

The Economic Outlook

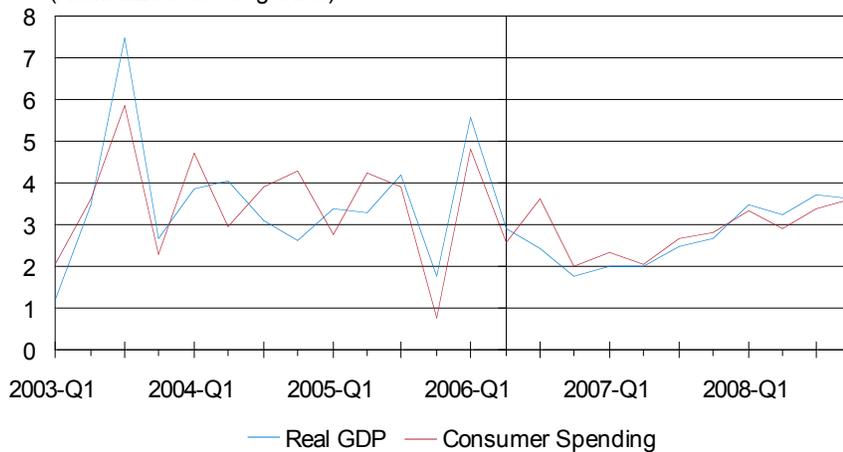
Nigel Gault
Group Managing Director
North American Macroeconomic Services

FTA Revenue Estimating Conference
Portland, Oregon
September 18, 2006

Copyright © 2006 Global Insight, Inc.

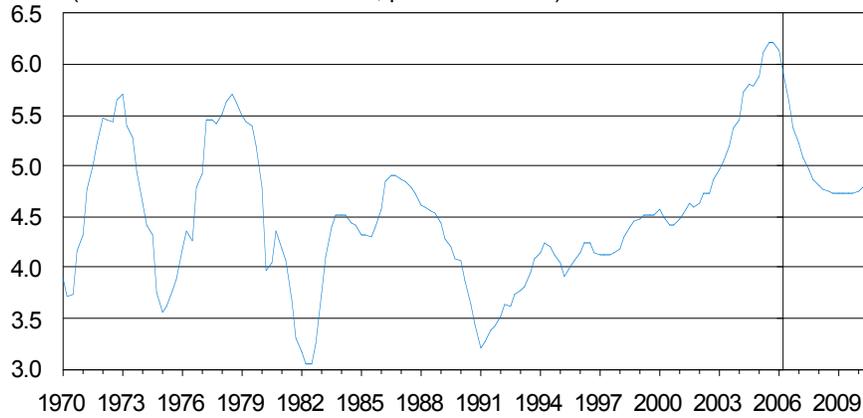
U.S. Growth Is Cooling

(Annualized rate of growth)



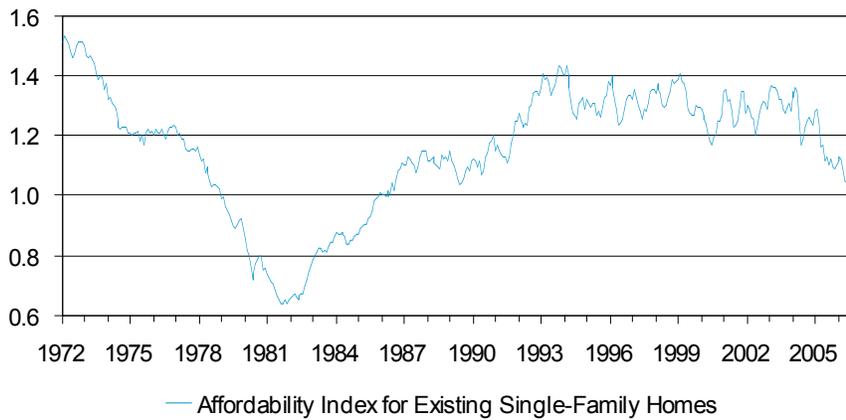
Residential Construction Is Turning Down

(Residential fixed investment, percent of GDP)



Housing Affordability Has Deteriorated...

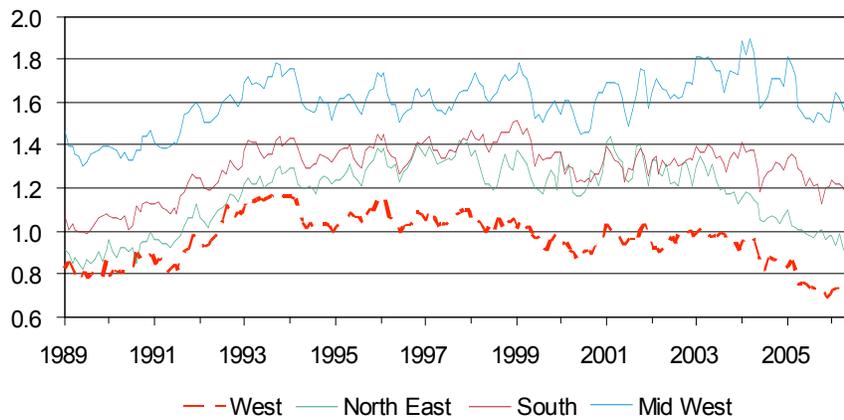
A higher index means homes are more affordable



Source: National Association of Realtors

...And Is Becoming a Major Problem in Some Regions

A higher index means homes are more affordable



Source: National Association of Realtors

GLOBAL INSIGHT

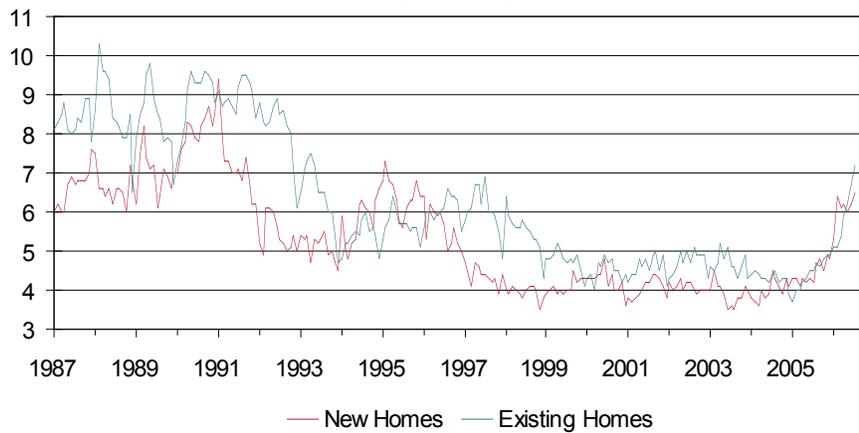
Copyright © 2006 Global Insight, Inc.

09/2006

5

Home Inventory Is Now Rising Sharply Relative to Demand

(Months' supply at current selling rate, single-family homes)



GLOBAL INSIGHT

Copyright © 2006 Global Insight, Inc.

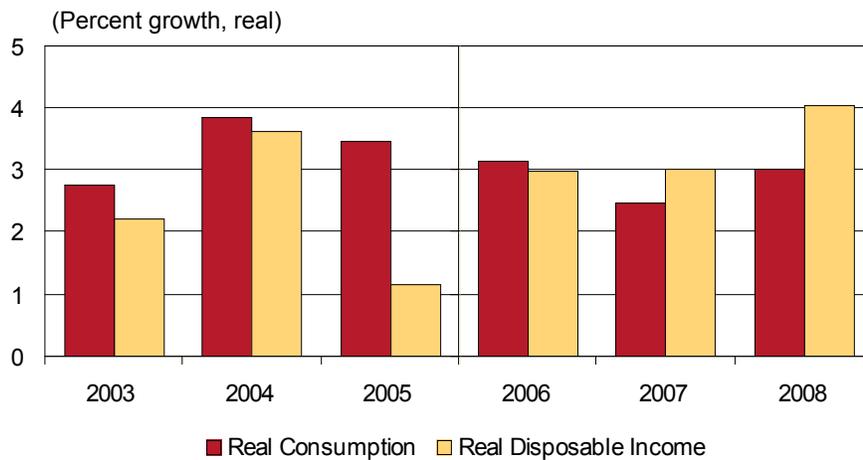
09/2006

6

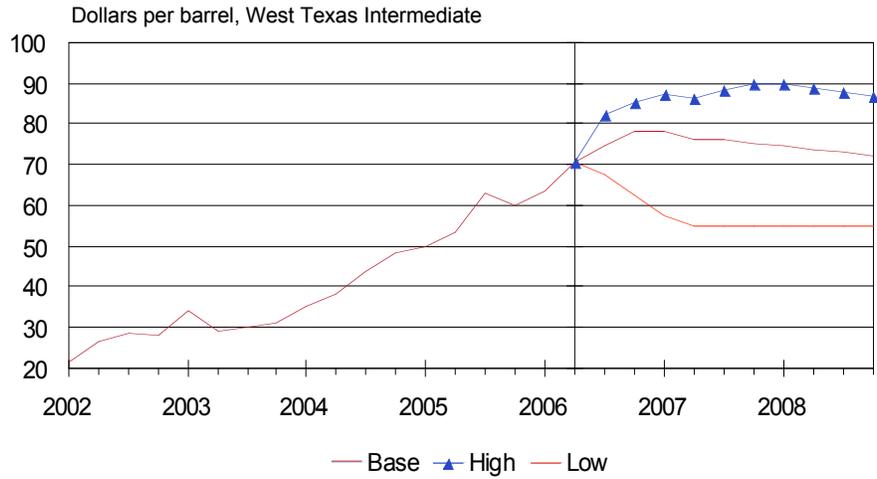
The Housing Downturn



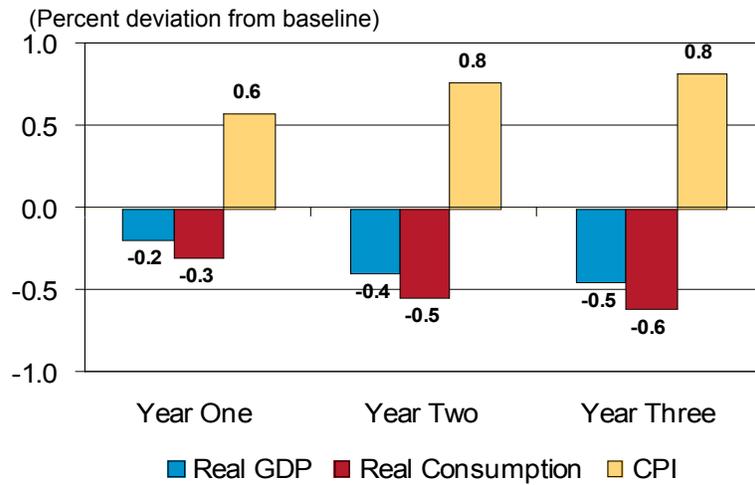
Consumer Spending Won't Outpace Income Growth Forever



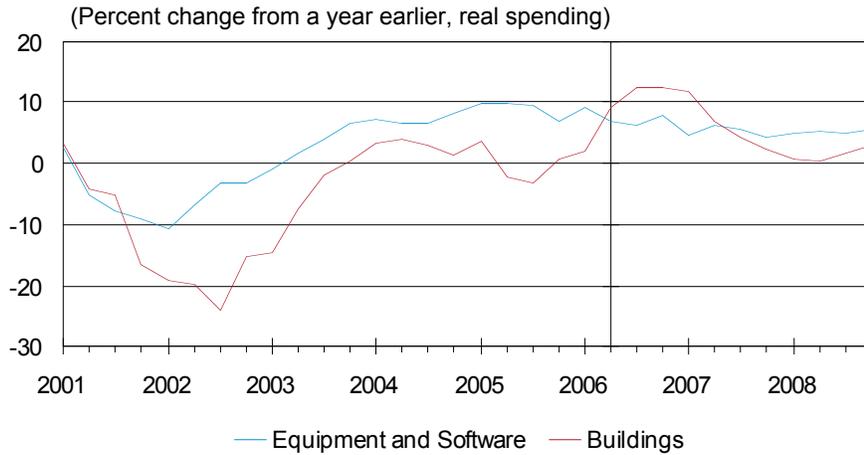
Oil Prices Are A Wild Card



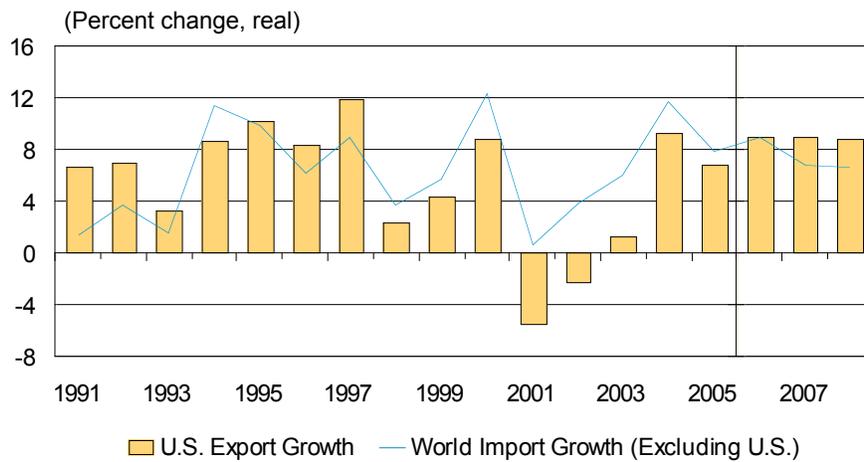
Impact of a \$10 Rise in Oil Prices On the U.S. Economy in the Global Insight Model



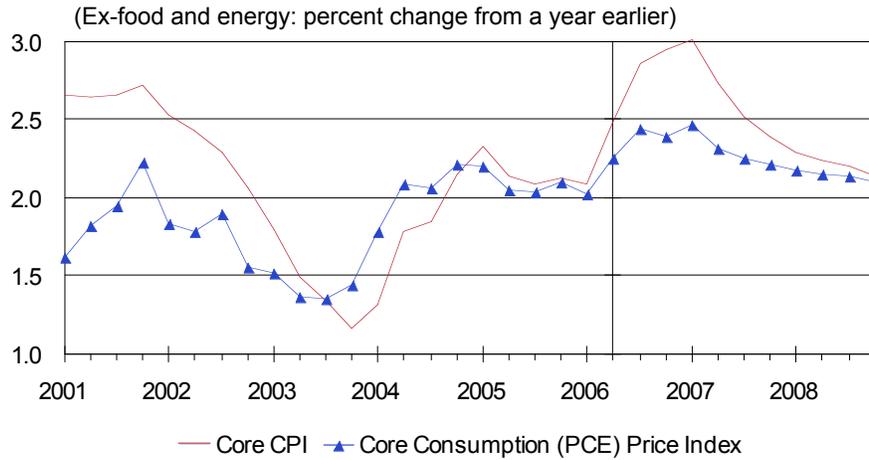
The Business Capital Spending Cycle: Construction To Take The Lead



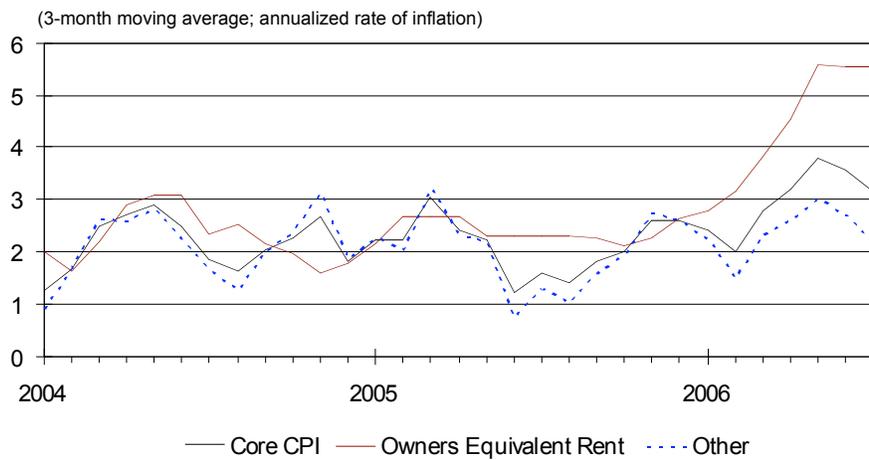
U.S. Export Growth Is Catching Up With World Trade Growth — Helped By The Falling Dollar



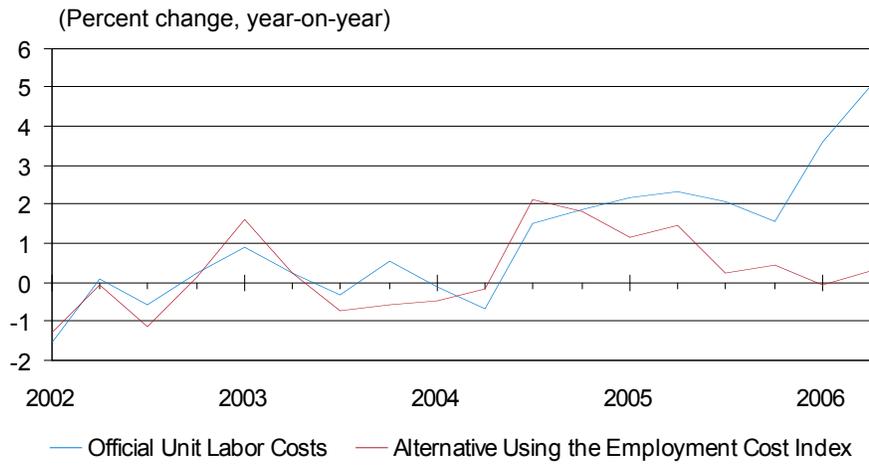
Core CPI Inflation Is Moving Well Above 2%



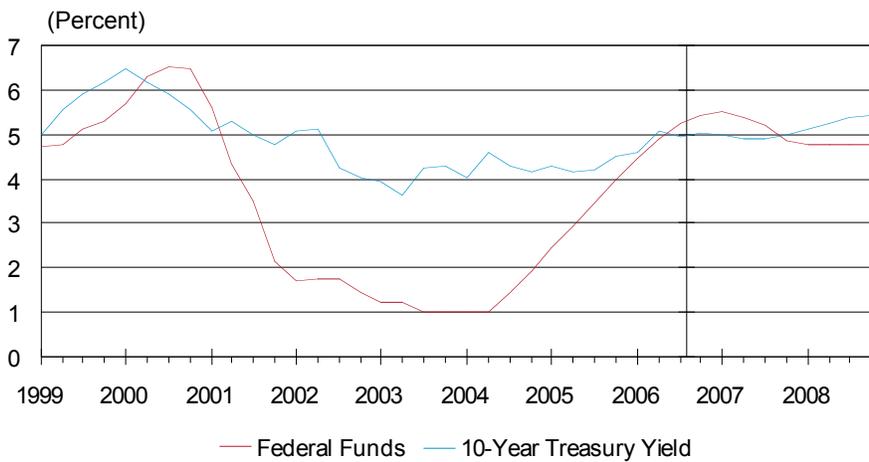
Homeowners' Rent Has Driven Most Of the Pick-Up in Core CPI Inflation



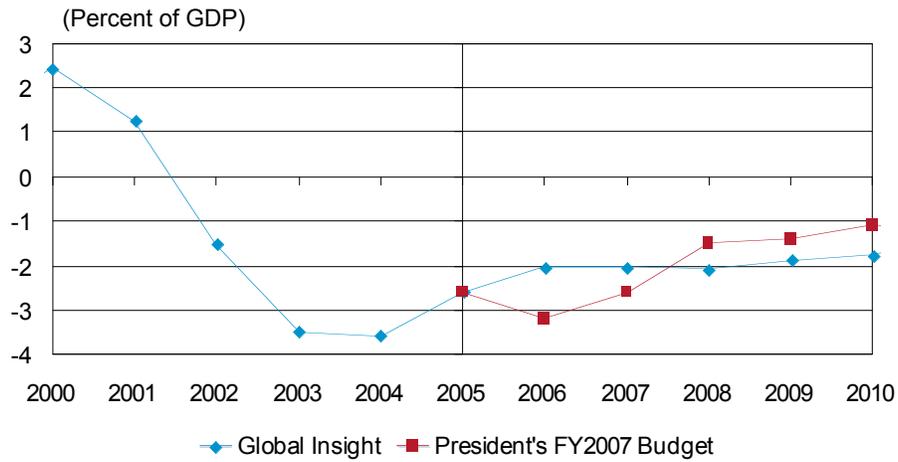
Are Labor Costs Actually Rising Or Not?



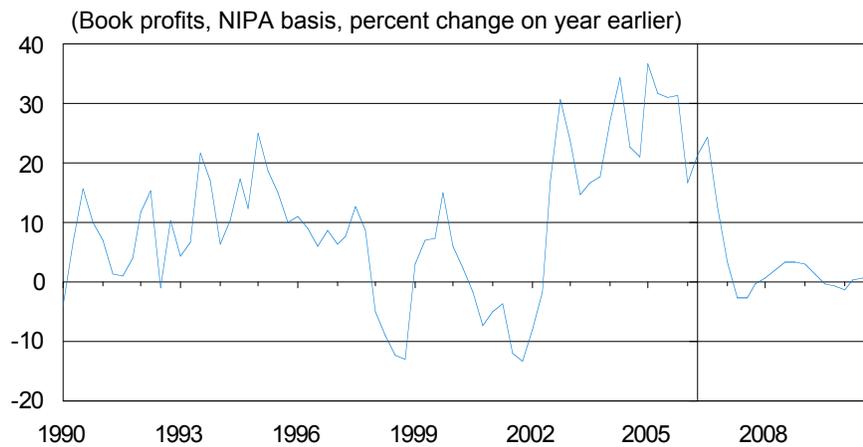
The Fed May Have A Bit More Work to Do – But We Expect It To Cut Rates in 2007



The Federal Budget Deficit Is Doing Much Better Than Expected



The Profits Boom Is Nearing Its End



Bottom Line

- Growth is slowing towards 2%
- Consumption & housing momentum are weakening
- But core inflation is still edging higher; the Fed may not yet be done raising rates
- U.S. dollar to fall further
- Risks (1): Stubbornly above-comfort-zone inflation might mean that rates have to rise above our 5.50% federal funds peak
- Risks (2): Housing downturn may turn into a rout
- Risks (3): Vulnerability to another energy shock remains high

U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

	2005	2006	2007	2008
Real GDP	3.2	3.4	2.2	3.1
Consumption	3.5	3.2	2.5	3.0
Light Vehicle Sales (Millions)	16.9	16.5	16.3	16.5
Residential Investment	8.6	-3.5	-11.4	-2.9
Housing Starts (Millions)	2.07	1.87	1.64	1.64
Business Fixed Investment	6.8	8.2	6.3	4.2
Government	0.9	2.1	1.4	1.5
Exports	6.8	8.9	8.9	8.8
Imports	6.1	5.9	3.7	4.4

U.S. Economic Growth by Sector

(Percent change unless otherwise noted)

	2005	2006	2007	2008
Employment	1.5	1.4	1.0	1.3
Unemployment Rate (%)	5.1	4.7	5.0	5.0
CPI Inflation	3.4	3.5	2.7	1.9
Oil Prices (WTI, US\$/bbl)	56.56	70.82	76.13	73.38
Core CPI Inflation	2.2	2.6	2.7	2.2
Federal Funds Rate	3.21	5.01	5.23	4.75
10-year Government Bond Yield	4.29	4.90	4.95	5.29
\$ (Major Currency Index, 2000=1)	0.83	0.81	0.75	0.72