efficiency lens to all the factors outside the four walls of the factory that impact competitiveness.

KCAA links government, business, labor, and education together to support the creation of local, family wage jobs for this generation and the next. The factories, workforce, and the supply chain are all here. But we cannot take our advantages, nor our success, for granted. Growth opportunities are coming. So is tougher competition. We need to work shoulder-to-shoulder in this state to build our



**Dow Constantine**

aerospace industry and help it thrive.

KCAA supports Governor Chris Gregoire's statewide action agenda. These six bills would:

- Set more rigorous standards for math and science instruction;
- Create grant opportunities for career courses in Science and Engineering;
- Coordinate workforce training for aerospace manufacturing;
- Establish a joint center for aerospace and technology innovation, and
- Extend the existing B&O tax credit for aerospace from 2024 to 2034.

King County is home to about half of our state's 870 aerospace companies and a well-educated, highly qualified workforce. The aerospace industry is not just the backbone of our local economy; it's what built King County. It's in our DNA.

But, our workforce is aging. The average Boeing worker is nearly 50. And while that doesn't sound nearly as old to me as it used to, the fact is that the next generation of aviation workers must get trained and be ready to step into available jobs at Boeing and hundreds of other aerospace companies.

Global competition for these jobs is fierce. A recent Washington Aerospace Partnership

competitiveness study warns that our rivals are not merely Texas, South Carolina, or Alabama, or even Western Europe. They are emerging, aggressive commercial airplane manufacturers around the world: from Russia to Brazil, China to Canada.

By the time that enterpriseSeattle holds its Jan. 12 Economic Forecast Conference in Seattle we will have received a preliminary, independent report on how King County can best support and expand our aerospace industry. This report will help guide the work to come.

Keeping the 737 MAX production right here in Renton is a great accomplishment. Our charge is to ensure that it is but the first of many victories as we return our region from recession to prosperity and ensure local, family-wage jobs for generations to come.



King County Executive Dow Constantine at the launch of the King County Aerospace Alliance in October 2011. Photo courtesy of King County.

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grant to offer new student loan funding specifically for aerospace training programs. "It's difficult to have the work but not the training with our aging workforce. Parents who are strapped would love their kids to get this education with a 90% hiring rate, but they couldn't afford to pay up front, so the ability to pay off in three years is huge."

The grant, designated to students working in programs at the Washington Aerospace Training and Research Center, Renton Technical College and Spokane Aerospace Technology Center was implemented in November and has qualified 22 applicants who will begin the training this month, 50% of whom are between the ages of 19-25.

"Five to six thousand aerospace employees will retire within the next five years," Lanham concludes, "programs like this will help fix the aging workforce issue."

AFA is instituting several other programs as well, including two high school certificate programs that will prepare potential workers

within six months of graduation from high schools in Kent, Auburn and Yakima. "Cool Girls in Aerospace" has teamed with the Boys and Girls Club to get girls interested in aerospace at a younger age. Still, the 28-year aerospace veteran remains cautious.

"Right now aerospace is the hot button," Lanham says, "but when the economy is humming along people walk away from it. Each time we become the hot button then we have to start from scratch. For years we have downsized and people have walked away, now we need to ramp up again and fast."

Lanham believes the current collaboration and subsequent publicity may finally erase the former boom or bust trends in

Washington's aerospace industry, beginning with the public's preconception that the local aerospace industry consists of just one company, Boeing.

"We have over 650 aerospace companies located in 29 of



Illustration of Boeing 737 Max. Photo courtesy of The Boeing Company.

Washington's 39 counties, and a quarter of those businesses employ less than 100 people. This acute relationship of small companies within the aerospace industry was a key element to getting the 737 MAX project," she says. "It's what makes the industry successful. Everyone is beginning to understand the importance of taking care of

every facet, that other aerospace companies need our attention."

Preparedness (The 737 MAX will be in full production when today's six graders enter the workforce!) remains the preeminent question according to all aerospace industry experts from the governor's office to the Accenture study to a lawyer who volunteers his time to secure the region's aerospace future as a strategy to reverse dangerous trends in education and, potentially, in the community's health.

"We must do more, we must do it quickly and we must do it well," Marlena Sessions states unequivocally, observing that in her career she has never seen such cooperation between government, industry and educational institutions.

Agrees Linda Lanham, "I have been in the industry for a long, long time and this is the most exciting time I can recall."

*Crai S. Bower is a Seattle-based freelance writer with Flowing Stream Writing. He can be reached at craisb@FlowingStreamWriting.net.*

## IT BEATS THE ALTERNATIVE

By Ken Goldstein

Despite a little more 'temporary' pep in the U.S. economy late in 2011, the global economy was showing signs of tiring. What will change in 2012? The U.S. is heading into a cold economic winter. Maybe the second half of 2012 will see better conditions domestically and globally. Just maybe.

Two trends combined to cool off the global economy. First, commodity prices had a nice run but that pushed up inflation enough, especially in the Asia/Pacific region to cool down industrial production and consequently global trade. It certainly didn't help that Europe was enmeshed in a struggle to define the way forward for the common currency. The consequent run up in interest-rate spreads evoked specters of another global financial market freeze up. The immediate impact was felt in financial sensitive sectors, like global trade. The result of all this was to take a global economy that entered 2011 running at about a 4 percent rate of growth and drop it down to not much more than 3 percent.

The U.S. is not immune to global developments. Still, more than two-thirds of U.S. economic activity is consumption. Three factors drove up



**Ken Goldstein**

the pace of consumption, and two virtually dictate that it will prove a window, not a trend. First, there was a sense this past summer that the U.S. economy might slip back into recession, and very anemic job growth might stall. Consumers, having patiently waited for more than two years for the restart of the Great American Job Machine, started to give up hope. Consumer expectations plummeted. The good news is that the economy instead of imploding, actually inched forward. That was enough to dispel some doom and gloom.

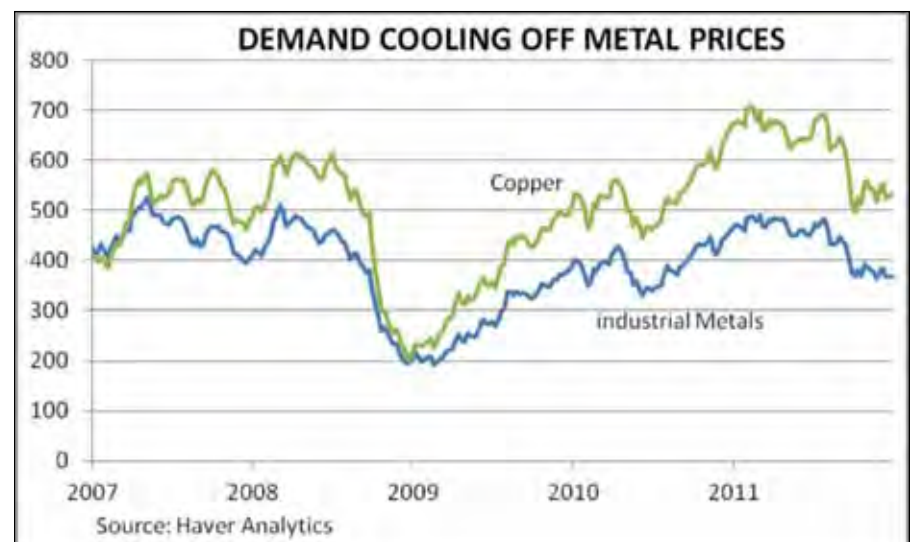
More than that, consumer fatigue set in. At least some consumers decide 'enough waiting.' And they replaced the old family clunker, that broken sofa, that troublesome washing machine. Or, the clunker, sofa, washing machine simply gave out and had to be replaced. Either way, consumption picked up a notch in the third quarter and continued right

through the holidays.

However, you know there was a catch, this spending was accomplished by dipping into savings and by borrowing — after years of deleveraging (paying down debt) and building up savings. Without dipping into savings and borrowing that clunker, sofa, or washing machine could not be purchased. To be sure, the economy started to generate about 120,000 to 130,000 new jobs a month in the second half of 2011. And the pay checks from these jobs helped turn falling disposable income into slightly rising disposable income.

if the housing sector finally drifts a bit higher. This sequence is going to play out. They only question is timing: First half of 2012 or will it take at least a year more than that.

Either way, these developments play out against a global backdrop of regaining momentum— another inevitability with the only question being that of timing. Well, actually there is a second question. And that has to do with the global transition: The international economy is now less dependent on the American consumer than on the Chinese investor.



But the bottom line is that it wasn't enough. Spending rose faster than income for much of the second half of the year. One doesn't need an advanced degree in economic theory to know that trend is not sustainable.

It won't be. After a reasonably good final quarter of 2011, expect the American consumer to settle down to a long winter's nap. Unless. Is there a chance that spending power might rise fast enough to allow spending growth to be sustained? Yes, of course, and in fact the odds while less than 50-50, are not minimal. What would this economic story look like?

Assuming only normal weather impacts (as if earthquakes and hurricanes ever behave normally), or China crashing, there is a chance that job growth might inch up, especially

Finally, the American economy is not just struggling to regain cyclical traction but continuing to undergo major fundamental transitions. The net impact is to deliver an economy growing by 2.5 percent, perhaps with 2.5 percent inflation, and bond yields and mortgage rates of about 6 percent or more. That is still three or four years down the road. And it will be less impacted by spikes in oil prices, but continuing to adjust to austerity in the public sector. This all adds up to a big story for later in the decade. Until then muddling through remains par for the course. As the doctor said to the patient recovering from surgery, "It beats the alternative."

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## The U.S. macroeconomic outlook: 2.5% in 2012 makes a raging bull?

By Michael Dueker

Based on Russell's current research, we expect U.S. real GDP will grow 2.5 percent on a year-on-year basis with jobs gains averaging 150,000 per month.

With U.S. GDP growth poised to finish 2011 at an anemic 1.8 percent on a year-on-year basis, it was a year in which little went right in an economy that still badly needs to recover from the Great Recession of 2007-09. In 2012, we expect growth to rebound to 2.5 percent, which, amazingly enough, puts Russell Investments in the 75th percentile among the 50 Blue Chip forecasters. Is the world really in such a state that a 2.5 percent growth forecast is for raging bulls only? It seems that, after overestimating growth in 2011, many forecasters are once bitten, twice shy—hence the low consensus forecasts for 2012.

We think, however, that 2012 will bring some improvement in economic growth. On the affirmative side, many of the setbacks in 2011 need not repeat themselves in 2012. First, inflation expectations appear to be more firmly anchored near 2 percent than they were in early 2011, when speculative bidding drove up commodity prices and fueled a temporary rise in inflation that is now falling out of the 12-month inflation numbers. Second, we can reasonably assume that the Japanese earthquake and the attendant supply-chain problems will not recur in 2012. Third, Libyan oil exports should only increase in 2012 after civil war took the country's oil production off line. Fourth, the debt-ceiling debacle from last summer will not likely be a precipice issue until 2013.

Lastly, we can only hope for policy clarity on resolution of the European debt crisis and long-term budget consolidation in the United States. Unfortunately this continuous policymaker injection of uncertainty was the most serious impediment to a strong 2011, yet it is the most likely to continue in 2012. In fact, one could argue that policymakers never missed an opportunity to inject uncertainty in 2011, as they raised expectations for definitive measures and then continually fell short. Examples included the August 2011 debt-ceiling debacle, followed by the do-nothing budget Super Committee in the United States Congress. More importantly, the European "big bazooka" policy proposals in November 2011 clearly failed to contain Italian bond yields to a solvency level.

One way to frame the specter of European financial meltdown is to ask whether market fears are moving out of the Cuban missile crisis phase and into ordinary Cold War danger levels. During the Cuban missile crisis, the probability of Armageddon reached a level high enough that people stopped what they were doing and reacted only to the



Michael Dueker

developing crisis. My general take on global stock markets, starting in August 2011, is that they assigned roughly a 20 percent probability that Europe would experience a financial meltdown, and market volatility ensued as news caused that probability to rise and fall by one or two percentage points. The question is whether the missile-crisis phase will end if the probability of a European financial meltdown declines and stays at 15 percent or so. At that level, people might treat Europe's problems like the constant threat of a nuclear exchange during the Cold War, in that they would get on with their lives and make decisions that largely ignore the worst-case scenario.

For this reason, my central-tendency forecast suggests that economic prospects are brighter for 2012 U.S. growth, even as the Eurozone experiences a shallow recession—barring a full financial meltdown in Europe. To bolster U.S. growth and to counteract the linkages that transmit economic and financial weakness from Europe to the United States, the Federal Reserve will likely be poised to undertake an additional round of Quantitative Easing by the Federal Reserve in 2012 if needed.

One key observation in our interest-rate outlook is that additional Quantitative Easing by the Fed would be warranted if the 10-year Treasury yield were to linger below 2.25 percent. Whether Fed policymakers see things the same way depends on whether they view today's low long-term yields as the product of a safe-haven anomaly in the face of European turmoil or truly weak growth expectations. Long-term interest rates can be too low for an economy's well-being, with low long-term interest rates reflecting expectations of low growth, low rates of return and low inflation. One of the chief purposes behind the Fed's two rounds of Quantitative Easing and Operation Twist, which is scheduled to end in June 2012, has been to reverse expectations of economic stagnation that lead to low long-term bond yields.

The details of Russell's U.S. economic outlook for 2012:

- Real GDP growth is expected to be 2.5 percent on a year-on-year basis in 2012. Our central-tendency forecasts are predicated on not having a full-bore financial meltdown in Europe.

- Our baseline forecast is that Europe will have a recession in late 2011 and in 2012, but the United States will not be dragged into it. This scenario is the reverse of 1990 and 2001, when the United States entered recession and Europe did not. Nevertheless, the U.S. economy would not be able to hum through a European financial meltdown in the way it did through the East Asian crisis of 1997-98. The financial and economic linkages between these two economies are too great to make the U.S. impervious to a European meltdown.
- Nonfarm payroll employment gains are expected to reach a plateau level between 180,000 and 190,000 jobs per month in the summer of 2012. Even with this improved level of job creation, the unemployment rate is expected to fall very slowly in 2012 with such a small gap between the year's jobs gains and the trend rate of increase in the labor force of about 150,000 entrants per month.
- Russell expects that the benchmark 10-year Treasury

yield will climb gradually above 2.5 percent by the third quarter of 2012, and it will end the year at about 2.75 percent. If this scenario unfolds, the U.S. economy will exit Japan-style stagnation expectations in 2012.

- Inflation outlook: Russell forecasts that the all-items Consumer Price Index (CPI) will increase at an average rate of 2.1 percent in 2012. Decent economic growth globally (with the exception of the Eurozone) will support energy prices that should keep the all-items CPI increase above core inflation, which is expected to remain near the target level of 2 percent. We do not expect a repeat of speculative increases in energy prices of the magnitude that we saw in the first half of 2011.
- Equities: Russell gauges that fair value for the Russell 1000® Index will be 720 (1300 for the S&P500 Index) at the end of 2012.

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