

## ECONOMIC OUTLOOK

The California and national economies faced considerable headwinds in 2007—a deepening housing slump, a breakdown in mortgage markets, tighter credit, more volatile financial markets, and rising energy prices. Upward resets of subprime mortgage rates made payments unaffordable for many borrowers and helped push mortgage defaults and foreclosures to record levels. Several large financial institutions reported huge losses on subprime mortgages and securities backed by these mortgages. Uncertainty about how far the problems with these mortgages would spread increased financial market volatility and prompted lenders to tighten credit standards. The Federal Reserve injected liquidity into the financial markets and eased monetary policy on a number of occasions in the second half of the year, but as year-end neared, financial markets were still not functioning normally (Figure ECO-01).

The effects of the housing slump are evident in a broad range of measures of the national economy. New home sales will likely be down between 35 and 40 percent in 2007 from their peak level in 2005 and new single-family home building, about 25 percent from the peak level in 2006. Total job growth will be the smallest since 2004, and unless future revisions change

Figure ECO-01

**Key Economic Indicators**  
 (Annual Percent Change, except for New Housing)

|  | 2007 | Forecast |      |
|--|------|----------|------|
|  |      | 2008     | 2009 |
| U.S. Real Gross Domestic Product                           | 2.1  | 1.9      | 2.9  |
| California Nonfarm Employment                              | 0.8  | 0.7      | 1.0  |
| California Personal Income                                 | 5.6  | 4.8      | 5.2  |
| California Consumer Price Index                            | 3.3  | 2.6      | 2.7  |
| California New Housing Units<br>(Thousands of Total Units) | 117  | 95       | 104  |

Forecast based on data available as of November 2007

the historical numbers significantly, real GDP growth will be the lowest since 2002.

**THE NATION**

The struggling housing sector continued to slow the national economy in the first 11 months of 2007. Home building, home sales, and related retail sales all declined. The slowdown in home building alone reduced national output growth by almost one percentage point, on average, in the first three quarters of the year. As 2007 closed, there was little evidence that the housing downturn is abating. The problems with subprime mortgages have raised financial market volatility and have spurred a credit tightening that not only could delay a housing recovery, but hurt parts of the economy outside the housing sector as well.

The outlook for the national economy is for slower growth in 2008 and improved growth in 2009 and 2010. Real GDP is projected to grow 1.9 percent in 2008, and 2.9 percent in

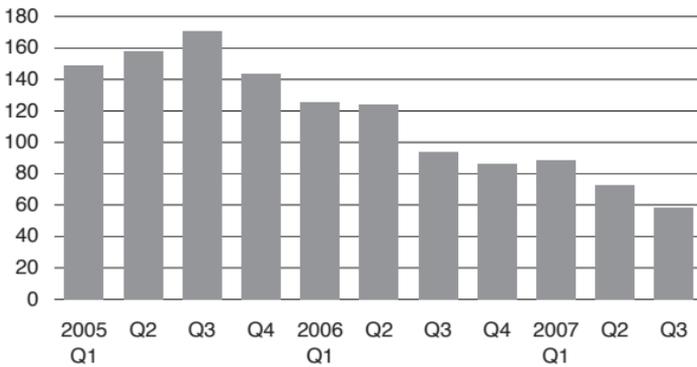
2009 and 2010, as compared to 2.1 percent in 2007. Nonfarm payroll employment is forecast to increase 0.8 percent in 2008, 1.2 percent in 2009 and 1.3 percent in 2010, as compared to 1.3 percent in 2007.

## CALIFORNIA

In California, where the housing slump has been deeper than the vast majority of other states, single-family housing permits in the third quarter of 2007 were only about one third of their level in the third quarter of 2005 and existing home sales, about half of their level two years ago (Figure ECO-02).

Figure ECO-02

### California Single-Family Housing Permits 1,000s of Units, Seasonally Adjusted Annual Rate



Source: Construction Industry Research Board

Total personal income has held up surprisingly well in California during the housing slump. This broad measure of the economy was 5.8 percent higher than a year earlier in the first half of 2007, which is not much lower than the 6.5 percent growth in both 2005 and 2006.

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However, the housing slump and higher energy prices have taken a significant toll on other measures of the economic performance. Taxable sales decelerated in 2007. New vehicle registrations fell in 2006 and in the first nine months of 2007.

The outlook for the California economy is also for slower growth in 2008 followed by improved growth in 2009 and 2010. Personal income is projected to grow 4.8 percent in 2008, 5.2 percent in 2009, and 5.4 percent in 2010, as compared to 5.6 percent in 2007. Nonfarm payroll employment is forecast to increase 0.7 percent in 2008, 1.0 percent in 2009 and 1.6 percent in 2010, as compared to 0.8 percent in 2007.