STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

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HOUSE OF REPRESENTATIVES

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FINANCE ADVISORY COMMITTEE
December 10, 2007
Senate Hearing Room 1 – 9:30 a.m.

Members Present:
Dan Anderson, Arizona Board of Regents
Jay Butler, Arizona State University
Brian Cary, Salt River Project
Dean Martin, State Treasurer
Georganna Meyer, Department of Revenue
Elliott Pollack, Elliott D. Pollack and Co.
Marty Shultz, Arizona Public Service
Randie Stein, Stone & Youngberg
Marshall Vest, University of Arizona
Don Wehbey, Department of Economic Security Research Administration

Mr. Richard Stavneak, Director, JLBC Staff, opened the meeting at 9:35 a.m. and welcomed everyone to the Finance Advisory Committee (FAC) meeting. The panel meets 3 times a year to discuss the economy and to provide the Legislature with guidance on state revenue projections.

Mr. Stavneak started the JLBC Staff presentation with an overview of state revenues. (Click here to view.)

Mr. Eric Jorgensen, Mr. Hans Olofsson, and Ms. Leah Ruggieri, JLBC Staff, continued the presentation on Sales Tax Collections, Individual Income Tax, and Corporate Income Tax.

Mr. Elliott Pollack gave a slide presentation on the national economy. (Click here to view.)

Senator Carolyn Allen asked if oil prices are a factor in the economy. Mr. Pollack replied that oil is a factor, however, it is unpredictable. It is based on uncontrollable events, such as conflict in the Middle East and other political events.

Representative Andrew Tobin asked if Arizona's population is still growing by 20,000 to 25,000 people per month. Mr. Pollack replied that the problem is that population is known only after the census every decade. He added that if there are difficulties selling homes in other states where people moving to Arizona come from, then the logical conclusion is the population flows have to be smaller.

Representative Tobin asked if retirees are taken into consideration. Mr. Pollack said that there are people still retiring to Arizona, however, they still need to be able to sell their home in order to move here. There are probably fewer of those retirees than there otherwise would be.

Mr. Stavneak asked Mr. Pollack's perspective relative to the growth rate of 1% to 1.5% over the next 18 months.

Mr. Pollack said that the next year will be difficult; the range of 1% to1.5% is reasonable. The risks are on the downside.

Mr. Jay Butler gave a presentation on the real estate market. (Click here to view.)

Mr. Stavneak asked what the best measure is in gauging the housing market. Mr. Butler replied that the best measure is the rate of appreciation. It is hampered by the fact that it only measures the rate of appreciation of homes sold. There is a small percentage of the market in active play; there are some homes that cannot be sold. The majority of people are in "dream" homes, they are bigger and have better locations and they have traditional interest rates; these people are not going to move. There is no push for people to want to move to a better home because they are already in a better home. Remodeling has also picked up. It is hard to measure where the market is standing. The gigantic proportion of the housing market is staying reasonably happy in their respective houses.

State Treasurer Dean Martin gave a slide presentation of the Office of the State Treasurer's Operating Account Balance. (Click here to view.) In response to the revenue growth path, Mr. Martin stated that in September, he thought that 2009 would be better than 2008. He now believes that potentially the worst is yet to come with a negative 2008 and flat or mixed in 2009. Things will not get better until 2010 or 2011.

Mr. Brian Cary said that the formation of new residential accounts at SRP is still positive but down from a year ago. New construction activity has dropped, which is not a surprise. It had been running double the level necessary to accommodate new homes on a real-time basis. Commercial customer growth continues to be strong. Overall energy sales have continued to be positive. The residential weakness is most represented in the overall picture of the economy. Most other segments of the economy are in reasonably good shape. Long-term fundamentals of the area continue to see positive growth, although, at significantly lower levels than what has been accustomed to over the past few years. Corporate revenue is a relatively small share of the total revenue and will probably fall faster than predicted in the forecasts. Sales tax revenues that have been negative will continue to slump, however, it will move back to the positive range before this fiscal year is over. Income tax revenue has been soft in the past few years, but will also move back into the positive range for the duration of the forecast period. We are in a soft period of the business cycle and it will look and feel similar to what was seen in the early part of this decade. He agrees with Mr. Pollack that it does not matter if we are technically in a recession; it feels like it regardless.

Mr. Stavneak noted that in regard to Mr. Pollack's comment regarding the lack of good census data between every 10-year cycle, utility hookups are looked at as a proxy. He asked if utility hookups are half of what they were a year ago.

Mr. Cary replied that while hookups have not been growing as rapidly as a year or two ago, they are still growing at a reasonably positive rate. It is not down by one-half.

Mr. Marshall Vest said the forecast he recently issued stated that Arizona's economy is in a recession. Given the data for Arizona, the case has been that Arizona has been in a recession as early as the 2nd quarter. Once there has been enough revised data a year down the road, it will show that the peak will be in the 3rd quarter and punctuated by the layoffs amongst mortgage lenders. It feels like a recession and the economy is close to retracting/contracting. The focus should now be on how long or how bad things are going to be. This recession should be short and mild. FY 2009 is weaker than FY 2008. There will not be a v-shape recovery. It has to do with housing, there are a lot of houses with few buyers and there are credit restraints. Significant growth will not start again until 2010.

Ms. Georganna Meyer stated that the final November corporate numbers were down (151.2)% due to the impact of consolidated credit refunds; however, taking out consolidated refunds, they were up 139%. Out of the $23 million in refunds sent out in November, about $15 million was for consolidated credit. Fiscal year to date numbers without consolidated credit refunds shows (2.6)% compared to (8.5)% with consolidated.

Mr. Stavneak explained that the consolidated credit was granted about 10 years ago. Companies were able to take the credit against their liability; ultimately, there was not enough liability and the state still owed them the credit. The companies were able to take the remaining credit in FY 2008.

Mr. Dan Anderson said that he generally is more optimistic than the consensus of 1.5% in FY 2008 and the 1% in FY 2009.

Ms. Randie Stein said that the General Fund did better in the prior couple of years, there was more concern in the underlying economic factors at the same time. The hyper-growth and the raw percentage changes in the General Fund revenue categories will take a while to work through. There will continue to be underlying economic concern.

Mr. Stavneak asked Ms. Meyer if there were more individuals filing for tax extensions. Ms. Meyer replied that she has not looked into the numbers but would follow up.

Mr. Don Wehbey provided an explanation on his handouts illustrating the total state economy and the private sector. (Click here to view.) There was a strong economy that has now slowed down. Part of that was the economic activity generating sales and growth. For 3 consecutive quarters there has been a slowdown in wages. Businesses have had reasonably good growth. The key with employment is a lean and mean scenario. Companies are cautious and in turn cut back. Retail growth was off by two-thirds of what was expected for this time of year. The quarterly census of employment wages (QCEW) comes 6-months behind and will help corroborate where the ground is for employment.

Mr. Stavneak said that numbers of the month-over-month job growth data compared to the prior year are higher than the 1%, which seems like the data is catching up. Mr. Wehby replied that Mr. Stavneak is correct, and QCEW is expected to continue to slow through this year.

The meeting adjourned at 11:00 a.m.

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Yvette Medina, Secretary

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Tim Everill, Assistant Director

NOTE: A full audio recording of this meeting is available at the JLBC Staff Office, 1716 W. Adams. A full video recording of this meeting is available at http://www.azleg.gov/jlbc/meeting.htm.

Finance Advisory Committee

December 10, 2007

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Current Economic Conditions Have Had Widespread Impact on Revenue Collections

- Through November, collections are down (0.6)%
- General Fund revenues are $(310) million below forecast
  - Sales tax: (0.2)%.
  - Individual income tax: (1.0)%
  - Corporate income tax: (2.4)%.

3 Main Problems

- Housing Market
  - Imbalance in supply and demand.
  - Mortgage financing.
- Inflated Revenue Base
  - Revenues grew 38% in ’05 and ’06 compared to 19% personal income growth.
- “Wealth effect”
  - Declining housing values affect consumer psyche.

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2 of 3 Real-Time Indicators Have Dropped This Fiscal Year

- Retail spending – down (1.7) %.
- Jobs – 45,000 jobs created compared to 135,000 a year ago.
- Withholding – up 6%.

Overall Revenue Forecast

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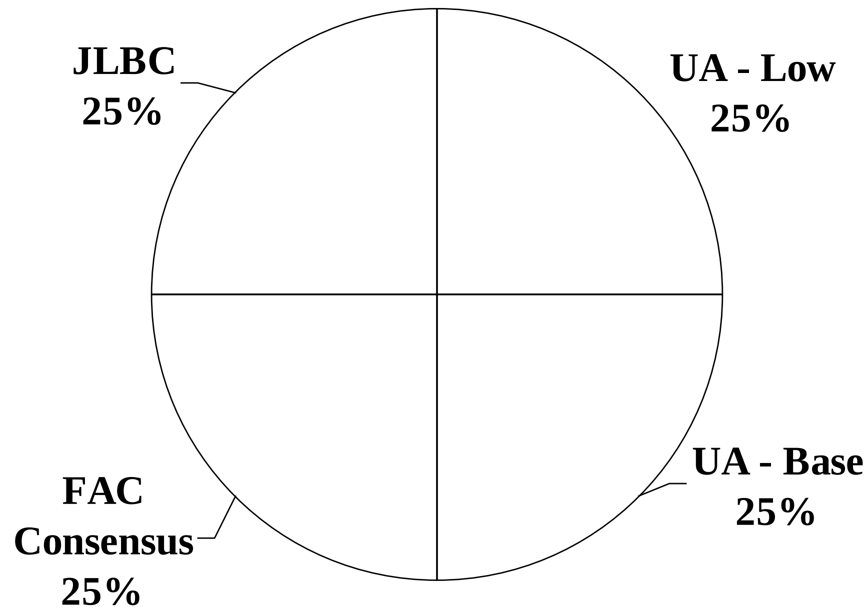
Where Are We Headed Over the Next Few Years?

- Four-Sector Consensus Forecast Incorporates Different Economic Views, Including the FAC

4-sector forecast equally weights:

- **FAC average**
- **UofA model - base**
- **UofA model - low**
- **JLBC Staff forecast**
- **Remaining revenues (4% of total) are staff forecast**



*** Includes Big 3 categories of sales tax, individual income and corporate income taxes.**

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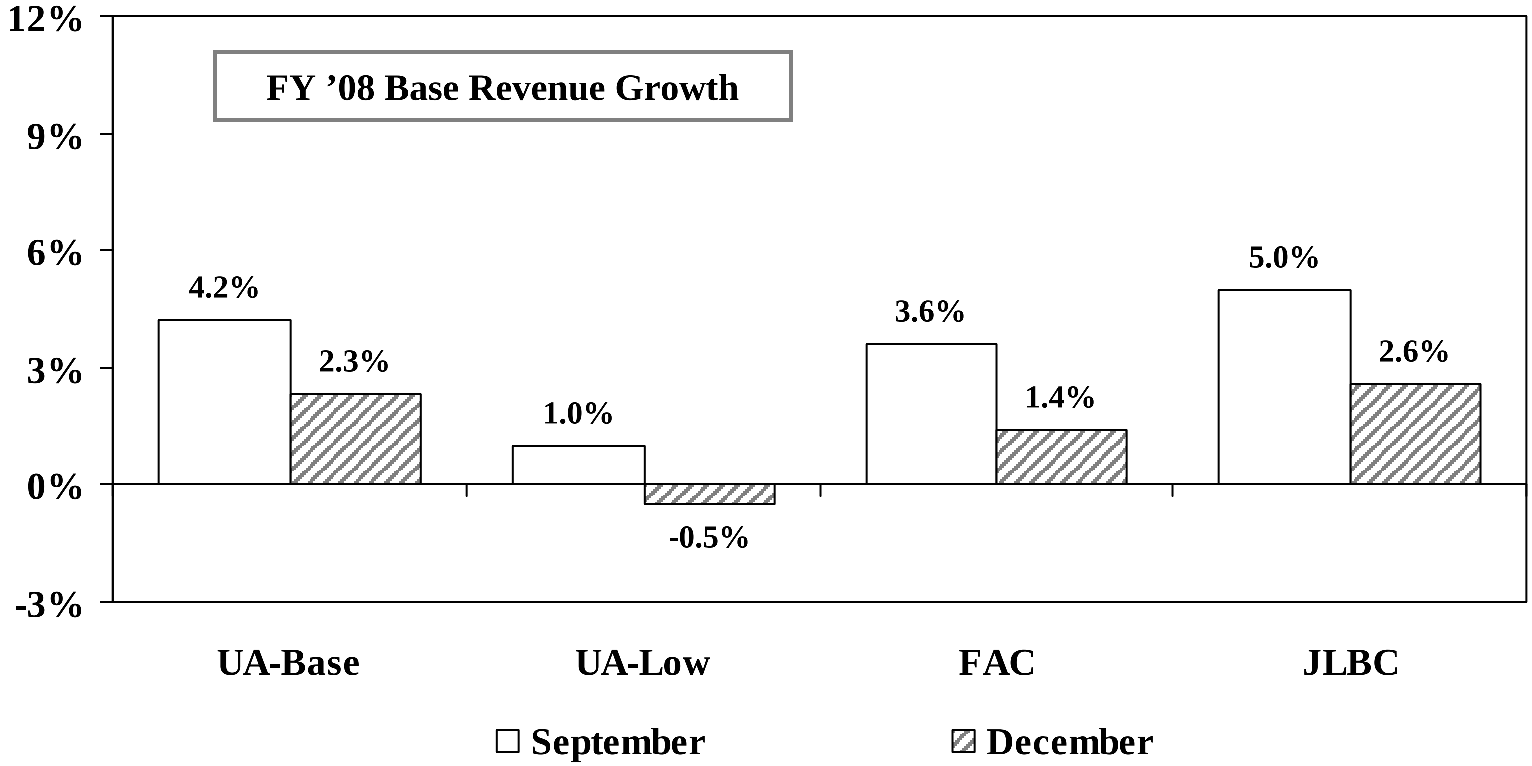
New FY '08 4-Sector Growth Forecast is 1.5%

- Compares to 3.5% in September and a Budgeted Rate of 8.4%



Weighted Big 3 Average
Prior to Tax Law Changes

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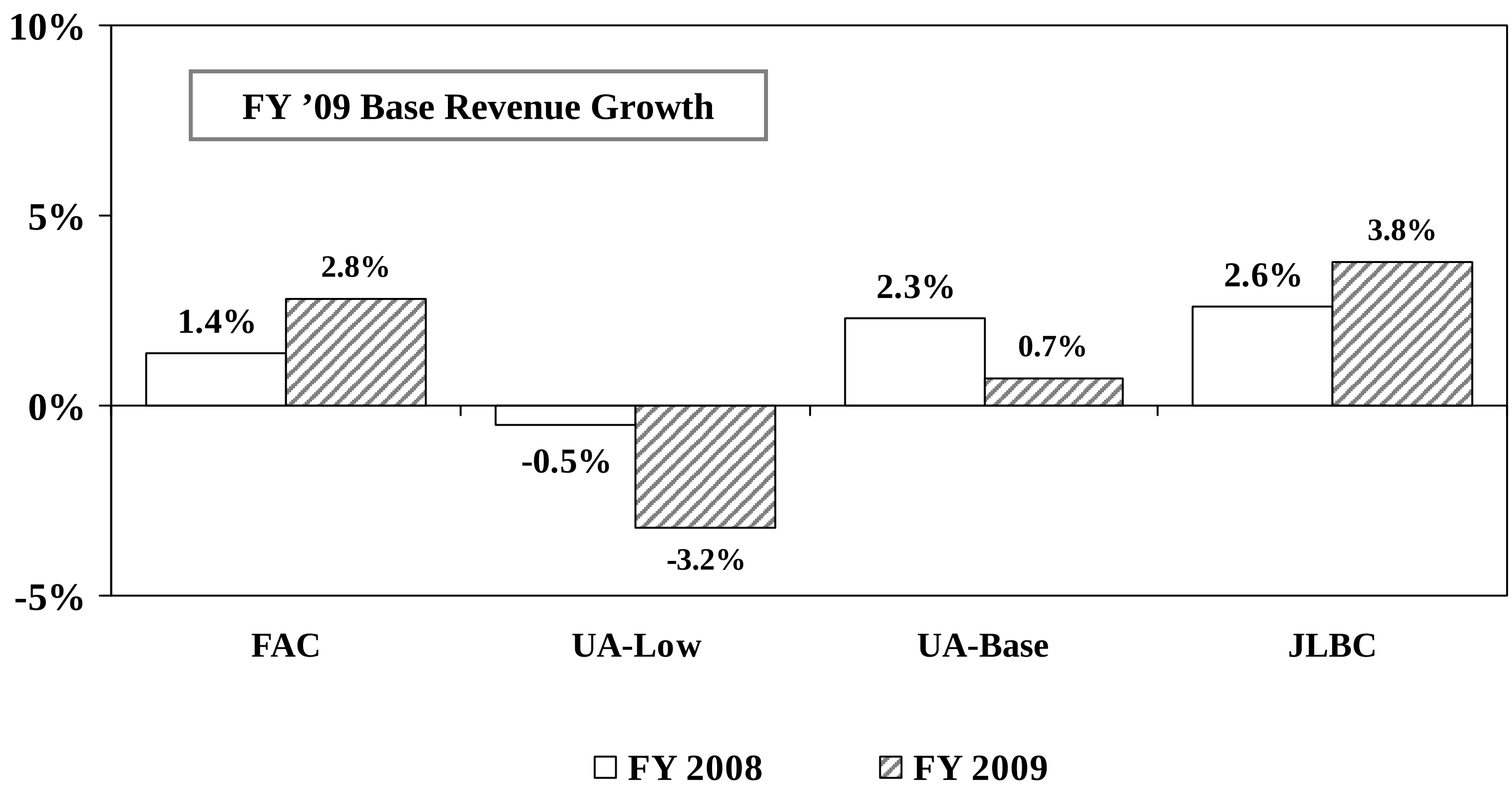
New FY ’09 4-Sector Growth Drops from 1.5% in ’08 to 1.0% in ‘09

- In September, ’09 Growth Was 2.6%



Weighted Big 3 Average
Prior to Tax Law Changes

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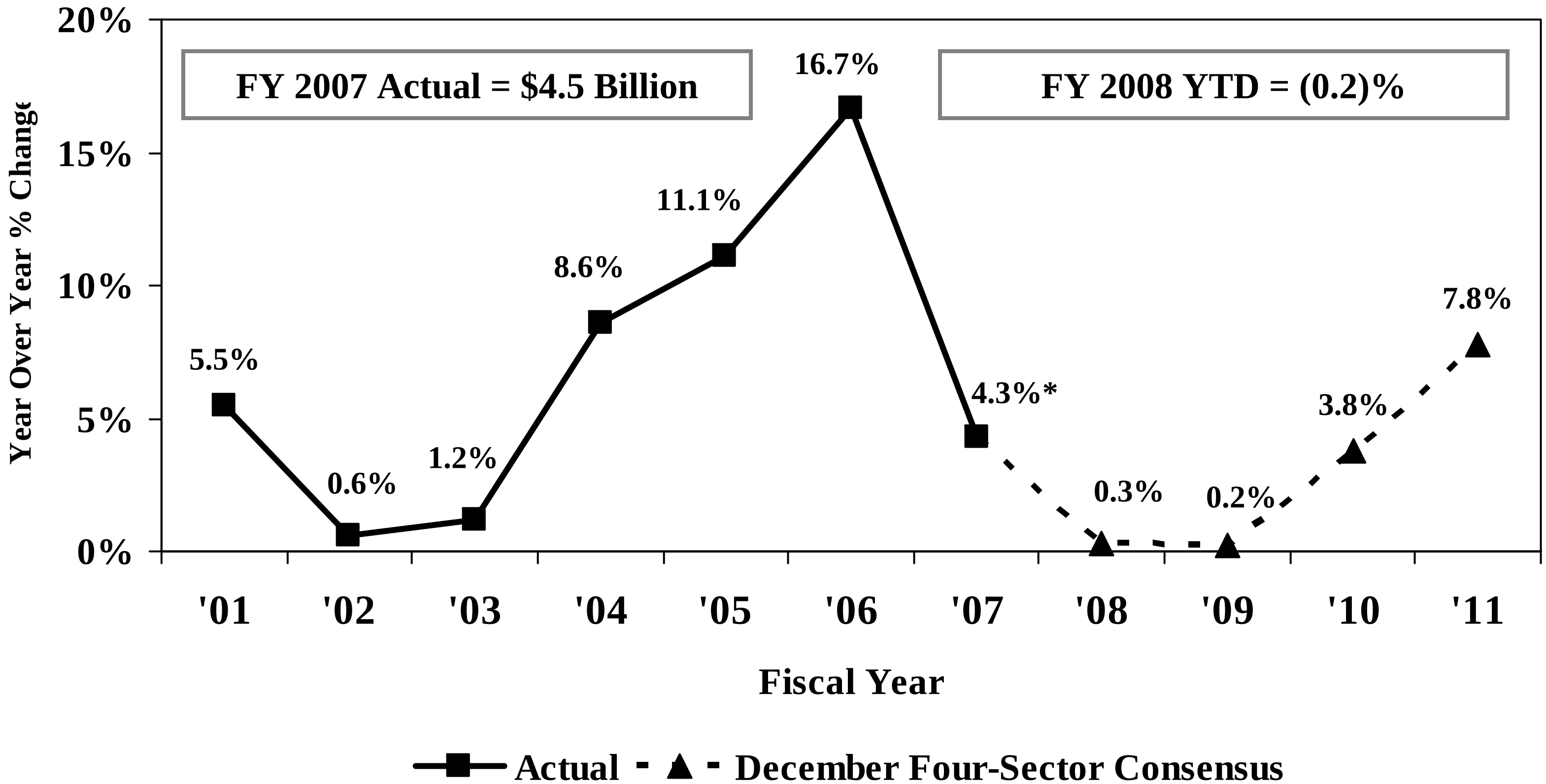
Revenue Forecast by Category

Sales Tax Growth Flat in '08 and '09



* 5.6% without the $(55.2) million estimated payment threshold change.

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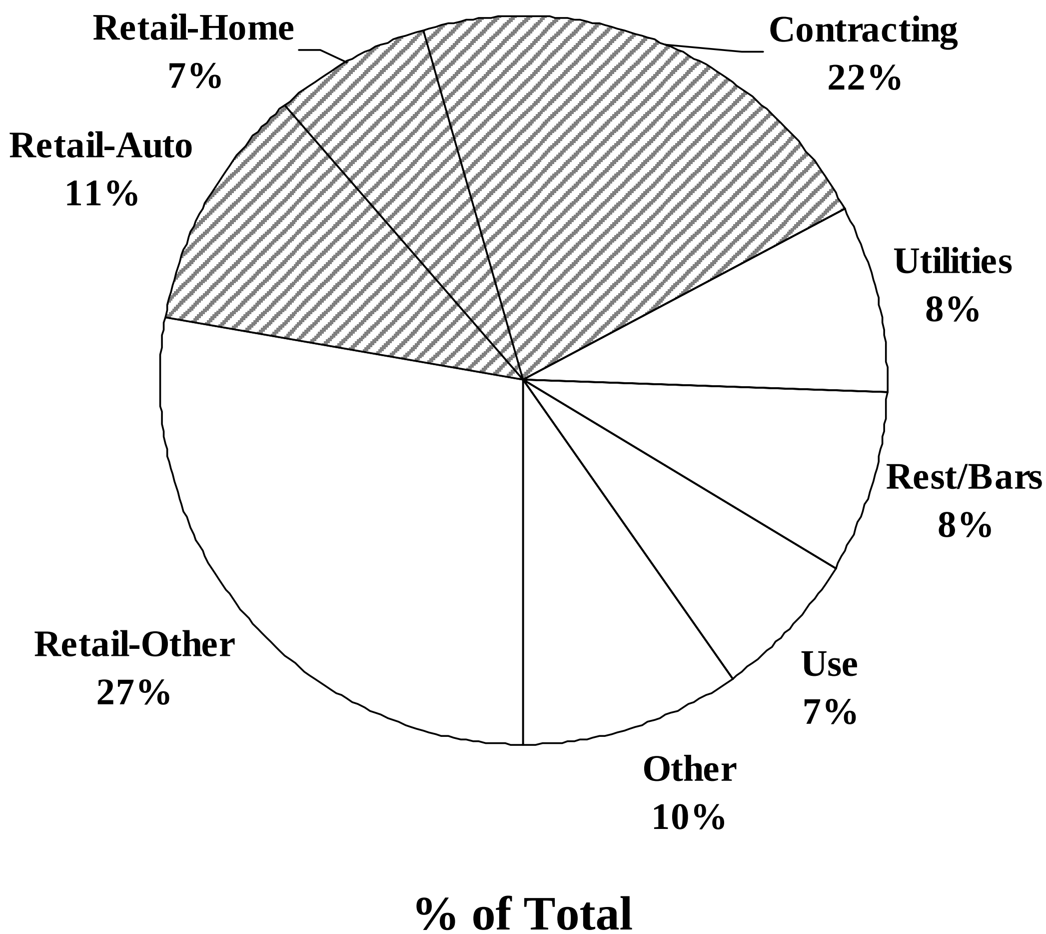
Construction and Vehicles Constitute 39% of Sales Tax Collections



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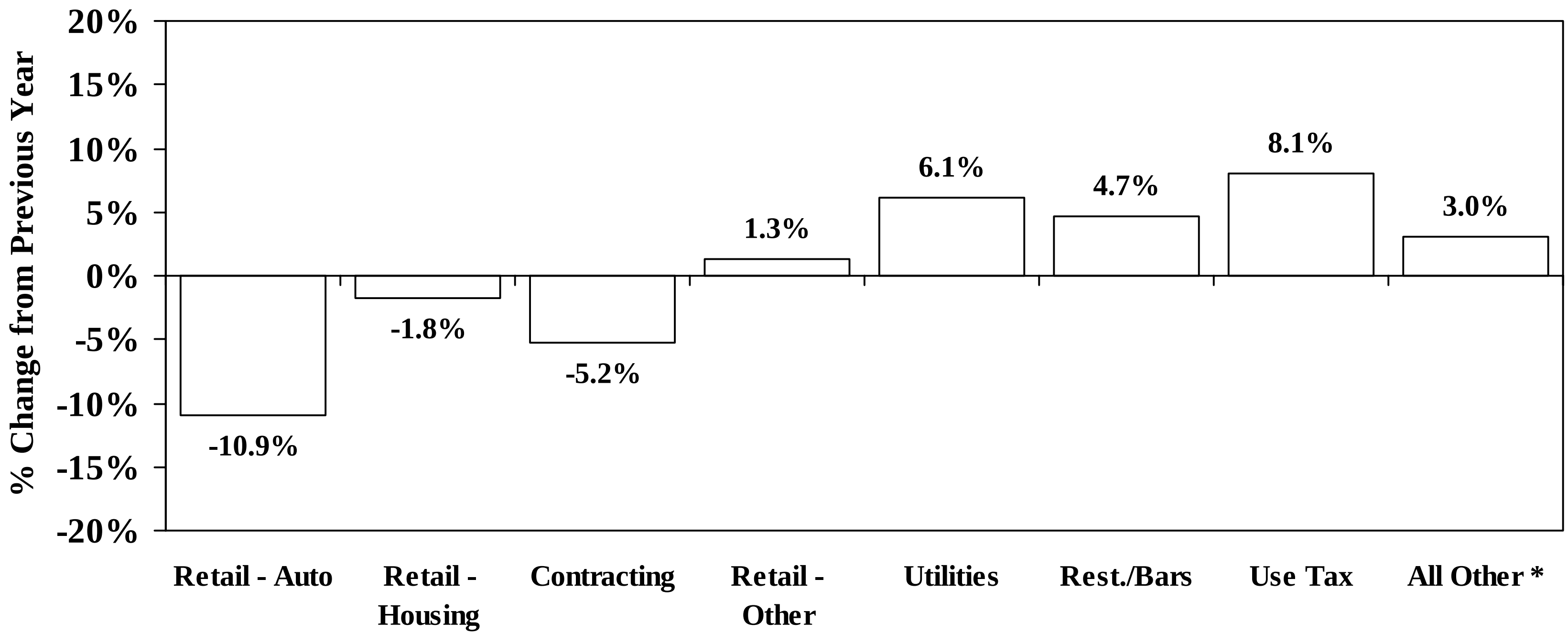
The Decline in Construction and Vehicle Spending Are Offsetting Gains Elsewhere



FY 2008 Year to Date – (Through October)

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Falling Home Prices
Affecting Consumer Spending

The "Wealth Affect"

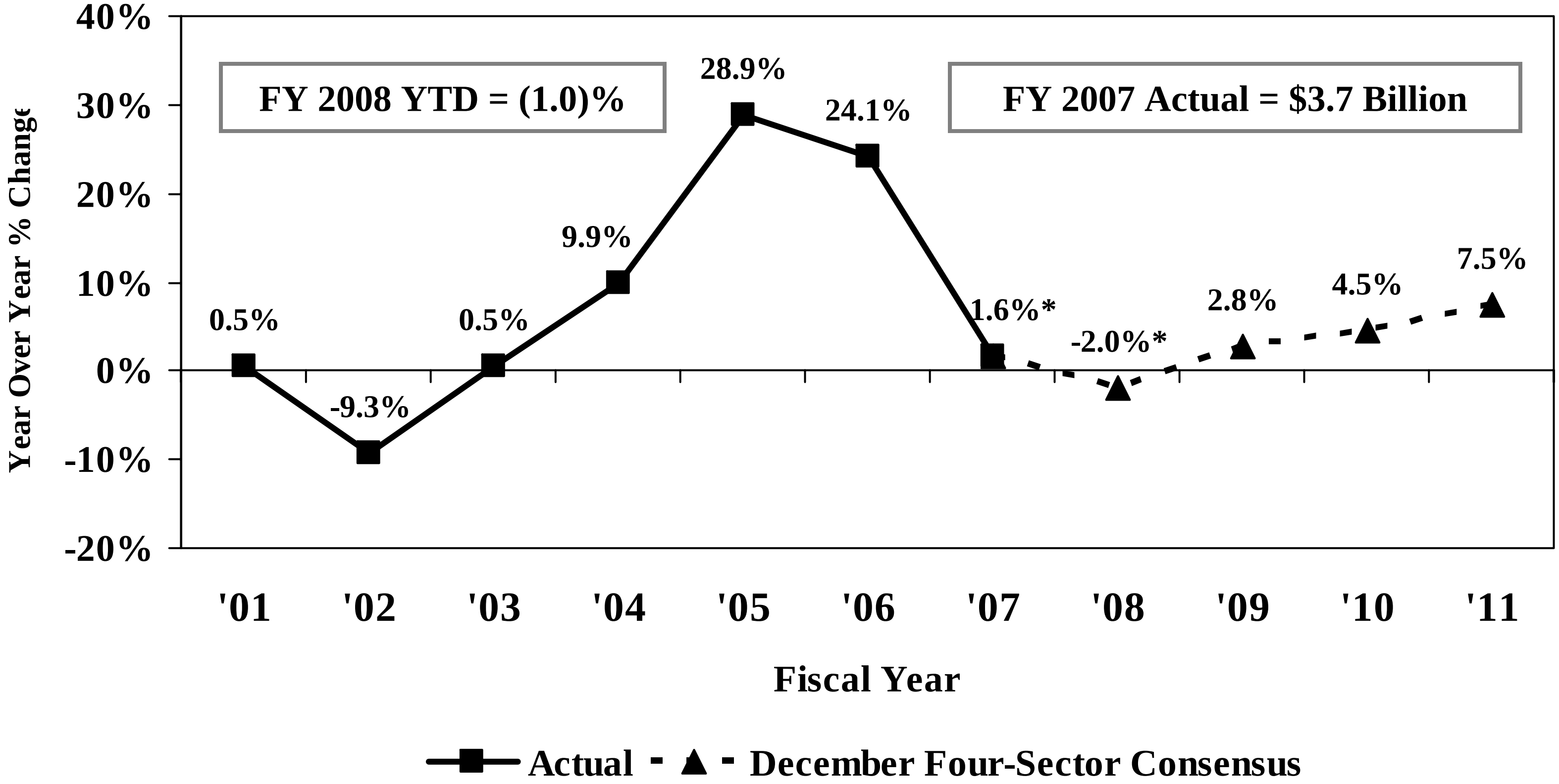
- Even if consumers are not selling their homes, declining housing values are thought to reduce their spending habits.
- National studies estimate that consumers reduce spending by 4-9¢ for every $1 decline in house value.
- With a 10% decline in housing prices, Arizona sales tax would decline $50 million, or (1)%.

Will Mortgage Proposals Help?

- Proposal only affects 11% of subprime loans.
- For owner occupied homes, the Feds are proposing a 5 year rate freeze and refinancing assistance.
- Arizona has the 3rd highest rate of subprime loans, including 132,000 subprime ARMS.
- Feds' mortgage relief plan could affect an estimated 6,500 – 54,000 owner-occupied homes in the state.

Individual Income Tax Forecast

- Falls (2.0)% in ’08 With A Slow ’09 Recovery



* Includes reduction for tax law changes.

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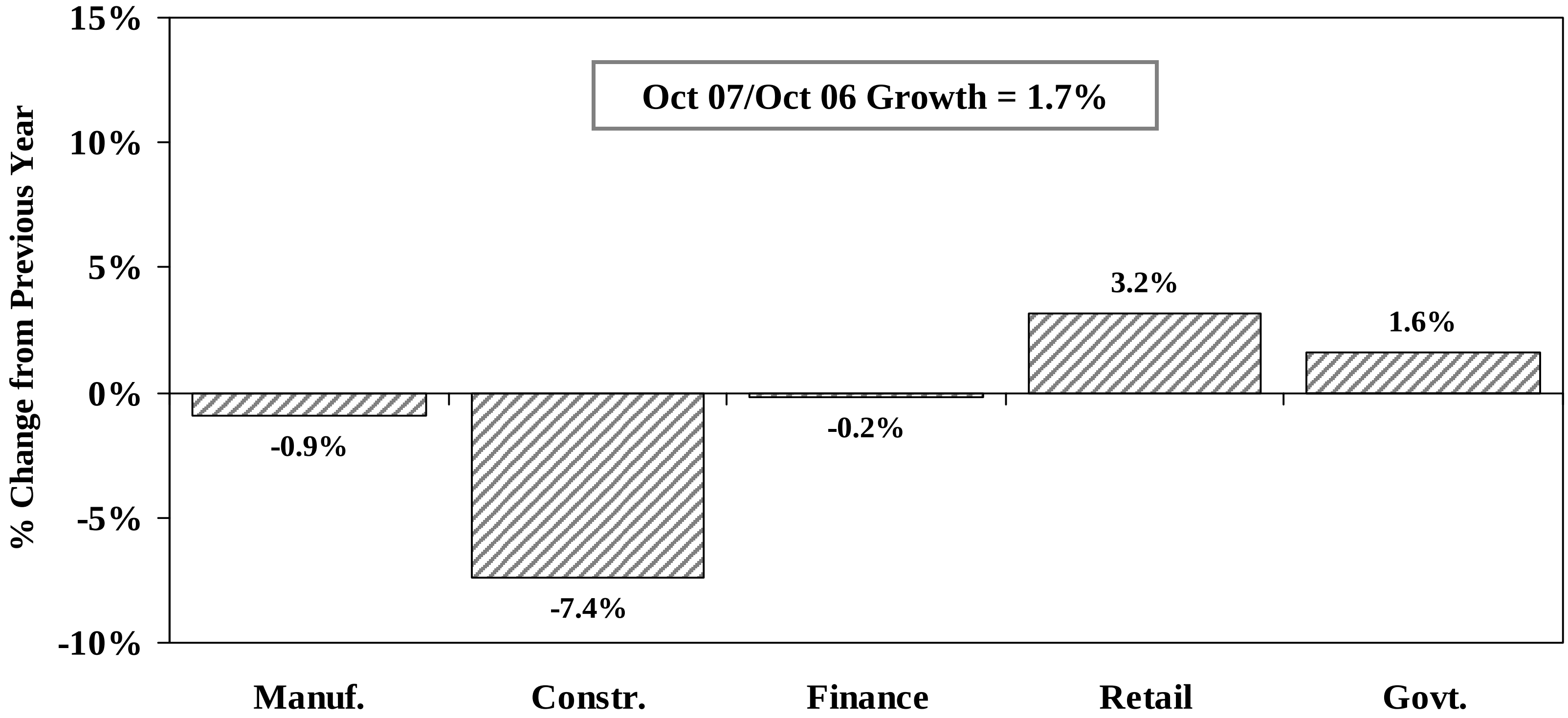
Individual Income Tax 5-Month Collections Down (1.0)%

- Refunds have increased over 60%
  - May be "hangover" effect – April extensions resulted in refunds paid out in last 2 months.
- Final payments are down (2)% YTD.
- Positive sign: withholding has maintained 6% growth for the first 5 months.

Job Losses May Moderate Further Withholding Growth

- Construction Sector Has Experienced Largest Job Loss



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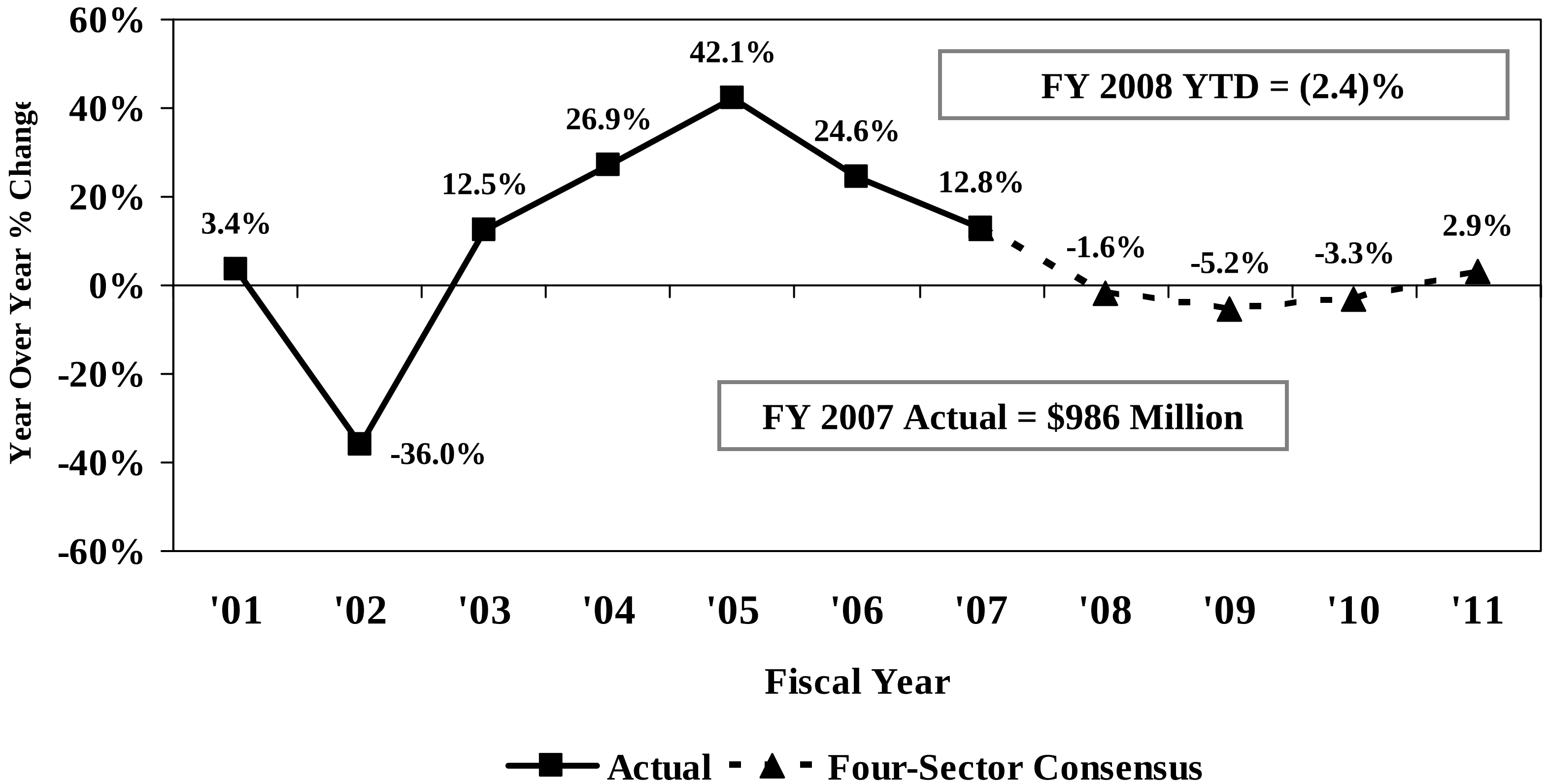
Corporate Income Tax Projected to Decline in Both FY ’08 and FY ‘09



* Includes reduction for tax law changes.

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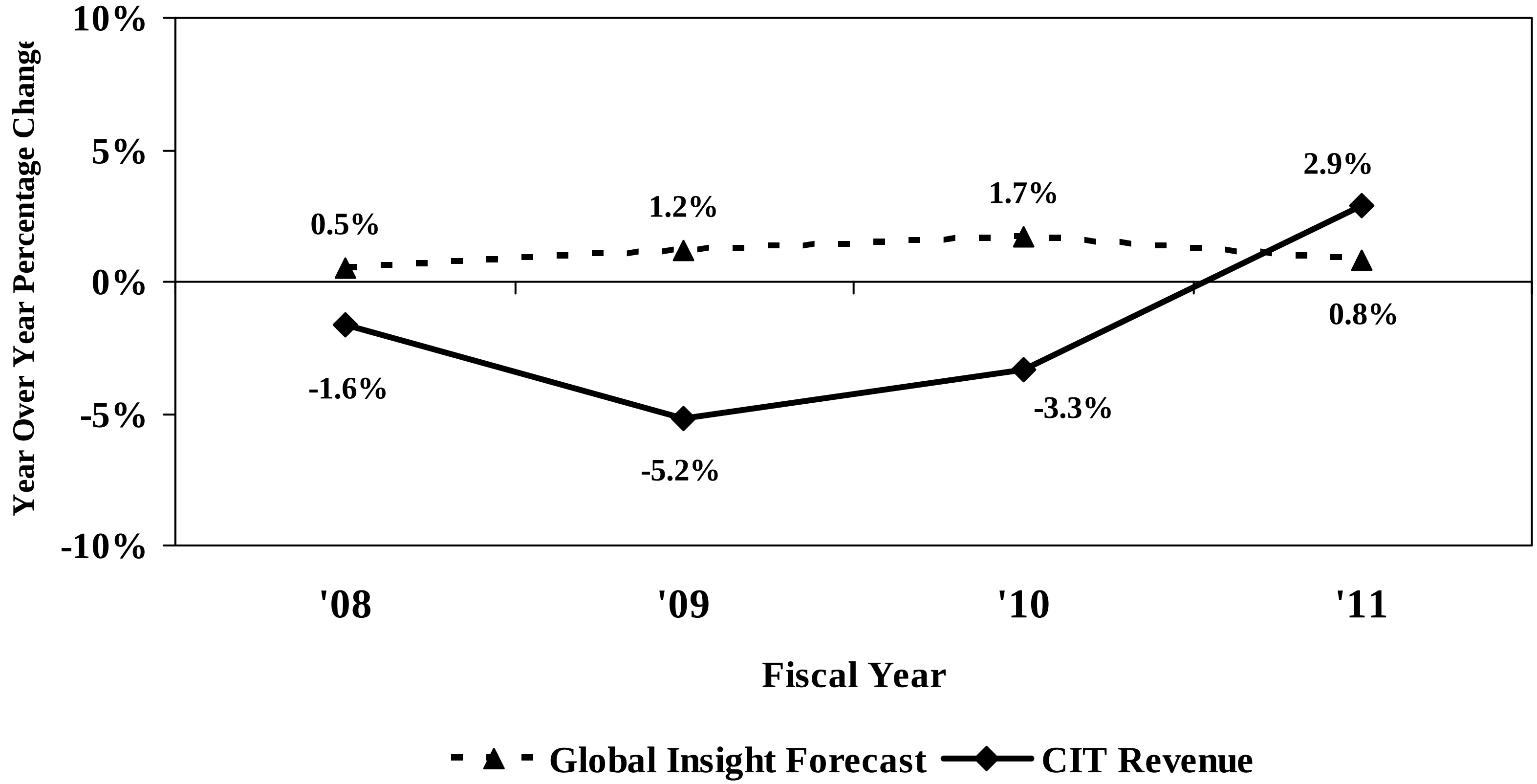
U.S. Corporate Profits are Expected to Slow

- National Forecasts Generally Support 4-Sector Revenue Projection



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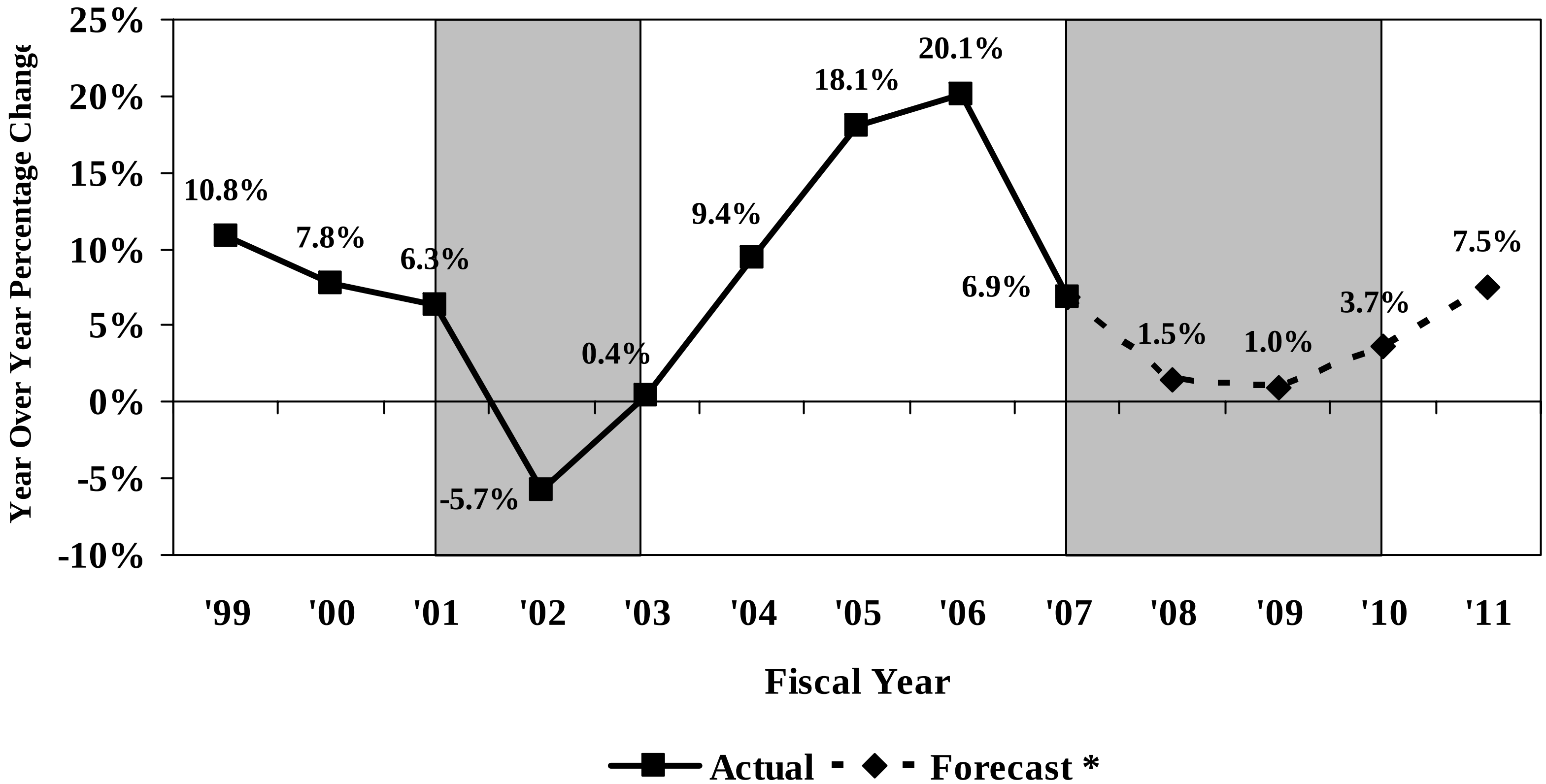
Growth Remains Slow Until FY 2011

- September Forecast Had Similar "U" Shaped Curve



* 4-sector forecast weighted average growth.

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4-Sector Projections Further Increase Budget Shortfall

- FY ’08 budget shortfall is projected to be $970 million.

- If none of FY ’08 solutions are on-going, FY ’09 budget shortfall is $1.8 billion.

FY 2008-FY 2011 Quartile Forecast Worksheet

	FY 2008	FY 2009	FY 2010	FY 2011
Sales Tax				
JLBC Forecast (11/07)	2.5%	3.0%	4.9%	6.7%
UA - Low (11/07 revision)	-1.9%	-4.3%	-0.1%	6.3%
UA - Base (11/07 revision)	-1.1%	-1.3%	3.7%	8.8%
FAC (12/10/07 Survey)	1.7%	3.5%	6.8%	9.4%
Average:	**0.3%**	**0.2%**	**3.8%**	**7.8%**
Individual Income Tax				
JLBC Forecast (11/07)	3.0%	4.8%	6.8%	7.8%
UA - Low (11/07 revision)	0.6%	-0.6%	0.3%	5.2%
UA - Base (11/07 revision)	5.8%	3.7%	3.9%	7.7%
FAC (12/10/07 Survey)	2.1%	3.1%	7.1%	9.2%
Average:	**2.9%**	**2.8%**	**4.5%**	**7.5%**
Corporate Income Tax				
JLBC Forecast (11/07)	1.9%	3.2%	2.2%	7.8%
UA - Low (11/07 revision)	1.6%	-8.5%	-5.5%	5.5%
UA - Base (11/07 revision)	4.9%	-2.3%	0.5%	2.7%
FAC (12/10/07 Survey)	-2.4%	-1.5%	2.2%	7.8%
Average:	**1.5%**	**-2.3%**	**-0.2%**	**6.0%**

	FY 2008	FY 2009	FY 2010	FY 2011
Consensus Weighted Average:	**1.5%**	**1.0%**	**3.7%**	**7.5%**
JLBC Weighted Average:	**2.6%**	**3.8%**	**5.4%**	**7.3%**
UA Low Weighted Average:	**-0.5%**	**-3.2%**	**-0.5%**	**5.8%**
UA Base Weighted Average:	**2.3%**	**0.7%**	**3.4%**	**7.7%**
FAC Consensus Weighted Average:	**1.4%**	**2.8%**	**6.5%**	**9.2%**

Forecast percentages are prior to tax law changes.

National Economic Outlook

Presented by:

Elliott D. Pollack

Presented for:

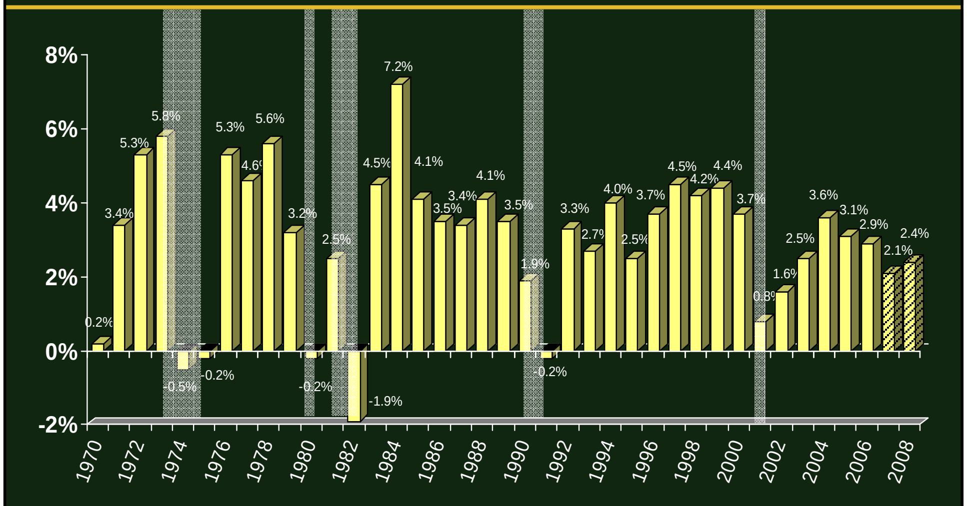
Finance Advisory Committee

December 10th, 2007

What causes economies to slow and where do we stand?

United States Real Gross Domestic Product*
Annual Growth 1970 - 2008**

Source: U.S. Bureau of Economic Analysis & *Blue Chip Economic Indicators*



* Based on chained 2000 dollars.

** 2007 - 2008 are forecasts from the Blue Chip Economic Indicators, November 2007

Recession Periods

ODDS OF A RECESSION

Source: National Blue Chip Panel

November 07 consensus:	33.6%
September 07 consensus:	32.1%
August 07 consensus:	25.8%
November 06 consensus:	24.8%

Odds of a recession survey question was not asked in October 2007
November's survey was conducted November 5th and 6th, 2007

Is a RECESSION Imminent?

Economic expansions do not die of old age.

They die from:

1. Structural imbalances
2. Fiscal and monetary policy errors

…Combined with unusual shocks

TYPICAL IMBALANCES

- Consumers holding too much debt
- Real incomes decline
- Excess capacity
- Business has too much debt
- Too much inventory
- Employment markets too tight
- Inflation
- Bad tax policy
- Bad monetary policy

Few of these imbalances presently exist to any significant degree.

PRESENTLY

- Employment still growing
- Real incomes growing
- Business awash in cash
- Capacity utilization at a level associated with increases in plant spending
- Employment markets do not appear to be tight
- Inflation still appears under control
- Exports booming
- Fed has reacted well

The economy is no longer running on 8 cylinders; more like 3 or 4, but still driving forward….

…Slowly.

...hopefully.

LAST YEAR
WE SAID:

Weakening economies are more sensitive to shocks.

Examples of Direct Shocks:

- Unexpected oil supply disruption.
- Unexpected oil price escalation.
- Terrorist event (especially to financial or commerce infrastructure).
- Decline in housing prices.

THIS YEAR'S SHOCK:

- Housing prices
- Mortgage backed securities

Liquidity dried up…

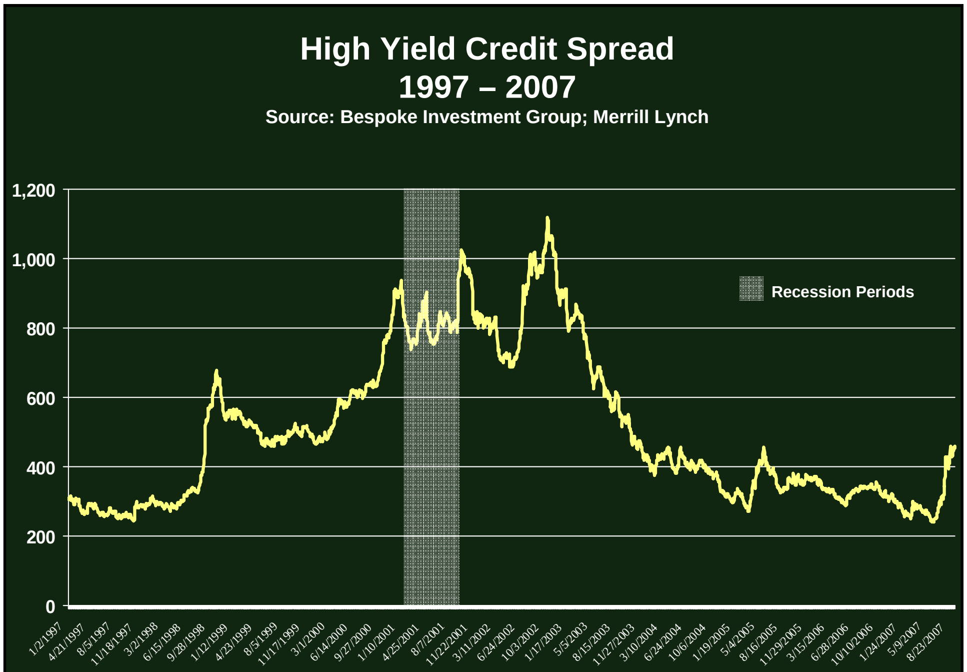
Market re-prices risk.

High Yield Credit Spread
2004 – 2007

Source: Bespoke Investment Group; Merrill Lynch

*Data through August 2007.

** The spread between high yield corporate bonds (non investment grade/below bbb rated) and comparable Treasuries.



*Data through August 2007.
** The spread between high yield corporate bonds (non investment grade/below bbb rated) and comparable Treasuries.

Credit Crunch

Banks and others significantly curtail their lending to all sectors.

Problem Areas Linked to Most Leveraged Sectors

— Mortgage Backed Bonds

— Leveraged Buyout Loans

— Junk Bonds

To Get a *Full Blown* Credit Crunch you need:

1. FEAR –

   Of big losses on current & future loans.

2. UNCERTAINTY –

   How big will the losses be?

   When will the market stabilize?

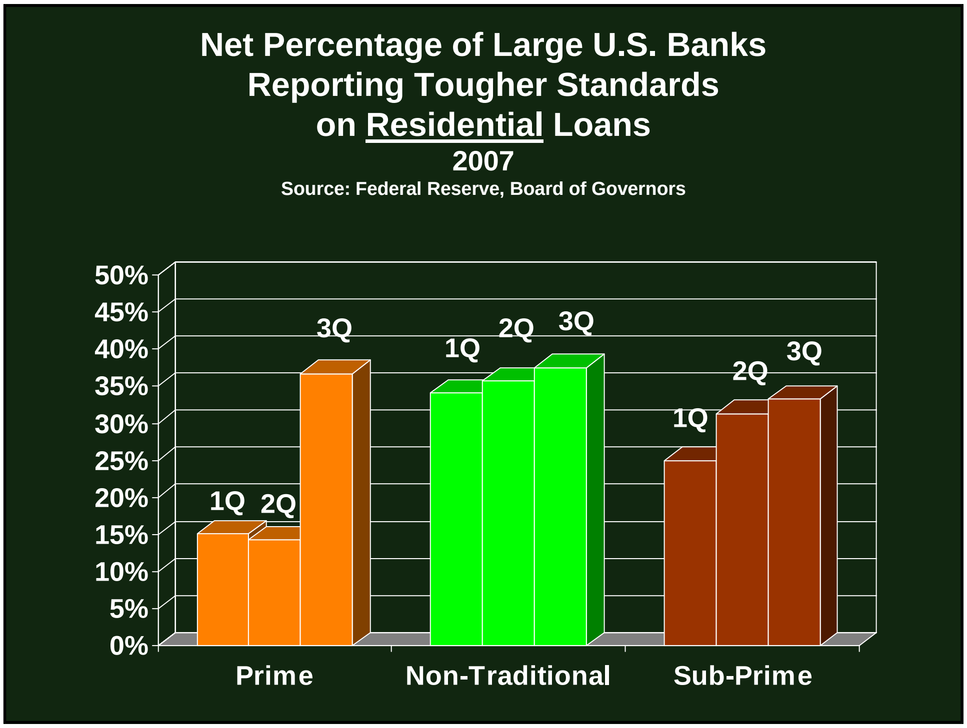
   At what price will it stabilize?

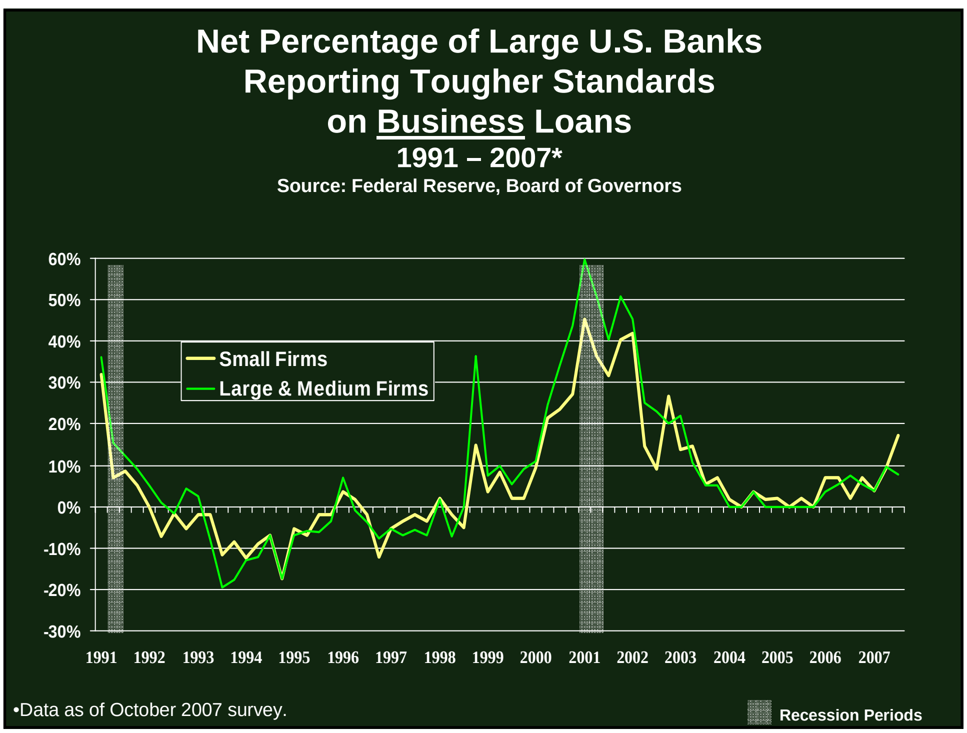
NOW – A ***Limited*** Credit Crunch

The crunch has not yet spread to the general economy.

Characteristics of a ***Limited*** Credit Crunch:

- **Banks are still lending to consumers & businesses.**
- **Credit card agencies are still issuing credit.**
- **Mortgage lenders are still lending to qualified borrowers.**

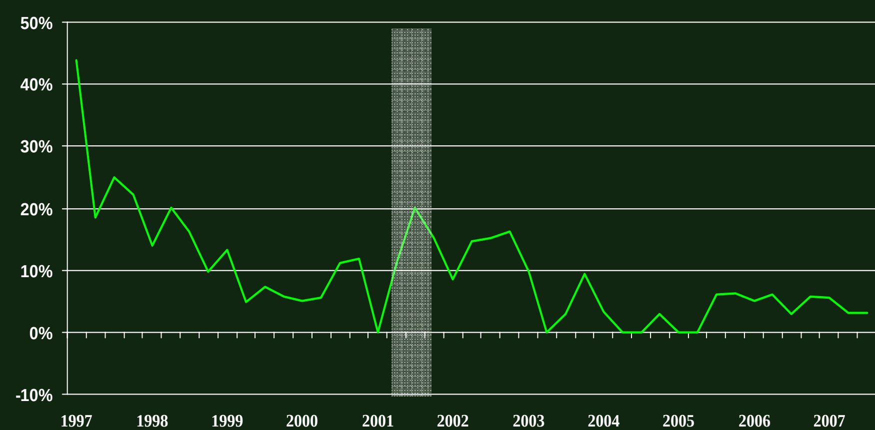

Net Percentage of Large U.S. Banks
Reporting Tougher Standards
on Residential Loans
2007
Source: Federal Reserve, Board of Governors
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
1Q
2Q
3Q
Prime
Non-Traditional
Sub-Prime


Net Percentage of Large U.S. Banks
Reporting Tougher Standards
on Business Loans
1991 – 2007*
Source: Federal Reserve, Board of Governors
Small Firms
Large & Medium Firms
60%
50%
40%
30%
20%
10%
0%
-10%
-20%
-30%
1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
•Data as of October 2007 survey.
Recession Periods

Net Percentage of Large U.S. Banks Reporting Tougher Standards on <u>Consumer</u> Loans

1997 – 2007*

Source: Federal Reserve, Board of Governors



•Data as of October 2007 survey.

Recession Periods

ACTIONS OF THE FED

Common Themes of Manias

- Extreme speculative hype.
- Frenzy by all levels of investors.
- Severe departure from the investments “intrinsic value.”
- Huge flows of new credit – usually new types of instruments.
- No formidable barriers to entry.

The “Busting of the Bubble” shares similar features:

- Liquidity contracts
- Exogenous events my cause/exacerbate situation
- Prices decline, then plunge

The Perfect Storm in the Housing Market?

What Happened:

- Falling prices
    - Fear
        - Tightening of credit
            - Less money to loan

Scheduled re-pricing of sub-prime loans pushes up delinquent and foreclosure rates, adding new supply that pushes down housing prices…

…which starts the process over again.

Danger Ahead – ARMS to Reset

$263 billion (Jan-07 to Aug-07)

+

$700 billion (Sep-07 to Dec-08)

Source: Banc of America Securities, Business Week, 9/17/07

The credit crunch ends when banks see stability.

Synopsis: Economy-Wide Negatives

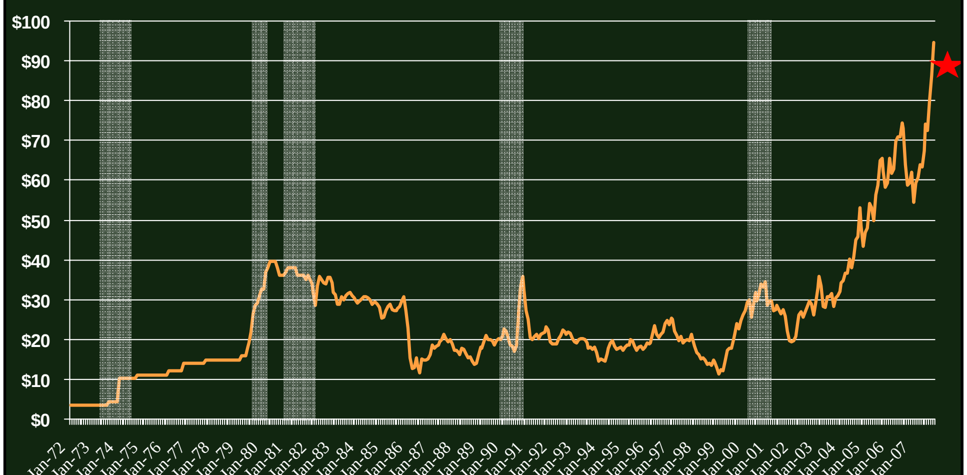
- Credit crunch
- Housing market
- Consumer spending
- Inflation ??? (food & energy)

Synopsis: Economy-Wide Positives

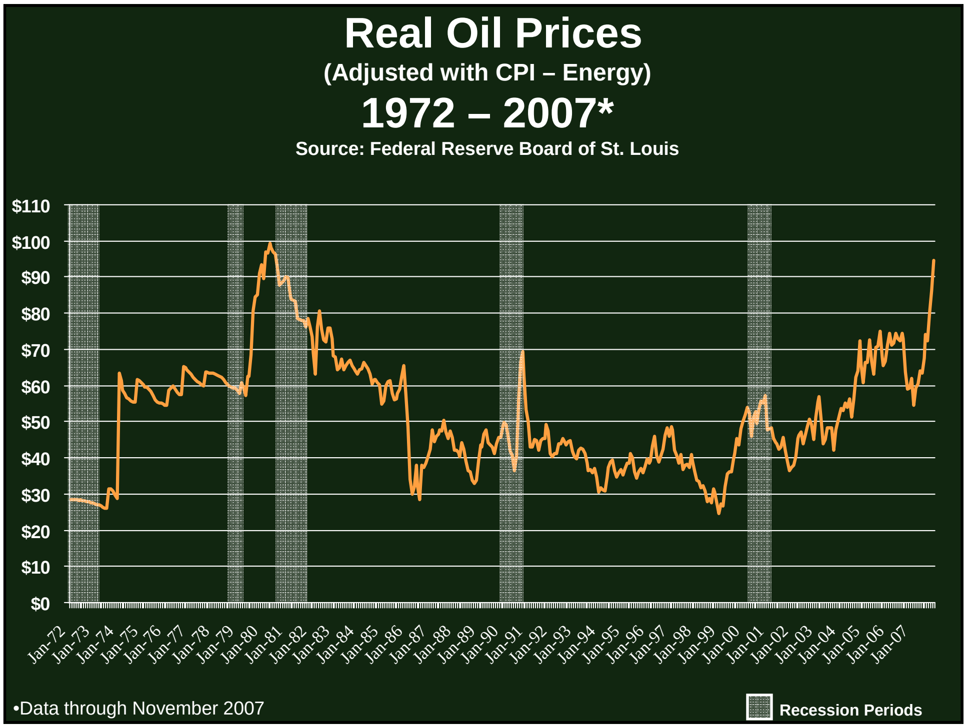
- Employment still positive.
- Businesses lean and mean.
- Recession would be pointless, so Fed will try to avoid one.

Oil Prices 1972 – 2007*

Source: Federal Reserve Board of St. Louis



•Data through November 2007. ★ = December 4th was $88.32 — Recession Periods


Real Oil Prices
(Adjusted with CPI – Energy)
1972 – 2007*
Source: Federal Reserve Board of St. Louis
$110
$100
$90
$80
$70
$60
$50
$40
$30
$20
$10
$0
Jan-72
Jan-73
Jan-74
Jan-75
Jan-76
Jan-77
Jan-78
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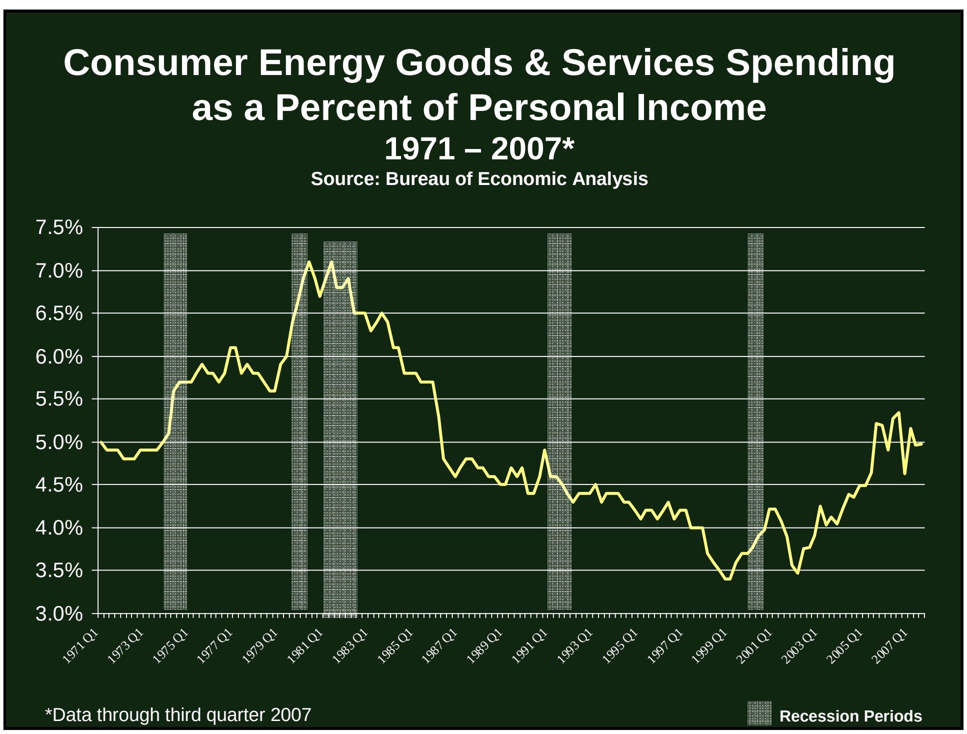
Jan-07
•Data through November 2007
Recession Periods


Consumer Energy Goods & Services Spending as a Percent of Personal Income
1971 – 2007*
Source: Bureau of Economic Analysis
7.5%
7.0%
6.5%
6.0%
5.5%
5.0%
4.5%
4.0%
3.5%
3.0%
1971 Q1
1973 Q1
1975 Q1
1977 Q1
1979 Q1
1981 Q1
1983 Q1
1985 Q1
1987 Q1
1989 Q1
1991 Q1
1993 Q1
1995 Q1
1997 Q1
1999 Q1
2001 Q1
2003 Q1
2005 Q1
2007 Q1
*Data through third quarter 2007
Recession Periods

For perspective, if oil prices stabilize at around $100 per barrel, gas prices will escalate to about $4 per gallon.

National Perspective

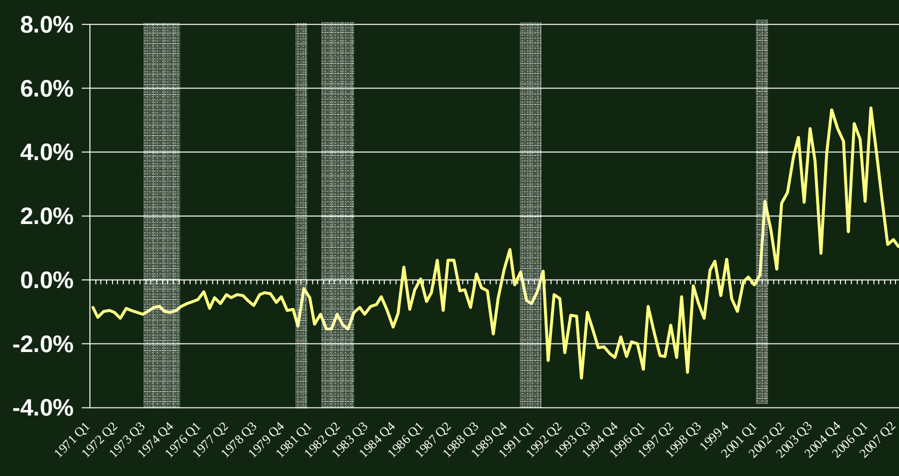
Let’s look at some data.

CONSUMER SPENDING: Causes of Consumer Caution

- Reduced home-related spending on home improvement items such as furnishings, appliances, and building materials.
  (Look at completions not starts)
- Housing-related industries are now cutting jobs.
- Mortgage equity withdrawal slowing.

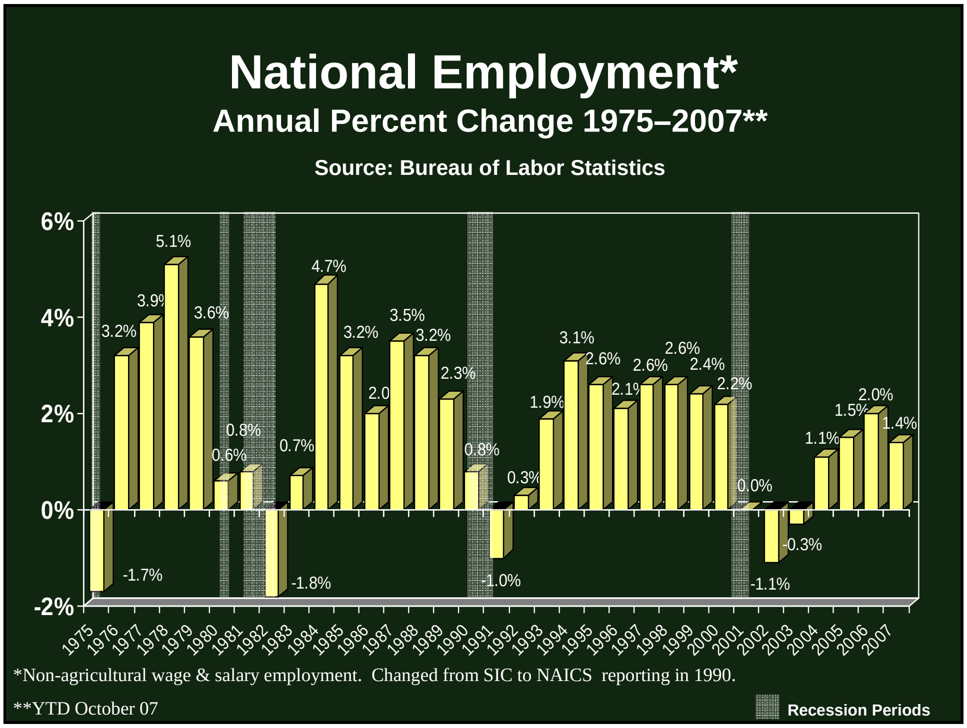
Mortgage Equity Withdrawal as a share of Disposable Income U.S.: 1971 – 2007*

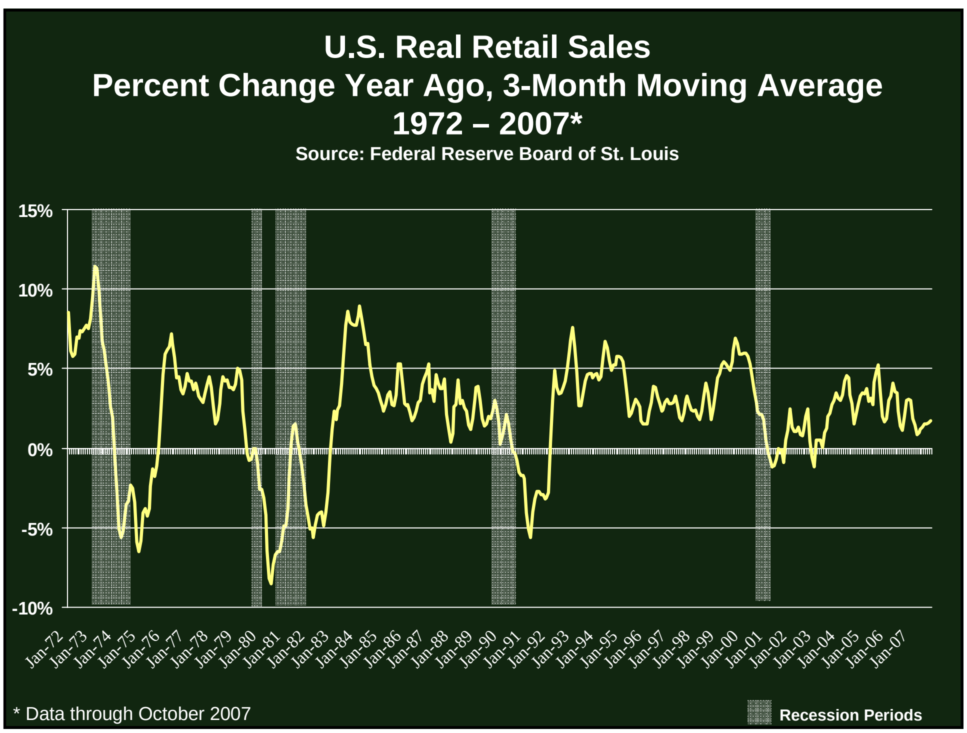
Source: Bureau of Economic Analysis

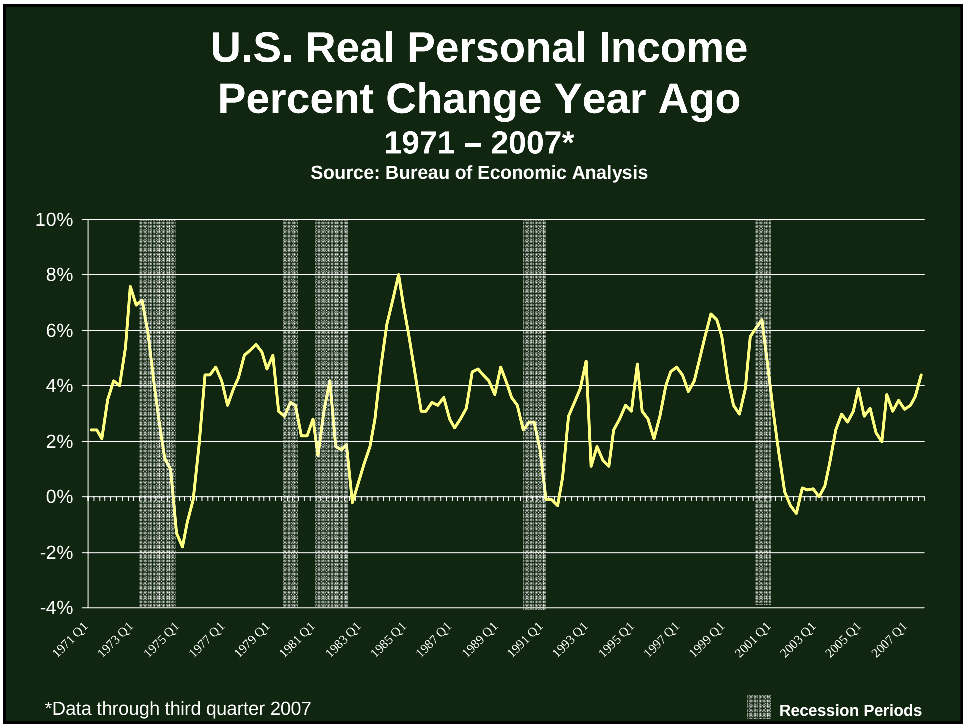


* Data through second quarter 2007

Recession Periods


National Employment*
Annual Percent Change 1975–2007**
Source: Bureau of Labor Statistics
6%
4%
2%
0%
-2%
-1.7%
3.2%
3.9%
5.1%
3.6%
0.6%
0.8%
-1.8%
0.7%
4.7%
3.2%
2.0
3.5%
3.2%
2.3%
0.8%
-1.0%
0.3%
1.9%
3.1%
2.6%
2.1%
2.6%
2.6%
2.4%
2.2%
0.0%
-1.1%
-0.3%
1.1%
1.5%
2.0%
1.4%
1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
*Non-agricultural wage & salary employment. Changed from SIC to NAICS reporting in 1990.
**YTD October 07
Recession Periods


U.S. Real Retail Sales
Percent Change Year Ago, 3-Month Moving Average
1972 – 2007*
Source: Federal Reserve Board of St. Louis
15%
10%
5%
0%
-5%
-10%
Jan-72 Jan-73 Jan-74 Jan-75 Jan-76 Jan-77 Jan-78 Jan-79 Jan-80 Jan-81 Jan-82 Jan-83 Jan-84 Jan-85 Jan-86 Jan-87 Jan-88 Jan-89 Jan-90 Jan-91 Jan-92 Jan-93 Jan-94 Jan-95 Jan-96 Jan-97 Jan-98 Jan-99 Jan-00 Jan-01 Jan-02 Jan-03 Jan-04 Jan-05 Jan-06 Jan-07
* Data through October 2007
Recession Periods



The inflation threat goes away if the economy slows significantly.

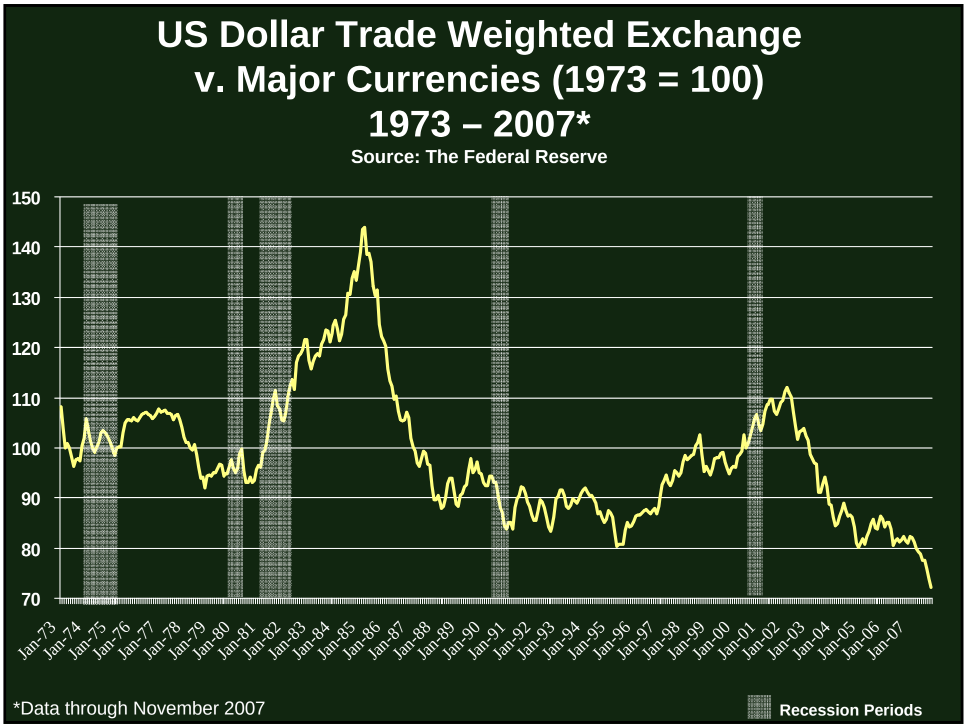
Business

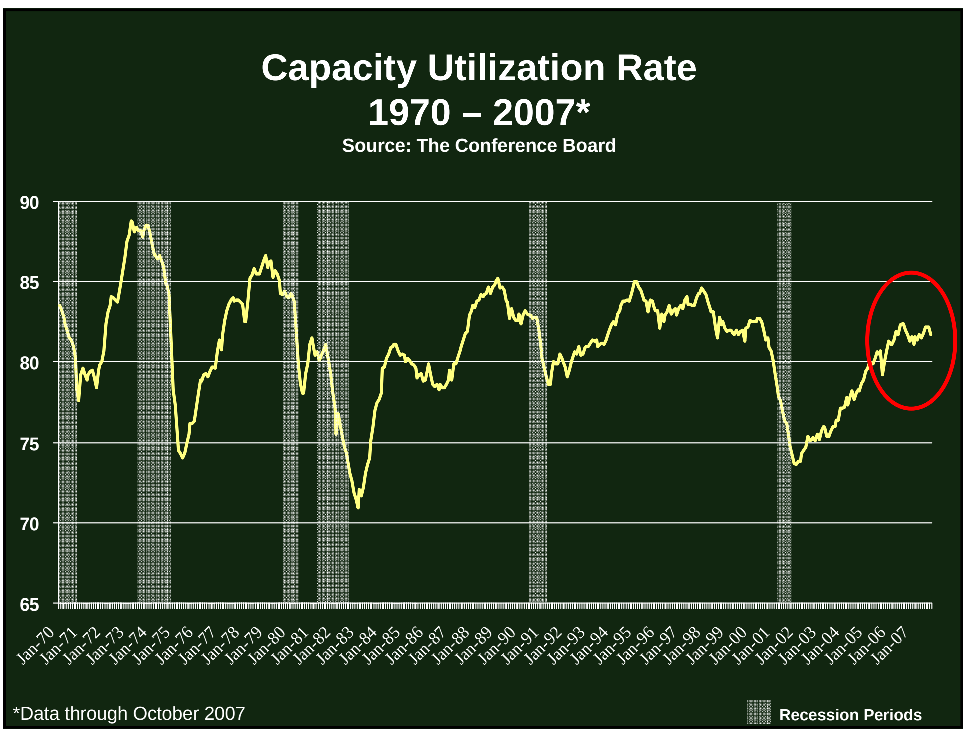
U.S. Real Exports as a Percent of Real GDP

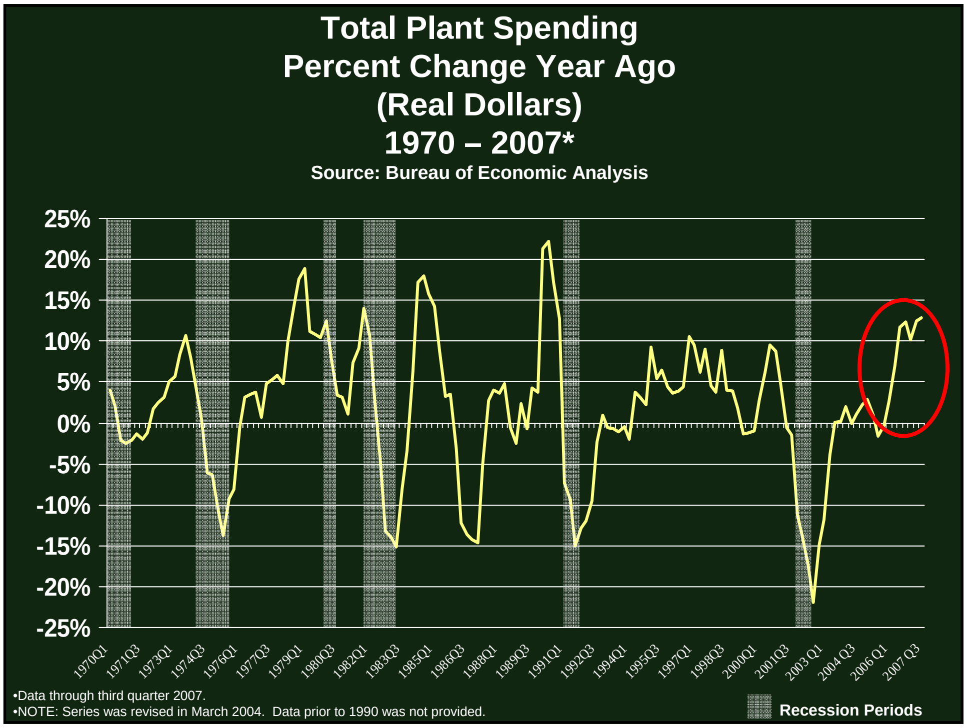
1971 – 2007*

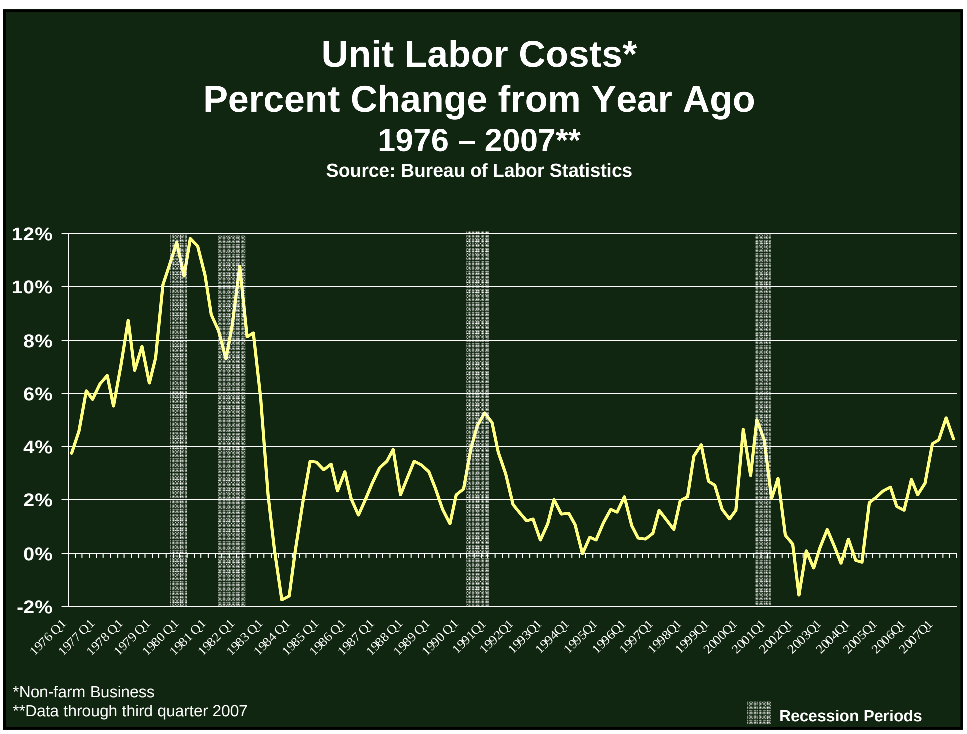
Source: Bureau of Economic Analysis

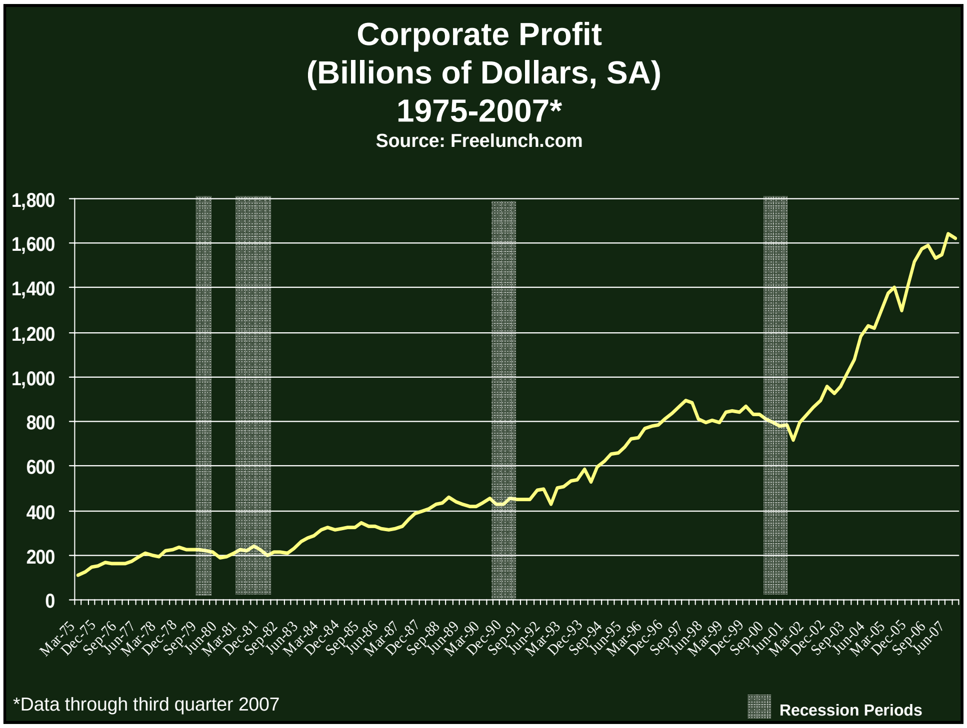
*Data through third quarter 2007


US Dollar Trade Weighted Exchange v. Major Currencies (1973 = 100)
1973 – 2007*
Source: The Federal Reserve
150
140
130
120
110
100
90
80
70
Jan-73
Jan-74
Jan-75
Jan-76
Jan-77
Jan-78
Jan-79
Jan-80
Jan-81
Jan-82
Jan-83
Jan-84
Jan-85
Jan-86
Jan-87
Jan-88
Jan-89
Jan-90
Jan-91
Jan-92
Jan-93
Jan-94
Jan-95
Jan-96
Jan-97
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
*Data through November 2007
Recession Periods


Capacity Utilization Rate
1970 – 2007*
Source: The Conference Board
90
85
80
75
70
65
Jan-70
Jan-71
Jan-72
Jan-73
Jan-74
Jan-75
Jan-76
Jan-77
Jan-78
Jan-79
Jan-80
Jan-81
Jan-82
Jan-83
Jan-84
Jan-85
Jan-86
Jan-87
Jan-88
Jan-89
Jan-90
Jan-91
Jan-92
Jan-93
Jan-94
Jan-95
Jan-96
Jan-97
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
*Data through October 2007
Recession Periods


Total Plant Spending
Percent Change Year Ago
(Real Dollars)
1970 – 2007*
Source: Bureau of Economic Analysis
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
1970Q1
1971Q3
1973Q1
1974Q3
1976Q1
1977Q3
1979Q1
1980Q3
1982Q1
1983Q3
1985Q1
1986Q3
1988Q1
1989Q3
1991Q1
1992Q3
1994Q1
1995Q3
1997Q1
1998Q3
2000Q1
2001Q3
2003 Q1
2004 Q3
2006 Q1
2007 Q3
•Data through third quarter 2007.
•NOTE: Series was revised in March 2004. Data prior to 1990 was not provided.
Recession Periods


Unit Labor Costs*
Percent Change from Year Ago
1976 – 2007**
Source: Bureau of Labor Statistics
12%
10%
8%
6%
4%
2%
0%
-2%
1976 Q1
1977 Q1
1978 Q1
1979 Q1
1980 Q1
1981 Q1
1982 Q1
1983 Q1
1984 Q1
1985 Q1
1986 Q1
1987 Q1
1988 Q1
1989 Q1
1990 Q1
1991Q1
1992Q1
1993Q1
1994Q1
1995Q1
1996Q1
1997Q1
1998Q1
1999Q1
2000Q1
2001Q1
2002Q1
2003Q1
2004Q1
2005Q1
2006Q1
2007Q1
*Non-farm Business
**Data through third quarter 2007
Recession Periods



U.S. OUTLOOK - 2008

- Housing (-)
- Inflation (-)
- Productivity growth slowing (-)
- Consumer spending (-)
- Fiscal stimulus (+/ -)
- Low interest rates (+)
- Business spending (+)
- Monetary stimulus (+)
- Real incomes (+)
- Businesses mean and lean (+)
- Job growth (+)
- Exports (+)

ELLIOTT D. POLLACK
& Company

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480-423-9200 P 480-423-5942 F www.arizonaeconomy.com

Joint Legislative Budget Committee

Finance Advisory Committee

December 10, 2007

CRUCIAL CONCEPTS

- Housing market has rebounded
- Over hang of homes for sale, vacant and foreclosed
- Geopolitical Risks
- Financing: Cost & Availability
- Recession
- Affordability
- Resource Cost & Availability: Energy, time and water
- Consumer confidence & net income

EXPECTATIONS

	PERMITS	RESALES
2007	33,400	51,000
2008	37,500	59,000
2009	43,600	68,000

Note: Permits include Pinal; resales are just Maricopa

Arizona Single Family Construction Activity

County	2002	2005	2007
Maricopa	63 %	52 %	60%
Pinal	8	16	18
Pima	12	13	10
Coconino	2	1	1
Yavapai	4	5	3

Arizona Single Family Average Permit Value

County	2002	2005	2007
Maricopa	$155,080	$184,025	$182,520
Pinal	108,130	125,090	82,445
Pima	151,220	168,725	188,805
Coconino	145,910	200,835	205,500
Yavapai	136,725	179,985	194,190

Arizona Commercial Construction Activity

Share of State Commercial Activity

County	2005	2007
Maricopa	75 percent	79 percent
Pinal	4	2
Pima	10	7
Coconino	1	2
Yavapai	1	2

Arizona Commercial Construction Activity

Share of County Total Construction Activity

County	2005	2007
Maricopa	23 percent	37 percent
Pinal	6	9
Pima	12	24

NEW HOME MARKET

PERMITS	Maricopa	Pinal
2007 YTD	19,294	6,964
2006	27,976	10,788
2005	43,256	18,191
2004	48,136	11,495
2000s	293,046	
1990s	242,161	
1980s	151,796	
1970s	171,406	

NEW HOME
MEDIAN SALES PRICE

Area	Third Qtr. 2006	Third Qtr. 2007
Maricopa County	$273,665	$276,000
Maryvale	245,830	197,120
South Phoenix	272,500	256,735
Western Suburbs	294,000	247,825
Union Hills	781,630	347,715
Deer Valley	429,900	360,535

NEW HOME
MEDIAN SALES PRICE

Area	Third Qtr. 2006	Third Qtr. 2007
Pinal County	$229,850	$196,180
Apache Junction	285,225	218,500
Casa Grande	232,875	198,000
Maricopa	251,010	197,555
Queen Creek	220,995	192,645

Resale Median Sales Price

Maricopa County

Area	Second Qtr. 2005	Second Qtr. 2006
Maricopa County	$235,500	$265,000
Scottsdale	521,250	615,000
Phoenix	182,500	223,000
Mesa	210,000	248,000
Surprise	231,000	255,000
Glendale	215,000	250,000

RESALE MEDIAN SALES PRICE

Area	Third Qtr. 2006	Third Qtr. 2007
Pinal County	$199,900	$193,000
Apache Junction	224,000	218,500
Casa Grande	175,000	157,995
Maricopa	217,625	215,000
Queen Creek	220,000	193,050

Housing Indicators Maricopa County

- Affordability

Year	Resale	New
2001	124	108
2002	124	113
2003	126	113
2004	114	102
2005	84	80
2006	74	63
2007 3rd Qtr	75	70

COMPARATIVE RESALE HOUSING PRICES

Areas	2005	2006
United States	$219,000	222,200
Phoenix	247,400	268,200
San Diego	604,300	601,800
Las Vegas	304,700	317,400
Dallas	147,600	149,500
Atlanta	167,200	171,800

Source: NAR

Median Rate of Appreciation Maricopa County

2002	6.0 percent
2003	6.3 percent
2004	8.4 percent
2005	14.1 percent
2006	16.2 percent
1981-2006	4.6 percent

Housing Indicators Maricopa County

- Inventory Turnover

Year	Resale	New
2002	7 percent	3 percent
2003	8 percent	4 percent
2004	11 percent	5 percent
2005	11 percent	4 percent
2006	7 percent	4 percent
1982-2004	7 percent	3 percent

Housing Indicators
Maricopa County

Year	Jobs Resale	Jobs Permits
2001	26	44
2002	25	41
2003	22	35
2004	16	28
2005	15	29
2006	27	49
1982-2005	28	46

CONDOMINIUM MARKET
NEW HOMES

- Permits
  - 2007 YTD 5,831
  - 2006 6,187
  - 2005 4,526

- Median New Unit Sales Price
  - 2007 $ 245,155
  - 2006 225,400
  - 2005 214,615

CONDOMINIUM MARKET
RESALE HOMES

- Sales Activity
  - 2007 YTD 9,530
  - 2006 13,995
  - 2005 21,290

- Median Resale Home Price
  - 2007 YTD $180,000
  - 2006 174,000
  - 2005 150,000

APARTMENT MARKET

- UNITS AUTHORIZED
  - 2007 YTD 5,647
  - 2006 3,922
  - 2005 3,250
  - 2004 4,997

  - 1990s 51,608
  - 1980s 137,436

RETAIL SQUARE FOOTAGE

	2000	2007
Regional	**13,172,016**	**14,713,507**
Power	**27,163,988**	**49,584,416**
Neighborhood	**36,255,761**	**46,336,967**
Strip	**10,556,947**	**12,874,864**
Total	**87,238,712**	**123,509,854**

RETAIL MARKET
Third Quarter 2007

Inventory	123,509,854 sq.ft.
Occupied Space	111,531,020 sq.ft.
Vacant Space	12,675,765 sq.ft.
Absorption	2,823,131 sq.ft.
New Space	8,2155,551 sq.ft.
Under Construction	10,521,517 sq.ft.
Planned	11,611,486 sq.ft.

OFFICE SQUARE FOOTAGE

	2000	2007
Downtown	5,147,967	6,184,767
Uptown	11,119,594	11,119,594
Camelback	6,778,534	7,570,108
Northeast	8,807,153	13,458,239
Northwest	4,802,079	8,084,145
Southeast	6,082,653	9,770,720
Total	47,511,703	61,368,368

OFFICE MARKET
Third Qtr. 2007

Inventory	61,368,368 sq.ft.
Occupied Space	51,226,345 sq.ft.
Vacant Space	10,142,023 sq.ft.
Absorption	-5,357 sq.ft.
New Space	1,293,591 sq.ft.
Under Construction	7,296,440 sq.ft.
Planned	6,221,814 sq.ft.

Contact

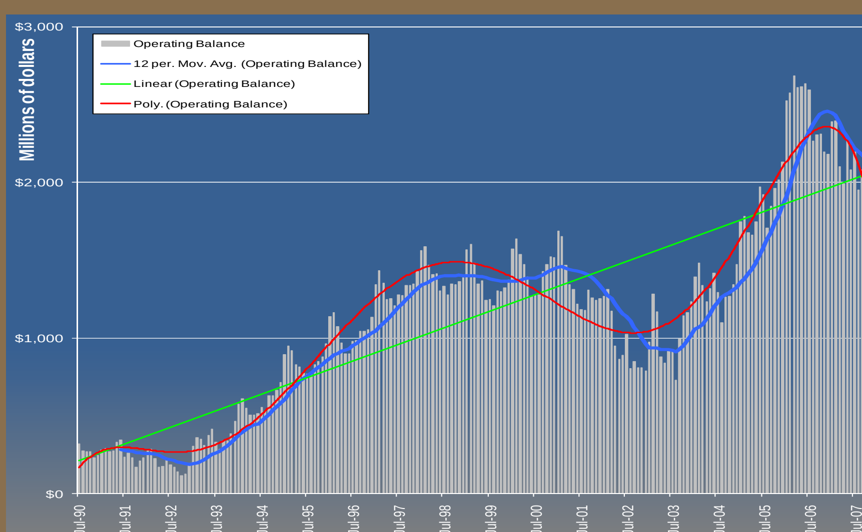
- WWW.POLY.ASU.EDU/AREC

Finance Advisory Committee
December 10, 2007

Office of the Arizona State Treasurer

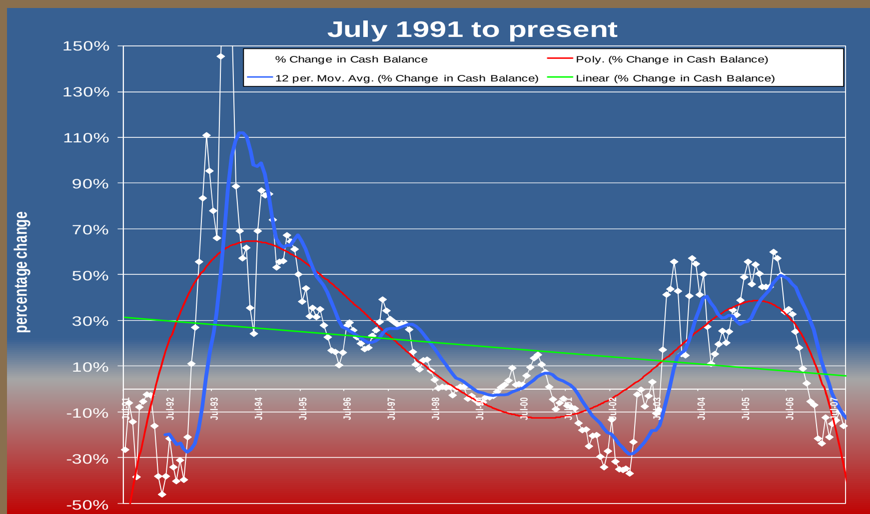
Treasurer Dean Martin

State Total Operating Account Average Monthly Balance
July 1990 to present

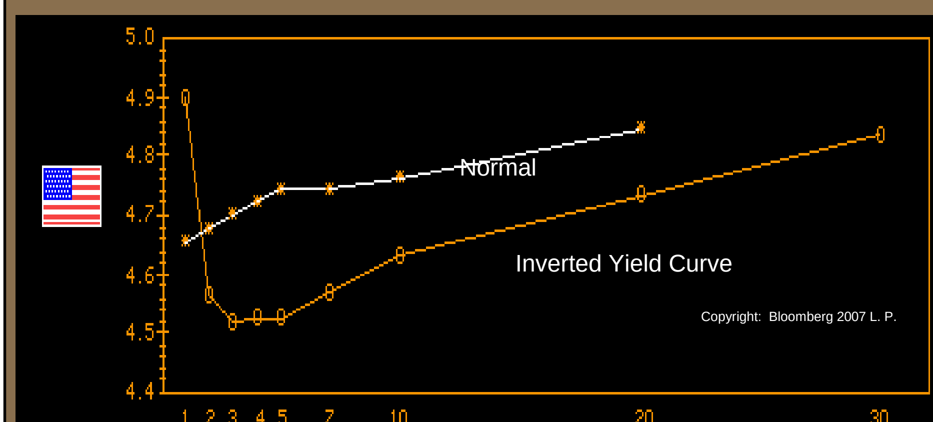


State of Arizona Operating Cash Balance On A Downward Trend

Percent Change in Operating Account Balance



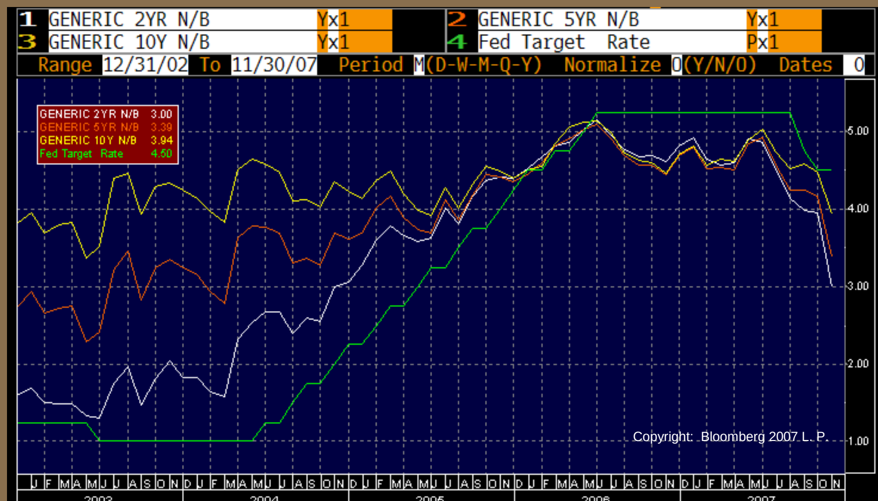
Inverted vs. Normal Yield Curve



2 YR/10 YR Govt. Spread since 1977

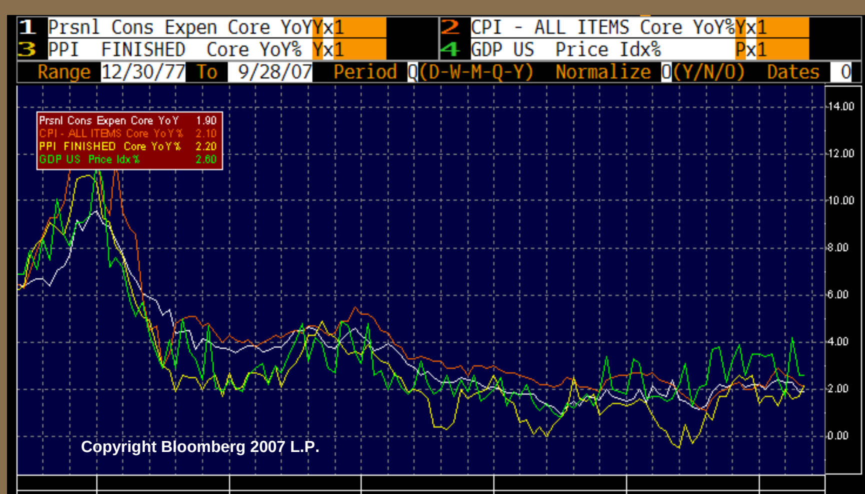
US Treasury Yields vs. Fed Funds since 1977

US Treasury Yields vs. Fed Funds since 2003



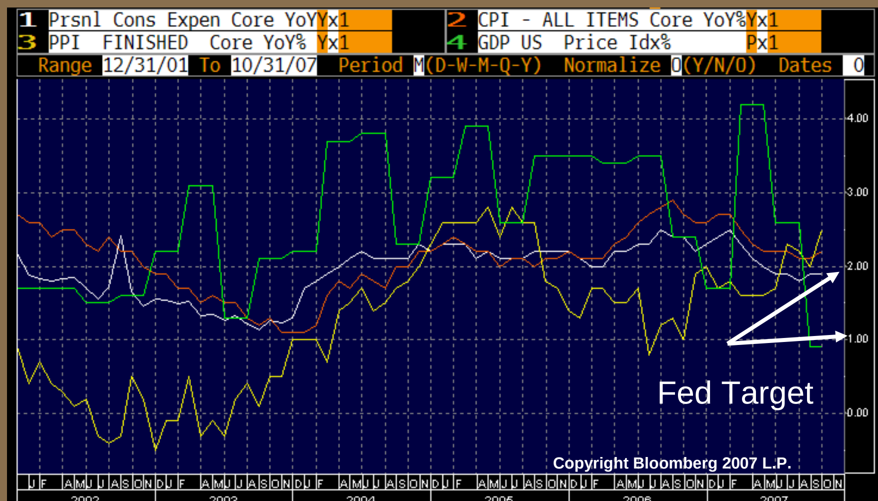
Inflation: GDP Deflator consistently above other measures

PCE, PPI, CPI CORE, and GDP RATES Quarterly since 1977

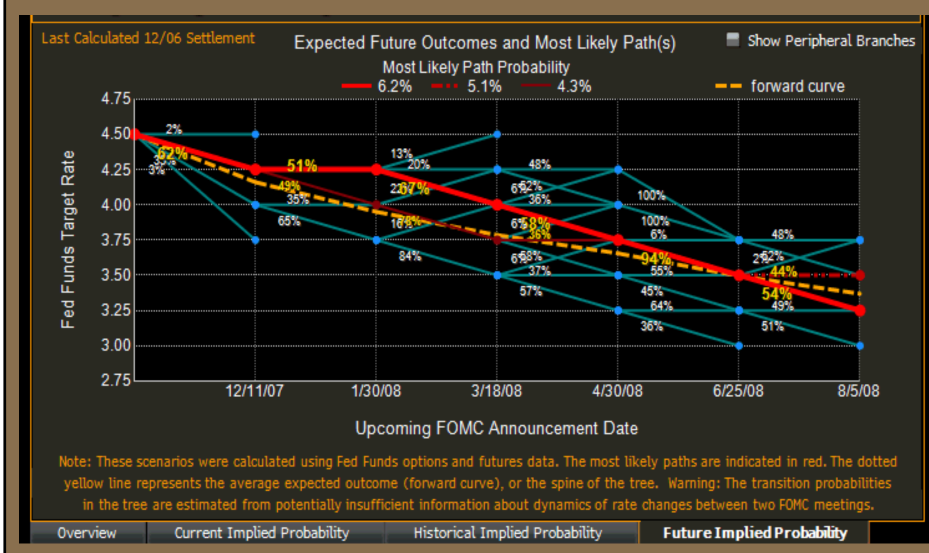


Inflation: GDP Deflator consistently above other measures

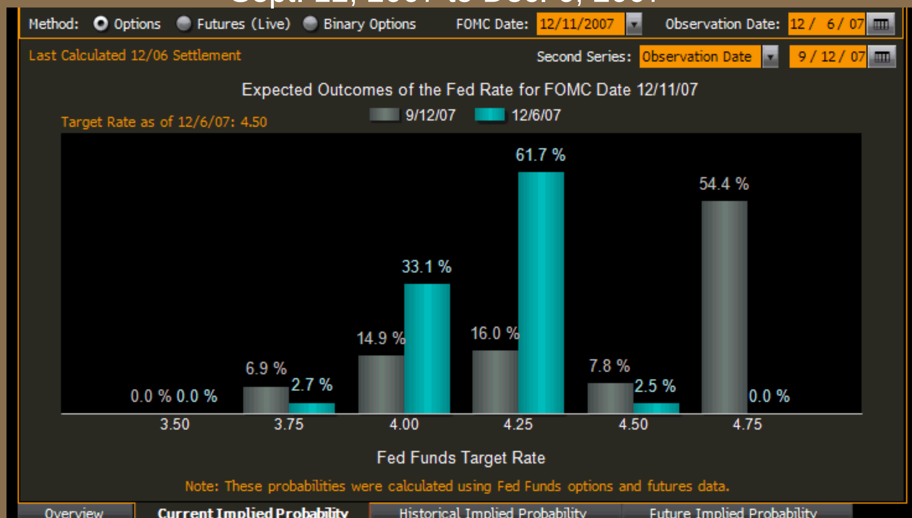
PCE, PPI, CPI CORE, and GDP RATES monthly since 2001



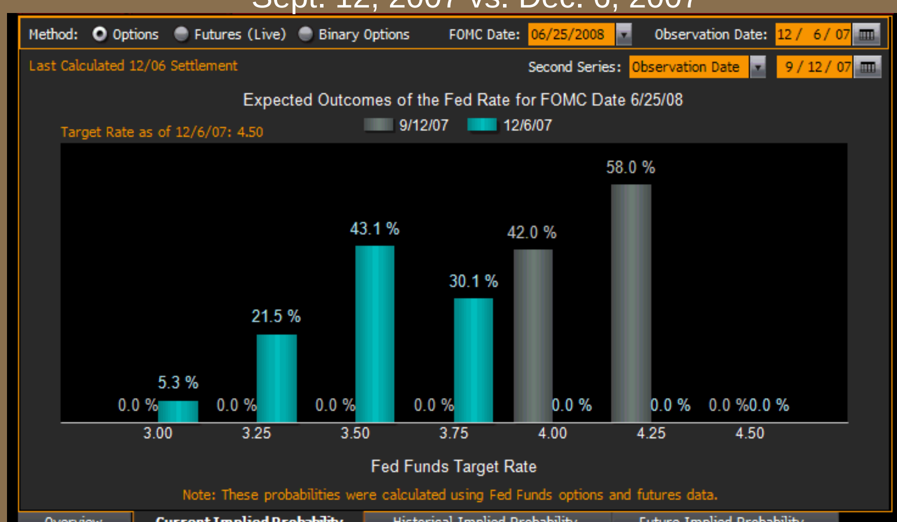
Fed Fund Futures and Options trading through August 08

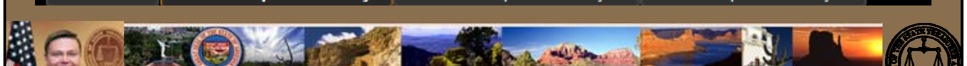


Where rates are expected to be tomorrow
Sept. 12, 2007 to Dec. 6, 2007

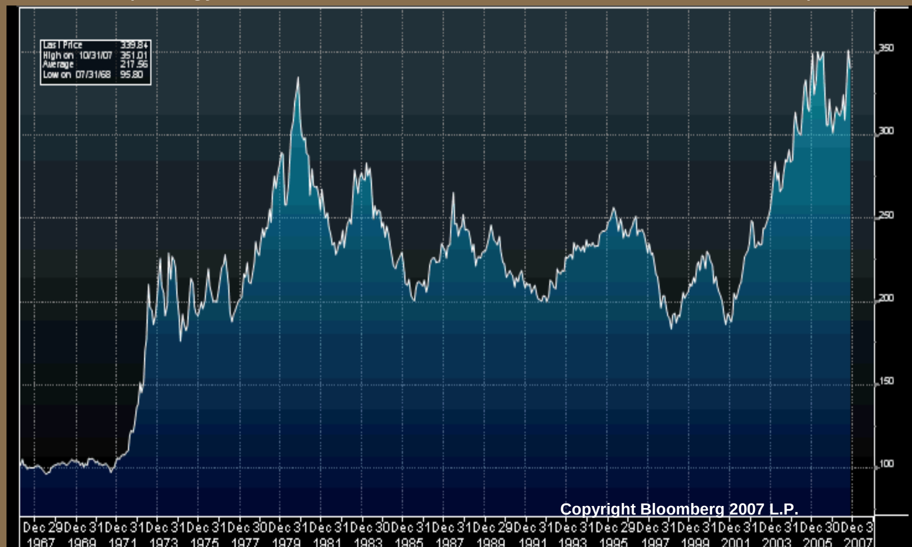


Where rates are predicted to be next June
Sept. 12, 2007 vs. Dec. 6, 2007

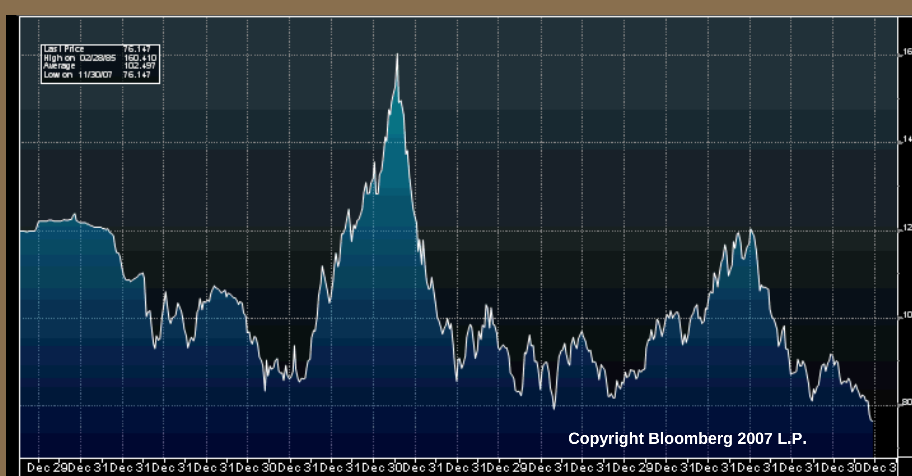




RJ/CRB Commodity Price Index weekly average since 1967
(Energy, Metals, Grains, Livestock, and Soft Commodities)



Value of U.S. Dollar vs. 6 major currencies for last 40 years
(Euro, Yen, Pound, Canadian Dollar, Swedish Krona, Swiss Franc)



Sub-Prime In Arizona

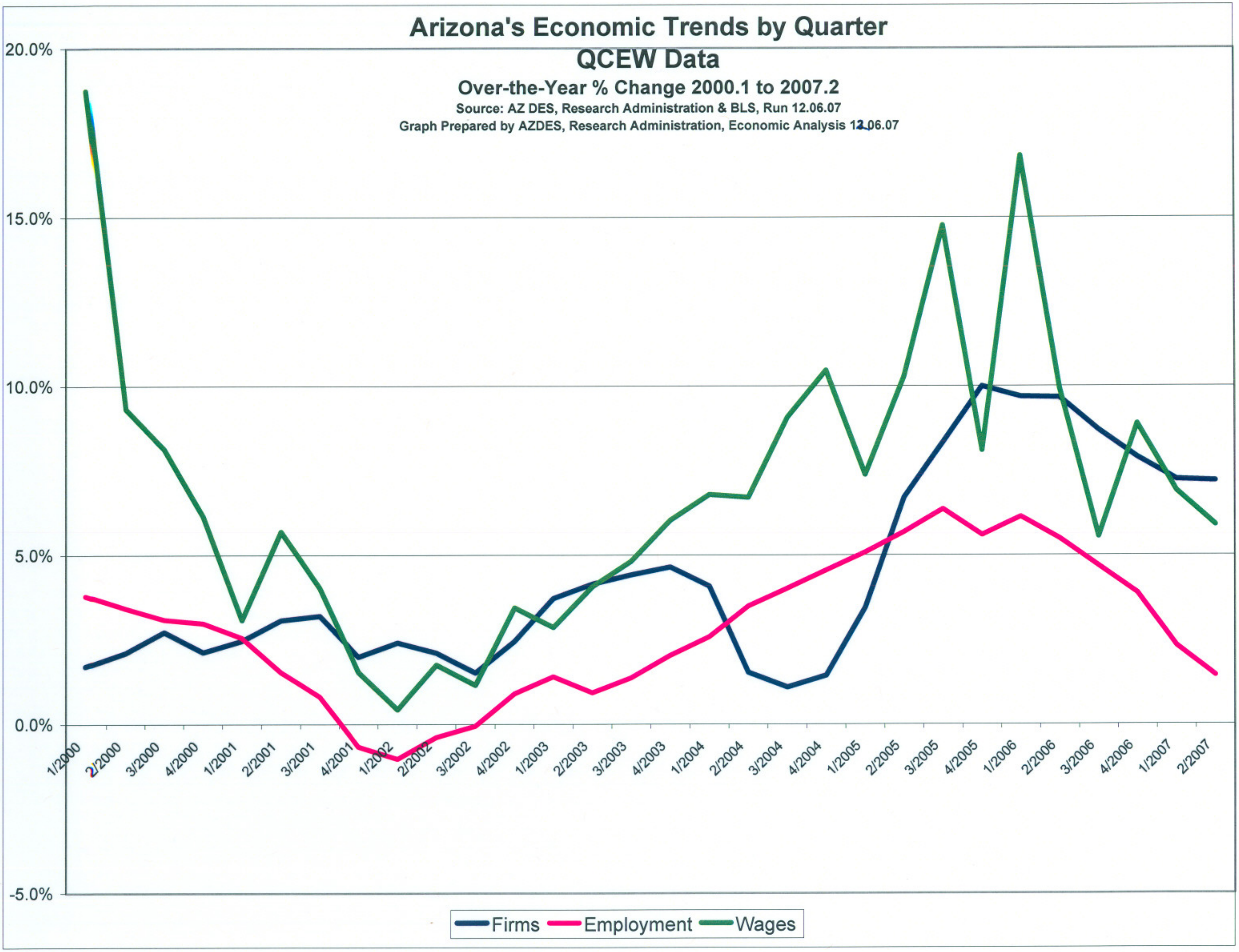
Arizona	CY 2004	CY 2005	CY 2006
Number of high rate loans	62,057	158,460	154,689
% of all mortgages	16	27.4	32.5
Volume in millions	$6,034	$21,934	$25,233
% of volume	10.7	21	27
State Rank	10	5	5

Source: WSJ, Federal Financial Institutions Examination Council, and U.S. H.U.D.

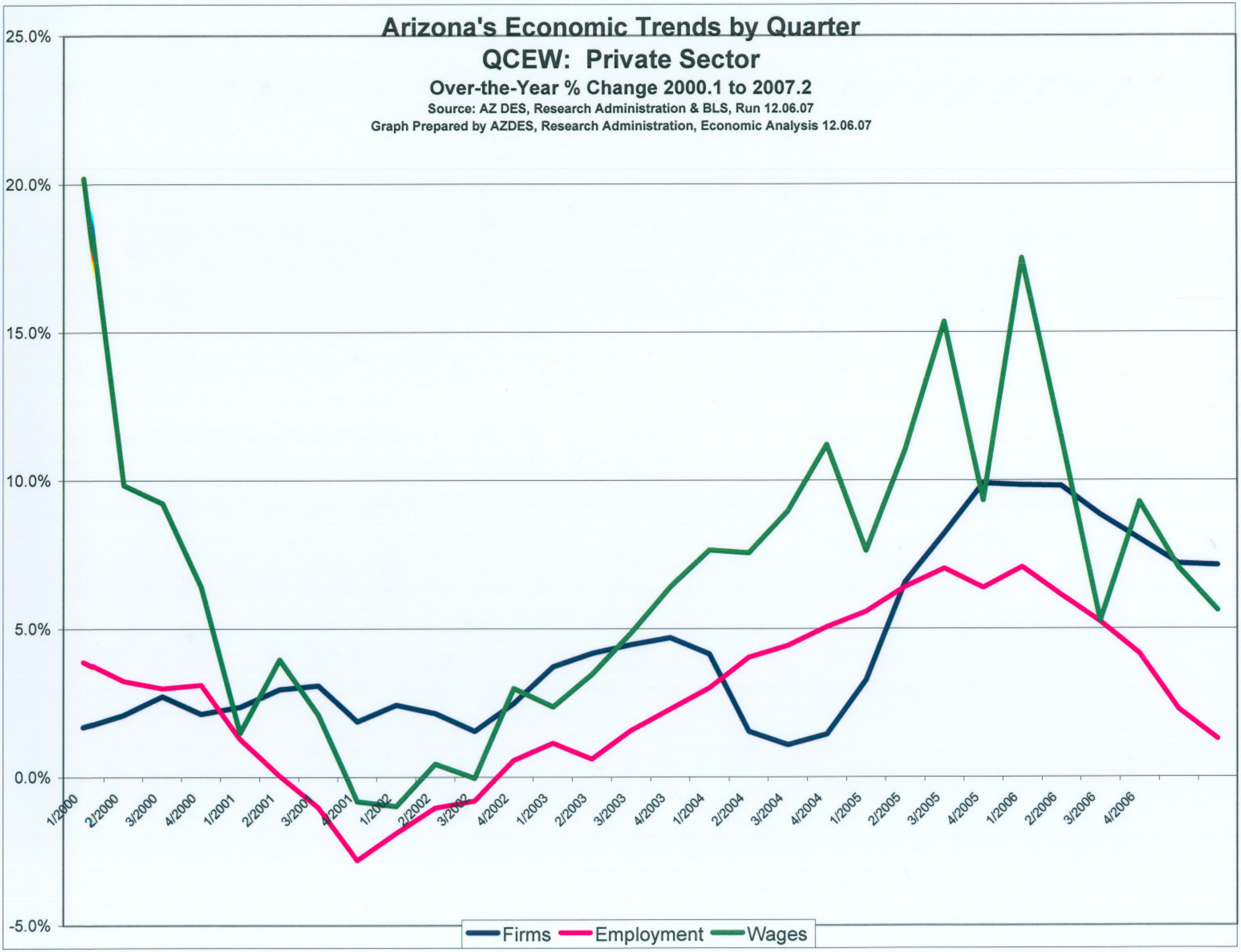
Sub-Prime In Phoenix

Phoenix	**CY 2004**	**CY 2005**	**CY 2006**
Number of high rate loans	**47,388**	**126,295**	**121,133**
% of all mortgages	**16.6**	**28.7**	**34.1**
As a % of all sales	**29.2**	**70.8**	**95.7**
Volume in millions	**$4,660**	**$18,016**	**$20,422**
% of volume	**10.9**	**22.2**	**28.1**
Metro Rank	**5**	**4**	**4**

Source: WSJ, Federal Financial Institutions Examination Council, and U.S. H.U.D.



Arizona's Economic Trends by Quarter
QCEW Data
Over-the-Year % Change 2000.1 to 2007.2
Source: AZ DES, Research Administration & BLS, Run 12.06.07
Graph Prepared by AZDES, Research Administration, Economic Analysis 12.06.07
20.0%
15.0%
10.0%
5.0%
0.0%
-5.0%
1/2000
2/2000
3/2000
4/2000
1/2001
2/2001
3/2001
4/2001
1/2002
2/2002
3/2002
4/2002
1/2003
2/2003
3/2003
4/2003
1/2004
2/2004
3/2004
4/2004
1/2005
2/2005
3/2005
4/2005
1/2006
2/2006
3/2006
4/2006
1/2007
2/2007
Firms
Employment
Wages


Arizona's Economic Trends by Quarter
QCEW: Private Sector
Over-the-Year % Change 2000.1 to 2007.2
Source: AZ DES, Research Administration & BLS, Run 12.06.07
Graph Prepared by AZDES, Research Administration, Economic Analysis 12.06.07
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
-5.0%
1/2000
2/2000
3/2000
4/2000
1/2001
2/2001
3/2001
4/2001
1/2002
2/2002
3/2002
4/2002
1/2003
2/2003
3/2003
4/2003
1/2004
2/2004
3/2004
4/2004
1/2005
2/2005
3/2005
4/2005
1/2006
2/2006
3/2006
4/2006
Firms
Employment
Wages