



Wisconsin Economic Outlook

**Wisconsin Department of Revenue
Division of Research & Policy
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The quarterly Wisconsin Economic Outlook is prepared by Romina Soria and Emily Camfield of the Division of Research and Policy, Wisconsin Department of Revenue. IHS Global Insight, Inc. prepared the national forecast on June 8, 2009. The forecast does not incorporate data released subsequent to that date.

I. ECONOMIC OUTLOOK

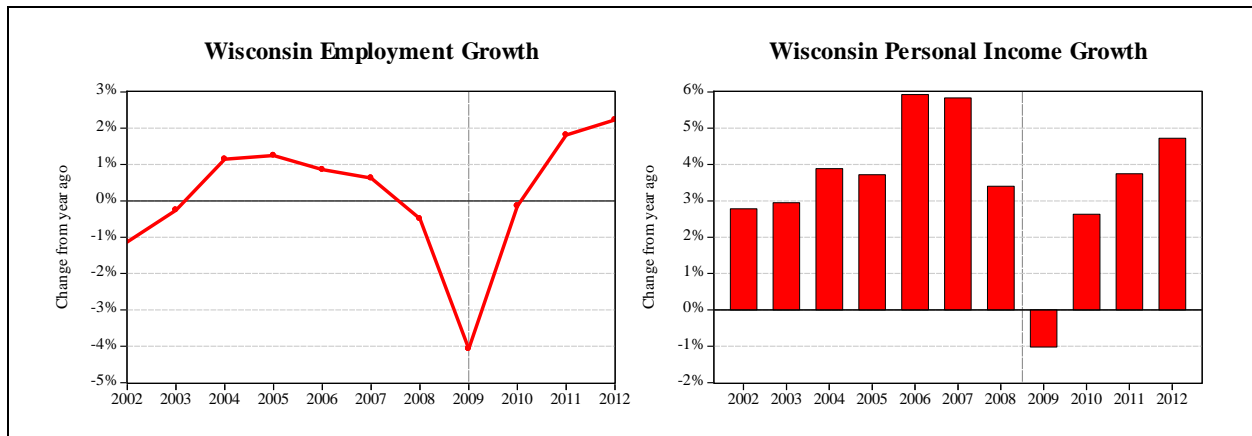
WISCONSIN OUTLOOK

The national economy has now been in recession for 18 months, starting in December 2007 as dated by the National Bureau of Economic Research. The employment loss since the beginning of the recession has already crossed the 6 million mark. Current trends of key indicators of the Wisconsin economy show that Wisconsin is also in a recession, having lost 143,300 jobs since December 2007.

The outlook has slightly worsened since our March release; with the current outlook calling for a peak-to-trough job loss of 155,300 or 5.4% of total employment, compared to the 143,400 (5.0%) job loss expected in March. Most of the economic decline in the current cycle will happen during the current year and employment is expected to hit bottom in the fourth quarter of 2009. Housing, the sector that originally triggered the current recession, is showing signs of improvement, but the recovery is expected to be slow.

The June national outlook is calling for a real GDP decline of 3.4% in 2009 and a growth rate of 1.4% in 2010. The U.S. labor market already lost 6.0 million jobs since December 2007, and is now expected to shed a total of 7.1 million jobs peak to trough, representing an employment decline of 3.7% and 0.6% in 2009 and 2010 respectively. The two major factors that have worsened the decline of the recession are the freezing of the credit market and the global character of the crisis. The dramatic decline in the U.S. and global demand has slashed prices. The June outlook for consumer prices is now expecting a decline of 0.9% in 2009 and a mild recovery with 1.3% growth in 2010.

Chart I.1



As shown in the left panel of Chart I.1, Wisconsin employment declined 0.5% in 2008 and is expected to decline 4.1% this year and be almost flat in 2010, declining just 0.1%. Wisconsin employment growth will recover in late 2010 and grow at 1.8% in 2011 and 2.2% in 2012, led by strong growth in the services industries and a return to positive growth for Construction and Manufacturing toward 2011.

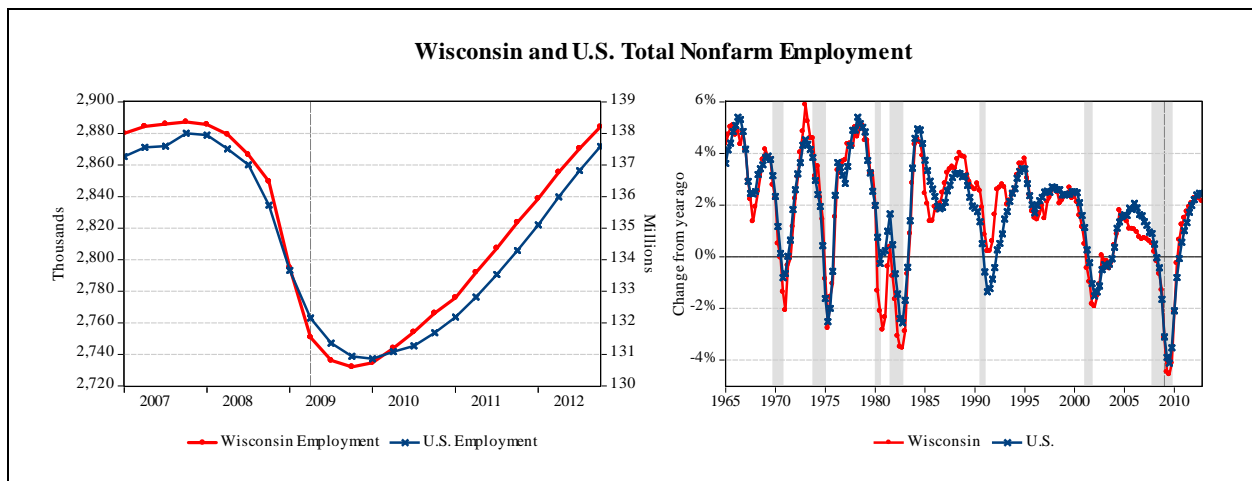
Wisconsin personal income rose 5.8% in 2007 and 3.4% in 2008 (see right panel of Chart I.1). The outlook expects a decline of 1.0% in 2009, as the economy hits bottom during the second half of 2009 and starts a slow recovery with personal income growing 2.7% in 2010. Wisconsin personal income is projected to grow 3.8% in 2011 and 4.7% in 2012. Given the deflationary outlook, real personal income is expected to decline 1.0% in 2009, after seeing small growth in 2008 (0.3%) and will post growth of 1.6% in 2010 as prices recover.

Employment Outlook

After modest 0.6% employment growth in 2007, Wisconsin saw a loss of 14,200 jobs in 2008, a reduction of 0.5%. The Wisconsin employment figure for the first quarter of 2009 shows a year over year decline of 3.1%. Deepening the trend, April and May posted year over year declines of 4.4% and 4.6% respectively. For the remaining quarters of 2009, Wisconsin employment is expected to decline above 4% on a year over year basis.

Chart I.2 below shows total nonfarm employment level (left panel) and growth (right panel) for the U.S. and Wisconsin. The vertical line at the second quarter of 2009 marks the beginning of the forecast. At the national level, the Construction, Manufacturing, Trade, Transportation and Utilities, Professional and Business services, and Financial Activities sectors continue to be the main drag on employment growth in 2009. As shown on the left panel, U.S. employment is expected to trough in the first quarter of 2010. Six sectors are forecasted to still post loss jobs in 2010, with the Construction and Manufacturing sectors showing the largest job losses. The timid recovery of the job market will be lead by the Education and Health Services and Professional and Business Services sectors.

Chart I.2



The 2008 Wisconsin job loss was the result of job losses in six sectors and job gains in the other five sectors. The sectors posting the largest job losses were Construction, as a result of the housing crises, and the Manufacturing and Trade, Transportation and Utilities sector as the global and domestic demand sank following the freeze of the credit markets. In 2009, already nine sectors are posting year over year job losses as of May, and the same is expected for the year as a whole. As shown on the left panel of Chart I.2, Wisconsin employment is expected to trough in the last quarter of 2009. The forecast expects a loss of 116,800 jobs in 2009, with the largest losses concentrated in Manufacturing, Trade, Transportation and Utilities, Construction, and Professional and Business Services. The only two sectors posting employment growth during the current year are Educational and Health Services and Government.

The forecast expects Wisconsin employment declines of 4.1% in 2009 and 0.1% in 2010 as the recession progresses and hits bottom later in the year before starting to recover in 2010. The right panel of Chart I.2 shows total nonfarm employment growth for the U.S. and Wisconsin over time. The forecasted employment decline during the current recession is expected to be the worst of the last 50 years. From peak to trough, U.S. employment is forecasted to lose 5.2% or 7.1 million jobs, while Wisconsin is expected to lose 5.4% or 155,100 jobs on a quarterly basis.

However, Wisconsin employment never recovered from the 1980 recession before entering again into what was defined by the NBER as a second recession for the U.S. Thus, the two 1980 and 1981-82 recessions, as dated by the NBER, can be considered as one long recession for the state. Considering the early eighties recessions as one, peak to trough Wisconsin job losses were 7.0% of the total employment

or 138,300 jobs, worse than the losses expected during the current recession (5.4% of total employment). The U.S. will still fare worse during the current recession.

Wisconsin employment will return to annual growth in 2011, with the forecast calling for a 1.8% and 2.2% growth for the years 2011 and 2012 respectively.

Housing

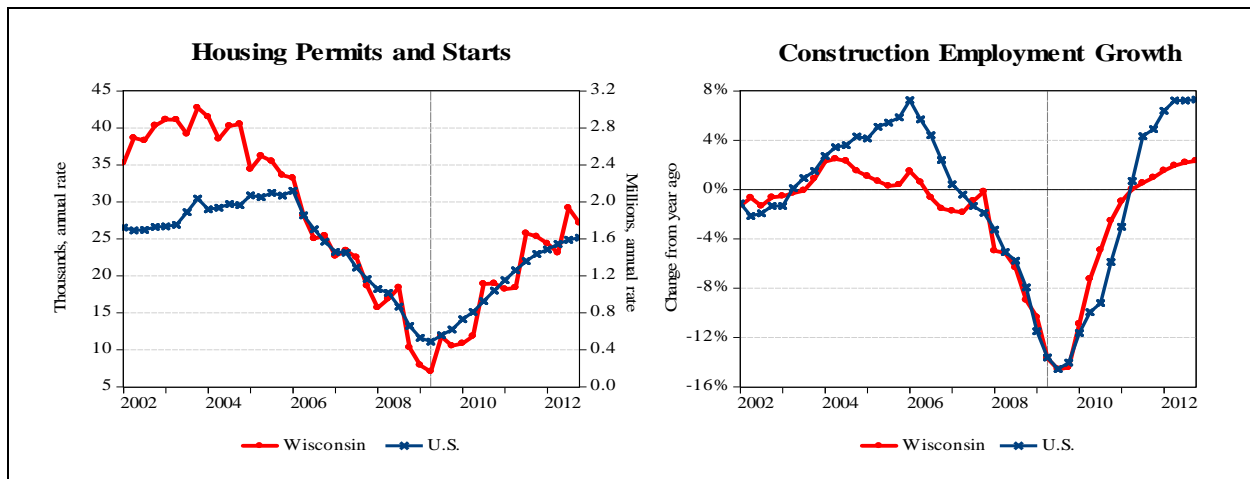
As we have been mentioned in past Outlook reports, the housing sector in Wisconsin did not experience the exorbitant growth in past years as the rest of the country. Hence it has not experienced the strong negative impact that the burst of the bubble had on the national economy. Global Insight is now signaling that most housing indicators (home sales, housing starts and permits) are showing signs of stabilization at the national level. Wisconsin housing building permits continue to post year over year declines, but February, March and April posted small gains from the previous month.

Home prices in Wisconsin were holding up until 2007, but they started to fall since early 2008, though not as hard as in other parts of the country. According to the Wisconsin Realtors Association, home sales and median prices both fell in the first quarter of 2009 compared to the same quarter last year. Existing home sales in Wisconsin were down 22.6% from the first quarter of 2008. The median home price statewide declined 9.5% to \$137,500 compared to the first quarter of 2008, still lower than the decline of 14.7% nationwide mainly driven by distressed sales in hardest hit markets.

The Federal Housing Finance Agency (FHFA) also releases its measures of house prices. The purchase-only house price index for the first quarter of 2009 was 0.9% lower than a year ago and 1.6% higher than the last quarter of 2008.

The real estate transfer fee collections are another key housing indicator that reflects the crisis in the state housing sector. The fee is imposed on all real estate conveyances at a rate of \$0.30 per \$100 of value. Collections peaked in 2005 at \$6.7 million, and it has been declining since. As of 2008, collections fell 35.4% to \$4.3 million. For the first five months of 2009, the real estate transfer fee declined 39.6% year over year, reflecting lower number of sales as well as also lower prices as distressed sales persist in a weak housing market.

Chart I.3



Wisconsin permits continued their declining path in the first quarter of 2009 (see left panel of Chart I.3) posting a year over year decline of 49.6%. Wisconsin permits have been declining since its peak at 42,727 permits in the last quarter of 2003 to 7,900 permits in the first quarter of 2009. The forecast is calling for the permits to trough in mid 2009. The RealtyTrac released 2009Q1 foreclosure data showing that national foreclosures increased 24% over 2008Q1. Following the national trend, foreclosures in

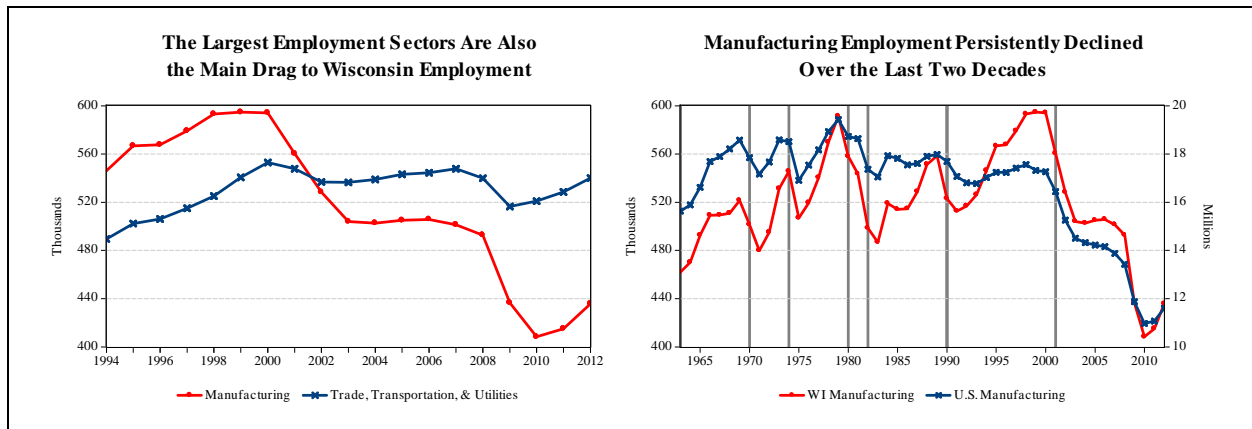
Wisconsin also increased. Wisconsin ranked 22nd, with one out of 287 households in foreclosure the first quarter of 2009, compared with one out of every 159 households in foreclosure nationwide.

Employment Sectors

The housing slowdown has a direct impact on employment in the Construction sector, as shown on the right panel of Chart I.3. Wisconsin employment in the Construction sector started to slow in 2004 as housing permits declined, and has been declining since mid-2006. Wisconsin employment in the Construction sector declined 1.2% in 2007 and 6.4% in 2008, while U.S. employment in the sector fell 0.8% in 2007 and decreased 5.5% in 2008. Wisconsin lost more than 21,000 construction jobs since its peak in 2006, equal to about 16.3% of the total employment in the sector. The outlook for Construction employment calls for two more years of job losses, reaching bottom in early 2011 and recovering to year over year positive growth in the third quarter of 2011.

Trade, Transportation and Utilities is the largest employment sector in Wisconsin since 2002, as shown on the left panel of Chart I.4. This sector now represents 19% of total Wisconsin employment, the same as for the nation as a whole. The Trade, Transportation and Utilities sector has been growing at a very timid pace in the last few years, at 0.6% a year on average for the period 2004-2007 and -1.5% in 2008. The weak situation of the job market, the decline of household wealth, debt overhangs, and still-tight credit are restraining consumers and thus hurting the commercial activity and employment in this sector. The Outlook calls for an employment decrease of 4.3% in 2009 and a mild recovery in 2010 (0.9%). Toward 2011, the sector is expected to recover stronger employment growth, posting gains of 1.5% and 2.2% in 2011 and 2012 respectively.

Chart I.4



Until 2002, Manufacturing was the largest employer for Wisconsin, but the manufacturing declining trend since 1999 has eroded manufacturing jobs, leaving the Manufacturing sector in second place behind Trade, Transportation and Utilities in Wisconsin. The significance of the Manufacturing sector for the state is still a distinctive characteristic of the Wisconsin economy. This contrasts with the smaller relevance of the sector in national employment, where Manufacturing is in sixth place.

As shown on the right panel of chart I.4, U.S. Manufacturing employment never recovered its pre-eighties level and has been falling every year since 1999. On the contrary, Wisconsin manufacturing employment was hardest hit during the early 1980s recessions, but the recovery during the 1990s brought manufacturing employment back to pre-1980s levels. The early 1980s recession hit the Midwest the hardest, and Wisconsin in particular, because of its large share of durable manufacturing, almost 20% of total employment versus less than 14% for the U.S. as a whole. Durable goods industries are pro-cyclical as the demand for their products shrink dramatically during a recession. Since the early 1980s, Wisconsin has significantly lowered its share of employment in the durable manufactures sector to about 10% of total employment. This structural change in the Wisconsin economy makes employment less exposed to cyclical changes than in the past. For this reason, during the current recession Wisconsin is expected to perform better than during the early 1980s recessions.

During the last several years, Wisconsin manufacturing employment outperformed the U.S. and it is expected to continue this trend. Table I.1 shows that Wisconsin manufacturing employment performed better than U.S. manufacturing employment, which never recovered from the last recession and continued losing jobs every year during the last recovery. Wisconsin recovered some jobs during the recovery years (2005 and 2006), but started to lose manufacturing jobs in 2007, declining 0.9% and 1.7% in 2007 and 2008, compared to the U. S. manufacturing employment declines of 2.0% and 3.3% respectively.

Table I.1

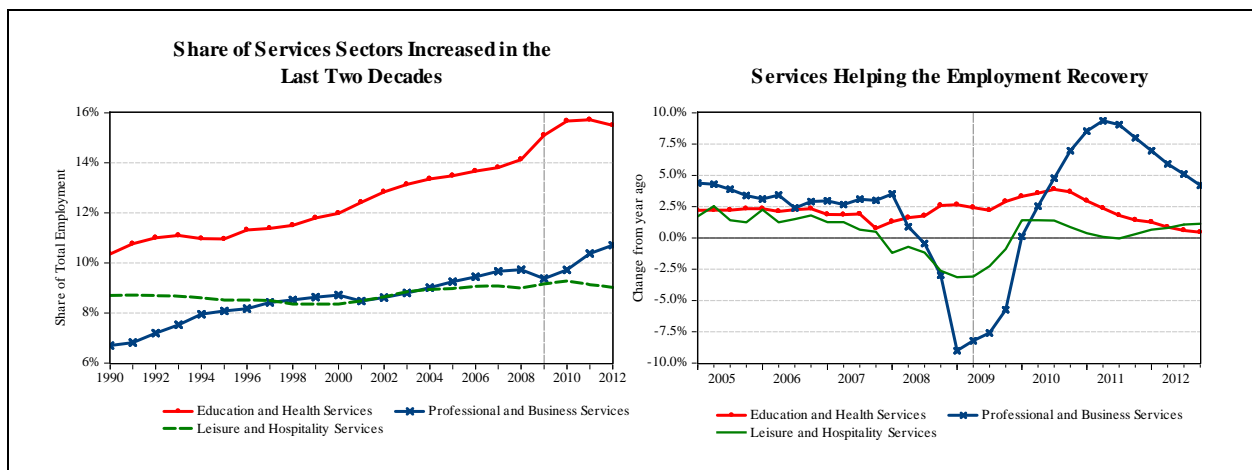
Manufacturing Employment	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
WI Manufacturing											
(Thousands)	528.3	504.1	502.7	504.9	505.8	501.3	492.7	436.5	408.4	415	435.6
(year ch.)	-5.7%	-4.6%	-0.3%	0.4%	0.2%	-0.9%	-1.7%	-11.4%	-6.4%	1.6%	5.0%
US Manufacturing											
(Millions)	15.3	14.5	14.3	14.2	14.2	13.9	13.4	11.9	11.0	11.1	11.6
(year ch.)	-7.2%	-4.9%	-1.3%	-0.6%	-0.5%	-2.0%	-3.3%	-11.5%	-7.6%	1.0%	4.8%

Since the beginning of the current recession, Wisconsin has lost 13% of its manufacturing jobs (65,400). The forecast calls for significant declines of 11.4% and 6.4% in 2009 and 2010 before recovering job growth in 2011.

The share of the Education and Health Services sector has been growing from 10.4% in 1990 to 14.1% in 2008 (see left panel of Chart I.5). Its share is expected to grow as all the other sectors shrink during 2009, reaching 15.7% in 2010.

The Education and Health Services sector was the only private sector posting year over year job gains in the last three months and is expected to be the only one featuring employment growth (2.5%) in 2009. Employment in the Education and Health Services sector grew 1.8% in 2008 and is expected to continue growing, being the only sector that will not lose jobs during the current recession, as shown on the right panel of Chart I.5. This sector is expected to grow 3.6% and 2.1% in 2010 and 2011, leading the employment recovery out of the recession.

Chart I.5



The Professional and Business Services sector is the fifth largest sector in terms of Wisconsin employment. Its share of the total employment has gained three percentage points since 1990, from 6.7% to 9.7%. Employment growth in the sector was strong until mid 2008, when it started to post small year over year declines, ending the year just 0.2% higher than 2007. During the first half of 2009, Professional and Business Services employment fell 8.9% from a year before and is expected to post a final decline of

7.7% in 2009. The sector is forecasted to recover quickly and lead the employment recovery jointly with the Education and Health Services sector, both growing above 3% year over year during 2010.

As shown on the left panel of Chart I.5, the Leisure and Hospitality Services share of total employment has been fairly stable for the last two decades, from 8.7% in 1990 to 9.0% in 2008. The Leisure and Hospitality sector employment declined 1.4% in 2008 after five years of relatively strong average annual growth of 1.7%. Discretionary spending is constrained by job losses, reduced wealth and tight credit markets, leading to another year of job losses (-2.4%) in 2009. However, the Leisure and Hospitality Services sector will contribute to the employment recovery in 2010, growing 1.3%, but will be almost flat in 2011 as the labor market begins to reinstate consumer confidence for discretionary spending.

The Financial Activities sector suffering from the turmoil in the financial market started to lose jobs in the last quarter of 2008 in Wisconsin compared with the U.S. that has been posting year over year job losses since the second quarter of 2007. This sector posted a small but still positive 0.2% growth in 2008 but is expected to decline 2.6% and 0.5% in 2009 and 2010. Employment in the Financial sector is expected to recover a healthy growth rate toward 2010, growing 1.1% in both 2010 and 2011. The Other Services sector accounts for slightly less than 5% of total employment. Other Services grew 1.2% in 2008 and its forecast calls for a decline of 2.4% and 0.4% in 2009 and 2010, before returning to positive growth rate in 2011.

Employment in the Information sector declined 0.2% last year and is expected to continue being a drag to Wisconsin private employment in the next two years, but will show positive growth in 2011 and 2012. The Information employment forecast calls for declines of 2.5% and 1.8% in 2009 and 2010. The sector will return to an average growth of 2.3% for the following two years.

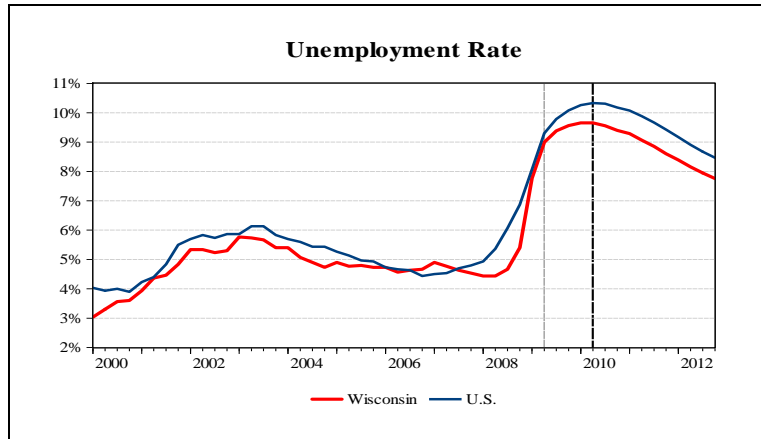
The Natural Resources and Mining sector has been declining since 2006. After declining more than 7.0% the last two years to 3,400 jobs, employment in this sector is expected to suffer significant declines of 9.7% and 6.2% in 2009 and 2010, respectively. However, the sector represents only 0.1% of Wisconsin employment. The forecast calls for employment in this sector to continue declining at a slower pace throughout the rest of the forecasted period.

Government employment in Wisconsin grew just 1.1% in 2008 compared with an increase of 1.2% nationally. Wisconsin Government employment is composed of federal (10%), and state (20%) and local (70%) government employment. The federal government component last year increased 1.5% in Wisconsin and 1.1% in the country. The forecast calls for an increase of 1.1% in 2009 and 4.5% as the census is carried out. The years following the 2010 Census will see some declines.

Wisconsin state and local government increased 1.1% in 2008 and was 1.7% above last year for the period January through May. The forecast expects state and local government employment to grow 1.2% in 2009 and stay flat for the next two years. However, the last two quarters of employment data will be revised early next year during the benchmark process and is most likely to be revised down. By the end of July, new employment figures from the unemployment insurance system will be released, covering the first quarter of 2009. This data and the final impact of the adopted state budget will be incorporated in the state and local government forecast for the September Economic Outlook.

Wisconsin's latest seasonally adjusted unemployment rate was 8.9% in May, more than double from a year ago. However, it is still half a percentage point below the national unemployment rate of 9.4% in May. The forecast expects the state unemployment rate to peak at 9.7% in the second quarter of 2010, while the national unemployment rate is expected to peak at 10.3% in the same quarter.

Chart I.6

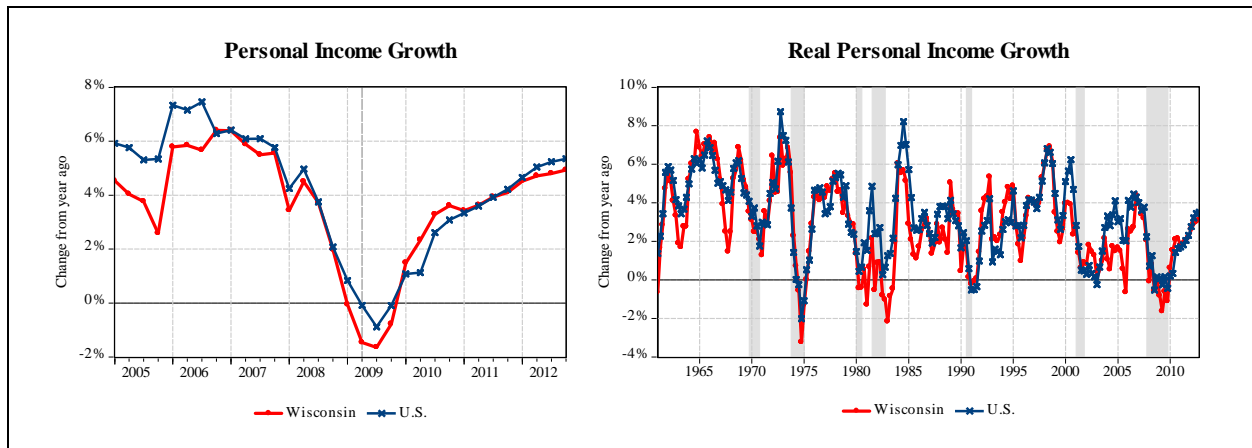


Details of the Wisconsin employment forecast are presented in Appendices 1 and 2.

Income Outlook

Wisconsin total personal income grew 3.4% in 2008, slightly lower than the national growth of 3.8% but higher than the regional average growth of 3.2%. The personal income outlook for the U.S. and Wisconsin were revised down since the March Outlook mainly due to further deterioration in the labor market that lowered the outlook for wages. The current forecast is calling for personal income to decline 1.0% in 2009, with wages falling 2.0% in 2009. The drop in personal income would be higher if not for the American Recovery and Reinvestment Act (ARRA) that is expected to increase transfer receipts by 9.5% in 2009. Personal income will return to growth in 2010 (2.7%) as wages start to grow again. The slow pace of the current recovery will yield personal income growth rates of 3.8% and 4.7% in 2011 and 2012 with stronger wage growth and slower but positive transfer receipts growth.

Chart I.7



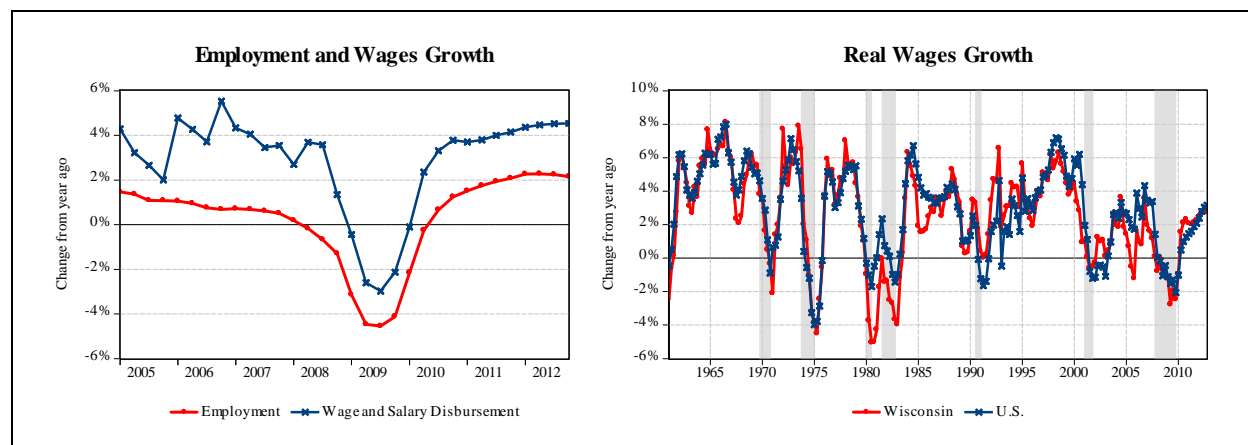
The personal consumption expenditures price index grew 3.3% in 2008 almost offsetting the gain in personal income. Thus, real personal income was almost flat in 2008 and is expected to decline 1.0% in 2009, as prices post only a minor upward movement (0.1%). During the recovery, as demand starts to put some pressure on prices, the price index is expected to show mild price growth (below 2.0%). With mild price growth, real personal income will grow 1.6% and 2.0% in 2010 and 2011, reaching almost 3.0% by 2012.

As shown on the right panel of Chart I.7, real personal income during the current recession will perform worse than the 1970, 1990 and 2001 recessions for both Wisconsin and the U.S. When compared with the mid-1970s and early 1980s recessions, Wisconsin is expected to perform relatively better in this recession. The U.S. will perform better than the mid-1970s recession but worse than during the early 1980s recession. Wisconsin real personal income is forecasted to fall 1.5%, peak to trough, during the current recession, compared with declines of 3.7% and 3.4% during the mid-1970s and early 1980s recessions.

Personal Income Components

Wisconsin wage and salary disbursements grew 2.8% in 2008 but are expected to decline 2.2% in 2009 before resuming growth at 2.3% in 2010. As shown in the left panel of Chart I.8, wages in 2009 are expected to decline as employment falls 4.1% during the year. The wage component of personal income is expected to recover as employment regains its pace of growth in 2010, posting a moderate 2.3% growth in 2010 and 3.9% in 2011. Wisconsin wages and salary disbursements will continue to represent a slightly higher share of total income than its national counterpart. The 2008 income data show that wage and salary disbursements account for 54.3% of Wisconsin personal income and 54.1% of U.S. personal income. By 2012 these shares are expected to be 53.5% and 52.8% respectively.

Chart I.8



Wage and salary disbursements, when adjusted for the increase in prices, declined in 2008. Real wages declined 0.5% in Wisconsin and 0.4% nationwide through 2008. As shown on the right panel of chart I.8, the forecasted peak-to-trough decline in real wages in the current recession is worse than the 1970, 1990 and 2001 recessions for both Wisconsin and the U.S. However, the expected fall is lower than the mid-1970s and early 1980s recessions for both Wisconsin and the U.S.

Wisconsin real wages are expected to fall 3.4% from its peak fourth quarter of 2007 to its forecasted trough, the third quarter of 2009. During the mid-1970s recession Wisconsin real wages fell by 5.6% and 10.3% in the early 1980s recession, when considering the two 1980s recessions as one as discussed above. The forecast expects U.S. real wages during the current recession (-2.6%) to perform better than the mid-1970s recession (-5.3%), but worse than the early 1980s recessions (-2.0%).

The supplements to wages and salaries component of personal income grew 2.7% in 2008 and is expected to show weak growth (0.7%) in 2009 as employment falls. This component of personal income consists of employer contributions for employee pension and insurance funds and employer contributions for government social insurance. The forecast calls for increasing growth rates between 2010 and 2012 from 2.3% to 4.5%.

Proprietor's income grew 8.5% in 2007 and fell 1.3% in 2008; this swing reflects fluctuations in farm's proprietor income, though it only accounts for less than 5% of the total Proprietor's income. Unusually

high agricultural prices yielded farm proprietors' income growth of 375% in 2007. However, the drop in commodities prices as the recession evolved during 2008 brought farm proprietor's income down 25%. Wisconsin milk prices grew from \$13.3 dollars per hundredweight of milk in 2006 to \$19.2 in 2007, a 44.7% annual growth. Last year Wisconsin milk prices declined 1.4% to \$18.9 in 2008 and 37.7% to 12.7 in the first quarter of 2009. Other commodities showed a similar growth pattern, adding more than the usual volatility of farm activities.

Rental income decreased 40.7% and 24.1% in 2006 and 2007, but increased 56.8% in 2008. U.S. rental income posted year-over-year 2008 increase of 60.9%. The outlook for rental income shows strong continuous growth through 2010 as the housing market completes its adjustment. The forecast calls for moderate but still positive growth in 2010 and 2011 and a decline of 8.2% in 2012.

Dividend income grew about 20% in 2006 and 2007, but its growth decelerated in 2008 to 8.0%. The forecast calls for a decline of 11.2% in 2009 and 2.3% in 2010 as companies adjust their distribution to recessionary business and profits levels. Moderate growth of 3.6% on average is expected for the following two years. Personal interest income experienced relatively strong growth between 2005 and 2007 but was flat during 2008. It is expected to post declines of 5.7% and 2.2% in 2008 and 2009 as a result of the Federal Reserve's policy and persistent weakness in the financial sector. The Federal Reserve started to cut the federal funds rate in September 2007, bringing its federal funds target to a range of 0.0-0.25% from 5.25% at the beginning of 2007. The June national forecast expects that this target will stay in place for all of 2009, with the Fed beginning to tighten in the fourth quarter of 2010.

Related Income Measures

Wisconsin disposable personal income grew 5.5% in 2007 and 4.2% in 2008, as personal tax payments decreased 2.3% in 2008 due to the 2008 federal fiscal stimulus package. Again, personal tax payments are expected to decline 16.4% in 2009 as a consequence of the ARRA. Thus, disposable income is expected to grow 1.1% in 2009 in spite of the decline in total personal income growth expected for the year. The forecast calls for weak 1.8% increase in disposable personal income as the recovery begins in 2010.

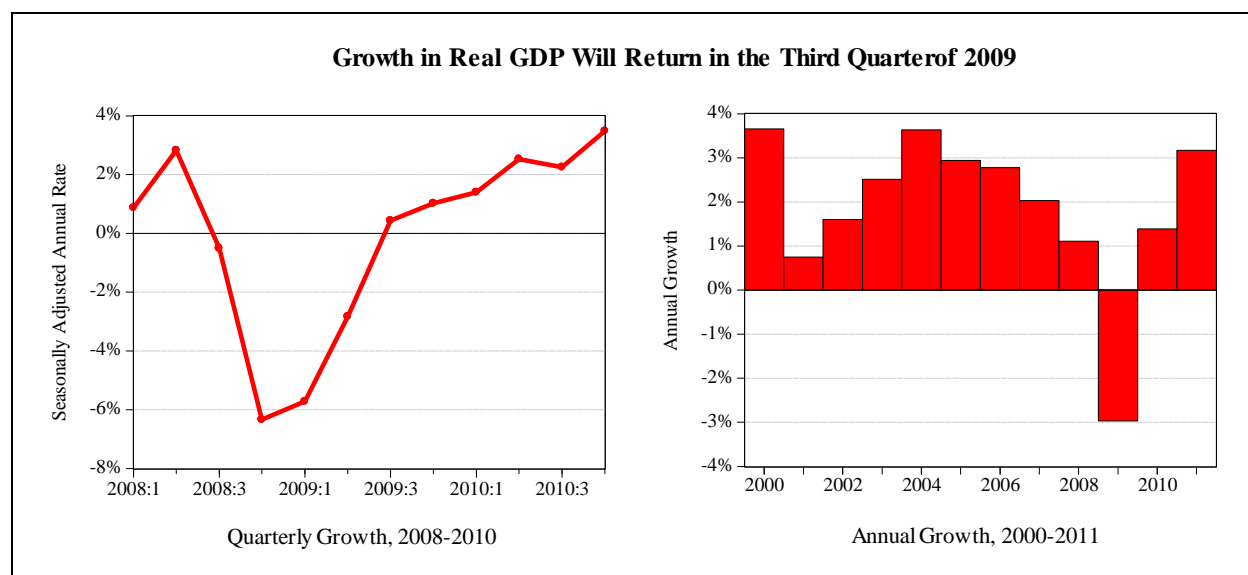
Per capita income grew 5.2% in 2007 and 2.8% in 2008; in real terms it grew 2.5% and declined 0.6% respectively. It is expected to decline 1.6% in nominal and real terms during the worst year of the recession. In the first year of the recovery, 2010, per capita income is expected to grow 2.1% and 1.0% when adjusted for price increases. It will return to healthier growth rates toward 2011 and 2012 with 3.2% and 4.2% growth rates respectively.

Details of the Wisconsin income forecast are presented in Appendices 3 and 4.

U.S. OUTLOOK

The recession remains severe, but a bottom is in sight, at least for output if not employment. In the June forecast, Global Insight expects GDP to begin to grow in the second half of the year. Recovery is expected to be slow, since credit conditions will stay tight. The economy is expected to contract 3.0% during 2009, before growing 1.4% in 2010. The unemployment rate will reach 10.3% in early 2010. Deflation fears have receded. Inflation remains a risk for the future, but it is not an imminent threat. Headline CPI inflation is in negative territory and wage inflation is falling, not rising. Bond yields have backed up as fears for the economy have diminished, but it is too soon for a major bear market in bonds.

Chart I.8



The Forecast in Brief

The economy remains on track to bottom out soon, at least in output terms. The current forecast expects the rate of contraction in GDP to slow in the second quarter to minus 2.8%, before GDP edges higher in the second half of the year. But a rapid recovery is not likely after such an extreme financial shock. Economists may be able to declare the recession technically “over” some time in the third quarter of 2009, but it will not feel that way for the unemployed. The unemployment rate will continue to rise and will peak at 10.3% in the first half of 2010.

The May employment report offered perhaps the most solid sign yet that the downturn is slowing. It showed a much more moderate rate of job loss in private services, suggesting that firms were very quick to react to the downturn at the turn of the year, and so no longer need to keep slashing jobs. Jobs will continue to decrease for the rest of the year, but progressively less rapidly. However, a retreat in the unemployment rate, now 9.4%, requires not just that jobs grow, but that they grow faster than the labor force. That remains a distant prospect.

The bleakest part of the jobs report was the still heavy loss of workers in manufacturing, suggesting that the inventory adjustment in the goods sector remains severe. The inventory cycle will be the key to the growth profile in 2009. Inventories took more than 2 percentage points out of first quarter GDP growth. Inventory/sales ratios are still elevated, and inventories will be a drag on growth again in the second quarter. Only in the second half of the year will the inventory cycle become a plus for growth. At that point, real GDP begins to expand even though final sales are still declining.

The consumer is still under stress. Consumer sentiment has improved, although that mainly reflects hopes for the future rather than better current conditions. The second quarter evidence suggests a mild setback for spending, despite help from reduced tax withholding and one-time payments to Social Security recipients, which are being more than offset by rising gasoline prices. Given continuing steep employment declines, reduced household wealth, debt overhangs, and still-tight credit, it is hard to make a case for a robust consumer recovery. The forecast expects spending to drop 0.9% in the current quarter, then only gradually improve over the second half of the year. Light vehicle sales fall to 9.7 million units in 2009, from 13.1 million units in 2008, before improving to 11.3 million in 2010.

Housing remains a major drag on growth, and until the housing market stabilizes, it will be difficult to draw a line under the financial crisis. Rising unemployment and reduced household wealth are damaging, but lower home prices and mortgage rates are now making housing look much cheaper, at least for those who can qualify for credit. Most key indicators of housing activity (home sales, housing starts and permits) are showing signs of stabilization. Higher mortgage rates will now test this stability. Global Insight expects housing starts to hit bottom in the second quarter of 2009, at just 487,000 units (annual rate), and to improve gradually thereafter. House prices will take longer to stabilize. The FHFA house price index will drop 8.7% from the fourth quarter of 2008 to the fourth quarter of 2009, and another 6.4% by the fourth quarter of 2010.

Business investment is still falling, but less steeply. The June forecast expects second quarter equipment spending to tumble 15.6%, another sharp drop, but less than half the 33.5% plunge in the first quarter. Growth will resume by the end of the year. For 2009 overall, a 19.0% drop in equipment spending is expected, followed by a 7.1% increase in 2010.

On the business structures side, the outlook is mixed. Total structures spending will probably increase in the current quarter, but the gains will be narrowly concentrated in oil refining and power generation. The trend for commercial construction such as retail developments, offices, and hotels remains downward. Declines in private nonresidential building will resume in the third quarter of 2009 and extend through the third quarter of 2010. The average spending decline is 11.9% in 2009 and 18.2% in 2010. Drilling activity in the energy sector is still falling steeply, but should stabilize in the second half of the year with energy prices bottoming out.

The global recession has hit exports hard. They plunged at a 28.7% annual rate in the first quarter of 2009. Although there are now signs that world trade is beginning to stabilize, Global Insight does not expect the U.S. recovery to be export-led. Apart from China, which has injected massive fiscal stimulus into its economy, the recovery should come more slowly to the rest of the world. This means that the trade gap will widen later this year, as imports pick up before exports. The dollar has started to weaken again as its safe-haven bid has diminished. The current account deficit should fall about 40% in 2009 (\$264 billion), almost entirely because of a \$230 billion plunge in the bill for imported oil.

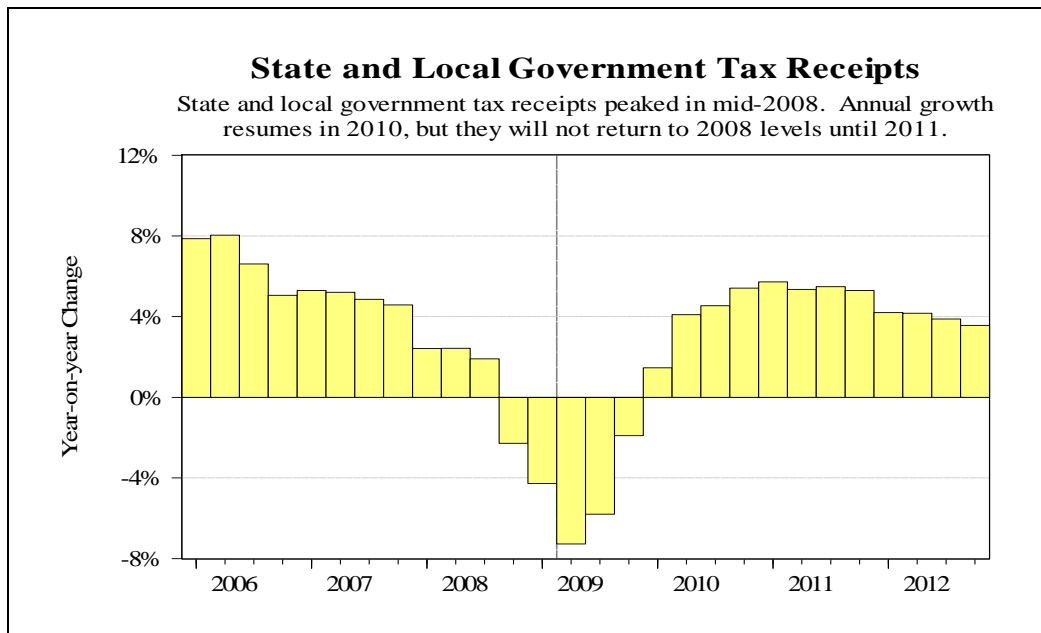
Rising commodity prices have eased fears of deflation, and there is now talk of inflation risks as some investors are viewing the magnitude of monetary and fiscal stimuli with alarm. Some commodity prices, notably oil, have moved in advance of the fundamentals, and some correction is likely. But even without such a correction, there is too much excess capacity in product markets and especially in the labor market for an inflation spiral to take hold any time soon. By the third quarter of 2009, headline CPI inflation is expected to be minus 2.4% year-on-year, largely on lower energy costs. Core consumer price inflation (inflation less food and energy prices) will soften and bottom out at 0.9% in the second quarter of 2010, just below the bottom of the Federal Reserve's 1-2% comfort zone.

Bond yields have moved much higher, into the 3.75-4.00% range for ten-year Treasuries. This movement is driven by a combination of reduced safe-haven demand, indigestion over heavy bond issuance, worry over future budget deficits, and concern over long-term inflation risks. Although

bond yields are headed substantially higher over the long term, it is too early for a major bear market to begin, since the economy is still weak and inflation is a distant threat.

In the state and local government sector, revenue growth is slowing or even negative, while financing has become more expensive. Real state and local government purchases began to decline in the fourth quarter of 2008. They will roughly stabilize by midyear, but only because of federal support for current and capital spending that is estimated at \$171 billion over calendar years 2009 and 2010.

Chart 1.9



The full fiscal stimulus package is valued at around \$787 billion over ten years, and Global Insight assumes that \$561 billion of this is injected during the first two calendar years. The stimulus adds about 0.8 of a percentage point to 2009 GDP growth and 1.3 percentage points to 2010 growth and is expected to create or save just under 2.5 million jobs by the fourth quarter of 2010.

Both the Federal Reserve and the federal government need “exit strategies” to keep core inflation at bay. The Federal Reserve is not yet ready to take its foot off the accelerator, but it is thinking about how and when to withdraw its unprecedented stimulus. Markets are beginning to price in a Fed interest rate hike later in 2009, but Global Insight believes that is far too early and does not expect higher rates until deep into 2010. But there is no doubt of the Fed’s resolve to act as necessary.

Key Forecast Assumptions

Fiscal Policy: The government’s stimulus package has a face value of around \$787 billion over ten years. Global Insight assumes that \$561 billion of stimulus is injected during the first two calendar years. The \$561 billion breaks down into \$143 billion in tax cuts for the personal sector (\$48 billion of which are classified as transfers because they exceed tax liabilities), \$97 billion in targeted transfer payments to the personal sector (e.g., food stamps, extended unemployment insurance), \$88 billion in corporate tax cuts, \$149 billion in transfers to the states (to support Medicaid and other current spending), and \$82 billion for infrastructure and other spending (partly channeled through the states). Global Insight does not consider the extension of AMT relief (worth \$70 billion) as stimulus, because it would have happened anyway.

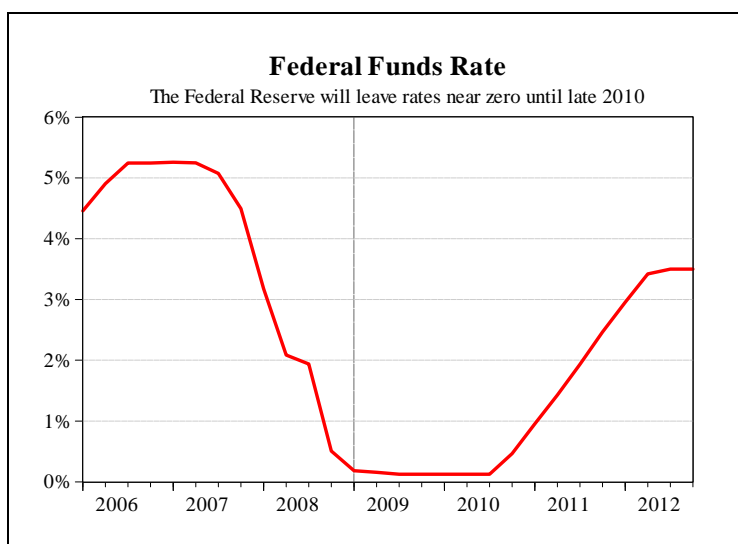
TARP: The Treasury has \$700 billion in budget authority under the Troubled Asset Relief Program (TARP). The forecast assumes that the Treasury actually spends only \$650 billion of the total, as financial market conditions have improved since the \$700 billion was approved and the top banks have been able to source private external capital. The top banks are expected to repay about \$50 billion in the next several months. Global Insight treats the capital injections and support for the auto sector on a net discount basis (rather than a cash basis), consistent with the Treasury’s change to reporting methodology announced in May 2009. The June forecast also assumes that the Public Private Investment Program (PPIP) is scaled back to cover only distressed securities (the whole loans program has been cancelled).

Of the TARP’s first tranche of \$350 billion, Global Insight assumes \$20 billion in auto sector support and \$330 billion of capital support for the financial system (\$270 billion for banks, \$40 billion for AIG, and \$20 billion for the term securities lending facility (TALF)). Of the \$300 billion spent out of the second tranche, the forecast allocates \$37 billion for auto sector support, \$75 billion for the housing plan, and \$188 billion for the financial sector (TALF II, \$20 billion; AIG II, \$30 billion; PPIP program, \$50 billion; and other capital injections, \$88 billion).

Auto Industry: The June forecast assumes the GM and Chrysler bankruptcies will allow smaller and leaner entities to emerge within months.

Federal Reserve to Hold Rates Near Zero: The Fed has cut its federal funds target to a range of 0.0-0.25%. This target is expected to stay in place for all of 2009, with the Fed beginning to tighten only in the fourth quarter of 2010.

Chart 1.10



Oil Price Assumption Raised: OPEC has been more successful than anticipated in putting a floor under the price of oil, though Global Insight believes that demand is too weak to keep the current price at around \$70/barrel. The forecast assumes the price of West Texas Intermediate averages \$51/barrel in the second half of 2009 (instead of \$39, as assumed in the March outlook). The price will average \$56/barrel in 2010, and then climbs to \$90/barrel by 2014.

Dollar Trading Range: The dollar rose sharply from mid-2008 against most major currencies (with the exception of the yen), as investors sought safe havens amid market turbulence, but has slipped recently as markets have stabilized. Over the rest of 2009, the dollar is expected to stay within recent trading ranges, with end-2009 values assumed of \$1.36/euro, 93 yen/dollar, and C\$1.17/dollar. China has at least temporarily halted the process of renminbi appreciation due to fears for economic growth. The renminbi will appreciate just 1.2% against the dollar over the coming 12 months.

Global Recession: Global Insight projects that GDP in the United States' major currency trading partners to decline 3.6% in 2009, before rising 1.0% in 2010. GDP for other important trading partners is also projected to decline in 2009, by 2.4%, before rebounding 3.2% in 2010.

Defense Spending Growth Expected to Slow: Real federal defense purchases rose 7.2% in calendar 2008, but are expected to see a smaller 2.9% increase in 2009 and a 1.1% decline in 2010 as the new administration scales back defense commitments.

DETAILS OF THE U.S. OUTLOOK

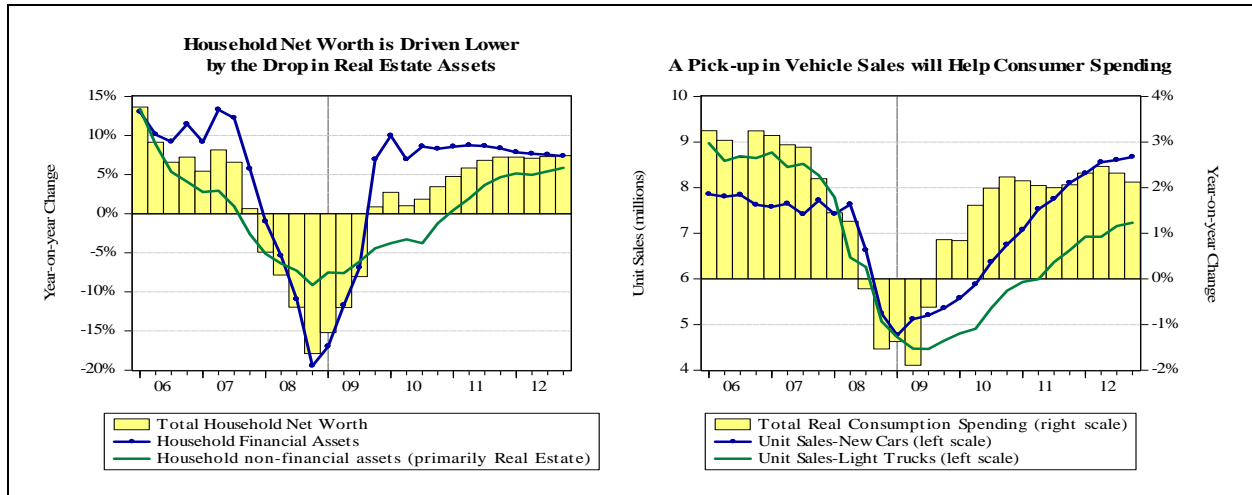
Consumer Markets

After retreating 1.2% in March and 0.2% in April, retail sales advanced 0.5% in May. A price-driven 3.6% jump in sales of gasoline accounted for over half of the May increase in total sales, as discretionary spending remained weak. Gains at building and garden supply stores, health and personal care stores, auto dealers, and food and beverage stores were partially offset by declines at department stores, electronics and appliances stores, home furnishings stores, and non-store retailers. Replacement of analog television sets should give electronics stores a much needed boost in June.

Household net worth decreased by \$1.3 trillion in the first quarter of 2009, bringing the cumulative decline since the second quarter of 2007 to \$13.9 trillion. This exceeds the \$12.1 trillion in total personal income earned last year. During the first quarter, asset values fell \$1.4 trillion, while liabilities decreased \$0.1 trillion, their second consecutive quarterly decline. Households lost \$448 billion in real estate and \$884 billion in financial assets during early 2009. The stock market rally of the past three months has restored only a small fraction of the wealth households had lost during the market's slide.

A slow recovery in consumer spending is expected to begin this summer, sparked by massive fiscal stimulus, an upturn in housing markets, and pent up demand for vehicles. Yet, real consumption growth will average just 1.4% from this spring through early 2010, barely outpacing population growth of 1.0%. Further job losses, tight credit conditions, and reduced household wealth will continue to restrain spending. The household saving rate is projected to climb from 1.8% in 2008 to 5.1% this year, its highest level in 16 years.

Chart I.11



The projected recovery will be the most subdued in the postwar era, with real consumption growth averaging just 2.0% annually from 2009 to 2012. This compares with growth in past recoveries of 3.0% from 2001 to 2004, 3.5% from 1991 to 1994, 5.4% from 1982 to 1985, and 4.7% growth from 1975 to 1978. High unemployment and increased labor market flexibility will limit wage gains, even as commodity prices rebound and consumer price inflation picks up. Meanwhile, the unwinding of fiscal policy stimulus and increased taxation of upper-income households will lead to rising income tax burdens and lower disposable incomes.

Housing and Construction

The construction market for single-family homes is on the mend. January 2009, the month single-family starts and permits hit all time lows, will mark the low point in the cycle. Single-family permits increased 7.9% in May to an annual rate of 408,000 units, and were up in all four regions. Single-family starts were up 7.5%. Based on May’s permits numbers, improving single-family housing starts numbers will continue over the next two to three months.

The market for multi-family homes, however, is in a deep slump. Multi-family starts for this category jumped 61.7% in May; however, this increase was not statistically significant. Multi-family permits, which better gauge underlying conditions, fell 8.3%, the 11th consecutive monthly decline, to a record low of 110,000 units (annual rate). The recent sharp decline in this market is likely related to financing. Some builders are overwhelmed with debt. Others cannot find funding to finance projects with positive net present values.

The proportion of homes falling into foreclosure rose to an all-time high of 1.3% in the first quarter. This amounts to about 650,000 homes. Foreclosures are likely to exceed 3 million in 2009.

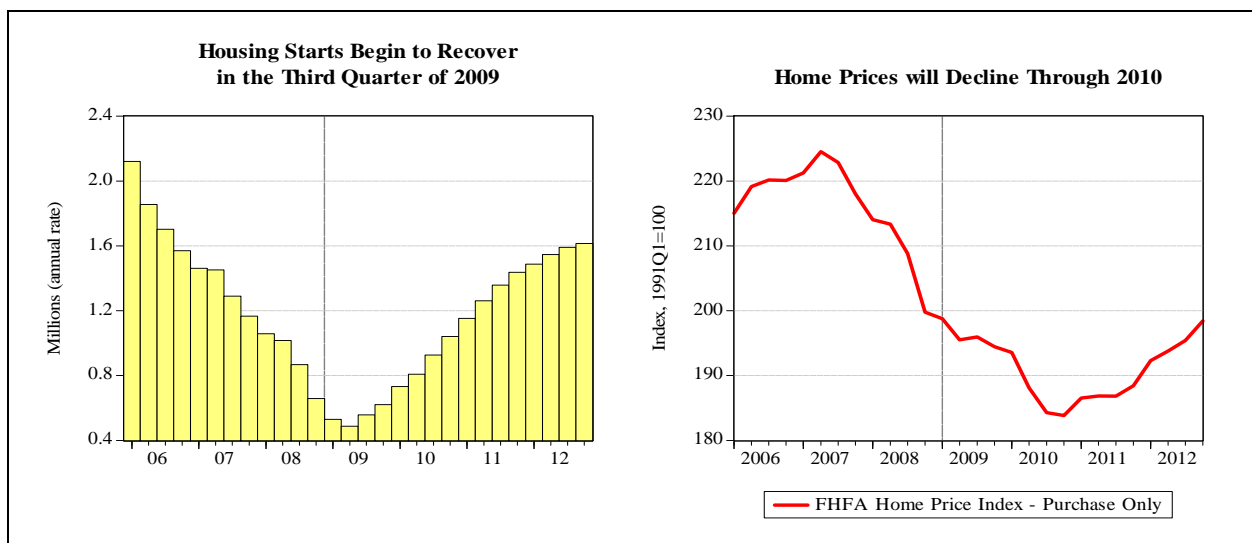
The 30-year fixed mortgage rate has shot up recently, and refinancing has plummeted as a result. Higher mortgage rates present another obstacle to the housing recovery. In the forecast, existing home sales turn around in early 2010.

Builders have slashed prices and production. As a result, inventories of unsold new homes have fallen sharply. Moving further ahead, single-family starts and new home sales will continue to improve, but the recovery will be slow, lasting two to three years. Multi-family starts will also continue to improve, but only because their recent collapse has brought their level so near the bottom. Overall, housing starts drop from 900,000 units in 2008 to 548,000 in 2009, and then bounce back to 877,000 units in 2010.

Based on the baseline forecast for housing starts, residential investment will cut real GDP growth by 0.8 percentage point in the second quarter and another 0.3 percentage point in the third; but in the fourth quarter, for the first time since 2005, it will start adding to growth.

Housing prices are near their equilibrium level, but they will continue to drop because current inventory levels remain near record highs and the foreclosure rate is still rising. In the forecast, the price of a median home bottoms out in the first quarter of 2011, after dropping another 5% from current levels.

Chart I.12



Business Investment

Spending on private nonresidential construction increased in April for the third straight month. However, April’s solid increase was on the heels of a first-quarter collapse in real spending on structures, and Global Insight believes that regardless of the up-tick in April’s data, builders face hard times ahead.

Two anomalies in the data, surges in manufacturing and power construction, accounted for April’s increase. In both instances, an unidentified spending category accounted for the surge. However, this is subject to large data revisions.

Orders of core capital goods are sliding, but are no longer in a freefall. However, shipments of this category are still dropping and will continue to do so in the near term, because the recent fall-off in orders has exceeded that of shipments. The core numbers have been weak across the board. In the first quarter, medical equipment was the only category (out of 19 that are identified in the Census tables) that posted a gain.

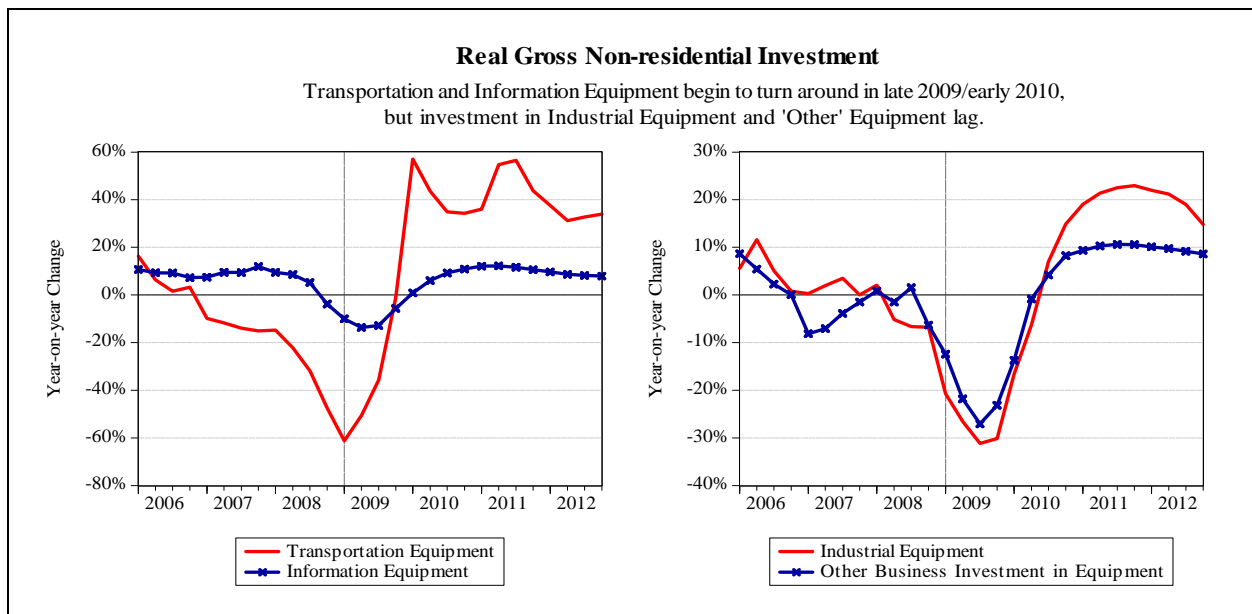
Drilling for oil and gas has fallen off a cliff because of lower energy prices. This abrupt slowdown accounts for a second straight 75%-plus drop (annualized) in real spending on mining and petroleum structures during the second quarter.

Outside of oil and gas, the outlook over the next two years is grim because underlying conditions are weak. In the June forecast, spending on nonresidential structures drops during the first six quarters of the projection period. The decline is balanced and deep. In 2010, every major category that is forecasted, outside of mining and petroleum structures, drops at a double-digit rate. Manufacturing plummets 30% in 2010 and 23% in 2011. Overall, real spending tumbles 18.0% in 2009 and 14.5% in 2010.

Business purchases of light vehicles have bottomed out. Indeed, net spending on light vehicles will grow at 100%-plus annual rates in the second and fourth quarters of 2009. However, these growth rates are deceptive. They are astronomical not because sales will take off, but because their starting point is so low. In the forecast, real equipment and software (E&S) spending drops 19.0% in 2009, its largest yearly decline since 1947, but rebounds 7.1% in 2010.

The plunge in business fixed investment (BFI) cuts real GDP growth by 2.0 percentage points this year. Real BFI will be flat in 2010, while its share of GDP drops to a 64-year low.

Chart I.13



International Trade

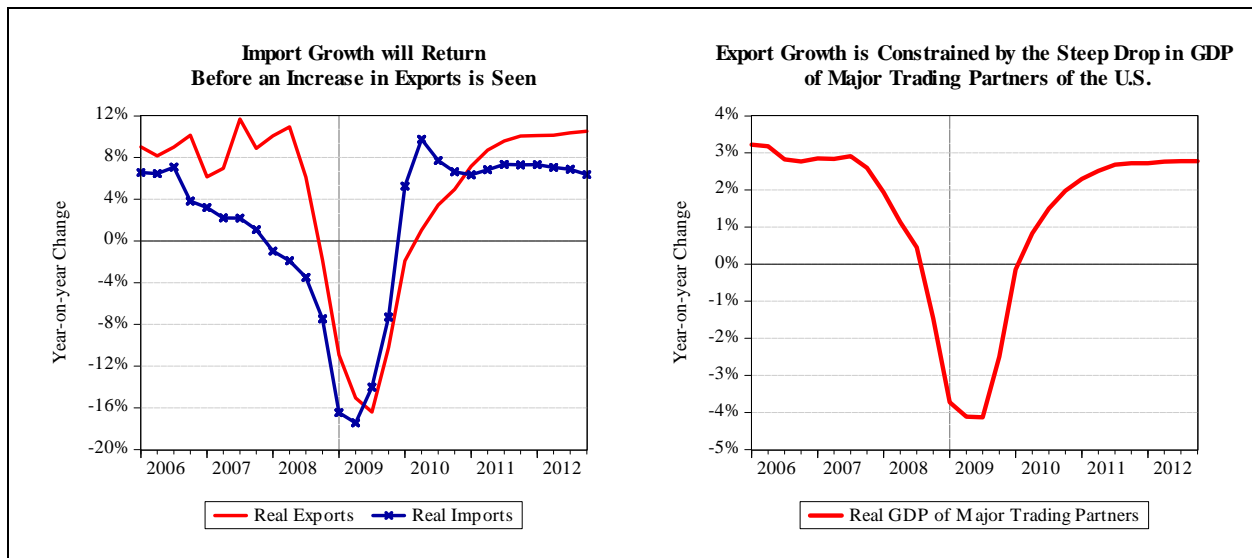
The trade balance deteriorated in April, hurt by an abysmal month for exports. Total imports declined 1.4%, despite a rise in the oil import bill. But exports tumbled 2.3%, with goods exports getting hammered for a 3.1% loss. The export drop hit all sectors hard, except for food, feed, and beverages.

One standard way to view the importance of foreign trade is to look at the ratio of exports plus imports to GDP. This ratio has the advantage of being broader than just the net trade balance alone, and it moves sideways when trade is expanding or contracting exactly in line with GDP. This ratio peaked in third-quarter 2008 at 32.2%, and plunged 8.0 percentage points to 24.2% in the first quarter of 2009. That drop is massive and was evident on both the import and export sides of the ledger, albeit aggravated by oil price declines. Back in the 1982 recession, the drop was 4.3 percentage points, and the nasty 1975 recession yielded a drop of only about 2.0 percentage points. This trade collapse is worldwide and more synchronized than its predecessors, but is probably doing its worst damage now.

The best days for the trade balance, in terms of rapid improvement, are behind us. The first-quarter NIPA-basis deficit of \$333 billion is about as small as it is likely to get, with the April deterioration due to plunging exports an example of why the gap will not narrow further. The recession turned global a bit later than it hit the United States. That time lag, plus the heightened significance of investment goods in U.S. exports, will keep the export side in retreat for one extra quarter after imports start to recover.

Imports will pick-up again as final sales begin to improve and inventories are reduced. This should take place during the end of the second quarter, and import volumes will begin to turn around in the second half of 2009. Firming sales to consumers and higher materials demands will keep imports growing in 2011 and 2012. It will not be at double-digits, but will be faster than GDP growth as world trade rebounds.

Chart I.14



Inflation

With energy prices much lower than in 2008, the Consumer Price Index (CPI) has slipped further from its year-earlier level, down 0.6% in April and down 1.0% in May. The current path of consumer prices reinforces the view that this year will mark their first annual decline since 1955. Excluding food and energy, “core” consumer prices rose 0.1% in May, down from 0.3% in April.

The Producer Price Index (PPI) edged 0.2% higher in May. The gain fell short of expectations, though, as the surge in gasoline prices was counteracted by a steep drop in food prices. Excluding food and energy, core producer prices fell 0.1%. While most components were relatively unchanged, prescriptions and civilian aircraft prices slipped 0.3% and 0.9%, respectively. This decline is the first for core prices since the recession began, and it highlights the still-present threat the economy faces from deflation.

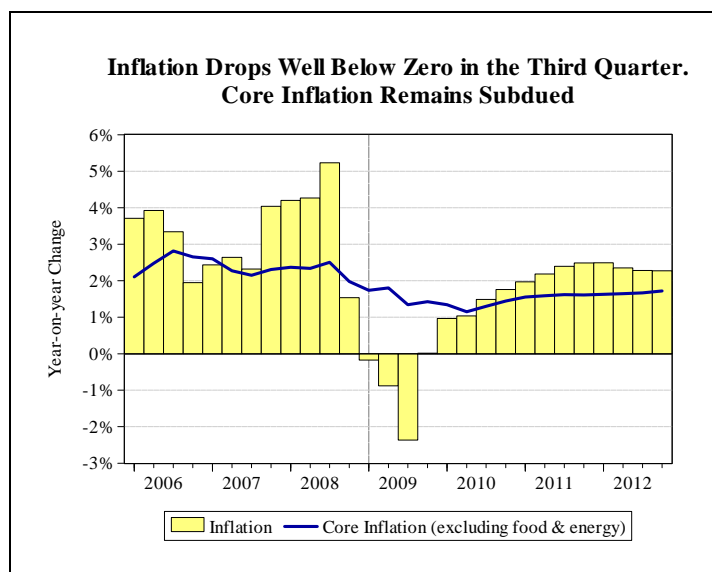
The Federal Reserve continues to hold its key interest rate near zero, which would be a recipe for inflation if demand was not so weak. The ten-year TIPS spread, a useful proxy of inflation expectations, averaged 1.57 percentage points in May. The spread has risen every month since its December low, but not high enough to trigger any immediate change in monetary policy.

Core personal consumption expenditures (PCE) inflation rose to 1.9% year-over-year (y/y) in April, nearing the upper boundary of the Federal Reserve’s 1-2% comfort zone.

In the forecast, headline CPI is expected to fall 0.9% in 2009, not as a result of significant declines in the coming months (since prices are likely to remain relatively muted), but due almost entirely to the absence of a surge in energy prices like the economy experienced last summer. As a result, 2009 should mark the first yearly CPI decline in 54 years. Excluding energy and food, the core CPI advances 1.6% in 2009 and a slimmer 1.3% in 2010. Core PCE inflation should reach its slowest pace in the final quarter of 2009, with an annualized quarterly rate of 0.6%. Unfortunately, the unwelcome companion of such stable prices is flat wages and salaries, held in check by a weak labor market.

On the producer side, the PPI for finished goods should fall 4.3% in 2009 and 0.1% in 2010. The slower recovery of PPI is due to the high unemployment rate keeping labor costs low. There is also a lag between the recoveries of the U.S. economy and the rest of the world, creating a delay in the return of export demand. Producers also face the prospect of slower productivity growth in 2009, which means higher unit labor costs and lower compensation growth for workers.

Chart I.15



Employment

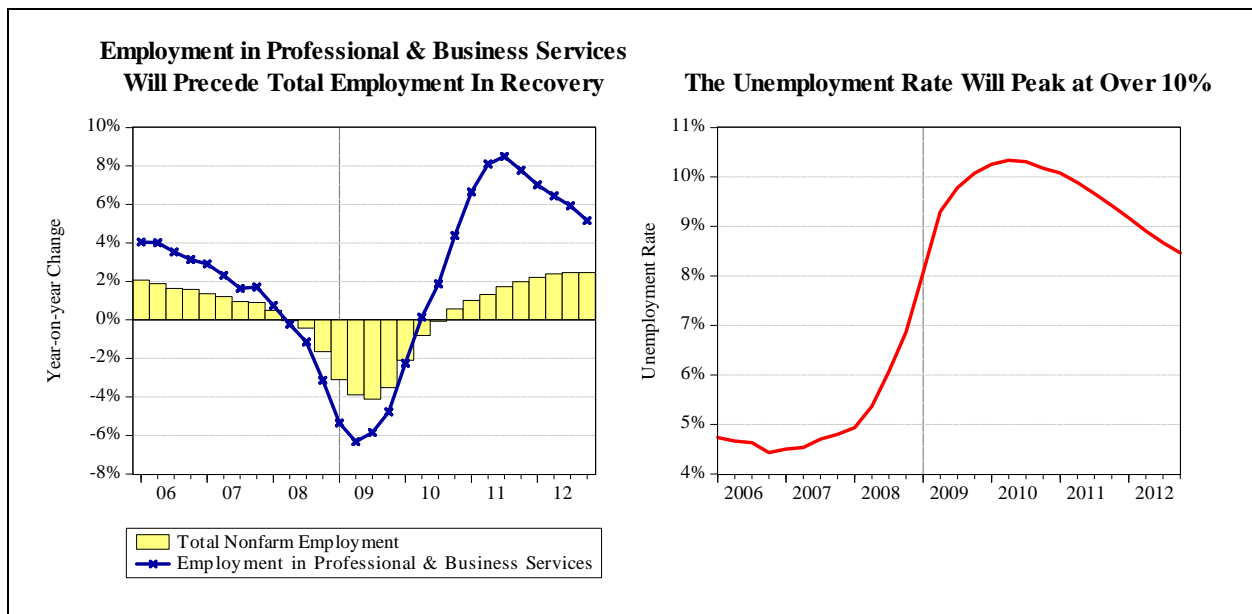
The May payroll decline of 345,000 was relatively mild, while revisions to prior months boosted payrolls by 82,000. The slower decline in payrolls owes some of its moderation to construction, which shed just 59,000 jobs. In comparison, during the bad December-to-February stretch, the sector lost an average of 115,000 jobs per month. Temporary help jobs shrank by just 6,500 in May, versus an average monthly decline of 78,600 during the peak job-shedding months.

Most sectors shared in the shallower declines. Unfortunately, not manufacturing, where 156,000 jobs were lost, thanks to a 29,800 loss in motor vehicles as Chrysler shut down production and other producers trimmed inventories. Among large employment sectors, only the federal government and information sectors had bad months by recent standards, and the federal cuts were caused by big layoffs at the post office. The unemployment rate shot up 0.5 percentage point, to 9.4%, with considerable help from a rise in the labor force, some of which was teenagers.

Temporary jobs have fallen sharply in recent years. Employment services employed 3.7-million workers at the peak in 2006, with about 73% of these “temps.” To the data collectors, these are people who work in other companies, but whose paychecks are issued by an employment agency. The peak number of temps fell from 2.65 million to just 1.77 million in May, a contraction of one-third. The May decline slowed to just 11,200 in employment services, with just 6,500 job losses in temporary help services. After bleeding about one-million jobs per year for two years, this major moderation in temporary job losses cannot be dismissed. Temporary help employment should turn positive within months and lead the recovery, as it led the decline.

Employment will continue to fall for the balance of 2009 and then turn around in early 2010. The last half of 2010 should show a more dramatic recovery. Payrolls will fall 3.7% this year and dip 0.6% next year. The subsequent three years of 2011-13 will then show the rebound, with sequential gains of 1.5%, 2.4%, and 2.0%. While this is a solid recovery, it takes until early 2013 to surpass the 138-million employment total that marked the record high in 2007. Even with solid job gains, the unemployment rate remains above 8.0% for all of 2013, after peaking at 10.3% next year.

Chart I.16

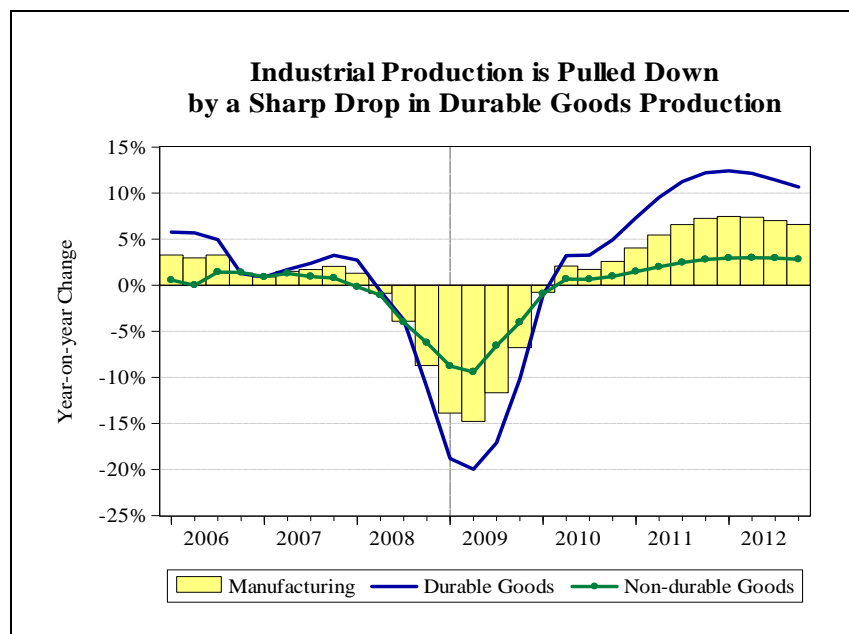


Industrial Production

The manufacturing sector continues to struggle. The ISM purchasing managers' index (PMI) did rise to 42.8% in May from 40.1% in April, but was still well below the 50% threshold that implies an expanding manufacturing sector. According to data from the Federal Reserve Board, manufacturing output declined again in May (by 1.1% month-on-month). Output has declined in 16 out of 17 months since peaking in December 2007. Manufacturing output and orders are running 15% and 23%, respectively, below a year ago. The operating rate in manufacturing has fallen to 65.0%, with traditional manufacturing at 65.2% and high-technology manufacturing at 61.8%.

Global Insight believes the worst is over, but there is nothing in the cards to suggest that manufacturers will be popping the champagne corks any time soon. Consumers remain reluctant to spend, as the employment situation remains dire. Summer car and truck plant shutdowns will be longer than usual, with some permanent, as the troubled auto industry deals with the recession and the bankruptcies of GM and Chrysler. Weak demand will force producers of appliances, home furnishings, and other consumer goods to keep a tight rein on production runs.

Chart I.17



At the same time, manufacturers, retailers, wholesalers, construction contractors, trucking companies, railroads, airlines, barge operators, and the service providers have been slashing capital spending programs in the face of faltering demand, lots of red ink, tighter credit conditions, and nagging uncertainty. The energy and mining industries have also trimmed capital spending in the face of weak demand and prices that remain well below year-ago levels. Investment by the farm sector will taper off over the near term as farm incomes decline. Production of machinery and transportation equipment will reflect the prolonged weakness in capital expenditures. Adding insult to injury, overseas demand has slowed to a crawl as the rest of the world reels from this severest of recessions, suggesting continuing weakness in export-related production.

The bottom line is that the industrial sector will struggle over the remainder of this year. Signs of life will emerge as we move through 2010, and the recovery will finally hit its stride in late 2010/early 2011. On an annual basis, manufacturing output is slated to decline 12.0% this year, rebound 1.1% in 2010, and then climb 5.1% in 2011 and 6.4% in 2012.

RISKS AND ALTERNATIVES

The economy appears to have passed the inflection point that separates a free-fall from a downturn that has a bottom in sight. Indeed, consumer spending is stabilizing, and housing is showing signs of stabilizing. Confidence is up, and this has helped boost the S&P 500.

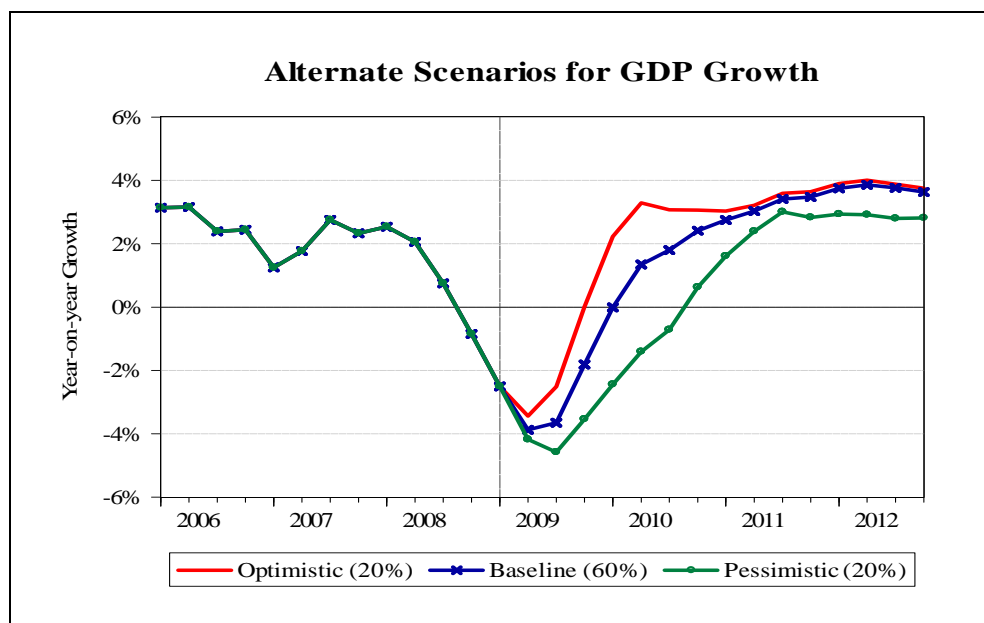
The U.S. economy is not out of this yet, however. Big problems remain. The economy is still shedding jobs. Conditions in the commercial real estate market remain poor. Housing prices are still falling, and mortgage delinquency rates are still rising. And output in the rest of the world is still contracting.

Are real green shoots of recovery emerging, or are the recent positive signals a false dawn?

In the pessimistic scenario, the remaining problems combine to throw the economy off the tracks again. This scenario assumes lower consumer spending, weaker business investment, slower foreign growth, and weak underlying productivity growth. It is a scenario with an even deeper recession in the near term, and slow growth afterward.

In the optimistic scenario, Federal Reserve and Treasury policies turn the economy around sharply in the second half of this year. With credit once again flowing, domestic consumer and business demands are rekindled, along with global demand. The U.S. economy still experiences a serious recession, but it is milder than in the baseline forecast, and strong growth resumes from the third quarter of 2009 onward.

Chart I.18

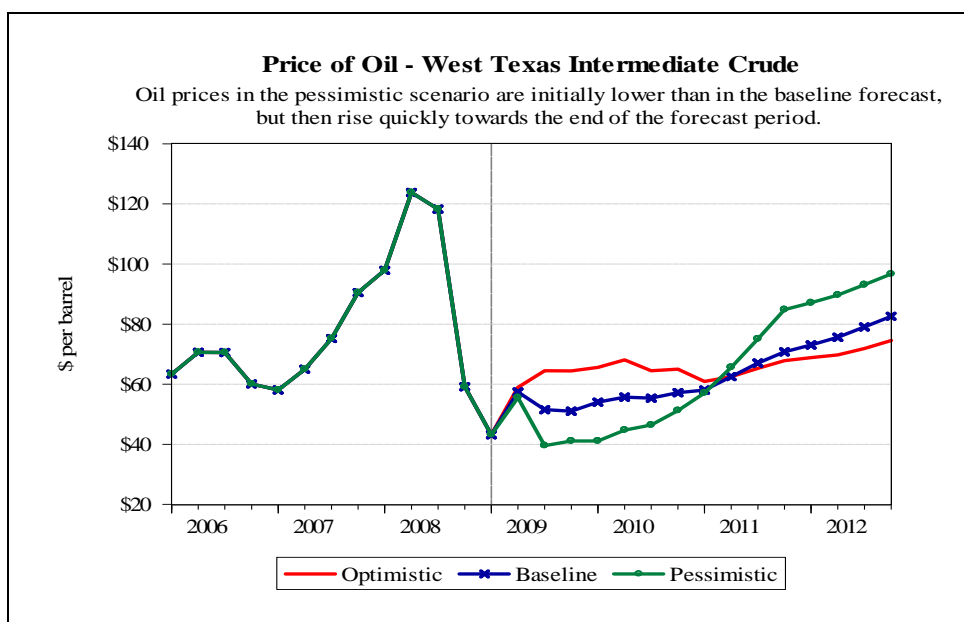


False Dawn (20% Probability): The pessimistic scenario features a deeper, longer recession. The simulation assumes that the financial crisis worsens, and the economy worsens dramatically. Credit markets remain clogged, both domestically and across the world. Without access to credit, domestic spending contracts and the housing market falls into an even deeper hole.

The pessimistic scenario assumes that the downward spiral in financial markets continues into 2010. The Treasury-eurodollar (TED) spread is still more than 100 basis points in the third quarter of 2009 (normally, it is less than 70 basis points). The spread between 30-year fixed mortgage rates and the 10-year Treasury note yield also remains wider than normal through 2010.

Oil prices are lower over the short run in this scenario because world demand is falling. As a result, bottom-line inflation is lower. Core inflation is also lower because demand is so weak. The low inflation readings give the Federal Reserve leeway to keep interest rates in the 0.0 - 0.25% target range, just as in the baseline, during 2009 and 2010. But when the economy begins to improve, inflation starts creeping up because of rising energy prices, a slowdown in productivity, a weaker dollar, and because of the Fed's traditional response to the crisis. The Fed responds to rising prices by steadily raising interest rates. But its response is not in time, and inflation continues to climb. Eventually, core inflation stabilizes, but at nearly a full percentage point above the baseline rate.

Chart I.19



In this scenario, the housing recession drags on. The median price of existing homes falls 13% below the baseline in 2010. Home sales are also much lower. Housing starts begin to turn around from record-low levels, but the rebound is sluggish, as starts drop from 900,000 units in 2008 to 528,000 in 2009 (compared with 548,000 in the baseline) and 710,000 in 2010 (compared with 877,000 in the baseline). The weakness in housing undermines consumer confidence. This, along with the drop in wealth associated with falling home prices and a slowdown in job growth, causes consumers to retrench sharply. Hit especially hard are light-vehicle sales, which fall to 8.6- million units in 2009 (versus 9.7 million in the baseline), and “other” consumer durables (i.e., jewelry, sporting equipment, motorcycles and pleasure boats, and aircraft).

Capital spending is also weaker, as firms respond to a bleaker outlook by scuttling long-term projects. Business fixed investment drops over nine straight quarters. Foreign economic growth is lower, which cuts into export growth. Indeed, real GDP among the United States' major-currency trading partners falls over six quarters, starting in the second quarter of 2008 (this category does not include China). As a result, exports deduct 1.9 and 0.4 percentage points from GDP growth in 2009 and 2010, respectively.

Over the longer term, GDP growth remains slower than in the baseline, mainly because productivity advances only 1.4% on average over the next 10 years, compared with 1.8% in the baseline. Inflation is higher because of the slower productivity gains and a weaker dollar, and because the Fed, after allowing inflation to creep past its comfort band to more than 2.5%, decides to stabilize it at that higher level, rather than risk another recession by bringing it down.

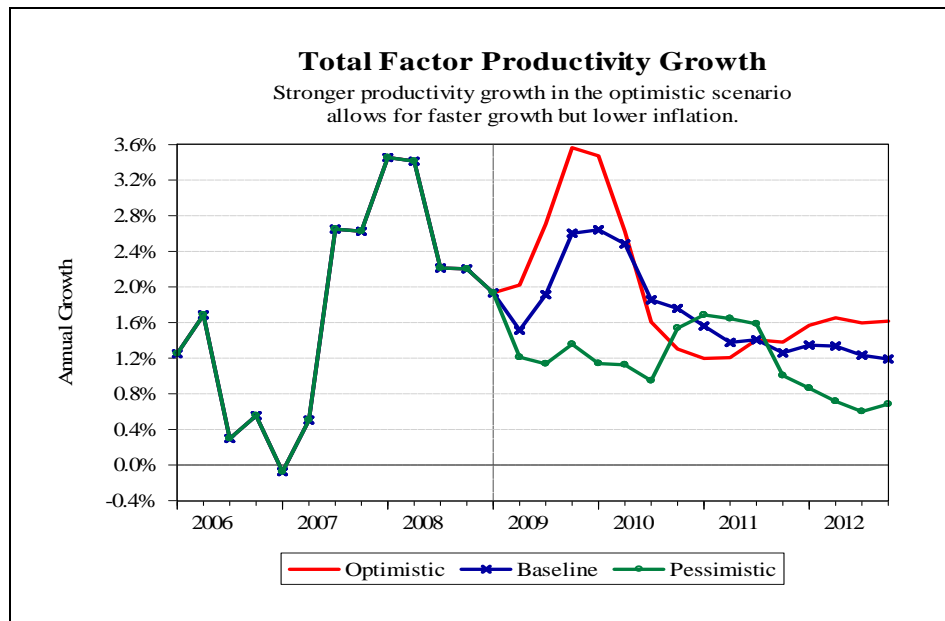
In this scenario, real GDP contracts 3.7% in 2009 and 1.0% in 2010 (compared with a 3.0% drop and a 1.4% gain, respectively, in the baseline). Employment drops for 11 straight quarters (the

economy loses 9.2 million jobs), manufacturing output falls over 11 straight quarters, and real GDP drops for seven straight quarters, starting with the third quarter of 2008. Unlike the previous two recessions, those of 1991 and 2001, this one takes a heavy toll. Peak to trough, real GDP drops 5.6%; not quite enough to be called a depression (defined as a 10% peak-to-trough drop in real GDP), but much worse than the losses during the 1973-75 and 1981-82 recessions. Unlike those recessions, however, the economy emerges from this downturn weaker, and facing more troubles ahead.

Green Shoots Sprout (20% Probability): In the optimistic scenario, the rapid response of the Federal Reserve to the crisis in financial markets, coupled with the Treasury’s “rescue” plan, Congress’ stimulus package, and help from central banks abroad, work to limit the downside. The recession is still a nasty one, though. There is no additional economic stimulus above the level in the baseline, but the primary difference is that the effects of stimulus start to achieve traction more quickly, producing growth of more than 3% in the third quarter.

In addition, the standard optimistic scenario assumption of stronger total factor productivity growth is also in place. Total factor productivity, a measure of how technological progress augments economic growth, is enhanced by reinvigorated innovation in the technology sector. This allows lower inflation over the long term. But in the short term, a stronger economy means that inflation is higher in the optimistic scenario than in the baseline, particularly in commodities.

Chart I.20



The stronger sales pace during 2009 in the optimistic scenario requires less of an inventory reduction than in the baseline, with demand recovery trimming inventories back to desirable levels. Final sales fall 1.8% in 2009 in the more optimistic scenario, as opposed to a 2.5% drop in the baseline.

With credit again flowing late this year, business fixed investment rebounds 6.5% in 2010, after suffering a severe 16.8% contraction in 2009. This compares with a steeper 18.6% drop during 2009 in the baseline forecast, and a 0.5% decline during 2010. The downturn in residential investment is also less severe in the optimistic scenario, with housing starts beginning to recover during the second half of 2009 and averaging close to 600,000 units for the year, compared with a much weaker baseline level of 548,000 units.

The optimistic scenario also assumes faster growth in the rest of the world, and a dollar that is initially weaker than the baseline, but later on is stronger. The dollar helps GDP early in the forecast period, but restrains it later on.

Finally, this scenario assumes slightly higher energy prices in the near term due to stronger global demand, but lower prices in the longer term due to a more optimistic assumption about supply. Oil prices remain in the mid-\$60s per barrel over the rest of 2009, rather than falling back in the baseline, and then gradually rise to the low \$80s by the end of 2014.

On net, these assumptions produce a much brighter economic outlook than the dismal pictures painted by the baseline and pessimistic scenarios. After falling 1.1% in the second quarter (compared with a 2.8% decline in the baseline forecast), real GDP undergoes a sharp turnaround, climbing 3.4% and 3.7% in the third and fourth quarters of 2009. Real GDP does even better in 2010, rising 2.9%, after shrinking 2.1% in 2009. The unemployment rate peaks near its present level (in the mid-9% range) and falls to 6.7% by late 2014.

Inflation implications of the milder recession in the optimistic scenario are modest. Consumer prices fall less than in the baseline and rebound more sharply at first, but by 2011 lower oil prices and improved productivity growth bring inflation down below its baseline pace. In short, the optimistic alternative sees more muted cycle dynamics, and a quicker turn in the cycle than the baseline.

A summary of the U.S. Forecast is contained in Appendices 5.

APPENDICES

Appendix 1: Wisconsin Employment Forecast: Industry Detail (Annual)

Appendix 2: Wisconsin Employment Forecast: Industry Detail (Quarterly)

Appendix 3: Wisconsin Income Summary: Personal Income by Major Source (Annual)

Appendix 4: Wisconsin Income Summary: Personal Income by Major Source (Quarterly)

Appendix 5: U.S. Economic Forecast

APPENDIX 1

WISCONSIN EMPLOYMENT FORECAST: INDUSTRY DETAIL
(THOUSANDS OF WORKERS)

	History				Forecast			
	2005	2006	2007	2008	2009	2010	2011	2012
Total Nonfarm	2,842.0	2,866.4	2,884.4	2,870.3	2,753.5	2,749.7	2,799.6	2,862.2
% Change	1.2	0.9	0.6	-0.5	-4.1	-0.1	1.8	2.2
Private Nonfarm	2,426.7	2,451.2	2,468.7	2,449.8	2,328.2	2,323.0	2,374.6	2,434.1
% Change	1.3	1.0	0.7	-0.8	-5.0	-0.2	2.2	2.5
Natural Resources & Mining	4.0	3.9	3.6	3.4	3.0	2.8	2.8	2.7
% Change	3.0	-0.6	-7.4	-7.8	-9.7	-6.2	-2.3	-1.2
Construction	127.6	127.5	126.0	118.0	102.4	95.7	95.7	97.4
% Change	0.6	0.0	-1.2	-6.4	-13.2	-6.5	0.0	1.8
Manufacturing	504.9	505.8	501.3	492.7	436.5	408.4	415.1	435.7
% Change	0.4	0.2	-0.9	-1.7	-11.4	-6.4	1.6	5.0
Trade, Transportation & Utilities	543.2	544.5	547.8	539.8	516.4	520.9	528.5	540.1
% Change	0.8	0.2	0.6	-1.5	-4.3	0.9	1.5	2.2
Information	49.7	49.3	50.3	50.2	49.0	48.1	49.7	50.3
% Change	-0.3	-0.9	2.0	-0.2	-2.5	-1.8	3.4	1.1
Financial Activities	159.8	161.8	163.1	163.5	159.2	158.4	160.1	161.8
% Change	0.7	1.3	0.8	0.2	-2.6	-0.5	1.1	1.1
Professional & Business Services	263.0	270.8	278.7	279.4	258.0	267.2	290.6	306.6
% Change	4.0	3.0	2.9	0.2	-7.7	3.6	8.7	5.5
Education & Health Services	383.3	392.0	398.3	405.5	415.8	430.8	440.0	443.5
% Change	2.2	2.3	1.6	1.8	2.5	3.6	2.1	0.8
Leisure & Hospitality	255.2	259.5	261.9	258.2	252.1	255.3	255.7	258.1
% Change	1.7	1.7	0.9	-1.4	-2.4	1.3	0.2	0.9
Other Services	136.0	136.0	137.6	139.2	135.9	135.4	136.4	137.8
% Change	0.6	0.0	1.2	1.2	-2.4	-0.4	0.7	1.1
Government	415.3	415.2	415.7	420.4	425.3	426.7	425.0	428.1
% Change	0.8	0.0	0.1	1.1	1.2	0.3	-0.4	0.7
Federal Government	29.2	29.2	29.2	29.6	29.9	31.3	29.2	29.0
% Change	-1.2	-0.1	-0.1	1.5	1.1	4.5	-6.6	-0.7
State & Local Government	386.0	386.0	386.5	390.8	395.3	395.4	395.8	399.0
% Change	0.9	0.0	0.1	1.1	1.2	0.0	0.1	0.8
Household Survey Employment Measures								
Labor Force	3,031.8	3,070.5	3,093.8	3,084.1	3,104.3	3,115.3	3,144.2	3,174.7
% Change	0.4	1.3	0.8	-0.3	0.7	0.4	0.9	1.0
Employment	2,886.6	2,927.3	2,948.1	2,937.9	2,827.5	2,817.3	2,862.7	2,918.8
% Change	0.6	1.4	0.7	-0.3	-3.8	-0.4	1.6	2.0
Unemployment Rate (%)	4.8	4.7	4.7	4.7	8.9	9.6	9.0	8.1

APPENDIX 2

WISCONSIN EMPLOYMENT FORECAST: INDUSTRY DETAIL
(THOUSANDS OF WORKERS)
Quarterly Data (Seasonally Adjusted, % Change at an Annual Rate)

	History				Forecast			
	2008:2	2008:3	2008:4	2009:1	2009:2	2009:3	2009:4	2010:1
Total Nonfarm	2,879.4	2,866.6	2,849.5	2,795.0	2,750.7	2,736.2	2,732.1	2,734.7
% Change	-0.9	-1.8	-2.4	-7.4	-6.2	-2.1	-0.6	0.4
Private Nonfarm	2,460.4	2,446.6	2,424.7	2,371.8	2,323.9	2,310.9	2,306.3	2,308.8
% Change	-1.2	-2.2	-3.5	-8.4	-7.8	-2.2	-0.8	0.4
Natural Resources & Mining	3.3	3.3	3.3	3.2	3.0	3.0	2.9	2.9
% Change	-26.9	8.4	-3.9	-15.2	-14.5	-7.4	-7.7	-6.7
Construction	119.2	117.6	114.6	108.2	102.9	100.5	98.1	96.4
% Change	-4.9	-5.0	-9.9	-20.6	-18.2	-9.0	-9.2	-6.8
Manufacturing	497.2	489.9	483.5	461.1	438.3	427.8	418.8	412.7
% Change	-2.3	-5.7	-5.2	-17.2	-18.4	-9.2	-8.1	-5.7
Trade, Transportation & Utilities	542.3	538.9	532.4	527.5	513.6	511.6	512.9	515.6
% Change	-2.5	-2.5	-4.8	-3.6	-10.1	-1.5	1.0	2.1
Information	50.5	50.3	50.1	49.5	49.3	48.7	48.3	47.9
% Change	4.1	-1.1	-2.1	-4.5	-1.8	-4.4	-3.4	-3.3
Financial Activities	164.6	163.6	161.7	161.1	159.0	158.4	158.1	158.1
% Change	1.4	-2.3	-4.6	-1.5	-5.1	-1.6	-0.7	-0.1
Professional & Business Services	280.4	278.2	273.6	259.6	257.3	257.0	257.9	259.9
% Change	-6.8	-3.1	-6.4	-19.0	-3.5	-0.4	1.4	3.1
Education & Health Services	404.2	407.8	408.7	411.9	414.0	416.8	420.6	425.5
% Change	2.9	3.6	1.0	3.2	2.0	2.7	3.7	4.8
Leisure & Hospitality	260.1	258.2	255.5	250.7	252.0	252.4	253.2	254.2
% Change	1.9	-2.8	-4.2	-7.3	2.1	0.5	1.4	1.6
Other Services	138.7	138.7	141.3	139.0	134.5	134.7	135.4	135.5
% Change	1.5	-0.2	7.8	-6.3	-12.3	0.4	2.3	0.1
Government	419.0	420.0	424.8	423.2	426.8	425.3	425.7	425.9
% Change	1.2	0.9	4.7	-1.6	3.5	-1.4	0.4	0.2
Federal Government	29.6	29.8	29.6	29.5	30.6	29.7	29.8	30.4
% Change	2.7	3.2	-2.7	-1.3	15.7	-11.0	0.8	8.6
State & Local Government	389.5	390.1	395.2	393.6	396.2	395.5	395.9	395.5
% Change	1.1	0.7	5.3	-1.6	2.6	-0.7	0.4	-0.4

Household Survey Employment Measures

Labor Force	3,077.1	3,079.4	3,097.3	3,109.1	3,105.9	3,101.2	3,101.1	3,104.6
% Change	-0.7	0.3	2.3	1.5	-0.4	-0.6	0.0	0.5
Employment	2,940.8	2,935.6	2,929.9	2,868.4	2,826.5	2,810.4	2,804.6	2,804.9
% Change	-0.6	-0.7	-0.8	-8.1	-5.7	-2.3	-0.8	0.0
Unemployment Rate (%)	4.4	4.7	5.4	7.8	9.0	9.4	9.6	9.7

APPENDIX 3

WISCONSIN INCOME SUMMARY
PERSONAL INCOME BY MAJOR SOURCE
(\$ Billions)

	History				Forecast			
	2005	2006	2007	2008	2009	2010	2011	2012
Total Personal Income	181.153	191.895	203.084	209.999	207.922	213.496	221.556	232.067
% Change	3.7	5.9	5.8	3.4	-1.0	2.7	3.8	4.7
Wages and Salaries	102.143	106.809	110.912	114.038	111.706	114.309	118.779	124.088
% Change	3.0	4.6	3.8	2.8	-2.0	2.3	3.9	4.5
Supplements to Wages and Salaries	24.861	25.781	26.350	27.073	27.273	28.250	29.186	30.211
% Change	5.2	3.7	2.2	2.7	0.7	3.6	3.3	3.5
Proprietor's Income	11.819	12.166	13.198	13.028	12.278	12.639	13.296	13.796
% Change	3.2	2.9	8.5	-1.3	-5.8	2.9	5.2	3.8
Rental Income	1.337	0.792	0.601	0.943	1.332	1.722	1.733	1.591
% Change	-40.5	-40.7	-24.1	56.8	41.3	29.3	0.7	-8.2
Personal Dividend Income	10.344	12.471	14.749	15.929	14.145	13.827	14.298	14.844
% Change	5.2	20.6	18.3	8.0	-11.2	-2.3	3.4	3.8
Personal Interest Income	17.092	19.418	20.884	20.893	19.708	19.276	19.870	21.836
% Change	5.8	13.6	7.6	0.0	-5.7	-2.2	3.1	9.9
Current Transfer Receipts	26.013	27.504	29.688	32.031	35.068	36.986	38.391	40.286
% Change	7.3	5.7	7.9	7.9	9.5	5.5	3.8	4.9
Residence Adjustment	3.320	3.476	3.779	3.910	3.954	4.144	4.409	4.709
% Change	4.6	4.7	8.7	3.5	1.1	4.8	6.4	6.8
Contributions to Government Social Ins.	15.774	16.523	17.078	17.632	17.267	17.656	18.406	19.294
% Change	3.8	4.7	3.4	3.2	-2.1	2.3	4.2	4.8
Personal Tax & Nontax Payments	21.023	23.370	25.332	24.756	20.693	22.900	25.126	27.853
% Change	10.4	11.2	8.4	-2.3	-16.4	10.7	9.7	10.9
Disposable Personal Income	160.131	168.525	177.752	185.243	187.229	190.595	196.431	204.215
% Change	2.9	5.2	5.5	4.2	1.1	1.8	3.1	4.0

Related Income Measures

Personal Income (2000 \$) (\$ Billions)	162.349	167.332	172.602	172.706	170.900	173.622	177.054	182.219
% Change	0.8	3.1	3.1	0.1	-1.0	1.6	2.0	2.9
Per Capita Income (2000 \$)	29,389	30,134	30,894	30,722	30,218	30,518	30,944	31,669
% Change	0.2	2.5	2.5	-0.6	-1.6	1.0	1.4	2.3
Per Capita Income (\$)	32,793	34,557	36,350	37,356	36,764	37,527	38,721	40,332
% Change	3.2	5.4	5.2	2.8	-1.6	2.1	3.2	4.2
Per Capita Income as a Percent of U.S.	94.7	94.2	94.3	94.3	93.7	94.8	95.1	95.2
Gross State Product (Baseline)	214.816	224.918	233.406	240.429	236.248	243.686	254.220	265.662
(year % ch.)	4.3	4.7	3.8	3.0	-1.7	3.1	4.3	4.5
GSPW_0*100/JPGDP	191.653	194.964	196.955	198.324	192.176	196.596	202.494	208.771
(year % ch.)	1.9	1.7	1.0	0.7	-3.1	2.3	3.0	3.1

APPENDIX 4

WISCONSIN INCOME SUMMARY
 PERSONAL INCOME BY MAJOR SOURCE (\$ Billions)
 Quarterly Data (Seasonally Adjusted, % Change at an Annual Rate)

	History				Forecast			
	2008:1	2008:2	2008:3	2008:4	2009:1	2009:2	2009:3	2009:4
Total Personal Income	207.640	210.787	211.102	210.468	207.527	207.702	207.633	208.825
% Change	2.5	6.2	0.6	-1.2	-5.5	0.3	-0.1	2.3
Wages and Salaries	113.250	114.146	114.569	114.188	112.743	111.174	111.153	111.752
% Change	2.1	3.2	1.5	-1.3	-5.0	-5.5	-0.1	2.2
Supplements to Wages and Salaries	26.832	27.155	27.167	27.136	27.256	27.180	27.224	27.433
% Change	2.1	4.9	0.2	-0.5	1.8	-1.1	0.6	3.1
Proprietor's Income	13.383	13.066	13.044	12.619	12.456	12.204	12.164	12.288
% Change	2.2	-9.1	-0.7	-12.4	-5.1	-7.8	-1.3	4.1
Rental Income	0.670	0.770	0.930	1.400	1.300	1.321	1.342	1.365
% Change	48.9	74.4	112.8	413.5	-25.7	6.6	6.5	6.9
Personal Dividend Income	15.943	16.212	16.105	15.456	14.633	14.162	13.929	13.857
% Change	8.1	6.9	-2.6	-15.2	-19.7	-12.3	-6.4	-2
Personal Interest Income	21.046	20.877	21.018	20.631	20.241	19.839	19.458	19.294
% Change	-3.7	-3.2	2.7	-7.2	-7.4	-7.7	-7.5	-3.3
Current Transfer Receipts	30.644	32.642	32.074	32.764	33.589	35.153	35.559	35.972
% Change	8	28.7	-6.8	8.9	10.5	20	4.7	4.7
Residence Adjustment	3.905	3.865	3.940	3.928	3.940	3.925	3.953	3.997
% Change	5.3	-4.0	8.0	-1.2	1.2	-1.5	2.9	4.6
Contributions to Government Social Ins.	17.531	17.685	17.701	17.609	17.529	17.257	17.148	17.133
% Change	5.9	3.6	0.4	-2.1	-1.8	-6.1	-2.5	-0.4
Personal Tax & Nontax Payments	25.776	22.800	25.000	25.450	22.000	20.471	20.134	20.165
% Change	-3.2	-38.8	44.6	7.4	-44.2	-25.0	-6.4	0.6
Disposable Personal Income	181.864	187.987	186.102	185.018	185.527	187.231	187.499	188.660
% Change	3.3	14.2	-4.0	-2.3	1.1	3.7	0.6	2.5
Related Income Measures								
Personal Income (2000 \$) (\$ Billions)	172.626	173.424	171.57	173.205	171.216	170.59	170.527	171.266
% Change	-1.1	1.9	-4.2	3.9	-4.5	-1.5	-0.1	1.7
Per Capita Income (2000 \$)	30,778	30,873	30,497	30,741	30,342	30,186	30,129	30,215
% Change	-1.7	1.2	-4.8	3.2	-5.1	-2.0	-0.7	1.1
Per Capita Income (\$)	37,021	37,524	37,524	37,354	36,777	36,752	36,685	36,841
% Change	1.9	5.6	0.0	-1.8	-6.0	-0.3	-0.7	1.7
Per Capita Income as Percent of U.S. (%)	94.2	94.2	94.3	94.5	93.7	93.2	93.9	94.2
GDP (Current Dollars)	239.913	242.054	241.870	237.883	234.000	238.033	234.890	238.070
% Change	7.9	3.6	-0.3	-6.4	-6.4	7.1	-5.2	5.5
GDP (2000 \$) (\$ Billions)	199.332	200.552	198.475	194.937	190.501	193.816	191.077	193.310
% Change	1.5	1.5	1.0	-1.0	-4.5	-3.4	-3.8	-0.9

APPENDIX 5

U.S. ECONOMIC FORECAST
IHS GLOBAL INSIGHT (JUNE 2009)

	2005	2006	2007	2008	2009	2010	2011	2012
Real GDP and its Components (Billions of Chain Weighted 2000 Dollars)								
Gross Domestic Product	10,989.5	11,294.9	11,523.9	11,652.0	11,306.0	11,462.7	11,825.9	12,269.6
% Change	2.9	2.8	2.0	1.1	-3.0	1.4	3.2	3.8
Consumption	7,791.7	8,029.0	8,252.8	8,272.1	8,208.8	8,345.9	8,518.1	8,714.5
% Change	3.0	3.0	2.8	0.2	-0.8	1.7	2.1	2.3
Investment (Incl. Inventory)	1,873.5	1,912.5	1,809.7	1,689.1	1,297.3	1,405.8	1,663.6	1,932.7
% Change	5.8	2.1	-5.4	-6.7	-23.2	8.4	18.3	16.2
Nonresidential Structures	249.8	270.3	304.6	338.8	277.9	237.6	245.0	281.5
% Change	1.3	8.2	12.7	11.2	-18.0	-14.5	3.1	14.9
Business Equipment	989.6	1061.0	1078.9	1047.0	848.0	907.8	1061.9	1210.8
% Change	9.3	7.2	1.7	-3.0	-19.0	7.1	17.0	14.0
Residential Fixed	595.4	552.9	453.8	359.5	277.6	306.3	392.3	460.5
% Change	6.3	-7.1	-17.9	-20.8	-22.8	10.3	28.1	17.4
Inventory Change	38.9	42.3	-2.5	-29.1	-75.3	6.2	31.8	53.7
Exports	1,205.3	1,314.8	1,425.9	1,514.1	1,314.0	1,338.4	1,457.7	1,607.7
% Change	7.0	9.1	8.4	6.2	-13.2	1.9	8.9	10.3
Imports	1,821.9	1,930.5	1,972.4	1,904.3	1,639.4	1,759.4	1,881.9	2,011.8
% Change	5.9	6.0	2.2	-3.5	-13.9	7.3	7.0	6.9
Federal Government	724.5	741.0	752.9	798.2	832.9	842.7	811.7	797.4
% Change	1.2	2.3	1.6	6.0	4.3	1.2	-3.7	-1.8
State and Local Government	1,214.3	1,230.2	1,259.0	1,273.0	1,258.6	1,257.5	1,251.9	1,254.3
% Change	-0.1	1.3	2.3	1.1	-1.1	-0.1	-0.4	0.2
GDP (Current Dollars)	12,421.9	13,178.4	13,807.6	14,264.6	14,047.8	14,365.4	15,012.9	15,782.9
% Change	6.3	6.1	4.8	3.3	-1.5	2.3	4.5	5.1
Employment, Unemployment, Wages and Prices								
Nonfarm Employment (Millions)	133.7	136.1	137.6	137.0	132.0	131.2	133.2	136.4
% Change	1.7	1.8	1.1	-0.4	-3.7	-0.6	1.5	2.4
Unemployment Rate (%)	5.1	4.6	4.6	5.8	9.3	10.3	9.8	8.8
Compensation per Hour (% Change)	4.0	3.8	4.1	3.7	4.0	2.7	2.0	2.3
Consumer Price Index (% Change)	3.4	3.2	2.9	3.8	-0.9	1.3	2.3	2.3
Personal Cons. Expenditure Index (% Change)	2.9	2.8	2.6	3.3	0.1	1.1	1.8	1.8
Producer Price Index (% Change)	7.3	4.7	4.8	9.8	-11.0	0.4	3.9	3.7
GDP Price Deflator (% Change)	3.3	3.2	2.7	2.2	1.4	0.8	1.3	1.3
Industrial Production (% Change)	3.3	2.3	1.5	-2.2	-10.2	0.8	4.2	5.3
Price of WTI Crude Oil (\$ Per Barrel)	56.6	66.1	72.2	99.8	50.8	55.5	64.6	77.5
Financial Markets								
Money Supply (M2) (\$ Billions)	6,633.8	6,979.4	7,382.5	7,992.0	8,563.1	8,999.4	9,517.0	9,982.9
% Change	4.0	5.2	5.8	8.3	7.1	5.1	5.8	4.9
Prime Commercial Rate (%)	6.2	8.0	8.1	5.1	3.3	3.3	4.7	6.3
Three Month Treasury Bills (%)	3.1	4.7	4.4	1.4	0.2	0.6	2.2	3.4
Ten-Year Treasury Note Yield (%)	4.3	4.8	4.6	3.7	3.3	3.6	3.9	4.5
General Obligation AAA Municipals (%)	4.3	4.2	4.1	4.6	4.6	4.7	4.9	5.3
Thirty-Year Mortgage Rate (%)	5.9	6.4	6.3	6.0	5.0	5.1	5.5	6.1
S&P 500 Stock Index	1,207.1	1,310.7	1,476.7	1,220.9	872.8	986.9	1,106.8	1,225.0
Income, Profits and Savings								
Personal Income (\$ Billions)	10,269.8	10,993.9	11,663.3	12,100.7	12,093.3	12,332.1	12,797.2	13,446.9
% Change	5.6	7.1	6.1	3.8	-0.1	2.0	3.8	5.1
Personal Income (\$ 2000) (\$ Billions)	9,203.1	9,586.6	9,912.4	9,951.7	9,940.0	10,028.9	10,226.7	10,558.5
% Change	2.6	4.2	3.4	0.4	-0.1	0.9	2.0	3.2
Personal Tax & Nontax Payments	1,207.8	1,353.2	1,492.8	1,457.3	1,194.1	1,275.4	1,449.6	1,634.8
% Change	15.4	12.0	10.3	-2.4	-18.1	6.8	13.7	12.8
Disposable Personal Income	9,062.0	9,640.7	10,170.5	10,643.3	10,899.2	11,056.7	11,347.5	11,812.1
% Change	4.4	6.4	5.5	4.6	2.4	1.4	2.6	4.1
Savings Rate (%)	0.4	0.7	0.5	1.8	5.1	3.9	2.7	2.7
Corporate Profits Before Tax (\$ Billions)	1,448.0	1,668.5	1,642.4	1,476.5	1,318.0	1,404.6	1,597.8	1,703.9
% Change	17.6	15.2	-1.6	-10.1	-10.7	6.6	13.8	6.6

II. SPECIAL REPORT

STRONG EXPORT GROWTH CONTINUED THROUGH 2008

Exports from Wisconsin increased for the seventh consecutive year, up 9.2% in 2008. Exports totaled \$20.55 billion in 2008, an increase of 78.5% since 2003.

Wisconsin's largest export partner remains Canada. Canada purchased 31.6% of Wisconsin's exports in 2008, totaling \$6.5 billion worth of goods. Mexico was Wisconsin's second largest market. Mexico purchased 8.6% of total exports, valued at \$1.8 billion. China (\$1.2 billion), Germany (\$790 million) and Japan (\$724 million) complete the list of Wisconsin's top five destinations.

Wisconsin's exports made up 1.6% of U.S. exports placing it 18th among the U.S. states and territories.

Exports comprised 8.5% of state gross domestic product (GDP) in Wisconsin in 2008. Nationally, exports were 9.2% of U.S. GDP.

In 2009, with the world-wide collapse in trade, exports will not be a contributor to the state's economy. Export growth will begin to pick up again in 2010 and 2011.

TOP EXPORT INDUSTRIES

Machinery

Machinery is Wisconsin's most prominent export. Nationally, Wisconsin ranked 6th in exports of machinery, representing 4.3% of national machinery exports. In 2008, machinery was 30.3% of total exports. Exports in this sector increased 13.0% to \$6.2 billion in 2008 up from \$5.5 billion in 2007

Machinery manufacturing includes agricultural, construction, and industrial machinery, as well as HVAC units, engines, and power transmission equipment.¹ In Wisconsin, employment is concentrated in general purpose machinery, which produces diverse products such as forklifts, compressors, and hydraulic jacks, and agricultural, construction, and mining machinery, such as tractors and bulldozers.

Computers and Electronic Products

Computers and electronic products were Wisconsin's second most common export shipment at 15.1% of the total. Nationally, Wisconsin ranked 14th in exports of computers and electronics. In 2008, computers and electronic product exports totaled \$3.1 billion, up 3.6% increase from 2007.

Computers and electronic products include computers, telephone equipment, broadcasting equipment for radio and television, audio and video equipment, semiconductor and electronic components, and electronic instruments (such as watches, clocks, and navigation equipment). The largest share of employment in this sector in Wisconsin is in electronic instruments.

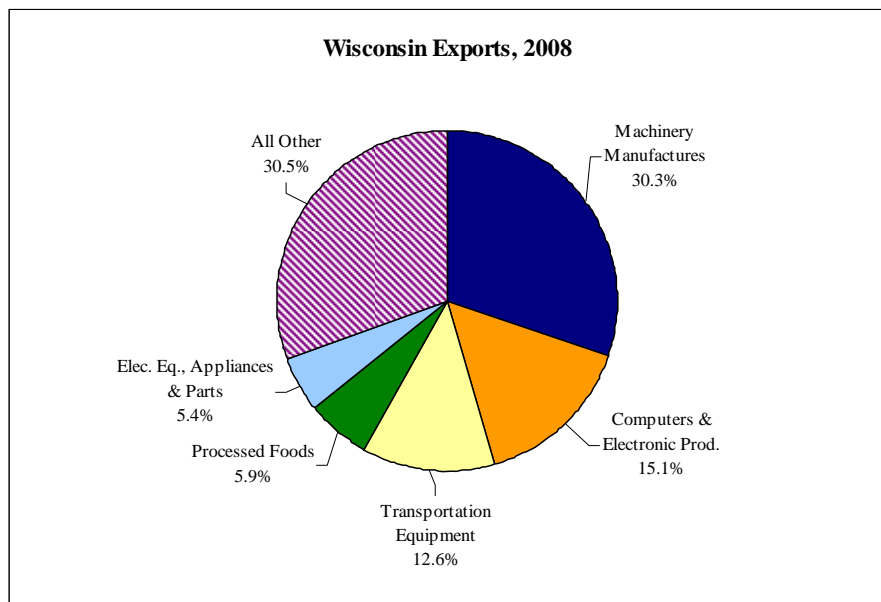
Transportation Equipment

Transportation Equipment sales made up 12.7% of Wisconsin exports. The state ranks 22nd out of the 50 states in transportation equipment. In 2008, Transportation equipment exports totaled \$2.6 billion, up 10.8% over 2007.

¹ The industry groups discussed are defined by the North American Industry Classification System (NAICS). For more information see <http://www.census.gov/epcd/www/naics.html>.

Transportation equipment is the nation's largest export sector and includes cars, truck, boats, railroad cars, planes, motorcycles, military vehicles, and other equipment used to move people and goods, as well as the parts used to produce these goods. In Wisconsin, motor vehicle parts make up the greatest share of employment in this sector.

Chart II.1



Processed Foods

Processed foods exports increased substantially in 2008, up 19.2% over the previous year. Processed foods equaled 5.9% of Wisconsin's exports or \$1.2 billion. Exports in this category have grown 87.9% since 2003. Processed foods are now Wisconsin's fourth most valued export. Only two years earlier, processed foods was only the seventh highest valued export from Wisconsin.

Processed food is a finished food product from a raw input of vegetable or animal origin. In Wisconsin, production is focused on dairy and meat processing.

Electrical Equipment

Electrical equipment and appliances exports totaled \$1.1 billion, or 5.4% of Wisconsin's total exports in 2008. The state ranked 13th nationally in electrical equipment exports.

Electrical Equipment and appliance manufacturing is the production of lighting fixtures, household appliances such as refrigerators and washers and dryers, and electrical equipment (transformers, generators, batteries, fiber optic cables, and wiring devices).

Agriculture

Agricultural products represented 2.3% of Wisconsin exports in 2008. Exports of crop products fell 42% in 2008, coming in at to \$342 million. Animal products exports decreased 14% to \$124 million.

Agricultural products include goods from crop production, animal production, and fishing, hunting, and trapping

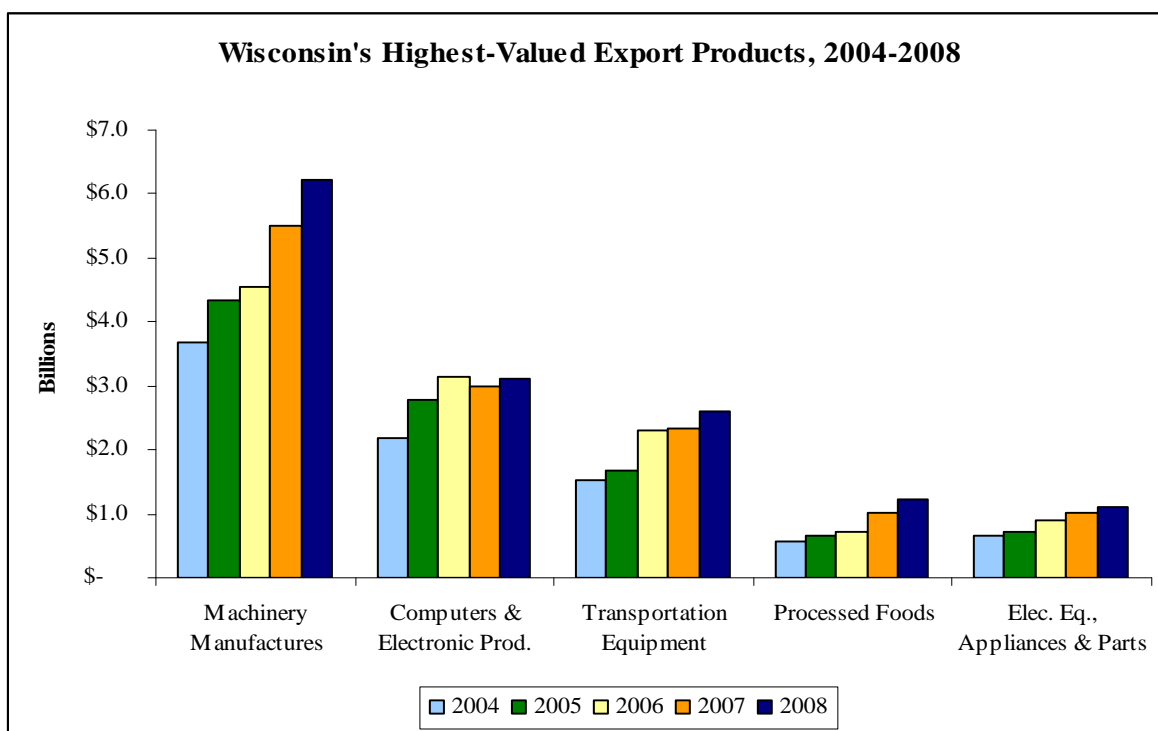
The Wisconsin Department of Agriculture, Trade, and Consumer Protection (DATCP) reports export revenues accounted for 20% of all Wisconsin farm cash receipts in 2008. The top agriculture exports were unmilled cereals (\$230 million); dairy, eggs, and honey (\$213 million); and bakery-related products,

such as prepared cereals, flours, starches, and malted milks (\$174 million).² Wisconsin was the second largest exporter of cheese (\$97 million).

Canada purchased the largest amount of Wisconsin's agricultural exports, valued at \$872 million in 2008. The next largest destination was Mexico, at \$187 million; Japan (\$88 million); Korea (\$77 million); and China (\$62 million).

Details of Wisconsin Exports Product Details are presented in Table II.2.

Chart II.2



TOP EXPORT MARKETS

Canada

Canada continues to be Wisconsin's largest trading partner. Exports to Canada increased 10.2% in 2008, and made up 31.6% of all Wisconsin exports. Wisconsin exports to Canada have increased by 33% since 2004, from \$4.9 billion to \$6.5 billion in 2008. Nationally, Wisconsin ranked 11th in exports to Canada, at 2.5% of the U.S. total.

Machinery was the largest export commodity to Canada, making up one-fourth of total exports (\$1.6 billion). The next most common export to Canada from Wisconsin was transportation equipment, with 15.9% of total shipments (\$1.0 billion), followed by processed foods, 8.2% (\$531 million), and paper products, 6.9% (\$448 million).

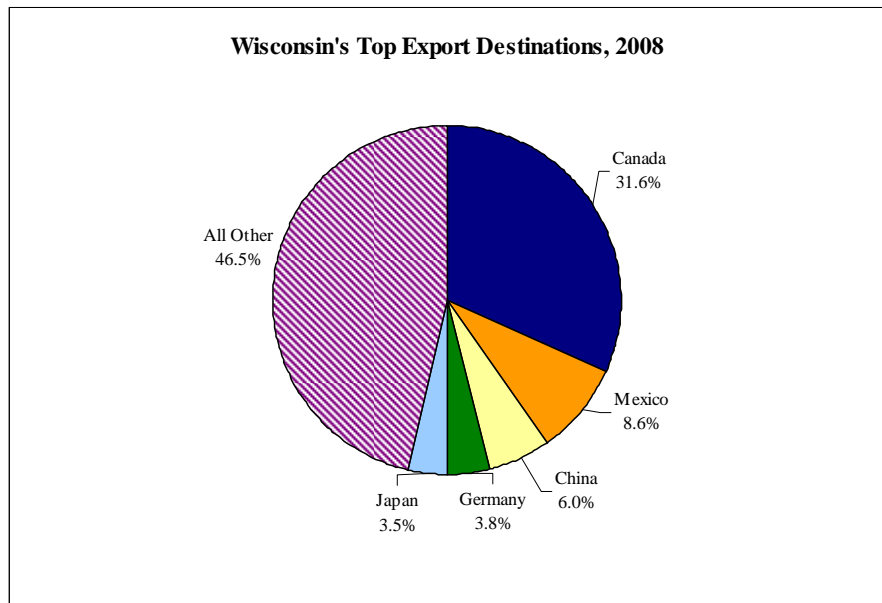
² The DATCP report uses a different coding system which is not comparable with the NAICS codes. The agricultural data in the DATCP report is defined by the Harmonized Commodity Description and Coding System (HS).

Mexico

Since 2004, Mexico has been the second largest importer of Wisconsin products. In 2008, 8.6% of shipments from Wisconsin went to Mexico, totaling \$1.8 billion. This was an increase of 18.9% over 2007.

Transportation equipment (\$310 million) was the most common product shipped to Mexico, making up 17.6% of all shipments. Machinery represented 16.2% (\$280 million) of total exports in 2008; waste and scrap, 11.2% (\$197 million), and electrical equipment and appliances, 9.8% (\$173 million).

Chart II.3



China

A decade ago, very few exports from Wisconsin made it to China. However, exports to China have grown considerably over the past five years. China has been the third largest destination for Wisconsin goods since 2006. Last year, exports to China increased 4.4% from the previous year, to \$1.2 billion, representing 6.0% of Wisconsin's total exports.

Exports of machinery represented 35.3% of Wisconsin's exports to China in 2008, equal to \$434 million. Computers and electronic equipment exports accounted for 17.5% of exports (\$215 million); transportation equipment, 9.6% (\$118 million); and waste and scrap, 9.2% (\$113 million). Shipments of transportation equipment to China are notable, as they increased nearly tenfold from 2007.

Germany

Germany is now Wisconsin's fourth largest trading partner, moving past Japan and the United Kingdom. Over the past five years, exports to Germany have grown 77.6%. In 2008 alone, Wisconsin exports to Germany increased 19.8%. Exports to Germany represented 3.8% of Wisconsin's total exports, up from 3.5% in 2007.

More than half of Wisconsin exports to Germany are in two categories. Machinery represents 29.4% of Wisconsin exports, valued at \$232 million in 2008, followed closely by computers and electronics, 27.0%

of exports (\$214 million). Other common exports to Germany include chemicals, 8.8% of total (\$107 million) and transportation equipment, 8.8% (\$69.5 million).

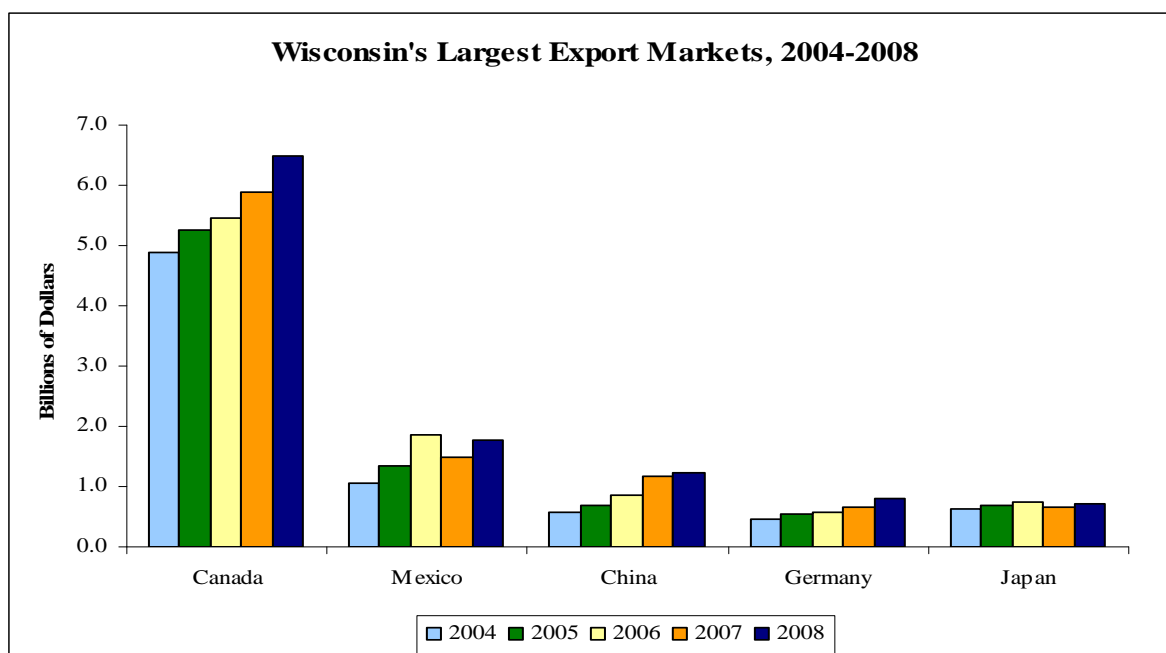
Japan

Japan once again became a top five destinations for Wisconsin exports in 2008. Wisconsin exports to Japan increased 10.6%, edging Japan past the U.K for the state's number five trading partner. Products shipped to Japan comprised 3.5% of Wisconsin's total exports last year, the same as the prior year.

The most common product category shipped to Japan is computer and electronic products, making up 41.2% of the total shipped to Japan, valued at \$298 million. This is an increase of 34.2% over 2007. The second most common export to Japan was machinery, at 21.8% of the total (\$158 million), followed by processed foods, 9.0% (\$65 million), and transportation equipment, 7.0% (\$51 million).

Details of Wisconsin Export Destinations are presented in Table II.3.

Chart II.4



OUTLOOK FOR EXPORTS

The U.S. economy, as well as Wisconsin's, was aided by strong export growth during the first three quarters of 2008. This reversed as the worldwide financial crisis unfolded beginning fourth quarter 2008. World trade has dropped dramatically since then.

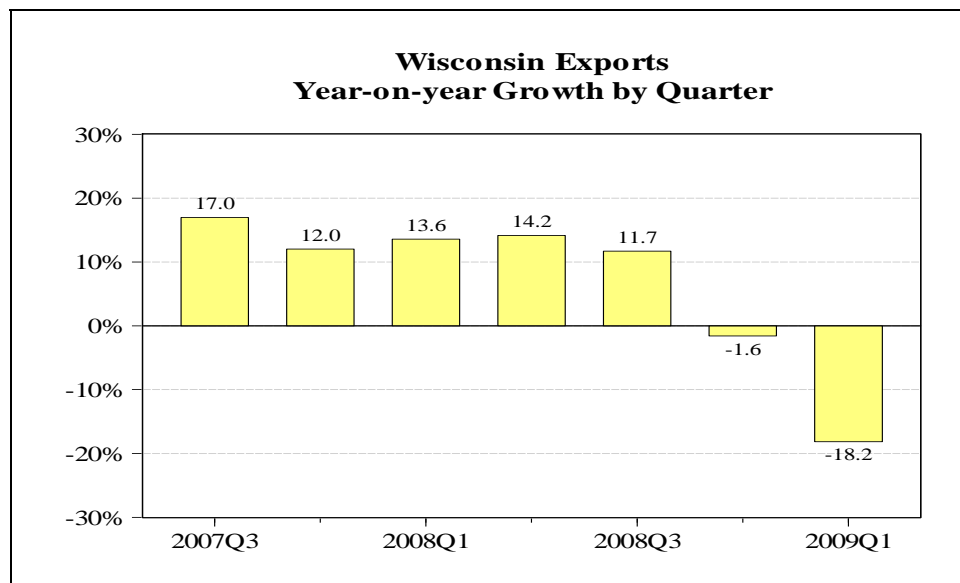
U.S. exports have declined sharply in the first half of the year but should grow again beginning late 2009. On the year as a whole, U.S. exports should decrease 18.8% in 2009. Exports will see some return to growth in 2010, with an increase of 2.3%. Stronger growth of 10.7% will follow in 2011.³

Wisconsin is not immune from the collapse in world trade. Its exports will likely follow a similar path as those from the U.S. The slowdown in export growth is already evident in the last six months. Looking at growth by quarter, Wisconsin's exports increased between 10 and 20% each quarter from the second half of 2007 through the third quarter of 2008. In the fourth quarter of 2008, however, Wisconsin's exports

³ IHS Global Insight, June 2009 Forecast.

declined 1.6%. The following quarter, the first quarter of 2009, exports plunged 18.2% (see chart III.5, below).

Chart II.5



While down on the year so far, Wisconsin exports are faring better than the rest of the country or its surrounding states. Based on cumulative export totals through April 2009, Wisconsin exports are down 14% compared to a 24% drop nationally and 31% drop for the Great Lakes Region as a whole.

Exports, valued at \$20.55 billion, equaled 8.5% of Wisconsin's state GDP in 2008, up from 5.7% in 1999. While this increase in exports has helped Wisconsin over the past decade, any decrease in exports will now have a bigger negative impact on growth than in years past.

Unfortunately, Wisconsin's largest trading partners are not expected to see strong growth this year. Canada is expected to see a 2.5% decrease in GDP, following growth of 0.5% in 2008. Mexico is expecting a larger decline, of 3.7% in 2009. China will see growth in their economy of 6.5% in 2009, but this is down from 9.0% growth in 2008 and 13.0% in 2007. Germany's expected decline in 2009 is 5.6%, and Japan will see the worst decline out of Wisconsin's five largest trading partners, at -6.2%.⁴

In summary, while export growth will begin to pick up again in 2010 and 2011, exports will not be a contributor to the state's economy in 2009 as it has been in recent years.

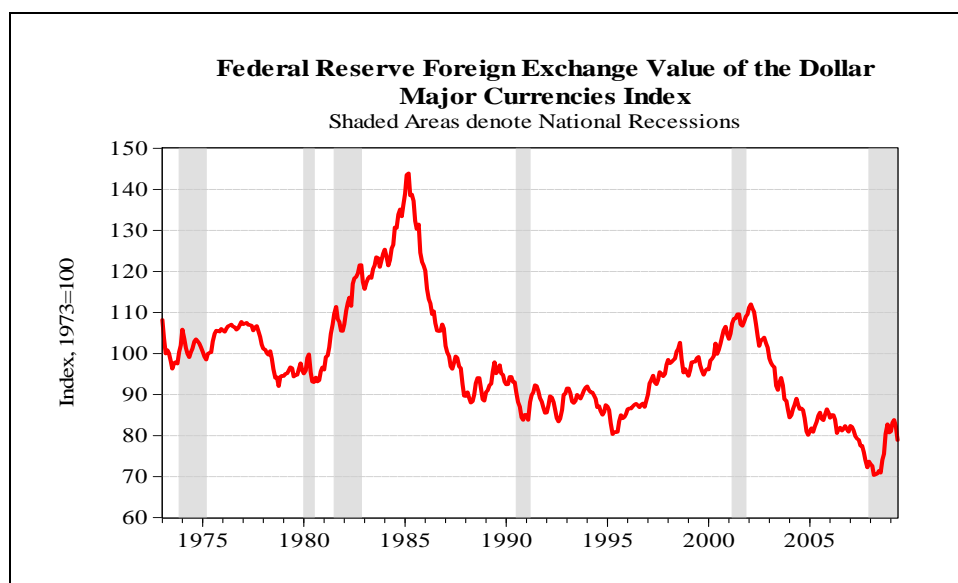
⁴ World Economic Outlook, International Monetary Fund, April 2009.

WISCONSIN VALUE OF THE DOLLAR

The strong growth in exports from both the U.S. and Wisconsin in 2008 is partly due to the weak value of the dollar. While the weak dollar contributed to high gasoline prices domestically, it also made U.S. products more competitive on the international market. Below is a chart of the Foreign Exchange Value of the Dollar, an index produced by the Federal Reserve. The chart spans from 1973 to mid-2009.

In 2001 and 2002 the value of the dollar reached its highest point in 20 years, making U.S. products relatively expensive in international markets. Those years corresponded to annual declines in U.S. exports, the only two years this decade that exports declined. The value of the dollar then decreased through early 2008, and U.S. exports grew rapidly.

Chart II.6



The worldwide trade arena changed in the second half of 2008. The value of the dollar increased rapidly as fearful investors looked for a safe haven for their investments. As they bought up the dollar, the value increased. Meanwhile, a worldwide recession quickly slowed international trade volumes.

The value of the dollar has begun to decrease again in the last few months. While normally a decreasing dollar would be a good sign for exports, international trade volumes have fallen so much that the falling dollar will only have a minimal impact on demand for U.S. exports. Indeed, total world trade is expected to decrease 11.0% in volume in 2009, as worldwide demand remains subdued.⁵

In order to determine the effect of the value of the dollar on Wisconsin's exports, the Department of Revenue has created a trade-weighted value of the dollar that is specific to Wisconsin. The methodology for its creation is similar to that used by the Federal Reserve for the U.S. Major Currencies Index. The main distinction is in the determination of weights. For the U.S., the weight is determined using import and export data. As there is no available import data for individual states, the Wisconsin value of the dollar is based on export weights only.

Below is the chart of the Wisconsin trade-weighted value of the dollar. It is charted with a corresponding U.S. Index constructed in an identical manner to the Wisconsin Index; that is, the weights are determined

⁵ World Economic Outlook, International Monetary Fund, April 2009.

by export patterns alone. At the bottom of the page is a table containing the weights used for the Wisconsin and the U.S. Indexes.

Chart II.7

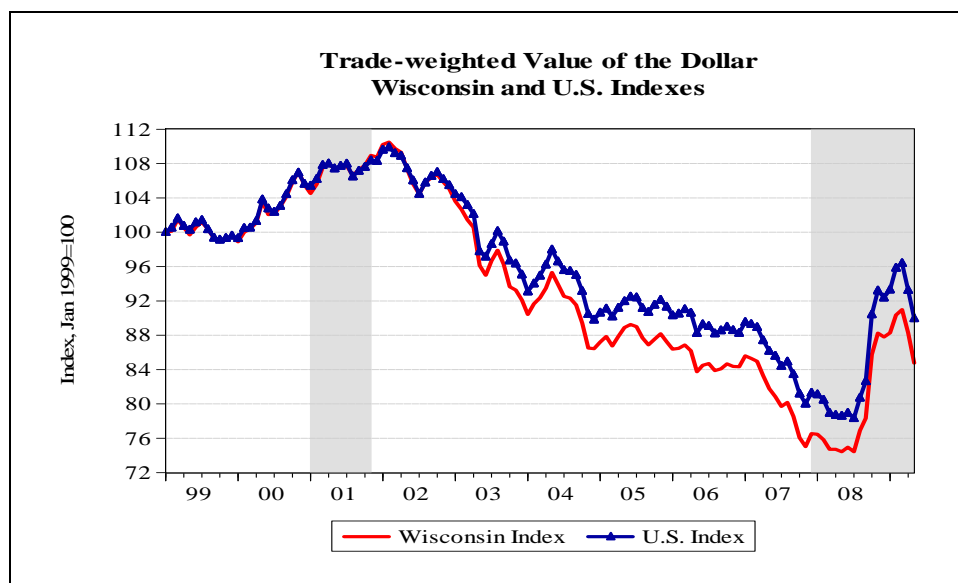


Table II.1

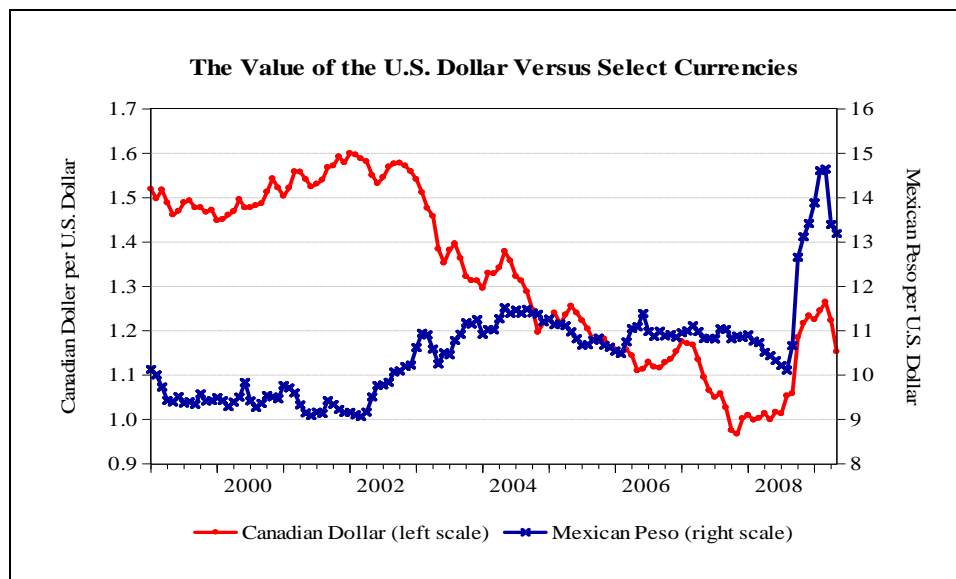
Weights used in the calculation of the Wisconsin and the U.S. Trade-weighted Value of the Dollar Indexes

WI Trading Partners	Weight	U.S. Trading Partners	Weight
Canada	0.472	Canada	0.329
Euro Zone	0.218	Euro Zone	0.261
Mexico	0.118	Mexico	0.194
China	0.087	Japan	0.076
Japan	0.055	China	0.074
United Kingdom	0.051	United Kingdom	0.066

What does this mean for Wisconsin? Both the U.S. and Wisconsin indexes above use the same exchange rates. The only difference is in the weights given to each of those currencies when calculating the index. Those weights are based on the pattern of export destinations. A higher percentage of Wisconsin exports go to nations that have a currency rising against the dollar. Compared to the base year 1999, the price of Wisconsin's total exports are relatively cheaper than those from the U.S. as a whole. Therefore, Wisconsin has a greater competitive advantage.

The largest differences in the weights are in Canada and Mexico. Canada has a greater weight for Wisconsin, while the U.S. trades more heavily with Mexico. The U.S. dollar has fallen against the Canadian dollar since 2002, whereas the dollar rose against the peso through 2004 and has been steady every year since until jumping in the last eight months (See Chart II.8 below). Because of Wisconsin's relatively heavier trade weight with Canada, the overall value of the Wisconsin dollar has remained below that of the U.S.

Chart II.8



However, the Wisconsin value of the dollar is not the only determinant of export growth. As shown by chart II.7 on the previous page, the Wisconsin value of the dollar has tended to be lower than that of the U.S. since 2003. As such, exports from Wisconsin have an advantage on the world market, given its mix of export partners. Yet in 2008, Wisconsin's exports grew 9.2%, while exports from the U.S. grew at a faster clip, at 11.8%. The relative value of the dollar is not the only factor determining growth in exports. Product mix matters, as well as the domestic demand at an export's destination.

For the U.S., the most common export product is transportation equipment, which made up 16.6% of exports in 2008. The next most common export product is computers and electronic products (14.8% of the total); followed by chemical manufacturing (13.2%); and machinery (11.1%). In contrast, Wisconsin's exports are much more concentrated, with nearly a third (30.3%) of all exports falling into the category of machinery, followed by computers and electronic products (15.1% of the total); transportation equipment (12.6%) and processed foods (5.9%).

The destination of exports also plays a role in determining growth in exports. About one-fifth (20.1%) of U.S. exports are bound for Canada, and 11.7% are shipped to Mexico. The next largest trading partners of the U.S. are China (5.5% of exports), Japan (5.1%) and Germany (4.2%). In comparison, Wisconsin ships a much larger percent of its products to Canada: 31.6% of exports went across Wisconsin's northern border in 2008. With relatively slow economic growth in Canada in 2008, there was less demand for products and services overall. Thus, it is no surprise that Wisconsin's export growth, which is more concentrated towards Canada, had slower growth than the U.S., despite the relative advantage from the value of the dollar in Wisconsin.

TABLE II.2

WISCONSIN EXPORTS: PRODUCT DETAIL
(THOUSANDS OF DOLLARS)

	2003	2004	2005	2006	2007	2008
Total, all Exports	11,514,767	12,705,394	14,961,410	17,173,628	18,825,489	20,552,773
% change		10.3%	17.8%	14.8%	9.6%	9.2%
Machinery Manufactures	3,217,772	3,687,151	4,331,601	4,554,903	5,517,770	6,233,814
% change		14.6%	17.5%	5.2%	21.1%	13.0%
Computers & Electronic Prod.	2,043,573	2,171,769	2,794,435	3,138,033	3,002,156	3,111,555
% change		6.3%	28.7%	12.3%	-4.3%	3.6%
Transportation Equipment	1,379,822	1,522,814	1,682,386	2,315,646	2,346,433	2,599,594
% change		10.4%	10.5%	37.6%	1.3%	10.8%
Processed Foods	647,755	561,081	669,945	717,424	1,021,106	1,216,987
% change		-13.4%	19.4%	7.1%	42.3%	19.2%
Elec. Eq., Appliances & Parts	549,389	653,401	714,011	887,017	1,030,157	1,115,498
% change		18.9%	9.3%	24.2%	16.1%	8.3%
Chemical Manufactures	585,627	641,192	708,835	738,301	827,260	1,010,777
% change		9.5%	10.5%	4.2%	12.0%	22.2%
Paper Products	563,024	667,808	775,039	777,852	809,248	753,909
% change		18.6%	16.1%	0.4%	4.0%	-6.8%
Fabricated Metal Products	353,025	423,247	478,458	532,474	559,622	614,095
% change		19.9%	13.0%	11.3%	5.1%	9.7%
Misc. Manufactures	380,361	390,258	448,188	490,597	555,755	566,845
% change		2.6%	14.8%	9.5%	13.3%	2.0%
Plastic & Rubber Products	347,854	370,665	388,758	459,130	474,202	523,958
% change		6.6%	4.9%	18.1%	3.3%	10.5%
All Other	1,446,565	1,616,008	1,969,754	2,562,251	2,681,780	2,805,741
% change		11.7%	21.9%	30.1%	4.7%	4.6%

Source: Origin of Movement (OM) series from the Foreign Trade Division of the U.S. Census Bureau

TABLE II.3

WISCONSIN EXPORTS: DESTINATION DETAIL
(THOUSANDS OF DOLLARS)

	2003	2004	2005	2006	2007	2008
World Total	11,514,767	12,705,394	14,961,410	17,173,628	18,825,489	20,552,773
% change		10.3%	17.8%	14.8%	9.6%	9.2%
Canada	4,359,897	4,886,504	5,259,367	5,459,259	5,896,125	6,497,735
% change		12.1%	7.6%	3.8%	8.0%	10.2%
Mexico	789,601	1,061,993	1,337,781	1,850,791	1,481,389	1,761,700
% change		34.5%	26.0%	38.3%	-20.0%	18.9%
China	548,314	580,176	673,256	870,111	1,178,915	1,231,218
% change		5.8%	16.0%	29.2%	35.5%	4.4%
Germany	444,974	459,518	550,040	582,051	659,769	790,365
% change		3.3%	19.7%	5.8%	13.4%	19.8%
Japan	816,508	624,588	695,737	738,752	655,118	724,430
% change		-23.5%	11.4%	6.2%	-11.3%	10.6%
United Kingdom	493,868	515,501	643,893	686,410	722,753	683,135
% change		4.4%	24.9%	6.6%	5.3%	-5.5%
Australia	279,788	324,948	425,078	466,637	563,672	583,454
% change		16.1%	30.8%	9.8%	20.8%	3.5%
Saudi Arabia	90,649	92,280	169,959	503,229	475,637	556,285
% change		1.8%	84.2%	196.1%	-5.5%	17.0%
France	370,727	364,802	414,783	467,820	441,907	517,860
% change		-1.6%	13.7%	12.8%	-5.5%	17.2%
Brazil	105,553	158,352	247,198	248,437	326,535	420,055
% change		50.0%	56.1%	0.5%	31.4%	28.6%
All Other	3,214,888	3,636,732	4,544,318	5,300,131	6,423,669	6,786,536
% change		13.1%	25.0%	16.6%	21.2%	5.6%

Source: Origin of Movement (OM) series from the Foreign Trade Division of the U.S. Census Bureau