Administration Estimates Michigan Economic and Revenue Outlook

FY 2005-06 and FY 2006-07

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Revenue Review and Outlook

- FY 2005 General Fund-General Purpose (GF-GP) revenue increased to $8,308.8 million, a 3.4 percent increase over FY 2004. One-time revenues, including unusually large estate tax payments, accounted for a large part of the increased revenue. School Aid Fund (SAF) revenue rose 2.8 percent to $10,909.9 million.
- FY 2006 GF-GP revenue is projected to decline 0.3 percent to $8,280.4 million. This total is $72.6 million above the January 2006 Consensus estimate.[1] SAF revenue is projected to increase 2.7 percent to $11,205.0 million, $25.9 million less than the January 2006 Consensus estimate.
- FY 2007 GF-GP revenue is forecast to increase 2.2 percent to $8,463.1 million. This total represents an $85.9 million increase over the January 2006 Consensus estimate. FY 2007 SAF revenue is forecast to grow 3.3 percent to $11,571.4 million. This represents a $19.7 million decline compared to the January 2006 Consensus estimate.

2006 and 2007 U.S. Economic Outlook

- Real gross domestic product growth is forecast to average 3.5 percent in 2006 and 2.8 percent in 2007, following 3.5 percent growth in 2005.
- Employment is projected to continue growing over the forecast horizon. The U.S. unemployment rate is forecast to average 4.7 percent in both 2006 and 2007.
- Historically low interest rates, increasingly creative financing arrangements, along with higher home prices, have provided consumers with the ability to purchase housing at historically high levels, refinance existing mortgages, and withdraw substantial mortgage equity. However, with wage and commodity price pressures building, interest rates are projected to increase through mid 2006, limiting the ability of consumers to use their houses to support consumption.
- Light vehicle sales are forecast to be 16.7 million units in 2006 and 16.4 million units in 2007.
- Consumer price inflation is forecast to average 2.8 percent in 2006 and 2.2 percent in 2007.

[1] Part of the increase ($11.1 million) was due to Public Act 69 of 2006 which reduced the share of the sales tax going to the Comprehensive Transportation Fund and increased the General Fund share.

2006 and 2007 Michigan Economic Outlook

- In 2006, Michigan wage and salary employment is forecast to fall 0.8 percent and rise 0.1 percent in 2007. Private non-manufacturing employment is projected to increase by 34,700 jobs in 2007 while manufacturing employment declines are expected to slow.
- The Michigan unemployment rate is forecast to remain unchanged at 6.7 percent in both 2006 and 2007.
- Wages and salaries income is forecast to increase 2.2 percent in CY 2006 and 3.4 percent in CY 2007. Personal income will post solid increases throughout the forecast horizon. In 2006 and 2007, personal income is forecast to rise 4.2 percent and 4.4 percent, respectively.
- In FY 2006 and FY 2007, Michigan wage and salaries income is expected to grow 2.4 percent and 3.0 percent, respectively. Disposable income is expected to rise 3.9 percent in FY 2006 and 4.2 percent in FY 2007.

Forecast Risks

A major supply disruption, increased demand, or heightened geopolitical tensions could raise oil prices well above the baseline forecast projections. This, in turn, would slow domestic demand more than forecasted along with spurring higher than expected inflation.

If international confidence in the dollar declines dramatically, the value of the dollar may fall sharply. A plummeting dollar could shake financial markets, severely curtailing both consumption and investment, and thus slow economic growth sharply. A rapidly falling dollar would also put upward pressure on inflation. A substantial decline in investor confidence in the long-term bond market would sharply decrease bond prices and significantly increase longer-term interest rates (which move in the opposite direction of bond prices). A spike in long-term interest rates would slow the housing sector, a major growth engine in the current economy, as well as consumption and investment growth in general. Thus, much higher long-term rates would severely curtail overall economic growth.

Firms' increased pricing power, increased obsolescence of current capacity, tighter labor markets, higher commodity prices, and rising health care and pension costs may lead to higher inflation than the baseline forecast projects. This higher inflation rate may crimp consumption and investment spending – especially if accompanied by even more aggressive inflation fighting on the part of the Federal Reserve.

A flattening or an outright decline in home prices would slow economic growth. Further, if a national housing bubble does exist and it bursts over the forecast horizon, there is a chance that the U.S. economy could slow severely. Coupled with other risks materializing, such as sharply higher oil prices and a rapidly declining dollar, a collapsing housing market could send the U.S. economy into a recession.

Geopolitical factors remain a forecast risk.

On the other hand, productivity could grow faster than expected. Faster productivity would both curb inflation and fuel growth. Similarly, oil prices could fall below baseline projections and support higher growth and lower inflation.

ECONOMIC REVIEW AND OUTLOOK
May 17, 2006

Current U.S. Economic Situation

Summary

The current U.S. economic expansion is four and a half years old, having begun in November 2001. Since the expansion began, real gross domestic product (GDP) has grown at a 3.3 percent annual rate. Over this time period, real consumption expenditures, expanding at a 3.2 percent rate, have grown at about the same pace as overall economic growth. Business fixed investment has grown at a somewhat faster pace (4.6 percent). However, residential construction has increased at a very rapid rate, averaging 7.9 percent growth since the expansion began. Import growth has outpaced export growth (8.0 percent vs. 5.9 percent). Government has grown at only a 2.5 percent annual rate with state and local government spending expanding at just one percent per year.

In 2005, real GDP grew at a 3.5 percent annual rate, down from 4.2 percent growth in 2004. Real consumption spending in 2005 matched overall economic growth while business fixed investment grew 8.6 percent. Residential construction increased 7.1 percent. Export growth slightly outpaced import growth. Government spending grew at only a 1.8 percent annual rate.

CY 2005 light vehicle sales totaled 16.9 million units, marking the seventh straight year that light vehicle sales topped 16.5 million units. In 2005, national vehicle production fell 0.3 percent.

Housing starts, reflecting the booming housing market, surpassed 2.0 million units and rose to their highest level since 1972. National payroll employment rose 1.5 percent, marking the second straight annual increase. With the rise in employment, the U.S. unemployment rate fell to 5.1 percent, down from 5.5 percent in 2004.

With the end of "employee pricing for everyone" incentives, durable consumption fell sharply in the final quarter of 2005, declining at a 16.6 percent annual rate. As a result, overall consumption grew at just a 0.9 percent annual rate. Boosted by higher oil prices, import growth outpaced export growth by more than two to one. Owing to the timing of appropriations, federal defense spending fell at an 8.9 percent annual rate. Taken together, these factors depressed fourth quarter economic growth substantially. Real GDP grew at a 1.7 percent annual rate in the fourth quarter -- its slowest pace in three years.

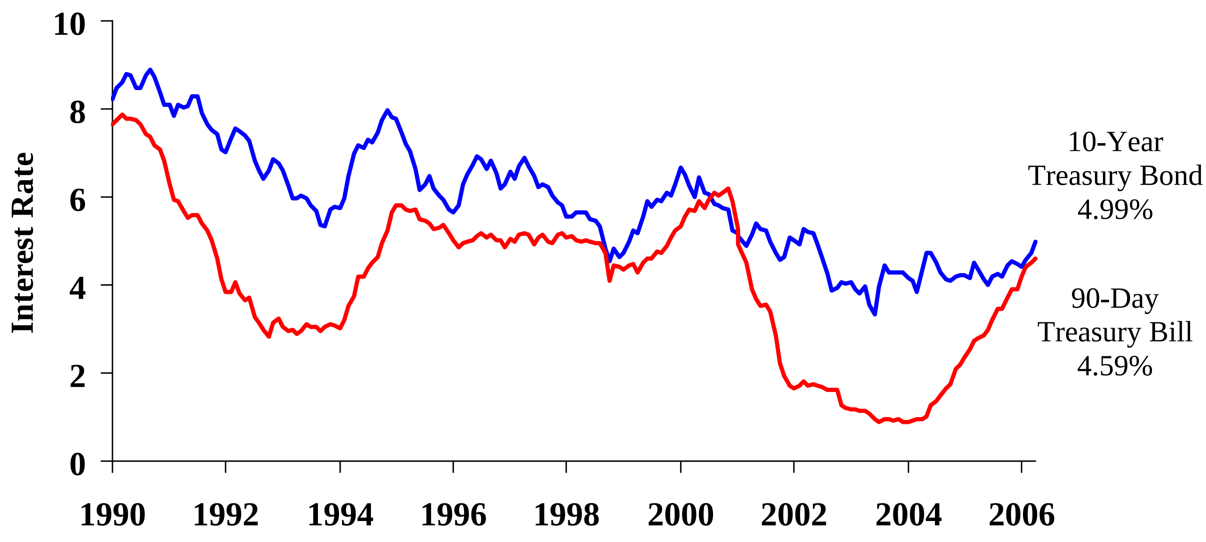
However, economic growth rebounded sharply in the first quarter of 2006 with the advance estimate showing real GDP growing at a 4.8 percent annual rate. Real consumption grew at a 5.5 percent annual rate while business fixed investment rose sharply, increasing at a 14.3 percent rate. Real government spending is estimated to have rebounded to 3.9 percent growth, despite flat state and local government spending. Residential construction rose at a 2.6 percent annual rate, marking the second straight quarter of sub 3.0 percent growth.

Low mortgage rates, increasingly more creative financing, and speculative buying have helped support a strong housing market. In addition, the vibrant housing market has, in turn, supported strong consumption growth and has allowed for a low or even negative savings rate. As the housing market cools, consumption growth will likely slow as consumers rebuild their savings.

Beginning in June 2004, the Federal Reserve Open Market Committee (FOMC) has increased the target federal funds rate 25 basis points at each of its meetings. At its March 2006 meeting, the Committee raised the target rate for the fifteenth time, increasing the rate to 4.75 percent, the highest federal funds rate in five years. During the 2001 downturn, the FOMC had reduced the federal funds rate to the lowest level in 46 years. As the expansion has taken hold, the FOMC has been raising rates to reduce monetary stimulus.

Despite FOMC actions, long-term interest rates have remained historically low. Between June 2004, when the FOMC began raising the federal funds rate and March 2006, the ten-year Treasury bond rate was essentially unchanged, falling 0.01 percentage points to 4.72 percent. Over the same time period, the three-month Treasury bill rate rose by 3.24 percentage points to 4.51 percent. Increased foreign investment, higher domestic business savings and relatively contained inflationary expectations helped keep long-term rates low. However, long-term rates have risen in recent months. After falling to 4.00 percent in June 2005, the ten-year Treasury bond rate averaged 4.72 percent in March 2006 and rose to 4.99 percent in April.

Both Short and Long Term
Interest Rates Now Rising



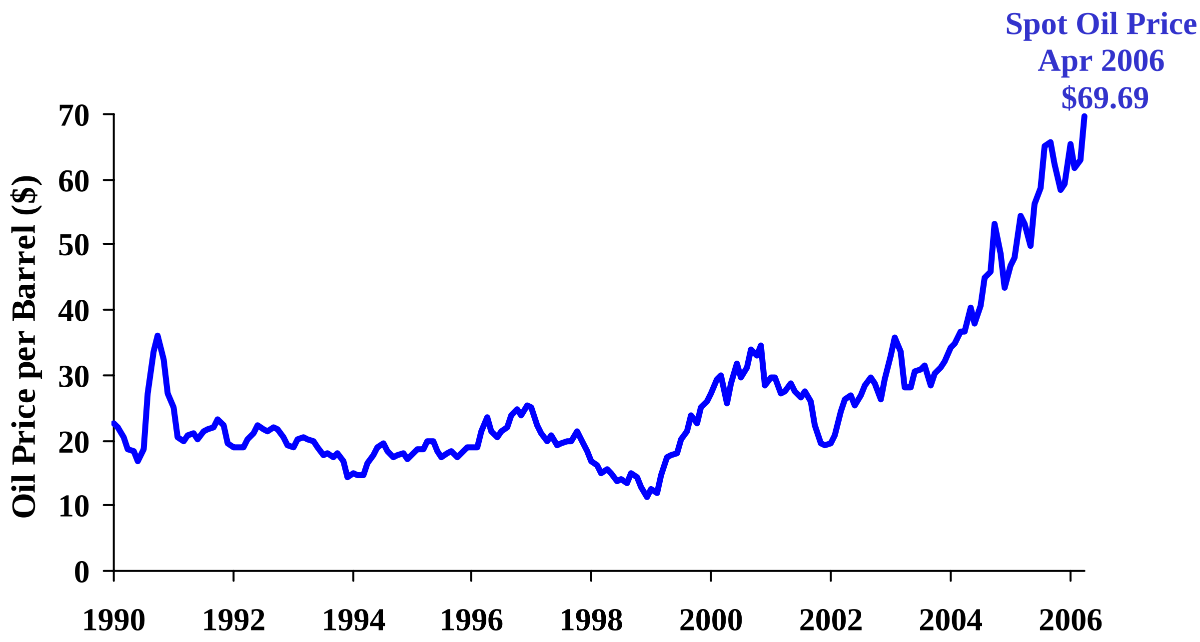
Source: Federal Reserve Bank

After falling to $43 a barrel in December 2004, the average monthly oil price rose to $66 a barrel in September 2005, in the wake of hurricane Katrina. Later in 2005, oil prices subsided. However in recent months, prices have risen again. In March 2006, oil prices rose to $63 a barrel and averaged $70 a barrel for the month of April. In the light of tensions surrounding

Iran's nuclear program and instability in Nigeria, oil prices rose to around $75 a barrel in late April.

Natural gas prices, which rose sharply following Hurricane Katrina, have fallen back in recent months in the face of increased production capacity and a mild winter. While the three-month average of natural gas prices was up 88 percent from a year ago in November 2005, natural gas prices were up 35 percent compared to a year ago in March 2006.

Oil Prices Up Sharply



Source: Federal Reserve Bank of St. Louis.

In the April Beige Book, the Federal Reserve noted that all districts cited high energy prices as a concern. In most districts, manufacturers noted rising energy costs and rising costs for other inputs. Many districts pointed to tight labor markets in their region.

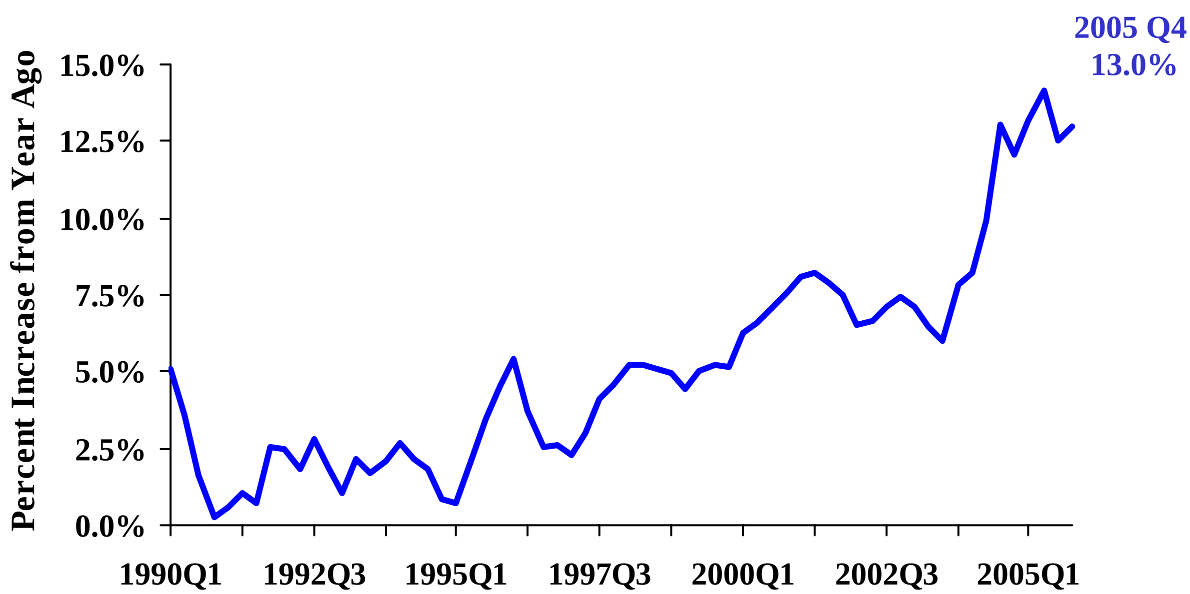
In the fourth quarter, productivity growth, in the face of the weakest quarter of economic growth in three years, was negative for the first time since the first quarter of 2001. Consequently, unit labor costs rose at a 3.0 percent annual rate. With the strongest economic growth in two and a half years, productivity rebounded in the first quarter of this year, increasing at a 3.2 percent annual rate. Compensation per hour, however, grew sharply. Thus unit labor costs slowed only slightly. From a year ago, the April 2006 ISM manufacturing price index was up only slightly. However, the non-manufacturing price index rose 6.4 points.

Tighter labor markets and higher energy prices will continue to exert upward pressure on inflation. Recent reports on hourly earnings provide one indication of these pressures. April marked the fifth straight month in which hourly earnings increases compared to a year ago exceeded 3.0 percent -- the first such streak in over four years. As noted earlier, oil prices pushed above $75 a barrel in late April and natural gas prices, while having decelerated, are still up 35 percent from a year ago.

However, there is little evidence that higher energy prices have pushed broader inflation substantially higher. Compared to a year ago, overall March 2006 consumer prices are up 3.4 percent. However, core prices (excluding food and energy) are up only 2.1 percent. Similarly, overall March producer prices were up 3.5 percent, but core producer prices were up just 1.7 percent.

The housing market has remained strong. The Office of Federal Housing Enterprise Oversight (OFHEO) reported that average U.S. home prices were up 13 percent in the fourth quarter of 2005 compared to a year ago. The fourth quarter marks the sixth straight quarter of double-digit year-over-year increases in home prices.

Housing Prices Up Sharply



Source: Office of Federal Housing Enterprise Oversight

However, there are signs that the robust housing market is cooling. New home inventories are up 24% from a year ago. The National Association of Realtors' index of pending sales of existing homes fell 6 percent in March compared to a year ago. In March, the number of unsold existing homes was up by one-third compared to a year ago. Existing home prices have flattened out in recent months and existing home sales are up only slightly from a year ago. According to the Federal Reserve's Beige book, most districts report cooling or moderation in residential real estate markets. Year-to-year price appreciation appears to be easing. Kansas City, Minneapolis, Chicago, Atlanta, New York, and Boston all report rising housing inventories.

Two key factors affect the economy with lags: interest rates and energy prices. Thus, current economic conditions are affected by past interest rates and energy price levels. Lower interest rates in 2004 helped support current economic growth. Conversely, higher interest rates today will serve to slow growth in the near future. Similarly, the current economy is influenced more by (relatively) lower energy prices in 2004 than current energy prices. Higher current energy prices will serve to slow the economy moving forward.

Major Economic Indicators

Major U.S. economic indicators point to continued economic growth. The manufacturing ISM index has hovered in the mid 50's during recent months. Compared to a year ago, the index is essentially unchanged. Over the past year, the non-manufacturing ISM index recorded a reading near or above 60.0 in all but two months. For about the past three years, the manufacturing and non-manufacturing indices have both indicated growth. A reading above 50 indicates a growing sector.

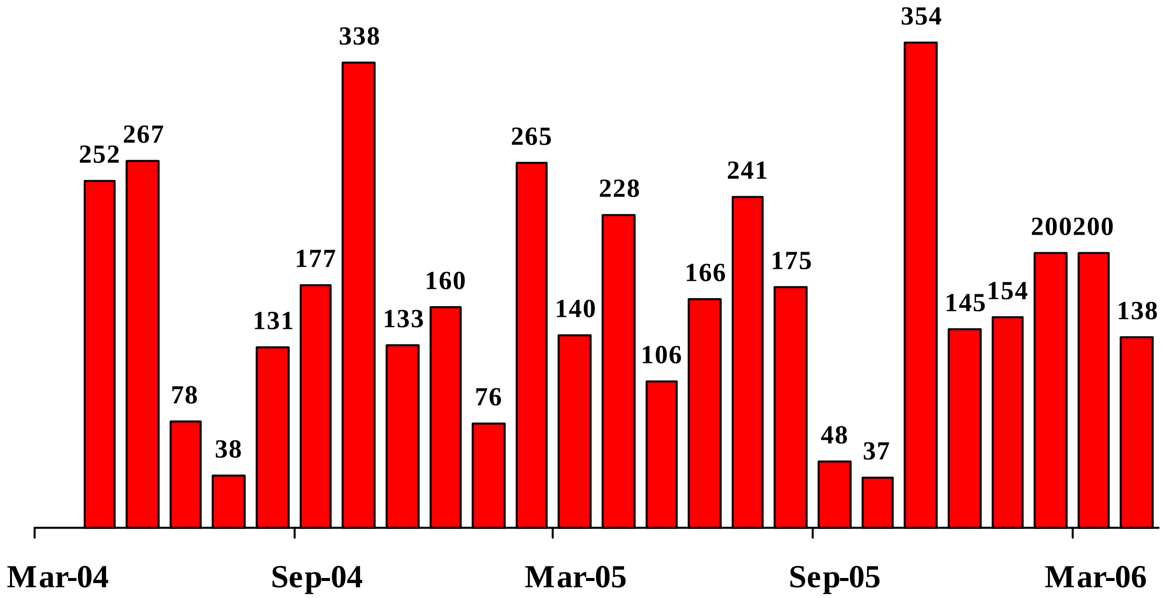
For nearly three years, new orders for durable goods have trended upward. Compared to a year ago, the three-month average of new durable goods orders was up 11.1 percent in March, marking the fifth straight month that the average has increased very near or above 10.0 percent. Excluding volatile defense and aircraft orders, the three-month average of new orders increased 8.3 percent. The three-month average of industrial production has increased 3.2 percent in the first quarter compared to a year ago.

In March 2006, the three-month average of retail sales was up 8.3 percent from a year ago. Excluding motor vehicle and gasoline sales, the average increased 8.6 percent – the strongest showing in at least thirteen years.

Consumer sentiment fell very sharply in September 2005 and declined again in October 2005. As a result, the sentiment index fell to its lowest reading in 13 years. The index then rebounded in November and December. Since December, the index has hovered between the mid 80's and low 90's. Compared to a year ago, the index is essentially unchanged. In mid-April, the ABC News/Washington Post consumer comfort index, which measures consumers' attitudes toward current economic conditions, rose to its highest level since the summer hurricanes before falling sharply the following week.

Following four months of substantial gains, the index of leading economic indicators fell in both February and March.

U.S. Employment Growing
(Monthly Change in Thousands)



<u>Employment</u>

U.S. employment has increased each month since mid 2003. Despite being depressed by the summer hurricanes, the U.S. economy gained 2.0 million jobs (1.5 percent) in calendar year 2005. Following September and October 2005 when the hurricanes slowed employment gains, U.S. employment rose sharply in November, reported moderate gains in December 2005 and January 2006 and then recorded solid increases in February and March. Employment growth then slowed in April. Through the first four months of 2006, national monthly employment gains have averaged nearly 175,000 jobs. April 2006 employment exceeds its pre-recession peak (February 2001) by 2.5 million jobs.

However, manufacturing employment remains hard hit. In April, manufacturing employment was 3.4 million jobs (19.2 percent) below its 1998 pre-recession peak. In calendar year 2005, while overall national employment rose 1.5 percent, manufacturing employment fell 0.6 percent. Motor vehicle and parts manufacturing sector employment was down 1.3 percent compared with 2004. Compared to its pre-recession CY 2000 peak, employment in the manufacturing sector was down 16.4 percent. Rapid productivity gains allowed firms to reduce payroll employment even as they continued to increase output.

Following the Gulf hurricanes, weekly initial unemployment claims rose above 400,000. However, initial claims have fallen sharply since October. Initial claims fell below 300,000 in January, which was unseasonably warm. Claims since January have risen slightly but remain around 300,000 (four-week moving average). Compared to a year ago, the average has fallen from around 330,000 to around 315,000.

With the exception of May 2005, the ISM manufacturing employment index component has signaled expanding sector employment every month since November 2003. Compared to a year ago, the component index is up 3.5 points. The non-manufacturing ISM employment index has signaled employment expansion each month since July 2003 except one month when the index signaled flat employment. Compared to a year ago, the April 2006 Challenger report count of announced layoffs rose 3.2 percent. In April 2006, the average workweek was up 0.1 of an hour compared to a year ago. Through March the average workweek remained in the narrow range between 33.6 and 33.8 hours for three and a half years. Hours worked rose from 33.8 to 33.9 hours in April.

In April 2006, the U.S. unemployment rate was unchanged at 4.7 percent, but was 0.4 of a percentage point lower than a year ago.

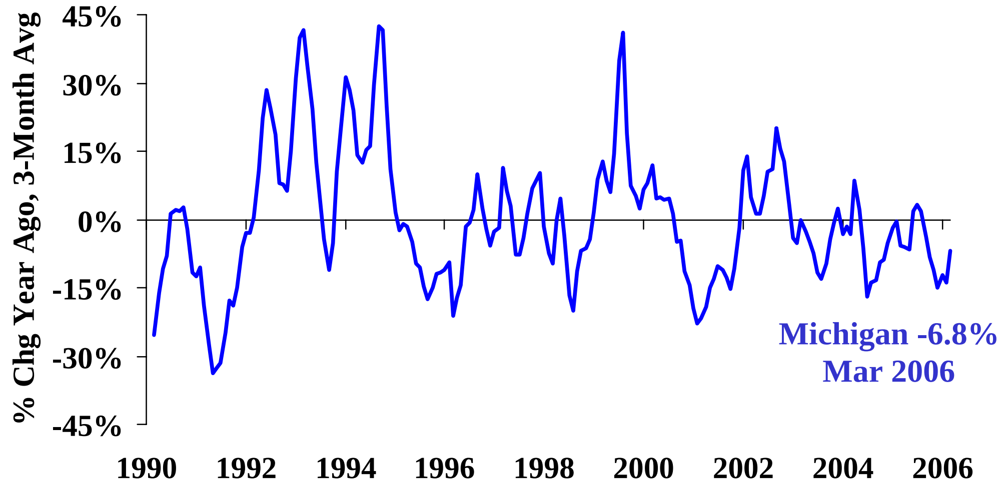
Vehicle Sales and Production

Boosted by "employee pricing for everyone" incentives, third quarter 2005 light vehicle sales rose to a 17.9 million unit rate, the highest rate since the fourth quarter of 2001. Following the promotion, light vehicle sales then fell sharply to a 15.8 million unit rate, the lowest sales rate in over seven years. Sales rebounded in the first quarter of 2006 to a 16.9 million unit rate.

Over the past several years, imports and transplants have continued to increase their market share. Thus, the traditional Big 3 market share has declined sharply. The Big 3 accounted for 71.6 percent of the U.S. light vehicle market in 1990. In 2005, the Big 3 accounted for only 57.1 percent, a record low.

In 2005, Michigan vehicle production fell 5.7 percent compared to a 0.3-percent decline nationally. Compared to 2000, Michigan vehicle production is down 20.8 percent compared with a 6.8 percent decline nationally. In the first quarter of 2006, State vehicle production fell 6.8 percent compared to a year ago, while overall U.S. vehicle production rose slightly.

Michigan Vehicle Production



Source: Automotive News and Michigan Department of Treasury

Current Michigan Economic Conditions

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 3 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.

Employment declines have slowed considerably since December 2002, with monthly declines slowed by more than half. However, from Michigan's employment peak in June 2000 compared to March 2006, Michigan has lost 316,700 jobs.

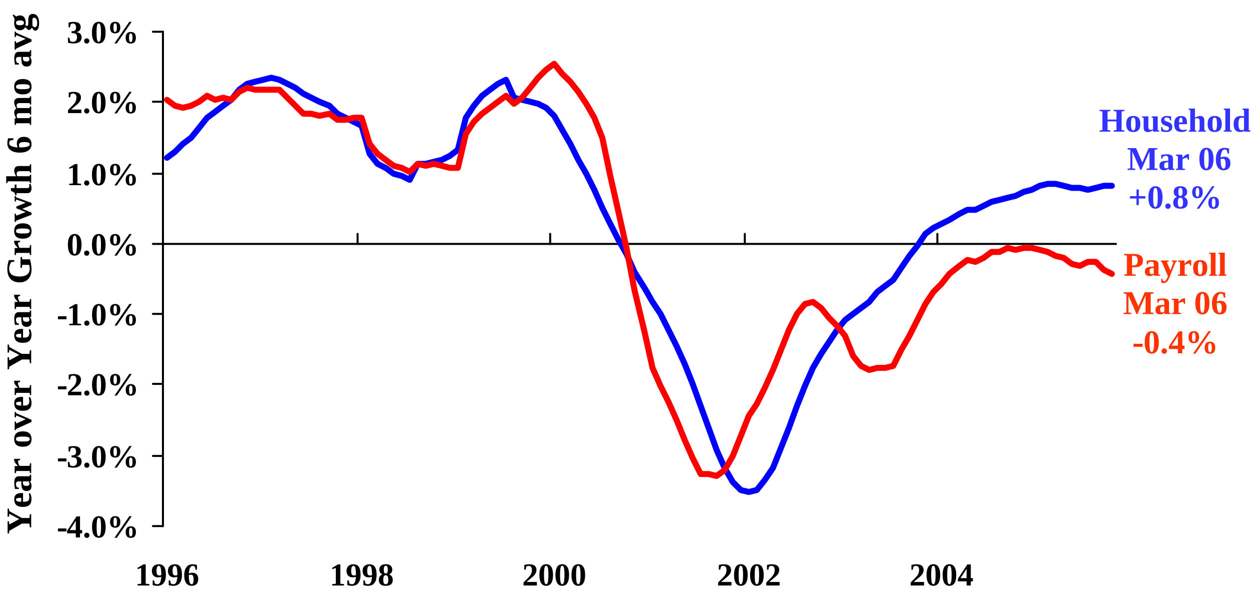
Michigan manufacturing employment has declined sharply. Since June 2000, Michigan manufacturing employment has fallen by 241,200 jobs. Michigan has lost more than one out of every four manufacturing jobs it had at the State's employment peak.

The Bureau of Labor Statistics provides two measures of employment:

1. Household employment data generated from a survey of households (Current Population Survey). Household employment is a count of the number of persons employed.
2. Wage and salary employment data generated from a survey of firms (Current Employment Survey). Wage and salary employment is a count of the number of jobs.

Over the past year, the two measures have diverged and there is now a substantial disparity between the two measures. Michigan wage and salary employment is *down* 0.4 percent, but Michigan household employment is *up* 0.8 percent (six month moving average). While wage and salary employment data are usually considered a better measure, household data often do a better job at detecting turning points than wage and salary data. Given the divergence, the household employment data may be detecting a turning point in Michigan's labor market that the wage and salary employment data have not yet picked up. The March benchmark revision reduced the gap between the household and payroll survey data.

Employment Surveys Send Mixed Signals



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

Unemployment Rate

In 2005, Michigan's unemployment rate averaged 6.7 percent, down from 7.0 percent in 2004. Michigan's unemployment rate averaged 6.5 percent in the first quarter of 2006. In March 2006, Michigan's unemployment rate was 6.8 percent.

Personal Income

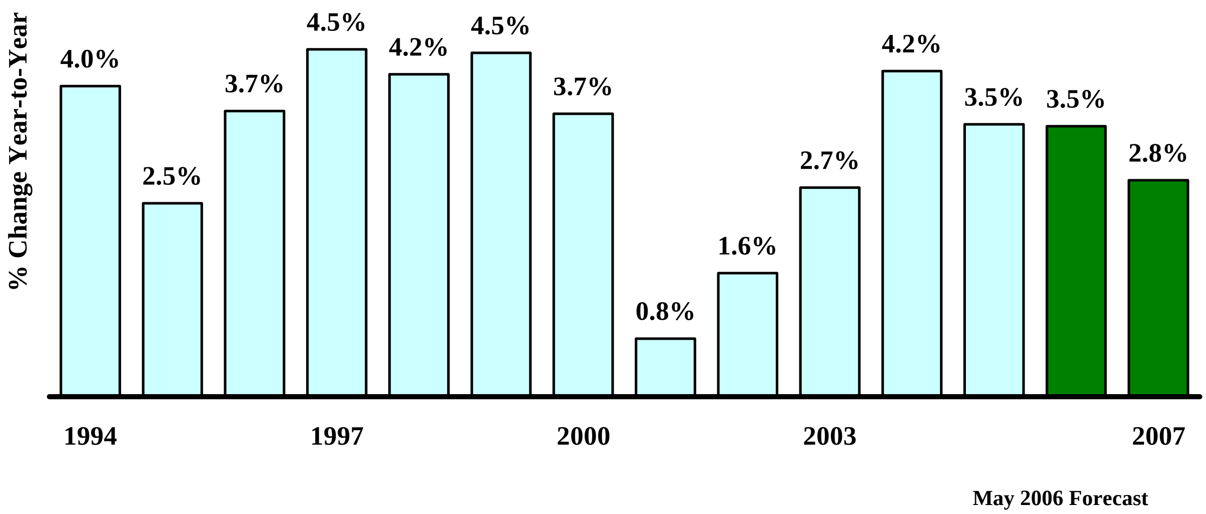
Michigan personal income rose 3.4 percent in 2005, while U.S. personal income increased 5.6 percent. Fourth quarter 2005 Michigan wages and salaries income grew 2.6 percent compared with 4.8 percent growth nationally. In the fourth quarter of 2005, Michigan personal income rose 3.3 percent compared to a year ago, while national personal income increased 4.7 percent.

2006 and 2007 U.S. Economic Outlook

Summary

Real GDP growth is forecast to remain unchanged at 3.5 percent in 2006. Growth is then expected to slow to 2.8 percent in 2007. High consumer debt levels, low savings rates, high energy prices, a cooling housing market and higher interest rates are expected to slow growth. On the other hand, increased business investment supported by profits and solid balance sheets should help buoy growth.

GDP Growth Slower in 2007

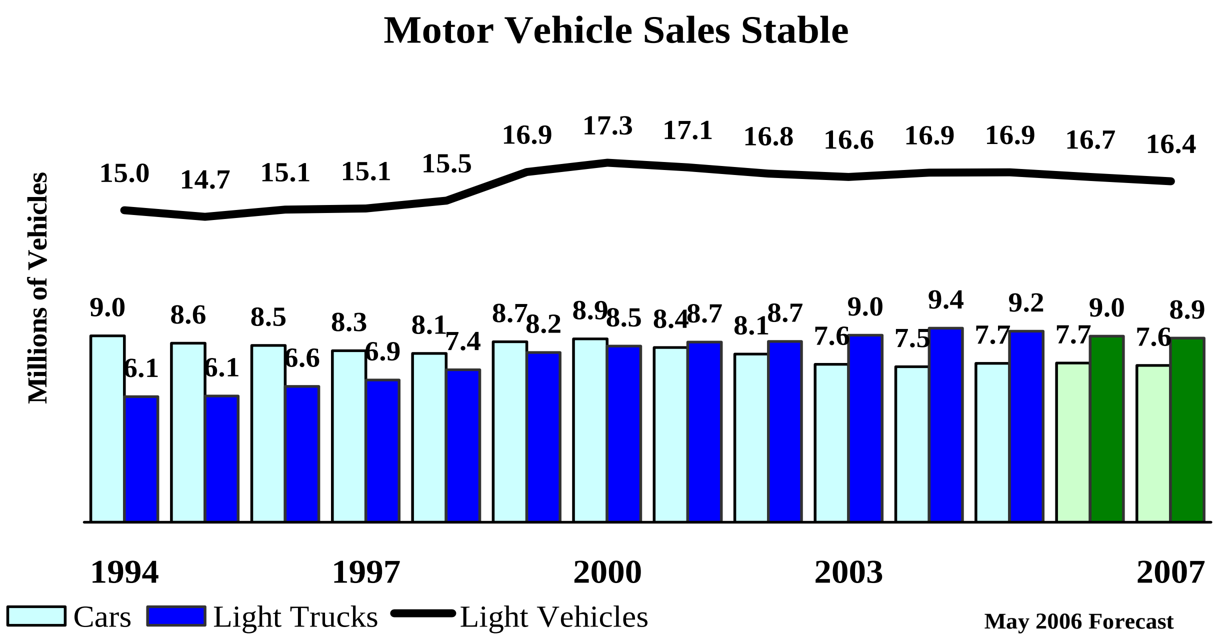


Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2006.

Light vehicle sales are projected to decline to 16.7 million units in 2006 and 16.4 million units in 2007.

As measured by the consumer price index (CPI), consumer inflation is expected to slow from 3.4 percent in 2005 to 2.8 percent in 2006 and 2.2 percent in 2007. Interest rates are forecast to rise as the Federal Reserve continues to raise the target federal funds rate through mid 2006. Between 2005 and 2007, the 3-month Treasury bill rate is forecast to increase from 3.2 percent to 4.9 percent while the Aaa corporate bond rate increases from 5.2 percent to 6.0 percent and 6.6 percent in 2006 and 2007, respectively.

U.S. wage and salary employment is forecast to rise in 2006 and 2007 with gains projected throughout the forecast horizon. Employment will increase by a projected 2.3 million jobs in 2006 and 2.2 million jobs in 2007. The U.S. unemployment rate is expected to fall from 5.1 percent in 2005 to 4.7 in both 2006 and 2007.



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2006.

<u>Assumptions</u>

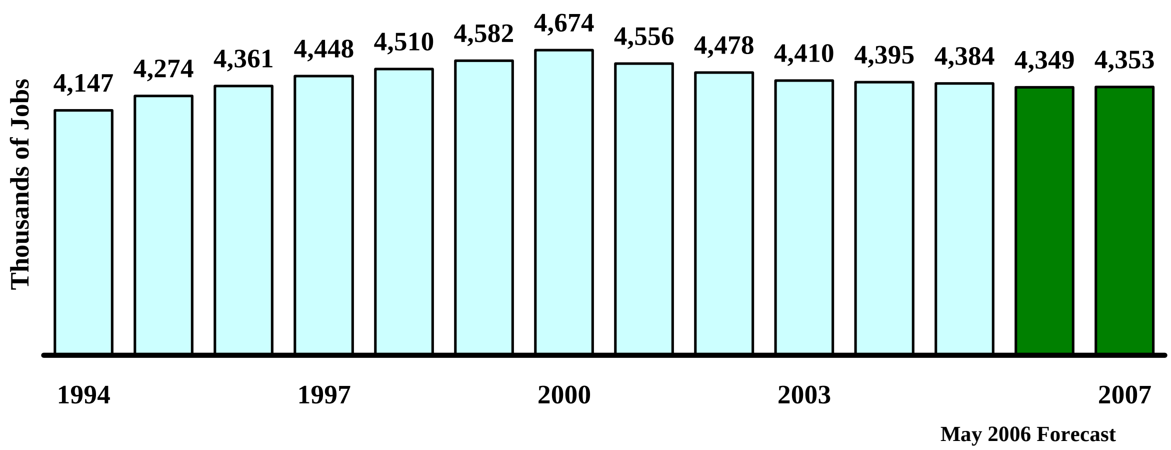
Oil prices are projected to remain near $70 a barrel through the end of 2006 before falling to around $65 a barrel by the end of 2007. With continued commodity price pressures, a relatively tight labor market, and high capacity utilization, the Federal Reserve is assumed to continue to raise the target federal funds rate through mid 2006. The target federal funds rate is projected to rise to 5.25 percent by mid 2006, at which time the Federal Reserve is expected to leave the target rate unchanged over the balance of the forecast horizon. The U.S. dollar is expected to gradually decline, falling 7.2 percent between the end of 2005 and end of 2007.

The household savings rate is forecast to rise from around zero to 0.9 percent over the forecast period. Home price increases are expected to slow over the forecast and stock market price gains are expected to be modest.

2006 and 2007 Michigan Economic Outlook

Employment is forecast to rise 0.1 percent in 2007 after declining 0.8 percent in 2006. Private non-manufacturing employment is projected to increase by 34,700 jobs in 2007 while manufacturing employment declines are expected to slow. While the Delphi bankruptcy and struggles at the domestic Big 3 automakers and concomitant restructurings will depress manufacturing employment, economic recovery will boost private non-manufacturing employment. Employment is forecast to begin rising in early 2007. In 2007, employment is forecast to increase an average of 3,500 jobs per quarter. Michigan's unemployment rate is expected to remain unchanged in both 2006 and 2007 at 6.7 percent.

Michigan Wage and Salary Employment



Source: Michigan Department of Labor and Economic Growth, U.S. Bureau of Labor Statistics, and Administration Forecast, May 2006.

Michigan wage and salaries income is projected to rise 2.2 percent in 2006. In 2007, wage and salaries income is forecast to increase 3.4 percent as employment grows. Michigan personal income is forecast to rise 4.2 percent in 2006 and 4.4 percent in 2007.

Inflation, as measured by the Detroit CPI, is forecast to rise 3.0 percent in 2006 and 2.1 percent in 2007. As a result, real Michigan personal income (inflation adjusted) is expected to rise 1.2 percent in 2006 and 2.3 percent in 2007.

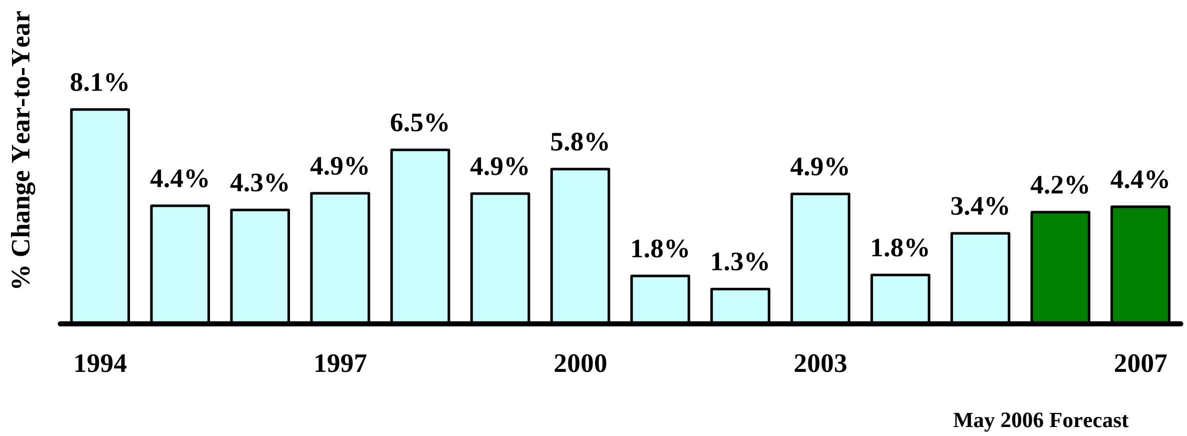
Table 1

Administration Economic Forecast

May 2006

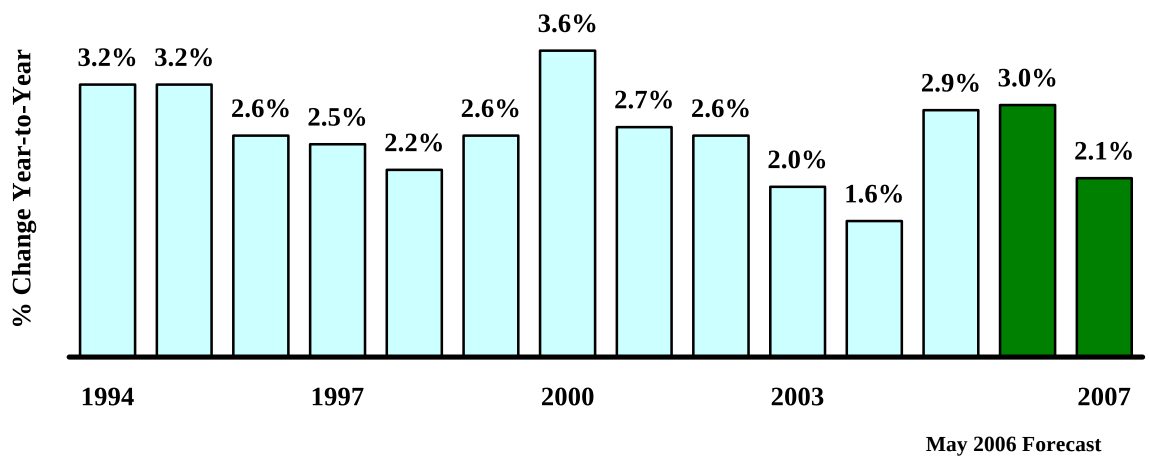
	Calendar 2004 Actual	Calendar 2005 Actual	Percent Change from Prior Year	Calendar 2006 Forecast	Percent Change from Prior Year	Calendar 2007 Forecast	Percent Change from Prior Year
United States							
Real Gross Domestic Product (Billions of Chained 2000 Dollars)	$10,756	$11,135	3.5%	$11,525	3.5%	$11,848	2.8%
Implicit Price Deflator GDP (2000 = 100)	109.1	112.1	2.8%	115.3	2.8%	118.4	2.7%
Consumer Price Index (1982-84 = 100)	188.9	195.3	3.4%	200.8	2.8%	205.2	2.2%
Personal Consumption Deflator (2000 = 100)	108.2	111.3	2.9%	113.9	2.3%	116.3	2.1%
3-month Treasury Bills Interest Rate (percent)	1.4	3.2		4.8		4.9	
Aaa Corporate Bonds Interest Rate (percent)	5.6	5.2		6.0		6.6	
Unemployment Rate - Civilian (percent)	5.5	5.1		4.7		4.7	
Light Vehicle Sales (millions of units)	16.9	16.9	0.0%	16.7	-1.3%	16.4	-1.2%
Passenger Car Sales (millions of units)	7.5	7.7	2.0%	7.7	0.2%	7.6	-1.4%
Light Truck Sales (millions of units)	9.4	9.2	-1.6%	9.0	-2.6%	8.9	-1.1%
Import Share of Light Vehicles (percent)	20.2	20.1		20.7		21.5	
Michigan							
Wage and Salary Employment (thousands)	4,395	4,384	-0.2%	4,349	-0.8%	4,353	0.1%
Unemployment Rate (percent)	7.0	6.7		6.7		6.7	
Personal Income (millions of dollars)	$324,134	$335,164	3.4%	$349,241	4.2%	$364,608	4.4%
Real Personal Income (millions of 1982-84 dollars)	$174,830	$175,663	0.5%	$177,821	1.2%	$181,849	2.3%
Wages and Salaries (millions of dollars)	$180,252	$186,722	3.6%	$190,886	2.2%	$197,418	3.4%
Detroit Consumer Price Index (1982-84 = 100)	185.4	190.8	2.9%	196.4	3.0%	200.5	2.1%
Detroit CPI Fiscal Year (1982-84 = 100)	184.4	189.0	2.5%	195.4	3.4%	199.5	2.1%

Michigan Personal Income Growth Stronger



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2006.

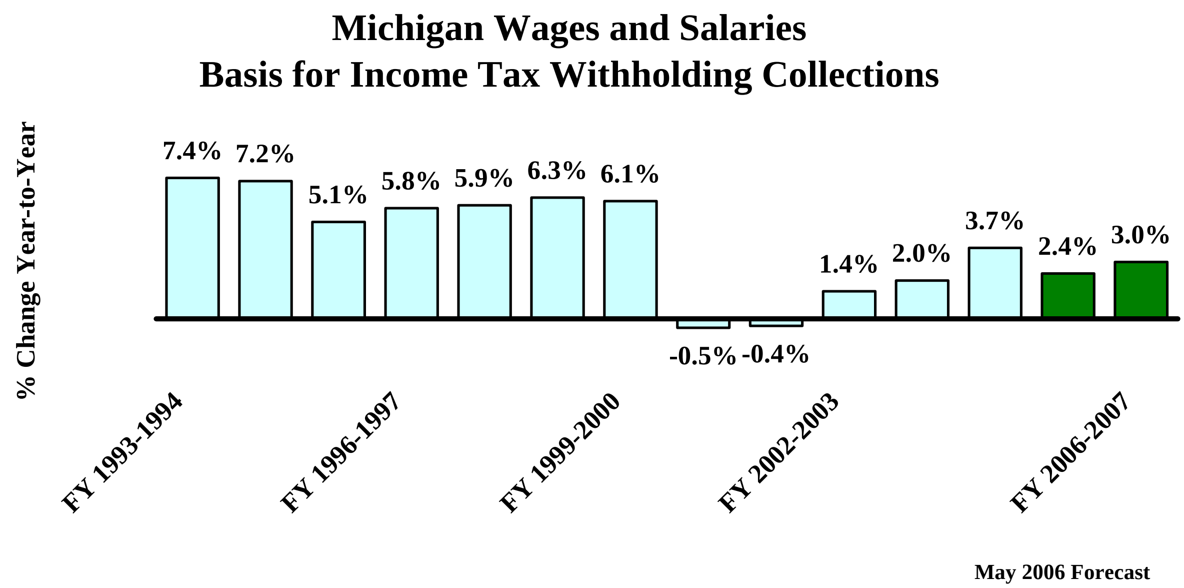
Inflation Rate Slows in 2007
Detroit CPI



Source: U.S. Bureau of Labor Statistics and Administration Forecast, May 2006.

Fiscal Year Economics

Michigan's largest taxes are the individual income tax ($6.4 billion), which includes refunds, and sales and use taxes ($8.5 billion). Income tax withholding is the largest income tax component. Withholding ($6.7 billion) is most affected by growth in wages and salaries. Michigan wages and salaries are expected to grow 2.4 percent in FY 2006 and 3.0 percent in FY 2007.



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2006.

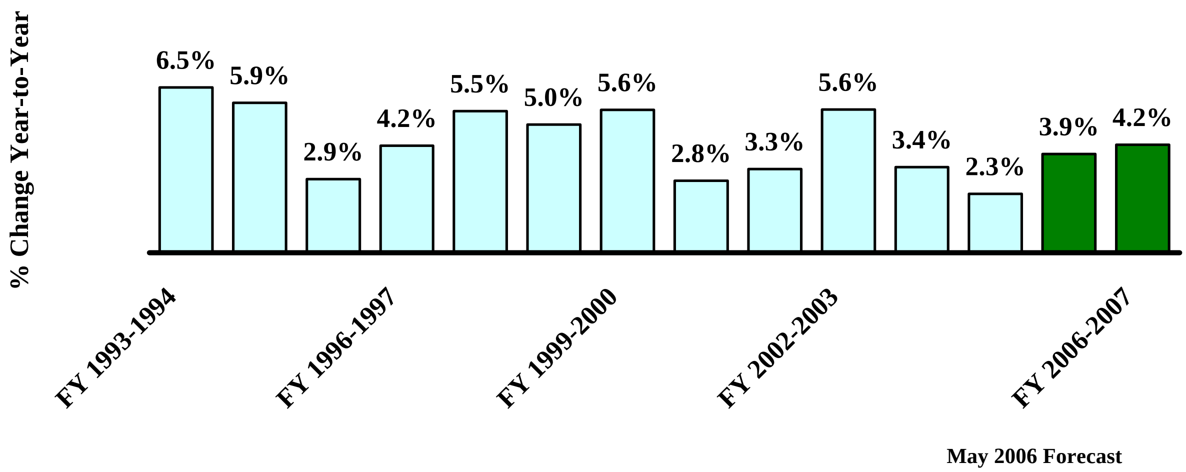
Sales and use taxes depend primarily on Michigan disposable (after tax) income and inflation. Disposable income is expected to rise 3.9 percent in FY 2006 and to increase 4.2 percent in FY 2007. The inflation rate is forecast to rise to 3.4 percent in FY 2006 and is expected to slow to 2.1 percent in FY 2007.

Forecast Risks

The baseline forecast assumes that the price of a barrel of oil will range between $65 and $70 a barrel through most of the forecast horizon. Geopolitical concerns, increased demand, or a major supply disruption could raise prices well above this assumed level. At the same time, recent high oil prices may slow the world economy leading to a reduction in the demand for oil and its price. A higher (lower) oil price will help retard/elevate domestic growth.

The baseline forecast assumes that the value of the dollar will fall in an orderly fashion. However, if international confidence in the dollar declines dramatically, the value of the dollar may fall sharply. A plummeting dollar could shake financial markets, severely curtailing both consumption and investment, and thus slow economic growth sharply. A collapsing dollar would also put upward pressure on inflation and possibly lead to still higher interest rates, which would further retard growth.

Michigan Disposable Income
Basis for Sales and Use Tax Collections



Source: Research Seminar in Quantitative Economics, University of Michigan, and Administration Forecast, May 2006.

Firms' increased pricing power, increased obsolescence of current capacity, tighter labor markets, higher commodity prices, and rising health care and pension costs may lead to higher inflation than the baseline forecast projects. This higher inflation rate may crimp consumption and investment spending – especially if accompanied by even more aggressive inflation fighting on the part of the Federal Reserve.

Given Michigan's manufacturing mix, it is very possible that manufacturing would grow substantially more slowly than U.S. economic growth itself would imply. This would retard Michigan economic growth, employment and income growth.

If business investment is above projected levels, economic growth may be more than forecast. For the Michigan economy, Big Three market share is important. Sharp declines in market share would affect the Michigan economy adversely compared to other states. Similarly, faster/slower productivity growth may decrease/increase employment. Faster/slower inventory investment will increase/decrease economic growth.

A substantial portion of current U.S. economic activity depends directly or indirectly on the strong housing market. Through refinancings, home equity loans, and realization of capital gains on housing sales, rapidly appreciating home prices have provided substantial support for the overall economy. In many ways, consumers have come to rely on appreciating home prices as a source of "income." To the extent to which home prices flatten out, or still more seriously decline, consumption, and in turn investment, may fall more sharply than the baseline forecast assumes.

The baseline forecast assumes that the Federal Reserve succeeds in averting a collapse of the U.S. housing market through federal funds rate increases that translate into increases in higher mortgage rates. To the extent to which the Fed is not successful in effecting an orderly correction in the housing market, a housing bubble may burst and the economy may grow substantially more slowly than the baseline forecast projects. There remains an outside chance that a collapsing housing market, combined with other risk factors, could send the U.S. economy into a recession.

Interest rates (which move in the opposite direction of bond prices) have remained low because bond prices have remained relatively high. To the extent that investors regard bonds as less and less attractive investments, bond prices could fall sharply and thus interest rates could rise steeply. A sharp rise in interest rates would adversely impact the housing market, whose strength is greatly dependent upon low mortgage rates.

Geopolitical factors remain a forecast risk.

ADMINISTRATION REVENUE ESTIMATES
May 17, 2006

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 2005 is the base year. Any non-economic changes to the taxes occurring in FY 2006 and FY 2007 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 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. 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 2005 Revenue Review

FY 2005 GF-GP revenue totaled $8,308.8 million on a Consensus basis, a 3.4 percent increase over FY 2004. One-time revenue from the estate tax and other one-time revenue items contributed to the increase in General Fund revenue. SAF revenue totaled $10,909.9 million, a 2.8 percent increase compared to FY 2004 (See Table 2).

Table 2

FY 2004-05 Totals

(millions)

	Actual	
	Amount	**Growth**
General Fund - General Purpose		
Baseline Revenue	$8,163.3	
Tax Cut Adjustments	$145.5	
Net Resources	$8,308.8	3.4%
School Aid Fund		
Baseline Revenue	$10,914.9	
Tax Cut Adjustments	($5.0)	
Net Resources	$10,909.9	2.8%
Combined		
Baseline Revenue	$19,078.2	
Tax Cut Adjustments	$140.5	
Net Resources	$19,218.7	3.0%

FY 2006 Revenue Outlook

FY 2006 GF-GP revenue is expected to be $8,280.4 million, a 1.8 percent baseline increase, and a 0.3 percent reduction after tax adjustments. Net GF-GP growth is slowed by a number of factors including the newly enacted single business tax cuts and the continued phase-out of the state's estate tax. The FY 2006 estimate is $72.6 million above the January 2006 Consensus estimate.[2] SAF revenue is forecast to be $11,205.0 million, representing 2.4 percent SAF baseline growth and 2.7 percent growth after tax adjustments. The FY 2006 SAF estimate is $25.9 million lower than the January 2006 Consensus estimate (See Table 3).

Table 3

FY 2005-06 Administration Revenue Estimates

(millions)

	Consensus January 12, 2006		Administration May 17, 2006		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue	$8,247.2	1.0%	$8,313.6	1.8%	
Tax Cut Adjustments	($39.4)		($33.2)		
Net Resources	$8,207.8	-1.1%	$8,280.4	-0.3%	$72.6
School Aid Fund					
Baseline Revenue	$11,205.4	2.7%	$11,179.4	2.4%	
Tax Cut Adjustments	$25.5		$25.5		
Net Resources	$11,230.9	2.9%	$11,205.0	2.7%	($25.9)
Combined					
Baseline Revenue	$19,452.6	2.0%	$19,493.0	2.2%	
Tax Cut Adjustments	($13.9)		($7.7)		
Net Resources	$19,438.7	1.1%	$19,485.3	1.4%	$46.6

[2] Part of the increase ($11.1 million) was due to Public Act 69 of 2006 which reduced the share of the sales tax going to the Comprehensive Transportation Fund and increased the General Fund share.

FY 2007 Revenue Outlook

FY 2007 GF-GP revenue is expected to be $8,463.1 million, a 2.6 percent baseline increase, and a 2.2 percent increase after tax adjustments. The FY 2007 GF-GP estimate is $85.9 million above the January 2006 Consensus estimate. SAF revenue is forecast to be $11,571.4 million, representing 3.3 percent for both SAF baseline growth and after tax adjustments (see Table 4). The FY 2007 SAF estimate is $19.7 million below the January 2006 Consensus estimate.

Table 4

FY 2006-07 Administration Revenue Estimates

(millions)

	Consensus January 12, 2006		Administration May 17, 2006		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue	$8,436.0	2.3%	$8,527.6	2.6%	
Tax Cut Adjustments	($58.8)		($64.5)		
Net Resources	$8,377.2	2.1%	$8,463.1	2.2%	$85.9
School Aid Fund					
Baseline Revenue	$11,567.5	3.2%	$11,547.9	3.3%	
Tax Cut Adjustments	$23.6		$23.6		
Net Resources	$11,591.1	3.2%	$11,571.4	3.3%	($19.7)
Combined					
Baseline Revenue	$20,003.5	2.6%	$20,075.5	3.0%	
Tax Cut Adjustments	($35.2)		($40.9)		
Net Resources	$19,968.3	2.5%	$20,034.6	2.8%	$66.3

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 2004 revenue is compared to CY 2002 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 via the income and single business taxes.

FY 2004 revenues were $4.4 billion below the revenue limit, while FY 2005 revenues are expected to be $4.2 billion below the limit. State revenues will also be well below the limit for FY 2006 and FY 2007. FY 2006 revenues are expected to be $4.5 billion below the limit, and FY 2007 revenues $4.6 billion below the limit (See Table 5).

Table 5

Administration Constitutional Revenue Limit Calculation

(millions)

	FY 2004	FY 2005	FY 2006	FY 2007
	Actual May 2005	Admin May 2006	Admin May 2006	Admin May 2006
Revenue Subject to Limit	$24,384.7	$25,626.7	$26,230.0	$27,190.0
Revenue Limit	**CY 2002**	**CY 2003**	**CY 2004**	**CY 2005**
Personal Income	$303,745	$314,460	$324,134	$335,164
Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	$28,825.4	$29,842.2	$30,760.3	$31,807.1
Amount Under (Over) Limit	**$4,440.7**	**$4,215.5**	**$4,530.3**	**$4,617.1**

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 remain unchanged in 2006. Therefore, the formula has no pay-in or withdrawal for FY 2006 (See Table 6).

Table 6

Budget and Economic Stabilization Fund Calculation
Based on CY 2006 Personal Income Growth
Administration Calculation

	CY 2005	CY 2006
Michigan Personal Income	$ 335,164 [(1)]	$ 349,241 [(1)]
less Transfer Payments	$ 51,756 [(1)]	$ 56,058 [(1)]
Income Net of Transfers	$ 283,409	$ 293,183
Detroit CPI	1.878 [(2)]	1.943 [(3)]
for 12 months ending	(June 2005)	(June 2006)
Real Adjusted Michigan Personal Income	$ 150,910	$ 150,892
Change in Real Adjusted Personal Income		0.0%
Between 0 and 2%		0.0%
GF-GP Revenue Fiscal Year 2005-2006		$ 8,280.4

	FY 2006-2007
BSF Pay-In Calculated for FY 2007	NO PAY-IN INDICATED

Notes:

(1) Personal Income and Transfer Payments, Administration Forecast, May 2006.

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

(3) Detroit Consumer Price Index, Administration Forecast, May 2006.

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 2007 SAF revenue adjustment factor is calculated by dividing the sum of FY 2006 and FY 2007 SAF revenue by the sum of FY 2005 and FY 2006 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 2007, the SAF revenue adjustment factor is calculated to be 1.0286 (See Table 7).

Table 7

Administration School Aid Revenue Adjustment Factor

For Fiscal Year FY 2007

	FY 2005		**FY 2006**		**FY 2007**
Baseline SAF Revenue	$10,914.9		$11,179.4		$11,547.9
Balance Sheet Adjustments	($5.0)		$25.5		$23.6
Net SAF Estimates	$10,909.9		$11,205.0		$11,571.4
Adjustments to FY 2007 Base Year	$28.6		($2.0)		$0.0
Baseline Revenue on a FY 2007 Base	$10,938.5		$11,203.0		$11,571.4
School Aid Fund Revenue Adjustment Calculation for FY 2007					
Sum of FY 2005 & FY 2006	$10,938.5	+	$11,203.0	=	$22,141.5
Sum of FY 2006 & FY 2007	$11,203.0	+	$11,571.4	=	$22,774.5
FY 2007 Revenue Adjustment Factor					**1.0286**

Note: Factor is calculated off a FY 2007 base year.

Revenue Detail

The estimated tax and revenue totals include the effects of all enacted tax changes except sales tax savings resulting from reductions in revenue sharing payments to local units. The revenue totals by tax are presented separately for GF-GP and for the SAF (See Tables 8 and 9). Tax totals for the income, sales, use, and tobacco taxes for all funds are also included (See Table 10).

Table 8

Administration General Fund General Purpose Revenue Detail

(millions)

	FY 2005		FY 2006		FY 2007	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
GF-GP Tax Amounts						
Income Tax	$4,121.1	3.6%	$4,183.1	1.5%	$4,276.1	2.2%
Sales	$109.2	6.8%	$105.6	-3.3%	$113.7	7.7%
Use	$934.6	6.5%	$949.5	1.6%	$987.6	4.0%
Cigarette	$116.5	-52.0%	$235.3	102.0%	$231.4	-1.7%
Beer & Wine	$51.0	-1.0%	$52.0	2.0%	$52.0	0.0%
Liquor Specific	$33.6	1.8%	$34.0	1.2%	$34.5	1.5%
Single Business Tax	$1,913.5	4.7%	$1,847.4	-3.5%	$1,895.2	2.6%
Insurance Co. Premium	$249.5	8.3%	$245.0	-1.8%	$251.0	2.4%
Telephone & Telegraph	$99.1	-2.2%	$83.0	-16.2%	$80.0	-3.6%
Inheritance Estate	$101.5	34.4%	$1.0	-99.0%	$0.0	0.0%
Intangibles	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Casino Wagering	$42.2	1218.0%	$44.6	5.7%	$45.0	0.8%
Horse Racing	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Oil & Gas Severance	$66.7	16.8%	$92.0	37.9%	$76.0	-17.4%
GF-GP Other Taxes	$52.5	118.8%	$53.7	2.3%	$60.4	12.5%
Total GF-GP Taxes	$7,890.9	3.8%	$7,926.2	0.4%	$8,102.9	2.2%
GF-GP Non-Tax Revenue						
Federal Aid	$35.7	-46.0%	$35.0	-2.0%	$35.0	0.0%
From Local Agencies	$0.3	-89.7%	$2.0	566.7%	$2.0	0.0%
From Services	$19.8	11.2%	$18.0	-9.1%	$18.0	0.0%
From Licenses & Permit	$27.4	-50.4%	$34.0	24.1%	$34.0	0.0%
Miscellaneous	$135.1	77.5%	$144.6	7.0%	$153.7	6.3%
Short Term Note Int.	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Interfund Interest	($54.4)	145.0%	($70.0)	28.7%	($75.0)	7.1%
Liquor Purchase	$142.2	2.0%	$140.0	-1.5%	$142.0	1.4%
Charitable Games	$11.7	-4.1%	$11.5	-1.7%	$11.5	0.0%
Transfer From Escheats	$100.0	12.4%	$39.0	-61.0%	$39.0	0.0%
Other Non Tax	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Total Non Tax	$417.8	-4.3%	$354.1	-15.2%	$360.2	1.7%
Total GF-GP Revenue	$8,308.8	3.4%	$8,280.4	-0.3%	$8,463.1	2.2%

Table 9

Administration School Aid Fund Revenue Detail

	FY 2005		FY 2006		FY 2007	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
School Aid Fund						
Income Tax	$1,985.6	4.9%	$2,055.7	3.5%	$2,115.8	2.9%
Sales Tax	$4,805.7	1.9%	$4,884.5	1.6%	$5,066.5	3.7%
Use Tax	$467.7	6.5%	$474.8	1.5%	$493.8	4.0%
Liquor Excise Tax	$33.1	2.2%	$34.0	2.7%	$34.5	1.5%
Cigarette	$472.7	0.3%	$473.3	0.1%	$463.8	-2.0%
Other Tobacco	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
State Ed Prop Tax	$1,914.6	4.9%	$2,019.0	5.5%	$2,128.0	5.4%
Real Estate Transfer	$313.5	-1.3%	$315.0	0.5%	$313.0	-0.6%
Ind and Comm Facilities	$138.2	-8.0%	$123.0	-11.0%	$126.0	2.4%
Casino (45% of 18%)	$97.6	1.9%	$103.2	5.7%	$104.0	0.8%
Commercial Forest	$3.1	10.7%	$3.1	0.0%	$3.1	0.0%
Other Spec Taxes	$10.5	-19.2%	$11.0	4.8%	$11.0	0.0%
Subtotal Taxes	$10,242.3	2.7%	$10,496.5	2.5%	$10,859.4	3.5%
Lottery Transfer	$667.6	3.5%	$708.5	6.1%	$712.0	0.5%
Total SAF Revenue	$10,909.9	2.8%	$11,205.0	2.7%	$11,571.4	3.3%

Table 10

Administration Major Tax Totals

Major Tax Totals (Includes all Funds)						
Income Tax	$6,108.2	4.0%	$6,240.3	2.2%	$6,393.4	2.5%
Sales Tax	$6,599.1	1.9%	$6,709.8	1.7%	$6,959.1	3.7%
Use Tax	$1,402.3	6.5%	$1,424.3	1.6%	$1,481.4	4.0%
Cigarette and Tobacco	$1,179.9	18.8%	$1,179.5	0.0%	$1,158.9	-1.7%
Casino Tax	$145.8	46.5%	$154.1	5.7%	$155.4	0.8%