2007: Mid Expansion Slowdown or Something More?

Where are we now?

- 6th Year
- Unemployment 4.5%
- Year old Housing Contraction
- Net Worth Increasing
- Energy Prices off Highs
- Fed on Hold
- Inflation above the Fed’s Comfort Zone
- Inverted Yield Curve
- New Political Landscape

Real GDP Growth-After Five Years
### The Last Six Quarters

<table>
<thead>
<tr>
<th></th>
<th>05/2</th>
<th>05/3</th>
<th>05/4</th>
<th>06/1</th>
<th>06/02</th>
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<tbody>
<tr>
<td>GDP</td>
<td>3.3%</td>
<td>4.2%</td>
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<td>5.6%</td>
<td>2.6%</td>
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<td>2.8</td>
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<td>15.6</td>
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<td>-.3</td>
<td>-11.1</td>
<td>-18.7</td>
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<td>Federal</td>
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<td>9.6</td>
<td>-4.6</td>
<td>8.8</td>
<td>4.5</td>
<td>1.3</td>
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<tr>
<td>S&amp;L</td>
<td>1.5</td>
<td>-1</td>
<td>1</td>
<td>2.7</td>
<td>4</td>
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<tr>
<td>Exports</td>
<td>9.4</td>
<td>3.2</td>
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<tr>
<td>Imports</td>
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<td>13.2</td>
<td>9.1</td>
<td>1.4</td>
<td>5.6</td>
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### Payroll Job Change 2003-2006

4.5% Unemployment Rate December

![Job Change Chart](chart)

### U.S. Employment Year to December 2006 (1.4%)
Consumer Price Index and Core 2005-2006 Year over Year

Inflation-The Long View 1979- November 2006

Inflation Review
- Information Quality
- Redistributions that serve no economic purpose
- Transactions that extend over time involve a price level expectation!
- Accounting and Tax System Distortions
- Managerial Attention Diversion
- Short Term Focus
Yield Curve: Benign or Ominous?

2006-2007 Life at Edge!
- Changing Leaders, Capacity Constraints
  Growth Moderating to 2.5%
- Back towards the Comfort Zone 2-2.5%
- Rates: Fed may or may not be finished: “The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth as implied by incoming information.” 12/12/2006

Headwinds        Tailwinds
- Housing/Autos
- Energy Shock
- ARMS Adjusting
- External Shock?
- Global Growth
- Falling Energy Prices
- Net Worth Gains

Net Worth Gains
2006-2007 Questions

- How will the housing correction play out?
- Will business investment and trade hold up?
- What does the inversion mean? What is the bond market telling us?
- Will energy bite us again?
- How tight are labor markets?
- What is the speed limit?
- Will financial conditions remain supportive?

Housing

- The Drag
- Not Just Construction-Mortgage, Title, Furniture, Realtors, Appraisers etc.
- Consumption Implications Wealth and Mortgage Equity Withdrawal
- Adjustables Adjusting!

Residential/Nonresidential Structures
GDP Contribution % Pts.

Residential
Nonresidential
Source: BEA
Residential Permits 2001-2006 (000, SAAR)

House Price Appreciation Annual to 9/30/2006 and (Q3 06)

- OFHEO Q3/2006
- US 7.73% (0.88%)
- Idaho 17.52% (3%)
- Utah 17.41% (4.7%)
- Oregon 16.9% (2.85%)
- Arizona 16.37% (1.02%)
- Washington 16.35% (3.14%)
- Florida 15.11% (1.15%)
- Wyoming 14.39% (4.62%)
- Hawaii 13.33% (1.27%)
- California 10.16% (6.2%)
- Nevada 8.63% (8.5%)
- Illinois 6.95% (1.18%)
- Texas 6.79% (1.83%)
- New York 6.53% (-.33%)
- Minnesota 3.38% (-.34%)
- Nebraska 3.22% (1.07%)
- Massachusetts 1.11% (-.49%)
- Ohio 1.02% (-.12%)
- Michigan -5% (-.52%)
- Anderson, Indiana -6.05%

Source: OFHEO

Resales Q3 (SAAR)

<table>
<thead>
<tr>
<th>Region</th>
<th>Q3 2005</th>
<th>Q3 2006</th>
<th>% Change</th>
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<td>Nevada</td>
<td>100,800</td>
<td>62,500</td>
<td>-38%</td>
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<td>Oregon</td>
<td>109,600</td>
<td>89,700</td>
<td>-18.2%</td>
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<td>California</td>
<td>612,400</td>
<td>437,500</td>
<td>-28.6%</td>
</tr>
<tr>
<td>Arizona</td>
<td>204,400</td>
<td>130,800</td>
<td>-36%</td>
</tr>
<tr>
<td>Florida</td>
<td>558,000</td>
<td>367,300</td>
<td>-34.2%</td>
</tr>
</tbody>
</table>

Source: NAR
How does the housing drag end?

- Construction Decline/Inventory Reduced
- Increased Affordability: Prices, Rates, Income
- Changed Expectations

Annual Average Labor Force Growth Rates 1984-2014 BLS

<table>
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<tr>
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<tbody>
<tr>
<td>16 Plus</td>
<td>1.4%</td>
<td>1.2%</td>
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<tr>
<td>16-24</td>
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<tr>
<td>25-54</td>
<td>2.3%</td>
<td>.8%</td>
<td>.3%</td>
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<tr>
<td>55 Plus</td>
<td>.4%</td>
<td>4%</td>
<td>4.1%</td>
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</table>
Energy Price Increases

- Decline in Standard of Living-Income Transfer Overseas- Give up more to get oil.
- Decreased Demand for US Goods and Services-short run
- Composition of Demand-SUVs, Energy Saving Devices
- Allocation of Resources Shifts
- Policy Changes?

Job Growth Update –November 2006 Data-49 States Growing

- Wyoming 1
- Nevada 2
- Arizona 3
- Utah 4
- Montana 5
- Idaho 6
- Louisiana 7
- South Carolina 8
- Washington 9
- Florida 10
- Oregon 15
- Virginia 25
- **CALIFORNIA 31**
- Tennessee 32
- New York 37
- Massachusetts 40
- New Jersey 45
- Rhode Island 48
- Ohio 49
- Michigan 50

Longer Term

- 354 Days from Today First Boomer Gets Social Security