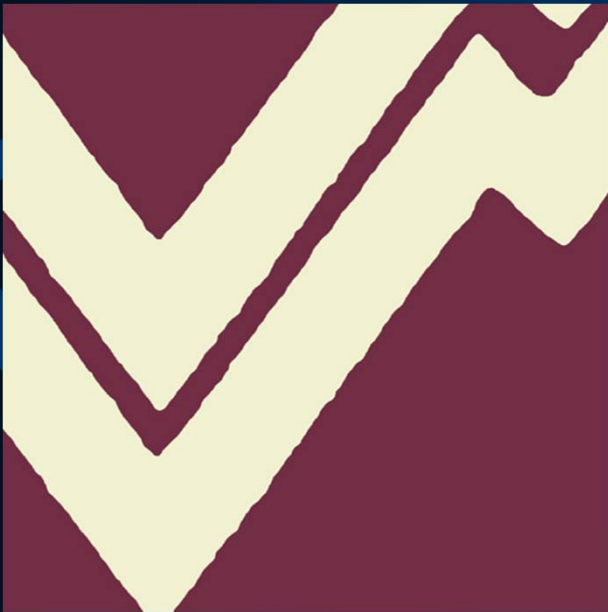


Economic and Revenue Review for the Vermont State Legislature

*Montpelier, Vermont
November 10, 2011*



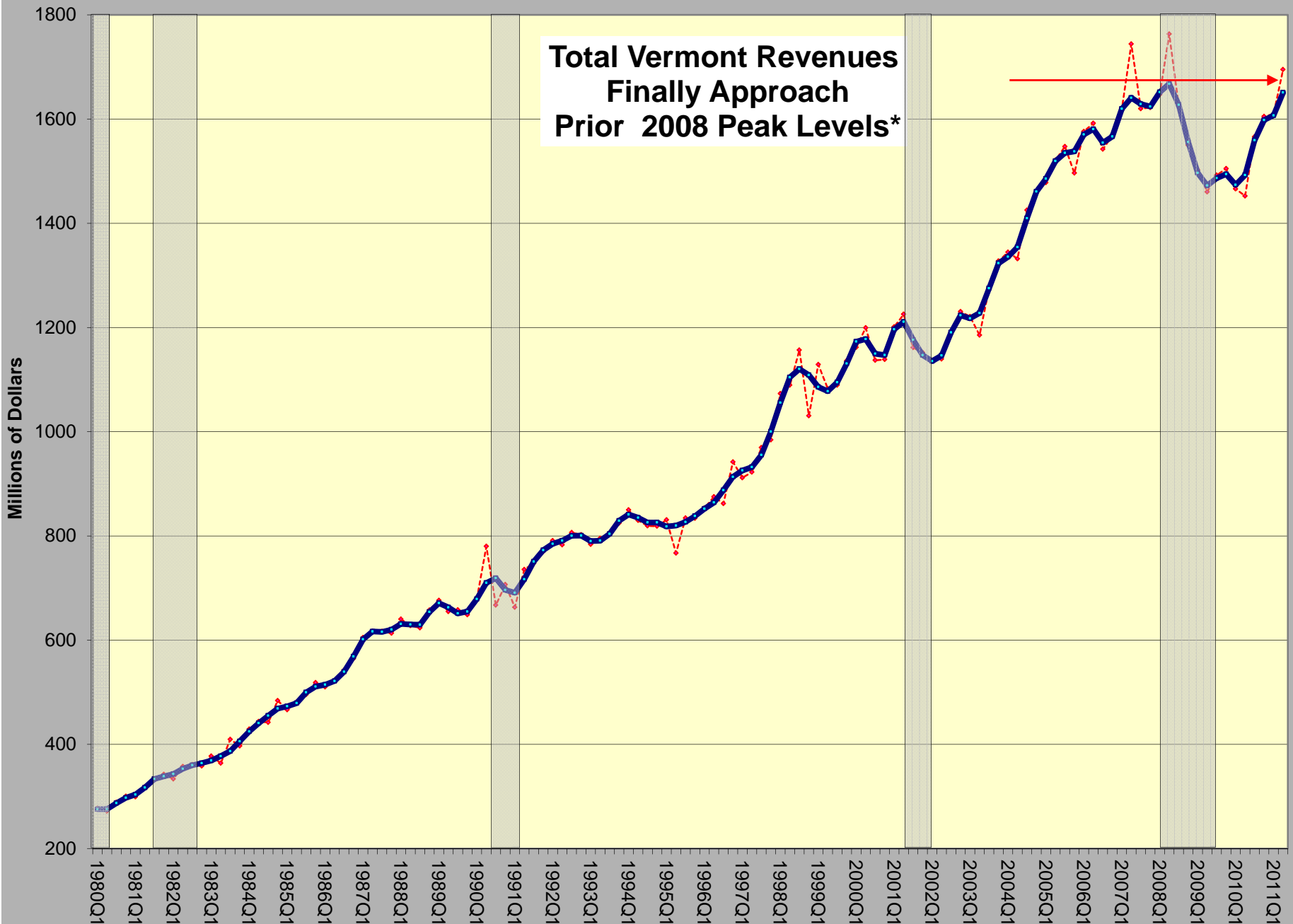
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- State Economist and Principal Economic Advisor to the Vermont State Legislature Since 1996
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Despite Multiple Headwinds, Vermont Revenues Remain Close to Target Through October

- Total Revenues (General, Transportation and derived Education Funds) are just over \$1M above target on a base of about \$520M - a variance of less than half of one percent (with an expected corporate income adjustment)
- Personal Income is up \$0.7M with \$196M collected through October
- Meals and Rooms revenues were up \$1.7M vs. targets (+4%), despite severe flooding damage and related business disruptions, although full Hurricane Irene impacts will not be known for another 2-3 months
- Slight weakness was evident in Motor Vehicle Purchase and Use (-\$1.1M), Property Transfer (-\$0.2M), Sales & Use (-\$0.6M) and Lottery (-\$0.4M) - consumption taxes bear close watching...

**Total Vermont Revenues
Finally Approach
Prior 2008 Peak Levels***

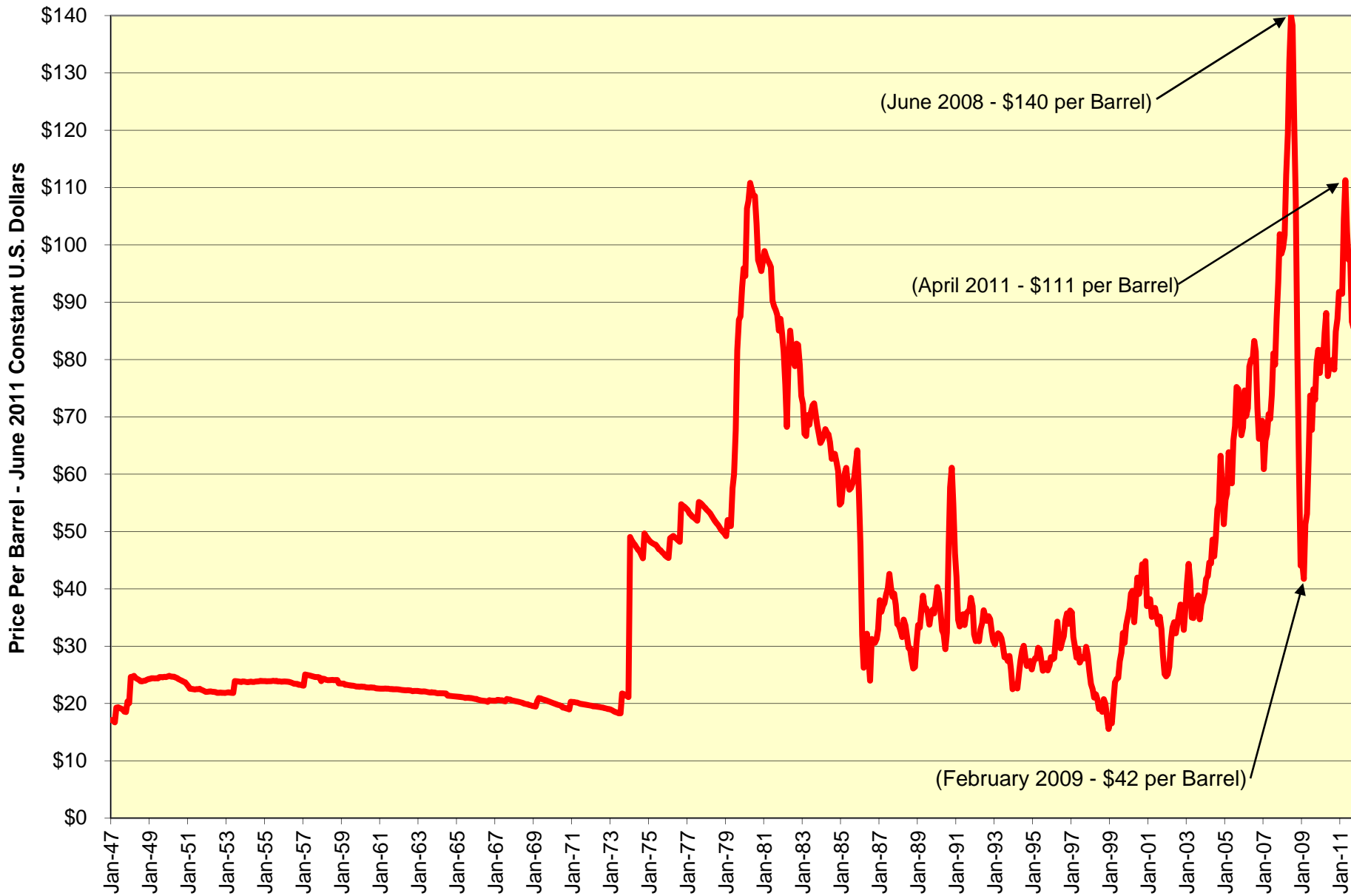


*Includes all Funds Except Education Fund Property Tax Revenues, Quarterly Seasonally Adjusted Annual Rates (red) and Trend-Cycle (blue) Data, With Official U.S. Recessionary Periods Shaded, Source: Vermont Joint Fiscal Office

External Economic Conditions, However, Continue to be Daunting

- Double Dip Recession risks are now close to 40% due to:
- Political and policy paralysis surrounding the European debt crisis
- Political and policy paralysis surrounding critical U.S. budget and fiscal issues
- Oil price hikes associated with the Arab Spring that have resulted in about \$125 billion in additional 2011 U.S. fuel costs (about the same as the entire payroll tax holiday)
- Receding federal fiscal stimulus and state and local spending cuts that have resulted in a net contractionary public sector fiscal policy
- The Japanese earthquake and tsunami in the spring of 2011 that negatively impacted domestic U.S. and global manufacturing activity
- Continued weakness in housing markets, as delayed foreclosures come to market and further depress prices

Real Oil Price Surge Tempers Economic Growth (West Texas Intermediate Crude Oil, PPB in September 2011 Constant Dollars)



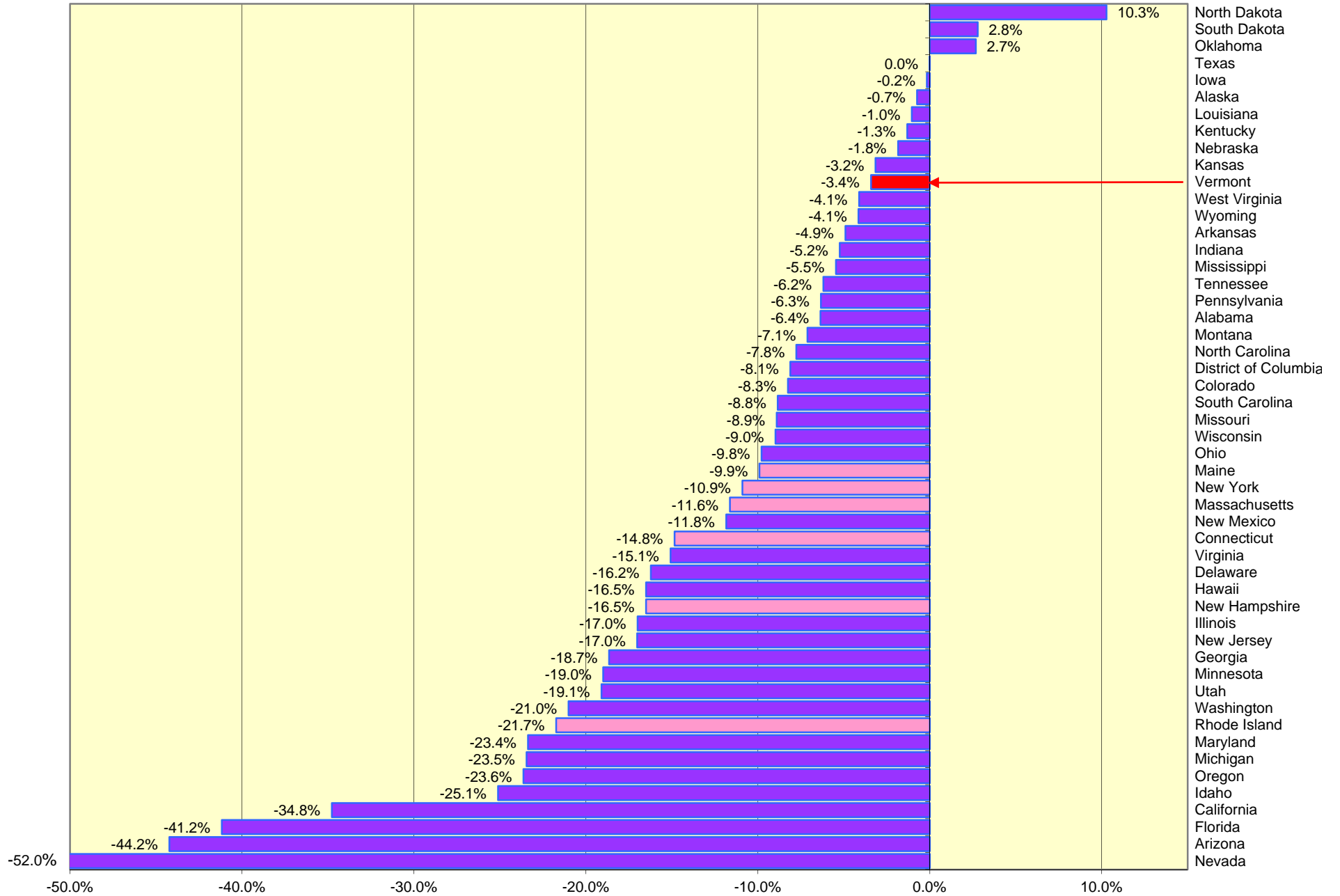
Sources: Wall Street Journal, Economy.com

Real Estate Markets Have Their Own Cycle and Will Not Fully Recover for Several Years

- Real estate markets are characterized by pronounced cyclicity and regional variation
- Housing price declines are slowing throughout the country and will probably end within 6-9 months in most states
- Renewed price appreciation, however, will be very slow for several years - depressing new construction and related industries
- Second-home prices have been and will be most vulnerable to decline
- The Vermont Property Tax base (Grand List) will not reach 2009 peak levels before 2016 (and not reach 2010 levels before 2015)

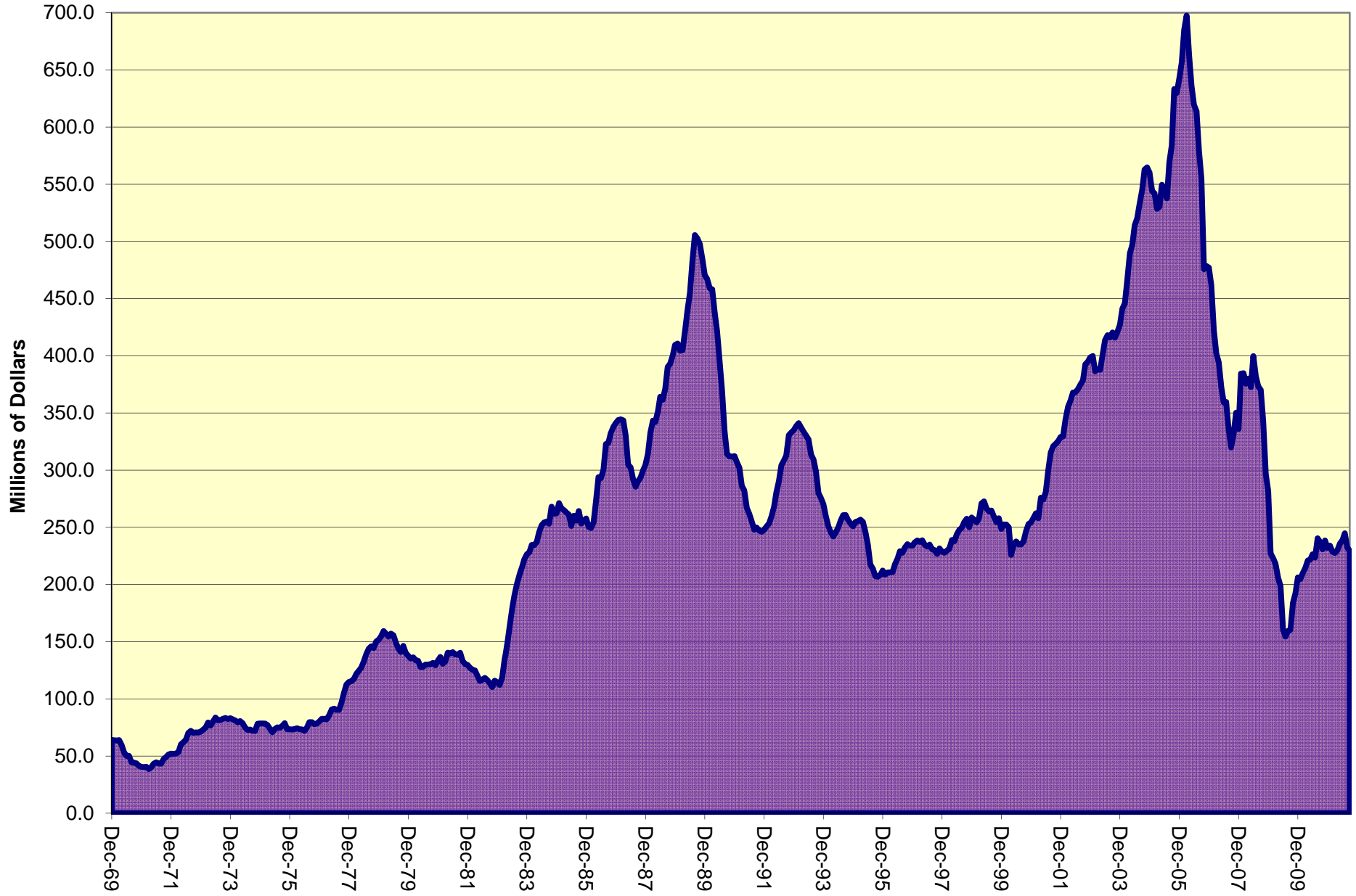
The Real Estate Market Crash: Wide Regional Variation

Percent Change, Second Quarter of 2011 vs. Second Quarter of 2007, Source: FHFA Home Price Index



Residential Construction in Vermont Struggles as Declining Prices Weigh on Markets

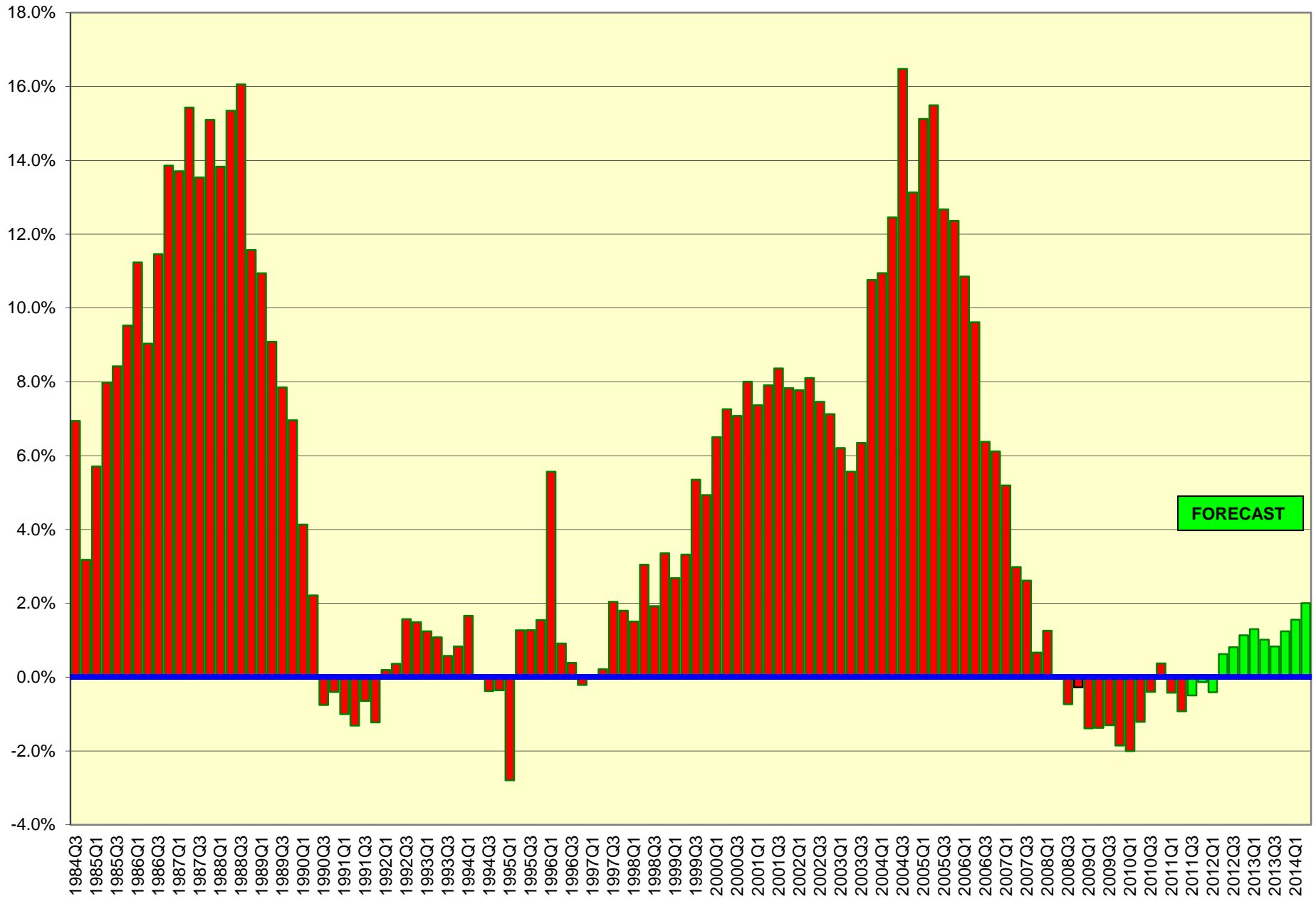
(Value of New Residential Construction Starts - 12 month moving total basis)



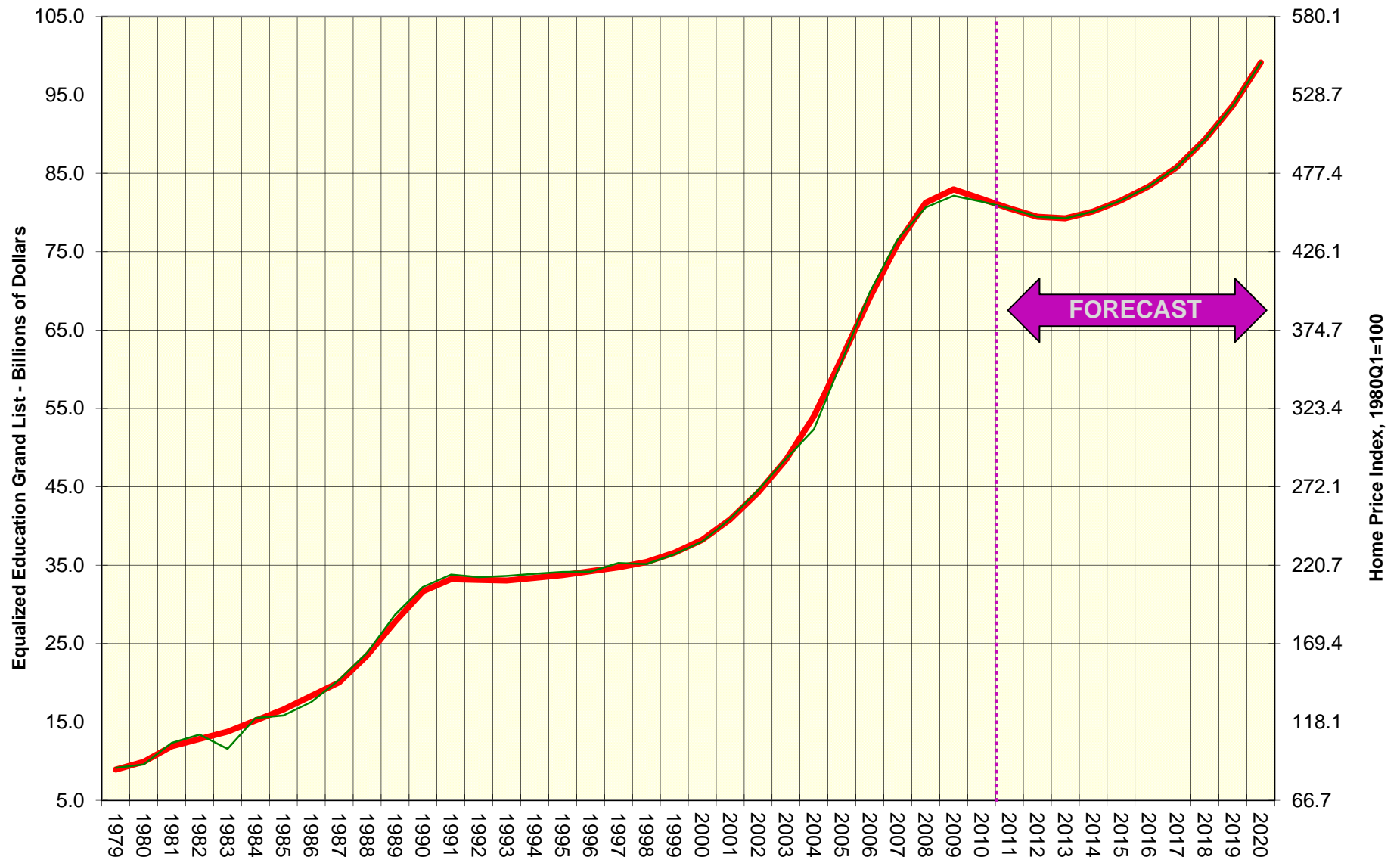
Source: F.W. Dodge/McGraw-Hill

Vermont Housing Price Declines Will End Soon, but E-Fund Tax Base Impacts will be Pronounced

(FHFA Vermont Housing Price Index Percent Change Vs. Year Ago)

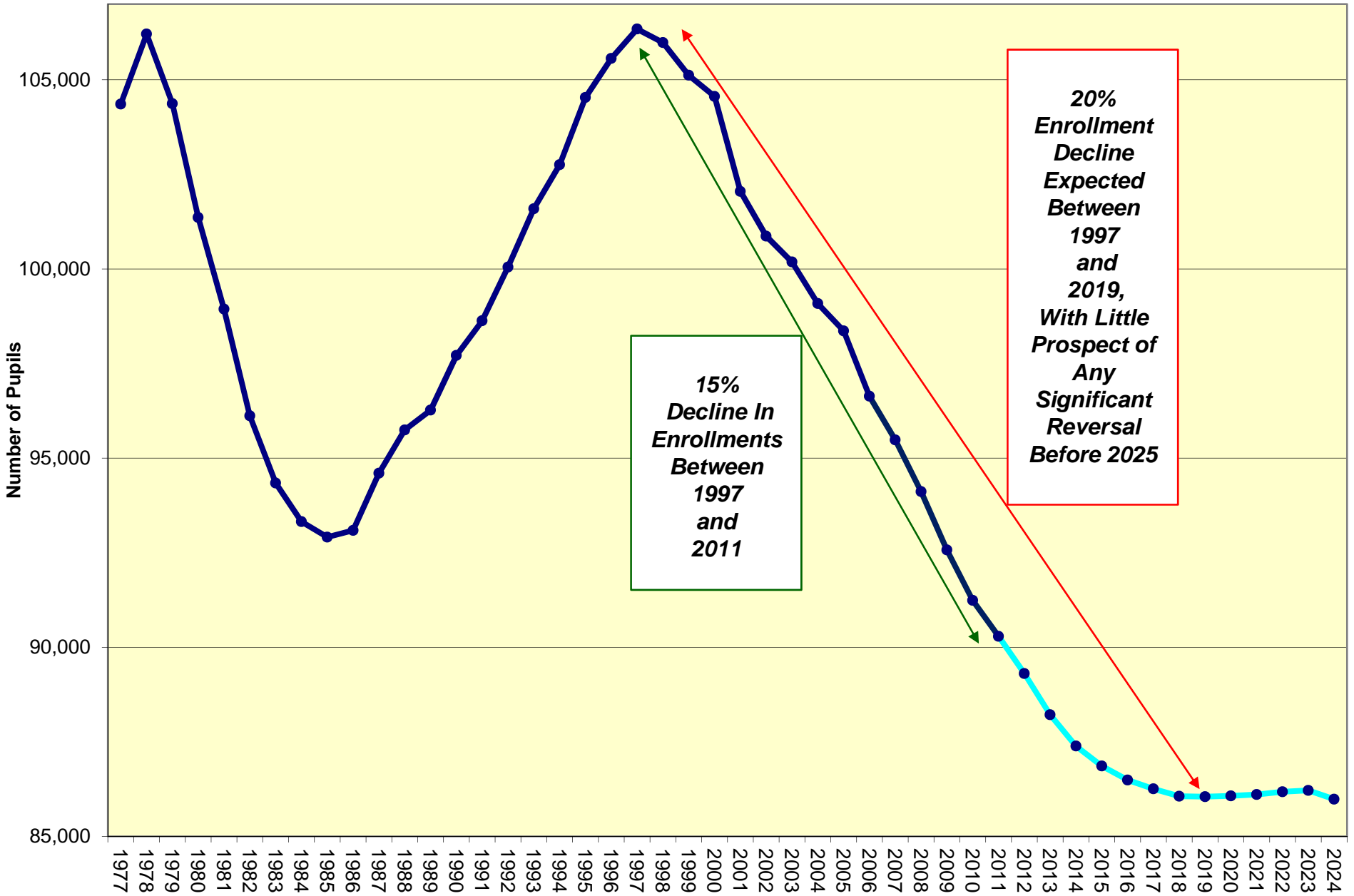


Vermont Adjusted Equalized Education Grand List (thick red line, left scale) Vs. FHFA Vermont Home Price Index, (Index 1980Q1 = 100) Lagged Five Quarters (thin green line, right scale)



Sources: Vermont PVR; U.S. FHFA; Prepared for the Joint Fiscal Office by Kavet, Rockler & Associates, October 2011

Vermont Public School Enrollment Declines Not Likely to be Reversed Soon...



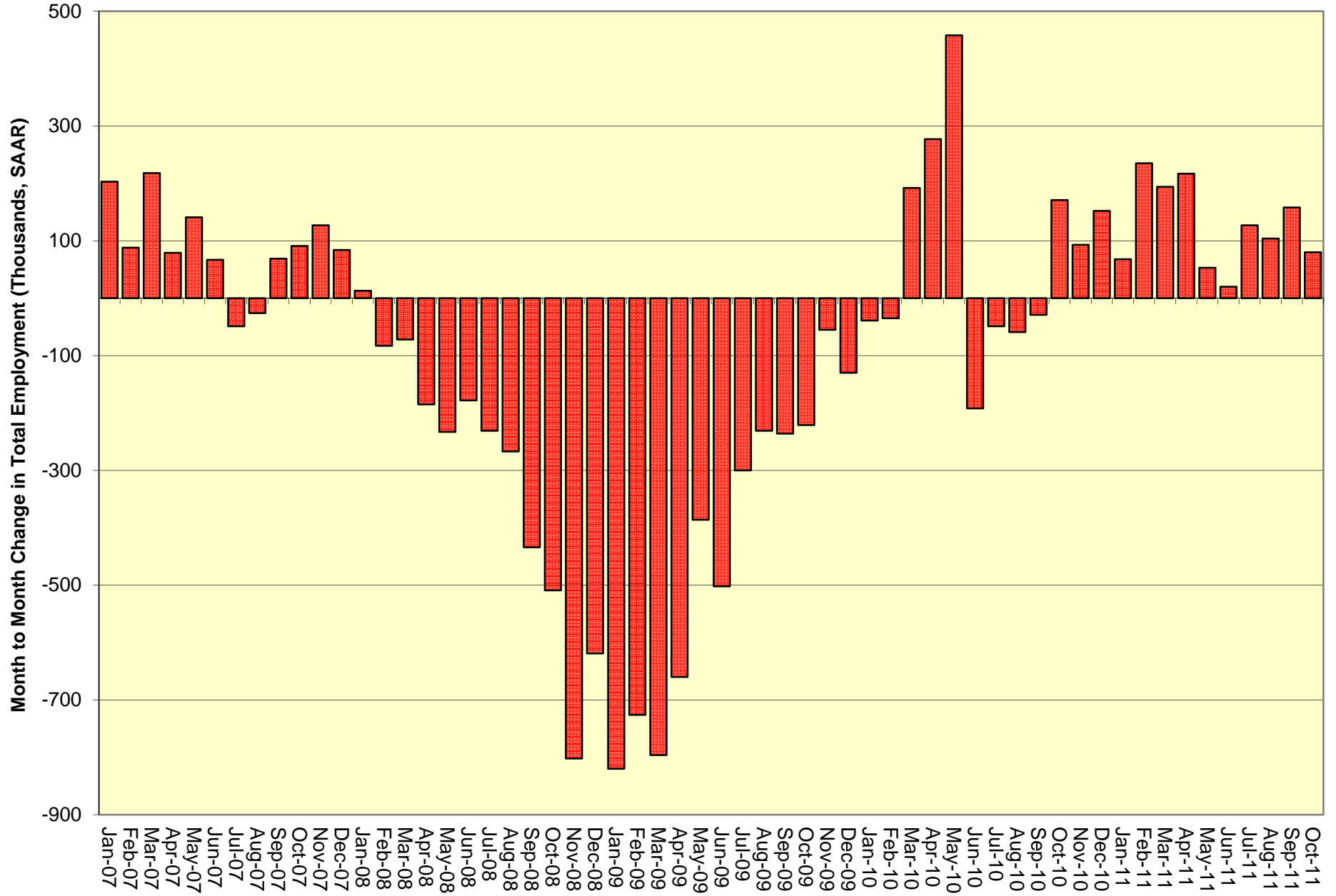
Sources: Vermont DOE and Consensus Administration and Joint Fiscal Office Projections - October 2011

Labor Markets Remain Exceptionally Weak

- Employment is still nearly 6.5M jobs below its prior peak, after losing 8.8M jobs between January 2008 and February 2010, regaining 2.3M
- Of the five most recent recessions, this downturn represents the most severe employment decline and slowest recovery of any
- More comprehensive unemployment measures (such as U6) that include underemployed and discouraged workers is 16.2% (October 2011) in U.S. vs. more commonly cited 9.0% (October 2011, U3) measure
- The average unemployment tenure reached all-time record level in September at 40.5 weeks
- High unemployment has depressed real wages and household income, which has limited consumer spending and associated demand

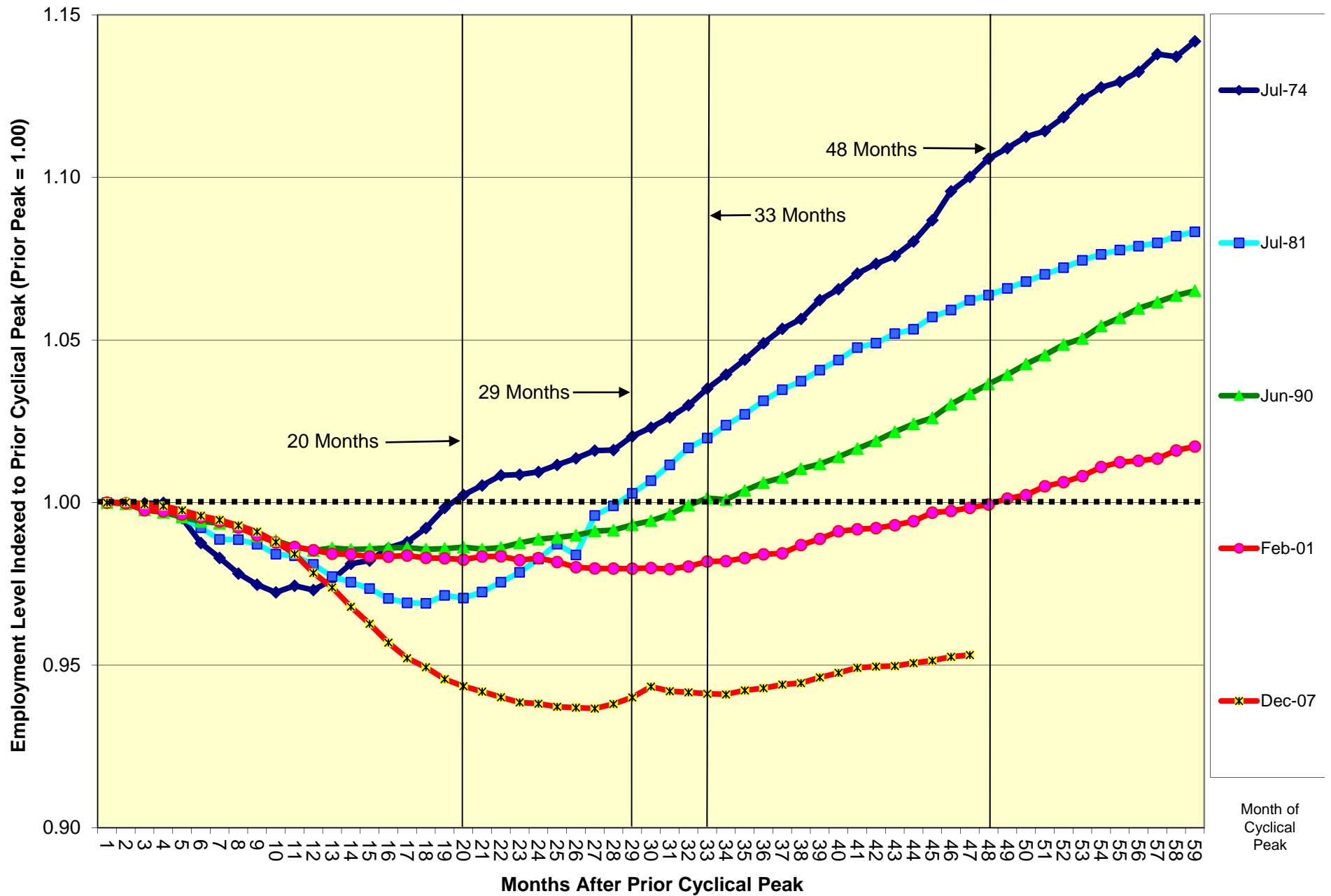
U.S. Job Growth Stalls in the Face of Higher Oil Prices and Receding Stimulus

(Monthly Change in Total Payroll Employment, Seasonally-Adjusted, Source: U.S. Bureau of Labor Statistics)



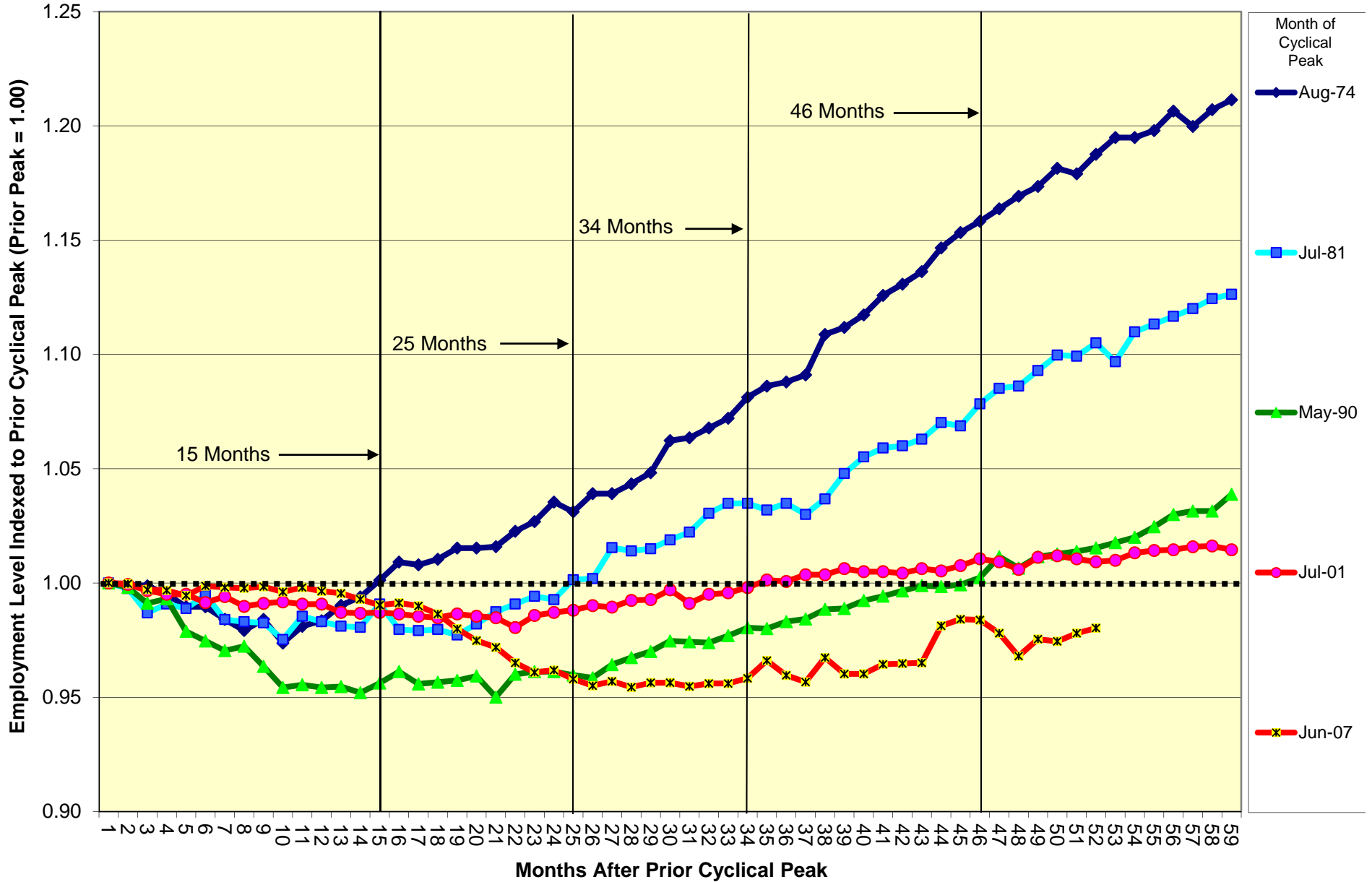
A Tale of Five U.S. Employment Cycles - Revisited

(Total U.S. Nonagricultural Employment Relative to Prior Cyclical Peak, Source: US Bureau of Labor Statistics)



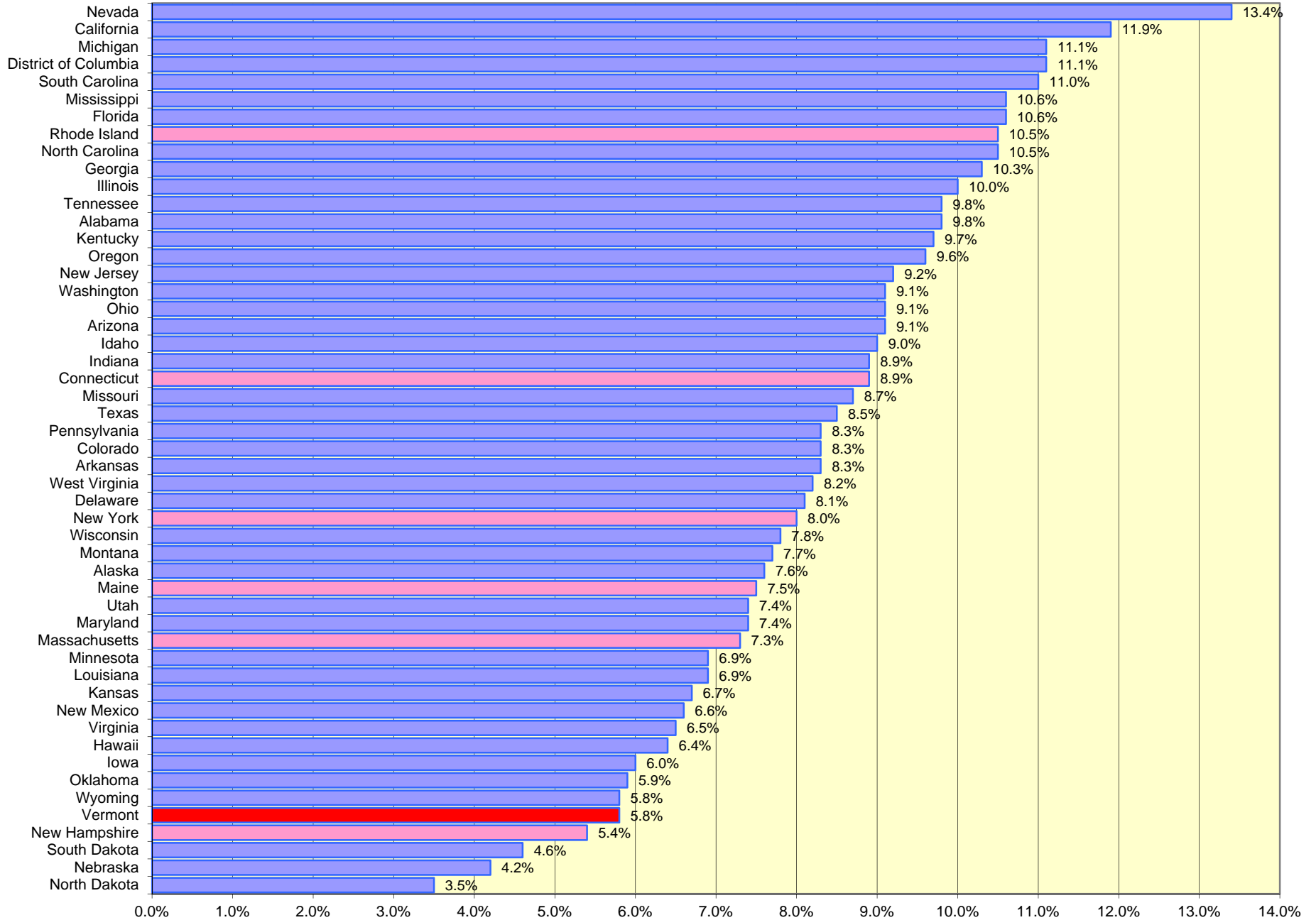
A Tale of Five Employment Cycles in Vermont - Revisited

(Total Vermont Nonagricultural Employment Relative to Prior Cyclical Peak, Source: US Bureau of Labor Statistics)



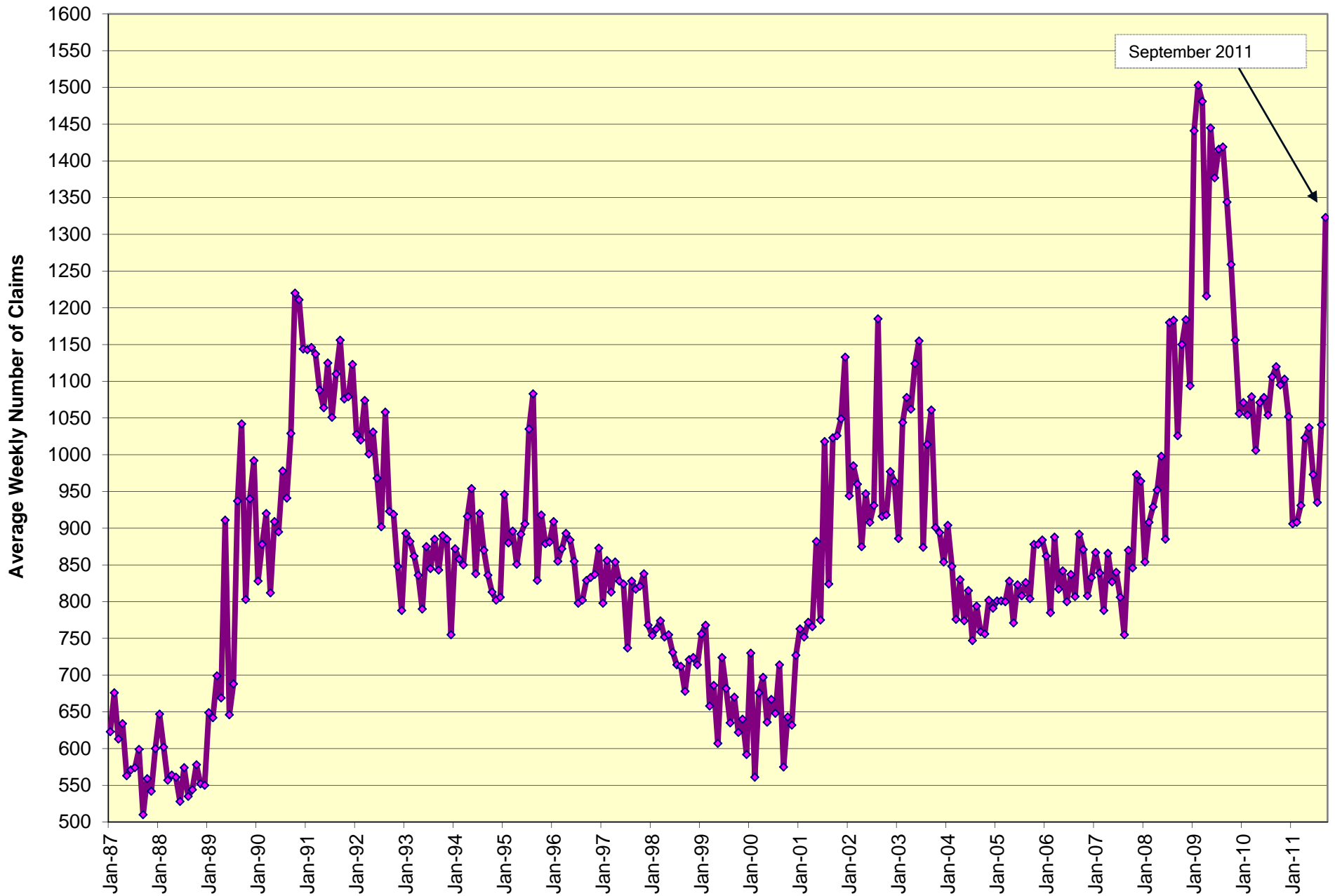
Unemployment Rate by State - September 2011

Seasonally Adjusted Data, Source: U.S. Bureau of Labor Statistics



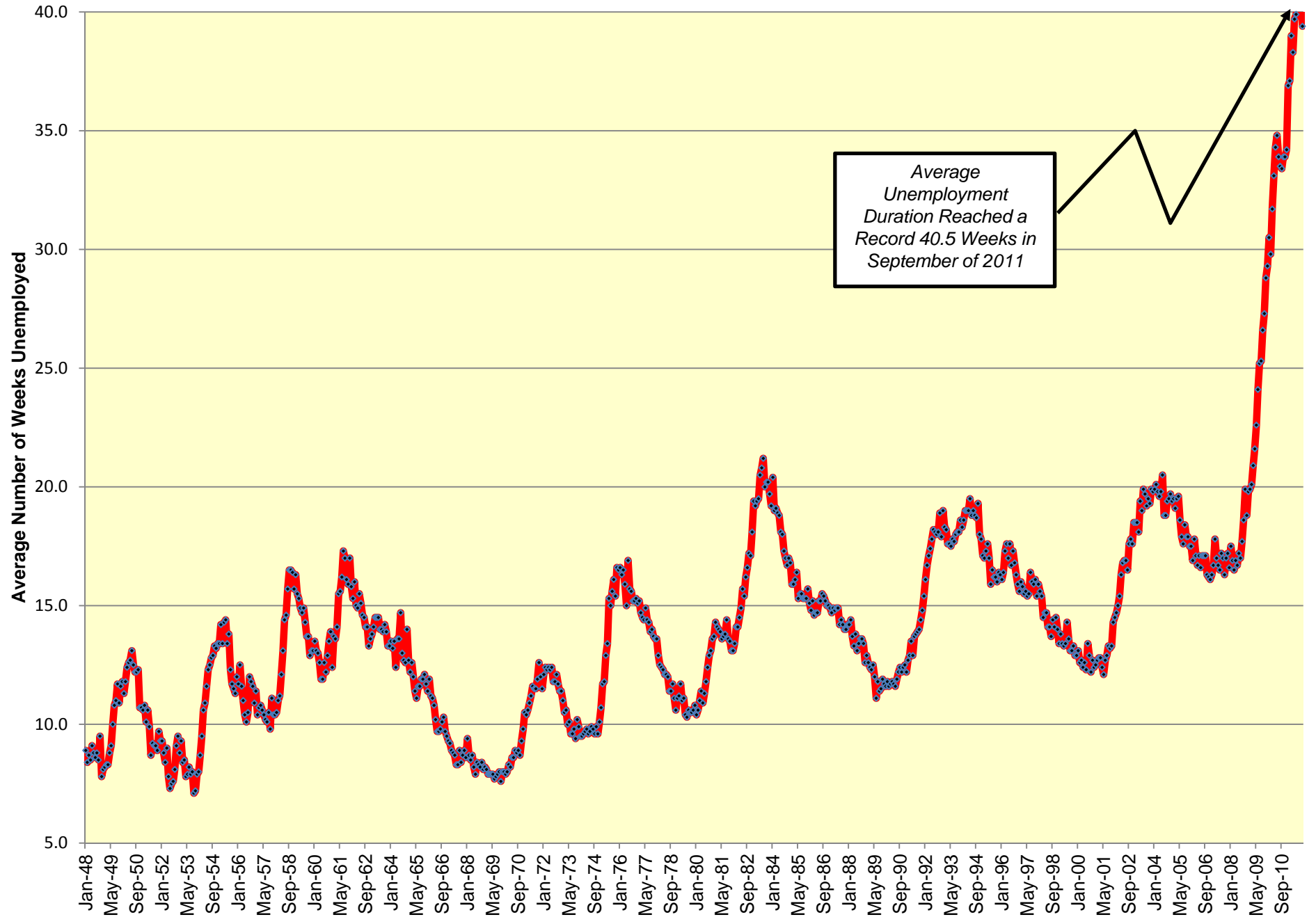
Hurricane Irene Floods Vermont UI Claims, As Labor Market Stress Persists

(Average Weekly Initial Claims for Unemployment in Vermont, Seasonally Adjusted, Source: BLS and Boston Fed)



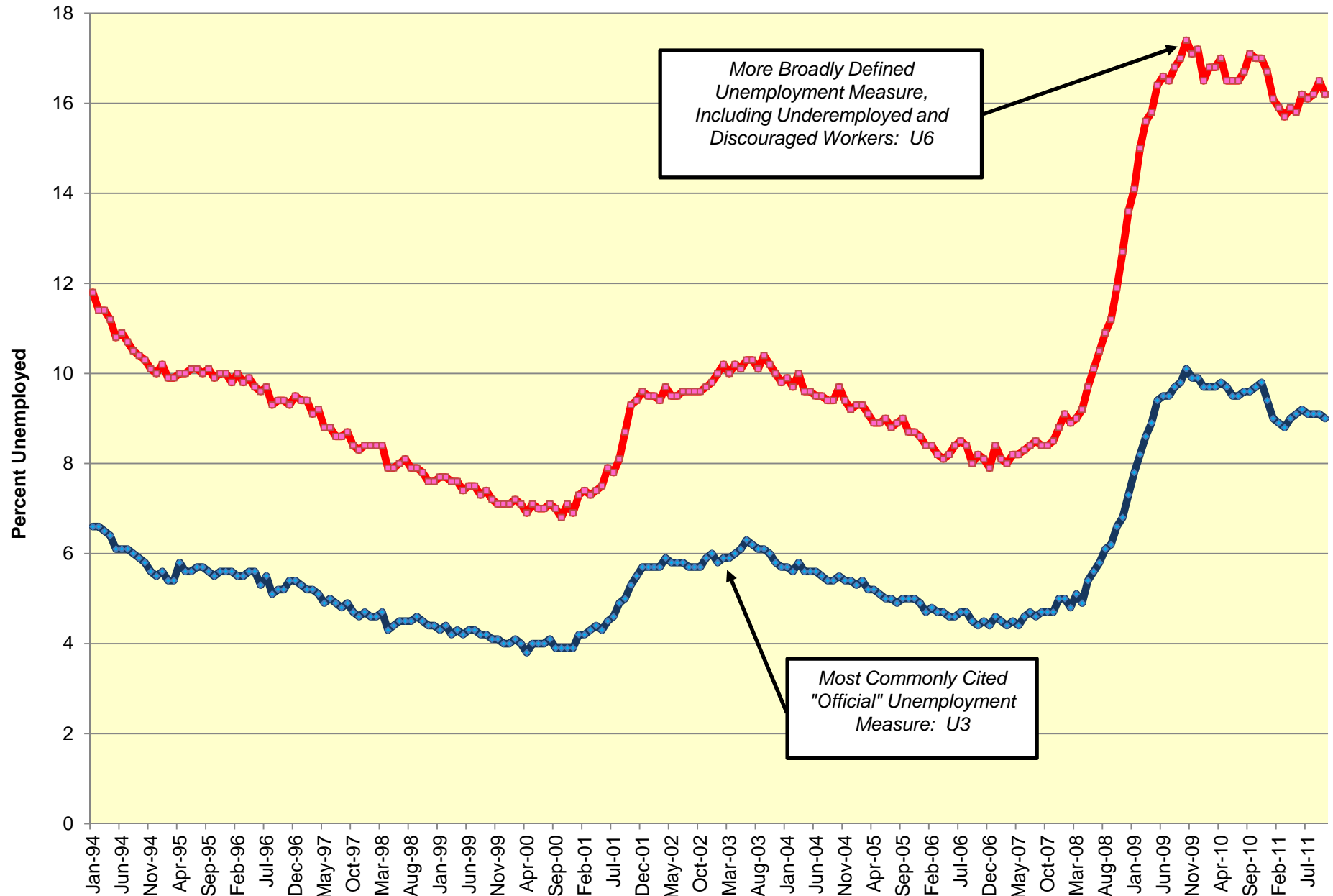
Bleak Prospects for the Unemployed as Time Off Work Reaches New Record Highs

Source: U.S. Bureau of Labor Statistics



More Inclusive U.S. Unemployment Measure Depicts Severe Labor Market Stress

Source: U.S. Bureau of Labor Statistics



*More Broadly Defined
Unemployment Measure,
Including Underemployed and
Discouraged Workers: U6*

*Most Commonly Cited
"Official" Unemployment
Measure: U3*

Economic Forum

WELL, THEY'RE NOT LAUGHING AT US NOW...

END IS NEAR



VOLCKER



P. KRUGMAN



C. LITTLE



GUY WITH SIGN

MIKELUCKOVICH 2009
ARTIST JOHN CONSTITUTIONS AR.COM

Safe Haven or Next Bubble? Global Financial Fears Send Gold Prices Soaring

(Monthly London PM Fix, U.S. Dollars Price Per Troy Ounce, Source: www.kitco.com)



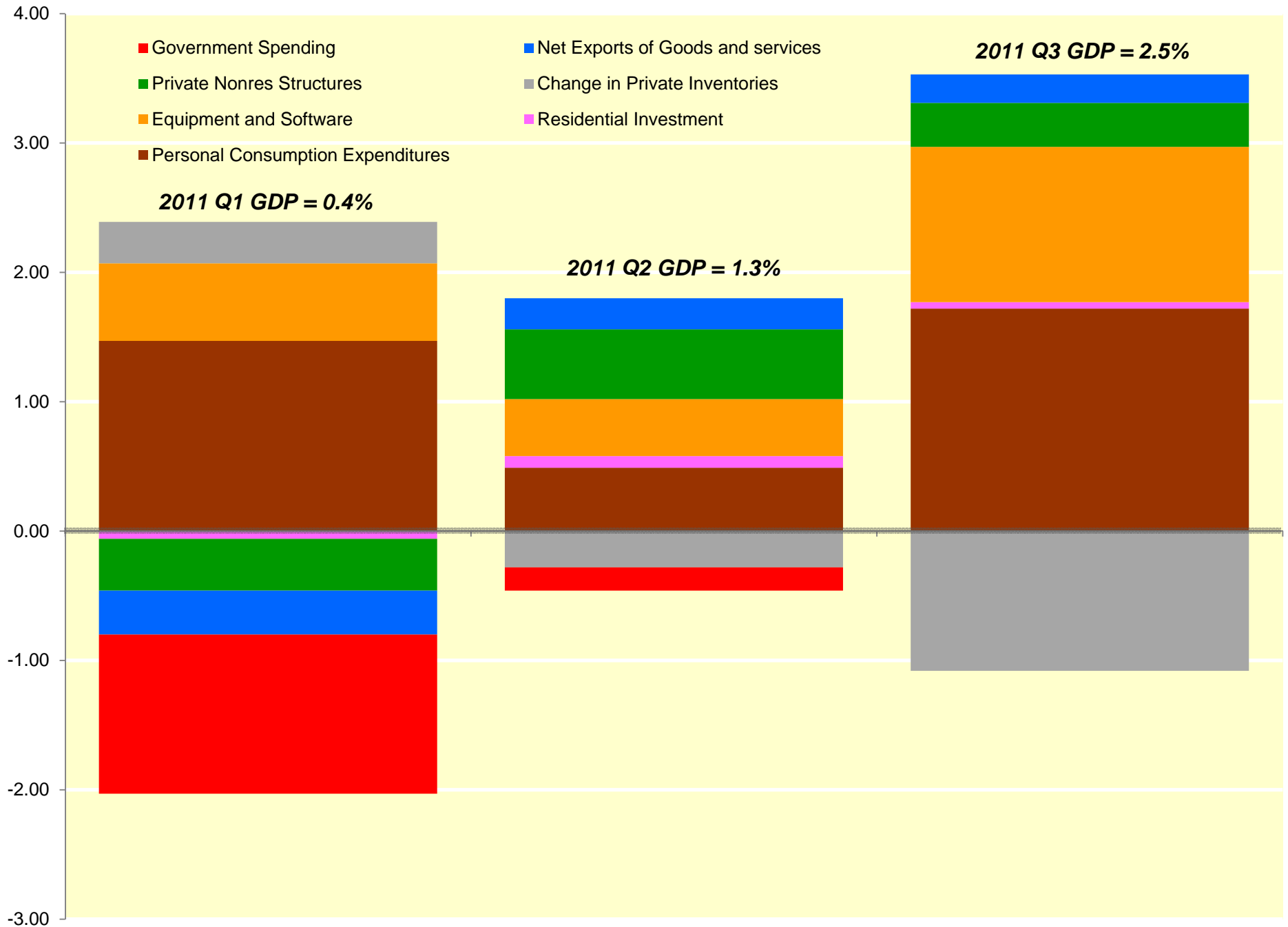
The Halting Economic Recovery Has Been Painfully Slow...



Are There Any Reasons for Optimism?

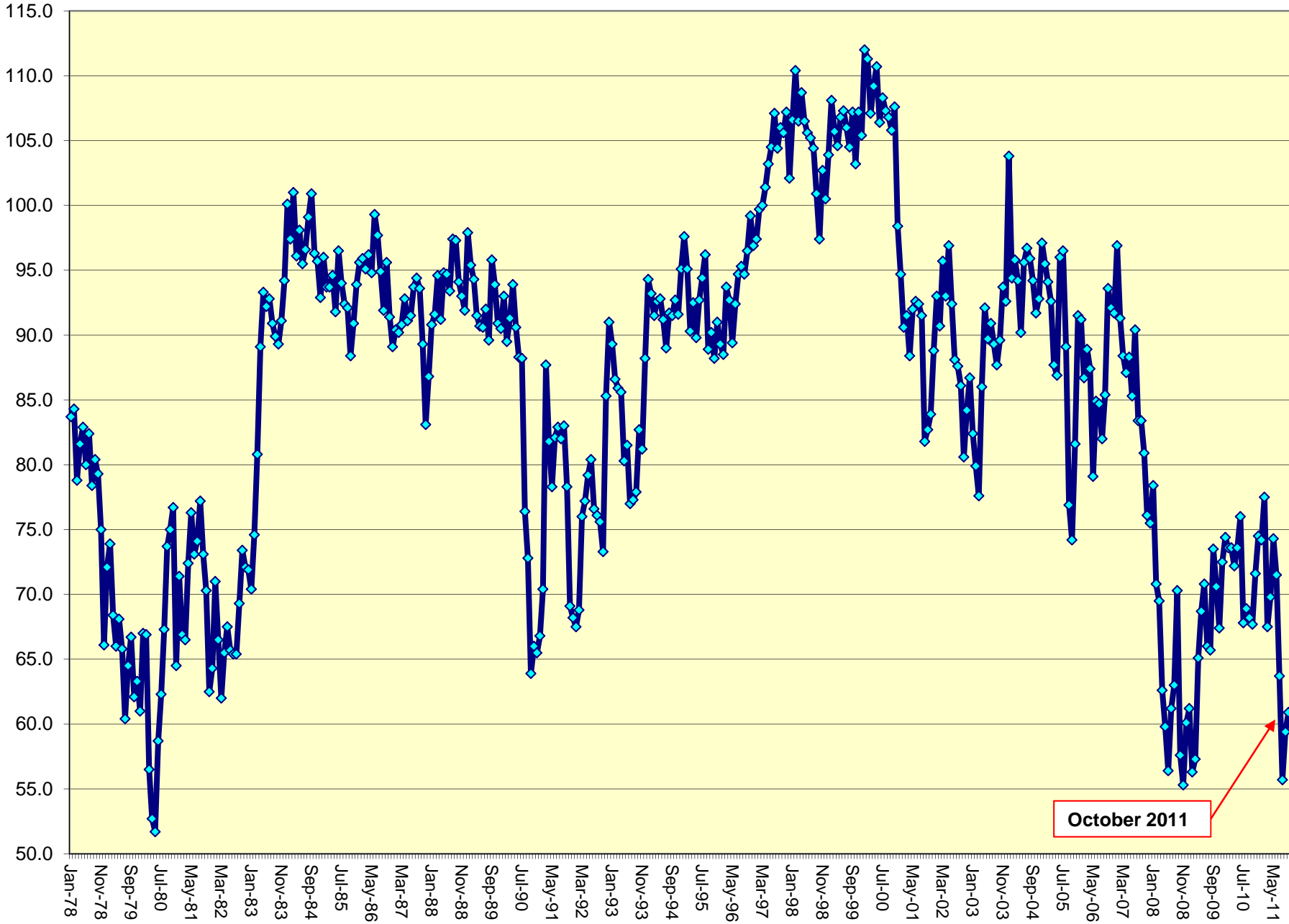
- Households have drastically reduced debt, with the portion of income devoted to debt servicing likely to reach a record low by early 2012. The delinquency rate for all debt besides first mortgages is lower than at the start of the recession and is still declining
- Corporate balance sheets are exceptionally strong, with record profits, productivity growth and margins. Corporate capital, especially for larger firms is plentiful and cheap. Debt refinancing has lowered costs and firms have ample capacity to hire if and when demand increases
- The U.S. banking sector is now generally well-capitalized and lending is picking up (albeit from very low levels), though standards remain stringent
- The weak U.S. dollar has pushed exports to record levels in virtually every region of the country. If/when foreign demand accelerates, the U.S. will benefit
- Public policy blunders aside, the U.S. is capable of near-term federal borrowing at very low interest rates and managing long term debt reduction without draconian spending cuts or massive tax increases if both are used
- The economy is cyclical, real estate is cyclical, equity markets are cyclical...

Contributions to Percent Change in Real GDP by Component Over Past 3 Quarters



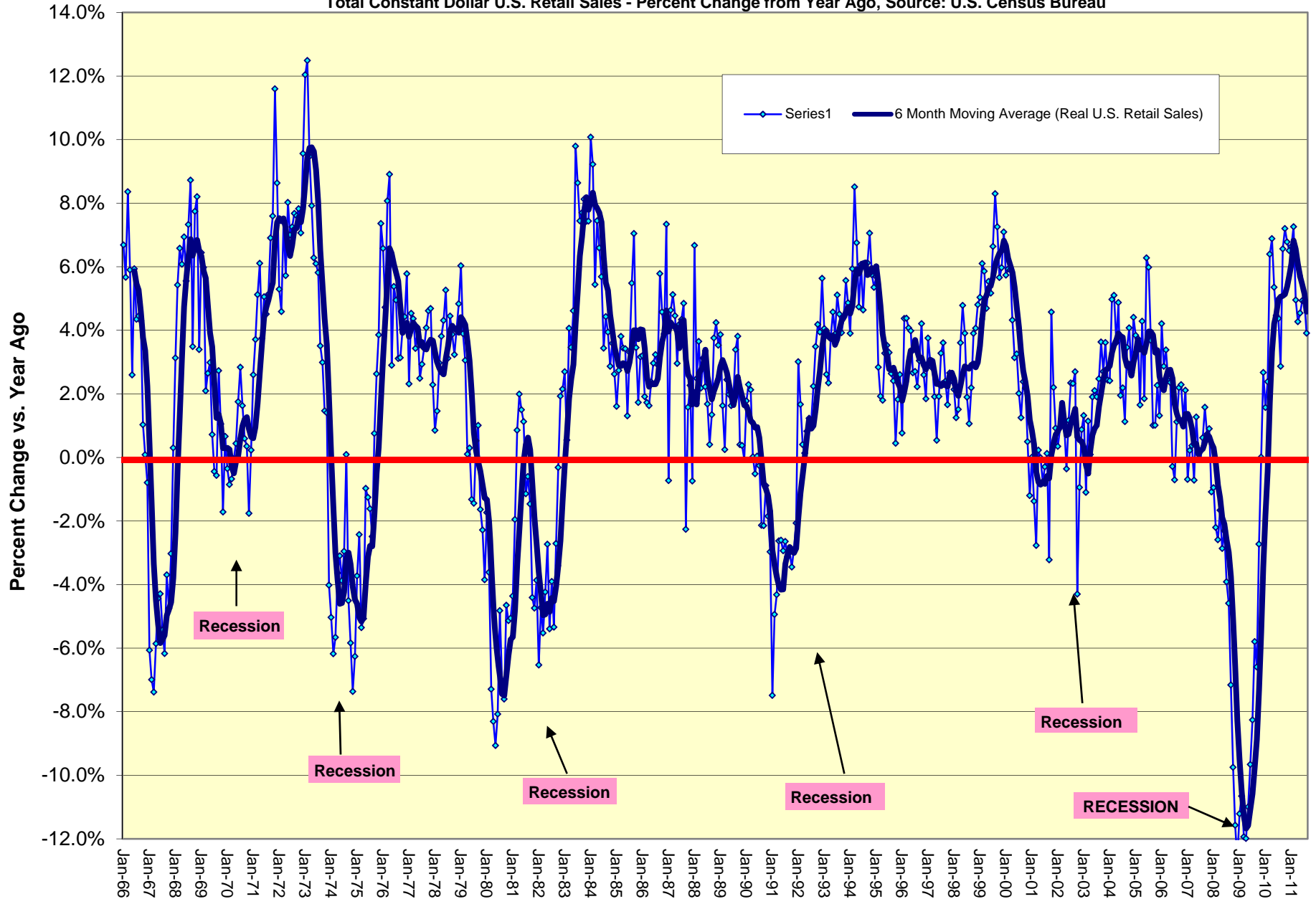
Consumer Sentiment Plunges, Underscoring Recession Risks...

(University of Michigan Consumer Sentiment Survey)



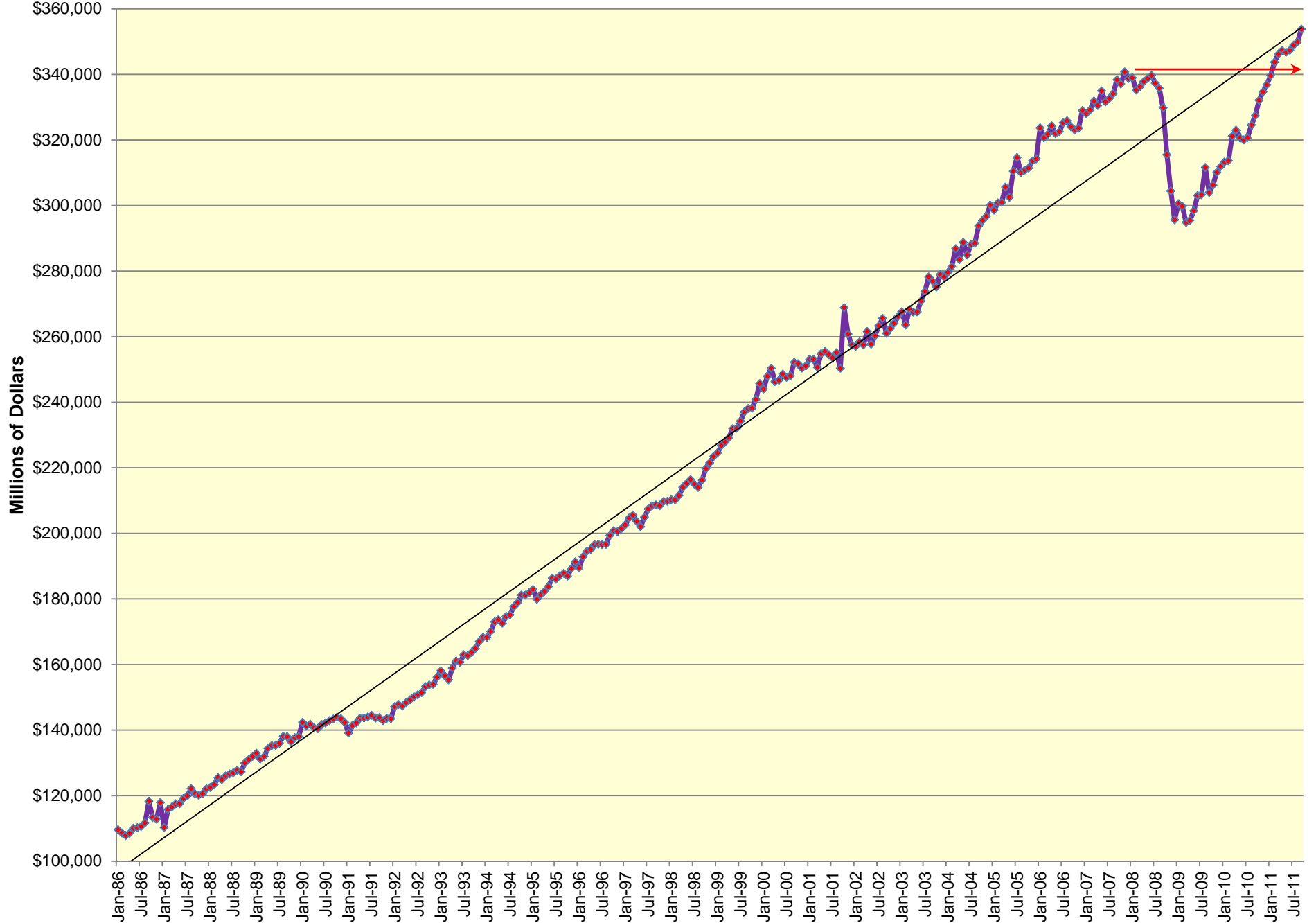
Consumer Spending Growth Slows, But Still Supports Economic Recovery

Total Constant Dollar U.S. Retail Sales - Percent Change from Year Ago, Source: U.S. Census Bureau



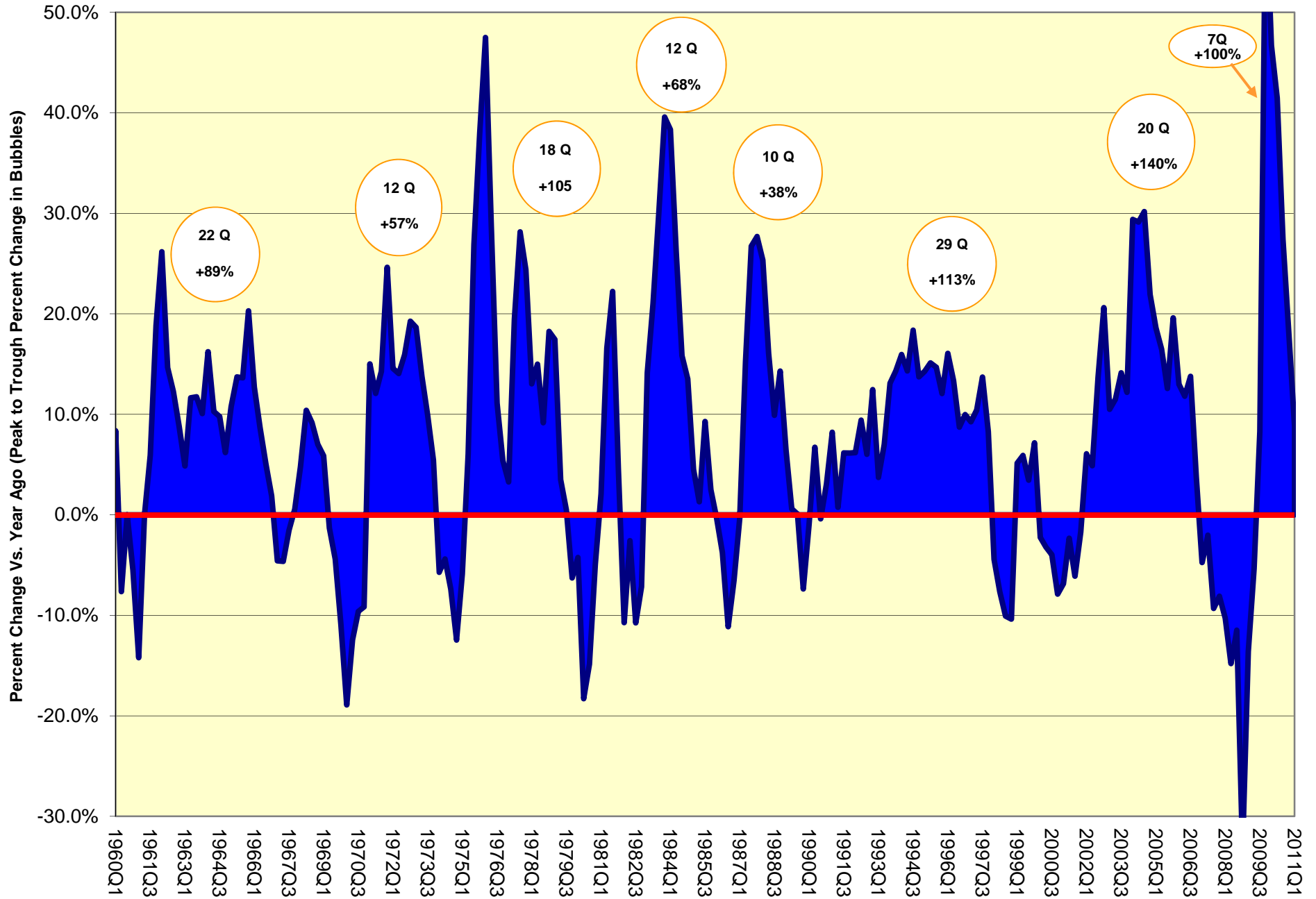
Consumers Spending Finally Surpasses November 2007 Peak Levels...

Total U.S. Retail Sales - Millions of Nominal Dollars, Seasonally Adjusted - Source: U.S. Census Bureau, with Trend Line



Corporate Profits Surge, With Commensurate Growth in Tax Revenues

(U.S. corporate profits with inventory valuation and capital consumption adjustment; Source: US BEA)



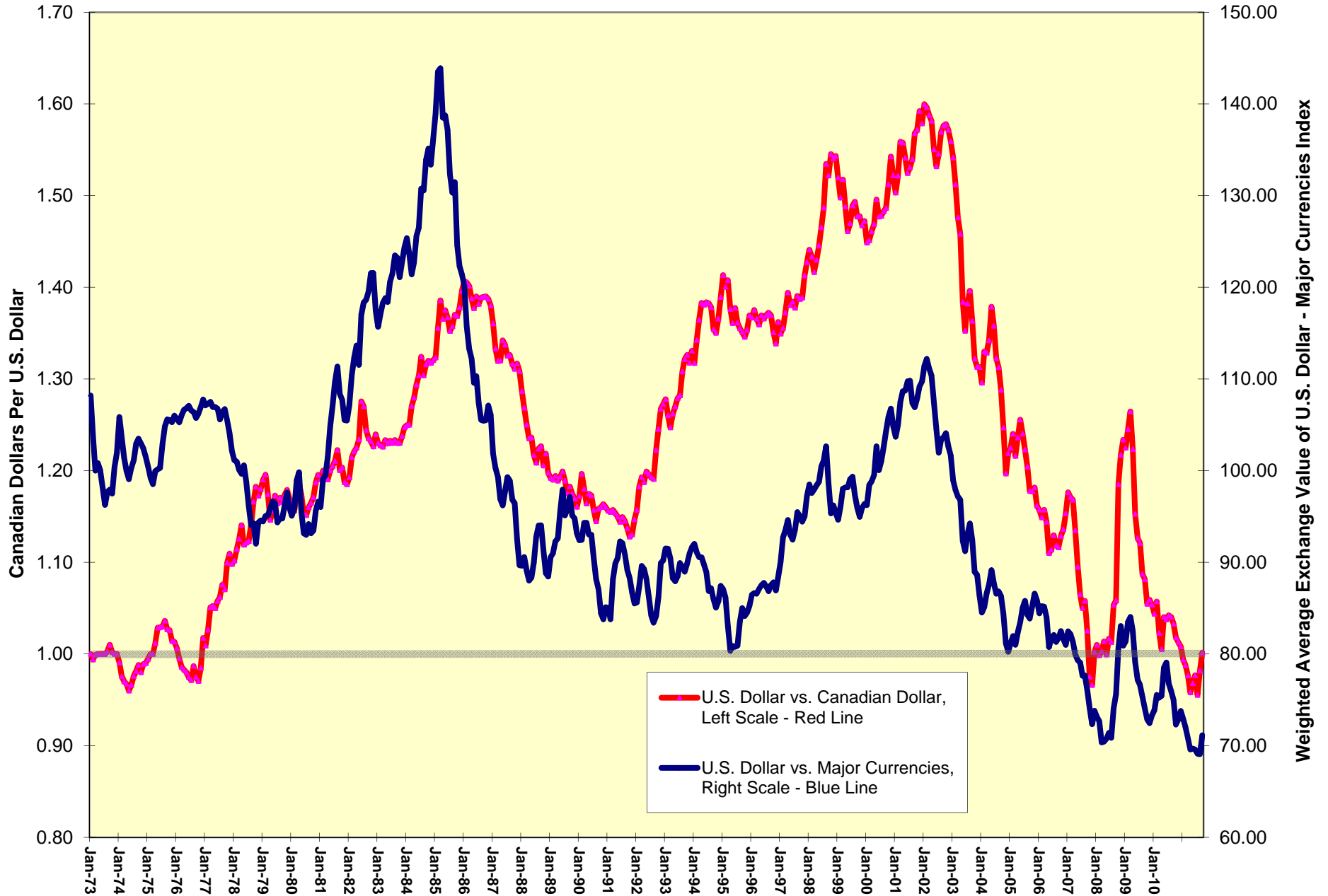
U.S. Stocks Recover, But Remain 20% Below Prior Peak Valuations

(S&P 500 Monthly Average, Source: Standard & Poor's, The McGraw-Hill Companies, Inc.)



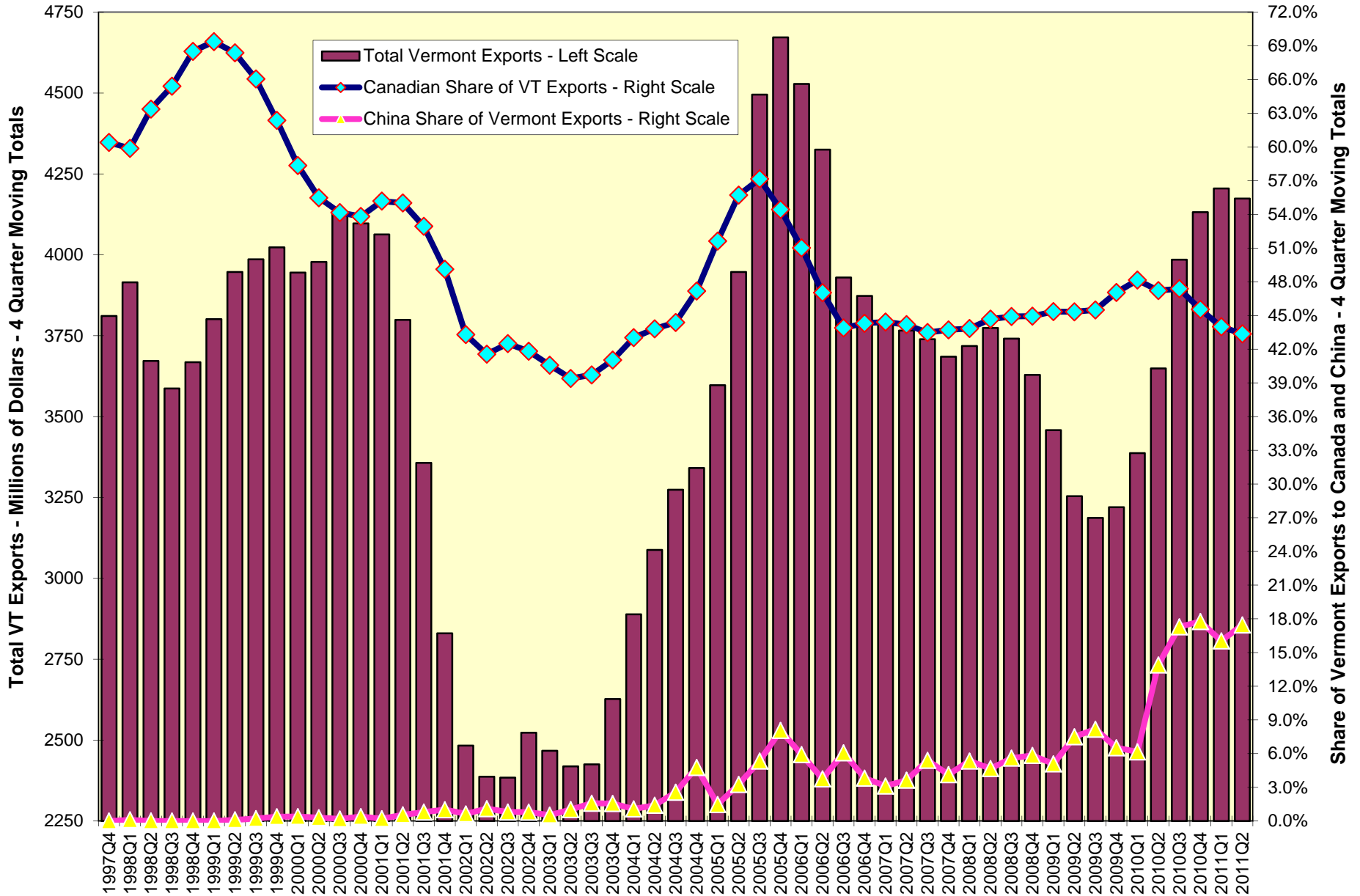
The U.S. Dollar Remains Near Historic Lows Against Most Major Currencies

(Source: U.S. Federal Reserve Board)



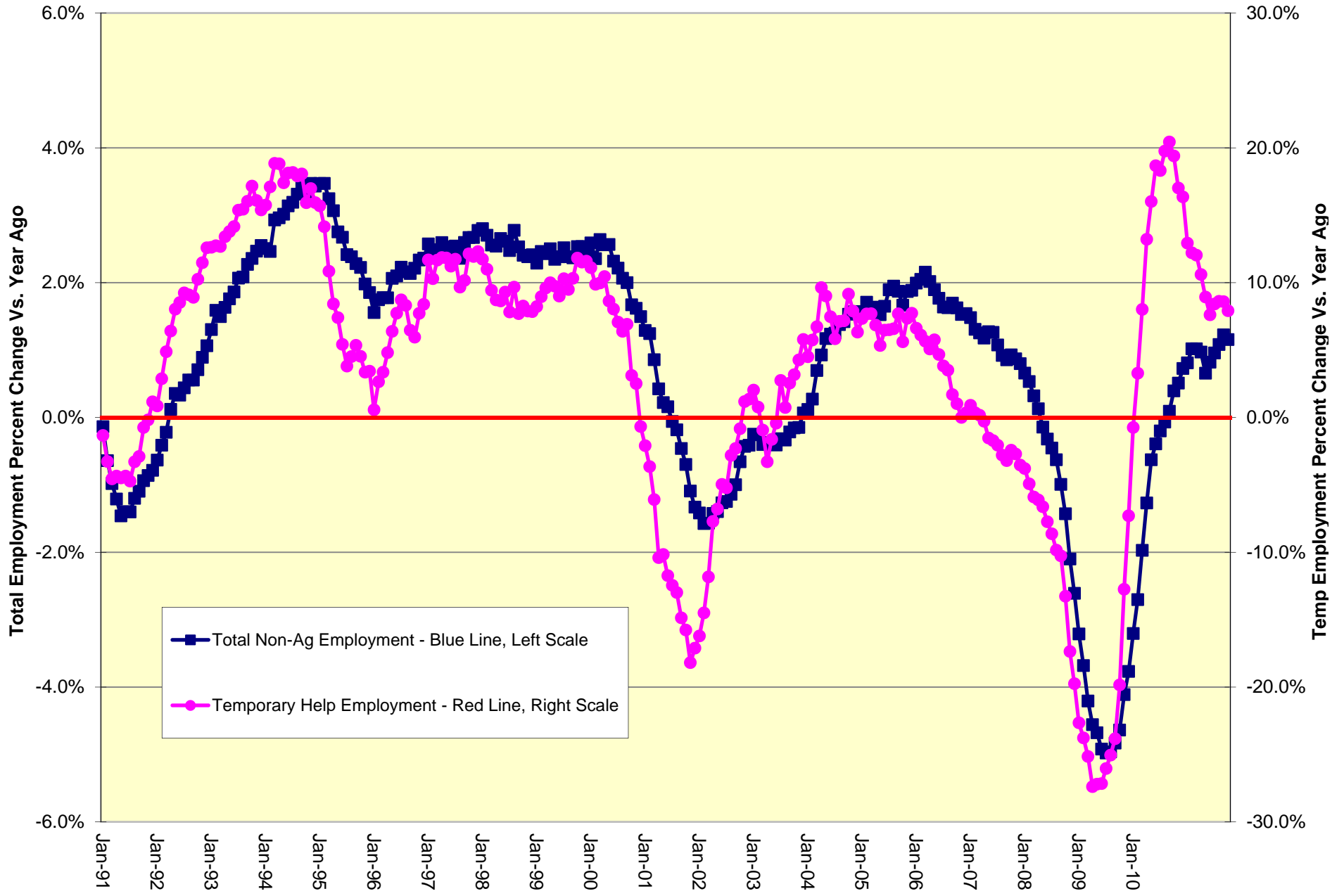
Vermont Exports Rally Amidst Persistently Weak Dollar

(Source: World Institute of Strategic Economic Research, Federal Reserve Bank of Boston)



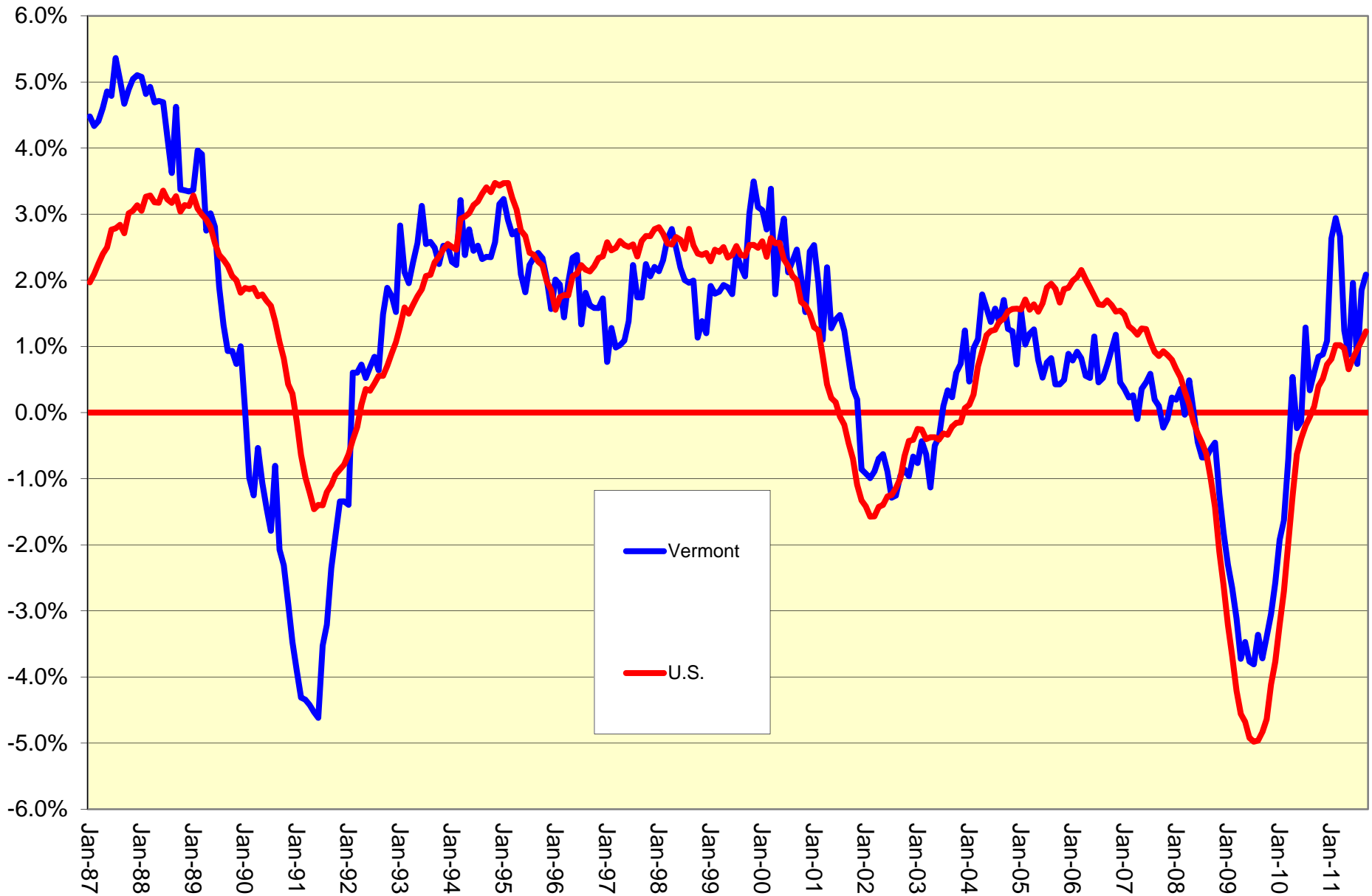
Disconnect? Cautious Employers Avoid Full-Time Hiring

Year Ago Percent Change, Seasonally Adjusted Data, Source: U.S. Bureau of Labor Statistics



Vermont Labor Markets Outperform U.S., But Recent Data are Erratic

(Total Nonagricultural Employment, Percent Change vs. Year Ago, Seasonally Adjusted Data)



Source: Bureau of Labor Statistics, U.S. Department of Labor

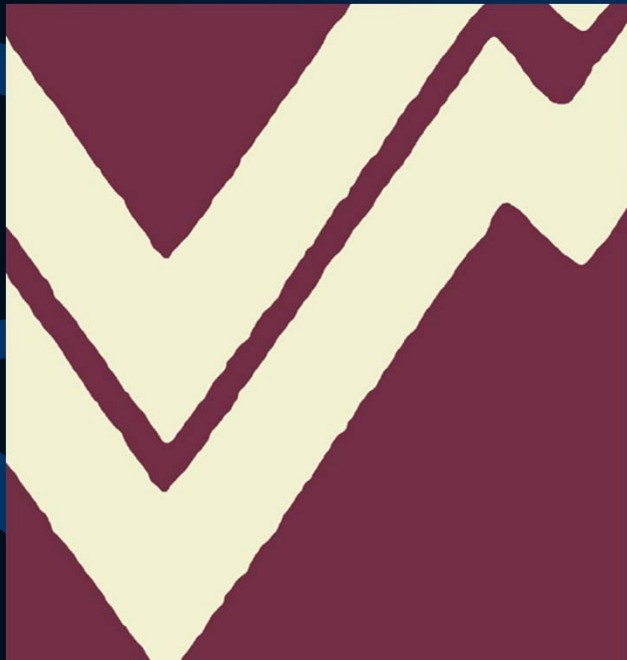
Public Policy Continues to be Critical to a Sustained Recovery

- Net government fiscal policy (federal, state and local) has been contractionary, as early federal stimulus fades. Recent job-related proposals, in part or whole, would renew and extend federal fiscal support to the economy at a critical time
- Reasonable political compromise is in the U.S. national interest
- With fewer political constraints, the Fed has engaged in broader public policy support, with an unprecedented 2 year commitment to the current 0% federal funds rate, plentiful liquidity, aggressive quantitative easing and other “twists,” however “treasonous”
- European policy-makers must act decisively to stabilize their financial sector and evolve political institutions commensurate with euro-zone economic realities

Uncertainty in External Economic Environment Will Require Heightened Attention To Changing Conditions

- Close scrutiny of emerging trends in Vermont tax receipts, especially consumption and income taxes
- Analysis and model simulations of potential contagion effects of European debt/default scenarios
- Hope, despite an election year, for political sanity in near term federal fiscal support and longer term fiscal realignment, with a reasonable mix of spending cuts and revenue enhancements
- Prayer for positive externalities, instead of negative ones...

For Further Information, Contact The Vermont Joint Fiscal Office or:



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