Members Present:
Dan Anderson, Board of Regents
Tracy Clark, ASU
Pete Ewen, APS, Pinnacle West
Georganna Meyer, DOR
Elliott Pollack, Elliott D. Pollack and Co.
Hank Reardon, Reardon Economics
Debra Roubik, VisionEcon
Marshall Vest, UofA
Don Wehbey, Dept. of Economic Security

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. Stavneak said JLBC Staff would be giving some perspective on where the economy is at this point. Mr. Pollack will give a presentation on the national economy and Tracy Clark will address the state economy.

Mr. Tim Everill, Mr. Hans Olofsson, Mr. Brian Cary, JLBC Staff, provided a slide presentation and handout with an overview of the major revenue categories. (Click here to view handout)

Georganna Meyer said she wanted to expand on something Brian Cary said. The four big months for Corporate Taxes are September, December, April and June. By now we have a good feel for estimated payments coming in for this tax year because we have gotten the April, June, and September payments. We can expect December to probably run the same, which is huge with a big percentage growth. The problem is the April and June payments. Those are the estimated payments for tax year 2005 and how large, if any growth occurs at all, is anyones guess.

Elliott Pollack gave a slide presentation and handout on the national economy. (Click here to view handout) He said there has not been much change since September. He said he expects the expansion to continue. In summary, there are mostly good times ahead in 2005: fiscal stimulus and monetary stimulus; real income is up; business is lean and mean; productivity growth remains strong to this point in the cycle; job growth is accelerating although slowly; the cheaper dollar means more exports; inflation is not a problem in the near term; and interest rates, by historic standards, remain incredibly low.

Brian Cary asked as a follow-up question about the decline of the dollar versus the Euro, and if there are more alternatives now to global industries than in previous cycles that might make that more likely.

Elliott Pollack said there are lots of alternatives now with the strength in Asia.
Tracy Clark said that oil prices have come down, but believes they will not go down much more, and may even go up. The short-term shock to the economy is over. In sociological terms there is a marked lack of commitment or a fear of commitment by U.S. businesses because they are uncertain. They do not have to hire a lot of people yet because of productivity gains. Benefits costs are high and businesses do not know if the increases in demand are permanent, consequently they are not hiring. He said he does believe we will continue to see the economy expand.

He said he would go over briefly where we are year-to-date versus the forecast in the Blue Chip. In terms of retail, we are about 8.7% so far year-to-date. The forecast for 2004 from the panel is 7.2%, and for 2005 is 7.0%. If you limit yourself just to department stores and what most people consider when holiday buying, it is probably going to be an a good season. The luxury goods market is doing very well. What is going to make it better for the panel’s purpose is that for a little while longer auto sales are going to stay strong. Retail sales should stay pretty good. Employment numbers year-to-date are at 2.3%, the panel expects us to be at 3.1% for 2004 and 3.8% for 2005. He does not think there is any way to get to 3.1%. There is no way that the revisions to the data will be large enough to get to 3.1%. The employment growth is coming from specialty trade contractors, furniture and home furnishing retailers, electronics and appliance retailers, building materials and garden supplies, management of companies and a lot of growth in healthcare. It is in things that have to do with population growth and our fears. Employment is worrisome, single-family construction permits are up 28.8% for the state. The majority of impact is going to be from investors. They are going to leave the market for one of two reasons. Either interest rates go up enough that it is no longer an economically feasible proposition to invest in real estate, or they get a better deal somewhere else. Mortgage rates are probably not going to go up enough to force people who actually want to live in the houses out of the market. It is enough to force investors out of the market. He said he couldn’t give exact numbers on how much of the market is made up of investors. It is significant, but where investors are even more significant is they are driving up a lot of the housing appreciation. Investors are bidding up the housing prices. One of the risk points for the revenue maybe some fallback in construction. Maybe 3% to 5% down. Personal income growth is good.

The meeting adjourned at 11:04 a.m.

__________________________
Cheryl Kestner, Secretary

__________________________
Tim Everill, Revenue Section Chief

NOTE: A full tape recording of this meeting is on file in the JLB Staff office at 1716 West Adams.
Finance Advisory Committee

December 14, 2004

JLBC
FY 2005 Revenue Collections
Strong Year-to-Date Performance

• Through October, revenue collections are $140 million over the budgeted forecast.
• Collections for the first 4 months are over 15% above last year.
• Preliminary November numbers show trend continuing.
• Big 3 categories all show strong increases.
FAC Forecast is a Component of JLBC Staff’s “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

In FY 04, these 3 revenues grew by 10.4%. The UofA base model, which forecasted 7.8% growth, came closest to predicting actual growth. FAC panel forecast of 7.3% was slightly lower.
Sales Tax Growth Rate
Gained Momentum in Recent Months
FAC Panel Below YTD Collections

FY 2004 Actual = $3.3 Billion
Sales Tax Collections are Robust In Most Categories

FY 2005 YTD Growth
Sales Tax Questions for the FAC Panel

• How long will the contracting boom continue?
• What are your expectations for the current holiday buying season relative to recent years?
• Will inflation or the decline of the dollar’s value in foreign exchange markets lead to higher long-term interest rates?
• What is your outlook for Arizona’s tourism industry?
Individual Income Tax Growth Rate
Continued Strong Collections
FAC Panel Slightly Below YTD Collections

FY 2004 Actual = $2.3 Billion
Performance of Categories Other Than Withholding Is Critical to the Forecast

- Estimated Payments – 3 out of 4 quarterly payments remain to be collected this fiscal year.
- Estimated Payments – Primarily based on non-wage earnings and is therefore a volatile revenue source.
- Final Payments and Refunds – 90% of these individual income tax components determined in the next 7 months.
Corporate Income Tax Growth Rate Continues to Accelerate
FAC Panel Sees Slowdown of Growth Rate by Year-End

FY 2004 Actual = $0.5 Billion
Corporate Income Tax Collections

* Includes 5 months actual collections and estimate for December.
** Based on FAC panel consensus forecast.
Critical Issues for Corporate Income Tax Revenue

• While corporate collections are growing rapidly, tax refunds are running far below the levels reported in recent years.

• Many large corporations have warned the financial markets that profits may fall short of expectations in the months ahead. After rising by an estimated 15.0% in 2004, the U.S. Blue Chip forecast panel predicts corporate profits will increase by 9.7% in 2005.
FY 2005 Growth Rates

FAC Panel – December Consensus More Optimistic Than September

Sales Tax: 7.9% (September), 8.2% (December)
Individual Income Tax: 8.2% (September), 10.1% (December)
Corporate Income Tax: 12.8% (September), 19.7% (December)
The Slippery Slope Upward

Elliott D. Pollack & Company

FAC
December 14th, 2004
Warning: Economic Forecast

DANGER AHEAD
FASTEN SAFETY BELTS
AND REMOVE DENTURES

GEVAAR VOOR
MAAK GORDELS VAS
EN VERWYDER KUNSTANDE
U. S Economy:
Is the Glass Half Full?

- Solid GDP Growth
- Low inflation rates
- Low Unemployment
- Stock Market?
- Business Spending & Hiring?
United States Real Gross Domestic Product*
Annual Growth 1970 - 2005**
Source: U.S. Bureau of Economic Analysis & Blue Chip Economic Indicators

* Based on chained 2000 dollars.

** 2004 - 2005 are forecasts from the Blue Chip Economic Indicators, Dec 2004

Recession Periods
## Gross Domestic Product

<table>
<thead>
<tr>
<th>Month</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>April</td>
<td>4.6%</td>
<td>3.8%</td>
</tr>
<tr>
<td>May</td>
<td>4.6%</td>
<td>3.8%</td>
</tr>
<tr>
<td>June</td>
<td>4.7%</td>
<td>3.7%</td>
</tr>
<tr>
<td>July</td>
<td>4.5%</td>
<td>3.8%</td>
</tr>
<tr>
<td>August</td>
<td>4.4%</td>
<td>3.7%</td>
</tr>
<tr>
<td>September</td>
<td>4.3%</td>
<td>3.6%</td>
</tr>
<tr>
<td>October</td>
<td>4.4%</td>
<td>3.5%</td>
</tr>
<tr>
<td>November</td>
<td>4.4%</td>
<td>3.5%</td>
</tr>
<tr>
<td>December</td>
<td>4.4%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>
The economy is still strong.
Any slowdown is likely to be transitory
Oil Prices
1972 – 2004*
Source: Federal Reserve Board of St. Louis

Data through December 10, 2004
IMPACTS

➢ Cuts into consumer spending.

➢ Squeezes corporate profits and leads to less hiring and spending.

➢ Price effects ➔ CPI ➔ Bond prices
IMPACT ON JOBS

Because labor is a major variable cost, higher energy outlays add more pressure to control labor costs.
So far, little price or bond effect.
U.S. Motor Gasoline Prices
1993 – 2004*
Source: Energy Information Administration

* Data through December 6, 2004.
Future of oil prices is uncertain.
But shocks could occur that would make the expansion bumpy.
Consumer
Consumer Price Index
Percent Change Year Ago
1991 – 2004*
Source: Bureau of Labor Statistics

• Three-month moving average. Data through October 2004.
U.S. Real Personal Income Percent Change Year Ago
1971 – 2004*
Source: Bureau of Economic Analysis

*Data through third quarter 2004
U.S. Real Retail Sales
1972 – 2004*

Source: Federal Reserve Board of St. Louis

* Data through October 2004.

Recession Periods
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 second quarter 2004.
U.S. Personal Savings Rate
1959 – 2004*
Source: U.S. Bureau of Economic Analysis

*Data through October 2004

Recession Periods
Bear Markets
Ranking of Peak to Trough Declines
S&P Composite Stock Price Index

<table>
<thead>
<tr>
<th>Year</th>
<th>Peak to Trough Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-02</td>
<td>48.7%</td>
</tr>
<tr>
<td>1973-74</td>
<td>48.2%</td>
</tr>
<tr>
<td>1968-70</td>
<td>36.1%</td>
</tr>
<tr>
<td>1987</td>
<td>33.5%</td>
</tr>
<tr>
<td>1980-82</td>
<td>27.1%</td>
</tr>
<tr>
<td>1976-78</td>
<td>19.4%</td>
</tr>
<tr>
<td>1966</td>
<td>19.1%</td>
</tr>
<tr>
<td>1983-84</td>
<td>14.4%</td>
</tr>
<tr>
<td>1990</td>
<td>13.1%</td>
</tr>
<tr>
<td>1971</td>
<td>10.7%</td>
</tr>
</tbody>
</table>

Since the October 9th, 2002 trough, S&P has increased 53.2% through Dec. 6, 2004.
Mortgage Equity Withdrawal as a share of Disposable Income
U.S.: 1971 – 2004*

Source: Bureau of Economic Analysis

* Data through third quarter 2004
## Unemployment Rate

### Unemployment Rate 34 months Post Recession

<table>
<thead>
<tr>
<th>Recession</th>
<th>UER at End</th>
<th>UER 34 months post</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>8.5%</td>
<td>7.0%</td>
</tr>
<tr>
<td>1982</td>
<td>10.8%</td>
<td>7.1%</td>
</tr>
<tr>
<td>1991</td>
<td>6.8%</td>
<td>6.5%</td>
</tr>
<tr>
<td>2001</td>
<td>5.6%</td>
<td>5.4%</td>
</tr>
</tbody>
</table>
National Employment
(Net change in jobs over year ago)
January 2001 – November 2004
Source: U.S. Bureau of Labor Statistics
# Civilian Labor Force:
Population Entering and Exiting the Labor Force

<table>
<thead>
<tr>
<th>Year</th>
<th>20-24 years</th>
<th>60-64 years</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>17,202</td>
<td>8,676</td>
<td>8,826</td>
</tr>
<tr>
<td>1980</td>
<td>21,386</td>
<td>10,143</td>
<td>11,243</td>
</tr>
<tr>
<td>1990</td>
<td>19,132</td>
<td>10,619</td>
<td>8,513</td>
</tr>
<tr>
<td>2000</td>
<td>19,140</td>
<td>10,867</td>
<td>8,273</td>
</tr>
<tr>
<td>2005</td>
<td>20,963</td>
<td>13,153</td>
<td>7,810</td>
</tr>
<tr>
<td>2010</td>
<td>21,995</td>
<td>16,638</td>
<td>5,357</td>
</tr>
<tr>
<td>2015</td>
<td>22,615</td>
<td>18,958</td>
<td>3,657</td>
</tr>
<tr>
<td>2020</td>
<td>21,859</td>
<td>21,186</td>
<td>673</td>
</tr>
</tbody>
</table>

Source: U.S. Census Bureau & Arizona Department of Economic Security
Business

You’re Fired!
Entering portion of cycle where business spending will drive economy.
Businesses playing things close to the vest
Capacity Utilization Rate
1970 – 2004*
Source: The Conference Board

* Data through October 2004.
Total Plant Spending
Percent Change Year Ago
(Real Dollars)
1970 – 2004*

Source: Bureau of Economic Analysis

• Data through third quarter 2004.
• NOTE: Series was revised in March 2004. Data prior to 1990 was not provided.
Total Equipment & Software Spending
Percent Change Year Ago
(Real Dollars)
1970 – 2004*

Source: Bureau of Economic Analysis

-25%
-20%
-15%
-10%
-5%
0%
5%
10%
15%
20%
25%


-Data through third quarter 2004.
-NOTE: Series was revised in March 2004. Data prior to 1990 was not provided.

Y2K

Recession Periods
Corporate Profit
1975-2004*
(Billions of Dollars, SA)
Source: Freelunch.com

• Data through third quarter 2004
Commercial & Industrial Loans, U.S. Based Banks
1975-2004*
(Billions of Dollars, SA)
Source: Federal Reserve Economic Database

• Data through October 2004.

Recession Periods
10-Year Treasury Rate minus 3-month Treasury Rate
1976 – 2004*
Source: Federal Reserve Economic Database

Data through November 2004.
10-Year Treasury Rate v. 3-month Treasury Rate
1976 – 2004*
Source: Federal Reserve Economic Database

• Data through November 2004.
Lots of Stimulus
Federal Funds Rate
1961 – 2004*
Source: Federal Reserve

• Data through November 2004.

Recession Periods
M2 Stock – Seasonally Adjusted
Percent Change Year Ago
1970 – 2004*


* Data through October 2004.
Fiscal Stimulus

$140 billion in 2004

- $47 billion marginal tax rate
- $36 billion marriage-penalty relief
- $16 billion childcare credit
Deficit ?
U.S. Debt Held by Foreign & International Investors
1975-2004*
(Billions of Dollars, SA)
Source: Federal Reserve Economic Database

Data through third quarter 2004.
2005
Good times ahead?
Mostly.
U.S. OUTLOOK GOOD NEWS

- 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
- Tech changes will shortly be upon us
- Low interest rates
Economy will continue to expand.
Greenspan Prays For Job Growth

Keys To Sustained Economic Upturn

- Policy Works
- Business Investment
- Job Growth
- Consumer Confidence
- Stock Market
- No External Shocks

Greenspan Prays For Job Growth