

The General Economic Outlook

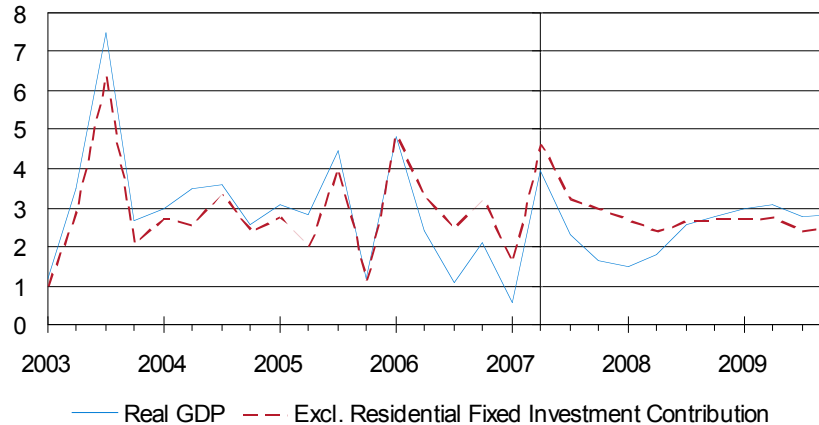
Nigel Gault
Group Managing Director
North American Macroeconomic Services

*FTA Revenue Estimating Conference
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Growth Resilient So Far Despite Housing Bust – But Can It Remain So?

(Real GDP, annualized rate of growth)



U.S. Economic Growth by Sector

(Percent change)

| | 2006 | 2007 | 2008 | 2009 |
|--------------------------------|------|-------|-------|------|
| Real GDP | 2.9 | 2.0 | 2.0 | 2.8 |
| Consumption | 3.1 | 2.9 | 2.3 | 2.6 |
| Residential Investment | -4.6 | -16.4 | -16.6 | 3.4 |
| Bus. Fixed Investment | 6.6 | 3.7 | 2.9 | 3.7 |
| Federal Government | 2.2 | 1.3 | 3.1 | 0.4 |
| State & Local Govt. | 1.6 | 2.2 | 1.5 | 1.0 |
| Exports | 8.4 | 7.0 | 8.8 | 8.4 |
| Imports | 5.9 | 2.0 | 3.7 | 5.0 |

Other Key Indicators

(Percent change unless noted)

| | 2006 | 2007 | 2008 | 2009 |
|---------------------------------------|------|------|------|------|
| Industrial Production | 4.0 | 1.9 | 1.5 | 2.5 |
| Payroll Employment | 1.9 | 1.3 | 0.8 | 1.1 |
| Light Vehicle Sales (Millions) | 16.5 | 16.1 | 16.1 | 16.3 |
| Housing Starts (Millions) | 1.81 | 1.36 | 1.16 | 1.39 |
| Consumer Price Index | 3.2 | 2.6 | 1.9 | 1.8 |
| Core Consumption Deflator | 2.2 | 2.0 | 1.8 | 1.9 |
| Federal Funds Rate (%) | 4.96 | 5.10 | 4.50 | 4.63 |
| 10-Year Treasury Yield (%) | 4.79 | 4.70 | 4.65 | 5.00 |



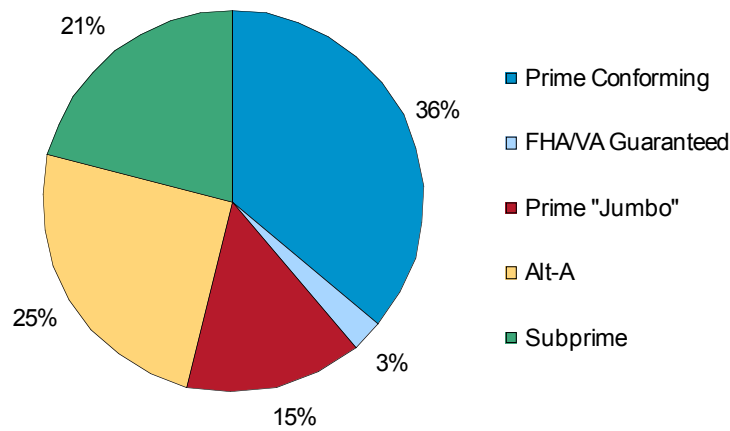
Credit Contagion

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Financial Fall-Out From the Subprime Debacle

- **Huge mortgage-related losses (\$100-\$200 billion?)...**
- **...Dispersed around the world, but nobody knows where for sure...**
- **...Have led investors to flee from mortgage-backed assets (if they can)**
- **Contagion has tainted investor appetite for all forms of risk**
- **Corporate debt and inter-bank funding markets have tightened—forcing central banks to intervene**

U.S. Mortgage Originations in 2006 by Loan Type



Credit Impacts on the Economy

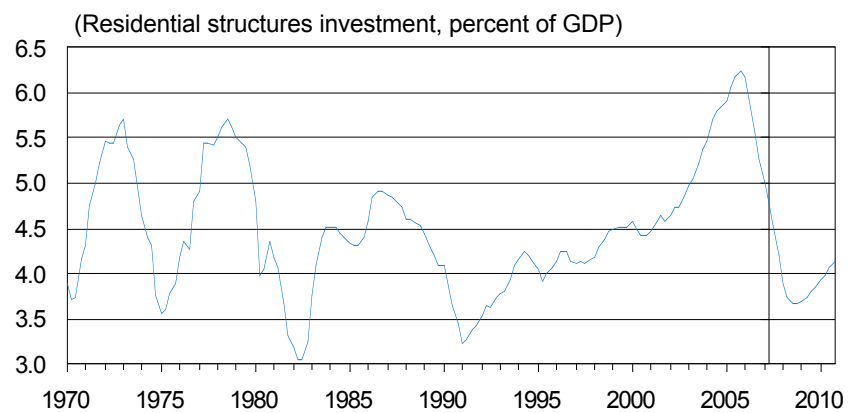
- **Home Mortgages**
 - More foreclosures, fewer qualified buyers
 - "Conforming" prime sector still intact
 - Adjustable rate resets have not yet peaked
- **Consumer**
 - Consumer credit standards likely to tighten
 - Home equity pump drying up
- **Business**
 - Leveraged buy-out market stalled
 - Increased credit spreads (but from very low levels)
 - Commercial paper market freezing up

The Housing Downturn

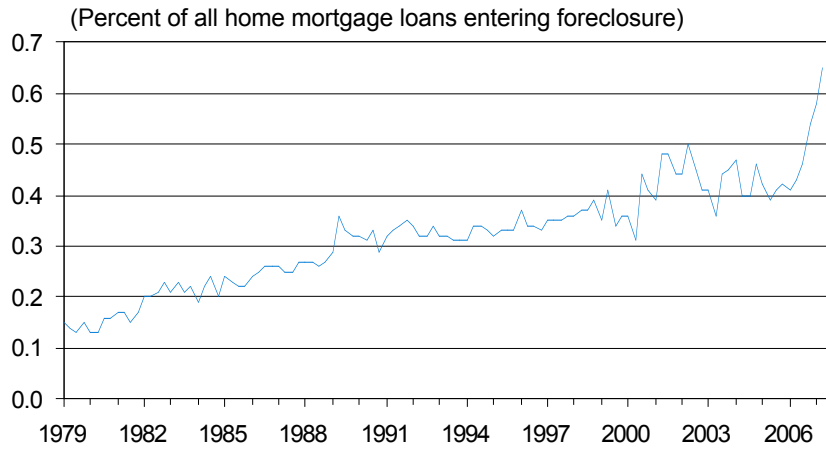


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Residential Construction Adjustment – Much More To Come...



Foreclosure Rate Has Hit New Highs



Source: Mortgage Bankers Association

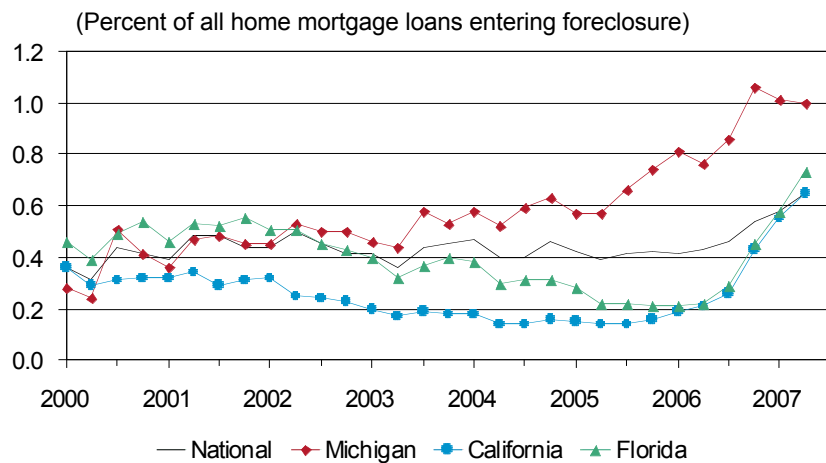


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11

Key State Foreclosure Variations



Source: Mortgage Bankers Association

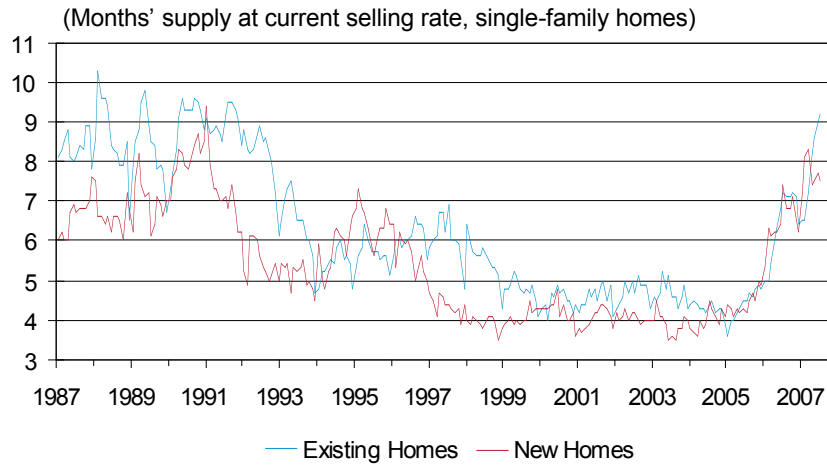


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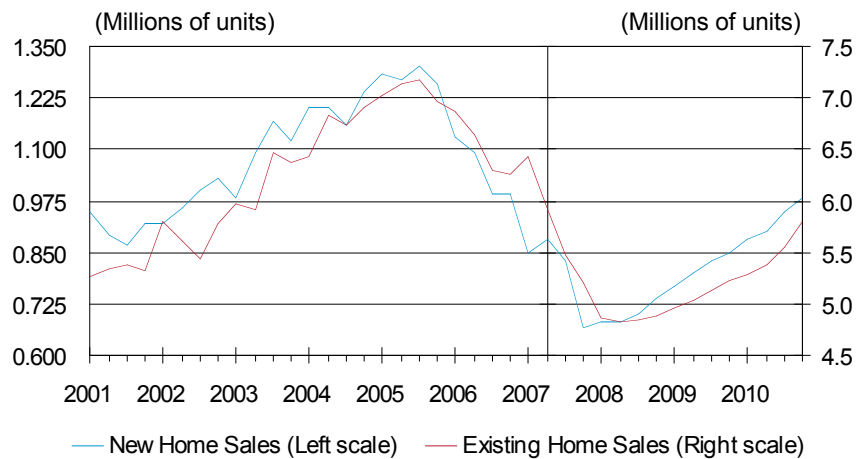
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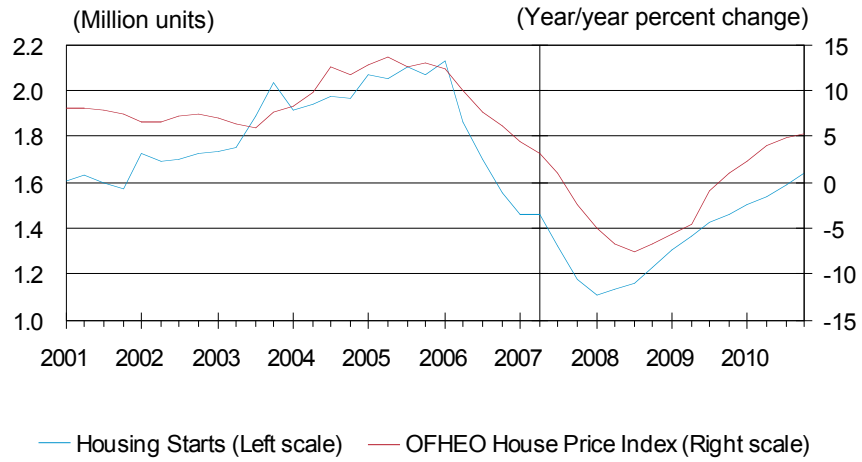
Bloated Supplies of Homes for Sale



Home Sales Have Further To Fall

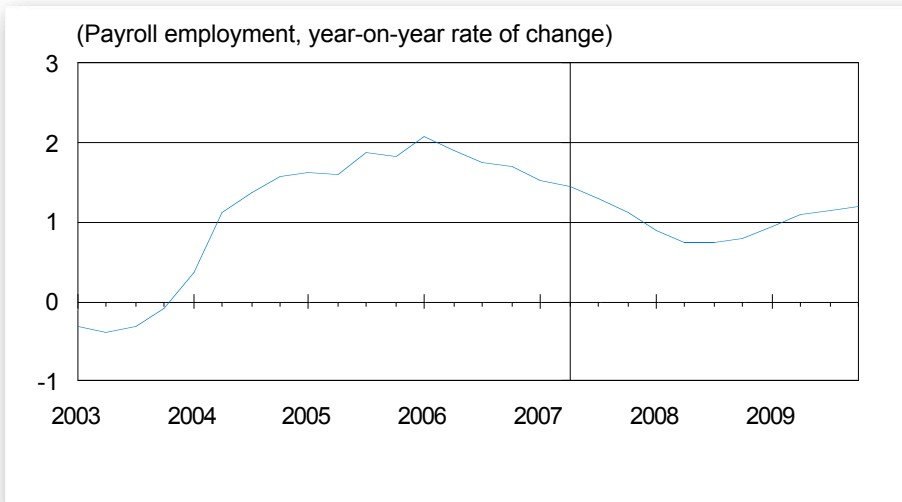


Housing Starts Dip Further, Prices To Fall

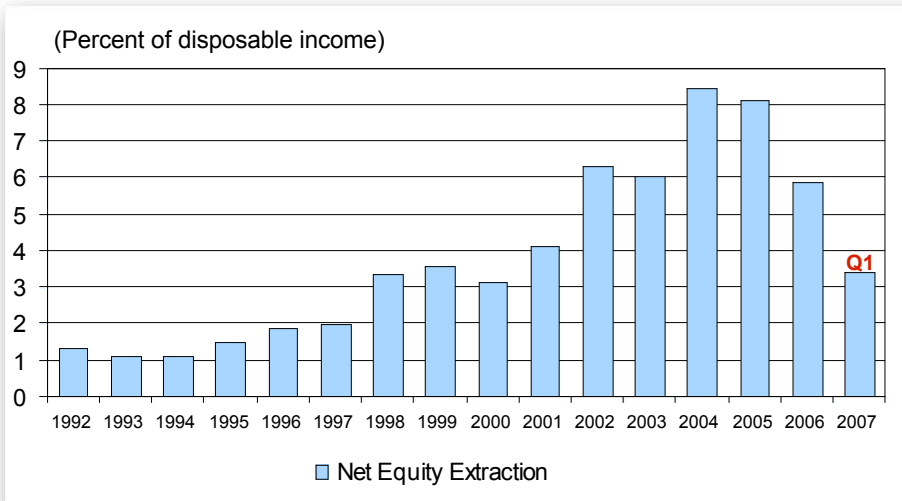


Consumers at Risk

Employment Growth Decelerating

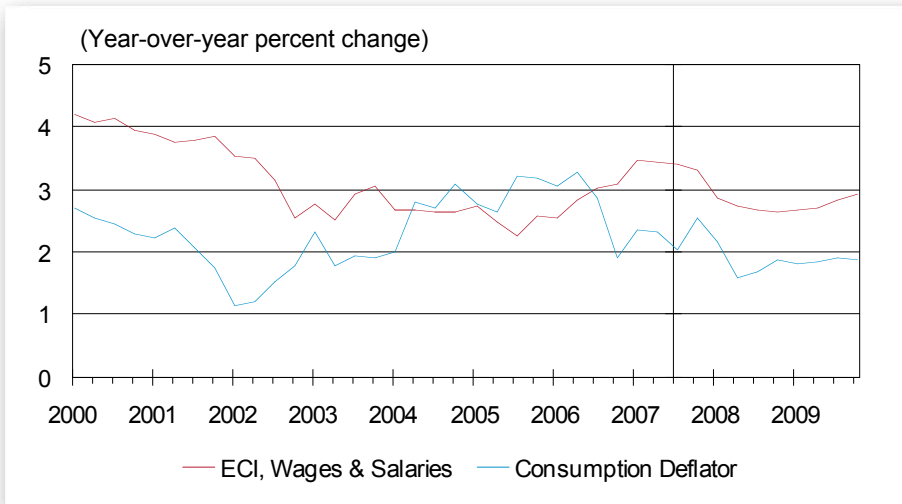


Mortgage Equity Withdrawal Has Been Fueling Consumer Spending, and Is Fading

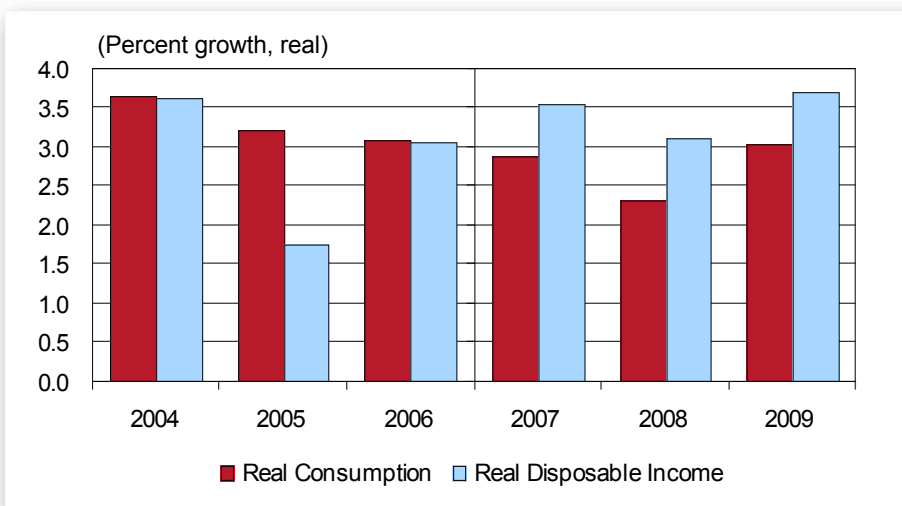


Source: Federal Reserve - Kennedy/Greenspan data updated as of June 2007

Good News: Wage Growth Outpacing Price Inflation



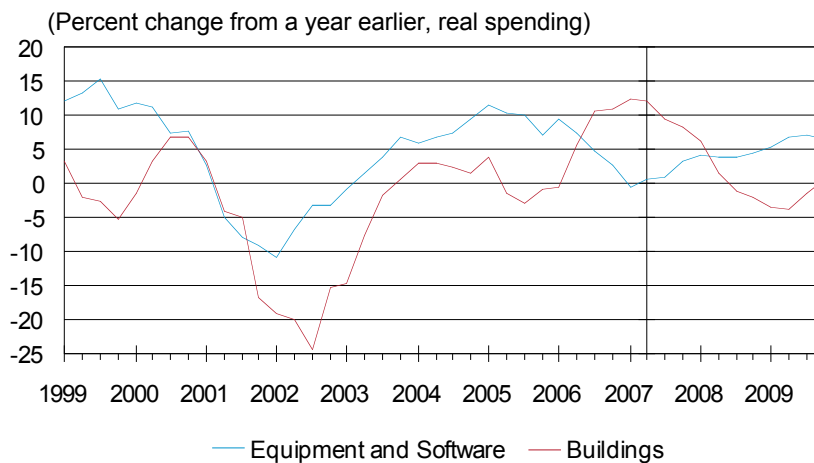
Consumption Growth Will Slow Further



Business Investment Has Been Less Supportive Than Hoped

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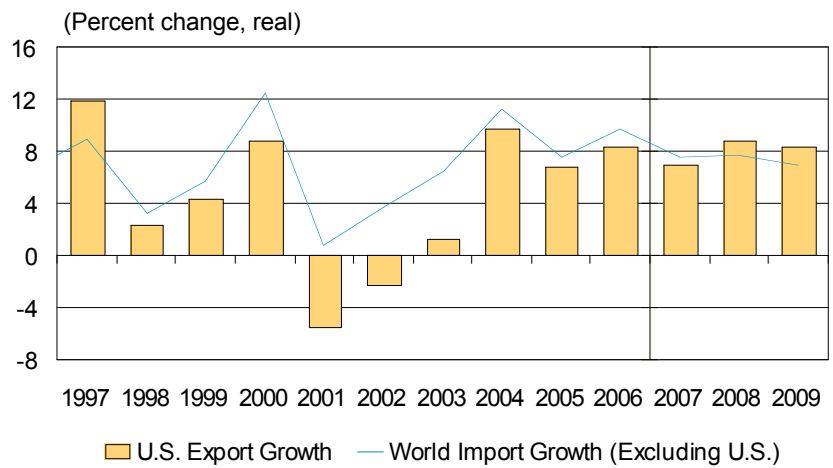
The Business Capital Spending Cycle: Construction Has Taken the Lead



Foreign Trade: Export-Led Growth

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U.S. Export Growth Is Catching Up with World Trade Growth — Helped By the Falling Dollar

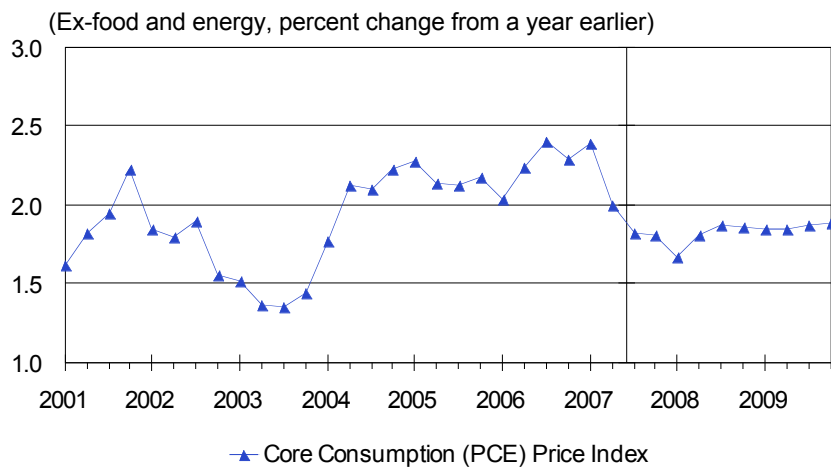


Inflation and Interest Rates

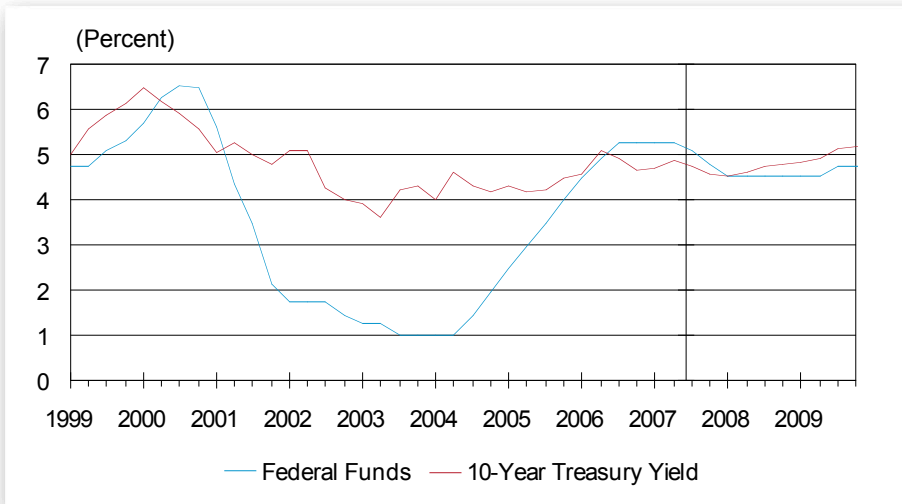


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Core Consumer Inflation Moving Below 2%

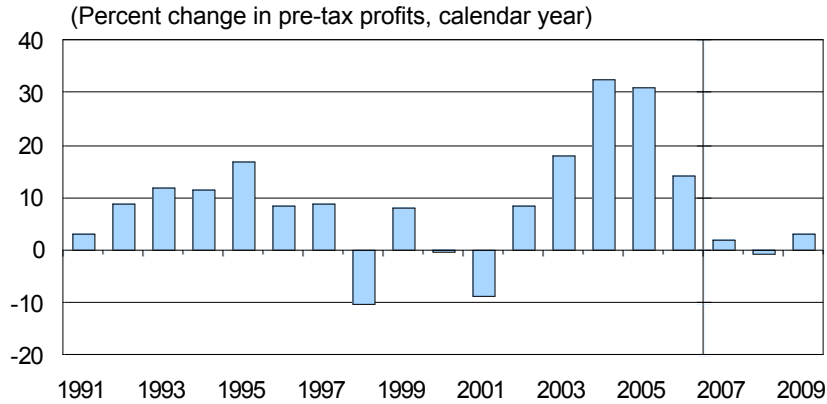


We Expect the Fed To Cut Interest Rates

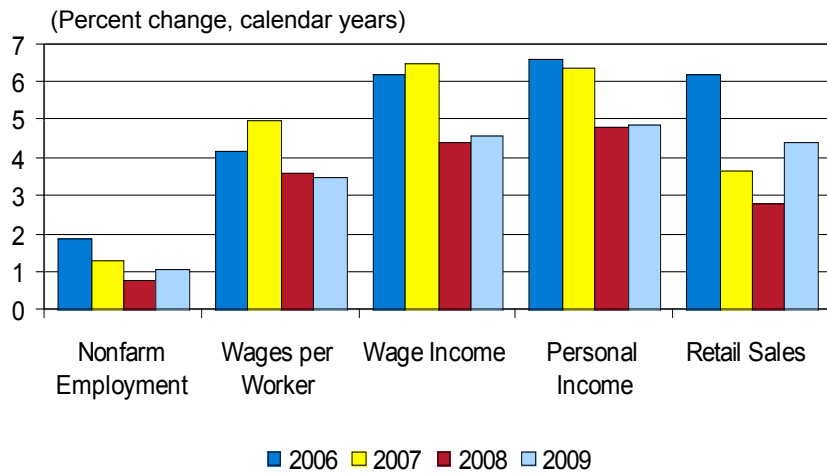


Government Revenue Issues

The Profits Boom Is Out Of Steam



Other Key Indicators Affecting State Budgets



Bottom Line

- **Sluggish growth at best; housing has further to fall, the consumer will be cautious**
- **A deeper slowdown is the main risk (recession risk: 30%)**
- **The prospect of growth sliding below 2% should trigger rate cuts**
- **Downside Risk (1): Credit contagion worsens, spills over more severely to the U.S. and global economies**
- **Downside Risk (2): Vulnerability to another energy shock remains high**
- **Downside Risk (3): Mutual Assured Destruction: Protectionism at home, buyer's strike against Treasuries by China**

Thank You!

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