

STATE OF ARIZONA

Joint Legislative Budget Committee

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FINANCE ADVISORY COMMITTEE

September 15, 2005

Senate Hearing Room 1 – 9:30 a.m.

Members Present:

Dan Anderson, Arizona Board of Regents
Tracy Clark, Arizona State University
Pete Ewen, APS, Pinnacle West
John Lucking, ECON-LINC
Georganna Meyer, DOR
Elliott Pollack, Elliott D. Pollack and Co.
Marty Shultz, Arizona Public Service
Randie Stein, Stone & Youngberg LLC
Marshall Vest, UofA

Mr. Richard Stavneak, Director, JLBC Staff, opened the meeting at 9:35 a.m. and welcomed everyone to the Finance Advisory Committee (FAC) meeting.

Mr. Tim Everill, Mr. Jake Corey, and Mr. Brian Cary, JLBC Staff, provided a slide presentation and handout with an overview of the state revenues and issues for the panel to consider. ([Click here to view handout](#))

Mr. Elliott Pollack asked how much money is being transferred to the Rainy Day Fund (Budget Stabilization Fund (BSF)).

Mr. Everill said that there is a provision that was enacted last year that says that any General Fund revenues in excess of the budget forecast gets transferred to the BSF.

Mr. Stavneak said that also interplays with the 7% cap on the BSF. The state deposited \$150 million in the fund last year and he thinks the cap would be about \$550 million. The excess revenues could reach \$400 million, thereby having about \$550 million in the fund at the end of the year. These transfers are made in 2 stages; February for the first 6 months and July for the second 6 months. It is still speculative as to what will go into the BSF on top of the \$150 million that is already there. He said that the way the fund is specifically calculated is 7% of prior year GF revenues.

Mr. Elliott Pollack gave a slide presentation and handout on the national and Arizona economies. ([Click here to view handout](#))

Mr. Stavneak asked what Mr. Pollack's perspective was on the consensus growth path in terms of state General Fund revenues.

Mr. Pollack said he is at a loss because so much of the revenues are transitory, either because of construction sales taxes or capital gains. He does not know what to make of it until he has more data. He noted that clearly you cannot sustain these levels of growth. Since they are transitory, it would be unwise to spend it because it may not be there in the long run.

Mr. Shultz asked Mr. Pollack to explain workforce shortages that he discussed in his presentation.

Mr. Pollack said that this is the worst recovery for manufacturing that the state has ever had. The benefit that Arizona has is that it has always had the ability to import labor. As long as that is the case, the state will not have any problems. Housing is related to population flows and essentially you take the population flow, divide it by 2.5 and you will get a trend-line estimate for how much demand there is going to be. Labor will be a problem nationally, especially for those places that cannot import labor.

Mr. John Lucking said he read an article that said that labor will be a major problem in the mining area over the next several years.

Mr. Pollack said there are a lot of reasons for healthcare problems and there is a shortage nationally. However, in Arizona it is a little more difficult because of the cost of malpractice insurance. This has helped to exacerbate the shortage of doctors.

Mr. Dan Anderson said he is a little bit more concerned about labor supply in the future. He said Arizona will be competing with other states where unemployment rates are going to be low. For example, what would make someone want to move from Illinois to Arizona if they have a lot of demand for labor in Illinois as opposed to relocating. The state will still be in an advantageous position, but in a more competitive situation than maybe 30 years ago. He said he is not sure that the labor shortage is so much of an industry issue as it is an occupational issue. The occupations that baby boomers moved into 30 years ago will be left vacant as they retire.

Mr. Pete Ewen said whenever skilled labor is an important part of production, that is where you will face the biggest challenges. The more skilled the positions are, the harder they are to fill.

Mr. Pollack said that in the housing market, with the combination of low interest rates, strong economy awash with funds, the opportunities to get a mortgage are endless. The only barrier is the supply, the ability to meet the demand. These things have caused a huge supply/demand imbalance. We thought 2002 was a great year, however, we have exceeded that the first half of 2005. Investors nationally, accounted for nearly 23% of all resales, at least 30% to 35% in Phoenix. Those things combined with an inability of municipalities to get through the entitlement process have created a huge supply/demand imbalance. That drove up home prices 40% over the last 4 quarters. He sees no housing disaster in Phoenix, however, things will slow and housing prices at the end of this will flatten for awhile.

Mr. Tracy Clark gave a presentation using a handout on the Arizona economy. ([Click here to view handout](#)). He said he sees personal income growth slowing in 2006 but mostly because the national economy will slow down.

Mr. Marshall Vest said that the contracting tax raised approximately \$700 million last year for the General Fund. That is the same amount that was raised with corporate income tax. The contracting tax is growing very rapidly but if you look at 3 years ago, it was slightly negative. It is very volatile and if that goes away there is a lot of money that also goes away with it. If it levels off, it does not mean that things crash, it just does not grow as rapidly. There is big risk on the sales tax end of it and contracting is a big part of the sales and use tax.

Regarding Limited Liability Companies (LLCs) Mr. Pollack said there are 3 components. First, every real estate partnership is now formed as an LLC. The second component, for estate planning purposes, is most people now have family limited partnerships that are LLCs. The third component is the business component. When you sell your home, you are not going to pay capital gains tax on it because there is such a large exemption when you roll it into the next one.

Mr. Vest said, regarding the individual income tax, the 28.9% growth rate after you adjust for the under-withholding situation, is still a big number, 21.6%. He asked if this is the \$152 million that was estimated to be under-withheld and is there any chance that that number is too low. Even if you adjust for the under-withholding, you cannot make the numbers work in relation to personal income growth.

Mr. Pollack said you just do not have data for that, so it is a problem.

Ms. Georganna Meyers, said that the real estate market is a huge part of the 21.6%. She has talked to multiple realtors who told her that their income doubled between 2003 and 2004. That is what they are seeing in 2005 but not just limited to realtors. There are also home inspectors, appraisers, lawyers etc. who will be affected when the housing market slows down.

Mr. Vest said given the volatility and unpredictability in corporate tax, we shouldn't be surprised if there is a zero increase this year. Typically, if you look at history, it is plus or minus 1% or 2% and then there is a big swing the other way. This time it was like the perfect storm. Everything came together to significantly boost revenues. However, he is afraid the state is going to give away a big portion of the tax base, once again, when it is based on a temporary surge in revenues. He said the 7% cap for the Rainy Day Fund is not nearly enough. It should be as high as 30%.

Mr. John Lucking said 2 things that he watches that relates to government overall is municipal bonds and insurance and to what extent they are affected by Hurricane Katrina. Evidently, they are not going to be severely impacted by the storm but he said he would not be surprised to see the rates change a bit. Regarding rates, he said the Feds are meeting on the 20th and everyone thinks they are going to go another 25 basis points, which seems entirely reasonable to him. Regarding the flattening yield curve, actually moving back, that helps municipal bonds because Phoenix may be coming up with a big issue. Usually, on projects, there is a negative carry for awhile. The way the yield curve is, it actually helps them a little bit in this regard. He is not concerned about it as much now as he would have been 10 years ago.

Mr. Dan Anderson said he is more optimistic in the short run than other members of the panel. The momentum of capital gains will carry into this fiscal year and we will see more transitory income this year than we think there is going to be. However, it is transitory so if you are going to spend it, it should be on one-time items; do not spend it on ongoing items. He thinks the forecast is on track and we will have to see what the unusual factor is that slows the economy down. One concern is that he thinks that the Arizona economy is driven, in the last 3 years, almost completely by construction. If construction slows down, what will be the engine of growth that keeps this economy going in 2007 or 2008? It has not been manufacturing or mining industries, and, if it was not for construction, where would we be. We will eventually not have construction at this level.

Mr. Pete Ewen said he agreed with many of Mr. Anderson's comments. Construction may not have accounted for as much of the growth recently, but it still is the highest share of total employment that we have had in 20 years. Energy prices are of a concern to him. He said that natural gas prices have not really fallen off at all. They are more than double what they were 2 years ago. Fortunately, for Arizona, in terms of direct natural gas consumption, it is not as much of a problem for Arizona households and businesses. It will be a problem for the national economy as opposed to Arizona where we do not have high heating costs. For this winter season, natural gas prices in January, February, and March are over \$12 a BTU. The problem for Arizona, along with the rest of the country, is that marginal fuel for electricity production is natural gas. Arizona Public Service has an application pending before the Corporation Commission for a 2.2% increase in rates, just to recover the higher fuel costs that they have

sustained from April through August of this year alone. He noted that energy is not as big a part of the economy as it was 20 years ago, which is the good news. The bad news is that with oil hovering at \$65 and no real promise of oil prices coming off, the natural gas and oil market continue to be very high and that is going to continue to percolating through the economy. We have not really started to see its impact yet.

Mr. Marty Shultz said that the consensus policy implications are that policy makers need to be very careful about volatile one-time and cyclical revenues tied to the various industries and industry conditions. They should not assume that this substantial upward trend is going to occur but be much more strategic and much more discriminating.

The meeting adjourned at 11:00 a.m.

Cheryl Kestner, Secretary

Tim Everill, Revenue Section Chief

Finance Advisory Committee

September 15, 2005

JLBC

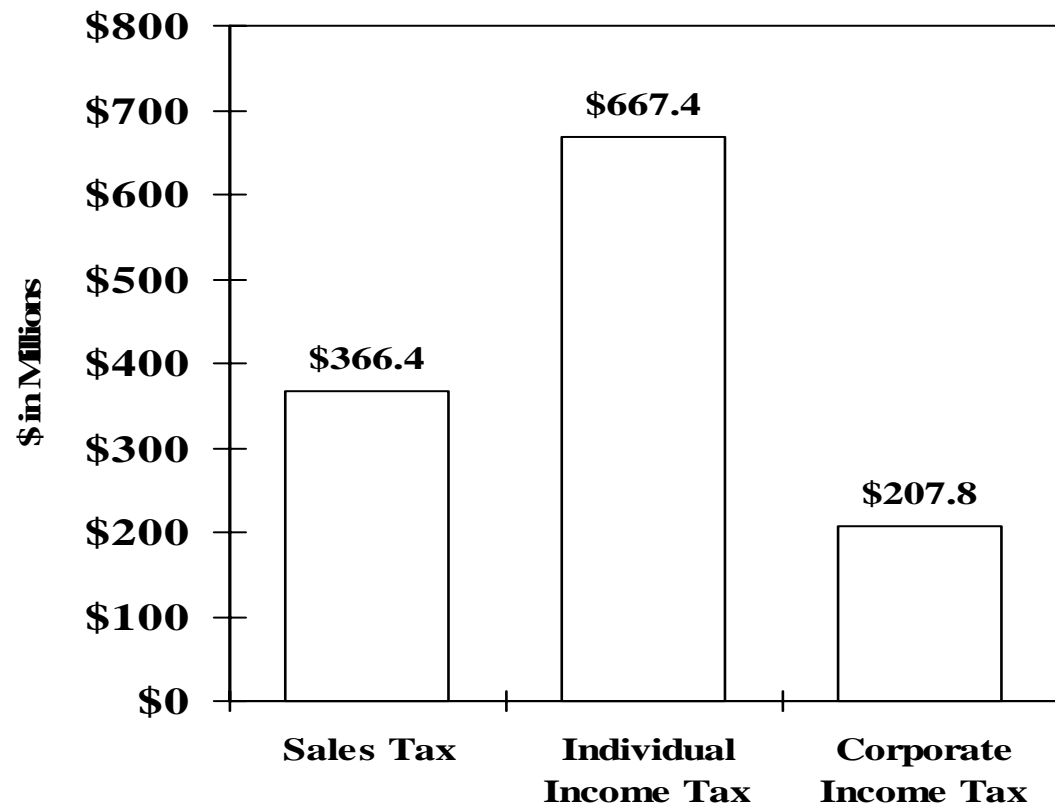
FY 2005 Revenue Collections

- Combined last quarter collections exceeded the forecast by over \$320 M.
- April's \$1.1 billion of receipts represented the single highest month of collections.
- Combined last quarter individual income tax collections grew by 50%.

FY 2005 Major Tax Collections were \$1.2 Billion Higher than Prior Year

- Individual and Corporate Especially Strong

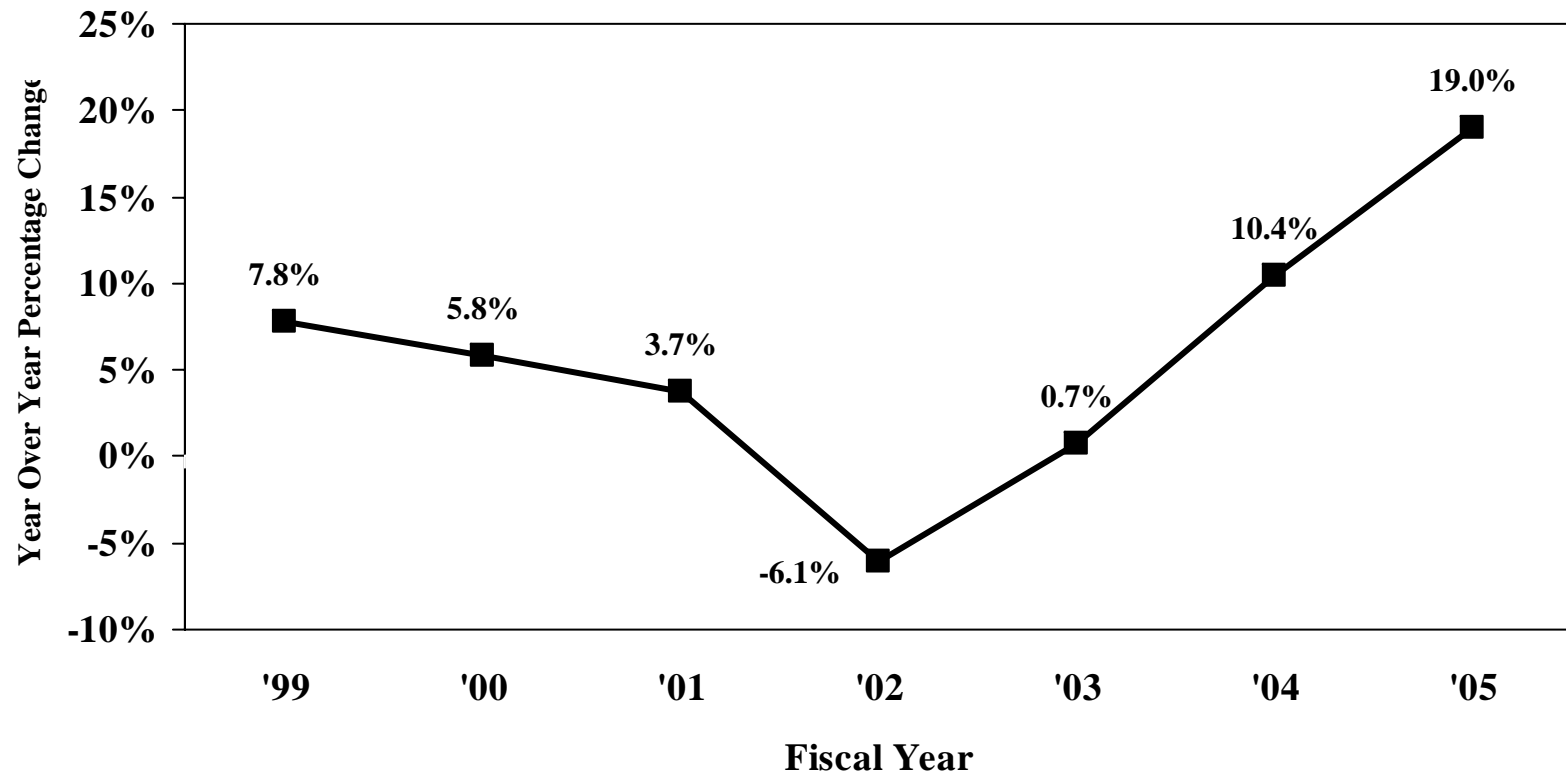
- 11.1% - Sales Tax Growth
- 28.9% - Individual Income Tax Growth
- 42.1% - Corporate Income Tax Growth



FY '05 above FY '04

General Fund Revenue Growth Rate

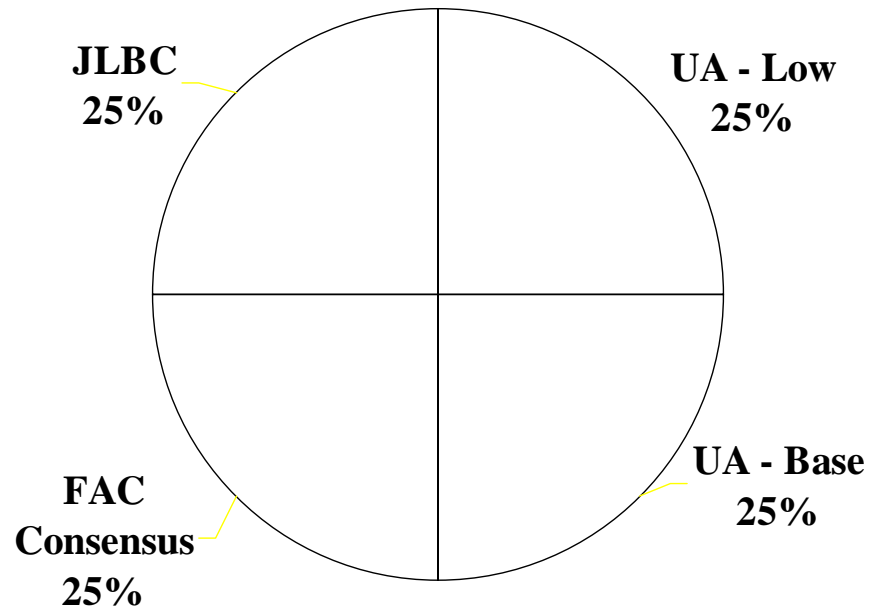
Exclusive of One-Time Revenue Sources



FAC Forecast is a Component of “Big 3” General Fund Revenue Consensus Estimate

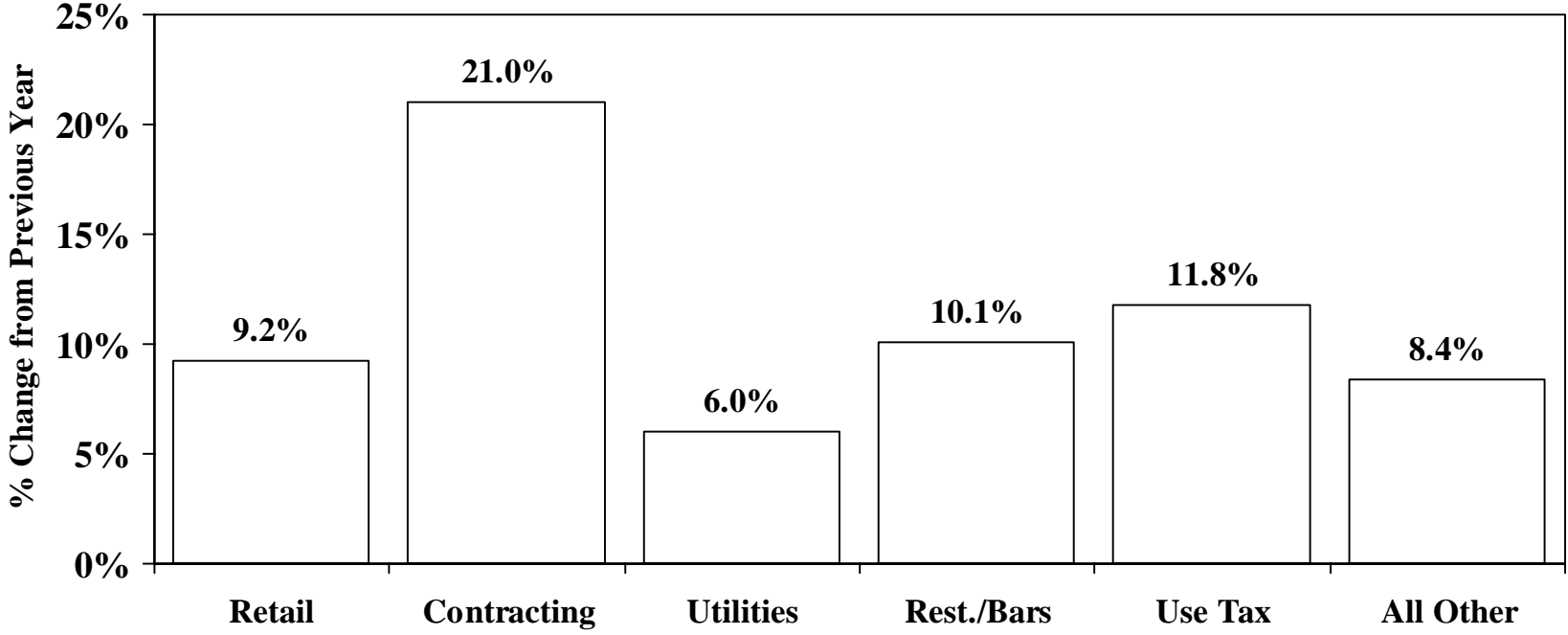
Big 3 forecast equally weights:

- **FAC average**
- **UofA model - base**
- **UofA model - low**
- **JLBC staff forecast**
- **Remaining revenues (6% of total) are staff forecast**



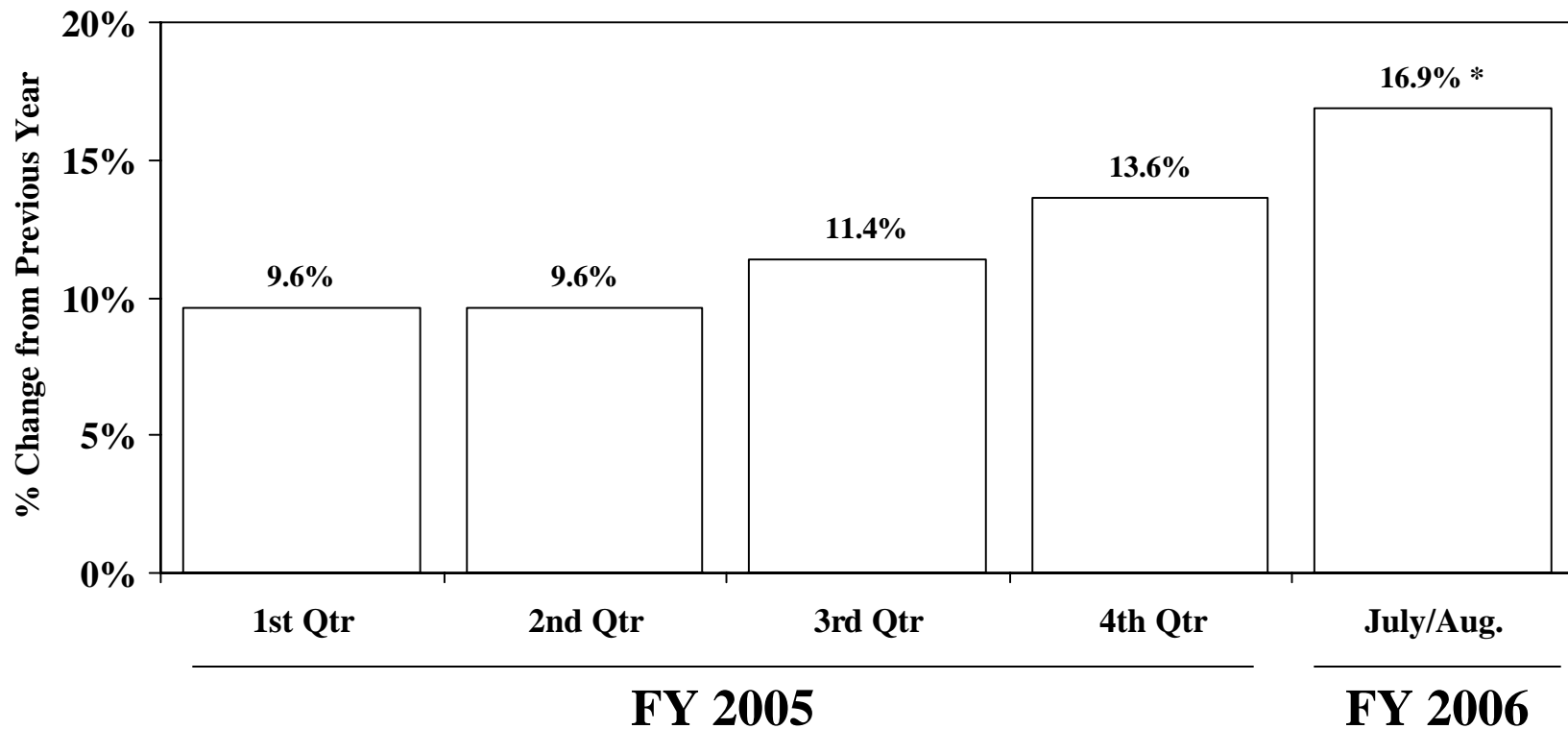
FY 2005 Sales Tax Collections were Robust

Overall Growth was 11.1%



FY 2005 – All Major Categories

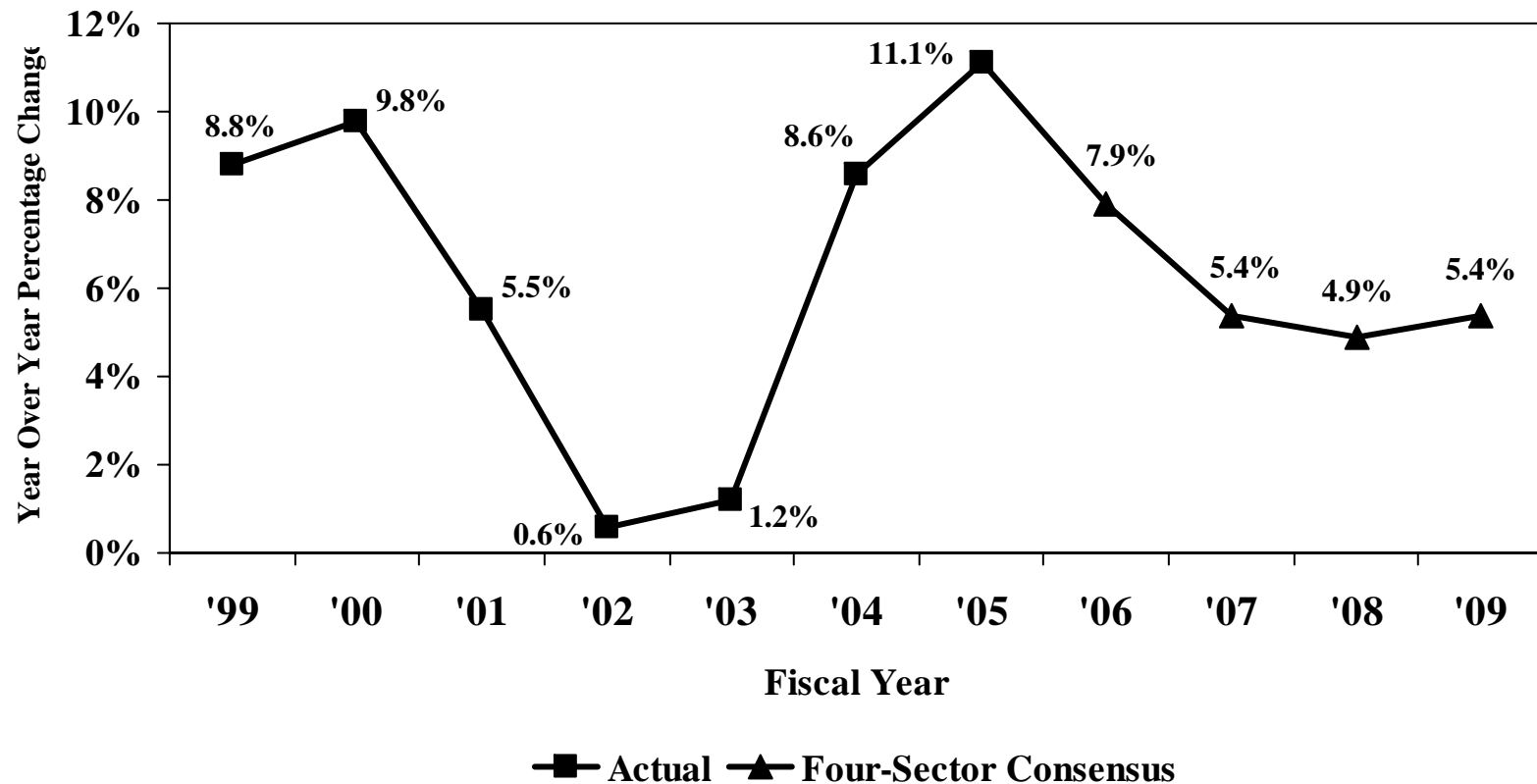
Sales Tax Collections Have Continued to Gain Momentum into FY 2006



* Based on preliminary August figures.

Sales Tax Growth Rate

Consensus Projects Growth Rate Will Taper Off



FY 2005 Actual = \$3.7 Billion

Sales Tax Questions for the FAC Panel

- How much of the growth in contracting is due to inflation in the cost of construction inputs?
- Will rising housing prices and interest rates have an impact on demand over the next year?
- To what degree will higher gas prices affect consumer spending?
- What factors are responsible for the recent climb in restaurant and bar receipts?

Likely Causes of FY05 Record-High Individual Income Tax Growth of 28.9%

- Strong employment and wage growth.
- Increased use of stock options and bonuses.
- Capital gains generated in both stock and real estate markets.
- Increased profits for small businesses that pay individual income taxes.
- After removing “withholding effect,” FY05 IIT growth estimated to be 21.6% rather than 28.9%.

Small Business Profits Increasingly Affect Individual Income Tax Collections

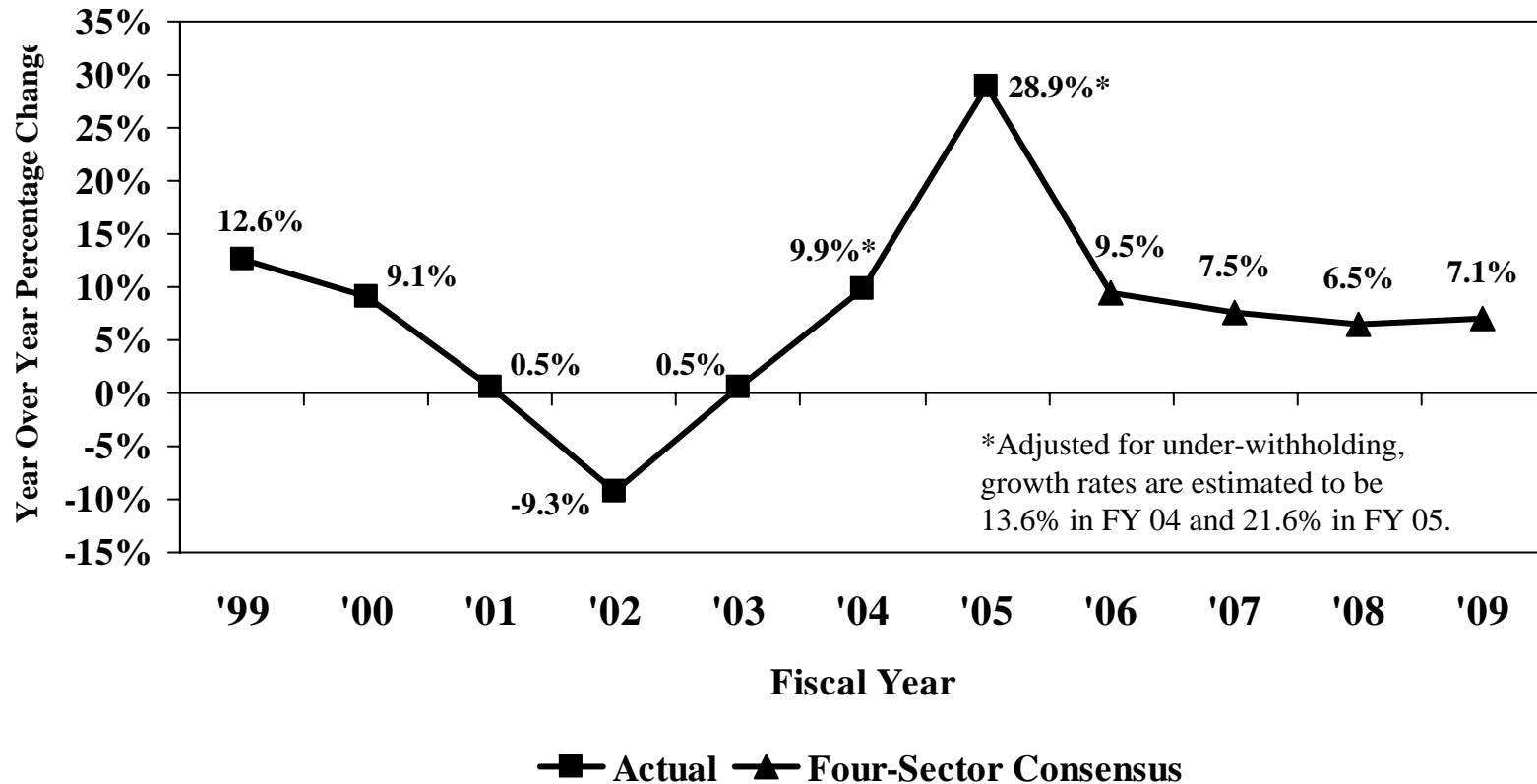
- More U.S. businesses are subject to individual than corporate income taxes.
- Business profit is passed on to owners who then include their share of it on their individual tax return.
- These “pass-through-entities” are typically small and mid-size businesses.
- The growing importance of pass-through-entities can be inferred from both national and state data.

Small Business Profits Contributed to Increased IIT Collections in FY 2005

- Council on State Taxation estimates that \$200 million (or 9%) of Arizona's FY04 IIT collections can be attributed to small business income.
- Based on inferences drawn from corporate tax data, IIT revenues generated by small businesses may have increased by \$100 million in FY05 relative to FY04.

Individual Income Tax Growth Rate

Consensus Projects a Return to Historical Rates



FY 2005 Actual = \$3.0 Billion

Individual Income Tax Questions for the FAC Panel

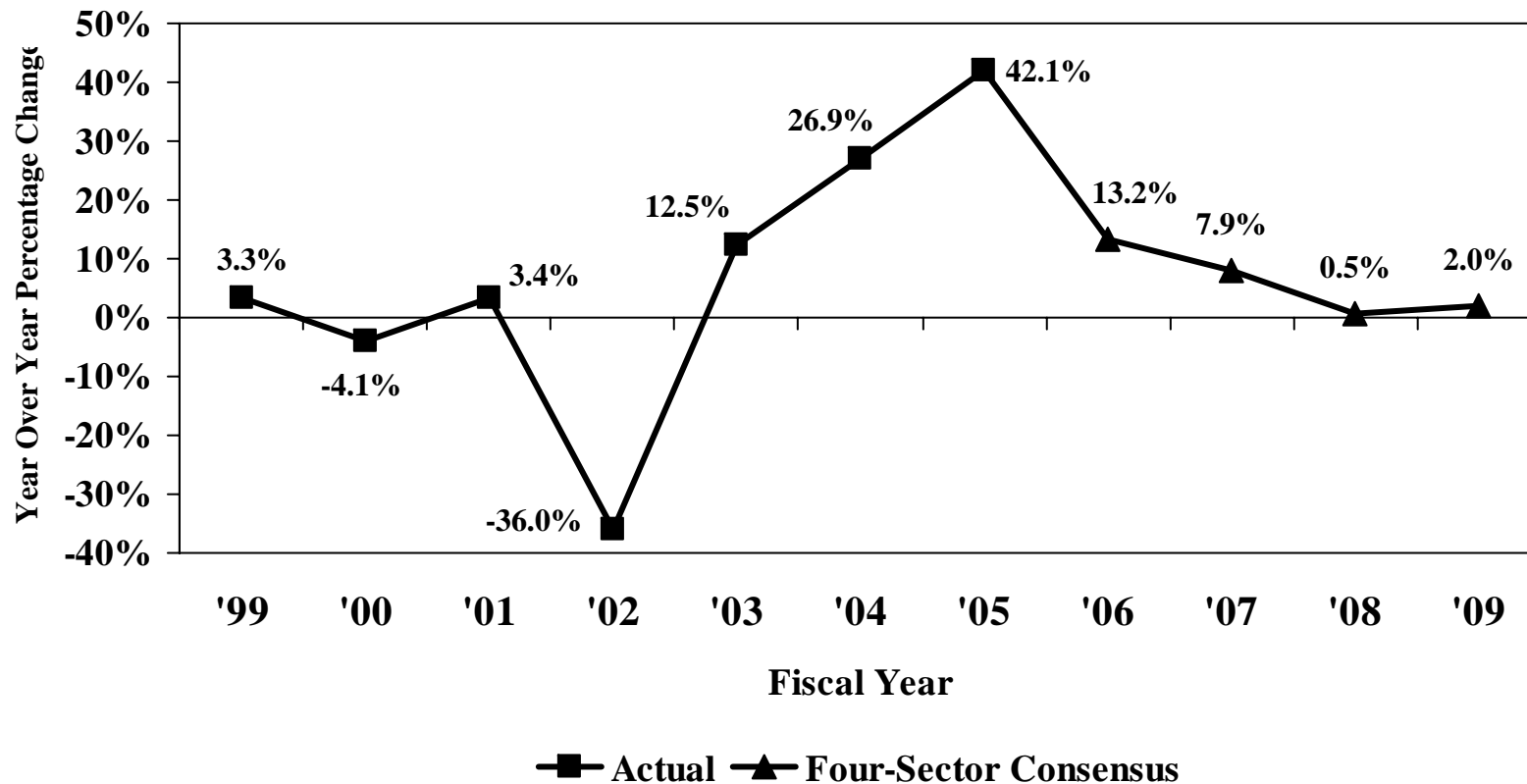
- How much of FY05 IIT growth can be attributed to the ongoing real estate market boom?
- Will capital gains from real estate transactions be of even greater importance in FY06 and FY07?
- What is your outlook on employment and wage growth over the forecast horizon?
- What is your outlook on non-wage earning growth?

FY 2005 Corporate Income Tax Collections Remain Strong

- The 42.1% FY 2005 growth rate was the strongest in the last 35 years.
- Corporations are reporting rising profits in a wide range of industries, including technology, financial services and home building.
- Companies with a strong presence in Arizona are benefiting from a regional economy that is growing faster than the U.S. average.

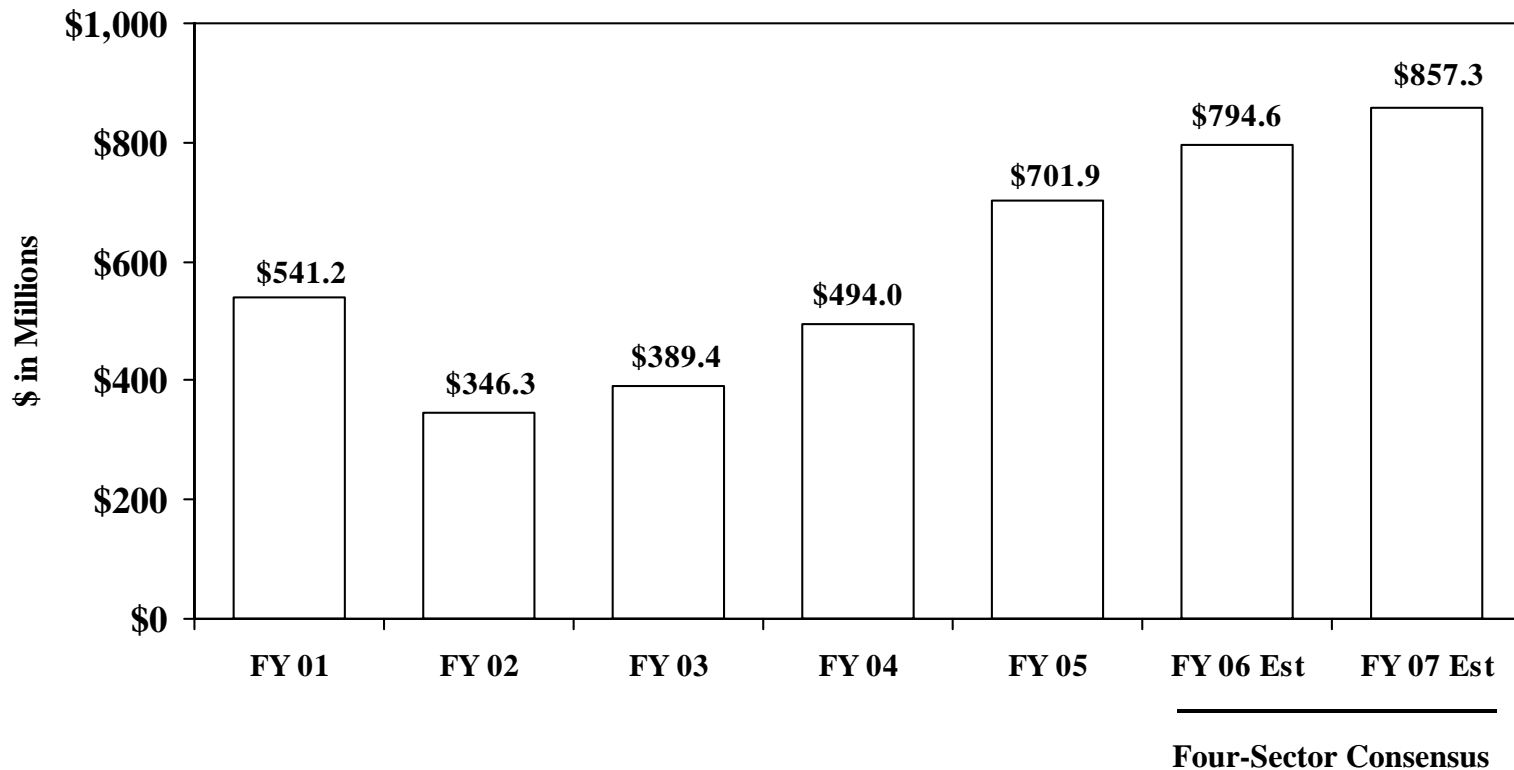
Corporate Income Tax Growth Rate

Consensus Projects Significant Decline in Growth Rate Compared to Last 2 Years



FY 2005 Actual = \$702 Million

Corporate Income Tax Collections Have Continued to Grow Rapidly



Corporate Income Tax Questions for the FAC Panel

- Will corporate profits be harmed by slowing productivity growth?
- Will higher fuel, labor, and borrowing costs reduce corporate profits significantly during the next two years?
- Will rising inflation provide corporations greater pricing power and better profitability?

Other Revenue Impacts

Potential Impact of the Ongoing Real Estate Boom on Property Taxes

- Increased home values will not automatically result in commensurate property tax increases.
- Arizona Constitution imposes certain limits on both valuation increases and local property tax levies.
- Statutory provisions (“truth-in-taxation”) are designed to offset valuation increases by commensurate tax rate reductions.
- Because of Maricopa’s use of a biennial valuation cycle, the impact of the current real estate boom on assessed values may not be fully realized until FY 2008.

How do Rising Fuel Prices Affect State Revenues?

- The motor vehicle fuel tax rate is 18¢ per gallon – so higher prices do not generate added revenues.
- If high gas prices reduce the # of gallons sold, then motor vehicle fuel tax collections would decrease.
- The majority of this tax revenue is deposited in the Highway User Revenue Fund (HURF).
- Of the HURF monies, about 50% get distributed to the State Highway Fund and the rest goes to local governments.
- Motor vehicle fuel tax collections for the HURF were \$481 Million in FY 2005.
- What is the Panel's perspective on the impact of increased fuel prices?

2005 Tax Law Changes

FY 2006 and FY 2007 Impact

	<u>FY 2006</u>	<u>FY 2007</u>
IRS Conformity	\$ (8.4)	\$ 0.1
Eliminate “Marriage Penalty”	(6.4)	(12.8)
Standard Deduction Indexing	(2.4)	(4.8)
National Guard Employment Credit	(0.3)	(0.3)
Motion Picture Production Incentives	(0.6)	(9.2)
Military Pay Exemption	--	(10.3)
Corporate Consolidated Credit	--	(4.0)
Business Property Tax Reduction	--	^{1/}
Total	<u><u>\$ (18.1)</u></u>	<u><u>\$ (41.3)</u></u>

^{1/} Increased education expenditures of \$12.3 million in FY 2007.

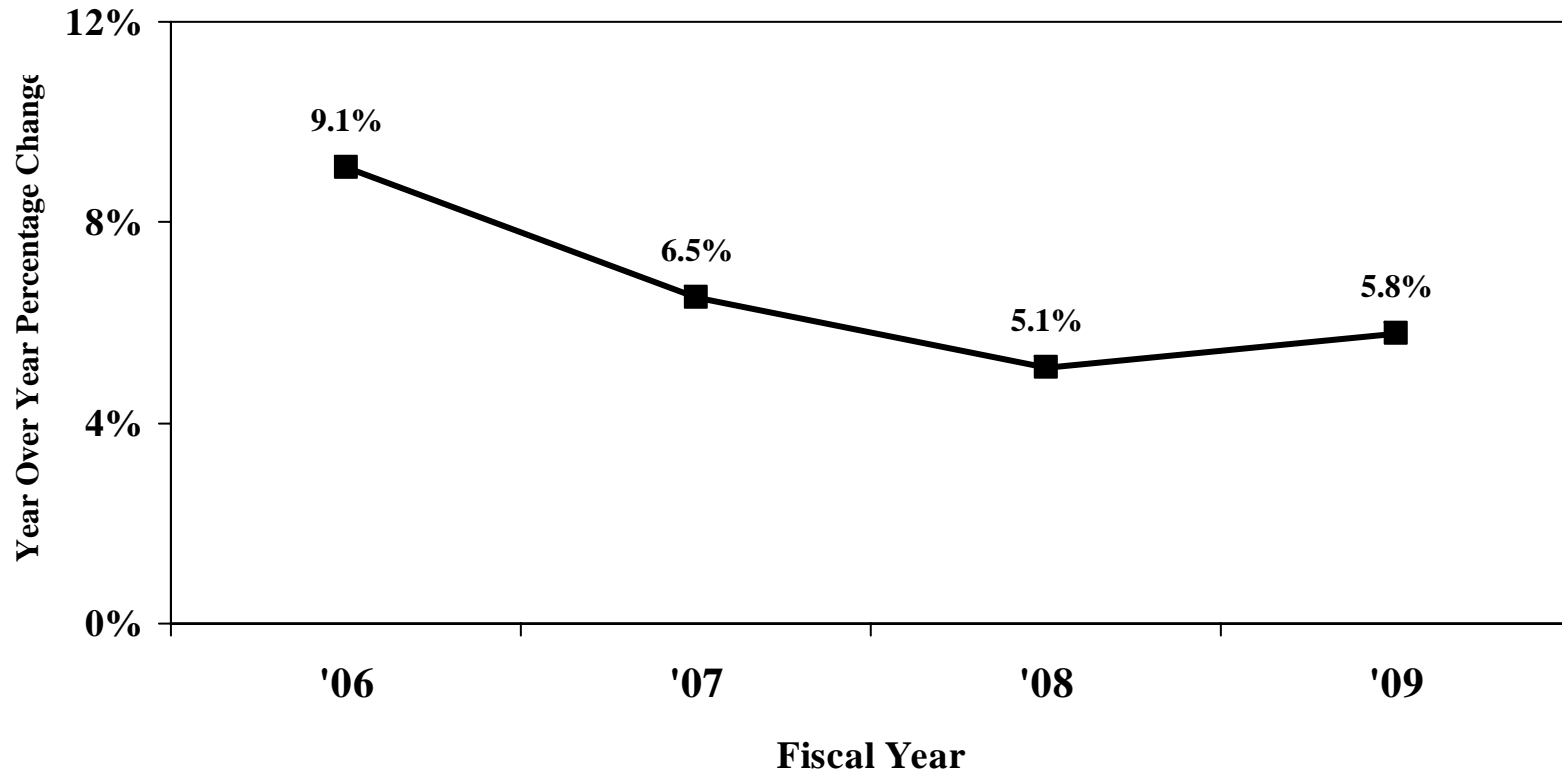
2005 Tax Law Changes

Potential Long-Term Impacts

- Corporate sales factor – estimated corporate income tax impact of \$(32) M in FY 2008, increasing to \$(120) M when fully implemented in FY 2011.
- Business property tax reduction – estimated to increase to \$140 M in FY 2016.
- Motion picture production – sales, individual, and corporate tax incentives - capped at \$(30) M in FY 2006, increasing to \$(70) M in FY2010.
- Small business investment credit – individual income tax credit capped at \$(20) M during FY 2007 – FY 2014 period.

Projected “Big 3” Growth Rates

Overall Weighted Average Four-Sector Consensus Forecast



FY 2006 – FY 2009 Quartile Forecast Worksheet

	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>
<u>Sales Tax</u>				
JLBC Forecast (9/05)	9.5%	7.2%	6.4%	5.8%
UA - Low (8/05 revision)	6.6%	2.7%	2.3%	4.1%
UA - Base (8/05 revision)	7.2%	5.8%	5.5%	6.1%
FAC (9/15/05 Survey)	8.2%	6.0%	5.4%	5.7%
Average:	7.9%	5.4%	4.9%	5.4%
<u>Individual Income Tax</u>				
JLBC Forecast (9/05)	9.6%	7.3%	6.5%	6.0%
UA - Low (8/05 revision)	7.9%	5.4%	4.6%	7.0%
UA - Base (8/05 revision)	9.0%	9.3%	8.7%	9.1%
FAC (9/15/05 Survey)	11.3%	8.0%	6.0%	6.3%
Average:	9.5%	7.5%	6.5%	7.1%
<u>Corporate Income Tax</u>				
JLBC Forecast (9/05)	10.0%	7.0%	3.5%	2.0%
UA - Low (8/05 revision)	12.7%	3.7%	-7.3%	-1.9%
UA - Base (8/05 revision)	17.3%	13.7%	2.3%	3.0%
FAC (9/15/05 Survey)	12.9%	7.2%	3.3%	5.0%
Average:	13.2%	7.9%	0.5%	2.0%
Overall Weighted Average:	9.1%	6.5%	5.1%	5.8%

National Economic Outlook

Finance Advisory Committee

Elliott D. Pollack & Company

September 15th, 2005



Synopsis:

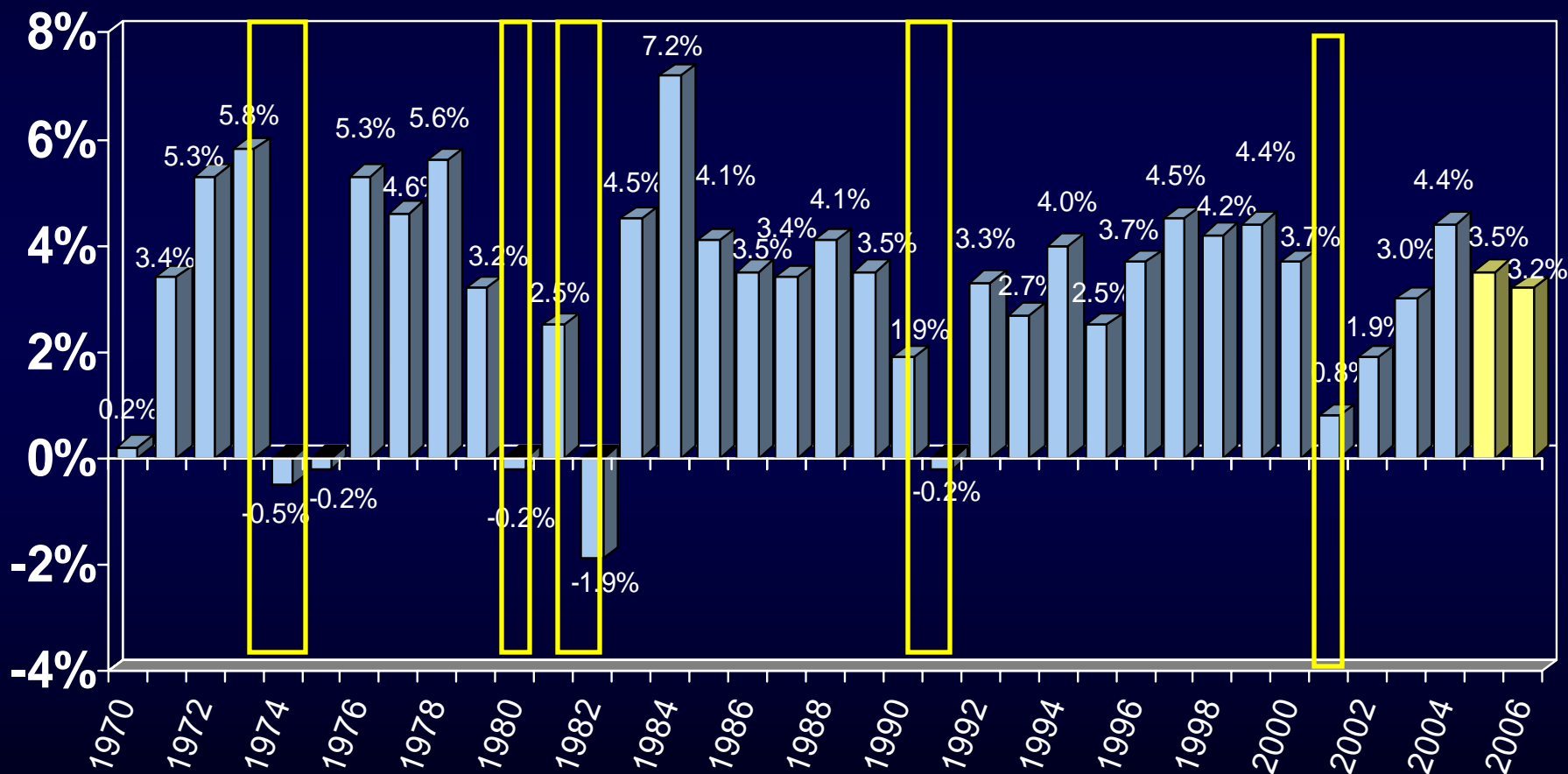
**The
economy
still has
“mo” ...**



**...But
look out
for
bumps in
the road.**

United States Real Gross Domestic Product* Annual Growth 1970 - 2006**

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



* Based on chained 2000 dollars.

** 2005 - 2006 are forecasts from the Blue Chip Economic Indicators, September 2005

Recession Periods

**There is always something
negative to focus on...**

**...the key is to focus on the
data as a whole and to not
place too much weight on
a single media report.**

Effects of Katrina



**Total impact will not be
known for weeks –
possibly months.**

There is new news daily.

Katrina

- Katrina is an immense human tragedy.
- While it will have a significant impact on the economy, it will not derail the current expansion.

The Economics of Disasters

\$ Billions 2005

Source: Economy.com

Disaster	Impacted Region	Econ. Loss Destruction	Econ. Aid Insurance
Hurricane Katrina	Gulf of Mexico	\$100.0	\$25.0
Hurricane Ivan	Gulf of Mexico	\$7.2	\$7.3
September 11th	Entire Nation	\$25.7	\$20.2
L.A. Northridge Quake	Los Angeles	\$23.6	\$16.1
Midwest Floods	MN to MO	\$6.1	\$1.3
Hurricane Andrew	Miami, FL	\$36.7	\$21.3
Loma Prieta Quake	Bay Area, CA	\$10.6	\$1.6
Hurricane Hugo	Charleston, SC	\$14.5	\$6.6

Affecting:

- Energy infrastructure
- Seaports
- Crops

Katrina

- Will reduce GDP growth by approximately 0.5% to 1% in second half of 2005 to about 3%+ GDP growth for the year as a whole.
- Alternatively, it could accelerate GDP growth in 2006 by approximately 0.5% to 1% to 3.5% to 4.0% GDP growth.

Media's Problem Du Jour



30 months ago:

“Double Dip”

2 years ago:

“Housing Bubble”

18 months ago:

“Inflation v. Defl.”

Last year:

“Jobless Recovery”

Last fall:

“Oil Prices”

Last winter:

“Dollar Decline”

Now:

“Housing Bubble”
...Again

“Oil prices”... Again

“Yield Curve”

OIL PRICE IMPACTS

- **Cuts into consumer spending.**
- **Squeezes corporate profits and leads to less hiring and spending.**
- **Price effects → CPI → Bond prices**

Consumer

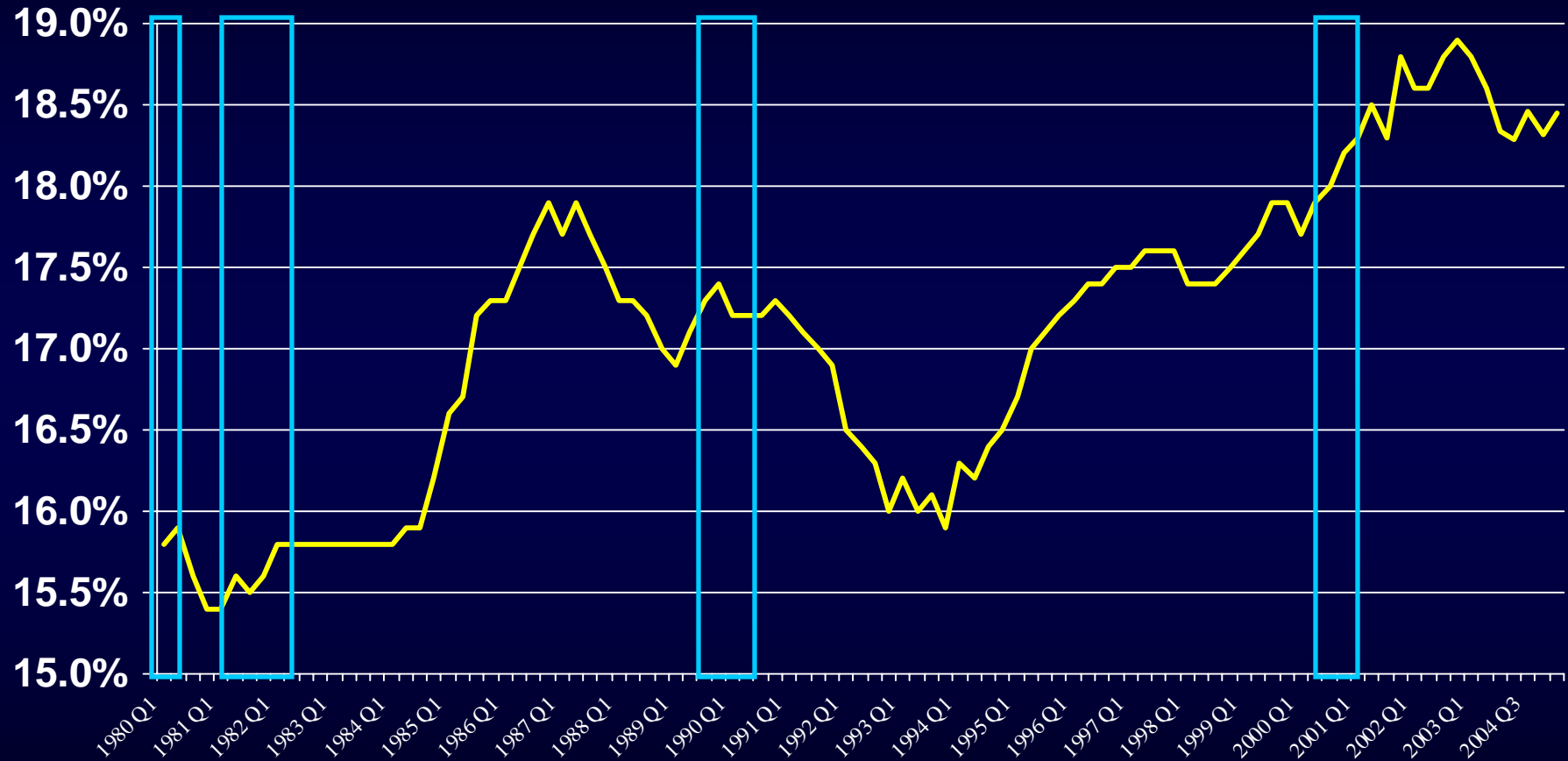


Why consumers are still spending...

- **Productivity growth → more output growth → more income growth.**
- **Inflation low compared to past four expansions → more real income growth.**
- **Low interest rates → housing demand.**
- **Despite rising mortgage debt, overall debt service as a percent of after tax income flat over last 2 years.**

Financial Obligation Ratio 1980 – 2005*

Source: Board of Governors, Federal Reserve Board

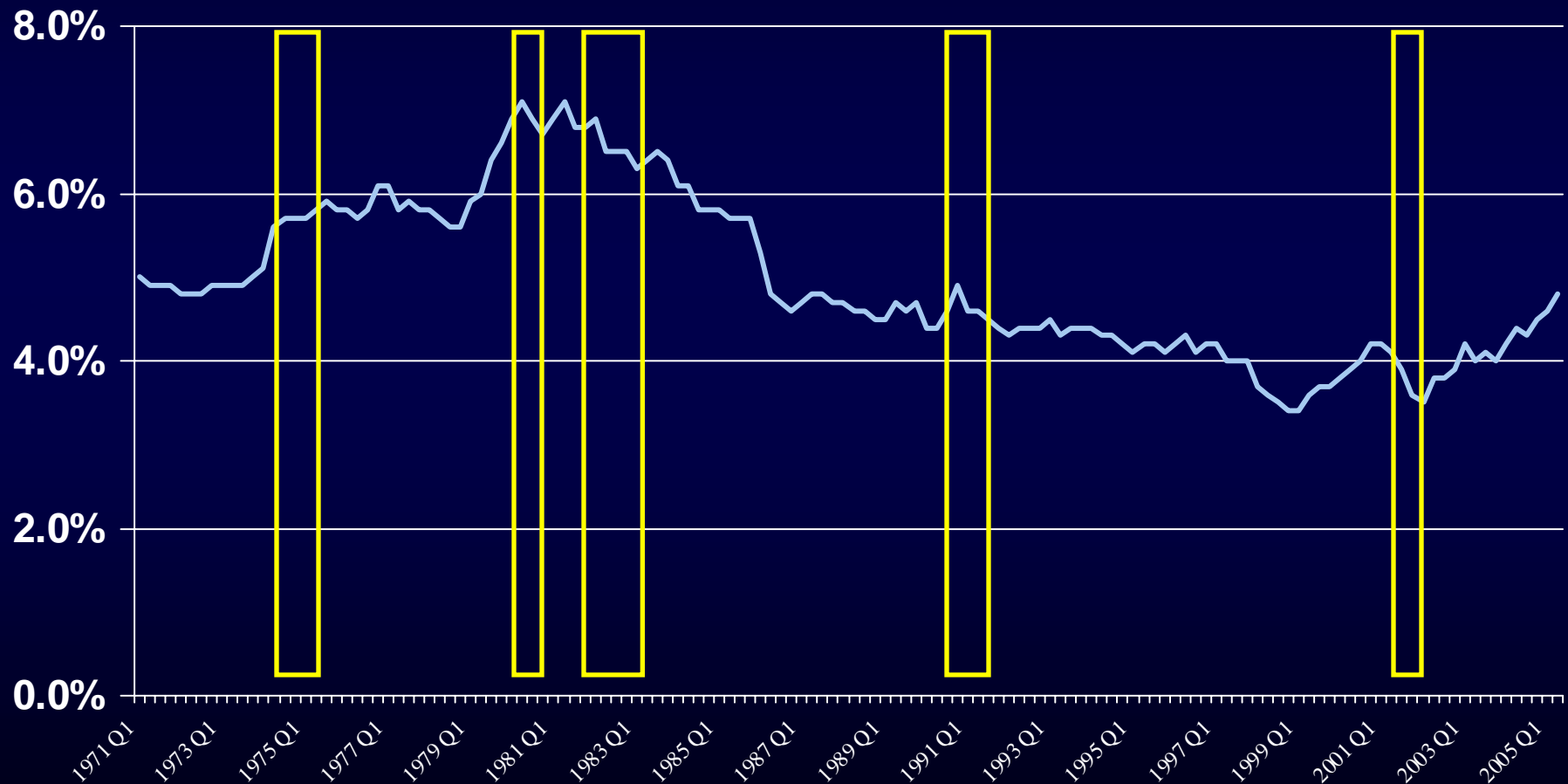


NOTE: The FOR includes debt service payments as a percent of disposable income. The FOR is a broader measure as it includes auto lease payments, rental payments, homeowner's insurance and property taxes.

*Data through first quarter 2005.

Consumer Energy Goods & Services Spending as a Percent of Personal Income 1971 – 2005*

Source: Bureau of Economic Analysis

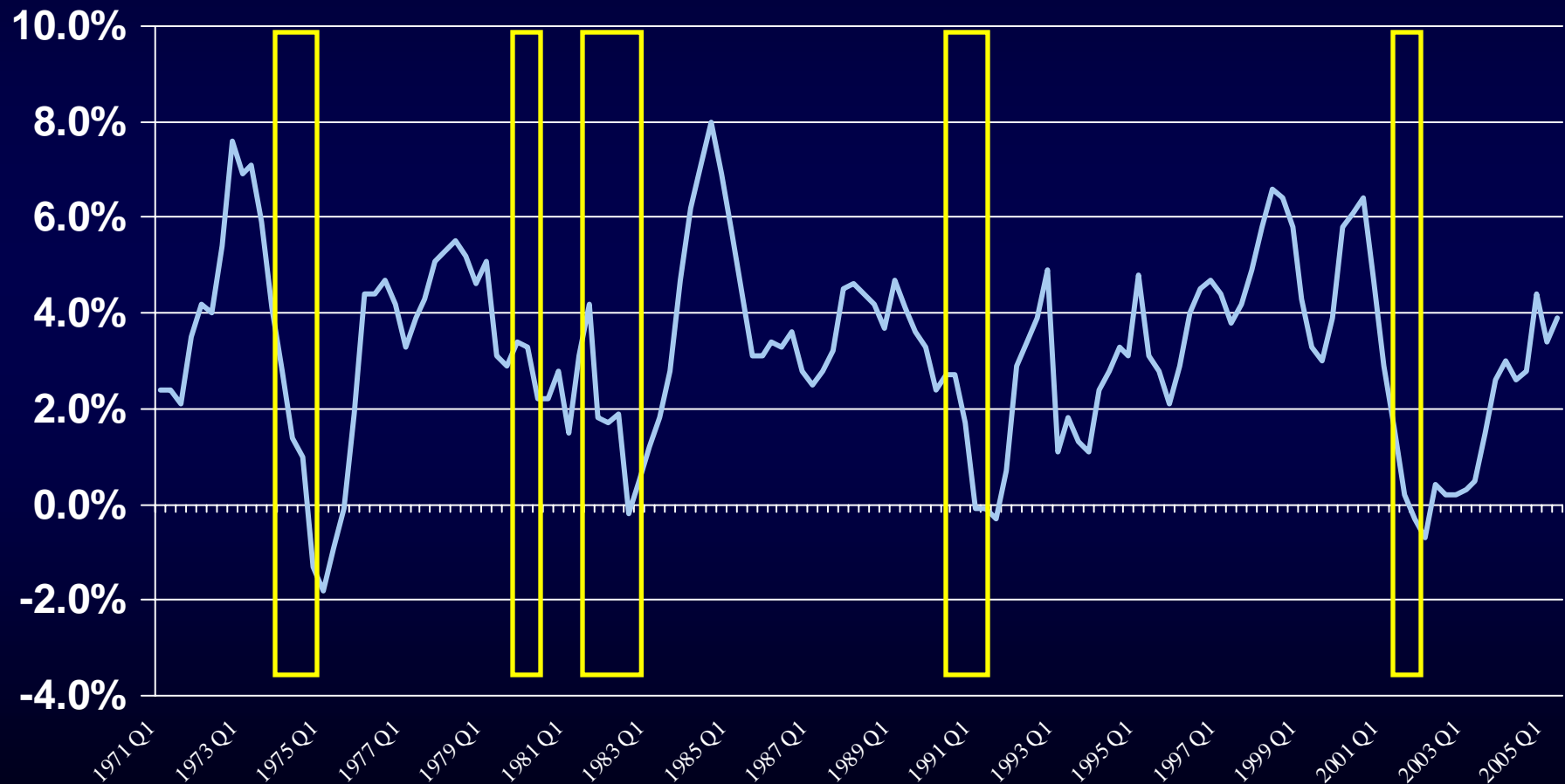


*Data through second quarter 2005

 Recession Periods

U.S. Real Personal Income Percent Change Year Ago 1971 – 2005*

Source: Bureau of Economic Analysis

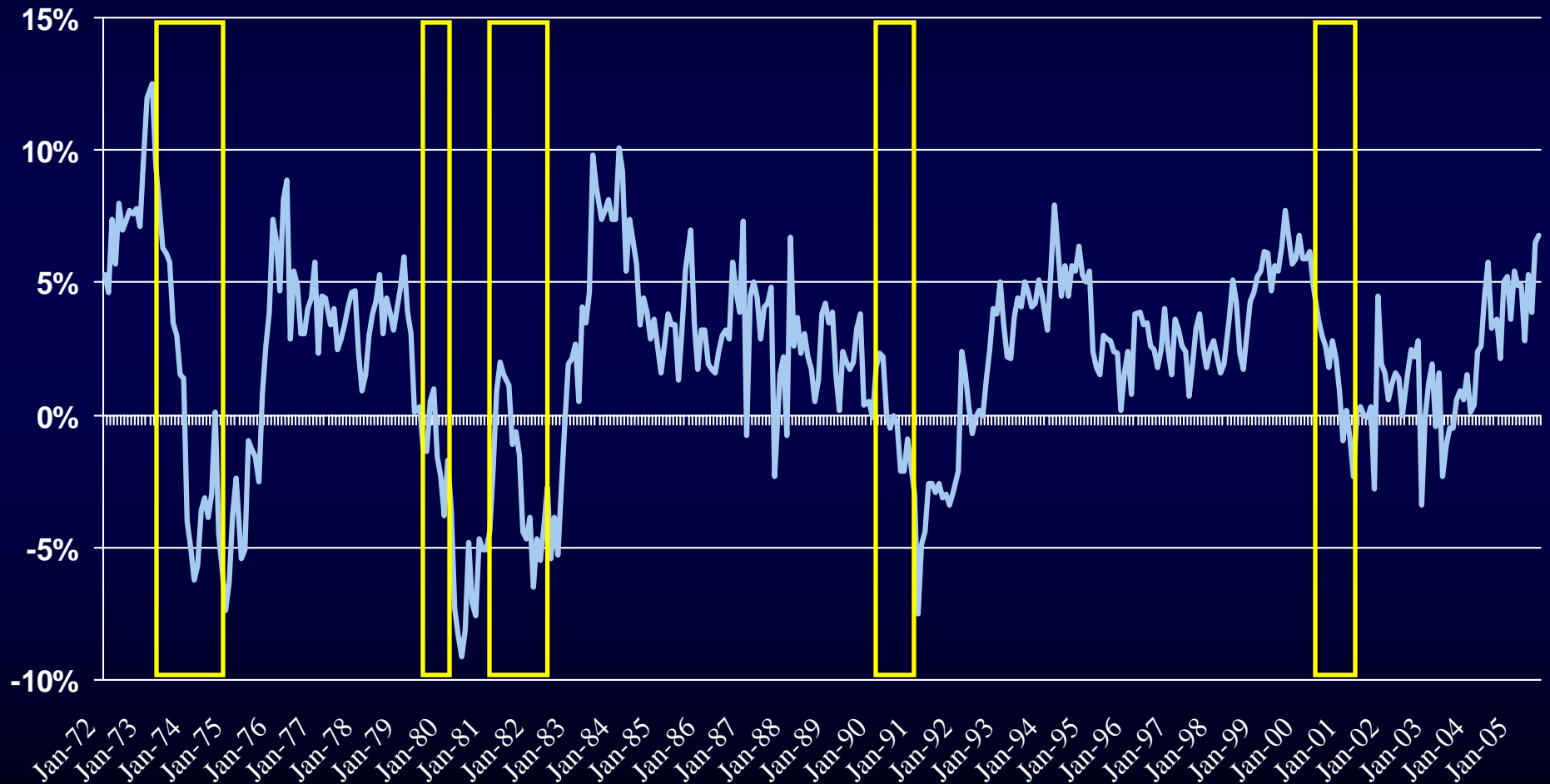


*Data through second quarter 2005

 Recession Periods

U.S. Real Retail Sales 1972 – 2005*

Source: Federal Reserve Board of St. Louis

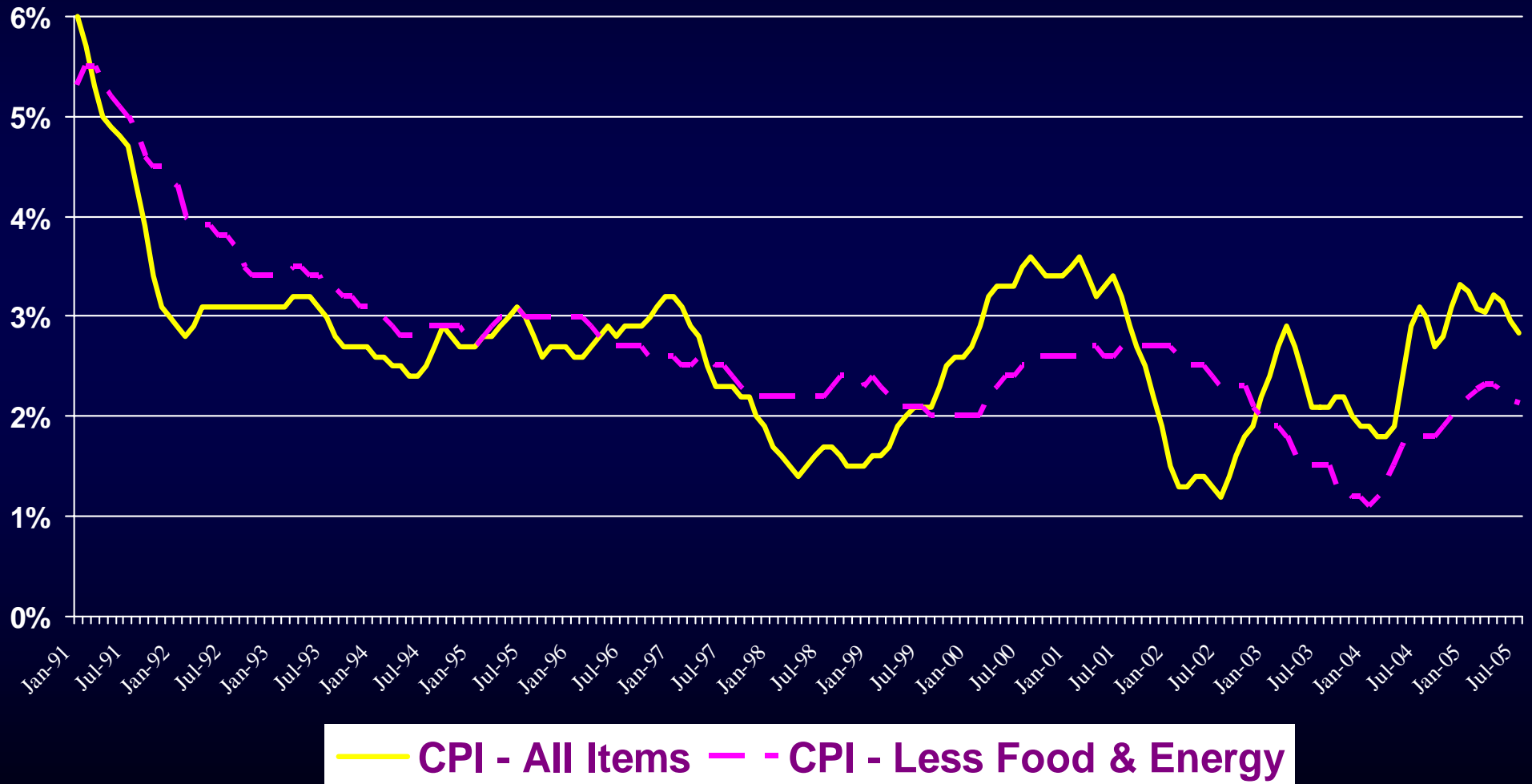


* Data through July 2005

 Recession Periods

Consumer Price Index Percent Change Year Ago 1991 – 2005*

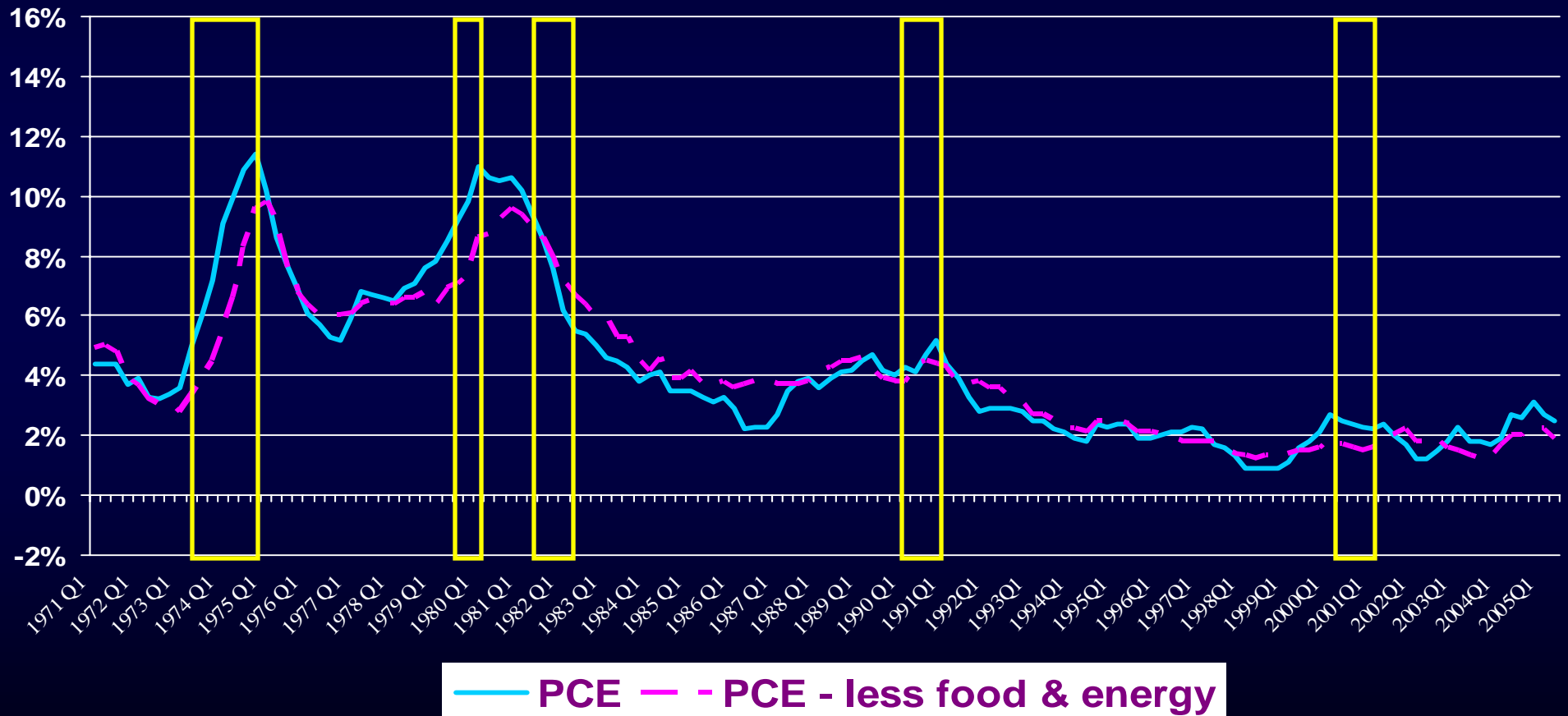
Source: Bureau of Labor Statistics



•Three-month moving average. Data through July 2005.

Personal Consumption Expenditures Price Deflator (2000=100) Percent Change Year Ago 1971 – 2005*

Source: Bureau of Economic Analysis



*Data through second quarter 2005.

Recession Periods

30-Year Conventional Mortgage Rates 1982 – 2005*

Source: Federal Reserve Economic Database



•Data through August 2005.

3-Month Treasury 1982 – 2005*

Source: Federal Reserve Economic Database

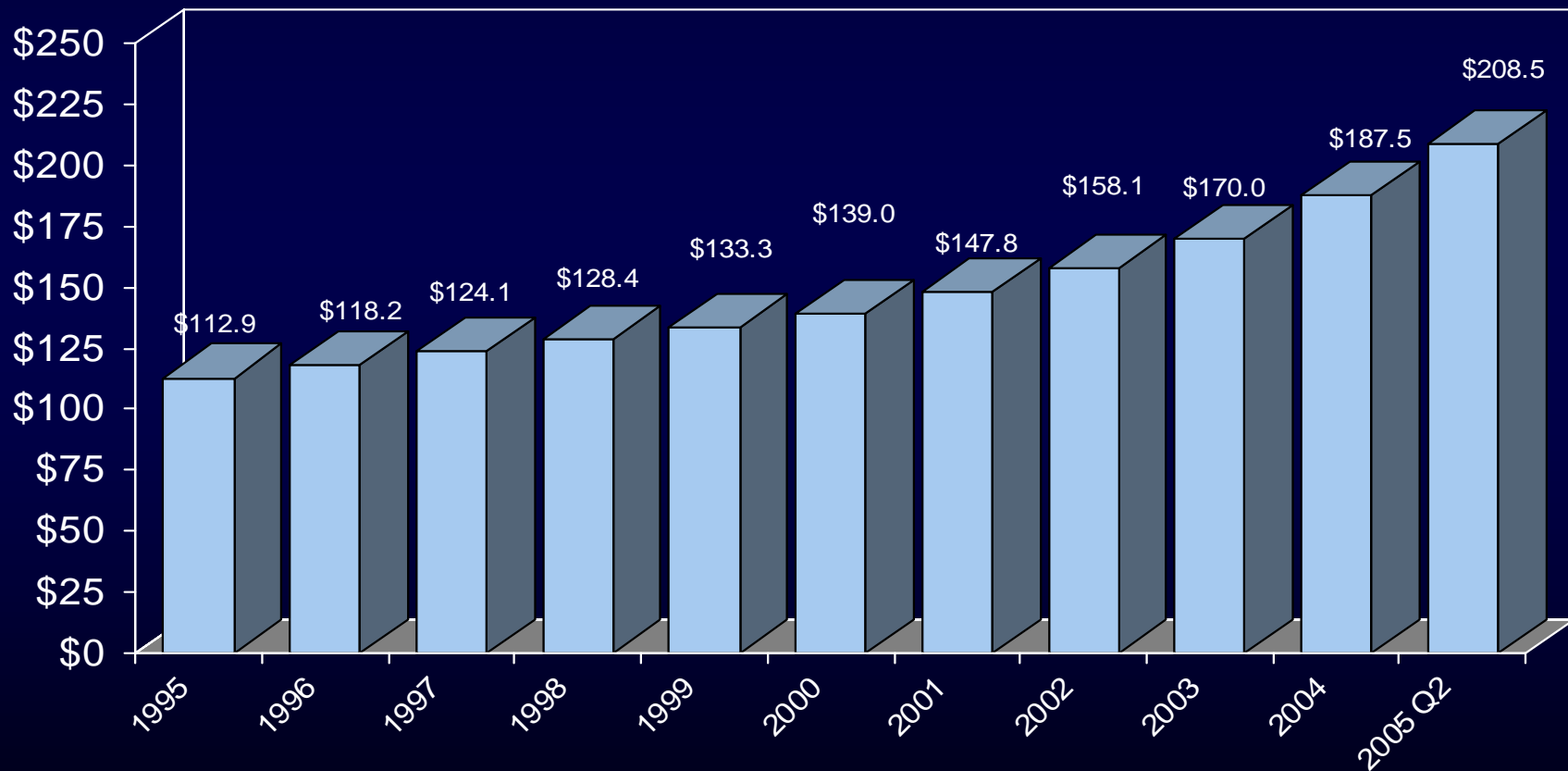


•Data through August 2005.

Single Family Median Price of Resales United States 1995–2005*

Source: National Association of Realtors

(\$ 000)

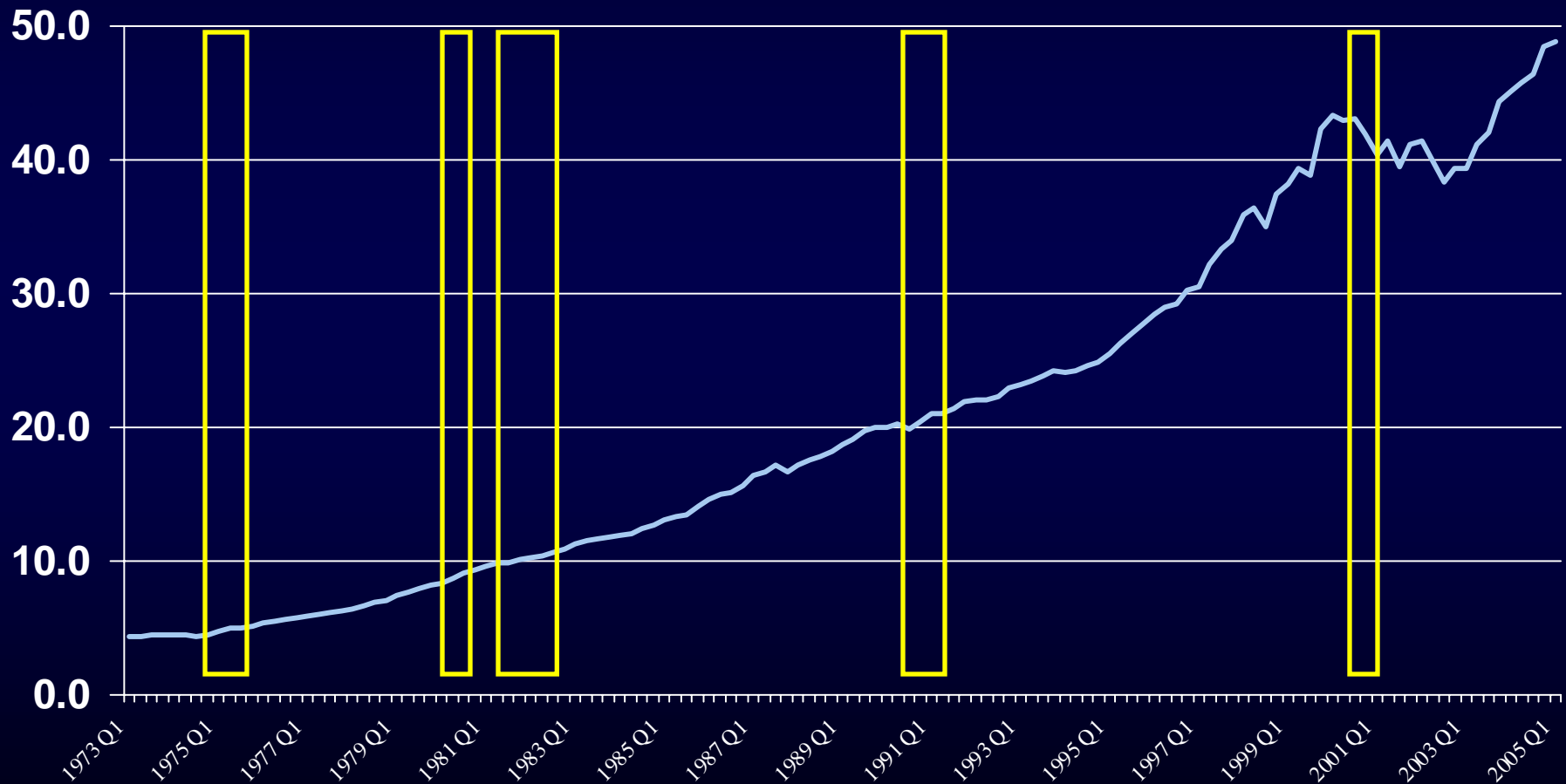


* As of second quarter 2005.

Household Net Worth

1973 – 2005*

Source: www.economy.com



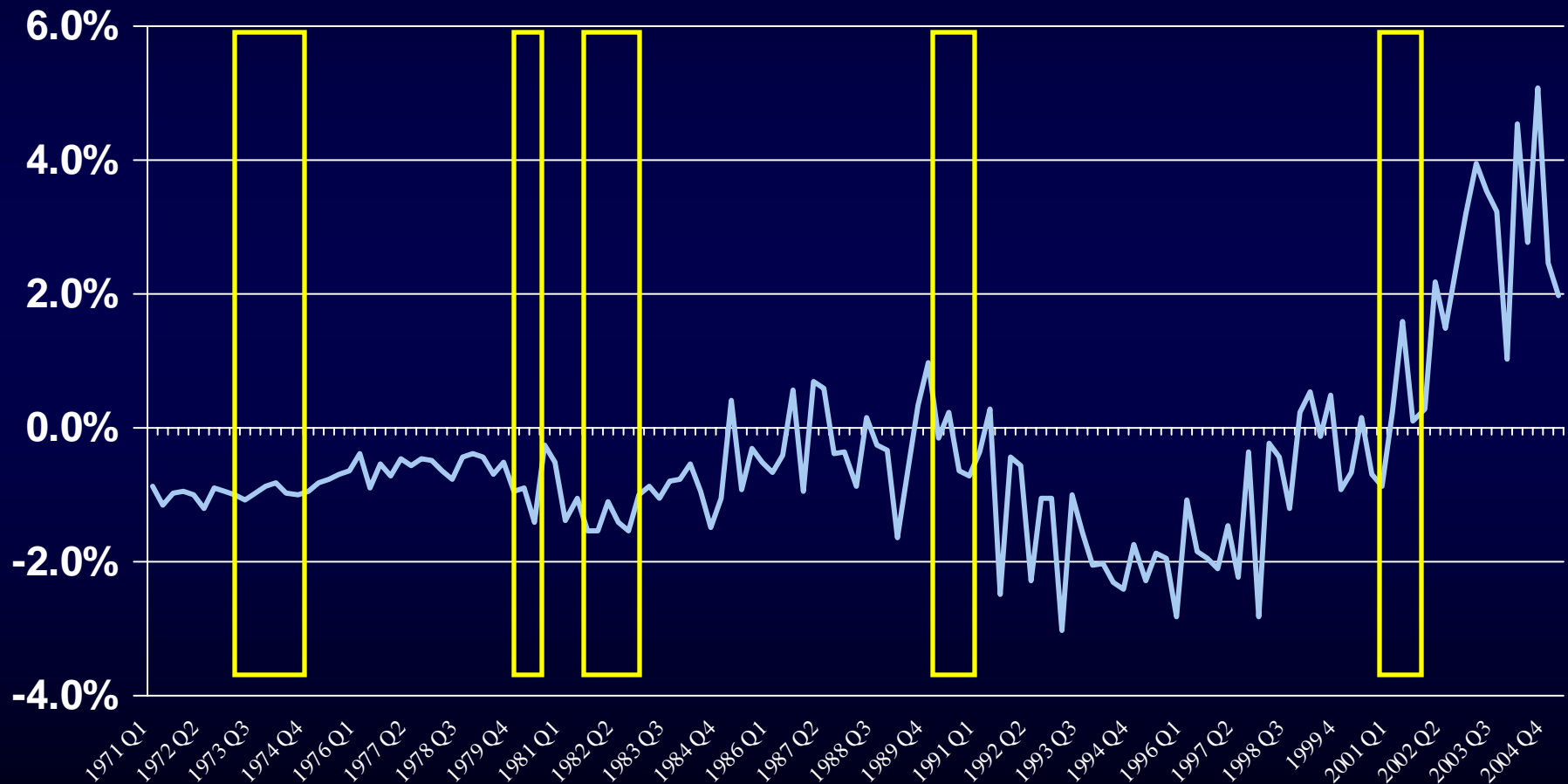
*Data through first quarter 2005

 Recession Periods

Mortgage Equity Withdrawal as a share of Disposable Income

U.S.: 1971 – 2005*

Source: Bureau of Economic Analysis



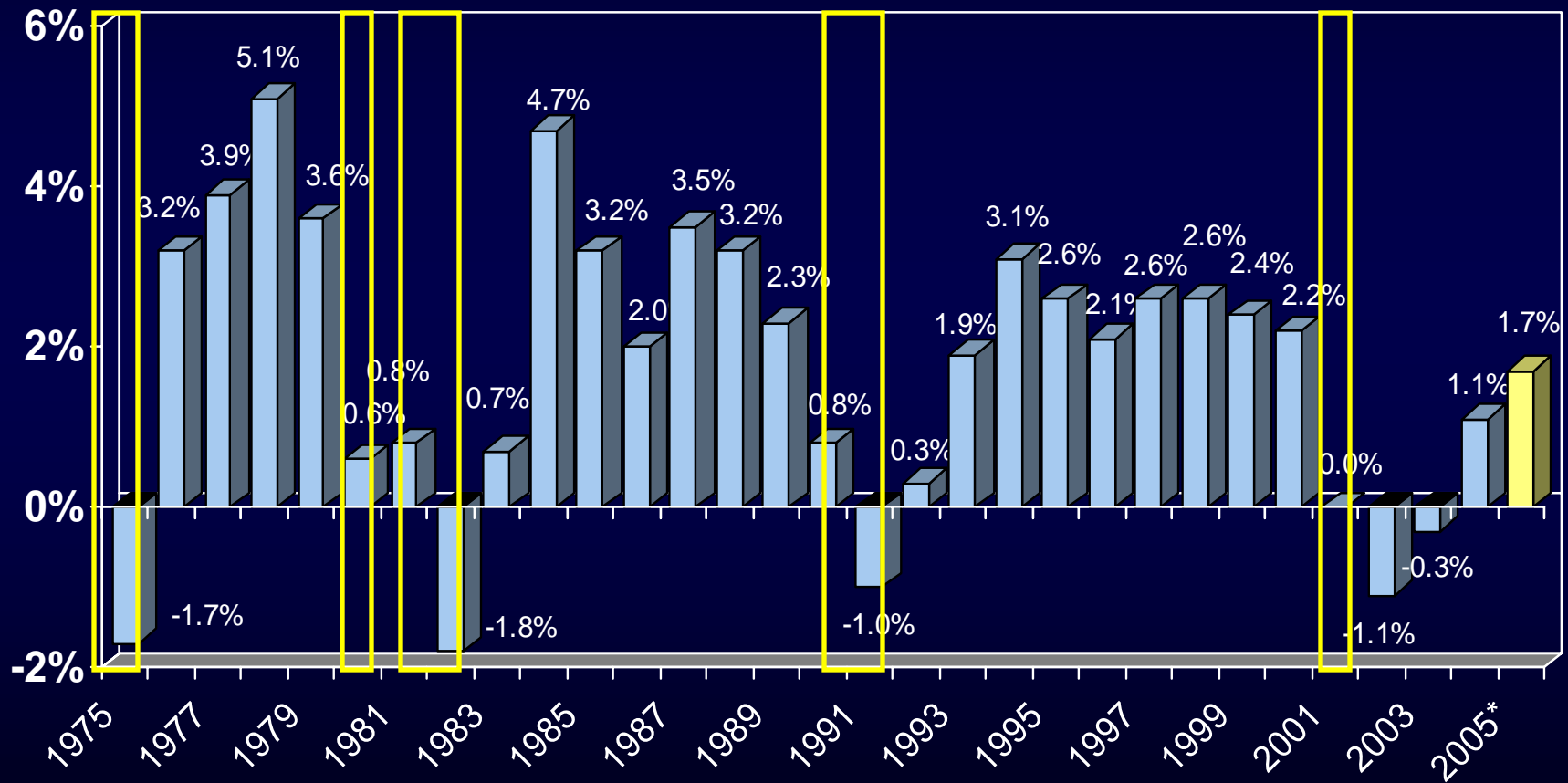
* Data through first quarter 2005

Recession Periods

National Employment*

Annual Percent Change 1975–2005**

Source: Bureau of Labor Statistics



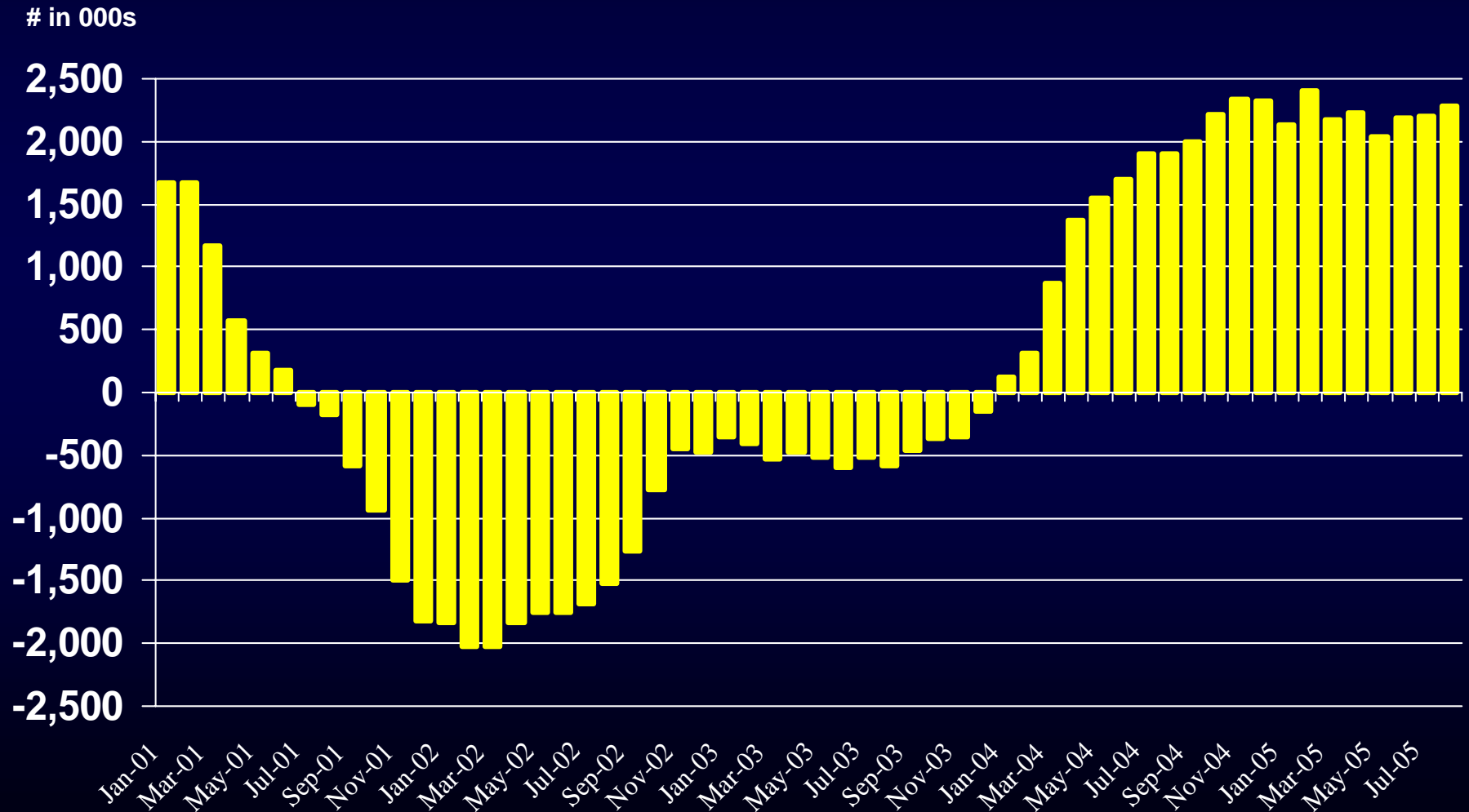
*Non-agricultural wage & salary employment. Changed from SIC to NAICS reporting in 1990.

**Year-to-date through August 2005.

 Recession Periods

National Employment (Net change in jobs over year ago) January 2001 – August 2005

Source: U.S. Bureau of Labor Statistics



National Employment Growth

<u>Recession</u>	<u>Annual Growth 44 months post over 32 months post</u>
1975	5.0%
1982	1.9%
1991	3.5%
2001	1.7%

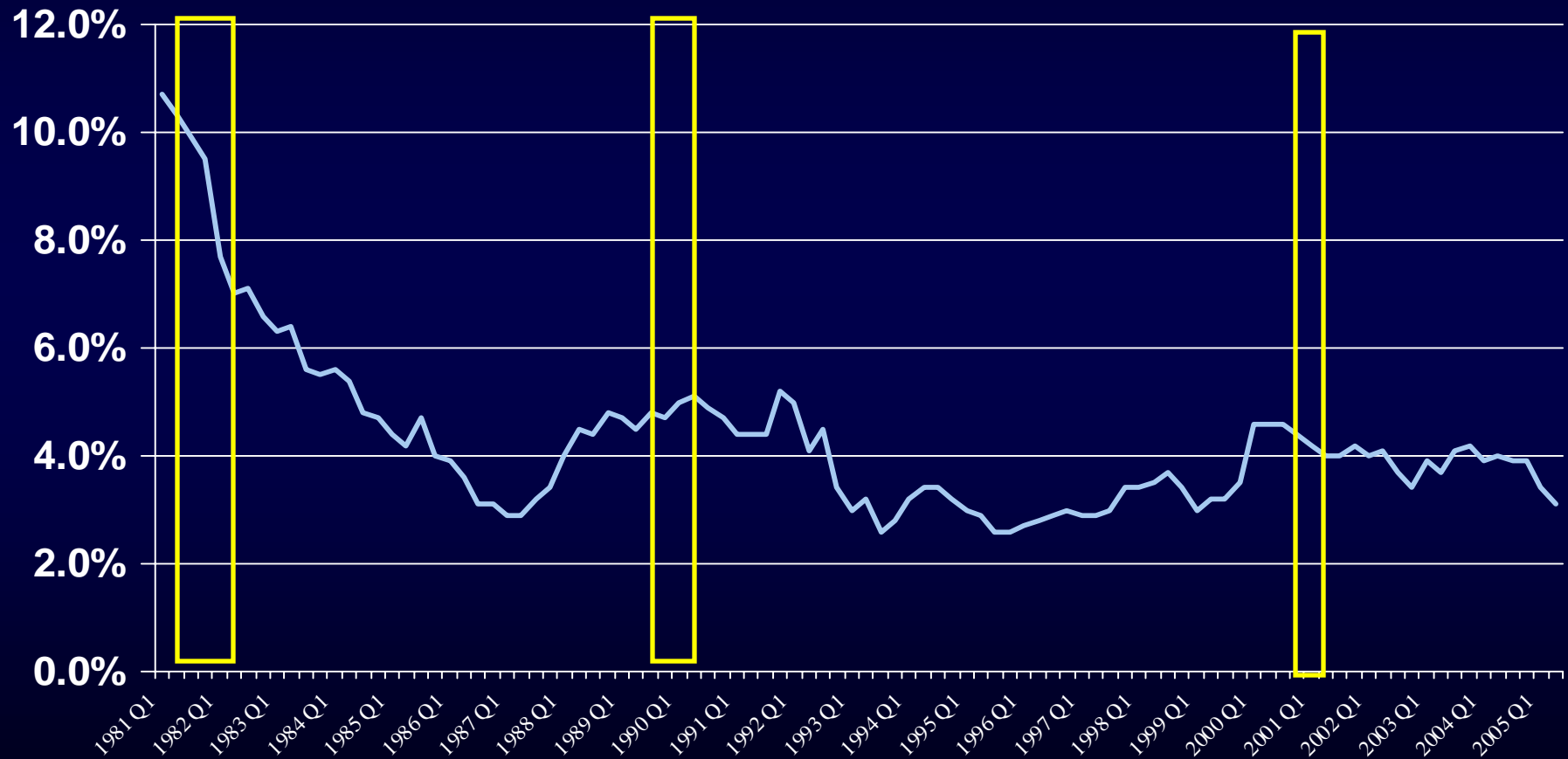
Output per Hour

Output per hour growth 3.5 years Post Recession

<u>Recession</u>	<u>Growth 3.5 years post</u>
1975	8.5%
1982	10.7%
1991	6.9%
2001	12.3%

Employment Cost Index Percent Change Year Ago 1981 – 2005*

Source: Bureau of Economic Analysis



*Data through second quarter 2005

Recession Periods

Unemployment Rate

Unemployment Rate 44 months Post Recession

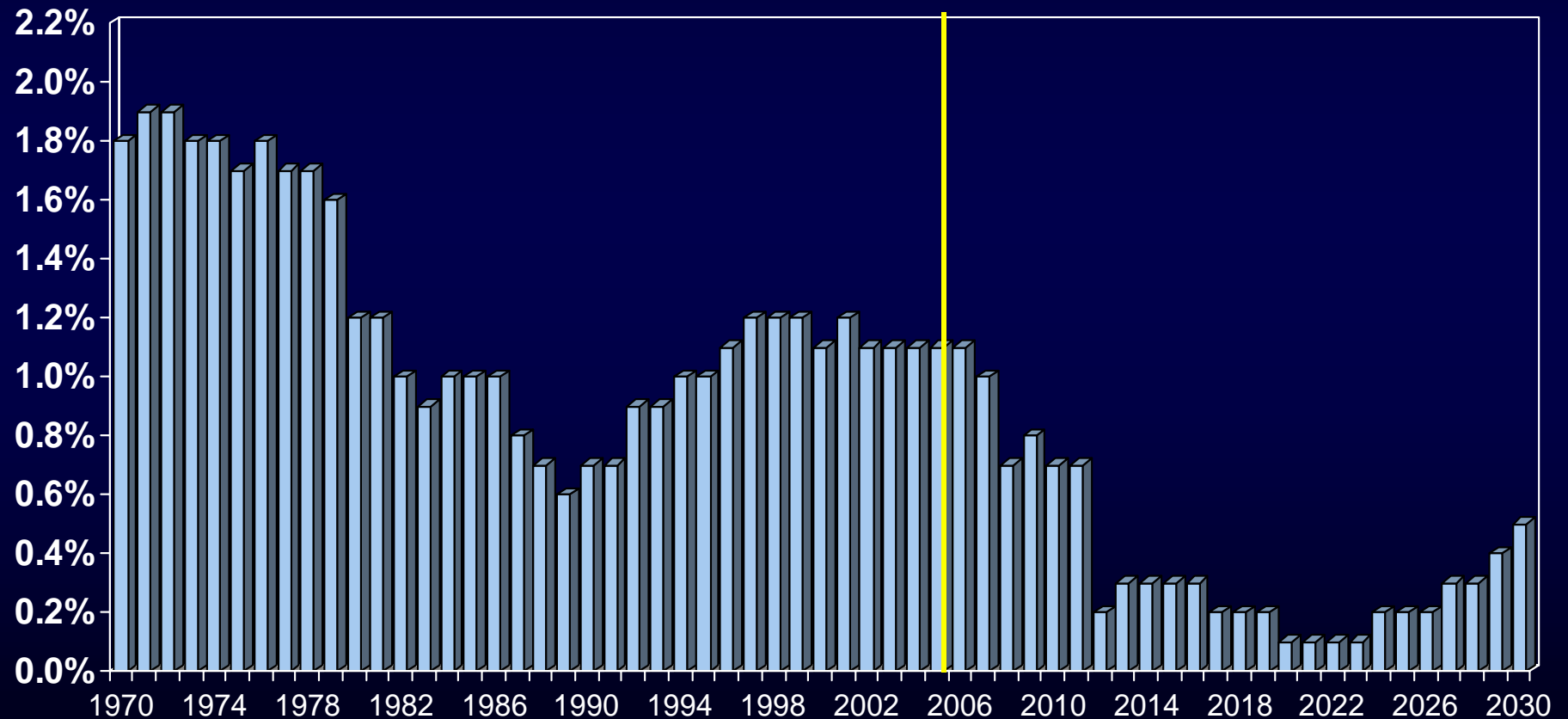
<u>Recession</u>	<u>UER at End</u>	<u>UER 44 months post</u>
1975	8.6%	5.9%
1982	10.8%	7.0%
1991	6.8%	5.6%
2001	5.6%	5.0%

Labor Force Growth

Annual Growth Rate of Working Age (16-64)

1970–2030

Source: Census Bureau

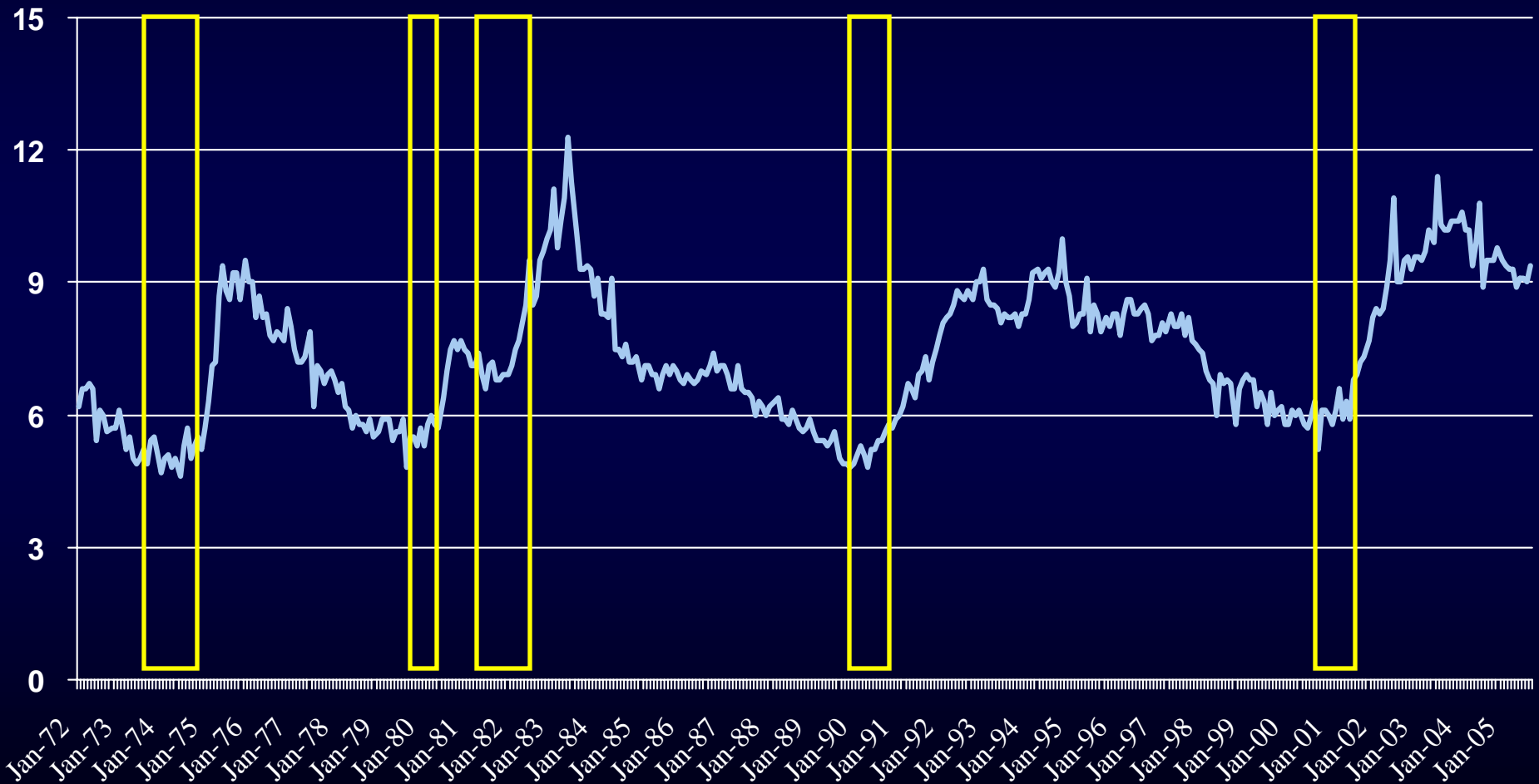


* Forecasts from the Census Bureau

Median Weeks Unemployed (S/A)

1972 – 2005*

Source: Bureau of Labor Statistics



•Data through August 2005.

 Recession Periods

Business



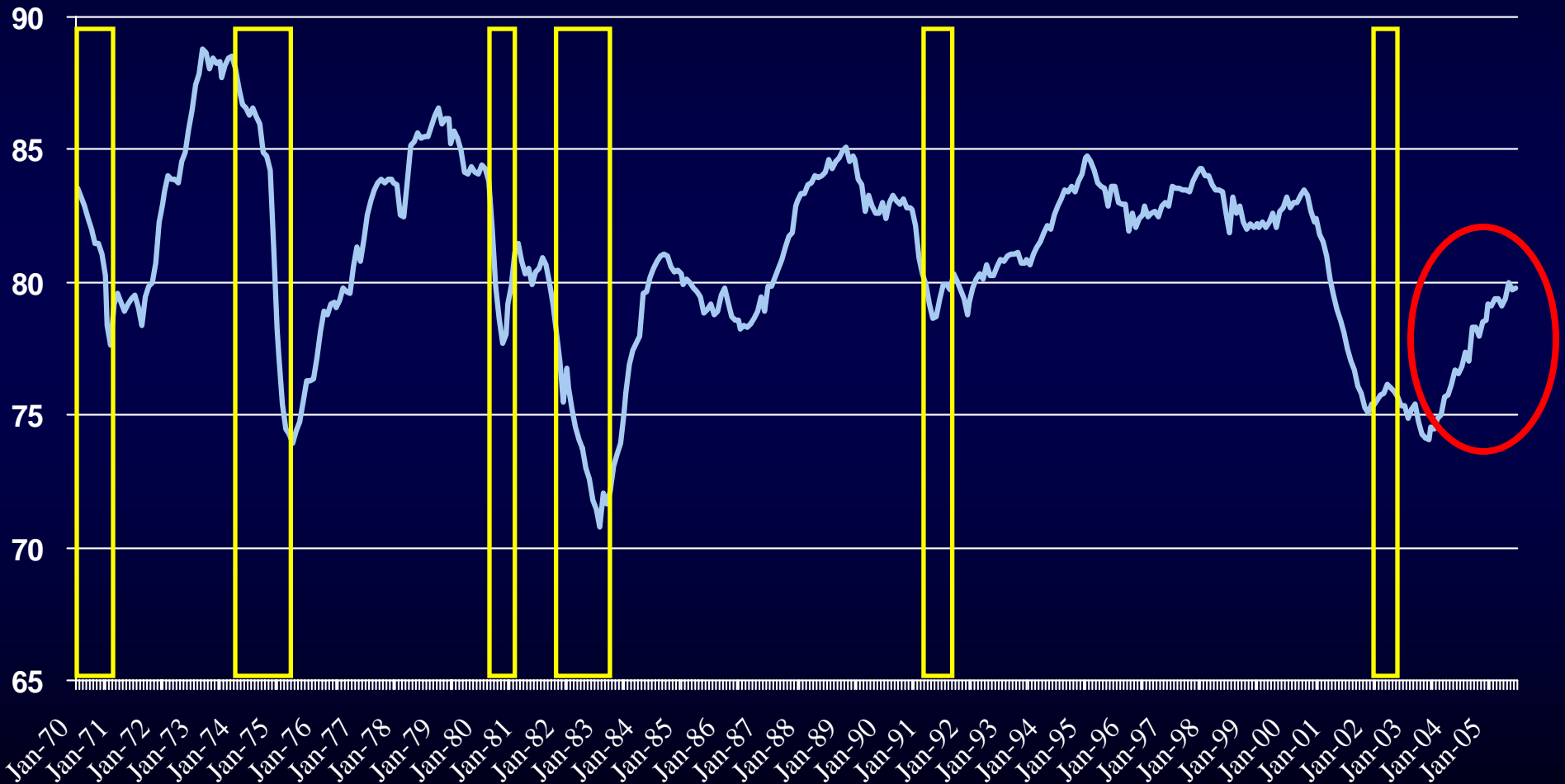


**Business
spending
has been
stingy...**

**Except for
equipment.**

Capacity Utilization Rate 1970 – 2005*

Source: The Conference Board

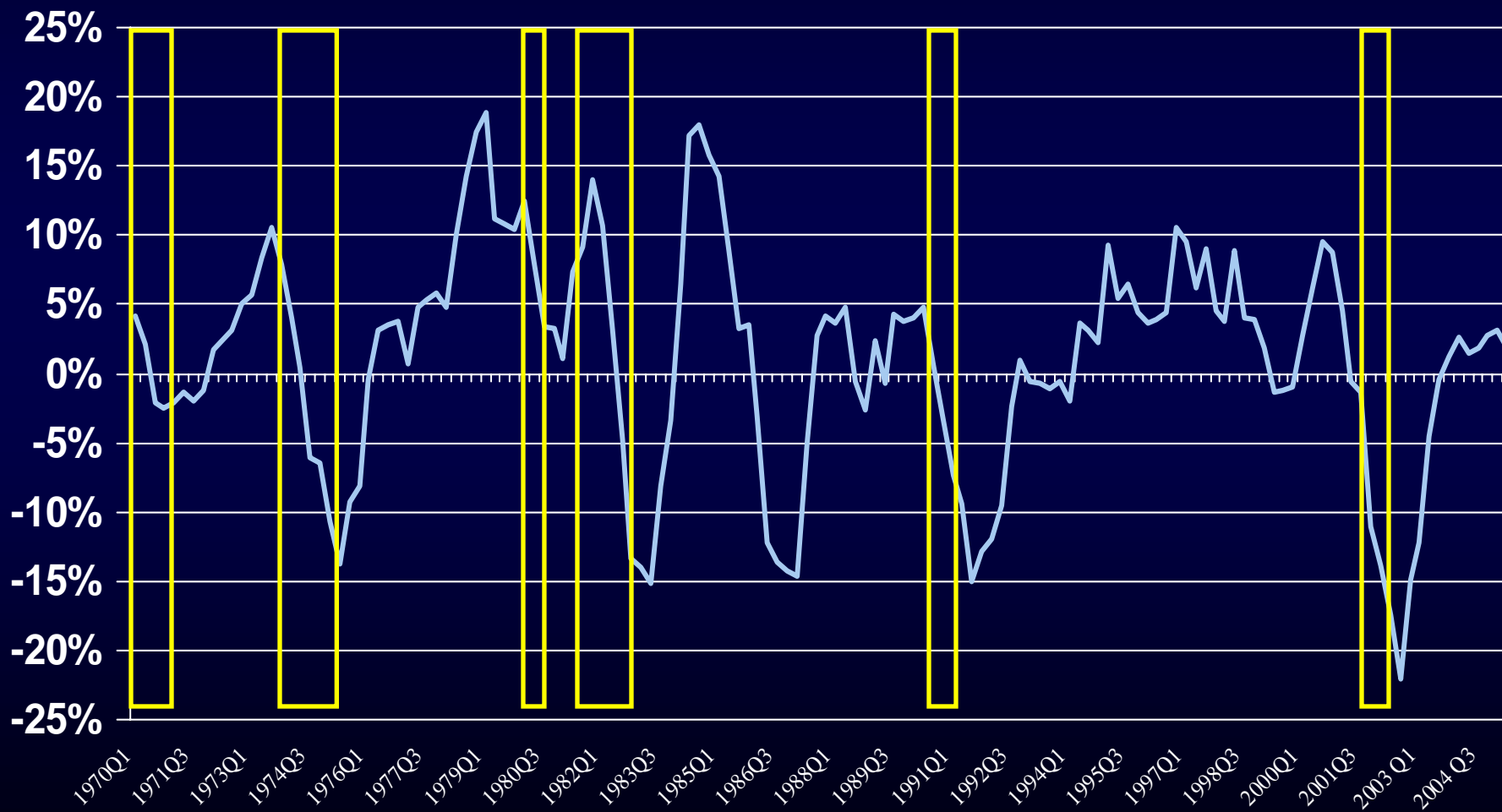


* Data through August 2005

Recession Periods

Total Plant Spending Percent Change Year Ago (Real Dollars) 1970 – 2005*

Source: Bureau of Economic Analysis



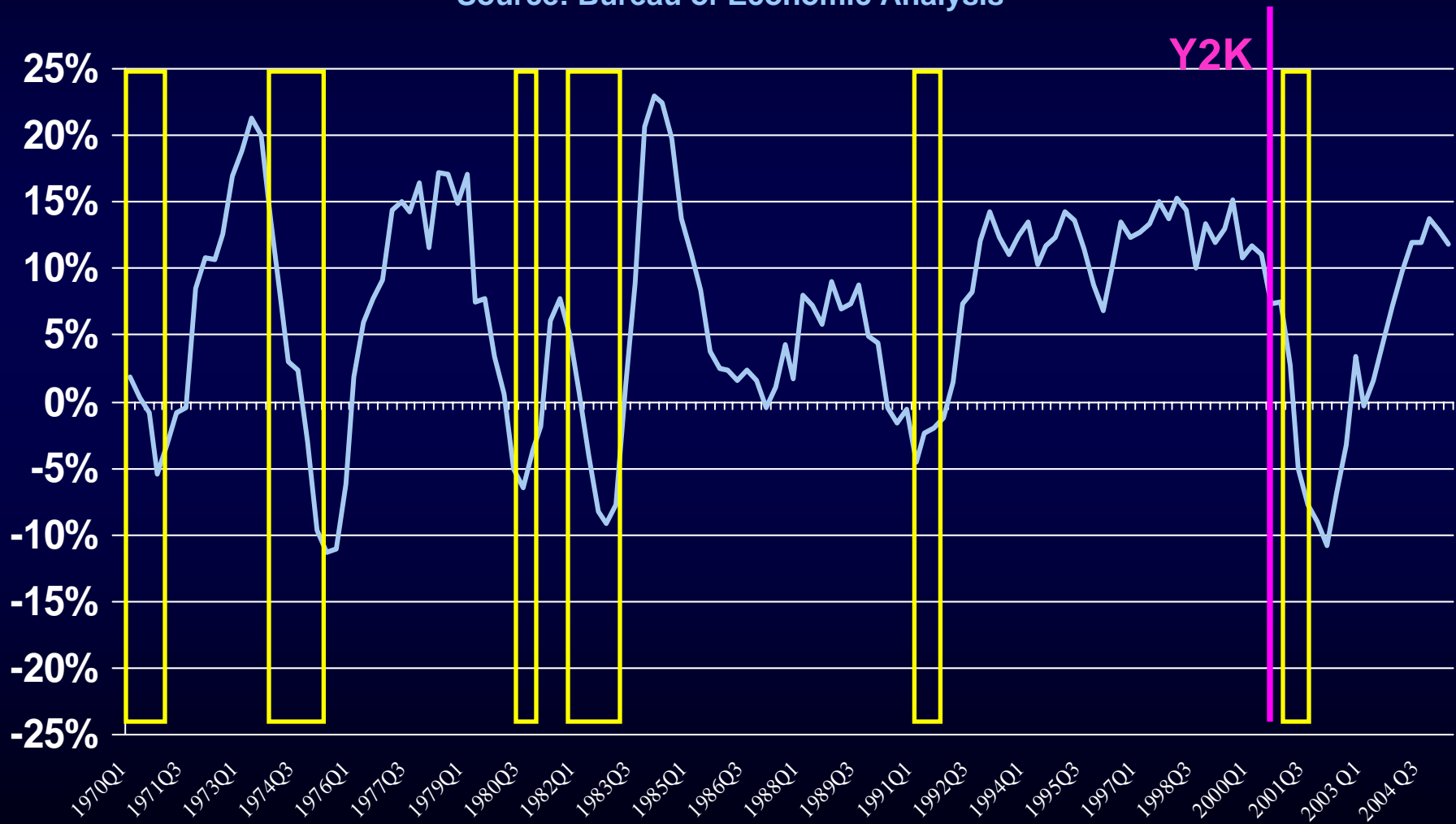
•Data through second quarter 2005.

•NOTE: Series was revised in March 2004. Data prior to 1990 was not provided.

 Recession Periods

Total Equipment & Software Spending Percent Change Year Ago (Real Dollars) 1970 – 2005*

Source: Bureau of Economic Analysis



•Data through second quarter 2005.

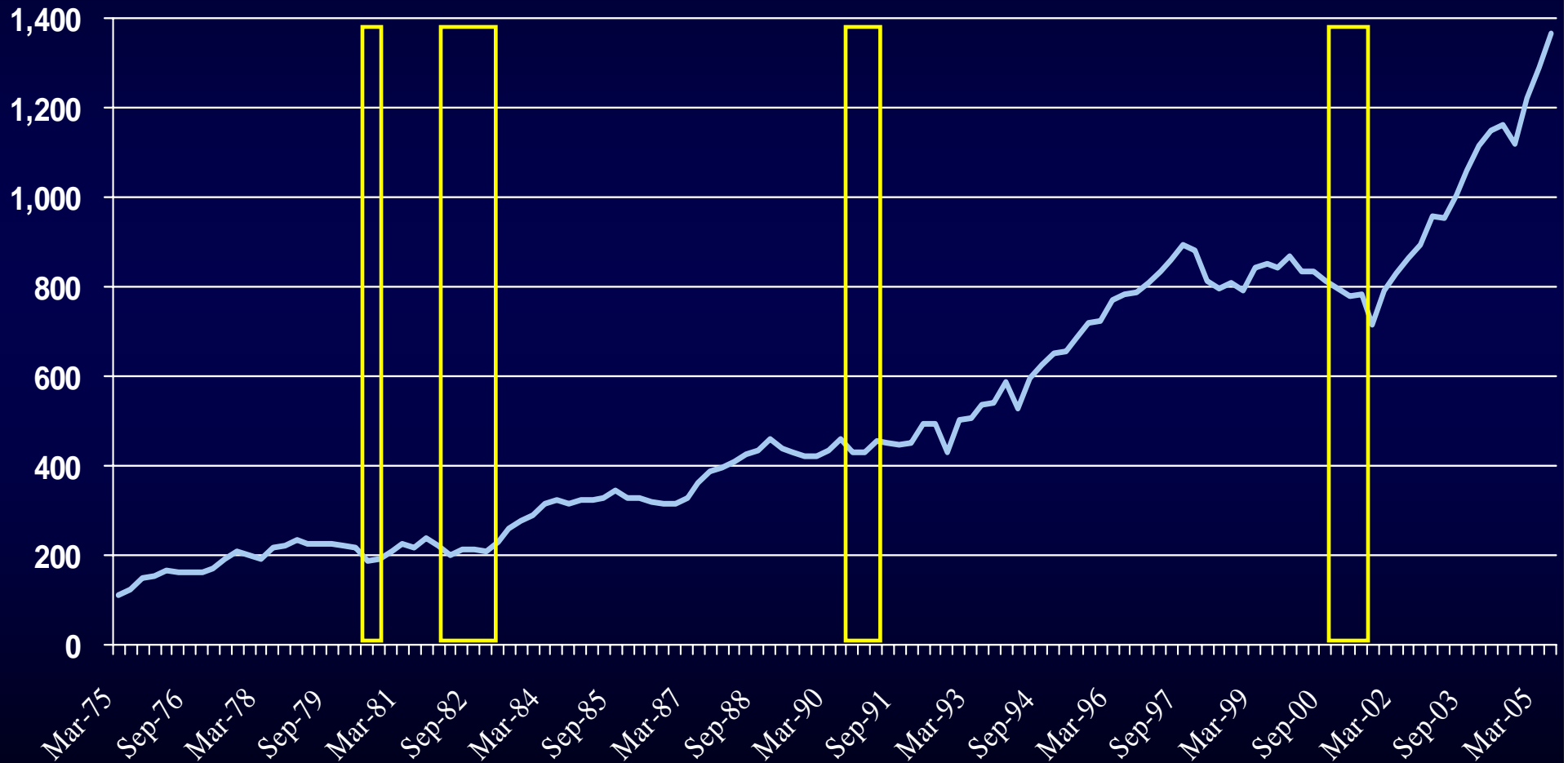
•NOTE: Series was revised in March 2004. Data prior to 1990 was not provided.

 Recession Periods

Corporate Profit 1975-2005*

(Billions of Dollars, SA)

Source: Freelunch.com



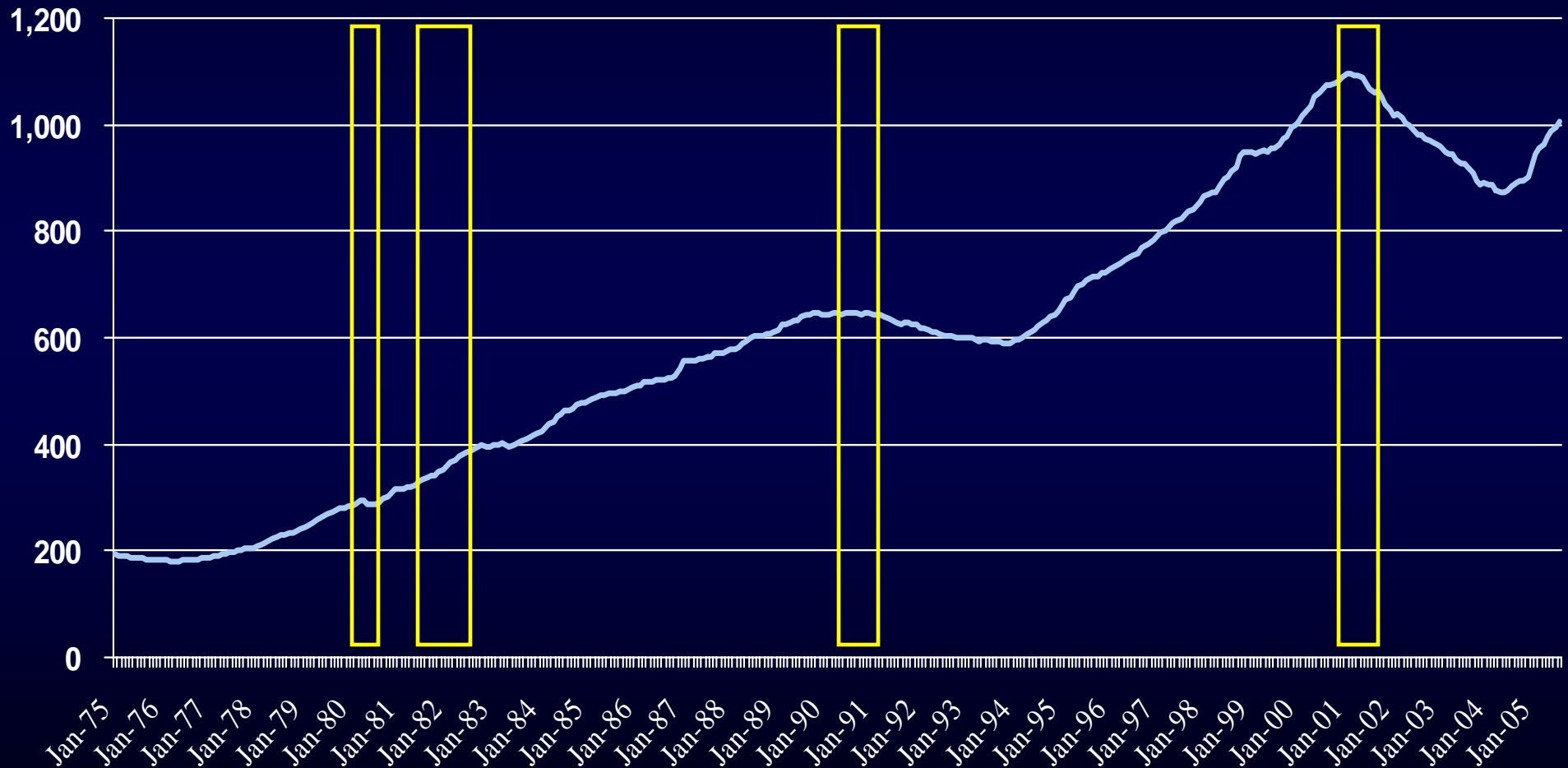
•Data through second quarter 2005

Recession Periods

Commercial & Industrial Loans, U.S. Based Banks 1975-2005*

(Billions of Dollars, SA)

Source: Federal Reserve Economic Database

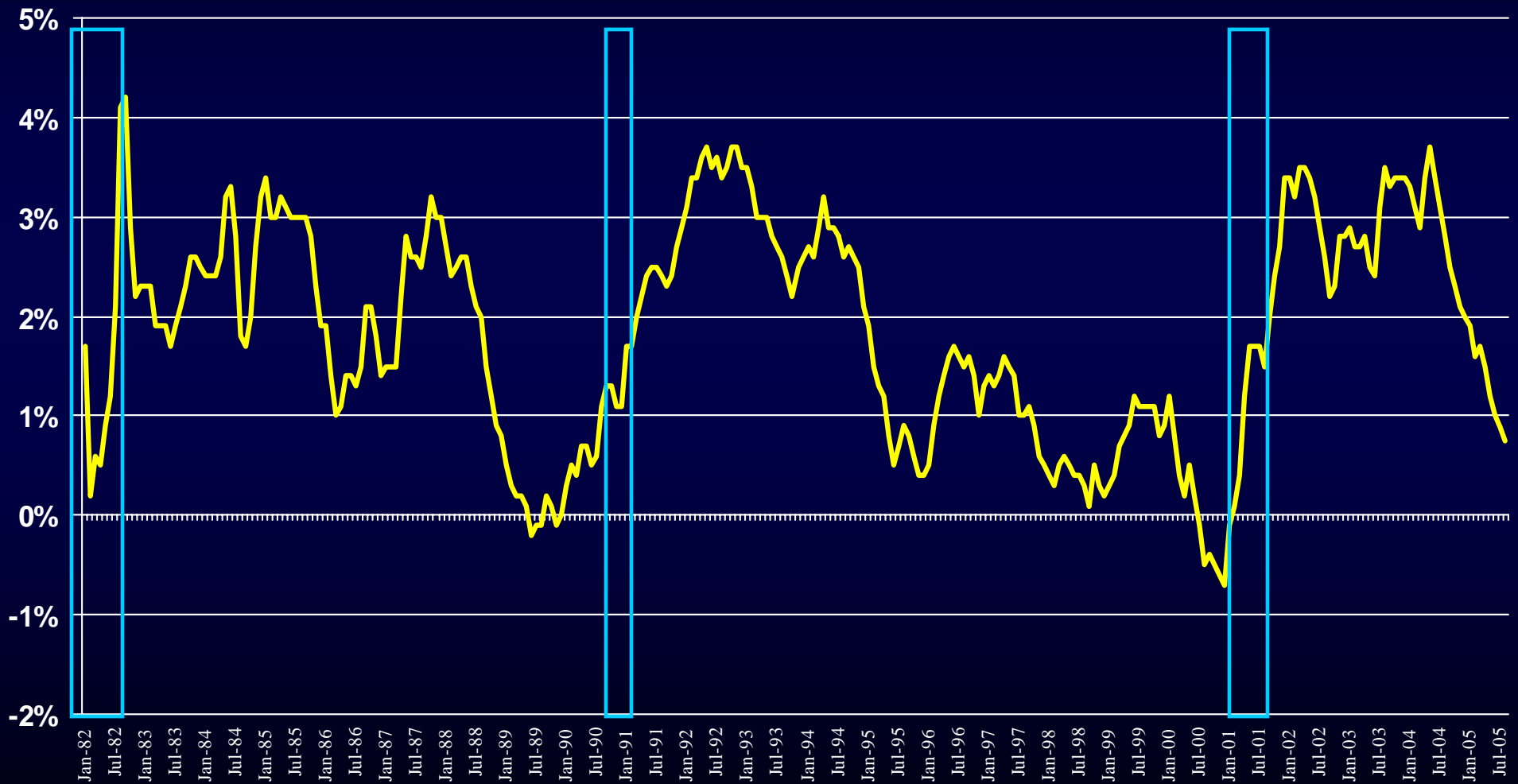


•Data through July 2005.

 Recession Periods

10-Year Treasury Rate minus 3-month Treasury Rate 1982 – 2005*

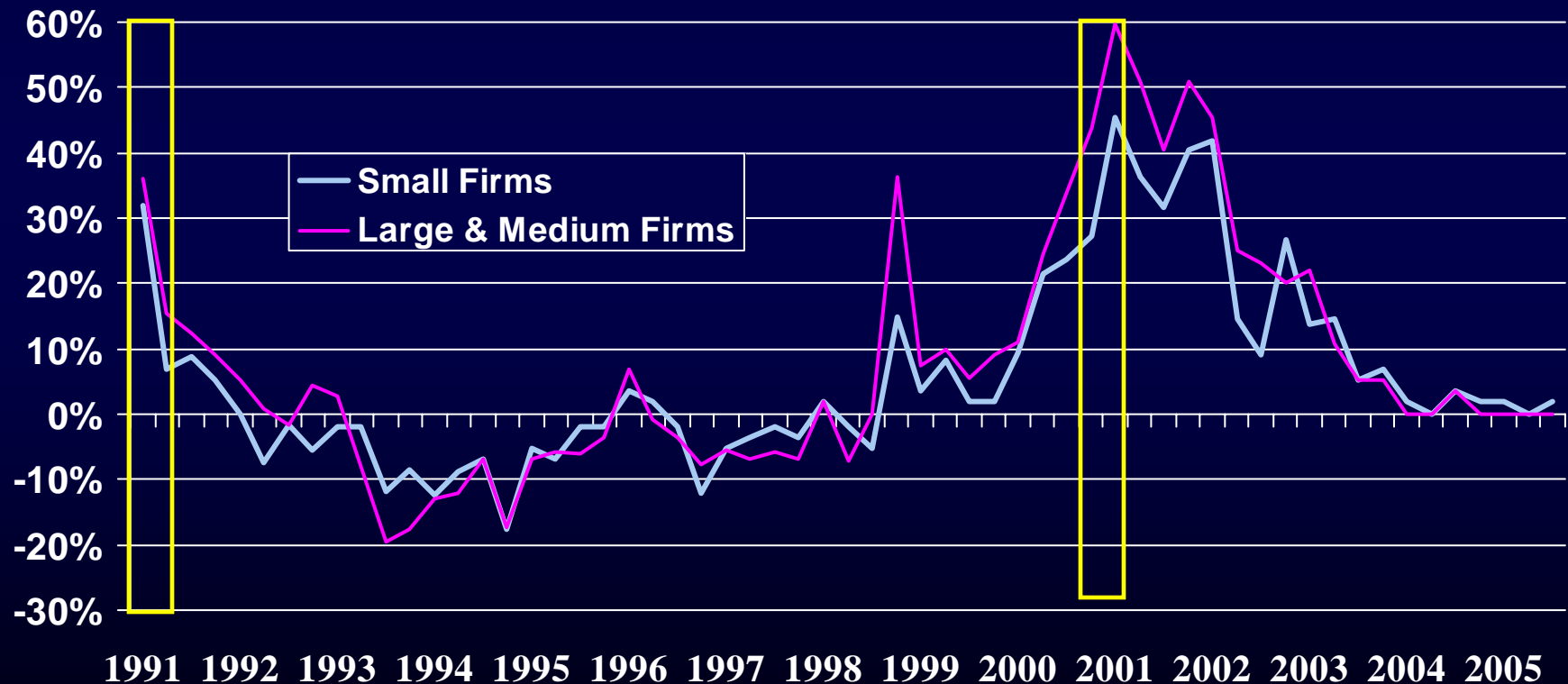
Source: Federal Reserve Economic Database



•Data through August 2005.

Net Percentage of Large U.S. Banks Reporting Tougher Standards on Business Loans 1991 – 2005 *

Source: Federal Reserve, Board of Governors



* Data through second quarter 2005

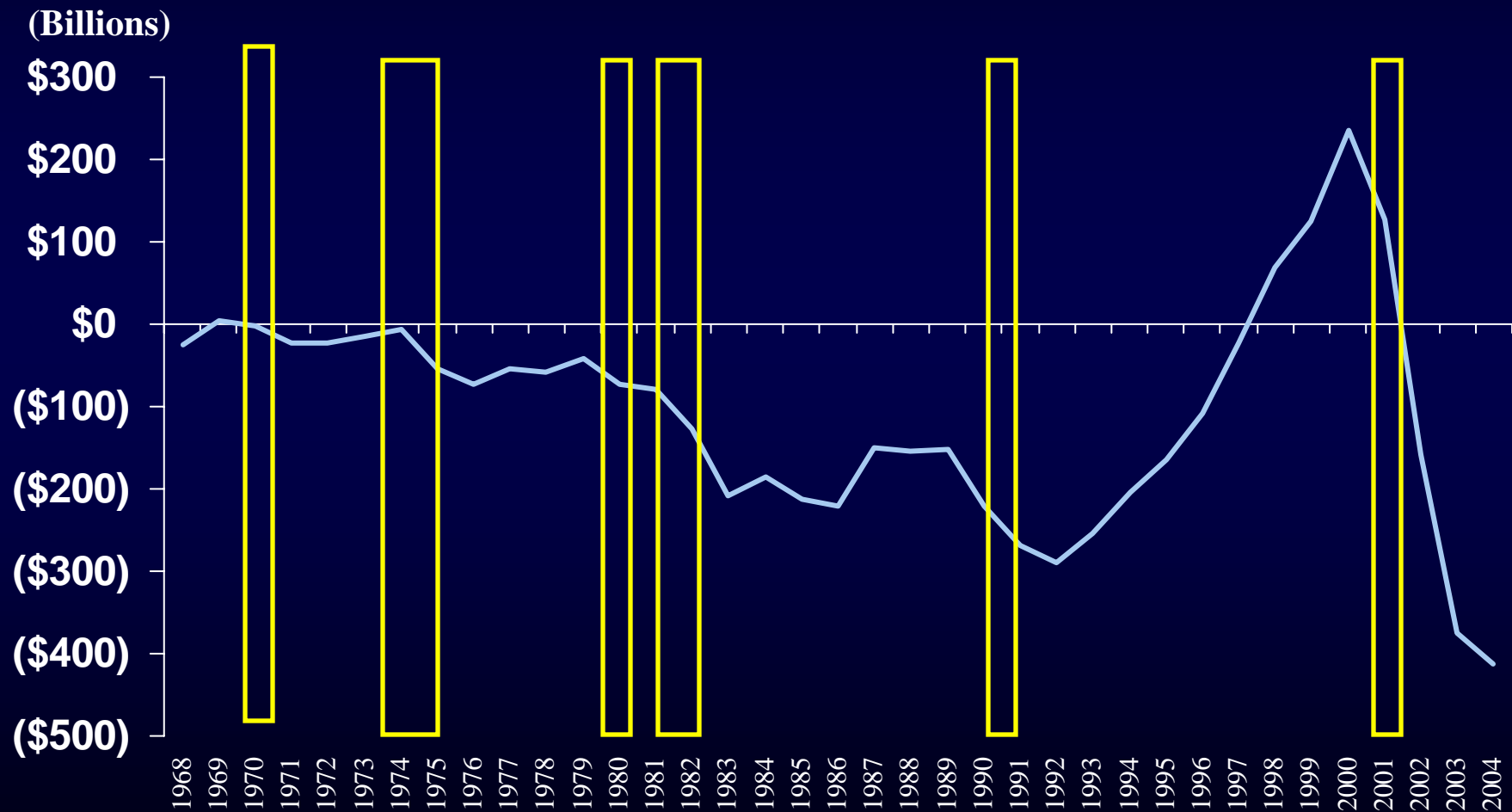
Recession Periods

Government



U.S. Federal Surplus/(Deficit) 1968 – 2004

Source: White House Office of Management and Budget

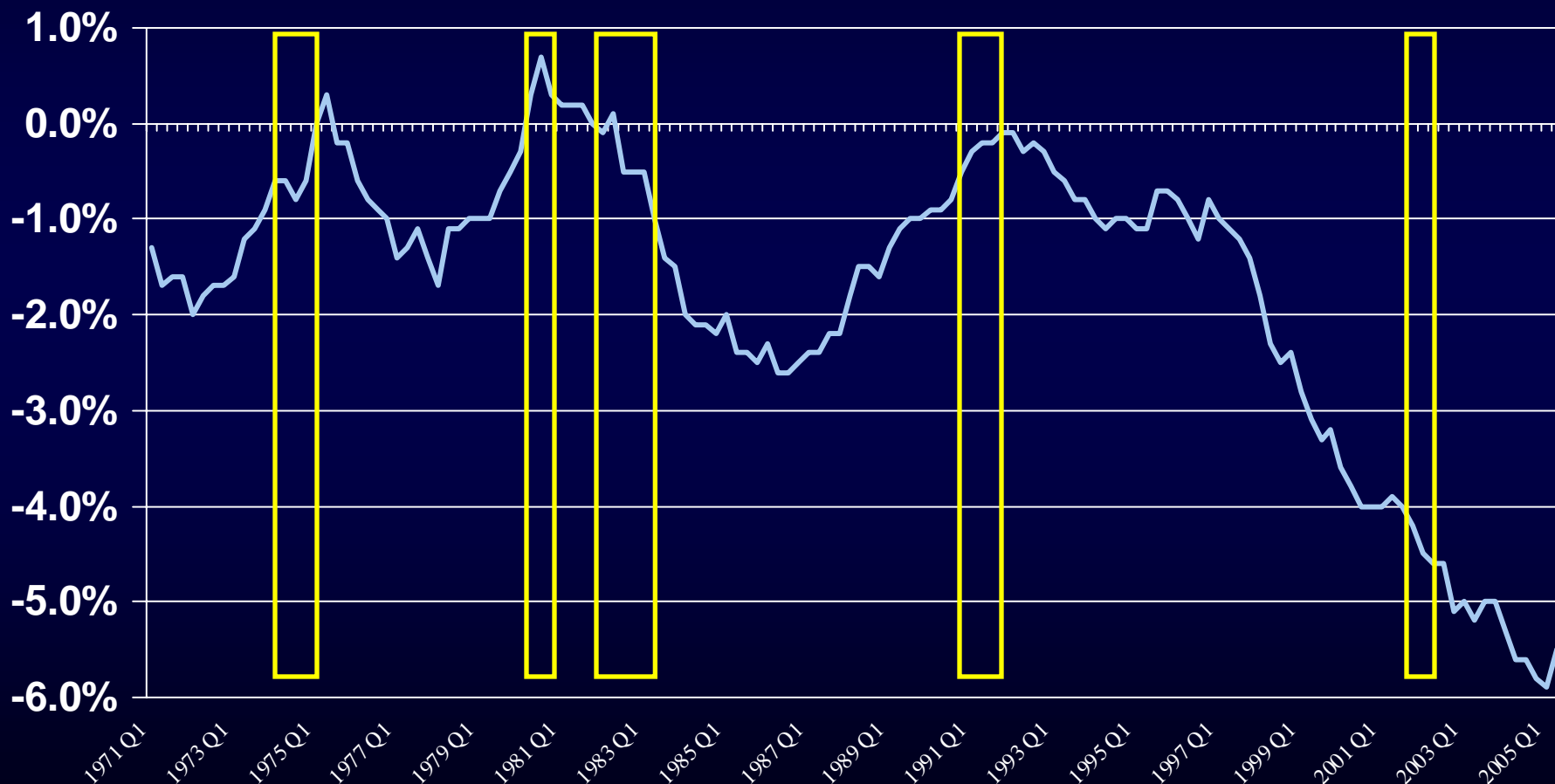


Deficit ?

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

1971 – 2005*

Source: Bureau of Economic Analysis



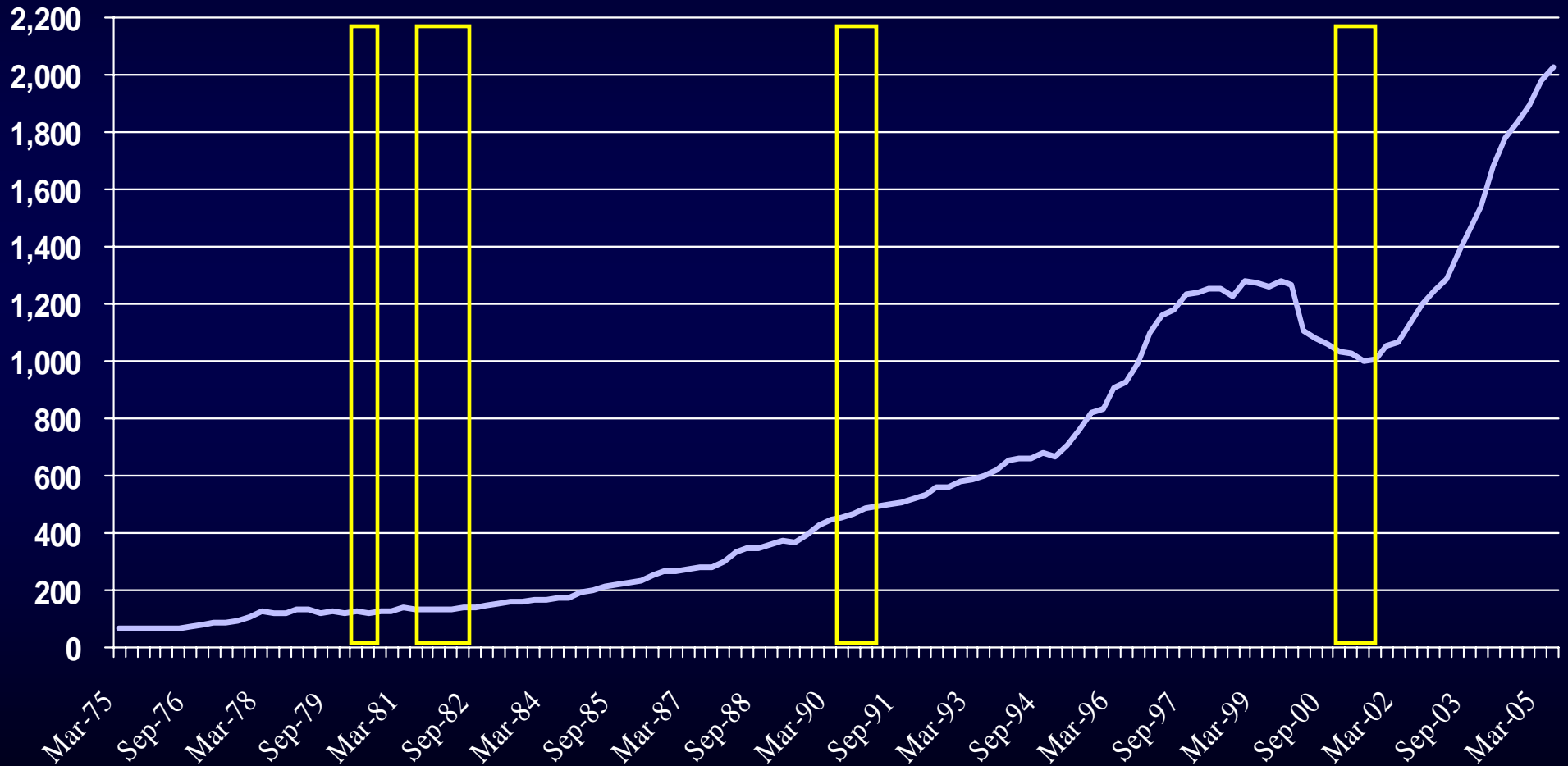
*Data through second quarter 2005

 Recession Periods

U.S. Debt Held by Foreign & International Investors 1975-2005*

(Billions of Dollars, SA)

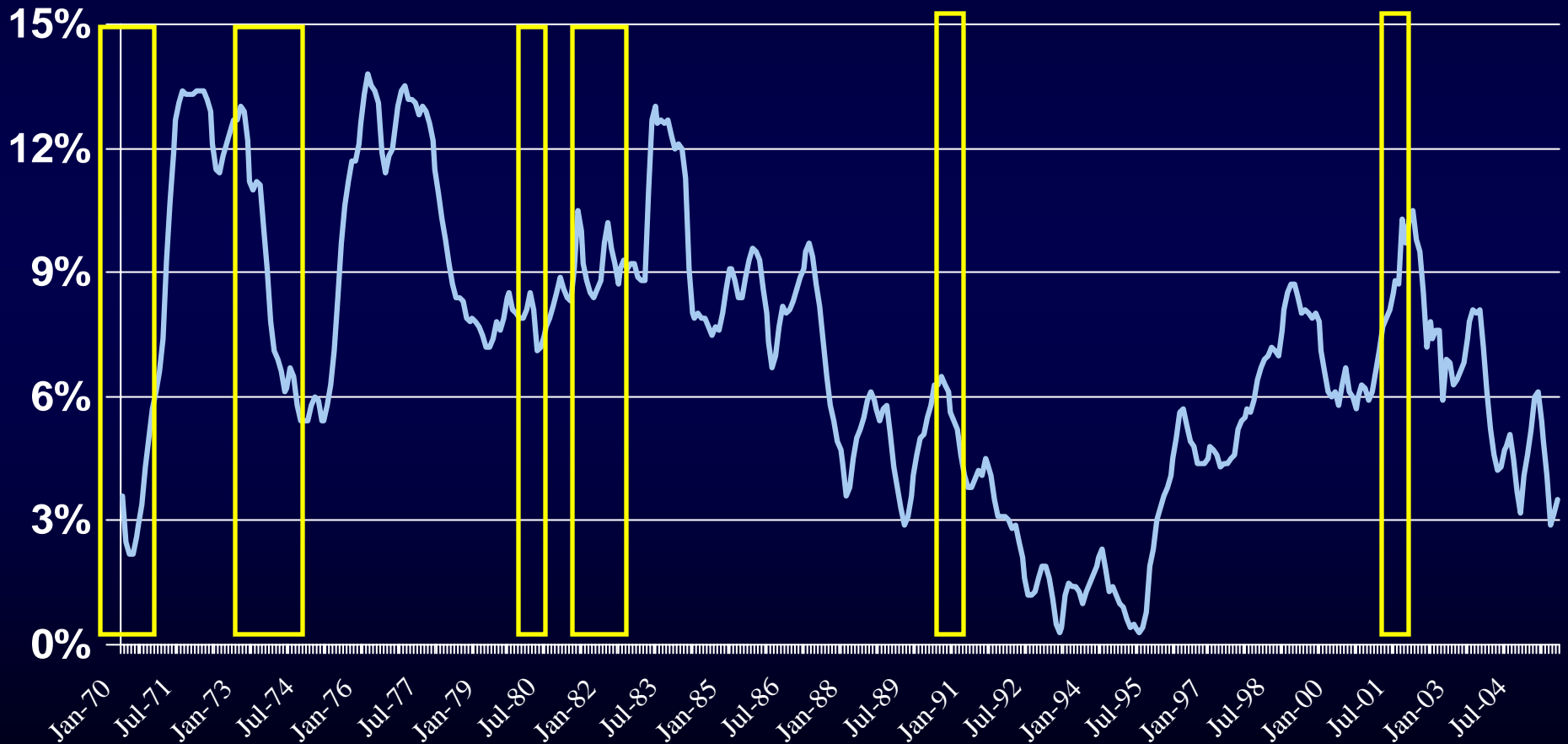
Source: Federal Reserve Economic Database



•Data through second quarter 2005.

M2 Stock – Seasonally Adjusted Percent Change Year Ago 1970 – 2005*

Source: Federal Reserve Bank of St. Louis, U.S. Bureau of Labor Statistics



* Data through July 2005.

Recession Periods

2004 v. 2005

U.S. OUTLOOK GOOD NEWS

LAST YEAR

- Fiscal stimulus
- Monetary stimulus
- Real incomes up
- Businesses mean and lean
- Productivity growth strong
- Job growth accelerating, albeit slowly
- Cheaper dollar means more exports
- Inflation (in near term) not a problem
- Low interest rates

THIS YEAR

- Not as much
- Strong (but not as much)
- Still strong
- Still strong
- Not as strong
- Same
- Same
- Moving up slowly
- Moving up, but still low

U.S. Economy: The Glass is Half Full

**... But not
as full as
last year.**



GOOD TIMES



**In our
future?**

Mostly.



ELLIOTT D. POLLACK
& Company

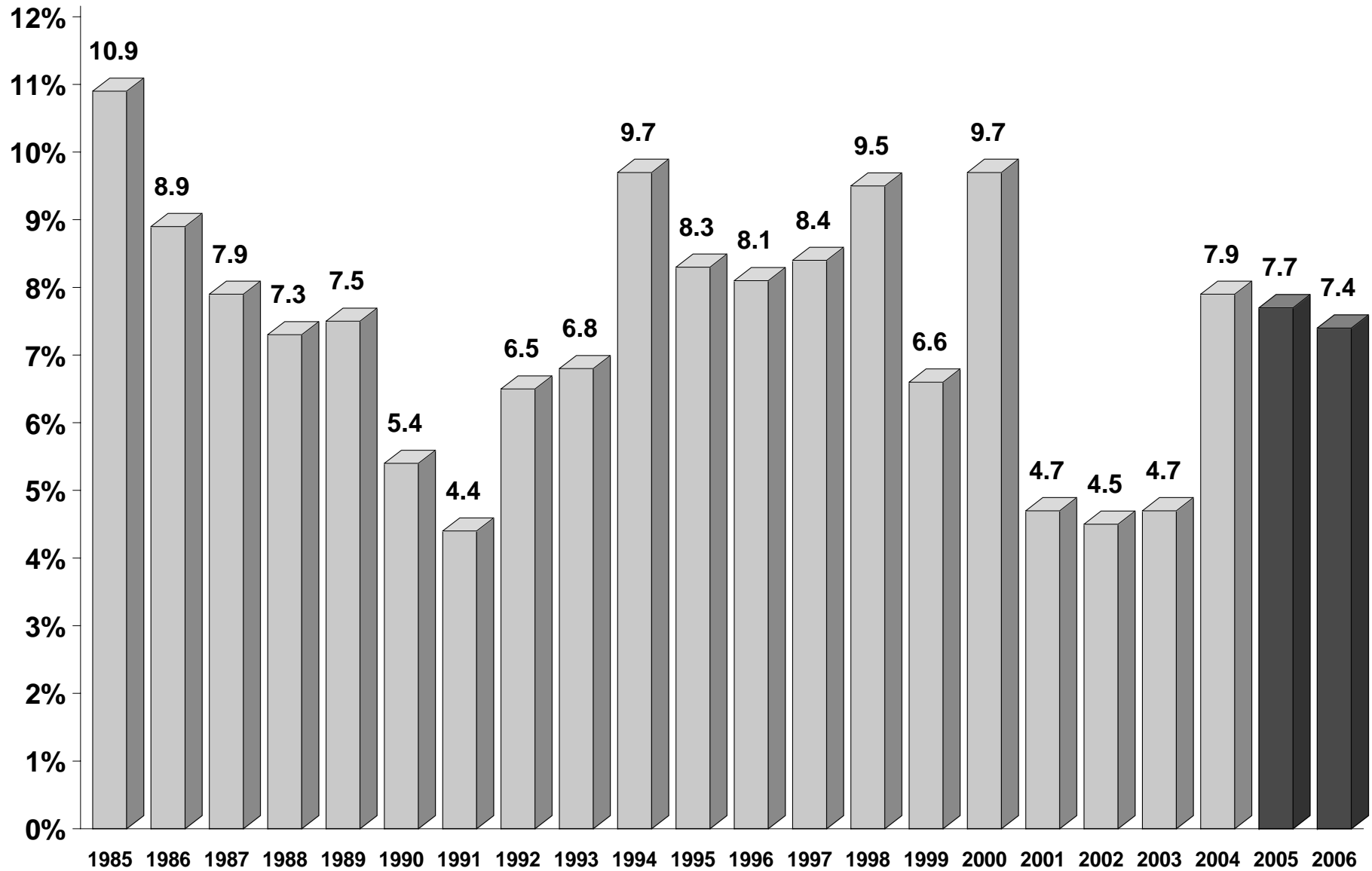
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480-423-9200 P 480-423-5942 F www.arizonaeconomy.com

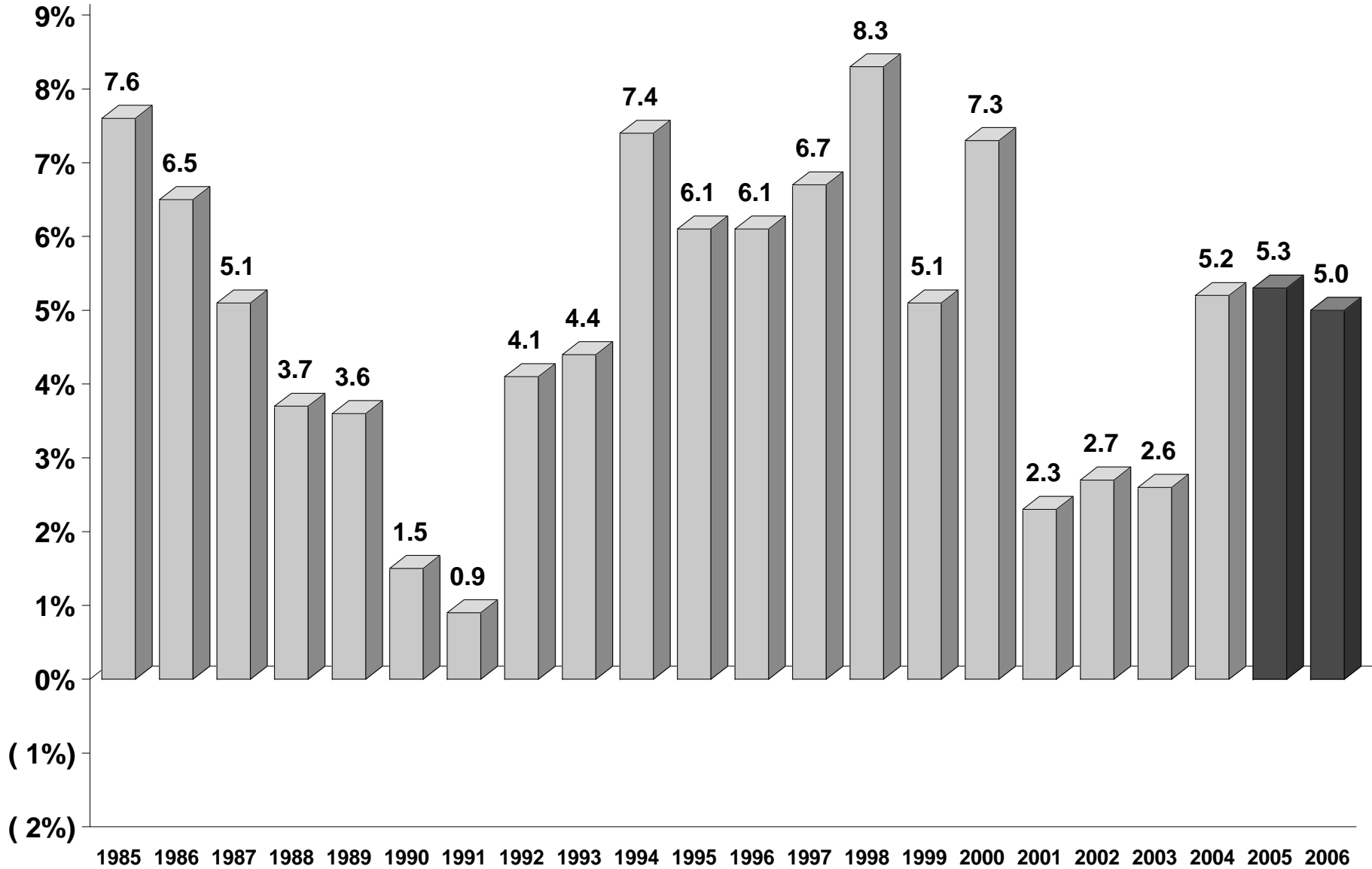
Arizona Personal Income Growth



History: Bureau of Economic Analysis (percent change)

Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

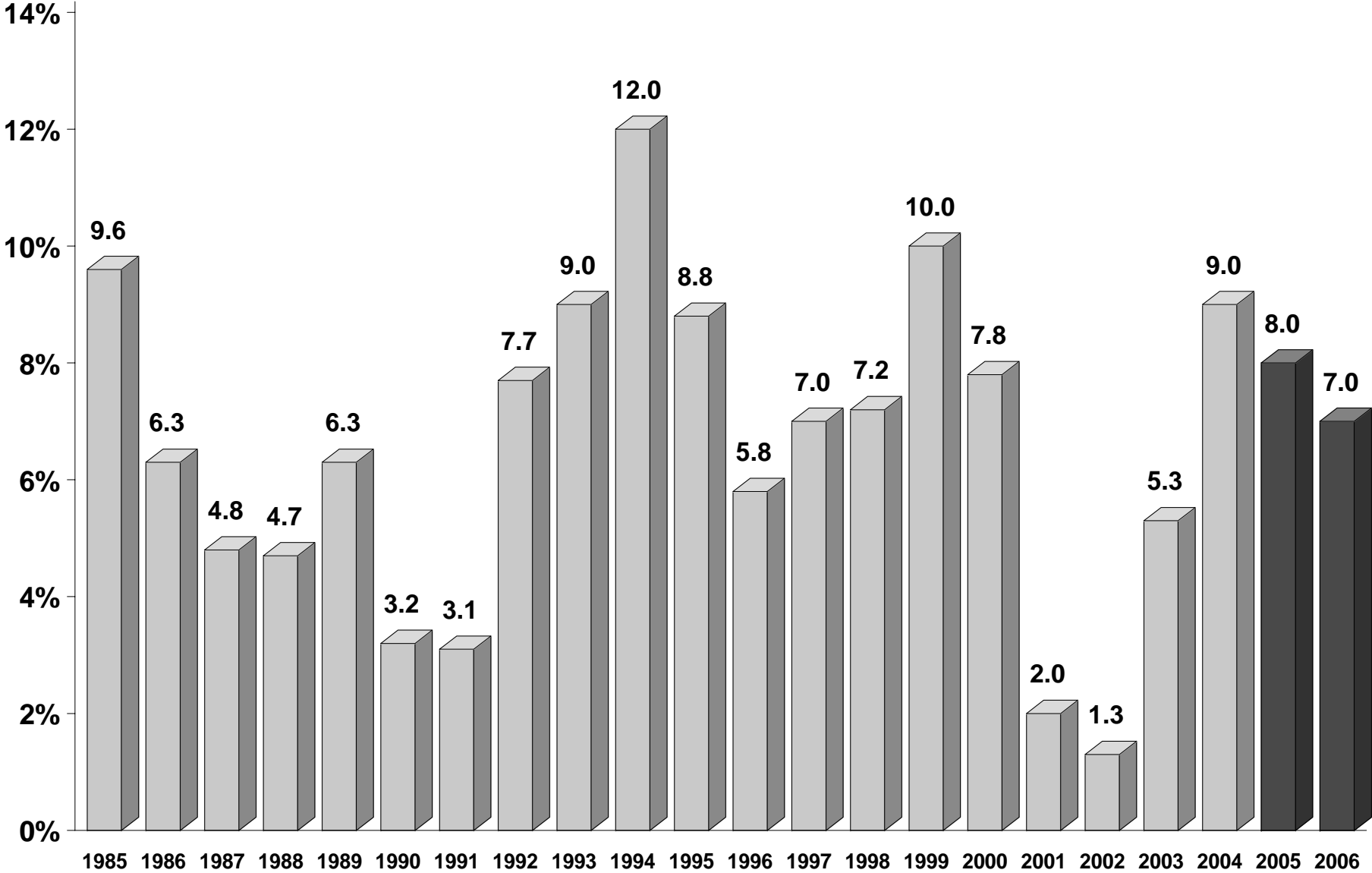
Arizona Real Personal Income Growth



History: Bureau of Economic Analysis (percent change)

Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

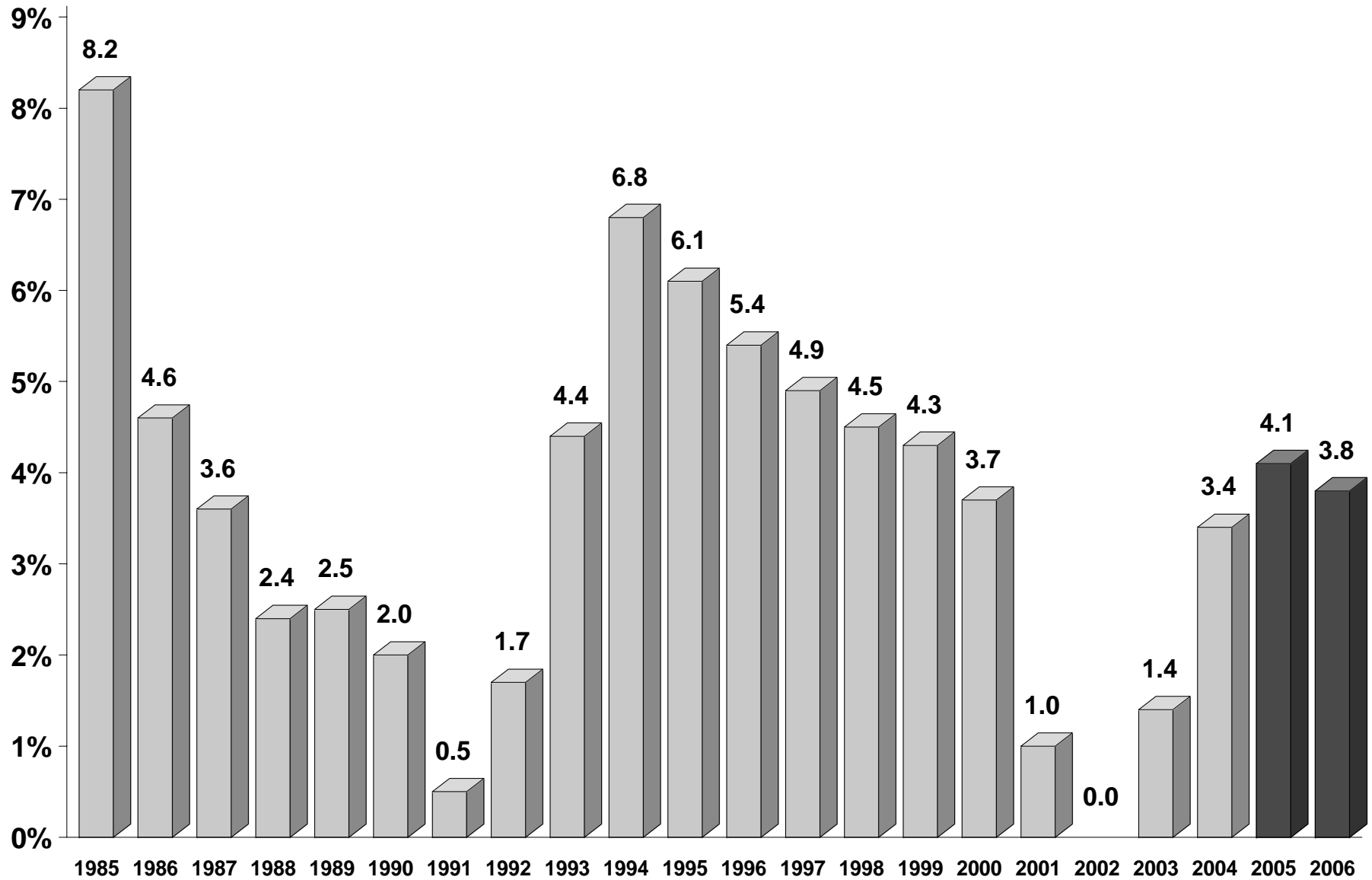
Arizona Retail Sales Growth



History: Arizona Department of Revenue (percent change)

Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

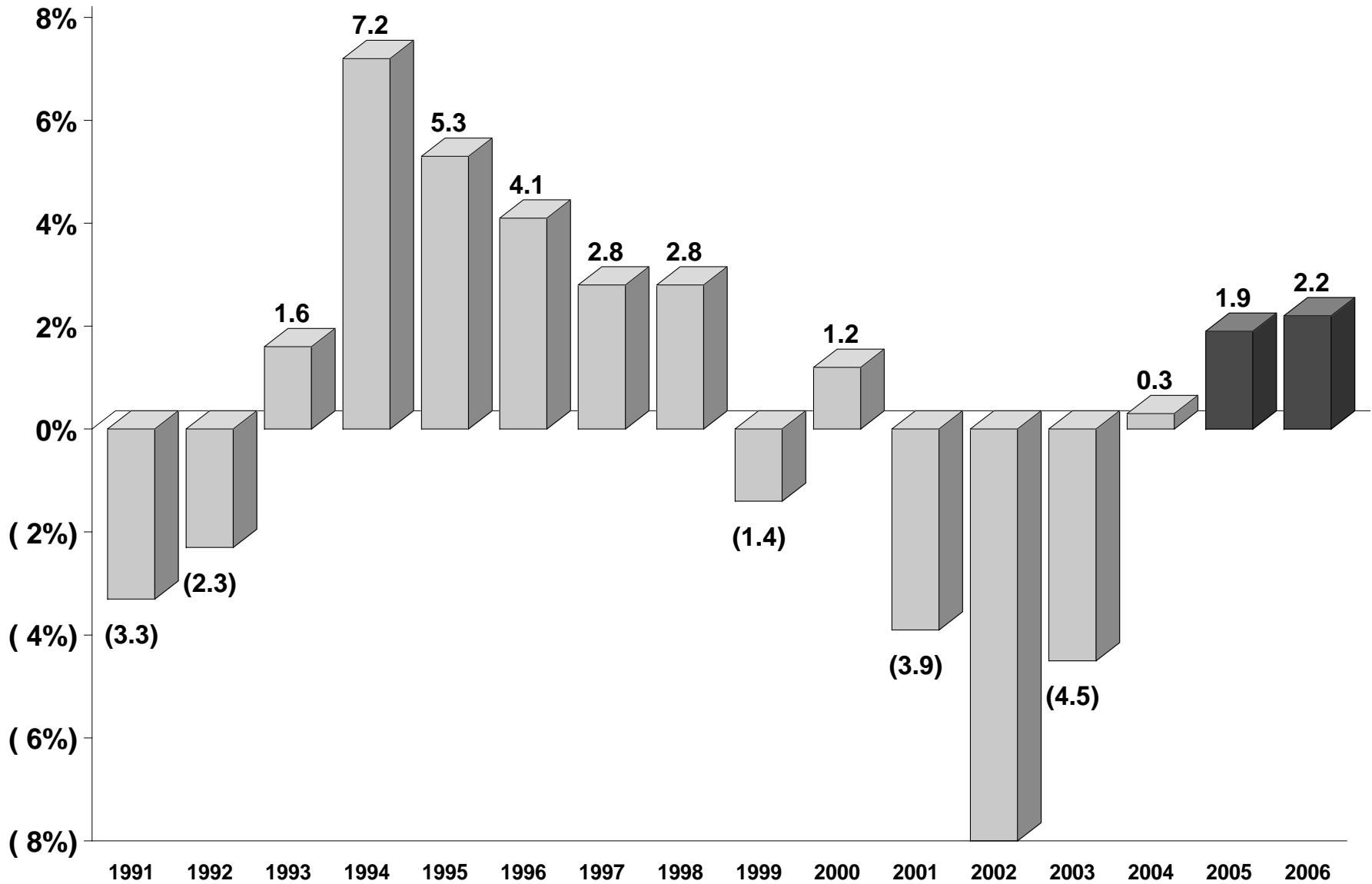
Arizona Wage and Salary Employment Growth



History: Arizona Department of Economic Security (percent change)

Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

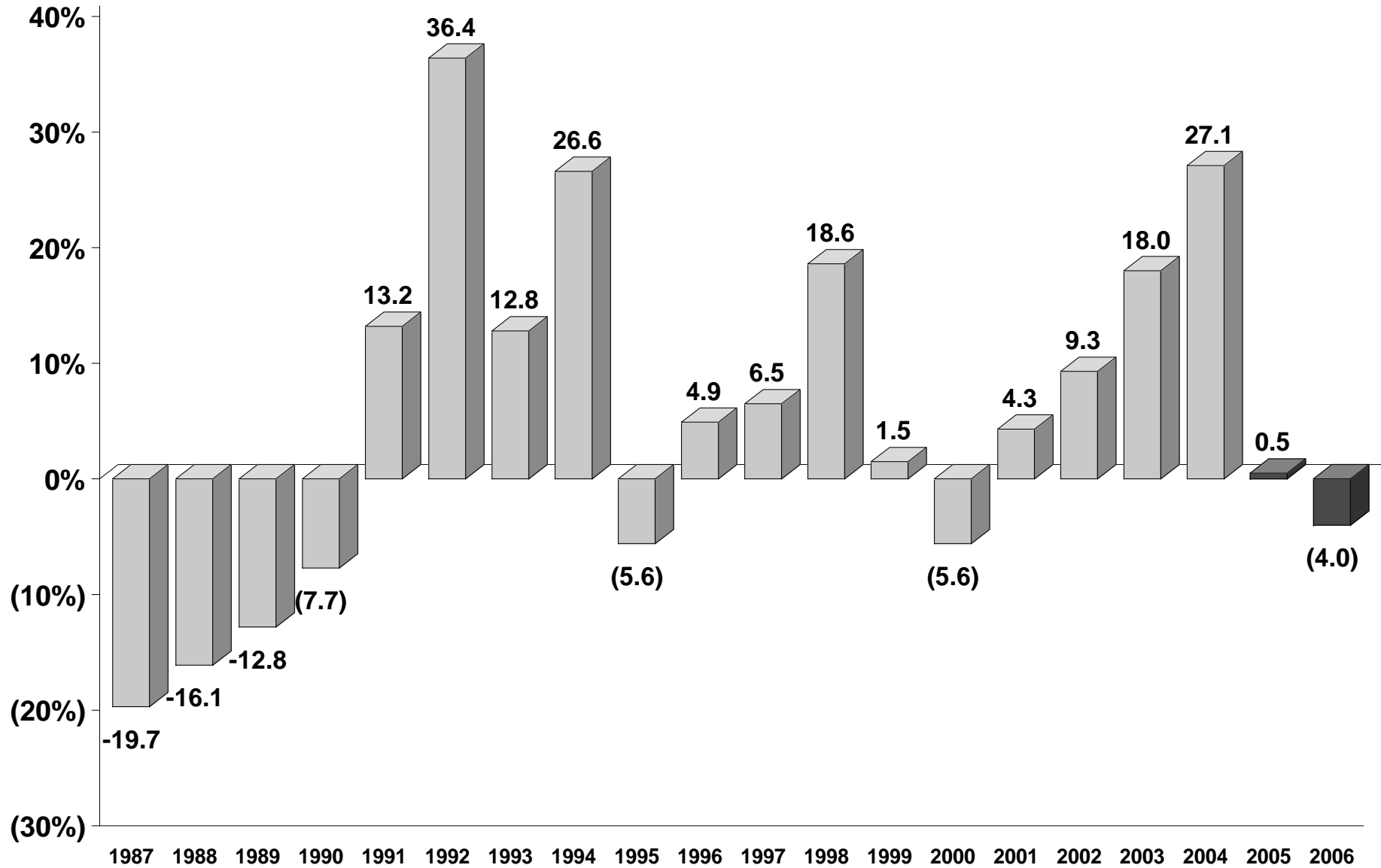
Arizona Manufacturing Employment Growth



History: Arizona Department of Economic Security (percent change)

Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

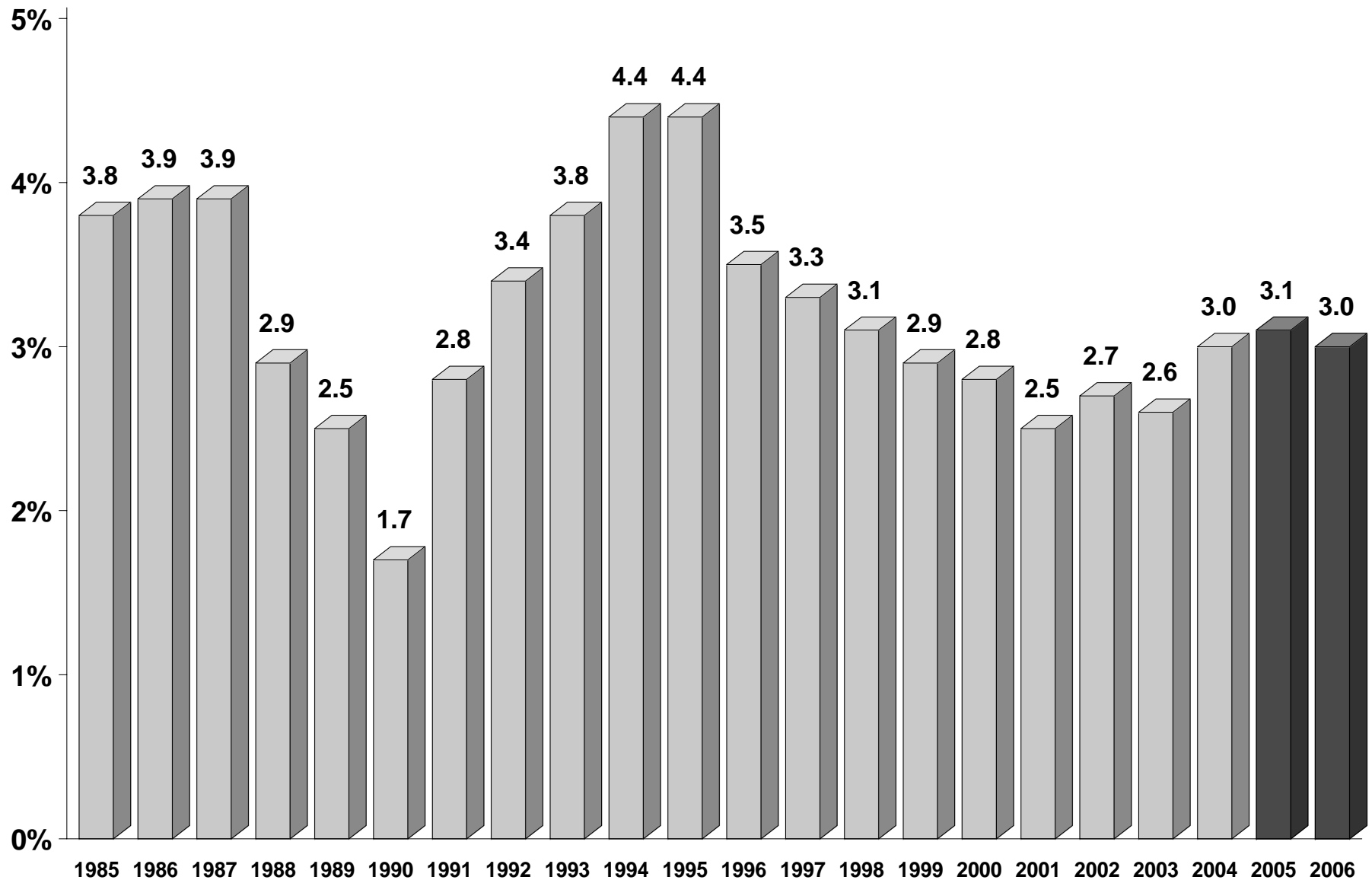
Arizona Single Family Permit Growth



History: Arizona Real Estate Center (percent change)

Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

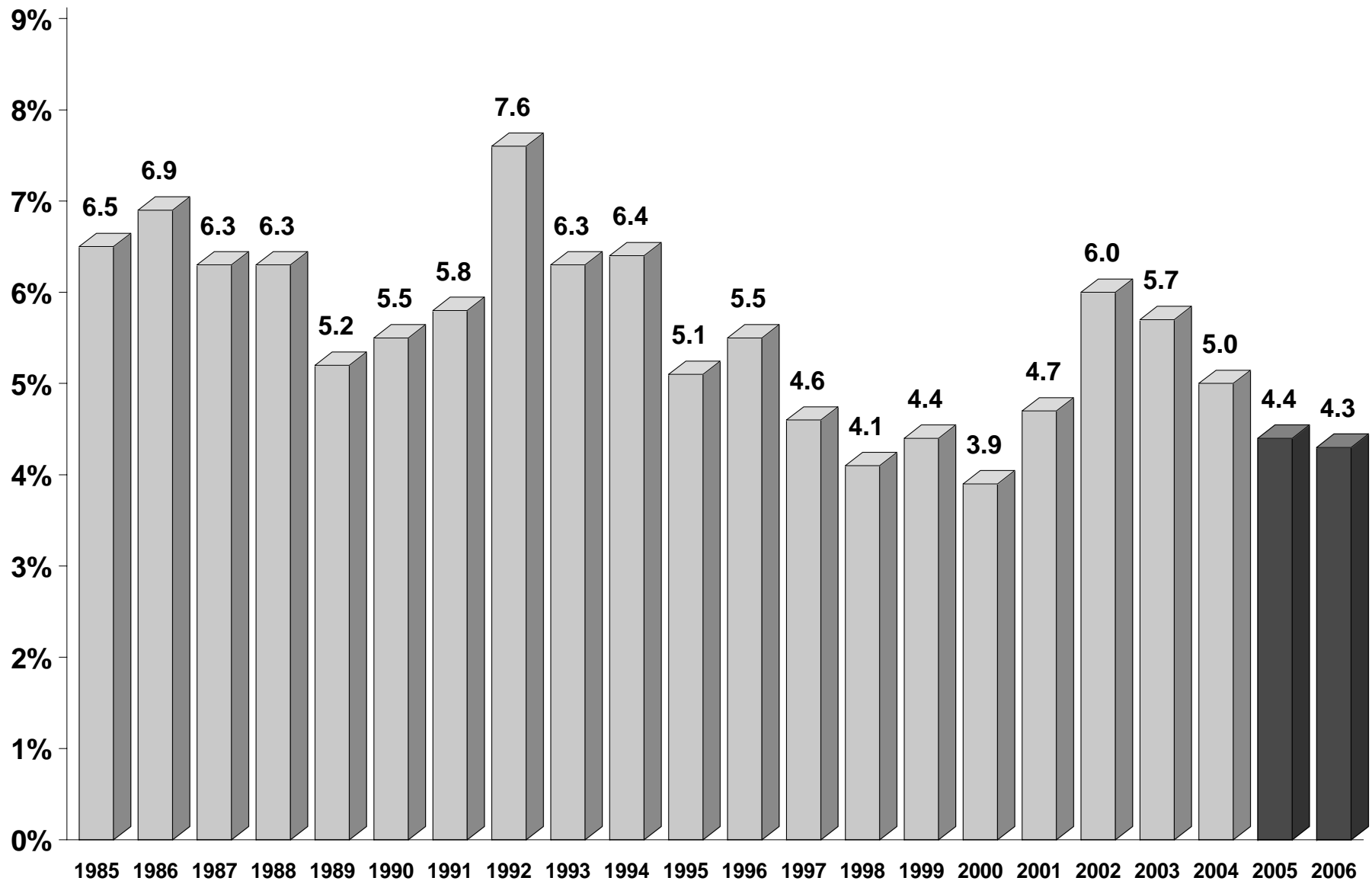
Arizona Population Growth



History: ASU Center for Business Research (percent change)

Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

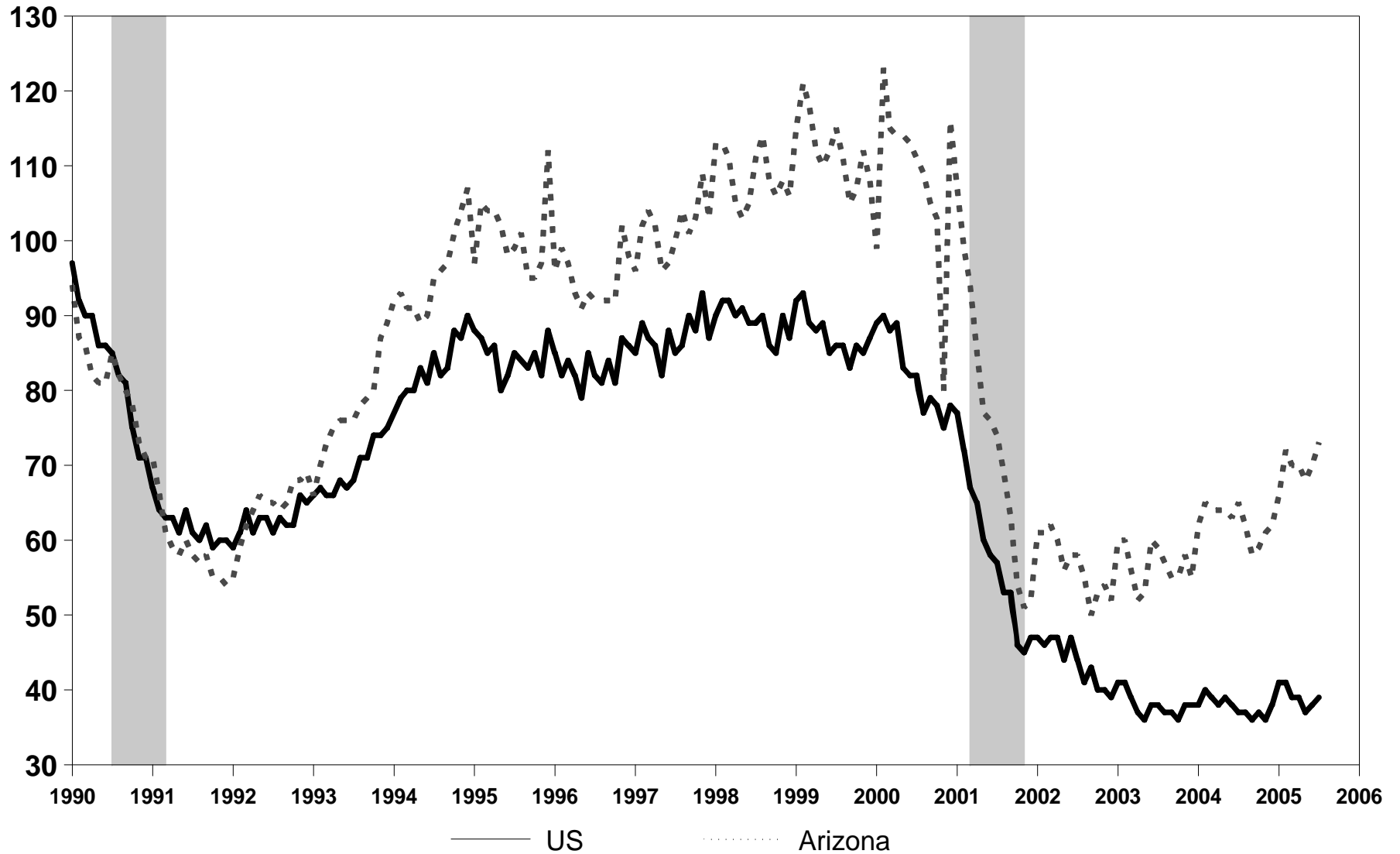
Arizona Unemployment Rate



History: Arizona Department of Economic Security

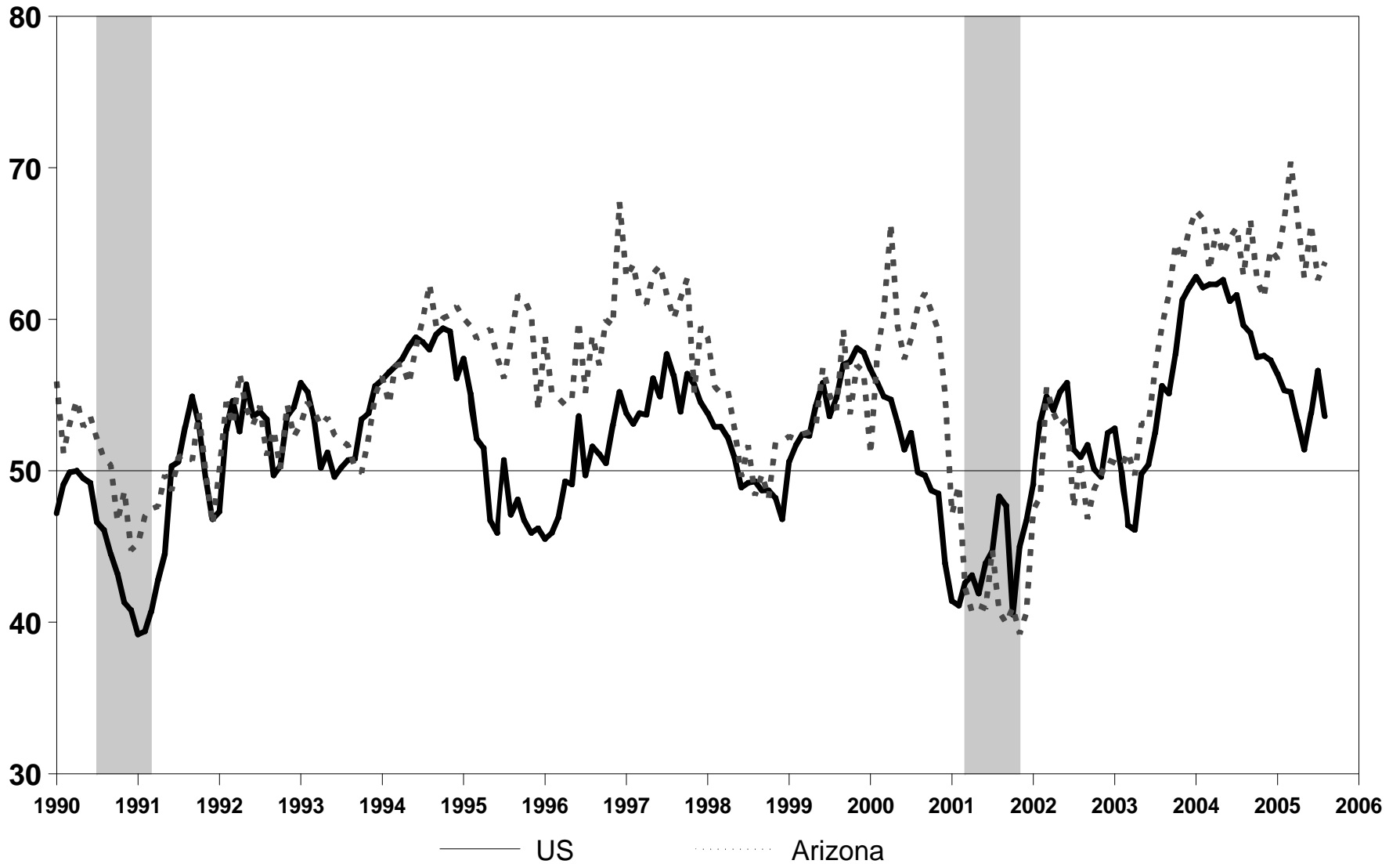
Forecasts are from the August Bank One Arizona Blue Chip Economic Forecast

Index of Help Wanted Advertising in Newspapers 1990 to 2005



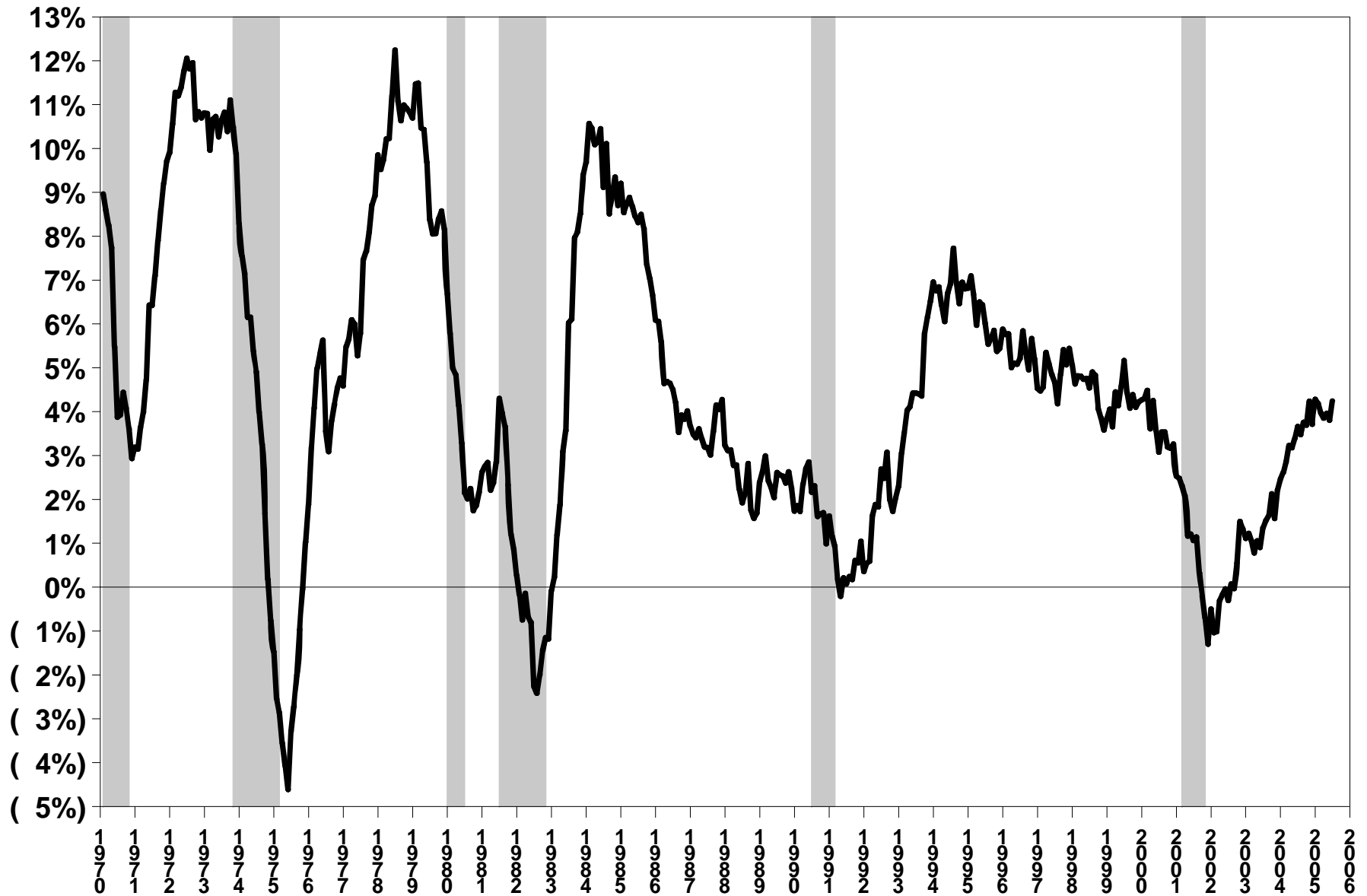
The Conference Board 1987=100
(last data point July 2005 US = 39 Arizona = 73)

Purchasing Managers Index 1990 to 2005



The National Association of Purchasing Managers and Bank One Economic Outlook Center 1987=100
(last data point August 2005 US = 53.6 Arizona = 63.7)

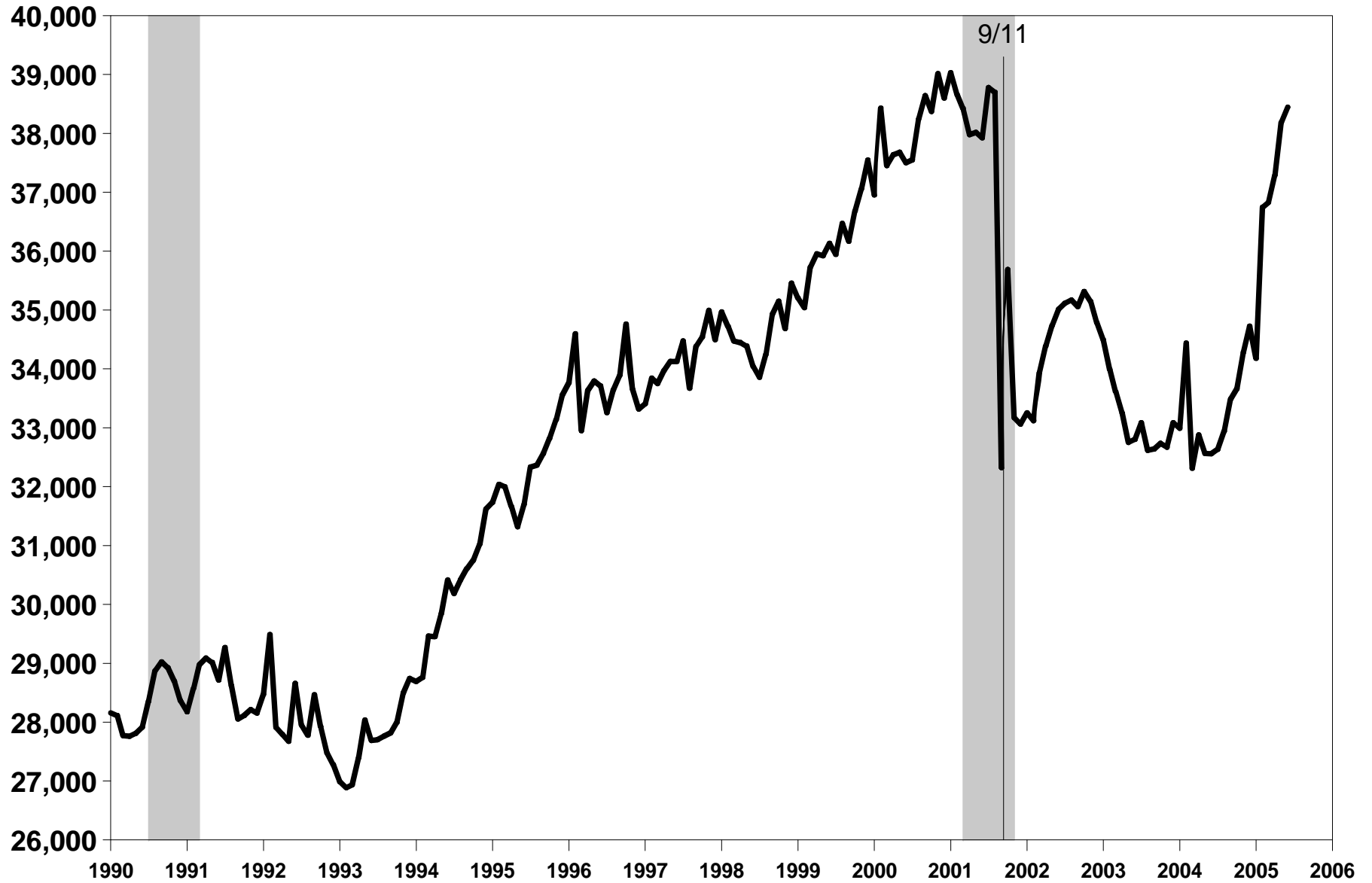
Arizona Total Nonfarm Employment Growth 1970 to 2005



Source: Arizona Department of Economic Security (last data point July 2005= 4.2%)

Arizona Air Carrier Landings

1990 to 2005



Source: Federal Aviation Administration (Seasonally Adjusted) (last data point June 2005= 38,443)

New York Harbor Gasoline Regular Future Contract 1 (Cents per Gallon)

