# Consensus Economic Outlook

The economic and revenue outlooks were agreed to at the January 9, 2009, Consensus Revenue Estimating Conference by the Administration, House Fiscal Agency and Senate Fiscal Agency.

## 2008 U.S. Economic Review

The U.S. has officially been in recession since December 2007. Over the first three quarters of 2008, real GDP grew at a meager rate and real domestic final demand (real GDP excluding real net exports) declined slightly. Real GDP, however, plummeted in the fourth quarter, falling at its fastest pace since the early 1980's. U.S. wage and salary employment declined each month of 2008, but declines ballooned beginning in September. While losing two-thirds of a million jobs in the first eight months of 2008, the economy lost more than twice that number (nearly 2.0 million jobs) between September and December.

The U.S. economy struggled in 2008 under the weight of high oil prices, a dismal housing market, a progressively worsening credit crunch and heightening instability in financial markets.

Having steadily increased since early 2007, oil prices rose to a record $134 a barrel in June 2008. As a result, gasoline prices also rose to record levels, rising above $4.00 a gallon by mid-year. Oil and gasoline prices dropped substantially in late 2008 as the U.S. economy contracted sharply. These fuel price declines have provided a partial, yet important, counterbalance to other forces depressing economic activity.

In calendar year 2008, housing starts totaled fewer than 1 million units for the first time in at least fifty years. Annualized monthly housing starts, which had peaked in early 2006 above 2 million units, fell to a new record low in each month between October and December. In December, housing starts fell to a record low 550,000 unit pace. With the sharply declining housing market, the percent of homeowners either delinquent or in foreclosure rose to a record 10.0 percent by 2008Q3. Home price declines accelerated each month during 2008 with November prices down 18.2 percent from the prior year.

With the booming housing market going bust and housing prices tumbling, lenders in turn tightened their lending standards – even beyond what they were prior to the boom. Credit conditions tightened substantially for both prime and sub-prime borrowers, for consumer loans as well as mortgage loans and for firms as well as individuals.

Vehicle sales fell sharply in 2008. Severe employment declines, substantial losses in consumer equity and the severe credit crunch pushed sales sharply lower. Calendar year 2008 sales fell an estimated 18.6 percent to their lowest level since 1992. Fourth quarter 2008 light vehicle sales plummeted to their lowest quarterly rate in 26 years.

Many loan originators had packaged and sold their mortgage loans to other companies. Thus, as loan defaults mounted, the repercussions spread widely across financial markets and the economy in general. Lehman Brothers' failure in September precipitated a near collapse of already shaken financial markets. What had been a credit crunch became, in many markets, a credit freeze.

The Federal Reserve has met shaky financial markets with substantial interest rate cuts and massive injections of liquidity. The Fed lowered its key bank lending rate to essentially zero. Excess bank reserves skyrocketed from around $2 billion in August to nearly $800 billion by the end of December. Complementing the Fed's efforts, Congress passed the Troubled Assets Relief Program (TARP). Under TARP, Congress authorized the Treasury Department to provide up to $700 billion to help stabilize financial markets and foster liquidity. Also under TARP, the Treasury Department extended a $17.4 billion bridge loan package to General Motors and Chrysler, both of whom were severely struggling as vehicle sales fell sharply. Earlier in the year, Congress passed the Economic Stimulus Act of 2008. The centerpiece of the legislation was $120 billion in mid-year personal income tax rebates.

## 2008 Michigan Economic Review

Sharply declining vehicle sales, combined with continuing declines in Big 3 market share and rationalization among vehicle suppliers, sharply accelerated Michigan's economic losses in 2008. Between Michigan's employment peak in June 2000 and December 2008, Michigan lost over 625,000 jobs (-13.6 percent). However, job losses in 2008 accounted for more than one-fourth (nearly 175,000) of the jobs lost over the past eight and half years. Michigan job losses between September 2008 and December 2008 alone totaled nearly 150,000 jobs. Michigan's 2008 unemployment rate rose to an estimated 8.4 percent, up 1.2 percentage points from 2007.

In 2008, Michigan wages and salaries grew an estimated 0.6 percent. Overall personal income increased an estimated 2.4 percent. With 2.8 percent inflation, real (inflation adjusted) personal income fell by an estimated 0.5 percent.

## 2009 and 2010 U.S. Consensus Economic Outlook

In 2009, real GDP is forecast to decline by 1.9 percent – matching 1982 for the largest calendar year real GDP decline since 1946. Real GDP is then projected to grow at a slow 1.6 percent pace in 2010 (see Table 1). Light vehicle sales are forecast to fall to 10.8 million units, the lowest annual sales since 1982. Vehicle sales are projected to rebound in 2010, but only to 12.2 million units, markedly lower than the 16.1 million units sold in 2007.

The 2009 U.S. unemployment rate is projected to rise sharply from 5.7 percent to 8.2 percent. The 2010 unemployment rate is then forecast to rise to 8.7 percent, the third highest unemployment rate since 1948.

With the economy contracting and job losses mounting, inflation is projected to slow to 0.7 percent in 2009, the lowest U.S. inflation rate since 1955. As the economy recovers in 2010, inflation is expected to accelerate to 2.5 percent.

**2009 and 2010 Michigan Consensus Economic Outlook**

Due to the slowing national economy in general and extremely weak light vehicle sales in particular, Michigan wage and salary employment is forecast to fall 4.6 percent in 2009 – the State's largest calendar year percent employment decline since 1982. Wage and salary employment is expected to drop another 2.0 percent in 2010, marking Michigan's tenth straight calendar year employment decline.

Michigan's unemployment rate is expected to rise from 8.4 percent in 2008 to 10.9 percent in 2009 and 11.2 percent in 2010. The forecasted 2010 unemployment rate would be Michigan's highest unemployment rate since 1984.

Michigan personal income is forecast to fall by 1.3 percent in 2009 – the state's first nominal (non-inflation adjusted) personal income decline since 1958. Personal income is then expected to rise a slight 0.8 percent in 2010. Inflation is forecast to be 0.4 percent in 2009 and 2.0 percent in 2010. As a result, real Michigan personal income is expected to decline 1.7 percent in 2009 and then fall 1.2 percent in 2010.

Quarterly Michigan employment declines are forecast to slow beginning in mid-2009. While quarterly declines are expected to average 55,000 jobs in fiscal year (FY) 2009, FY 2010 declines are forecast to average only 16,000 jobs per quarter.

**Forecast Risks**

The U.S. economy has been in recession since the end of 2007. The central questions now are "How long?" and "How deep?" Several factors, which helped cause the downturn, will likewise be key to determining the recession's length and depth. Higher oil prices (all else equal) will lengthen and deepen the recession, while lower oil prices will shorten the downturn and make it shallower. A faster sustainable recovery in the housing market will support a quicker overall economic recovery and less steep economic downturn. Similarly, a more sluggish housing market will delay recovery and deepen the recession.

Central to hastening the end of the recession and muting the economic downturn is stability and confidence in financial and credit markets. Here, uncertainty surrounds the speed and effectiveness of actions the Federal Reserve and Congress have taken and will be taking to address financial market turmoil and the associated credit crunch/freeze. Likewise, questions surround the speed with which policymakers will enact and implement a stimulus package, along with questions about the size and composition of the package (e.g., government spending vs. tax cuts).

Given the current extreme weakness in vehicle sales markets, the failure of one or more of the Big Three constitutes an extremely large downside risk to the national forecast, but especially to the Michigan economic forecast.

**Table 1**

# Consensus Economic Forecast

January 2009

| | Calendar 2007 Actual | Calendar 2008 Estimated | Percent Change from Prior Year | Calendar 2009 Forecast | Percent Change from Prior Year | Calendar 2010 Forecast | Percent Change from Prior Year |
|---|---|---|---|---|---|---|---|
| **United States** | | | | | | | |
| Real Gross Domestic Product (Billions of Chained 2000 Dollars) | $11,524 | $11,662 | 1.2% | $11,440 | -1.9% | $11,623 | 1.6% |
| Implicit Price Deflator GDP (2000 = 100) | 119.8 | 122.8 | 2.5% | 125.5 | 2.2% | 127.8 | 1.8% |
| Consumer Price Index (1982-84 = 100) | 207.3 | 216.0 | 4.0% | 217.5 | 0.7% | 222.9 | 2.5% |
| Personal Consumption Deflator (2000 = 100) | 117.7 | 121.7 | 3.4% | 122.7 | 0.8% | 125.0 | 1.9% |
| 3-month Treasury Bills Interest Rate (percent) | 4.4 | 1.4 | | 0.4 | | 1.0 | |
| Aaa Corporate Bonds Interest Rate (percent) | 5.6 | 5.7 | | 5.0 | | 4.7 | |
| Unemployment Rate - Civilian (percent) | 4.6 | 5.7 | | 8.2 | | 8.7 | |
| Light Vehicle Sales (millions of units) | 16.1 | 13.1 | -18.6% | 10.8 | -17.6% | 12.2 | 13.0% |
| Passenger Car Sales (millions of units) | 7.6 | 6.8 | -10.4% | 5.6 | -17.8% | 6.3 | 12.5% |
| Light Truck Sales (millions of units) | 8.5 | 6.3 | -25.9% | 5.2 | -17.5% | 5.9 | 13.5% |
| Import Share of Light Vehicles (percent) | 23.3 | 25.3 | | 28.0 | | 30.0 | |
| **Michigan** | | | | | | | |
| Wage and Salary Employment (thousands) | 4,262 | 4,190 | -1.7% | 3,997 | -4.6% | 3,917 | -2.0% |
| Unemployment Rate (percent) | 7.2 | 8.4 | | 10.9 | | 11.2 | |
| Personal Income (millions of dollars) | $345,885 | $354,187 | 2.4% | $349,583 | -1.3% | $352,379 | 0.8% |
| Real Personal Income (millions of 1982-84 dollars) | $172,831 | $171,935 | -0.5% | $169,044 | -1.7% | $167,004 | -1.2% |
| Wages and Salaries (millions of dollars) | $188,062 | $189,281 | 0.6% | $180,953 | -4.4% | $181,496 | 0.3% |
| Detroit Consumer Price Index (1982-84 = 100) | 200.1 | 206.0 | 2.8% | 206.8 | 0.4% | 211.0 | 2.0% |
| Detroit CPI Fiscal Year (1982-84 = 100) | 199.0 | 204.6 | 2.8% | 205.8 | 0.6% | 209.3 | 1.7% |