

ECONOMIC FORECAST

Review of FY 2007

The national economy posted moderate growth in FY 2007, remaining resilient despite the slowdown in the housing market and the subprime mortgage implosion. Consumer spending remained solid despite deteriorating conditions in the housing market, in part due to strong income growth. The labor market slowly expanded over the year. Despite these positives, escalating energy costs, the slumping housing market, and the credit crunch continued to be a source of caution for investors.

The Virginia economy trended toward slower growth in FY 2007. Growth in total nonagricultural employment was slightly weaker than projected. Income gains also lagged the forecast. The housing slowdown was a significant drag on growth, with double-digit declines in existing home sales and marginal price gains over the prior year. Economic growth was strongest in Richmond and Northern Virginia, with federal government spending providing stability in the face of the housing slump. In a departure from prior years, Virginia underperformed the nation in FY 2007.

National economic growth moderated in FY 2007

The U.S. economy continued to expand, albeit at a decelerating rate in FY 2007, with the housing slowdown placing a drag on economic growth.



Growth in U.S. Gross Domestic Product (GDP) slowed in FY 2007. The value of all goods and services produced within the U.S., adjusted for inflation, grew at 2.1 percent in FY 2007. Growth in total personal income was 6.4 percent, while wages and salaries increased by 6.1 percent.

Consumer spending remained resilient. Consumer spending grew by three percent in FY 2007.

The nation's businesses continued to expand their payrolls in FY 2007. Major drivers were leisure and hospitality services, professional and business services, and education and health services.

The Federal Reserve was neutral throughout the fiscal year. The federal funds rate target remained unchanged at 5.25 percent in nine consecutive meetings.

| US Economic expansion moderates | | | | |
|--|---------------|-------------|-----------------|-------------|
| | Actual | | Forecast | |
| | 2007 | 2008 | 2009 | 2010 |
| Real GDP | 2.1% | 2.1% | 2.5% | 2.9% |
| Total Employment* | 1.6% | 0.9% | 1.0% | 1.3% |
| Un-employment | 4.5% | 4.8% | 5.0% | 4.8% |
| CPI | 2.6% | 2.5% | 1.6% | 1.9% |

*Total nonagricultural employment. Figures represent percent change over previous year, except the unemployment rate, which is a percentage. Data based on the October 2007 Global Insight standard forecast. Source: Department of Taxation

In Virginia, the economy trended towards slower growth

The Commonwealth's labor market grew at slower rates than anticipated. Year-over-year job growth of 1.4 percent was below the forecast of a 1.7 percent annual gain. Total nonagricultural employment increased by 52,900 jobs, 10,900 less jobs than forecast after increasing by 70,800 jobs on average over the prior three fiscal years. The service sector was the major driver of growth.

Here is a look at regional employment in Virginia during FY 2007:

Northern Virginia

In Northern Virginia, which represents about a third of all jobs in the state, total employment increased by 1.8 percent -- a gain of 22,700 jobs, 43 percent of total state gains for the year. The service sector as a whole added 20,900 jobs, 92 percent of total regional gains, including 12,500 in professional and business services, most of which are federal government-related. Construction employment declined by 1,500 jobs with the slowdown in housing, the first decline since FY 2003 and a significant

shift from the 6,100 construction jobs added on average over the prior three fiscal years. The information sector shed an additional 1,300 jobs during the year, the sixth consecutive year of declines. Overall, the region benefited from its proximity to Washington, D.C., with a significant portion of government spending on homeland security flowing to area companies. The area added 1,000 federal government jobs in FY 2007.

Richmond/Petersburg

Employment in the Richmond-Petersburg Metropolitan Statistical Area increased 1.9 percent in FY 2007, an addition of 11,800 jobs. Gains were centered in leisure and hospitality services, trade, transportation and utilities, and education and health services. The construction and financial activities sectors added jobs during the year. The Richmond housing market has not seen the significant declines in home sales as experienced in Northern Virginia. As a result, employment growth outpaced that of Northern Virginia for the first time since FY 2002.

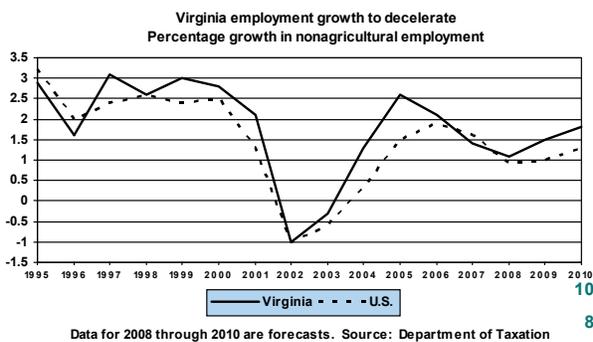
Norfolk/Virginia Beach/Newport News

The Norfolk-Virginia Beach-Newport News MSA experienced employment growth of 0.8 percent in FY 2007. The region had a gain of 6,500 jobs, down from the 9,600 jobs added on average over the prior three fiscal years. The continued deployment of many of the military personnel situated in the area remained a drag on growth. The tourism industry, long a staple of the area economy, added 1,200 jobs in FY 2007, about one-half the amount added

in the prior year, increasing 1.4 percent for the year.

Balance of the state

Employment in the balance of the state increased by 11,900 jobs, growth of 1.1 percent. Gains were strongest in service employment and trade, transportation, and utilities. Construction and mining employment increased only 400 jobs during the year after increasing 3,500 in FY 2006. The manufacturing sector experienced another annual decline, bringing total job losses since FY 1999 to 69,900 jobs, or 31 percent of the employment base. Many rural areas of the state, particularly Southside and Southwest Virginia, are still dependent on manufacturing activity and international trade. Weakness in those sectors continues to be a drag on overall growth.



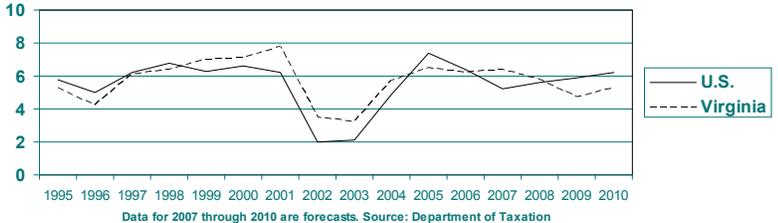
U.S. economic outlook expects extended period of below-trend growth

The October forecast anticipates that tight credit conditions will result in a deeper downturn in housing and more cautious consumers which is expected to drag the U.S. economy into an extended period of below-trend growth. At the November meeting of the

Governor’s Advisory Council on Revenue Estimates, the consensus economic forecast was for slower growth. Highlights of the economic outlook for the next three years include:

- Real Gross Domestic Product is anticipated to grow by 2.1 percent in FY 2008, 2.5 percent in FY 2009, and 2.9 percent in FY 2010.
- Job growth is expected to slow to 0.9 percent in FY 2008.
- The slowdown in the housing market and higher energy costs will force consumers to rein in spending. Real consumer spending is expected to grow by 2.6 percent, 2.4 percent, and 2.8 percent in fiscal years 2008 through 2010 respectively.
- Inflation is expected to stabilize over the forecast horizon, with growth falling below two percent in FY 2009 and FY 2010.
- The Federal Reserve is expected to continue trimming the federal funds rate, ending the year at 4.25 percent.

Personal income growth to equal the Nation's in fiscal year 2008



FY 2008 expected to be a year of near-trend growth

The Virginia economy is expected to grow near trend over the forecast horizon, with growth in employment and income near historical averages. The service sector will continue to contribute the bulk of the gains. High energy prices, expanding debt burdens, and the slowdown in housing represent significant risks to consumer spending. Here is a look at what economists are predicting for Virginia:

- Personal income is expected to grow 5.6 percent in FY 2008, 5.9 percent in FY 2009, and 6.2 percent in FY 2010. Wages and salaries are expected to grow 5.5 percent in FY 2008, 5.2 percent in FY 2009, and six percent in FY 2010.
- Employment growth of 1.1 percent, 1.5 percent, and 1.8 percent is expected over the forecast horizon.
- Employment in the professional and business services sector is forecast to grow at 3.3 percent in FY 2008 and 4.4 percent in FY 2009.
- Construction employment is expected to decline as the housing market slumps, falling 1.3 percent in FY 2008 before rebounding slightly in FY 2009 and FY 2010.
- Employment in trade, transportation and utilities is expected to grow near one percent over the forecast horizon.