

Northrim Bank 2008 Mid-year Economic Overview

Alaska's economy appears to be continuing its pace of slow, but steady growth in 2008. The Gross State Product (GSP) of Alaska has increased eight of the last ten years. In June the Federal Department of Commerce released GSP figures for 2007. They show Alaska's net value-added economic activity totaled \$44.5 billion, up 3.2% over 2006 in nominal terms.¹ This again placed Alaska 6th out of the 50 U.S. states in highest GSP per capita. Alaska's per capita GSP was \$44,807, 18% higher than the national average of \$38,020².

Another indicator of wealth creation is per capita personal income. In 2007 it rose in Alaska to \$40,352 and was 5.8% higher than 2006 levels³. Alaska's per capita income average has increased 35% since 2000, while inflation has increased 20.4% over the same period. One of the major reasons for this above average increase was the growth in high paying oil and gas jobs. There was a 14% increase of 1,400 jobs in this sector in 2007. The average wage for these 11,500 total jobs is \$108,326 per year⁴. The annual average for all jobs in the state is \$43,524, giving these energy jobs 2.5 times more impact on per capita wages.

Other major economic drivers include strong increases in oil prices, tourism activity, cargo shipping, government spending, and mining exploration. The only major category to decline in 2007 was construction. Construction contribution to GSP declined from \$1.9 billion in 2006 to \$1.67 billion in 2007, a 12% decrease.

Nationally, problems in the construction, finance, and insurance sectors were major factors in real economic growth slowing from 2.8% in 2006 to 2.0% last year. The average growth rate over the last five years had been 2.8%. Real⁵ GDP growth slowed in 36 states, with the Far West region hardest hit. The deceleration in growth in 2007 was most pronounced in Arizona, California, Florida, and Nevada. However, Utah led the nation with a 5.3% growth rate, more than twice the national average. In the first quarter of 2008 real GDP increased at an annualized rate of only 0.9%, but grew at 3.3% in the second quarter.

¹ Source: U.S. Department of Commerce, Bureau of Economic Analysis. www.bea.gov
After factoring in inflation, the real GSP growth for Alaska in 2007 was 0.3%. 2007 numbers are preliminary, and the 2006 numbers for Alaska were recently revised upwards from \$41.1 billion to \$43.1 billion, a nearly 5% correction.

² Delaware remains in the top spot with \$56,496 per capita in GSP contribution, followed by Connecticut, New York, Massachusetts and New Jersey. Mississippi was the lowest at \$24,477.

³ Source: U.S. Bureau of Economic Analysis and Bureau of the Census.

⁴ Source: State of Alaska, Department of Labor, <http://www.labor.state.ak.us/research/ee/07ee97ex.xls> is an average of wages for the oil & gas extraction and mining support activities sectors.

⁵ "Real" GDP growth means that it has factored in the effects of inflation, "nominal" numbers have not.

Job Growth - Last year marked the 20th consecutive year of employment increases in Alaska. There have only been four years of job declines since statehood. According to the State Department of Labor, in 2007 there was a monthly average of 318,600 payroll jobs in Alaska, a 1.2% increase⁶. This figure does not include the estimated 23,000 uniformed military and 22,000 self employed workers.

Monthly job totals through June of 2008 have averaged 314,233 compared to 312,333 for the same six month period in 2007, a 0.6% increase. Due to strong seasonality these totals will continue to increase through the summer months. June's average for 2008 is 338,700 jobs.

The largest gain in 2007 employment came from the oil and gas sector, which increased 13.9% to a monthly average of 11,500 jobs. This sector also provides the highest wages in Alaska. Through June of 2008, oil and gas continues to provide the largest growth, adding approximately 1,000 new jobs compared to the first six months of 2007.

Other job growth areas in 2007 include professional and business services (+3%) and leisure and hospitality (+2%). The health care sector added 200 jobs, a 0.8% increase, but the rate of growth has slowed considerably. Over the last three years health care had been adding an average of 1,000 jobs per year, increasing 4% annually.

The area of most concern is the construction sector, which decreased 4% from 18,200 to a monthly average of 17,500 jobs last year. The average through the first six months of 2008 is 817 jobs less than the same period in 2007.

Alaska's seasonally adjusted unemployment rate declined 0.1% in June 2008 to 6.8%. This is up from a recent low of 6.0% early in 2007 and closely mirrors the recent rise in unemployment throughout the U.S. The U.S. rate is currently 5.5% and Anchorage is 5.8%. Due to high unemployment in rural parts of the state, Alaska's rates are typically 1% to 1.5% higher than the nation.

According to Department of Labor economist Dan Robinson, "Although both the Alaska and U.S. unemployment rates have climbed since 2007, Alaska has not seen the corresponding loss in jobs that is generally more problematic for an economy. Payroll employment increased by 1,500 over the year behind continued strong growth in the oil industry."⁷

Population - Mirroring the trend in job growth, Alaska's population has increased each of the last 20 years, at an average annual growth rate of 1.25%. 2007 population changes were slightly lower at 0.9%. Current estimates from the state demographer place

⁶ Source: State of Alaska, Department of Labor, <http://almis.labor.state.ak.us>

⁷ Source: State of Alaska, Department of Labor press release <http://labor.alaska.gov/news/2008/news08-61.pdf>

Alaska's population at 684,000 which ranks us as the 47th most populous state.⁸ Alaska now has 35 communities with populations of more than 2,000 people.

Most of Alaska's gains have been through natural increase (births minus deaths), adding about 7,300 people per year. Alaska's migration pattern is nearly balanced, with approximately 35,000 people moving in and out of the state each year. 2007 saw a net loss from migration of 1,727 people. There was a net gain of 602 international migrants and a net loss of 2,329 domestic migrants.

A recent Labor Department study reported between 2000 and 2007 the Mat-Su Borough population grew by 20,734 to a total of 80,056 people. This is an average increase per year of 4.1%, with 3.5% growth between 2006 and 2007. The Municipality of Anchorage population increased 23,540 over the same period to a total of 283,823, which represents a 1.2% increase per year, though only 0.2% growth in 2007. Together, the Anchorage and Mat-Su regions account for 53.7% of the state's total population.

The Interior Region grew by 8,051 to 105,468 thus far this decade. This amounts to a 1.1% average growth rate, though it was a rapid 3.2% rate in 2007. The Fairbanks Northstar Borough added 8,123 people while there were declines in the Denali Borough and the Yukon-Koyukuk census area in the last eight years.

Of the 28 boroughs and census areas tracked in Alaska only 10 had population increases. The largest losses have been in the Southeast Region which has lost 5.1% of its population since 2000, a decrease of 3,754 people.

International Exports - In 2007, Alaska exported more than \$4 billion in products internationally⁹. Asia remains our principal export market, with Japan, Korea, and China consuming over two thirds of our products. Japan is by far our largest customer, purchasing over \$1 billion in products from Alaska last year. Natural resources in the form of seafood, natural gas, timber, minerals and precious metals accounted for 95% of the total.

According to the International Trade Administration, 310 companies exported from Alaska overseas last year. Foreign controlled companies employed 12,100 Alaskan workers with the largest investment coming from the United Kingdom, Japan and Canada¹⁰. The largest impact in 2008 will come from the mothballing of the Agrium plant which had provided over \$200 million in fertilizer exports in the recent past. Good news came in June of 2008 when the Department of Energy approved a two year extension of the LNG export license for the Kenai terminal. The permit is now extended

⁸ Source: State of Alaska, Department of Labor, <http://labor.state.ak.us> Alaska is more populous than Vermont, Wyoming, and North Dakota.

⁹ Source: U.S. Census Bureau, compiled by the State Office of International Trade
<http://gov.state.ak.us/trade/>

¹⁰ Source: International Trade Administration
http://www.trade.gov/td/industry/otea/state_reports/alaska.html

through March 31, 2011 and should continue to provide over \$100 million in energy exports.

Mining - The mining industry continues to boom due to dramatic increases in global mineral prices, an influx of foreign investment, widespread exploration activity, and new mine development. The total value of mining exploration, development and production has averaged just over \$1 billion throughout the last decade. Then in 2004 the industry grew to \$1.6 billion and doubled to \$3.2 billion by 2006. Preliminary estimates from a recent McDowell report peg the value of 2007 activity at nearly \$4 billion, an all-time record¹¹.

Last year saw a record \$275 million in exploration spending, a 54% increase above the already high 2006 levels. Another \$274 million was spent on the construction of nine major new developments or the expansion of existing mines throughout the state. The gross mineral production value was approximately \$3.4 billion. The profits from these activities are expected to result in \$359 million in direct taxes to state and local governments and payments to partnering native corporations.

The future growth of the entire industry will likely be determined by the public and legal response to the development of the massive Pebble Mine prospect in southwest Alaska. Partners Anglo American and Northern Dynasty have announced resource discoveries of approximately a half a trillion dollars of copper, molybdenum and gold. The mine would create about 2,000 jobs and improve the power and infrastructure development in the region. However, its progress faces numerous environmental and regulatory challenges before it can begin which will set a precedent statewide for mining.

A major legal hurdle for the industry was passed on August 26, 2008 when Alaskans voted against Ballot Measure 4. Opponents to mining attempted to pass a “clean water initiative” which would have added extensive new regulations to large mining operations.

Airports - Activity at Alaska’s principal airports in Anchorage and Fairbanks continue to be a driving force in diversifying our economy. Continuing a long term trend, the number of cargo aircraft landings at the Ted Stevens Anchorage International Airport increased by 2,577 to nearly 50,000, up 5.5% in 2007. Passenger activity also increased by 96,012 up 1.9% to a total of 5.14 million people enplaned, deplaned or in transit¹².

From July 2007 through June 2008 the number of cargo landings is down 5.3% to 46,991 compared to the previous year. However, the passenger activity has increased 4.7% to 5.38 million people through the middle of 2008.

In Fairbanks, the number of cargo landings decreased in 2007 by 8.9% to 5,459, while the number passengers transiting through the airport increased 4.8% to just over 1

¹¹ Source: <http://www.alaskaminers.org/mcd07sum.pdf>

¹² Source: State of Alaska, Department of Transportation
<http://dot.alaska.gov/anc/business/marketing/statistics/index.shtml>

million¹³. For the first half of 2008 there have been 2,283 cargo landings, down 8.3% from the 2,491 through June of 2007. Passenger activity for six months in 2008 has totaled 481,223 people, up 2.7% from the total 468,604 at this time last year.

National Economy Impacts - Currently, there is widespread discussion and uncertainty in the broader U.S. economy. The U.S. real gross domestic product (GDP) grew 2% in 2007 compared to an average of 2.8% over the last five years. In the first quarter of 2008, real GDP grew at an annualized rate of 0.9%. The second quarter ending in June was an annualized increase of 3.3%¹⁴. The growth was fueled by the economic stimulus checks, higher than expected U.S. exports and lower import levels as oil prices declined. A recession is defined as two consecutive quarters of GDP declines. Therefore the country is not in a recession, though the rate of growth has been slower in some parts of the country. However, in most cases the national economic problems may actually be a benefit to Alaska in the form of a depreciating currency, lower interest rates, tax cuts and the Federal fiscal stimulus package.

Weak Dollar - The weak U.S. dollar actually benefits our export driven natural resource economy. It has resulted in higher levels of foreign direct investment, most notably in the mining sector, where over 70% of the investment comes from Canadian companies. The stronger Canadian dollar makes exploring and investing in Alaska relatively more attractive as the dollar declines. A weak dollar has also been linked to rising prices in the dollar-denominated oil market. High prices have led to a multi-billion dollar budget surplus for the state government.

Tourism - Tourism improves as Alaska becomes less expensive to foreign travelers, and U.S. travelers reduce their international travel plans in favor of domestic locations such as Alaska. The total number of out-of-state visitors has increased by a total of 313,800 over the last three years to 1.9 million, a cumulative 20% increase¹⁵. 87% of the visitors come during the five month period between May and September. Slower growth is predicted in 2008 due to higher costs imposed by the new federal passport requirements and the new head tax on cruise ship passengers, who now account for more than half of the state visitors. Declines in disposable income for domestic travelers is also expected to moderate spending.

Monetary and Fiscal Policy - National economic problems have also led the Federal Reserve to cut interest rates. This should spur on lending and refinance activity as money becomes cheaper to borrow. Most economists believe the current Fed Funds rate of 2% is the bottom and the question now is when will rates begin to rise again? When the rate hit its low of 1% in June of 2003 the Fed held the rate there for one year and then began 17 consecutive 25 basis point increases over the next two years¹⁶. There is much debate

¹³ Source: State of Alaska, Department of Transportation, <http://dot.alaska.gov/faiiap/index.shtml>

¹⁴ Source: U.S. Department of Commerce, Bureau of Economic Analysis
<http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>

¹⁵ Source: State of Alaska, Department of Commerce, Community and Economic Development, Office of Economic Development <http://www.commerce.state.ak.us/oed/toubus/research.htm>

¹⁶ Source: The Federal Reserve Board, <http://www.federalreserve.gov/fomc/fundsrate.htm>

as to whether they will use a predictable, measured, approach in any future increase or take a more aggressive approach to fight potential inflation.

The Federal fiscal stimulus package of \$600 to adults and \$300 for dependents has begun to be delivered to tax payers. It should provide a noticeable stimulus to consumer spending through the third quarter of 2008. With an additional \$3,200 per resident from the Permanent Fund dividends and the energy rebate, Alaska can expect an injection of over \$2 billion in cash this Fall. This is roughly equivalent to 5% of the gross state product.

Alaska still receives the largest share per capita of Federal spending of any state. Federal earmarks are expected to decline in the future, but cash from the economic stimulus package and increased military activity in Alaska could offset any short term losses.

The entire fallout of the national mortgage credit issue is still unknown. It has lowered the amount of new construction activity as builders have been more conservative in their investment decisions and is likely to lead to tighter credit standards nationwide, including Alaska. A tighter money supply tends to constrict economic growth. A major concern would be if lenders over reacted to the national mortgage problems and dramatically altered their lending policies; especially if their local market does not warrant significant changes. If this greatly reduces the velocity of money circulating in the economy it may exacerbate the problems that everyone is trying to avoid. Because of the banking multiplier effect through leverage, the impact is more pronounced.

Inflation – The Bureau of Labor Statistics (BLS) reported low inflation levels in both Anchorage and the U.S. in 2007, though inflation pressures are building in 2008. Consumer prices rose 2.2% in Anchorage and 2.8% nationally in 2007. 2.3% is also the 10 year average for Anchorage¹⁷. For the first half of 2008 the U.S. inflation rate is now 5% higher than this time last year and 4.6% higher in Anchorage¹⁸.

As expected, the largest increase in 2007 was in the aggregate energy index, which rose 9.9%. Energy only counts for 8% of the entire “basket of goods” tracked by the BLS. Though prices remain high, the increase in gasoline was only 6.5% in Anchorage in 2007, compared to a 13.9% run up in 2006. Food and beverage prices climbed 4.6%, medical care rose 3.0% and housing was up 2.7%. Countering these increases were education and communication which added only 0.7%. Recreation prices decreased 0.1% and clothing fell 2.8%.

Nationally, there is a growing opinion that our country’s decade long period of below average inflation is coming to an end. Flat or declining prices in many manufactured products have been attributed to low priced items imported from China and other developing countries. However, the recent run up in prices for energy, minerals and other inputs is beginning to impact broader markets. The tightly controlled Chinese yuan has only appreciated 20% against the dollar in the last three years. Inflation pressures are

¹⁷ Source: U.S. Department of Commerce, Bureau of Labor Statistics, www.bls.gov

¹⁸ Anchorage is the only metropolitan area in Alaska tracked by the BLS

intense in China and they have seen three straight months of inflation over 8% annualized¹⁹. This is creating internal pressure to raise wages, which in turn deteriorates their competitive price position globally. The net affect will likely be higher prices in the U.S. The largest impact will be in the retail sector, specifically toys, shoes, and clothing.

The Consumer Price Index rose 1% in June of 2008 and is now 5% higher than the rate in June of 2007. More than half of the increase has been attributed to a dramatic rise of energy prices, up 29.1% in the first half of 2008 in a seasonally adjusted annualized rate (SAAR). The second largest impact has come from food prices. In the first six months of 2008, food prices have climbed 6.6% at a SAAR. This accounts for one sixth of the overall inflation increase for the year. Other major index changes for the first half of 2008 at a SAAR include: transportation (+ 11.9%), other goods and services (+ 4.8%), housing (+ 4.3%), education and communication (+ 4.1%), medical care (+ 2.7%), recreation (+ 1.5%) and apparel (- 1.9%).

Foreclosure and Delinquency Rates – Statistics continue to show that Alaska is weathering the national mortgage problems better than other states. Second quarter 2008 numbers rank Alaska as the third lowest in foreclosures of all 50 states and eighth best in delinquent mortgage payments.²⁰ Through June of 2008, 3.8% of approximately 93,000 loans were past due, compared to the national average of 6.2%. Subprime loan delinquencies were 8.8% in Alaska compared to 18.2% nationally.

The percentage of foreclosures in progress was only 0.86% in Alaska compared to 2.8% nationally. Foreclosures that began in the first quarter 2008 were 0.41% in Alaska versus 1.1% in the U.S.

The survey also highlighted that the problem is not as widespread as previously reported. “Only eight states had rates of foreclosure starts that were above the national average: Nevada, Florida, California, Arizona, Michigan, Rhode Island, Indiana, and Ohio. The remaining 42 states plus the District of Columbia were below the national average. California and Florida alone accounted for 39% of all the foreclosures started in the country during the second quarter and 73% of the increase in foreclosures between the first and second quarters.”²¹

Residential Building Permits – According to the U.S. Census Bureau, the number of 1-5 unit residential building permits in Alaska continues to decline. Through June of 2008 there have been 493 permitted units statewide, down from 982 for the same period in 2007 and 1,646 in 2006. The value of these permits through June was \$110 million this year, \$183 million in 2007 and \$298 million in 2006²². It is important to note that not all boroughs and census areas report permitting activity, so this is not considered a complete reporting of housing construction in the state.

¹⁹ <http://articles.moneycentral.msn.com/Investing/JubaksJournal/ChinasNewestExportInflation.aspx>

²⁰ Source: Mortgage Bankers Association of America. Only Montana appears to be in better standing than Alaska. Montana has the lowest foreclosure rate and third lowest delinquency rate.

²¹ <http://www.mortgagebankers.org/NewsandMedia/PressCenter/64769.htm>

²² Source: U.S. Census Bureau, <http://www.census.gov/const/www/C40/table2.html#monthly>

In Anchorage there has also been a significant decline in new privately owned residential building permits for all types of homes. The aggregate number of permitted units of single and multi-family housing declined by 37% from 1,370 in 2006 to 862 last year²³. Six month totals for 2008 have seen only 194 permits, compared to 474 at this time last year, 59% less. Some of this change is seen as a response to high inventory levels on existing homes and can also be linked to land scarcity limiting the number of attractive lots for large residential developments. Sales have also been slowing.

Housing Units Sold - The number of units sold in Anchorage has been declining each of the last three years from a recent high of 3,333 homes in 2004 to 2,749 in 2007. Sales declined 10.2% between 2006 and 2007. They also declined 10.7% when comparing the first half of 2007 to the same period in 2008.

There have been a total of 1,197 MLS sales of Class 1 homes in Anchorage this year through June, for an average of 200 per month. The comparable period in 2007 had a total of 1,345 sales or 224 a month. The only regions to show positive growth over last year in sales volume have been Downtown, Seward Hwy. to Boniface, and the Chugiak/Peters Creek area.

Anchorage condo sales are also slowing. 2008 has seen 560 sales or 93 a month, compared to 706 or 118 a month for the first half of 2007. Sales volume growth for condos was only seen in the Eagle River and Chugiak/Peters Creek areas.

The number of units sold in the Wasilla core commute area was up 24% in 2005 and another 52% in 2006 to a high of 1,003 units sold. Sales numbers declined 6.4% last year to 939. Thus far in 2008 there has been a 25% decrease in sales compared to the first six months of 2007, from 83 units a month down to 62 units per month. Palmer sales have declined 9.3% from 118 in the first half of 2007 to 107 so far in 2008.

In Fairbanks, the average annual sales rate for residential homes between 2000 and 2006 was 867 per year. 2006 had the highest volume at 1,016 homes sold. 2007 was just slightly lower at 1,010 sales. First quarter data shows 172 sales in 2008, down from 254 by March of 2007.

Housing Inventory - Active MLS listing inventory levels of Class 1 residential homes²⁴ in Anchorage continue to be nearly double the amount available each month in 2005. Anchorage listings began to spike in the summer of 2006 and have yet to decline. In the first half of 2008 there has been an average of 1,032 homes on the market each month, almost identical to the 1,029 each month through June of 2007.

As of July 8, 2008 there were 1,196 active Class 1 listings in Anchorage. The monthly average number of sales over the previous year was 223, meaning there is approximately 5.3 months of inventory available.

²³ Source: Municipality of Anchorage, <http://www.muni.org/BSD/PermitActivityReports.cfm>

²⁴ Source: Alaska MLS, Anchorage Class 1 residential home statistics exclude condos and mobile homes.

The largest current inventory is in the highest priced homes. There are only three sales per month on average in the \$750 thousand to \$1 million range, leaving 13.6 months worth of inventory listed. There are 34 homes listed for over \$1 million on the market. With less than one sale per month on average, there is approximately three years and four months worth of inventory available.

32% of the inventory is in the \$250 thousand to \$350 thousand price range and another 27% is in the \$350 thousand to \$500 thousand range, with roughly 4.5 months and 7.5 months worth of inventory respectively in these most popular price ranges. The significant declines in new construction should bring inventory levels back down in 2009 and help to keep prices stable.

Active listings in the Wasilla core commute area²⁵ followed a similar trend between 2005 and 2007. However, the active listings in the first half of 2008 are declining substantially. Through June of 2008 there has been an average of 427 per month compared to an average of 597 on the market each month in the first half of 2007. This amounts to a 28.5% decrease in one year.

Fairbanks data²⁶ is only available for the first quarter of 2008. It reveals that inventory levels continue to grow from 336 monthly active listings in 2006, 417 in 2007, up to 585 through March of 2008. The average days on market was 63 in 2006, 53 in 2007 and is currently 81 for 2008.

Housing Sales Price - The average sales price of a residential home in Anchorage has increased on average 8.1% a year between 2000 and 2007. In 2007 prices grew, but at a slower pace of 3.5%. The average sales price in Anchorage was \$327,085 last year. The average sales price for the first six months of 2008 has declined slightly by 0.8% to \$324,523. However prices tend to peak in July and August, so this seasonality will likely balance out prices by year end. The bottom line is that house prices are flat.

Anchorage condo sales prices had also been rising, up 16% in 2005, 6% in 2006 and 3.4% in 2007 to an average sales price of \$187,692. Thus far in 2008 the average has been \$188,109, a 0.2% increase.

Wasilla numbers combine residential homes and condos. Prices had increased 12.5% in 2005, 8% in 2006 and 1% in 2007 to an average of \$226,268. Year to date numbers for 2008 are up 0.8% to an average of \$228,026. Palmer prices rose 8.4% in 2005, 6.6% in 2006, and 6.1% in 2007 to \$232,063. For the first six months of 2008 they are down 1.8% to \$227,912.

The most recent Fairbanks data through March of 2008 shows an average sales price of \$212,485, up 1.2% over March of 2007, which was 9.6% higher than March of 2006.

²⁵ Source: Alaska MLS, Wasilla core commute area statistics combine residential and condo units.

²⁶ Source: Greater Fairbanks Board of Realtors, data does not specify if condos are included or not.

State Budget and Tax Policy - The Alaska housing market is in a minor adjustment period. However, most of the economic uncertainty appears to derive from factors occurring in the national economy, rather than the local economy. The one major exception is the future stability of the energy industry. The governor's administration has made a dramatic shift in policy to develop the natural gas pipeline project and significantly increased taxes on both oil and gas development. In the short run, this tax increase will transfer billions of dollars from the private sector to the state government. In the long run, this new direction may result in substantial delays in the advancement of the critical gas line project and reduce future investment in energy by making marginal fields uneconomic. These higher taxes are ultimately passed on to the end customer and have been an underreported reason why gasoline prices at the pump have risen.

In the last five years the State government total revenues have more than doubled from \$5.86 billion in fiscal year 2003 to an estimated \$13.59 billion for fiscal year 2008, with most of the increase due to higher oil prices. The most recent, unofficial revision pegs the 2008 number at \$14.89 billion²⁷. Final reporting will not occur until December when all of the tax collection and in-kind figures are finalized. The fiscal year 2009 total revenue estimate of \$12.25 billion is based on a preliminary projection of \$83.04 barrel oil and will likely be substantially higher.

State government spending has been rising rapidly along with recent large budget surpluses. The 2004 fiscal year budget authorized a total of \$6.96 billion in spending compared to FY 2008 authorized spending of \$11.54 billion²⁸. This amounts to a 66% increase in spending in only four years. During this time the operating budget rose from \$4.5 billion to \$5.8 billion, the capital budget nearly doubled from \$1.3 billion to \$2.4 billion and the use of debt and other supplemental appropriations climbed from \$459 million to \$1.3 billion.²⁹

The most significant change has been in the composition of capital budget spending. In 2004, only \$85 million came from state general fund spending, while another \$1 billion derived from Federal funds. In 2008, \$1.3 billion in capital spending came from the state general fund and only \$859 million was from the Federal government. The Legislature and Governor have enacted a budget authorizing \$11.12 billion in spending in fiscal year 2009.

State Budget Surplus - Along with this significant increase in spending there has also been an impressive amount of savings. In 2008, \$4 billion was saved in the Constitutional Budget Reserve Fund. An additional \$1.3 billion may be collected once

²⁷ The FY 2008 revenue forecast is based on the Spring Revenue source book estimate of \$85.73 per barrel of Alaska North Slope crude. Due to much higher than expected oil prices, which have continued since the forecast publication, the Department of Revenue upward revised their oil revenue numbers from a reported \$8,934,700,000 in the Spring Forecast to \$10,238,800,000. This results from an expected increase of \$1.159 billion in production tax and a \$144 million increase in royalties due to the higher price of oil above projections. <http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?1338f>

²⁸ Source: State of Alaska, Office of Management and Budget
http://www.gov.state.ak.us/omb/09_omb/budget/bills/FY09_Fiscal_Summary_rev_6-16-08.pdf

²⁹ Alaska Permanent Fund operational costs, dividends and inflation proofing account for the remainder.

final revenue collections are complete. (See footnote #26 for more information). The Legislature has recently approved giving a large portion of this excess surplus to every Alaskan qualified for the Permanent Fund Dividend as an additional \$1,200 “energy rebate”.

The FY 2009 budget is predicted to result in a \$3.36 billion surplus based on average oil prices of \$83.04 per barrel. This amount does not include permanent fund contributions and inflation proofing.

The current market value of the Alaska Permanent Fund is now over \$36 billion dollars³⁰. The FY 2008 authorized state budget contributed \$805 million to inflation proof the fund and allocated \$1.25 billion for dividends. Last year 604,149 Alaska residents received a check for \$1,654. Assuming a similar number of residents qualify this year, the expected dividend this October should be a record of over \$2,000 per person.

With such a large surplus, history dictates capital budget spending on special projects will remain at recent high levels, with positive impacts felt statewide. However, it appears these spending levels will not be sustainable without new energy development, as oil production continues to decline and historical oil price levels are significantly lower than today’s prices.

Oil Price and Production - North Slope oil production declined over 100,000 barrels per day (bpd) in fiscal year 2007 to 740,000 bpd, a 12.5% drop, after severe maintenance and repair issues were discovered³¹. State economists predict this troubling trend to continue at a slower rate of 6% per year over the next decade. For the first half of 2008 production statewide has averaged 728,762 bpd.

Despite this fall in production, state revenues continue to rise due to record high prices and a substantial increase in production taxes. From 1987 to 2004, the average price for Alaska North Slope crude was \$20.34 per barrel. Over the last three years it has increased dramatically to an average of \$71.54 a barrel in 2007 and is currently selling for \$112.17 as of August 19, 2008³².

Total oil revenues to the state increased 18% in 2007 and are expected to increase 74% in 2008 to a total of \$8.93 billion³³. As a result, oil revenues will account for 66% of total state revenues from all sources (including federal funds and permanent fund earnings) and 90.5% of all “unrestricted” revenue sources that are available without specific spending limitations. 19% of the total revenue will come from Federal sources, 7% from investments including the Permanent Fund, and 8% from other taxes.

³⁰ Source: Alaska Permanent Fund Corporation, <http://www.apfc.org/home/Content/home/index.cfm>

³¹ State of Alaska, Department of Revenue Tax Division
<http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?1202f>

³² State of Alaska, Department of Revenue Tax Division, <http://www.tax.state.ak.us/>

³³ This is based on the Department of Revenue estimates in the Spring 2008 Revenue Source Book. More recent, but unofficial estimates place the number \$1.3 billion higher at \$10.24 billion due to continued price increases between the documents publication on April 10th and the fiscal year end June 30, 2008. This would result in a 99% increase in oil revenue over 2007 levels.

Conclusion - The foundation of Alaska's economy appears solid in the short run. Major drivers include strong increases in oil prices, tourism activity, cargo shipping, government spending, and mining exploration. Areas to keep a close eye on because of the potential volatility they could create in the economy include:

- Federal spending levels in Alaska, national fiscal and monetary policy;
- State government tax, spending and saving decisions;
- Tightening of the money supply and lending standards;
- Progress in advancing the natural gas pipeline project;
- Oil prices, production, and investment levels;
- Mineral prices and the regulatory/permitting environment;
- Construction job levels;
- Housing market activity.

Mark Edwards
Commercial Loan Officer
Northrim Bank