Consensus Revenue Agreement
Final Report
January 11, 2010

Economic and Revenue Forecasts
Fiscal Years 2010 and 2011

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Table of Contents

List of Tables

CONSENSUS ESTIMATES
EXECUTIVE SUMMARY
January 11, 2010

Revenue Review and Outlook

- The preliminary total for FY 2009 General Fund-General Purpose (GF-GP) revenue is $7,365.6 million, down $69.7 million from the May 2009 Consensus estimate. GF-GP revenues decreased 21.3 percent as the Michigan and national economies struggled throughout the year. School Aid Fund (SAF) revenue fell 5.1 percent to $10,922.2 million, down $21.5 million from the May Consensus estimate.

- FY 2010 GF-GP revenue is forecast to decline 6.3 percent to $6,898.4 million, down $51.3 million from the May 2009 Consensus estimate. FY 2010 SAF revenue is forecast to decline 4.2 percent to $10,458.1 million, which is $105.0 million below the May 2009 Consensus estimate.

- FY 2011 GF-GP revenue is forecast to increase 1.0 percent to $6,968.4 million, which is $70.0 million above the GF-GP estimate for FY 2010. FY 2011 SAF revenue is forecast to increase 0.2 percent to $10,480.5 million, which is $22.4 million more than the FY 2010 SAF estimate.

2010 and 2011 U.S. Economic Outlook

- Real gross domestic product is forecast to rebound in 2010, rising 2.2 percent before growing 2.7 percent in 2011.

- In 2010, the U.S. unemployment rate is forecast to rise to 10.2 percent – a record high in history dating back to 1948. The unemployment rate is then expected to fall to 9.7 percent in 2011.

- Light vehicle sales are estimated to total 10.3 million units in 2009 (a 39-year low). Sales are expected to rebound to 11.2 million units in 2010 and 12.5 million units in 2011. In 2010, the import share of light vehicle sales is expected to drop 1.2 percentage points to 25.5 percent before rising to 26.0 percent in 2011.

- After declining for the first time since 1955, consumer prices are forecast to rise 2.7 percent in 2010 and 2.3 percent in 2011.

- Housing starts are expected to increase significantly, rising above 1.0 million starts in 2011. However, starts will remain substantially below historic averages.

2010 and 2011 Michigan Economic Outlook

- While 2010 and 2011 will mark the tenth and the eleventh straight annual Michigan employment decline, declines will slow markedly from 2009 when employment dropped an estimated 6.8 percent. Michigan wage and salary employment is forecast to fall 2.2 percent and 0.9 percent, respectively, in 2010 and 2011.

- In 2010, the Michigan unemployment rate is forecast to rise from 14.1 percent to 15.7 percent – the State's highest calendar year unemployment rate in history dating back to 1976. The unemployment rate is then expected to drop to 15.3 percent in 2011.

- After dropping 7.9 percent in CY 2009, wages and salaries are forecast to drop slightly (-1.0 percent) in CY 2010 and rise slightly (0.6 percent) in CY 2011. Following a 2.7 percent decline in 2009, calendar year personal income is forecast to rise 1.0 percent in 2010 and 1.7 percent in 2011.

- Fiscal year Michigan wages and salaries income is expected to fall 3.1 percent in FY 2010 before rising very slightly (0.1 percent) in FY 2011.

- Disposable income is forecast to rise 1.6 percent in FY 2010 and 0.3 percent in FY 2011.

Forecast Risks

- A sluggish recovery may impact consumer and investor confidence more than assumed. Consequently, consumption and investment may be significantly lower than forecast.

- As major elements of fiscal and monetary policy wind down, the private economy may not be able to sustain the budding recovery.

- Failure of one or more of the Big Three vehicle manufacturers would lead to more significant employment declines in Michigan.

- Higher oil prices would depress economic activity by lowering consumer's discretionary income. Higher oil prices would also spur higher inflation.

- The baseline economic forecast sees Michigan being hit disproportionately harder because of its greater reliance on the manufacturing sector in general and the automotive industry in particular. This greater reliance could lead to an even weaker Michigan economy than forecast.

- A stronger (weaker) housing market would boost (depress) economic activity more than forecast.

- Geopolitical factors, such as a domestic terrorist attack, would depress economic activity.

ECONOMIC REVIEW AND OUTLOOK
January 11, 2010

Current U.S. Economic Situation

Summary

The U.S. economy fell into recession beginning in December 2007 -- as determined by the National Bureau of Economic Research (NBER). While U.S. wage and salary employment has declined every month following the official start of the recession, sharp real GDP declines began a year later. In 2008Q4, real GDP fell at a 5.4 percent annual rate followed by a 6.4 percent rate of decline in 2009Q1. Real GDP fell only slightly in 2009Q2 (-0.7 percent rate). Nevertheless, 2009Q2 marked the first time since at least 1948 that the economy had declined four straight quarters as well as the largest four-quarter real GDP decline (-3.8 percent) in at least 60 years. Over these four quarters, residential investment fell by 25.6 percent while non-residential investment declined 19.7 percent. Taken together, the declines in these two types of investment accounted for most (84.6 percent) of the entire amount of the real GDP decline. Personal consumption fell by 1.7 percent with durable goods consumption declining 8.8 percent. The drop in durable consumption amounted to 20.2 percent of the overall real GDP decline. Increases in net exports (lower trade deficit) and higher federal government purchases lessened the overall GDP decline.[1]

The NBER has not yet determined *if* the recession has ended and, if so, *when* the recession ended. However, many economists hold that the recession has ended and did so some time in 2009Q3. In the third quarter, real GDP rose modestly (2.2 percent rate). 2009Q3 marked the first quarter in nearly four years that residential investment grew, contributing 0.43 of a percentage point to the quarter's growth. Following three quarters of detracting from growth, inventory growth accounted for 0.69 of a percentage point of growth. Helped by "Cash for Clunkers," durable consumption contributed 1.36 percentage points to growth. It is widely held that the economy grew in 2009Q4.

Housing Market

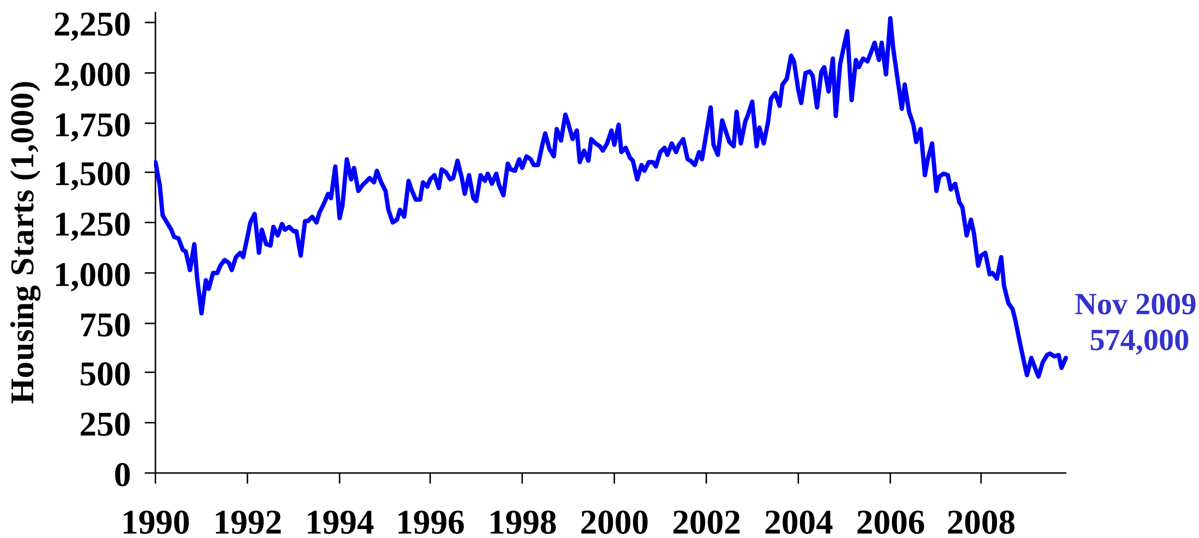
The housing market is in its worst shape in recorded history dating back to 1959. Calendar year 2008 housing starts totaled only 901,500 units – the first time annual starts fell below 1.0 million. Further, the 2009 housing market will invariably be the worst on record. In April 2009, housing starts fell to a record monthly low sales rate (479,000 units). For 2009, housing starts are estimated to be 580,000 units – a 35.6 percent reduction from calendar year 2008 starts. The November 2009 starts rate (574,000 units) was 12.4 percent below a year ago. This performance stands in sharp contrast to the 2.1 million units pace in 2005 and even the 1.8 million and 1.4 million units pace in 2006 and 2007, respectively.

[1] Statistics cited in this Report were current as of the January 11, 2010 Consensus Revenue Estimating Conference. Thus, data do not reflect subsequent releases and/or revisions.

Despite record low mortgage rates, the Mortgage Bankers Association market index in mid-December was down sharply (-52.2 percent) from a year ago with the purchase sub index falling 32.6 percent and refinancing index dropping nearly 57.2 percent. Compared to a month ago, the indices are down slightly with the overall index down 0.8 percent. The purchase sub index is down 4.4 percent from a month ago and less than 5 percent above its cyclical low set earlier in 2009.

The December 2009 National Association of Home Builders sentiment index was up 7 points from a year ago. However, the December reading was 3 points below its recent peak and remained historically low at 16.

Housing Starts Little Changed from Record Low



Source: U.S. Census Bureau.

In November 2009, sales of new homes decreased by 11.3 percent from October 2009 to a 355,000 units annual pace – its weakest pace since February 2009. The Midwest reported a sales increase both from a month ago and a year ago. The other three regions saw declines, both from a month ago and a year ago. The widespread weakness in new home sales was likely due to potential new home buyers' believing that a house they contracted in November would not close prior to the original November 30th deadline for the first-time homebuyer credit.

With new construction down substantially, construction employment has fallen sharply. In November 2009, construction employment was down 14.1 percent from a year ago -- compared to a 3.5 percent year-over-year decline in overall payroll employment.

With new construction of homes down considerably from a year ago, the number of vacant homes is also down substantially from a year ago. The number of unoccupied housing units for sale in 2009Q3 was down 242,000 units from one year ago. However, the number is still running 750,000 units above the 1996 to 2005 average. These high numbers will serve to depress future home sales and construction.

The recent extension and expansion of the homebuyer credit should help boost housing starts and new home sales into the first half of 2010. In addition, many statistics point toward an improving housing market.

The pending home sales index increased by 3.7 percent between September and October to a level of 114.1 -- the index's ninth consecutive monthly increase. Compared to a year ago, October pending sales are up 31.8 percent and almost 42 percent higher than January's trough.

In November 2009, existing home sales reported their second sharp monthly increase – rising to a 6.5 million unit rate, up 44.1 percent from a year ago. November sales were the strongest since early 2007. As with new home sales, recent strong existing home sales were likely due to the rush to buy prior to the original November 2009 deadline for the first-time homebuyer credit. The credit was later expanded and extended to June 2010. The extension may moderate near term sales as the rush subsides in the very near term. However, on balance, lengthening and broadening the credit should help boost sales through mid-2010 compared to what they would have been otherwise.

In its December 2009 *Beige Book*, the Fed reported, "Home sales and construction activity improved across much of the nation" and noted that nine of its twelve districts reported increased sales activity. Further, while the Fed characterized "the level of new residential construction activity . . . as weak," it pointed out that "recent trends have been mixed" with a few districts reporting a pickup, a few reporting declines and a few describing new residential construction activity as "flat."

Counterbalancing this tempered optimism about the residential real estate market, the Fed characterized the state of commercial real estate in unequivocally negative terms:

> Commercial real estate conditions were widely characterized as weak and, in many cases, deteriorating further. Market conditions were reported to have weakened in virtually all Districts, with rising vacancy rates, downward pressure on rents, and little, if any, new development. Expectations for 2010 were also quite low.

House Prices

There are several indications that housing prices may be slowing their decline. The Census Bureau's November 2009 median new home sales price is down only 1.9 percent from a year ago. This compares to double-digit declines earlier in 2009. According to the National Association of Realtors, the November median existing-house price was down 4.3 percent from a year ago, the third consecutive month of only single-digit depreciation. While down 1.9 percent from a year ago, the Federal Housing Finance Agency (FHFA) October 2009 purchase-only house price index increased by 0.6 percent from September.

The seasonally adjusted S&P/Case-Shiller 20-city home price index climbed 0.4 percent in the three months ending October 2009. The index shows house prices grew for the fifth consecutive month in October -- the longest stretch of consistent gains in more than three years. On a year-ago basis, the index declined by 7.3 percent, the smallest decline since October 2007.

Consistent with these statistics, the Fed's December 2009 *Beige Book* reported that "though [home] prices were generally said to be declining modestly . . . some Districts did note some pickup in activity."

Caution should be taken in inferring from these data that housing prices may be stabilizing. The federal government's Home Affordable Modification Program (HAMP) is currently keeping many homes from foreclosure as action is taken to see if more affordable mortgage terms may be found for currently delinquent homeowners in the program. Currently the program has worked out "permanent" terms for only a very small subset of homeowners who have entered the program. If the program's performance does not improve markedly in the near future, many of the homes currently in the program could go on the market as distressed sales, raising supply and depressing home prices. In addition, if the Federal Reserve, as is currently planned, suspends its purchase of mortgage backed assets in Spring 2010, mortgage rates (now at historically low levels) could rise significantly. Higher interest rates would depress housing demand and serve to accelerate home price declines.

Repercussions on Financial Markets

The depressed housing market and concomitant home price declines -- along with the poor jobs market – have had serious repercussions. In 2009Q3, the mortgage delinquency rate rose to a new all-time record at 9.64 percent for the 37 year-old Mortgage Bankers Association's (MBA) National Delinquency Survey – up 0.40 of a percentage point from the prior quarter and 2.65 percentage points higher than a year ago. The percentage of loans in foreclosure at the end of 2009Q3 was 4.47 percent – up 0.17 of a percentage point from 2009Q2 and 1.50 percentage points higher than a year ago. Thus, a record 14.41 percent of all mortgages were either delinquent or in foreclosure.

Declining home prices have meant lower homeowner equity (house value less mortgage debt). Each quarter between 2007Q1 and 2009Q1, inclusive, the *amount* of homeowner equity fell. Over this period, the amount of homeowner equity fell by $7.9 trillion (59.9 percent). As a result, the homeowner equity rate (the amount of homeowner equity/homeowner real estate value) dropped by 23.7 percentage points falling from 57.2 percent to 33.5 percent. Prior to the current housing bust, the homeowner equity rate had never fallen below 50 percent. Over the last two quarters, homeowner equity did rise. As a result, about $1.0 trillion in homeowner equity has been recouped and the homeowner equity rate has risen to 37.6 percent. While these gains are significant, they still leave homeowners with $6.9 trillion less in homeowner equity than at the end of 2006.

Foreclosure moratoriums and the Home Affordable Modification Program (HAMP) have created a backlog of mortgages more than 90 days overdue and thus pushed up the overall delinquency rate. As noted above, if HAMP is not successful, many of the homes in the program would go into foreclosure. However, if HAMP does succeed in reaching workable terms for a large number of those enrolled, these longer term delinquencies would become current again.

When the housing market was booming, lenders relaxed their lending standards and extended credit to subprime (more risky, less qualified) borrowers. When the booming market went bust, lenders tightened their lending standards – even beyond what they were prior to the boom.

Consumer finances remain in very poor shape. According to Economy.com, the aggregate household default rate hit a new high of 3.19 percent in November 2009. Further, November's household delinquency rate (7.09 percent) is down only slightly from August's cyclical peak (7.18 percent). However, Economy.com points to the first year-ago drop in 30-day delinquencies in four years as evidence that the state of consumer finances may be bottoming out.

Lending conditions remain tight. However, the *rate* of tightening is substantially slower than a year ago. In 2008Q4, 69.2 percent of banks reported tighter lending conditions for prime mortgage loans. However, a year later, only 24.1 percent of banks reported tightening. Similarly, while 89.7 percent of banks reported tighter lending conditions for nontraditional loans at the end of 2008, that figure had dropped to 30.4 percent by the end of 2009.

A smaller percentage of banks reported tighter lending standards for commercial and industrial loans to large and mid-sized firms at the end of 2009, as compared to the end of 2008. In 2008Q4, 83.6 percent of banks reported tighter lending standards. However, that figure dropped to 14.0 percent in 2009Q4.

While households borrowed at an $808.0 billion annual rate in 2007Q4, that rate nearly halved in 2008Q1 and fell by 92.6 percent in 2008Q2. In 2008Q3, for the first time in a history going back to 1952, household borrowing turned negative (-$62.1 billion annual rate) -- indicating that, on net, households are paying down debt. Through 2009Q3, household borrowing has remained negative. In 2009Q3, households borrowed at a -$351.3 billion annual rate. With the substantial declines in household borrowing, the personal savings rate has risen sharply. The rate had hovered around 1.0 percent between late 2007 and early 2008. However, between 2008Q4 and 2009Q3, the savings rate has ranged between 3.7 percent and 5.4 percent. In 2009Q3, consumers saved at a 4.5 percent rate. While bolstering long-term growth, the increased savings rate will dampen near-term growth by tempering consumption.

Between 2007Q3 and 2009Q1, overall consumer net worth fell each quarter compared to the prior quarter. Over this period, net worth declined by $17.5 trillion (26.6 percent). Prior to these declines, net worth had never fallen for more than two straight quarters in a data series dating back to 1952. Net worth rose in both 2009Q2 and 2009Q3. As a result, net worth has regained nearly $5.0 trillion of the $17.5 trillion it had lost. However, 2009Q3 net worth ($53.4 trillion) is still 19.1 percent less than its all-time peak 2007Q2 level.

Spillover into broader financial markets has meant sharp declines in stock prices along with the sharp house price declines. The U.S. stock market plummeted following Lehman Brother's declaring bankruptcy in mid September 2008. From the last trading day before the Lehman bankruptcy (September 12, 2008) and the market's March 9, 2009 trough, the Wilshire 5000 lost nearly half (46.3 percent) of its value. Since March, the market has rebounded and has regained more than three-fourths (78.5 percent) of what it had lost following the Lehman debacle. However, at the end of 2009, the Wilshire 5000 was still 27.3 percent off its October 11, 2007 peak. There have been some indications that investor worries have moderated recently.

In Fall 2008, at the height of the panic, banks were extremely wary of lending to each other. However, this wariness has lessened considerably. The TED spread (the difference between the three-month LIBOR rate, a benchmark for the rate banks charge each other to borrow from one another, and the 90-day Treasury bill rate) provides a good measure of banks' wariness to lend to one another. In mid-October 2008, at the height of the panic, the TED spread rose to a record 4.56 percentage points. The spread fell sharply over the next month, but remained above 2.00 percentage points into early December 2008. The spread then fell to around 1.00 percentage point by mid-January 2009 where it hovered until the end of April 2009. The spread has since fallen back to prior low levels, dropping to 0.20 percentage points by late-December 2009.

The junk (below investment grade) corporate bond market provides an indication of the bond market's lending wariness. In mid-December 2008, at the height of the panic and credit freeze, those buying junk corporate bonds were demanding a record 21.8 percentage points higher interest rate (a 21.8 percentage point spread). A year later, the spread shrank to 6.75 percentage points. The amount of junk bond issuance further highlights investors reduced risk aversion. In 2009, junk bond issuance totaled a record $147.7 billion – three times the $47.7 billion issued in 2008.

The recent increased risk taking will help spur increased investment and, in turn, greater growth. However, if investor optimism is significantly disappointed within the forecast horizon, this may serve to severely reduce investment and hence economic growth compared to baseline projections.

Monetary Policy

Faced with credit market tightening, turmoil in the financial markets and the floundering housing market, the Federal Open Market Committee (FOMC) began cutting the target federal funds rate in September 2007. Between September 2007 and October 2008 in a combination of scheduled and unscheduled meetings, the FOMC cut the federal funds rate from 5.25 percent to 1.00 percent. Finally, at its December 16, 2008 meeting, the FOMC took an unprecedented step and lowered the target federal funds rate range to 0.00 percent to 0.25 percent. At the same time, the FOMC cut the discount rate to 0.50 percent, its lowest level since the 1940s.

In total, between September 2007 and December 2008, the Federal Reserve cut the target federal funds rate ten times and the discount rate eleven times. As a result, the target federal funds rate was cut a total of 500-525 basis points and the discount rate was cut 525 basis points.
The FOMC has continued to state that it will maintain interest rates at their record low levels for a significant length of time:

> The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

The Fed also addressed the financial and economic crises by injecting substantial liquidity into financial markets. While having remained relatively flat over the past few years, Federal Reserve Bank reserves have exploded since mid-September 2008. Between mid-September 2008 and mid-December 2008, Federal Reserve Bank credit more than doubled from $890.4 billion to $2,225.8 billion. Reserve bank credit has remained around these extremely high levels with credit totaling $2,219.9 billion in late December 2009.

In November 2008, the Federal Reserve Board created the Term Asset-Backed Securities Loan Facility (TALF) to support the asset backed securities (ABS) market, a key source of credit for households and small businesses, by helping to unfreeze the ABS market and narrow outsized interest rate spreads. TALF's express purpose is "to increase credit availability and support economic activity by facilitating renewed issuance of consumer and business ABS at more normal interest rate spreads."

Over time the Fed has broadened TALF's size, reach and duration. When first introduced, the Fed announced plans, under TALF, to lend up to $200 billion in loans for ABS backed by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration. In February 2009, the Federal Reserve stated that it was ready to expand the Term Asset-Backed Securities Loan Facility to $1 trillion. The Fed also broadened the types of ABS supported by the facility (e.g., ABS backed by certain commercial mortgage-backed securities and certain residential mortgage-backed securities). In mid-March, the Fed again broadened the range of eligible ABS to include those backed by mortgage servicing advances, by loans or leases relating to business equipment, by leases of vehicle fleets and by floor plan loans.

The Fed officially launched TALF in March 2009. On May 1, 2009, the Fed announced that, starting in June, commercial mortgage-backed securities (CMBS) and securities backed by insurance premium finance loans would be eligible collateral under the TALF. In August, recognizing that "the markets for asset-backed securities (ABS) backed by consumer and business loans and for commercial mortgage-backed securities (CMBS) are still impaired and seem likely to remain so for some time," the Fed extended the eligibility date for newly issued ABS and legacy CMBS through March 31, 2010 and newly issued CMBS to June 30, 2010. The Fed had previously authorized loans through December 31, 2009.

With financial markets improving, the FOMC indicated in its December 16, 2009 statement, the FOMC indicated that it planned to phase out its purchases of mortgage backed securities and agency debt by early 2010:

> To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve is in the process of purchasing $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt. In order to promote a smooth transition in markets, the

> Committee is gradually slowing the pace of these purchases, and it anticipates that these transactions will be executed by the end of the first quarter of 2010. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets.

In addition, many of the liquidity programs the Fed established in response to the financial crisis either have expired or will expire in early 2010. The Money Market Investor Funding Facility expired on October 30, 2009. Further, the following programs are scheduled to expire February 1, 2010:

- Asset-Backed Commercial Paper Facility
- Money Market Mutual Fund Liquidity Facility
- Commercial Paper Funding Facility
- Term Securities Lending Facility
- Primary Dealer Credit Facility

The massive size and broad range of the Federal Reserve's programs have played a critical role in facilitating and improving the functioning of financial markets and thus the overall economy. Significant uncertainty surrounds the impact of ending many of these programs in early 2010.

Fiscal Policy

In late 2008, in the wake of the Lehman Brothers' debacle, Congress passed a $700 billion financial rescue package, the Troubled Asset Relief Program (TARP), designed to complement the Fed's actions to restart lending. As originally conceived, TARP was to buy toxic mortgage assets to help clean up financial institutions' books. However, Treasury was granted broad latitude in how it implemented TARP. Consequently, Treasury instead used the appropriated funds to buy ownership into major financial institutions and instituted a program to assist companies issuing credit cards, car loans and/or student loans. The goal remained the same as originally conceived: to enhance liquidity and, hence, financial institutions' willingness to lend. TARP also raised the FDIC limit on insured deposits from $100,000 to $250,000.

To date, under TARP, the federal government has expended approximately $600 billion in gross outlays. Offsetting a portion of these outlays, major financial institutions have repaid more than $140 billion in TARP loans earlier than expected. These early repayments suggest that a certain measure of stability is returning to the financial sector. In addition, the payments increase the amount of potential outlays for further stimulus to approximately $250 billion.

On February 17, 2009, the President signed the American Recovery and Reinvestment Act (ARRA). The Act took a multi-pronged approach and included federal tax relief, expansion of unemployment benefits and other social welfare provisions, and domestic spending in education, health care, and infrastructure, including the energy sector. The Act's stimulus exceeded $700 billion. The bill provided for $218 billion in tax cuts, with the bulk ($167 billion) going to individuals.[2] The key element of the individual tax cuts was a $400 per worker ($800 per couple) tax credit. The Act also included an expansion of the child tax credit and the college credit. The Act increased Medicaid funding to states by an estimated $86.6 billion. The Act also provided a 65 percent subsidy of health care insurance premiums for the unemployed with an estimated cost of $24.7 billion. To help aid in preventing local school district layoffs and cutbacks, $44.5 billion in aid to districts was provided. Further, the Act provided for extended unemployment benefits and increased spending on the Food Stamp program. Complementing the worker tax credit, the Act called for a one time $250 payment per recipient to those receiving Social Security. The Act also provided increased funding for infrastructure spending for projects such as bridge and highway projects. The lion's share of ARRA funds will be expended by late-2010, introducing a significant element of uncertainty especially for the 2011 forecast.

The U.S. government has engaged in a number of programs to bolster the housing market. In early 2009, the federal government enacted "The Making Home Affordable Program." The program had three elements:

- $200 billion for preferred stock purchases in Fannie Mae and Freddie Mac with the goal of keeping mortgage rates low.
- Home Affordable Refinance Program which relaxed loan-to-value ratios for Fannie Mae and Freddie Mac to allow slightly underwater (owing more than house is worth) borrowers to take advantage of the low rates.
- Home Affordable Modification Program (HAMP) with the goal of moving the loan servicing industry to make sustainable loan modifications.

In late December 2009, the U.S. Treasury said it would cover an unlimited amount of losses at mortgage giants Fannie Mae and Freddie Mac through 2012. As of December 2009, the U.S. government, directly or indirectly, underwrites nine of every 10 new residential mortgages, nearly twice the percentage before the crisis.

The federal government also enacted homebuyer tax credits. The original $8,000 credit applied only to first-time homebuyers and was due to expire at the end of November 2009. However, the first-time homebuyer credit's deadline was pushed back to mid-2010. In addition, a second $6,500 credit was added for existing homebuyers who have lived in their home for at least five consecutive years.

<u>Inflation</u>

Inflation has accelerated since mid-2009, but inflationary pressures remain moderate. Between June 2008 and February 2009, oil prices fell from a record $133.93 per barrel to $39.16 per barrel. Oil prices have since risen, increasing to $78.08 per barrel in November 2009. Improving conditions in many major economies have pushed oil prices up from their mid-2009 trough.

[2] The Act also provided for a one-year extension of AMT relief. However, since this provision's passage was widely expected even in the absence of any stimulus package, its estimated value is excluded from the numbers cited here.

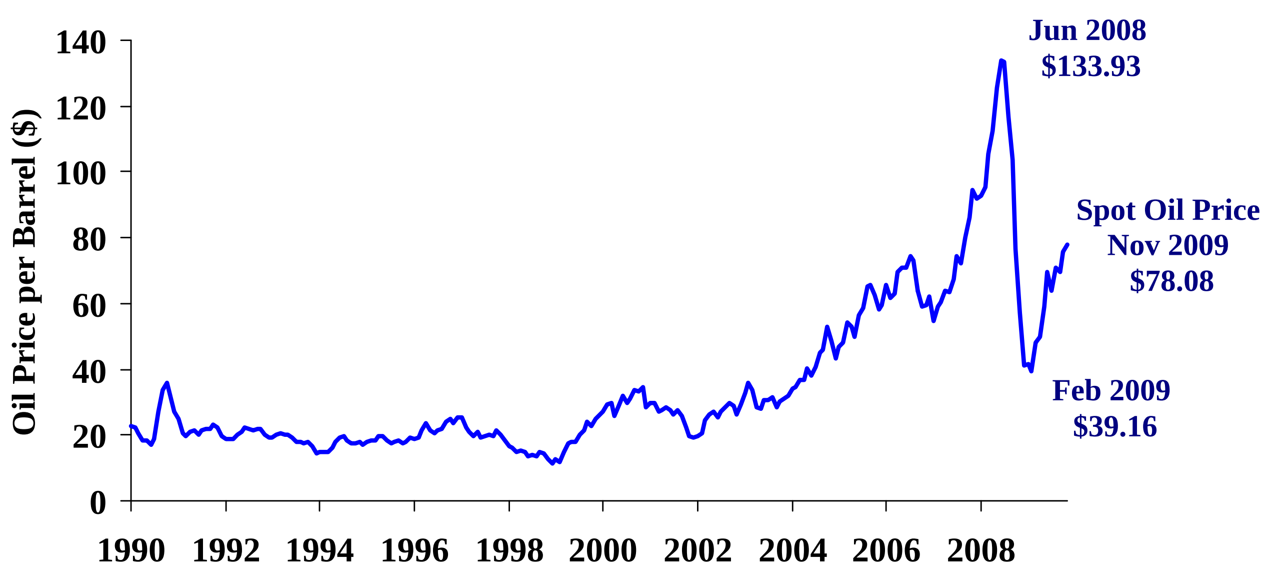
Relatively lower oil prices have kept gasoline prices down. Following oil prices down, the average price of gasoline fell from a record $4.05 a gallon in mid-July 2008 to $1.59 a gallon by the end of December 2008 (Energy Information Agency). Gasoline prices have risen significantly since the end of 2008 with the price of a gallon of gasoline up by almost one dollar to $2.56 per gallon by early December 2009. Prices, however, remain substantially lower than their peak levels. This decline, from its peak levels, has served to increase consumers' discretionary spending.

Natural gas prices have also remained relatively low. While having had risen to the second highest level in history in July 2008, natural gas prices have since fallen significantly. By July 2009, natural gas prices had fallen 69.1 percent compared to a year ago. November 2009 natural gas prices were down 16.3 percent from last November.

The Federal Reserve's December 2009 Beige Book reported that

> Districts generally reported little or no upward wage pressures, while some Districts noted upward pressure in commodity prices, and most Districts reported stable selling prices. . . . Most Districts reported stable prices overall, although some reported higher input prices, largely for energy and other commodities used in production, with a limited ability to raise selling prices.

Oil Prices Up from Early 2009
Still Down Sharply from mid-2008



Source: Federal Reserve Bank of St. Louis.

While 80 percent of manufacturing firms surveyed by the Institute for Supply Management (ISM) reported paying higher prices in mid-2008, only 2 percent reported paying higher prices in December 2008. That figure rose to 38 percent by August 2009 before falling to 20 percent in

November 2009. Similarly, while 72 percent of non-manufacturing firms reported paying higher prices in mid-2008, only 9 percent reported having done so in December 2008. The percentage alternately rose and fell over the next year, peaking in June 2009 at 26 percent. In November 2009, 21 percent reported paying higher prices.

While overall July 2008 producer prices (finished goods) were up tremendously from a year ago (9.9 percent), July 2009 producer prices were actually *down* 6.8 percent from a year ago – the largest year-over-year decline in producer prices in a history dating back to 1948. Year-ago declines have moderated in recent months, lessening to a -1.9 percent change in October 2009. Producer prices rose 2.4 percent in November 2009.

In July 2008, the overall year-over-year consumer price inflation rate stood at 5.6 percent, a 17-year high. However, by December 2008, consumer price inflation was essentially flat (0.1 percent). Between March 2009 and October 2009, the economy saw deflation for the first time since 1955. The economy saw the largest cyclical consumer price decline in July 2009 with a 2.1 percent decline. By October, consumer prices were nearly flat (-0.2 percent). In November, consumer prices rose 1.8 percent from a year ago. Core consumer inflation decelerated from 2.5 percent in September 2008 to 1.4 percent in August 2009. Core consumer inflation rose to 1.7 percent in November 2009.

The Economic Cycle Research Institute's (ECRI) future inflation gauge (FIG) indicates that price pressures will remain moderate in the near term. In March 2009, the FIG fell to 77.9 (its lowest level since 1958). Since March, the index has gradually increased each month, rising to 95.7 in October 2009. However, the index remains historically low and substantially below its last peak (125.1) in October 2005.

Major Economic Indicators

On balance, major economic measures indicate that the U.S. economy has improved substantially since the May 2009 Consensus Conference. Further, several indicators strongly suggest that the economy has entered into recovery.

Between August 2008 and December 2008, the ISM manufacturing index (PMI) fell each month. By December, the index had fallen to 32.9 -- its lowest level since June 1980. The index then rose each month between January 2009 and August 2009. As a result, the August reading signaled an expanding manufacturing sector for the first time since January 2008. Registering above 50, the index has signaled expansion in each month since August. In October, the index rose to 55.7 – its highest reading since April 2006; the index then fell to 53.6 in November.

The ISM non-manufacturing business activity index fell sharply in both October 2008 and November 2008. As a result, November's reading (33.3) represented the index's lowest reading in the index's 11-year history. The index posted solid gains in December and in January 2009. While the index fell in February, it recovered nearly all of its losses in March. The index rose still further in April. Then – albeit haltingly – the index rose above 50.0 in August. After signaling growth through October, the index fell sharply in November, falling just below 50.0 (49.6).

Industrial production worsened considerably between mid-2008 and mid-2009. While the three-month average of industrial production was down 0.7 percent from a year ago in July 2008, the average fell an astounding 12.9 percent between July 2008 and July 2009. The July 2009 decline was the largest year-ago decline since the sharp downturn in 1946, following the end of World War II. Since July 2009, declines have lessened considerably even while remaining severe. In November 2009, industrial production was down 6.0 percent from a year ago.

As industrial production fell, so too did capacity utilization. Between February 2008 and July 2009, the three-month average of capacity utilization fell every month. As a result, the average fell to a record low 68.6 percent for the series which dates back to 1967. In July through November, the average rose each month. However, the average still stands at a historically low 70.8 percent -- lower than any reading before 2009.

New durable goods orders rose slightly between October 2009 and November 2009 (0.2 percent). As a result, overall durable goods orders are down 6 percent from a year ago. Compared to a year ago, core new durable goods orders were down 12.1 percent. In May 2009, core new orders had been down 23.2 percent from a year ago.

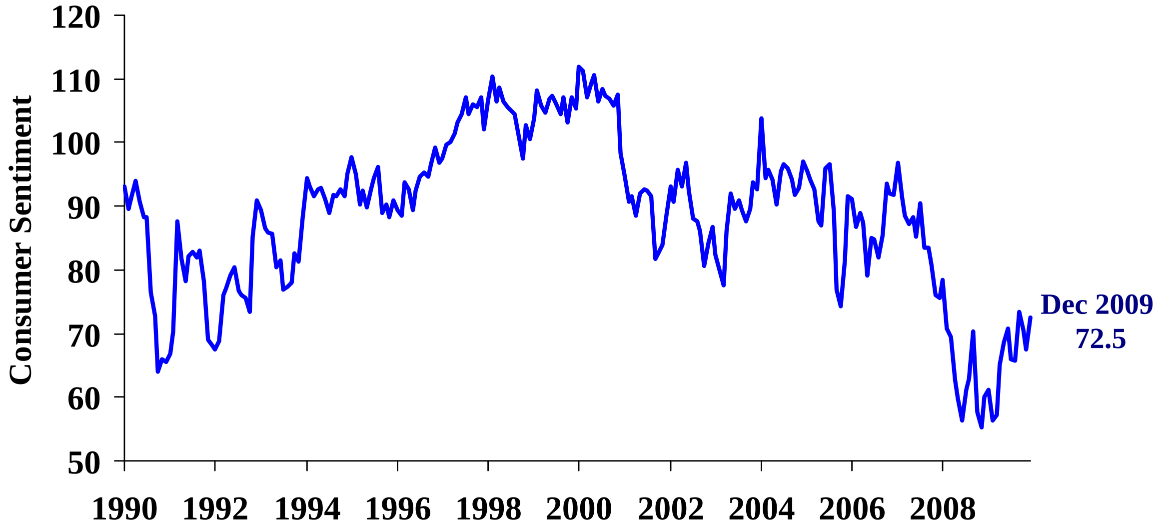
In November 2008, the three-month average of retail sales, excluding motor vehicle and gasoline sales, fell compared to a year ago for the first time in a history extending back to 1992. The average has fallen compared to a year ago each month since November 2008. However declines have lessened in recent months. In July 2009, the average reported its greatest year-ago decline (-4.1 percent). By November 2009, the average was down only 0.3 percent from a year earlier.

The Conference Board index of consumer confidence plummeted to a record low 25.3 in February 2009 – 51.1 points lower than a year earlier. The index rose sharply in April and May, increasing to 54.8**.** Since May, the index has moved within a 10-point range between the mid 40's and the mid 50's. In December 2009, the index stood at 52.9 – markedly better than in early 2009 but still historically low.

In November 2008, the University of Michigan index of consumer sentiment fell to 55.3 – a 28-year record low. The index rose in December before falling back nearly to November's low in February 2009. Between March 2009 and June 2009, the index rose each month – rising to 70.8 in June. Since June, the index has moved in a saw-toothed fashion. In September, the index reached its recent high (73.5). The index then fell in the next two months before recovering nearly all those losses in December, rising to 72.5. Compared to a year ago, the December 2009 reading is up 12.4 points.

Since mid April 2007, the ABC News/Washington Post Consumer Comfort index has not been above -40.0 and has moved in a relatively narrow range between -40 and -54. In late November 2008, the index fell to -54 -- setting the all-time record low for the index's now 24-year history. In late December 2009, the index stood toward the top of the range at -44. These readings stand in marked contrast to the index's record high of +38 set in early 2000.

Consumer Sentiment Up from 28 Year Low
To Highest Reading Since September



Source: University of Michigan Survey of Consumers.

During late 2008 and early 2009, the Conference Board index of leading economic indicators fell almost every month. However, following March 2009, the index has reported increases in eight consecutive months. The November 2009 leading index was 5.9 percent higher on a year-ago basis. This is the fastest year-ago growth rate seen since 2004 and is a dramatic change from March's 3.9 percent decline.

In a dramatic reversal from a year ago, recent Economic Cycle Research Institute (ECRI) weekly leading index readings point to recovery. In early December 2008, the index's smoothed annualized growth rate fell to its lowest reading in the index's forty year history (-29.7). By late April 2009, the growth rate had improved to -17.2, still pointing at decline, but a slower one. The growth rate then accelerated sharply over the next few months. By early October, the rate had risen to +28.1 – a record *high.* Since October, the rate has slowed but has remained at historically high levels. In late December 2009, the growth rate stood at +24.2.

<u>Employment</u>

Major employment readings are mixed. Many data point to a weak and worsening labor market. However, several measures indicate that declines have slowed substantially since the May 2009 Consensus Conference. Some data point to a bottoming out of employment. Some readings even suggest that the labor market has recently started expanding or is at least on the verge of expansion.

The U.S. unemployment rate has risen sharply since April 2008. Between January 2008 and April 2008, the unemployment rate fluctuated in the narrow band between 4.9 percent and 5.1 percent. However, the rate rose to 7.2 percent by the end of 2008. By October 2009, the rate had risen to 10.2 percent – the highest monthly rate since 1983. The rate fell slightly in November to 10.0 percent.

Several recent indicators point to a reduction in layoffs. At the same time, many point to a continued poor hiring picture.

In late December 2009, the four-week average of unemployment insurance initial claims fell for the 17th straight week to its lowest level in over a year. Compared to a year ago, the average was down 15.4 percent. More striking, between the May 2009 Consensus Conference and late December, the four-week average has fallen from 629,750 initial claims to 460,250 initial claims (a 26.9 percent drop). While the average is still above the 400,000 threshold which would indicate stable labor market conditions, the sizeable decline in the average (a leading economic indicator) is encouraging.

Challenger Report data indicate that job layoffs have eased over the course of 2009. In the first quarter of 2009, announced layoffs averaged 193,000 per month. Average announced layoffs, between September and November, have fallen to 57,000 per month.

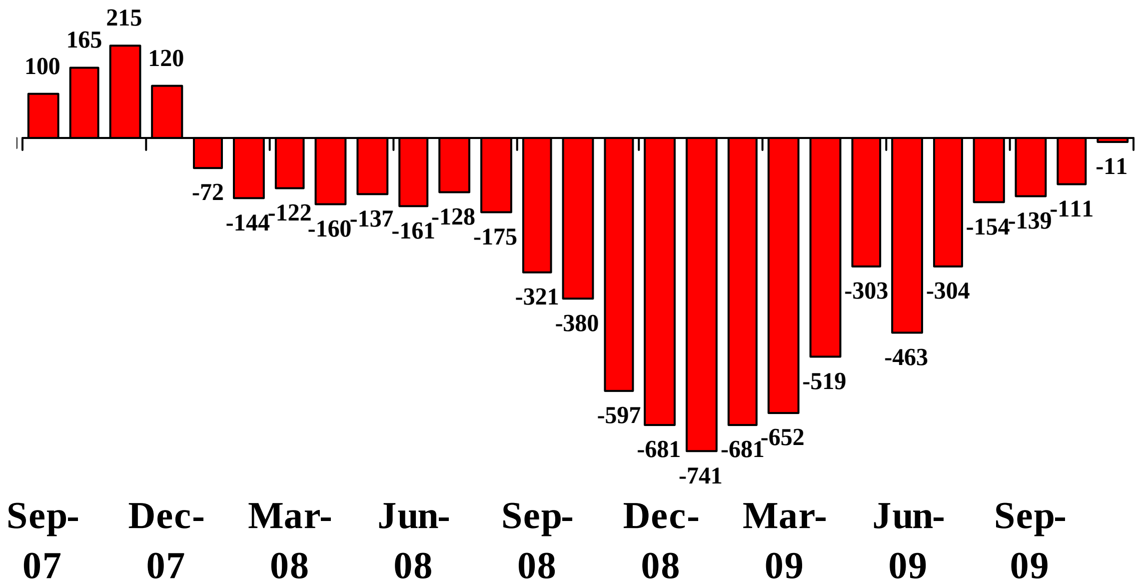
According to the most recent Job Openings and Labor Turnover Survey, the number of job openings fell in October 2009 to 2.5 million – down 26.1 percent from a year ago. Compared to a year ago, the jobs openings rate was down 0.5 of a percentage point to 1.9 percent. Hiring remained only slightly above its early 2009 trough and the hire rate fell to a new low of 3.0 percent. Separations continued to decline, falling to 4.2 million, the lowest number in the series' eight year history. Both layoffs and quit rates fell.

According to the December 2009 Conference Board survey, the share of consumers viewing jobs as plentiful fell to 2.9 percent, a new cyclical low and the lowest share since February 1983. The share of consumers finding jobs hard to get stood at 48.6 percent – down only slightly from November's 26-year high.

According to the National Federation of Independent Business, only eight percent of small businesses in November 2009 had unfilled job openings, which is unchanged since August 2009 and the lowest since 1986.

Since January 2008, employment has fallen every month, declining a total of 7.2 million jobs to its lowest level since March 2004. Compared to a year ago, overall employment is down 3.5 percent. However, declines have slowed markedly since early 2009. In the first quarter, monthly declines averaged 691,000 jobs per month. In sharp contrast, declines have averaged only 87,000 jobs over the past three months (September-November). In November, the economy lost only a net 11,000 jobs.

Employment Declines Have Slowed Markedly in Recent Months
(Monthly Change in Thousands)



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

Manufacturing employment remains particularly hard hit having lost 1.4 million jobs over the past year – an 11.0 percent reduction. In addition, the bursting housing bubble and credit crunch have exacted an enormous toll on the construction industry. Between November 2008 and November 2009, construction employment has fallen by 979,000 jobs, representing 14.1 percent of that industry's jobs. However, like the overall employment market, declines in these hard hit industries have slowed. While manufacturing employment fell an average of 202,000 jobs per month in 2009Q1, declines have averaged only 44,000 in the three most recent months. Similarly, construction employment declines have slowed from 124,000 jobs to 45,000 jobs.

Temporary help services employment, a leading indicator for the overall jobs market, suggest that labor markets are heading toward stability. While the temporary jobs sub-sector averaged a 73,000 monthly jobs *loss* in 2009Q1, the sub-sector has averaged a 38,000 jobs *gain* in the three most recent months.

Between August 2008 and September 2009, the ISM manufacturing employment index signaled a worsening manufacturing sector employment picture (index less than 50.0) every month. However, the index has improved considerably from early 2009. In 2009Q1, the index averaged 28.0 (a record low for a series that dates back to 1948). However, in the two most recent months reported, the index has indicated a slightly improving sector employment. The index rose to 53.1 in October, before falling to 50.8 in November.

Since January 2008, the ISM non-manufacturing component index has signaled worsening employment in the services sector in all but one month, when the index indicated a flat employment picture. While the index has improved compared with early 2009, the improvement has been slight and halting.

Vehicle Sales and Production

In early 2009, light vehicle sales fell off considerably, compared to 2008, to historic lows. Between May 2008 and February 2009, sales fell from a 14.2 million unit rate to a 9.1 million unit rate – the lowest light vehicle sales rate since December 1981. Adjusting for population, the February sales rate was the lowest since 1961. Vehicle sales rebounded slightly but remained below a 10.0 million unit rate through June 2009. With the enactment of the federal government "Cash for Clunkers" program, vehicle sales rose above a 10.0 million unit rate in July and increased substantially in August, rising to its highest sales rate in over a year (14.1 million unit rate). Following the incentive program, sales retreated in September before rising gradually in October and November.

Compared to a year ago, November 2009 light vehicle sales were up 5.0 percent with domestic sales up 8.0 percent and foreign sales down 3.5 percent. However, year-to-date, light vehicle sales were down 23.7 percent with both domestic and foreign sales each down by more than 20.0 percent.

Estimated CY 2009 light vehicle sales rate totaled 10.3 million – well below the 13.2 million unit rate for calendar year 2008 and substantially less than the 16.1 million unit sales rate in 2007. The 10.3 million unit rate is the lowest sales rate since calendar year 1970 (9.9 million).

Vehicle sales have flagged under the weight of weaker employment, substantially tighter credit markets and dramatic declines in household assets. The Big Three's precarious situation seriously harms Michigan's economy, which is tightly linked to the Big Three as the State's three largest private sector employers.

In late December 2008, using TARP funds, the Bush Administration extended a bridge loan package to help General Motors and Chrysler keep afloat. Both companies, however, needed more loans. As a condition of additional assistance, the Obama Administration required each firm to restructure in a manner that the Administration found necessary to assure financial viability. Working in close concert with the federal government, Chrysler reached agreements with its major creditors and the UAW, but failed to reach agreement with a few of its creditors by the May 1, 2009 deadline set by the Administration. As a result, the company entered into bankruptcy proceedings. GM filed for bankruptcy protection a month later.

Fortunately, Chrysler and General Motors remained in bankruptcy for a relatively short period of time. Chrysler emerged from bankruptcy on June 10, 2009 upon sealing a deal with Fiat under which the Italian automaker took partial ownership of Chrysler along with management control. GM emerged from bankruptcy on July 10, 2009 with the U.S. federal government taking 60 percent ownership of the auto company.

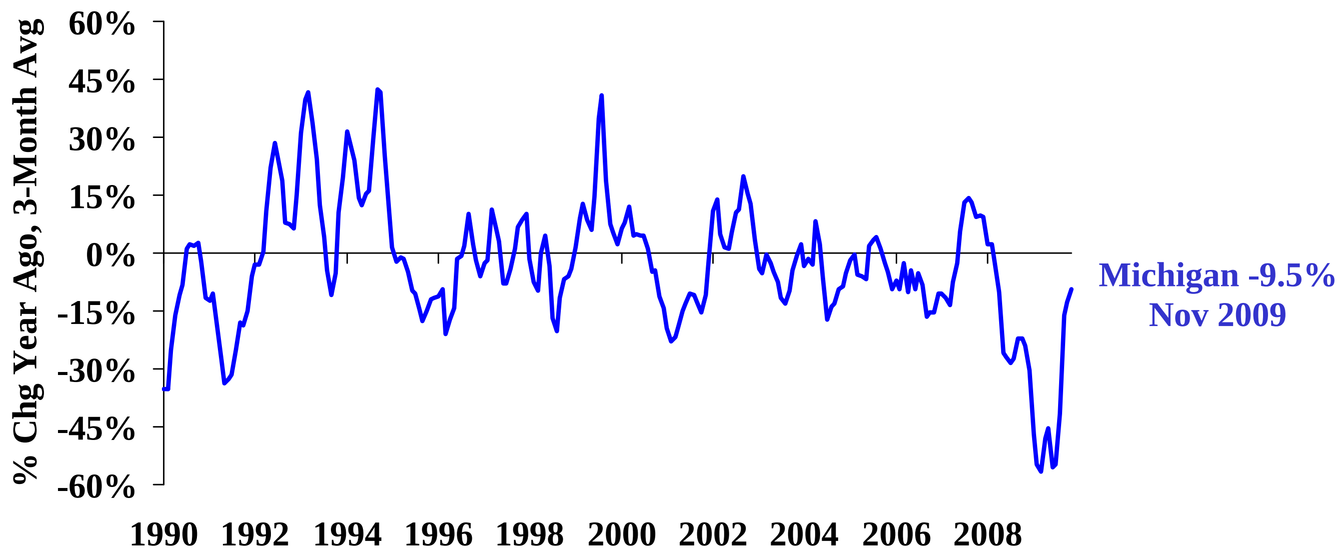
In November 2009, the three-month average of U.S. vehicle production was down 6.4 percent compared to a year ago. Year-ago comparisons have improved markedly as General Motors and Chrysler plants that were on extended closures have been reopening. In mid-2009, U.S. vehicle production had been down by more than 50 percent compared to mid-2008 levels.

Current Michigan Economic Conditions

Vehicle Production

In November 2009, the three-month average of Michigan vehicle production was down 9.5 percent compared to a year ago. Auto production was down 18.4 percent while truck production was essentially flat (+0.8 percent). Year-to-date, Michigan vehicle production is off by 39.6 percent compared to the first eleven months of 2008.

Michigan Vehicle Production Declines Have Slowed Substantially



Source: Automotive News and Michigan Department of Treasury.

Employment

Michigan's economy relies heavily on the performance of the manufacturing sector in general and the auto industry specifically. Given extremely weak manufacturing employment performance, declining vehicle production, continued declines in Big Three market share along with continued supply rationalization among vehicle suppliers, Michigan's employment performance has been below the national average. Substantial productivity gains in the vehicle industry have also contributed to Michigan's weaker employment performance.

Michigan wage and salary employment fell for the eighth consecutive year in 2008, falling 2.6 percent, compared to 1.4 percent declines in 2006 and in 2007. Michigan manufacturing employment fell for the ninth straight year in 2008, falling 7.2 percent.

Between November 2008 and November 2009, Michigan employment fell by 240,200 jobs (-5.9 percent). With its employment declining 17.1 percent, the manufacturing sector accounted for 94,900 of these lost jobs.

From Michigan's employment peak in June 2000 to November 2009, Michigan has lost 840,900 jobs (-17.9 percent). Since June 2000, Michigan manufacturing employment has fallen by 447,000 jobs, nearly a loss of half (49.2 percent) of the jobs in that sector at the state's overall employment peak.

Michigan's unemployment rate has remained in double-digits for each of the past 12 months. In September 2009, Michigan's unemployment rate increased to 15.3 percent – the state's highest rate since April 1983. Michigan's unemployment rate has since fallen slightly – dropping to 14.7 percent in November 2009. However, Michigan's November unemployment rate was the highest state rate in the nation.

Housing Market

Despite not being one of the major participants in the housing boom, with skyrocketing home prices and rising housing starts, Michigan has been hit disproportionately hard from the housing bust due to sharply declining employment.

In October 2009, according to Case-Shiller house price measures, the Detroit MSA recorded a 15.2 percent year-over-year house price decline, substantially steeper than the 7.3 percent average decline for the twenty U.S. metro areas surveyed for the measure. However, Detroit's October 2009 year-ago decline was the area's smallest drop since January 2008.

Compared to a year ago, November 2009 housing unit authorizations in Michigan were up 3.9 percent compared to a 1.3 percent increase nationally. Year-to-date, Michigan authorizations were down by 58.0 percent while U.S. authorizations fell 38.5 percent.

In 2009Q2, 15.8 percent of mortgages in Michigan were either delinquent or were in foreclosure according to the Mortgage Bankers Association. Michigan's share ranks as fourth highest behind Florida, Nevada and Arizona.

In November 2009, Michigan ranked sixth among U.S. states in foreclosure rates with one foreclosure for every 283 housing units -- compared to one foreclosure for every 417 units nationally (Realty Trac).

Personal Income

For the last three quarters, Michigan personal income has fallen compared to a year earlier. However, the declines have gotten smaller each quarter. While 2009Q1 Michigan personal income was down 3.5 percent from a year ago, 2009Q3 Michigan personal income dropped 2.0 percent from 2008Q3 – compared to a 1.6 percent drop nationally.

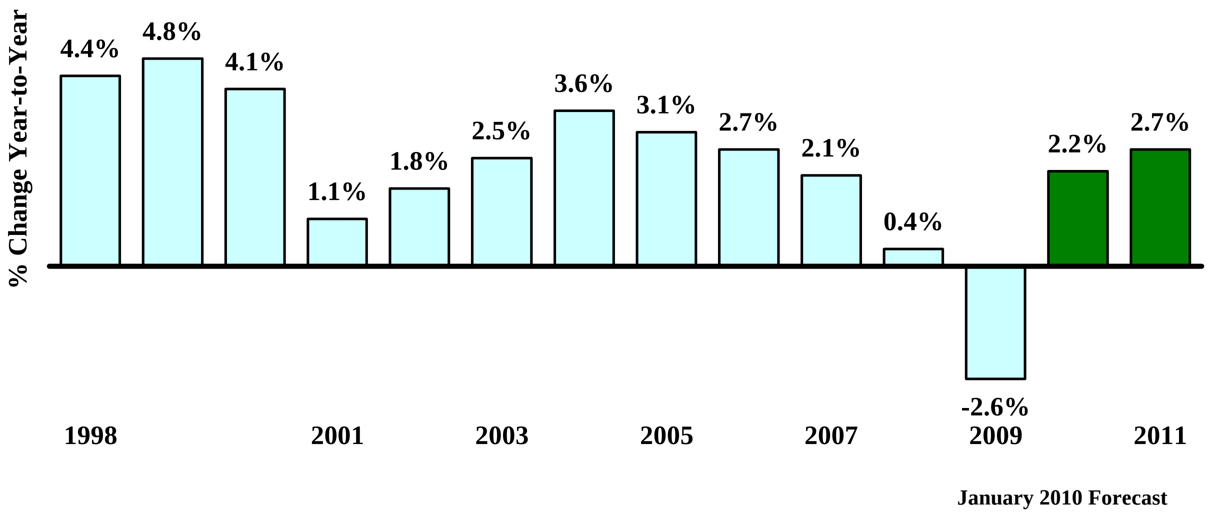
Michigan wage and salary income has decreased in each of the past five quarters. 2009Q1 saw the largest year-ago percent drop (-8.5 percent). In 2009Q3, Michigan wages and salaries were down 7.4 percent from 2008Q3. Nationally, wages and salaries fell 3.7 percent. Manufacturing wages and salaries were down very sharply in Michigan compared to a year ago (-18.8 percent) compared with a 10.7 percent decline nationally.

2010 and 2011 U.S. Economic Outlook

Summary

After declining 2.6 percent in 2009, real GDP is forecast to rise 2.2 percent in 2010 and then increase 2.7 percent in 2011. High consumer debt levels, still tight credit markets, a weak housing market and labor market are expected to restrain growth in 2010.

Real GDP Rebounds in 2010 and 2011



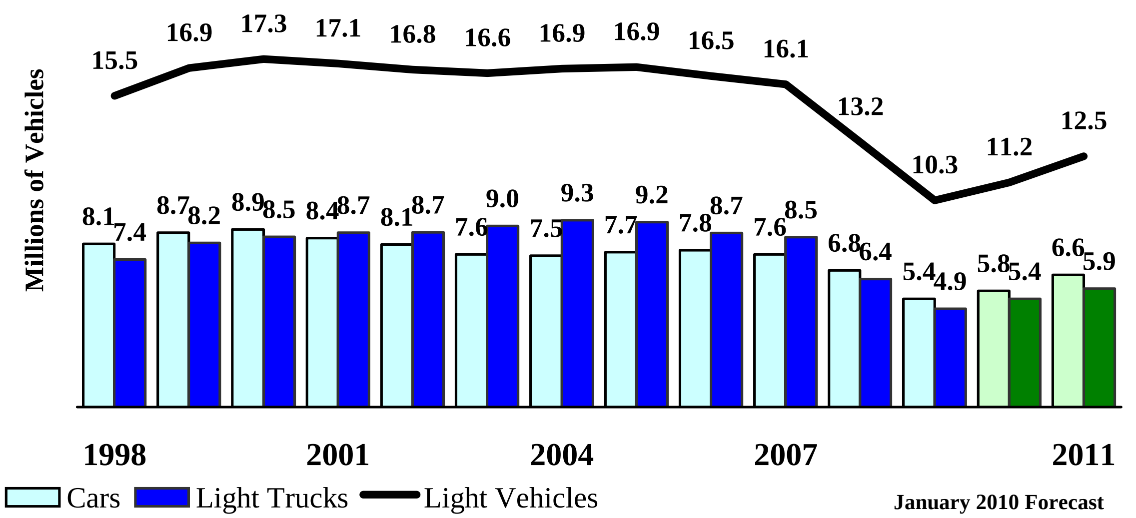
Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Consensus Forecast, January 2010.

Light vehicle sales are projected to increase to 11.2 million units in 2010 and rise again in 2011 to 12.5 million units. In 2010, the import share of light vehicle sales is expected to drop 1.2 percentage points to 25.5 percent before rising to 26.0 percent in 2011.

The U.S. unemployment rate is forecast to rise to 10.2 percent in 2010 – the first double digit annual U.S. unemployment rate in a history dating back to 1948. The rate is then expected to fall slightly to 9.7 percent in 2011. Following their first decline since 1955, overall consumer prices are forecast to rise 2.7 percent in 2010 and increase 2.3 percent in 2011. In fiscal year (FY) 2010, U.S. consumer prices are expected to rise 2.5 percent, followed by a 2.3 percent increase in FY 2011.

The short-term Treasury Bill rate is forecast to remain unchanged at 0.2 percent from 2009 to 2010. The rate is then expected to rise to 0.9 percent in 2011. The Aaa corporate interest rate is forecast to change slightly over the forecast horizon with the rate falling from 5.3 percent in 2009 to 5.0 percent in 2010 and 4.9 percent in 2011.

Vehicle Sales Rise from Near 40-Year Low



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Consensus Forecast, January 2010.

Forecast Risks

Severe challenges remain facing an economic recovery. These include a still shaky financial system accompanied by significantly tight lending standards and substantial hesitancy by many households to borrow. The housing sector remains weak. The durable goods sector and in particular transportation equipment continues to face substantial challenges going forward.

According to many economists, the U.S. economy has entered a recovery from the recession the nation experienced for well over a year. The questions now are "How strong?" and "How steady?". The baseline forecast places the recovery as beginning in 2009Q3 and sees the recovery as a slow but fairly steady one. Historically, a deep recession is followed by a sharp "V-shaped" recovery. The 2007-2009 recession was the most severe one since World War II with real GDP declining 3.7 percent from 2007Q4 to 2009Q2.

However, the economic recovery is facing some severe challenges. The recession did serious damage to household balance sheets and psyches, and significantly tightened credit conditions. The housing sector remains weak with housing starts near the record low set in the recession. Home values (and the worth of other assets) are still well below their pre-recession peaks. At the same time, the non-residential construction sector is worsening. Further, while employment declines have lessened considerably in recent months, the labor market remains in poor shape with the monthly U.S. unemployment rates in double-digits for the first time since 1983. Given these conditions, it seems more reasonable to peg the recovery as a gradual "U-shaped" one.

The related question is whether the current recovery will falter as fiscal and monetary policies that helped pull the economy out of recession are phased out resulting in a "W-shaped" recovery in which the economy falls back into recession followed by a second recovery.

In large part, the risks to the baseline represent the four major factors that precipitated the recession: the housing market, the roiled financial markets and the accompanying credit crunch, oil prices, and a depressed light vehicle sales market.

Housing Market. The baseline forecast expects substantial increases in housing starts each quarter over the forecast horizon. If the housing market fails to pick up as forecasted, the U.S. and Michigan economies would be weaker than expected. However, despite the projected increases, 2010 housing starts total well below 1.0 million units and only 1.1 million units in 2011. A stronger housing market would boost the overall economy. In addition, a substantially worsening non-residential construction market poses a significant risk.

Credit Crunch Impact. The baseline forecast assumes that financial markets will stabilize soon and remain stable even as the Federal Reserve ends many of its current support programs. The fragility of the financial system poses a substantial downward risk to the baseline forecast. Lawrence Summers, President Obama's chief economic advisor, recently commented "The kind of financial and economic collapse that looked very possible last fall appears remote right now." However, while less fragile than last year, significant fragility remains. There continues to be, for example, a significant number of small banks failing.

Auto Industry. The baseline forecast is for steadily improving light vehicle sales. However, the forecast assumes that all three Big Three vehicle manufacturers remain viable. The failure of one or more of the Big Three constitutes a large downside risk to the national forecast, but especially to the Michigan economic forecast. Along similar lines, continued financial pressures upon auto suppliers pose a significant risk to both the U.S. and Michigan economic outlooks.

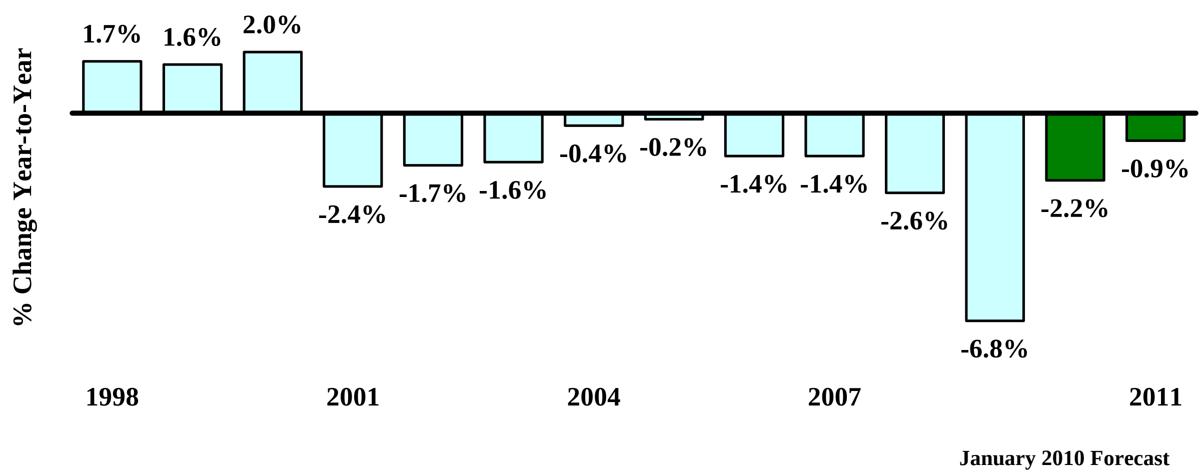
Oil Prices. Geopolitical concerns, increased demand, or a major supply disruption could raise oil prices drastically. Higher oil prices (and consequently higher gasoline prices) would retard domestic growth by depressing consumer sentiment, reducing households' disposable income and increasing input costs to businesses. Higher oil prices may lead the Federal Reserve to hike rates. This risk is heightened as many other countries around the world recover and thus boost demand.

Other Factors. Geopolitical factors (such as a domestic terrorist attack) remain a downside risk to the baseline forecast. It is also possible that the current outbreak of the new H1-N1 influenza strain – and more especially – the reaction to the outbreak could depress near term economic activity.

2010 and 2011 Michigan Economic Outlook

Michigan employment fell an estimated 6.8 percent in 2009 – its sharpest decline since 1958. State employment is expected to drop another 2.2 percent in 2010 and fall 0.9 percent in 2011. Struggles at the domestic Big Three automakers and vehicle suppliers along with concomitant restructurings will depress manufacturing employment.

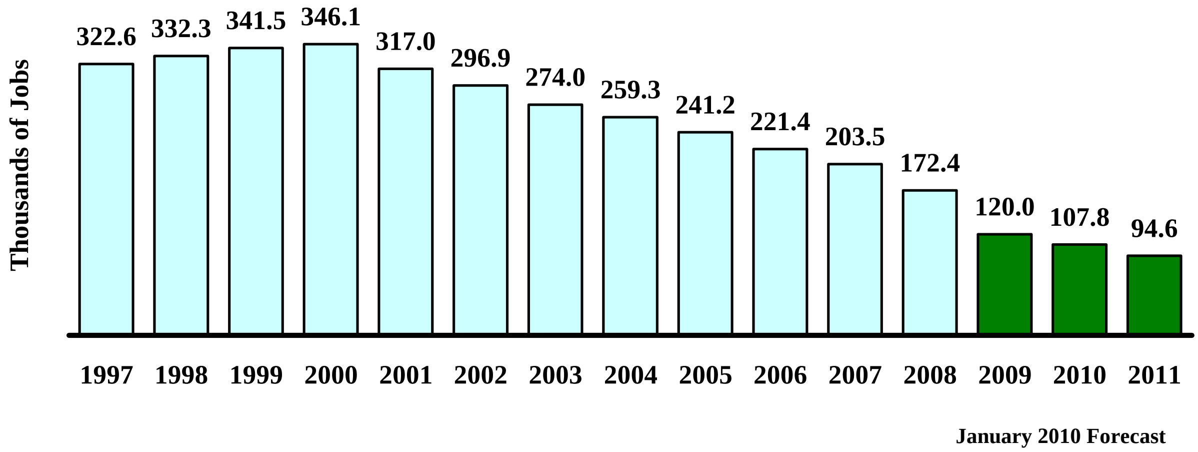
Michigan Wage and Salary Employment Declines for Eleventh Straight Year



Source: Michigan Department of Labor and Economic Growth, U.S. Bureau of Labor Statistics, and January 2010 Consensus Forecast.

The decline in Michigan transportation equipment employment is expected to continue but slow markedly from 2009's 30.4 percent decline. Based on agency averages, the sector's employment is projected to fall 10.2 percent in 2010 and 12.2 percent in 2011. Nevertheless, the projected 2011 level of Michigan transportation equipment (94,600 jobs) would equal just over one-fourth (27.3 percent) of the State's 2000 transportation equipment employment (346,100). Further, this forecast assumes that all three of the Big Three remain viable. The failure of one or more of the major automakers would further slash this sector's employment and, with spillover, sharply cut Michigan's manufacturing and overall employment level.

Michigan Transportation Equipment Employment Declines

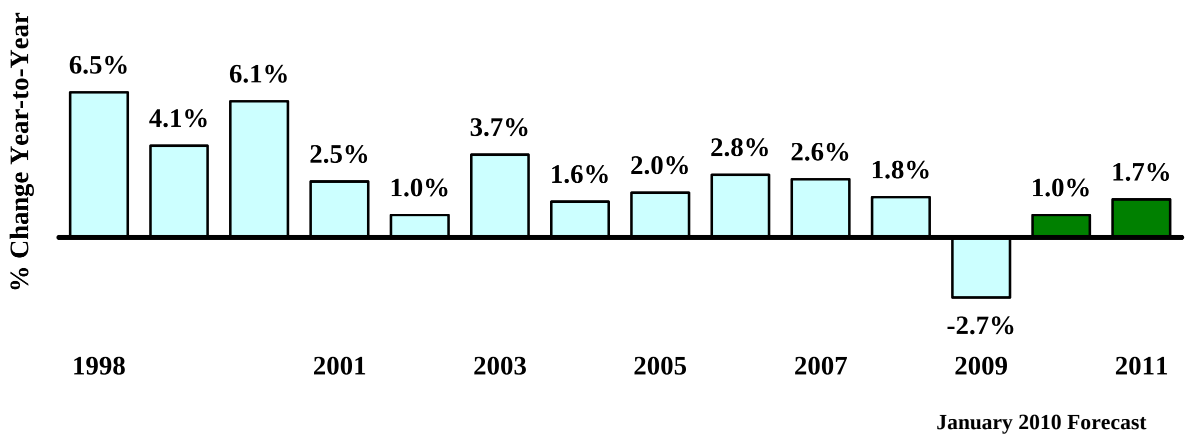


Source: Michigan Department of Labor and Economic Growth, U.S. Bureau of Labor Statistics, and January 2010 Agency Averages.

The consensus forecasts of overall Michigan employment project significantly smaller job losses than the estimated 282,000 job loss in 2009. The consensus projects a 2010 loss of 85,300 jobs and a 2011 drop of 34,100 jobs. However**,** 2011 would mark the eleventh straight year of Michigan employment declines. Further, 2011 wage and salary employment would be Michigan's lowest calendar year employment in 24 years. After soaring from 8.4 percent to 14.1 percent in 2009, Michigan's unemployment rate is expected to rise further to 15.7 percent in 2010 – marking the State's highest rate in at least 35 years. Michigan's unemployment rate is then forecast to fall to 15.3 percent in 2011.

After falling 7.9 percent in calendar year (CY) 2009, Michigan wages and salaries are projected to fall slightly in 2010 (-1.0 percent) and then rise 0.6 percent in 2011. In CY 2009, overall Michigan personal income is estimated to have declined 2.7 percent. Personal income is forecast to increase 1.0 percent in 2010 and to rise 1.7 percent in 2011. The overall CY price level, as measured by the Detroit CPI, is forecast to increase 2.4 percent in 2010 and then 1.9 percent in 2011. As a result, real (inflation adjusted) Michigan personal income is expected to fall 1.4 percent in 2010 and decline slightly in 2011 (-0.2 percent).

Michigan Personal Income Rises in Both 2010 and 2011



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Consensus Forecast, January 2010.

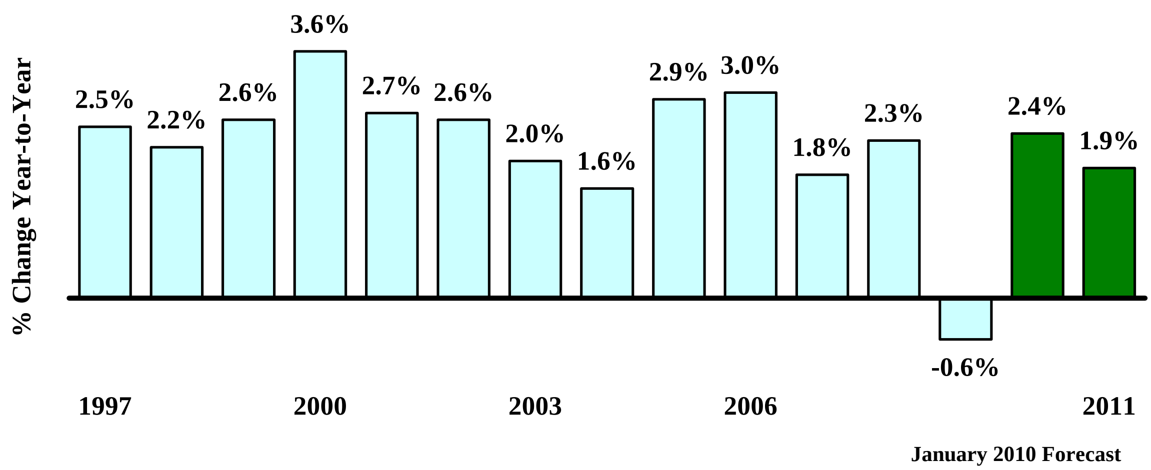
Table 1

Consensus Economic Forecast

January 2010

	Calendar 2008 Actual	Calendar 2009 Forecast	Percent Change from Prior Year	Calendar 2010 Forecast	Percent Change from Prior Year	Calendar 2011 Forecast	Percent Change from Prior Year
United States							
Real Gross Domestic Product (Billions of Chained 2005 Dollars)	$13,312	$12,966	-2.6%	$13,251	2.2%	$13,609	2.7%
Implicit Price Deflator GDP (2005 = 100)	108.5	110.0	1.2%	111.0	0.9%	112.8	1.6%
Consumer Price Index (1982-84 = 100)	215.3	214.7	-0.3%	220.5	2.7%	225.6	2.3%
Consumer Price Index - Fiscal Year (1982-84 = 100)	214.5	213.8	-0.3%	219.1	2.5%	224.1	2.3%
Personal Consumption Deflator (2000 = 100)	121.6	122.0	0.2%	124.4	2.0%	126.5	1.7%
3-month Treasury Bills Interest Rate (percent)	1.4	0.2		0.2		0.9	
Aaa Corporate Bonds Interest Rate (percent)	5.6	5.3		5.0		4.9	
Unemployment Rate - Civilian (percent)	5.8	9.3		10.2		9.7	
Housing Starts (millions of starts)	0.901	0.580	-35.6%	0.710	22.4%	1.100	54.9%
Light Vehicle Sales (millions of units)	13.2	10.3	-22.0%	11.2	8.7%	12.5	11.6%
Passenger Car Sales (millions of units)	6.8	5.4	-20.6%	5.8	7.4%	6.6	13.8%
Light Truck Sales (millions of units)	6.4	4.9	-23.4%	5.4	10.2%	5.9	9.3%
Import Share of Light Vehicles (percent)	25.4	26.7		25.5		26.0	
Michigan							
Wage and Salary Employment (thousands)	4,159	3,876	-6.8%	3,791	-2.2%	3,757	-0.9%
Unemployment Rate (percent)	8.4	14.1		15.7		15.3	
Personal Income (millions of dollars)	$349,612	$340,173	-2.7%	$343,575	1.0%	$349,416	1.7%
Real Personal Income (millions of 1982-84 dollars)	$170,752	$167,145	-2.1%	$164,863	-1.4%	$164,508	-0.2%
Wages and Salaries (millions of dollars)	$187,914	$173,069	-7.9%	$171,338	-1.0%	$172,366	0.6%
Detroit Consumer Price Index (1982-84 = 100)	204.7	203.5	-0.6%	208.4	2.4%	212.4	1.9%
Detroit CPI Fiscal Year (1982-84 = 100)	204.6	202.8	-0.9%	207.5	2.3%	211.4	1.9%

Overall Price Level Rises Moderately
Detroit CPI

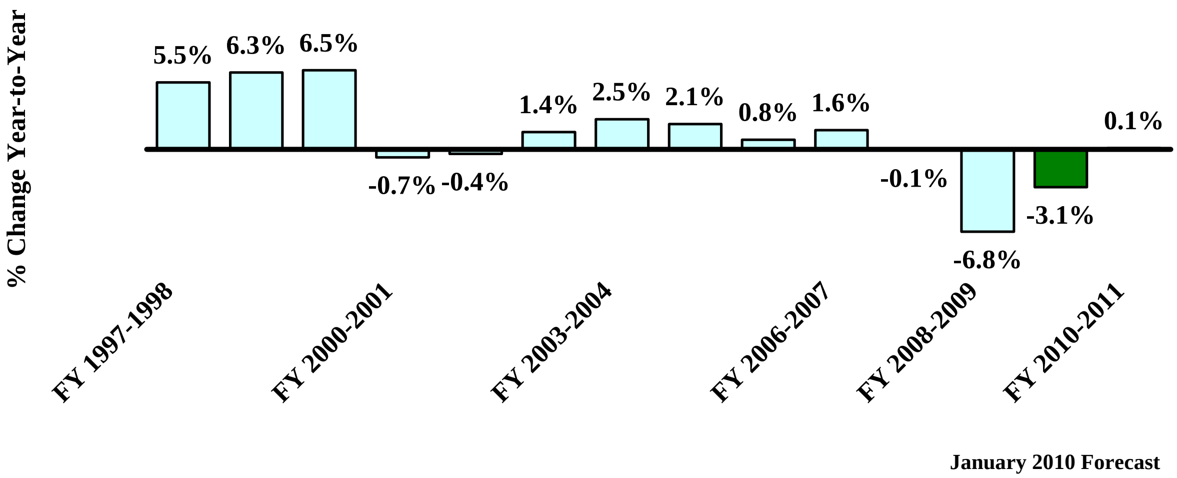


Source: U.S. Bureau of Labor Statistics and Consensus Forecast, January 2010.

Fiscal Year Economics

Michigan's largest taxes are the individual income tax ($5.9 billion in FY 2009), which includes refunds, and sales and use taxes ($7.2 billion). Income tax withholding is the largest income tax component. Withholding ($6.8 billion) is most affected by growth in wages and salaries. After falling 6.8 percent in FY 2009, Michigan wages and salaries are expected to fall 3.1 percent in FY 2010 and then rise very slightly (0.1 percent) in FY 2011.

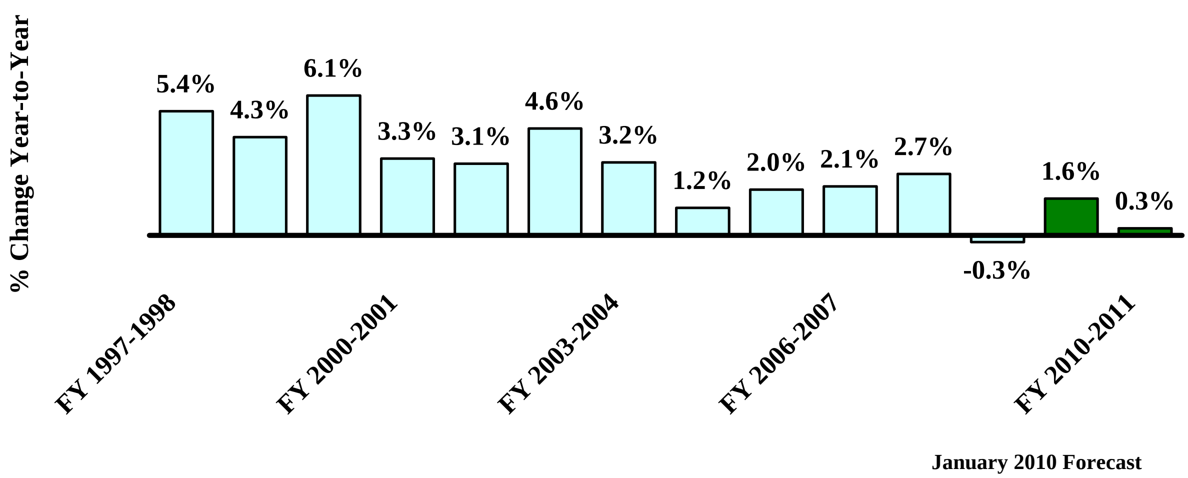
Michigan Wages and Salaries Drop Substantially in FY 10
Basis for Income Tax Withholding Collections



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Consensus Forecast, January 2010.

Sales and use taxes depend primarily on Michigan disposable (after tax) income and inflation. Disposable income is expected to rise 1.6 percent in FY 2010 and is forecast to increase 0.3 percent in FY 2011. In FY 2010, overall prices are expected to rise 2.3 percent before increasing 1.9 percent in FY 2011.

Michigan Disposable Income Increases Slightly
Basis for Sales and Use Tax Collections



Source: Research Seminar in Quantitative Economics, University of Michigan, and Consensus Forecast, January 2010.

CONSENSUS REVENUE ESTIMATES
January 11, 2010

Revenue Estimate Overview

The revenue estimates presented in this section consist of baseline revenues, revenue adjustments, and net revenues. Baseline revenues provide an estimate of the effects of the economy on tax revenues. For these estimates, FY 2009 is the base year. Any non-economic changes to the taxes occurring in FY 2010 and FY 2011 are not included in the baseline estimates. Non-economic changes are referred to in the tables as "tax adjustments." The net revenue estimates are the baseline revenues adjusted for tax adjustments.

This treatment of revenue is best illustrated with an example. Suppose tax revenues are $10.0 billion in a given year, and that based on the economic forecast, revenues are expected to grow by 5.0 percent per year. Baseline revenue would be $10.0 billion in Year 1, $10.5 billion in Year 2, and $11.0 billion in Year 3. Assume a tax rate cut is in place that would reduce revenues by $100 million in Year 1, $200 million in Year 2, and $300 million in Year 3. If Year 1 is the base year, the revenue adjustments for Year 1 would be $0 since the tax cut for this year is included in the base. The revenue adjustments for Year 2 would be $100 million, and the revenue adjustments for Year 3 would be $200 million, since the revenue adjustments are compared to the base year.

In the example above, the baseline revenues would be $10.0 billion, $10.5 billion, and $11.0 billion, for Years 1 through 3, respectively. The revenue adjustments would be $0 in Year 1, $100 million in Year 2, and $200 million in Year 3. The $200 million in Year 3 represents the tax cuts since Year 1. Net revenue would be $10.0 billion in Year 1, $10.4 billion in Year 2, and $10.8 billion in Year 3.

The following revenue figures are presented on a Consensus basis. Generally speaking, the Consensus estimates do not include certain one-time budget measures, such as withdrawals from the Budget Stabilization Fund, the sale of buildings, etc. The figures also assume the full statutory amount for revenue sharing payments to local governments from the sales tax. In addition, the estimates only include enacted legislation and do not include the effects of any proposed changes. The School Aid Fund estimates consist of taxes plus the transfer from the State Lottery Fund.

FY 2009 Revenue Review

FY 2009 GF-GP revenue totaled $7,365.6 million on a Consensus basis, a 21.3 percent decrease compared to FY 2008. The significant weakening of the national and state economies resulted in the sharp decline in revenues. FY 2009 SAF revenues totaled $10,922.2 million, a 5.1 percent decrease compared to FY 2008 (See Table 2).

Table 2

FY 2008-09 Consensus Revenue Estimates

(millions)

	Consensus May 15, 2009		Preliminary FY 2009		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue			$7,097.1	-13.3%	
Tax Cut Adjustments			$268.5		
Net Resources	$7,435.3	-20.6%	$7,365.6	-21.3%	($69.7)
School Aid Fund					
Baseline Revenue			$10,896.3	-8.5%	
Tax Cut Adjustments			$25.9		
Net Resources	$10,943.7	-4.9%	$10,922.2	-5.1%	($21.5)
Combined					
Baseline Revenue			$17,993.3	-10.5%	
Tax Cut Adjustments			$294.4		
Net Resources	$18,378.9	-11.9%	$18,287.8	-12.4%	($91.2)

Prepared By: Office of Revenue and Tax Analysis, Michigan Department of Treasury

FY 2010 Revenue Outlook

FY 2010 GF-GP revenue is forecast to be $6,898.4 million, a 2.9 percent baseline decline, and a 6.3 percent decline after tax adjustments. The FY 2010 estimate is $51.3 million below the May 2009 Consensus estimate.

SAF revenue is forecast to be $10,458.1 million, representing a 4.0 percent baseline revenue decline and a 4.2 percent decline after tax adjustments. The FY 2010 SAF estimate is $105.0 million below the May 2009 Consensus estimate (See Table 3).

Table 3

FY 2009-10 Consensus Revenue Estimates

(millions)

	Consensus May 15, 2009		Consensus January 11, 2010		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue			$6,890.6	-2.9%	
Tax Cut Adjustments			$7.8		
Net Resources	$6,949.7	-6.5%	$6,898.4	-6.3%	($51.3)
School Aid Fund					
Baseline Revenue			$10,458.1	-4.0%	
Tax Cut Adjustments			$0.0		
Net Resources	$10,563.0	-3.5%	$10,458.1	-4.2%	($105.0)
Combined					
Baseline Revenue			$17,348.7	-3.6%	
Tax Cut Adjustments			$7.8		
Net Resources	$17,512.7	-4.7%	$17,356.5	-5.1%	($156.2)

Prepared By: Office of Revenue and Tax Analysis, Michigan Department of Treasury

FY 2011 Revenue Outlook

FY 2011 GF-GP revenue is estimated to be $6,968.4 million, a 2.0 percent baseline increase and a 1.0 percent increase after tax adjustments. The FY 2011 GF-GP revenue estimate is up $70.0 million above the current GF-GP estimate for FY 2010. SAF revenue is forecast to be $10,480.5 million; representing a 0.1 percent baseline increase and a 0.2 percent net increase. The FY 2011 SAF estimate is $22.4 million above the current SAF estimate for FY 2010 (see Table 4).

Table 4

FY 2010-11 Consensus Revenue Estimates

(millions)

	Consensus January 11, 2010	
	Amount	**Growth**
General Fund - General Purpose		
Baseline Revenue	$7,025.2	2.0%
Tax Cut Adjustments	($56.9)	
Net Resources	$6,968.4	1.0%
School Aid Fund		
Baseline Revenue	$10,464.8	0.1%
Tax Cut Adjustments	$15.7	
Net Resources	$10,480.5	0.2%
Combined		
Baseline Revenue	$17,490.0	0.8%
Tax Cut Adjustments	($41.1)	
Net Resources	$17,448.9	0.5%

Prepared By: Office of Revenue and Tax Analysis, Michigan Department of Treasury

Constitutional Revenue Limit

Article IX, Section 26, of the Michigan Constitution establishes a limit on the amount of revenue State government can collect in any given fiscal year. The revenue limit for a given fiscal year is equal to 9.49 percent of the State's personal income for the calendar year prior to the year in which the fiscal year begins. FY 2008 revenue is compared to CY 2006 personal income. If revenues exceed the limit by less than 1 percent, the State may deposit the excess into the Budget Stabilization Fund (BSF). If the revenues exceed the limit by more than 1 percent, the excess revenue is refunded to taxpayers.

FY 2008 revenues were $4.7 billion below the revenue limit. State revenues will also be well below the limit for FY 2009 through FY 2011. FY 2009 revenues are expected to be $7.7 billion below the limit, FY 2010 revenues $8.9 billion below the limit, and FY 2011 revenues are expected to be $7.8 billion below the limit (See Table 5).

Table 5

Consensus Constitutional Revenue Limit Calculation

(millions)

	FY 2008	FY 2009	FY 2010	FY 2011
	Final Apr 2009	Consensus Jan 2010	Consensus Jan 2010	Consensus Jan 2010
Revenue Subject to Limit	$27,716.3	$25,105.8	$24,239.0	$24,498.0
Revenue Limit	**CY 2006**	**CY 2007**	**CY 2008**	**CY 2009**
Personal Income	$341,075	$345,885	$349,612	$340,173
Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	$32,368.0	$32,824.5	$33,178.2	$32,282.4
Amount Under (Over) Limit	**$4,651.7**	**$7,718.7**	**$8,939.2**	**$7,784.4**

Budget Stabilization Fund Calculation

The Management and Budget Act contains provisions for calculating a recommended deposit or withdrawal from the BSF. The calculation looks at personal income net of transfer payments. The net personal income figure is adjusted for inflation. The change in this figure for the calendar year determines whether a pay-in or pay-out is dictated. If the formula calls for a deposit into the BSF, the deposit is made in the next fiscal year. If the formula calls for a withdrawal, the withdrawal is made during the current fiscal year.

If real personal income grows by more than 2 percent in a given calendar year, the fraction of income growth over 2 percent is multiplied by the current fiscal year's GF-GP revenue to determine the pay-in for the next fiscal year. If real personal income declines, the percentage deficiency under zero is multiplied by the current fiscal year's GF-GP revenue to determine the withdrawal available for the current fiscal year. If the change in real personal income is between 0 and 2 percent, no pay-in or withdrawal is indicated.

Real calendar year personal income for Michigan is expected to decrease 1.3 percent in 2010. Thus, the formula has a withdrawal of $89.7 million for FY 2010 (See Table 6). In 2011, real calendar year personal income for Michigan is forecast to decrease 0.1 percent, and the formula calls for a withdrawal of $7.0 million in FY 2011 (See Table 7). Withdrawals will be limited by the available balance of the BSF, which is currently just over $2 million.

Table 6

Budget and Economic Stabilization Fund Calculation
Based on CY 2010 Personal Income Growth
Consensus Calculation

	CY 2009	CY 2010
Michigan Personal Income	$ 340,173 [1]	$ 343,575 [1]
less Transfer Payments	$ 75,491 [1]	$ 79,093 [1]
Income Net of Transfers	$ 264,682	$ 264,482
Detroit CPI	2.036 [2]	2.061 [3]
for 12 months ending	(June 2009)	(June 2010)
Real Adjusted Michigan Personal Income	$ 130,008	$ 128,306
Change in Real Adjusted Personal Income		-1.3%
Amount Under 0%		-1.3%
GF-GP Revenue Fiscal Year 2009-2010		$ 6,898.4

	FY 2009-2010
BSF Pay-Out Calculated for FY 2010	$ (89.7)

Notes:

[1] Personal Income and Transfer Payments, Consensus Forecast, January 2010.

[2] Detroit Consumer Price Index, Average of 6 monthly values reported by BLS for each 12-month period.

[3] Detroit Consumer Price Index, Consensus Forecast, January 2010.

Table 7

Budget and Economic Stabilization Fund Calculation
Based on CY 2011 Personal Income Growth
Consensus Calculation

		CY 2010			CY 2011	
Michigan Personal Income	$	343,575	(1)	$	349,416	(1)
less Transfer Payments	$	79,093	(1)	$	79,633	(1)
Income Net of Transfers	$	264,482		$	269,783	
Detroit CPI		2.061	(2)		2.104	(2)
for 12 months ending		(June 2009)			(June 2010)	
Real Adjusted Michigan Personal Income	$	128,306		$	128,224	
Change in Real Adjusted Personal Income					-0.1%	
Amount Under 0%					-0.1%	
GF-GP Revenue Fiscal Year 2010-2011				$	6,968.4	
					FY 2009-2010	
BSF Pay-Out Calculated for FY 2011				$	(7.0)	

Notes:

(1) Personal Income and Transfer Payments, Consensus Forecast, January 2010.

(2) Detroit Consumer Price Index, Consensus Forecast, January 2010.

School Aid Fund Revenue Adjustment Factor

The School Aid Fund (SAF) revenue adjustment factor for the next fiscal year is calculated by dividing the sum of current year and subsequent year SAF revenue by the sum of current year and prior year SAF revenue. For example, the FY 2011 SAF revenue adjustment factor is calculated by dividing the sum of FY 2010 and FY 2011 SAF revenue by the sum of FY 2009 and FY 2010 SAF revenue. The SAF revenue totals are adjusted for any change in the rate and base of the SAF taxes. The year for which the adjustment factor is being calculated is used as the base year for any tax adjustments. For FY 2011, the SAF revenue adjustment factor is calculated to be 0.9798 (See Table 8).

Table 8

Consensus School Aid Revenue Adjustment Factor

For Fiscal Year FY 2011

	FY 2009	FY 2010	FY 2011
Baseline SAF Revenue	$10,896.3	$10,458.1	$10,464.8
Balance Sheet Adjustments	$25.9	$0.0	$15.7
Net SAF Estimates	$10,922.2	$10,458.1	$10,480.5
Subtotal Adjustments to FY 2011 Base	($10.2)	$15.7	$0.0
Baseline Revenue on a FY 2011 Base	$10,912.0	$10,473.8	$10,480.5

School Aid Fund Revenue Adjustment Calculation for FY 2011

Sum of FY 2009 & FY 2010	$10,912.0	+	$10,473.8	=	$21,385.8
Sum of FY 2010 & FY 2011	$10,473.8	+	$10,480.5	=	$20,954.3

FY 2011 Revenue Adjustment Factor	**0.9798**

Note: Factor is calculated off a FY 2011 base year.

Revenue Detail

The estimated tax and revenue totals in Tables 9 through 11 include the effects of all enacted tax changes except sales tax savings resulting from reductions in revenue sharing payments to local units. The net revenue totals by tax are presented separately for GF-GP and for the SAF (See Tables 9 and 10). Tax totals for the income, sales, use, tobacco and casino taxes for all funds are also included (See Table 11).

Table 9

Consensus General Fund General Purpose Revenue Detail

(millions)

	FY 2009		FY 2010		FY 2011	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
GF-GP Tax Amounts						
Income Tax	$3,959.2	-22.5%	$3,494.4	-11.7%	$3,545.4	1.5%
Sales	$4.2	-94.5%	$58.9	1291.2%	$79.3	34.7%
Use	$744.0	-18.4%	$762.0	2.4%	$773.3	1.5%
Cigarette	$208.4	-2.1%	$197.0	-5.5%	$189.5	-3.8%
Beer & Wine	$50.8	-0.2%	$51.0	0.4%	$52.0	2.0%
Liquor Specific	$38.0	1.9%	$38.2	0.5%	$38.5	0.8%
Single Business Tax	$24.1	-95.8%	($20.0)	-183.0%	$0.0	NA
Insurance Co. Premium	$261.0	16.9%	$271.0	3.8%	$284.6	5.0%
Michigan Business Tax	$1,530.6	-1.3%	$1,501.7	-1.9%	$1,490.4	-0.7%
Telephone & Telegraph	$63.0	-22.0%	$62.0	-1.6%	$63.0	1.6%
Casino Wagering	$11.6	-24.7%	$0.0	-100.0%	$0.0	NA
Oil & Gas Severance	$47.2	-51.4%	$55.0	16.5%	$60.0	9.1%
GF-GP Other Taxes	$36.9	-29.0%	$34.0	-7.9%	$30.0	-11.8%
Total GF-GP Taxes	$6,979.1	-22.3%	$6,505.2	-6.8%	$6,606.1	1.6%
GF-GP Non-Tax Revenue						
Federal Aid	$31.2	110.8%	$29.0	-7.1%	$29.0	0.0%
From Local Agencies	$1.0	900.0%	$0.5	-50.0%	$0.5	0.0%
From Services	$9.4	-48.9%	$10.0	6.4%	$10.0	0.0%
From Licenses & Permits	$28.8	29.1%	$29.0	0.7%	$29.0	0.0%
Miscellaneous	$37.4	-19.4%	$40.0	7.0%	$40.0	0.0%
Driver Responsibility Fees	$101.9	-3.6%	$102.0	0.1%	$102.0	0.0%
Interfund Interest	($33.2)	-39.0%	($30.0)	-9.6%	($65.0)	116.7%
Liquor Purchase	$161.0	1.1%	$163.0	1.2%	$165.0	1.2%
Charitable Games	$11.8	11.3%	$11.8	0.0%	$11.8	0.0%
Transfer From Escheats	$37.2	-25.0%	$38.0	2.2%	$40.0	5.3%
Other Non Tax	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Total Non Tax	$386.5	3.7%	$393.3	1.8%	$362.3	-7.9%
Total GF-GP Revenue	$7,365.6	-21.3%	$6,898.4	-6.3%	$6,968.4	1.0%

Table 10

Consensus School Aid Fund Revenue Detail

	FY 2009		FY 2010		FY 2011	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
School Aid Fund						
Income Tax	$1,895.3	-10.5%	$1,777.4	-6.2%	$1,802.8	1.4%
Sales Tax	$4,424.7	-10.2%	$4,281.8	-3.2%	$4,320.9	0.9%
Use Tax	$368.5	-19.8%	$381.0	3.4%	$386.7	1.5%
Liquor Excise Tax	$37.6	1.9%	$38.2	1.6%	$38.5	0.8%
Cigarette & Tobacco	$410.4	-3.4%	$384.2	-6.4%	$367.0	-4.5%
State Education Tax	$2,040.6	-1.9%	$1,875.0	-8.1%	$1,800.0	-4.0%
Real Estate Transfer	$125.3	-26.2%	$127.0	1.4%	$135.0	6.3%
Michigan Business Tax	$729.0	NA	$726.7	-0.3%	$746.3	0.0%
Industrial Facilities Tax	$41.8	-51.5%	$32.8	-21.5%	$32.8	0.0%
Casino (45% of 18%)	$108.1	-3.6%	$109.6	1.4%	$112.0	2.2%
Commercial Forest	$3.0	-25.0%	$3.0	0.0%	$3.1	3.3%
Other Spec Taxes	$13.3	3.9%	$13.2	-0.8%	$13.2	0.0%
Subtotal Taxes	$10,197.6	-5.3%	$9,750.1	-4.4%	$9,758.3	0.1%
Lottery Transfer	$724.5	-2.2%	$708.1	-2.3%	$722.2	2.0%
Total SAF Revenue	$10,922.1	-5.1%	$10,458.1	-4.2%	$10,480.5	0.2%

Table 11

Consensus Major Tax Totals

	FY 2009		FY 2010		FY 2011	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
Major Tax Totals (Includes all Funds)						
Income Tax	$5,855.6	-19.0%	$5,273.3	-9.9%	$5,349.7	1.4%
Sales Tax	$6,089.1	-10.1%	$5,894.5	-3.2%	$5,947.6	0.9%
Use Tax	$1,112.5	-19.2%	$1,143.0	2.7%	$1,160.0	1.5%
Cigarette and Tobacco	$1,044.7	-2.7%	$981.8	-6.0%	$942.5	-4.0%
Casino Tax	$121.4	-6.4%	$109.6	-9.7%	$112.0	2.2%