MICHIGAN LOCAL GOVERNMENT OUTLOOK

Presentation delivered a conference of
the Michigan Local Government Benchmarking Consortium
Lansing, Michigan
December 3, 2013

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OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments

Outlook for health care and economic development

Conclusions

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OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2013

Outlook for the general economy

- This is not your father's recession
- The threat of inflation and the "tapering" issue

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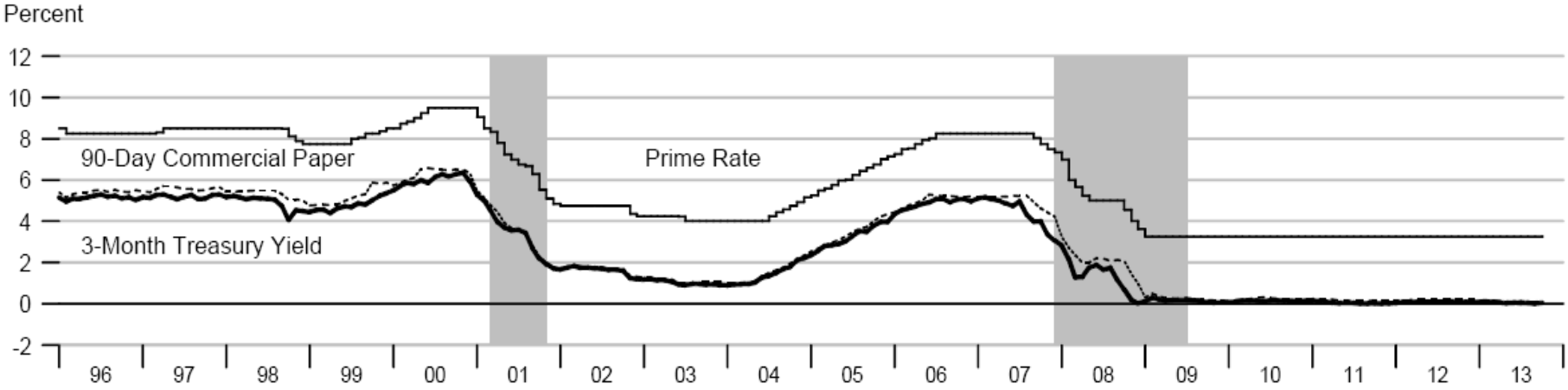
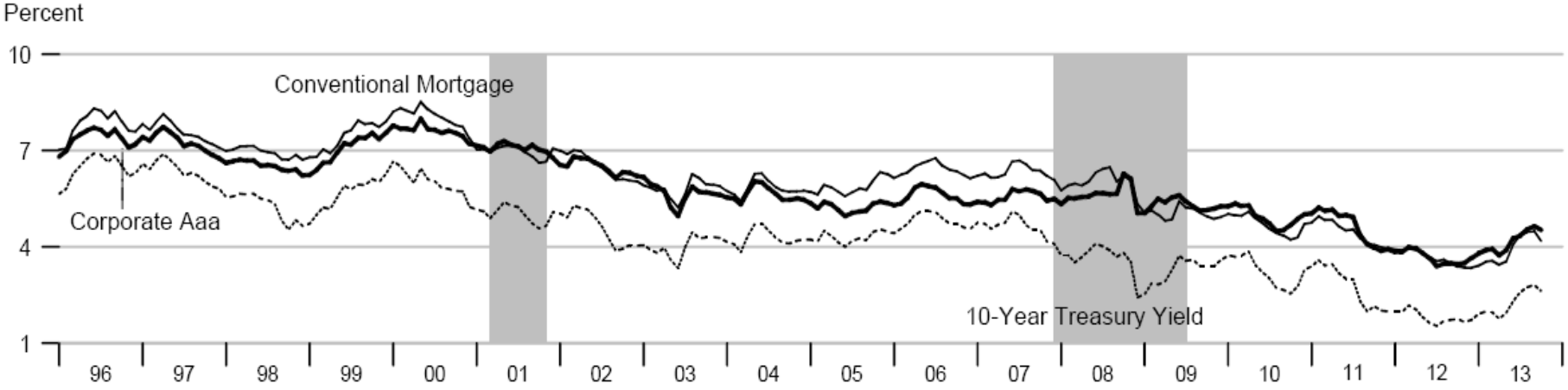
Short-Term Interest Rates

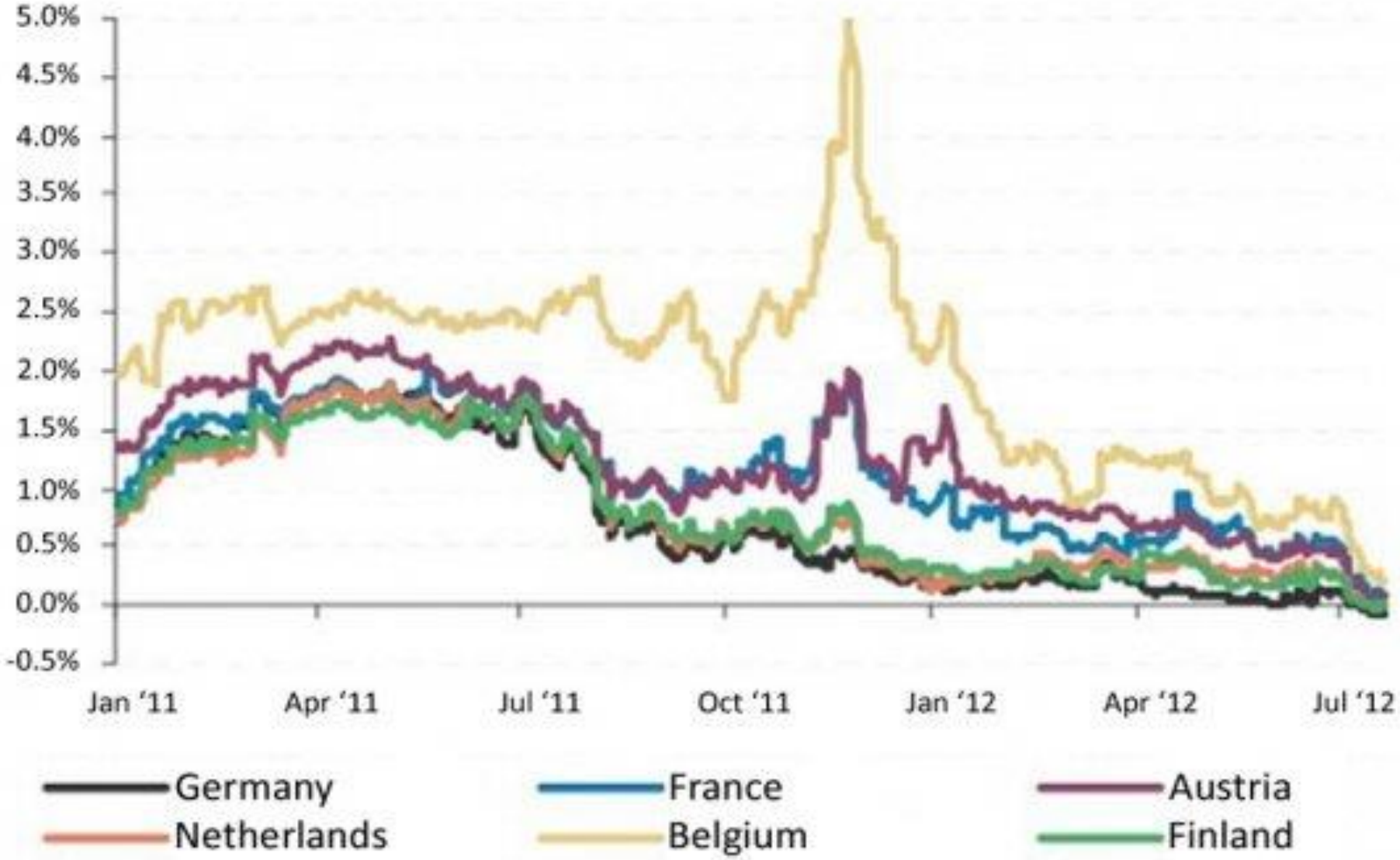


Long-Term Interest Rates



2-Year Yields "Core" And "Semi Core" Converge To 0%

Source: Morgan Staley Research, Bloomberg



THE CREDIT CRISIS & RECOVERY OUTLOOK: THIS IS NOT YOUR FATHER'S RECESSION

The technical definition of recession: A significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income, and other indicators.

A recession begins when the economy reaches a peak of activity and ends when the economy reaches its trough.

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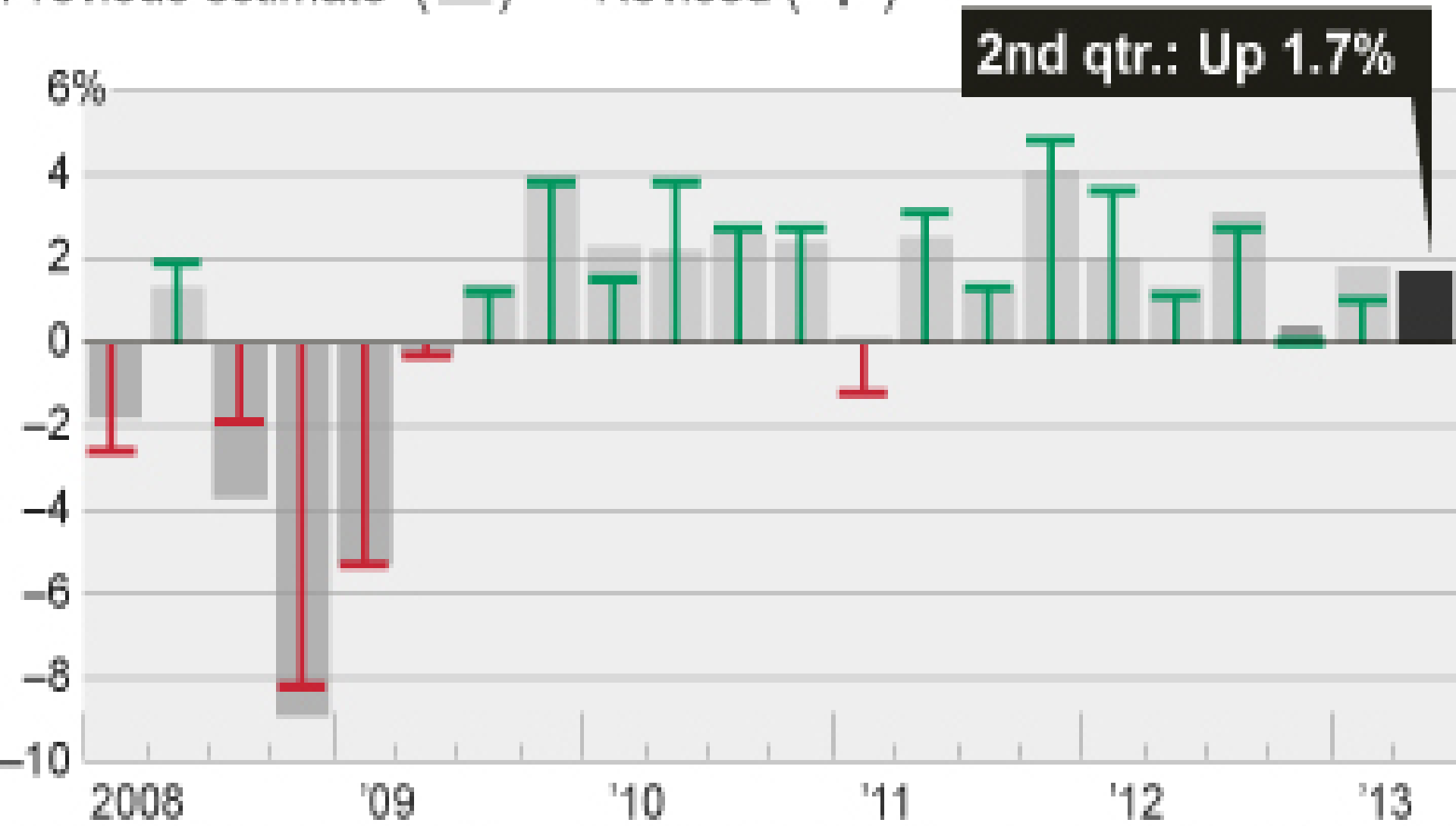
Second-Quarter GDP, the First Reading

Quarterly change at an annual rate, inflation-adjusted

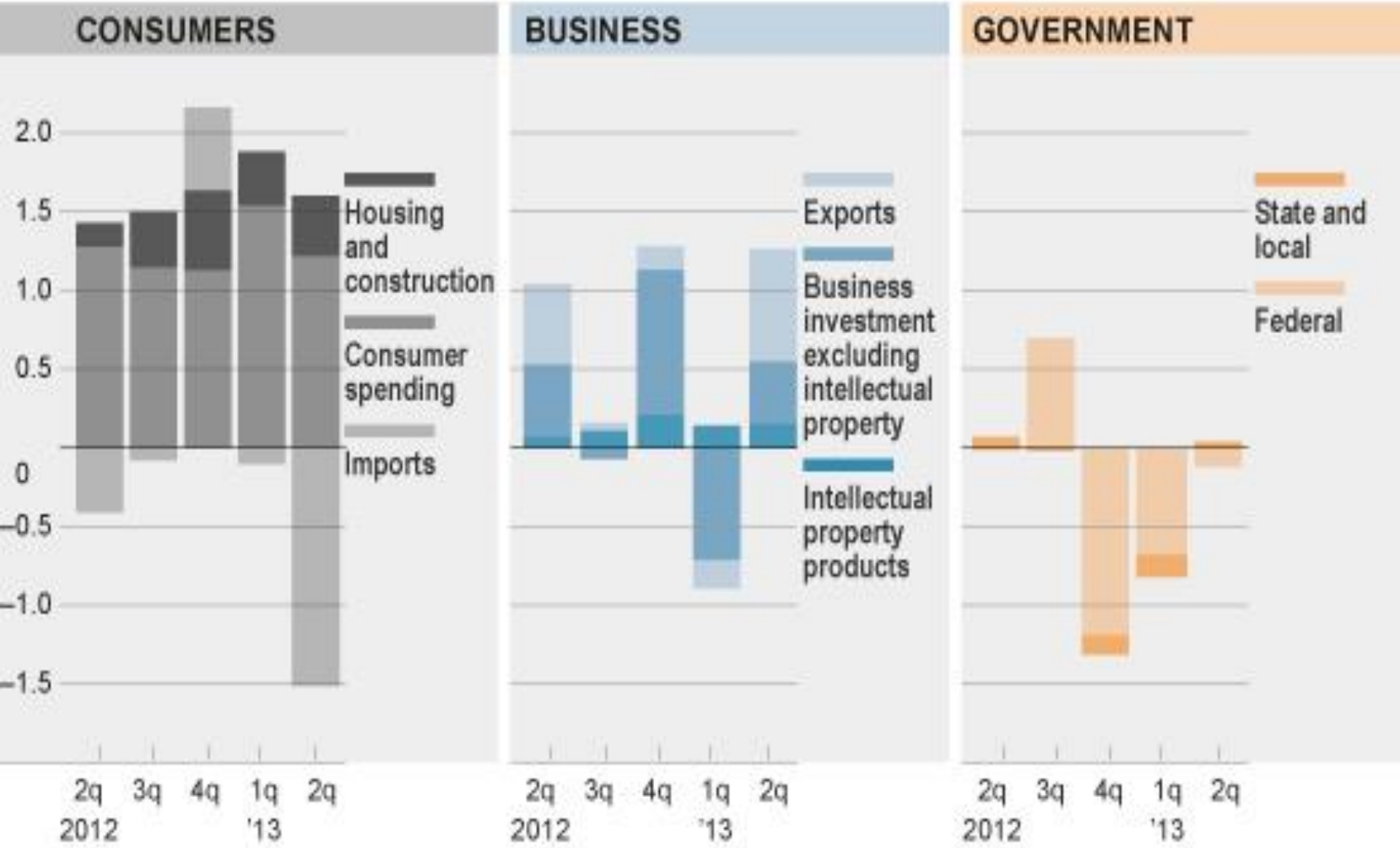
Previous estimate ( ) Revised (T)



Note: Seasonally adjusted Source: Commerce Dept. The Wall Street Journal

Why the Economy Grew

How much each part of the economy contributed to the quarterly change in GDP, in percentage points; measured at an annual rate



Note: Data are adjusted for inflation and the seasons. Source: Commerce Department The Wall Street Journal

THE CREDIT CRISIS & RECOVERY OUTLOOK: THIS IS NOT YOUR FATHER'S RECESSION

The key part of the definition: ***A recession begins when the economy reaches a peak of activity and ends when the economy reaches its trough***.

–Is it over yet?

- Peak of economic activity: 4Q of 2007.
- Trough of economic activity: 3Q of 2009.
- So is the recession over? Technically, yes.
- But why doesn't it feel like it?

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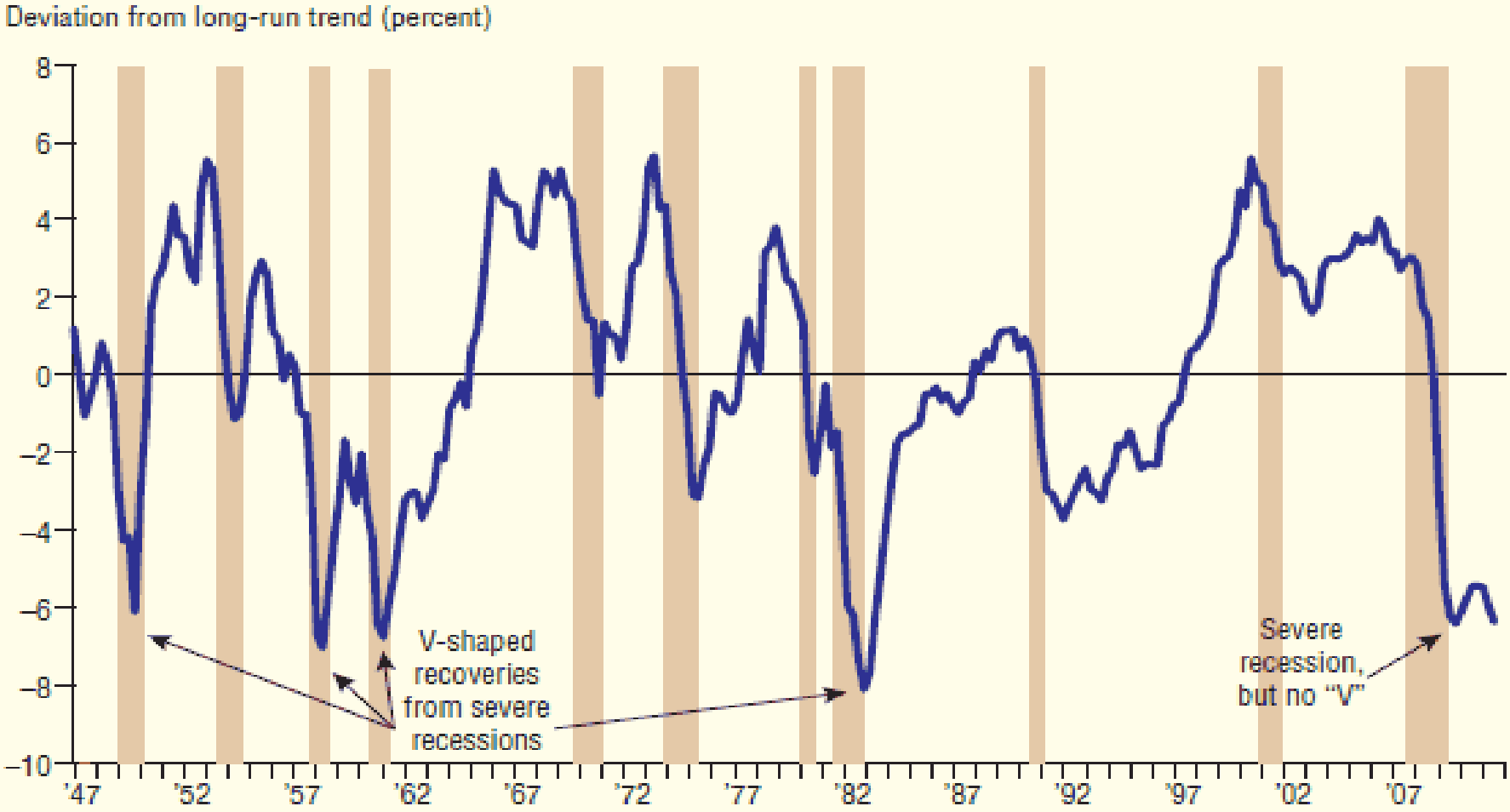
Chart 1

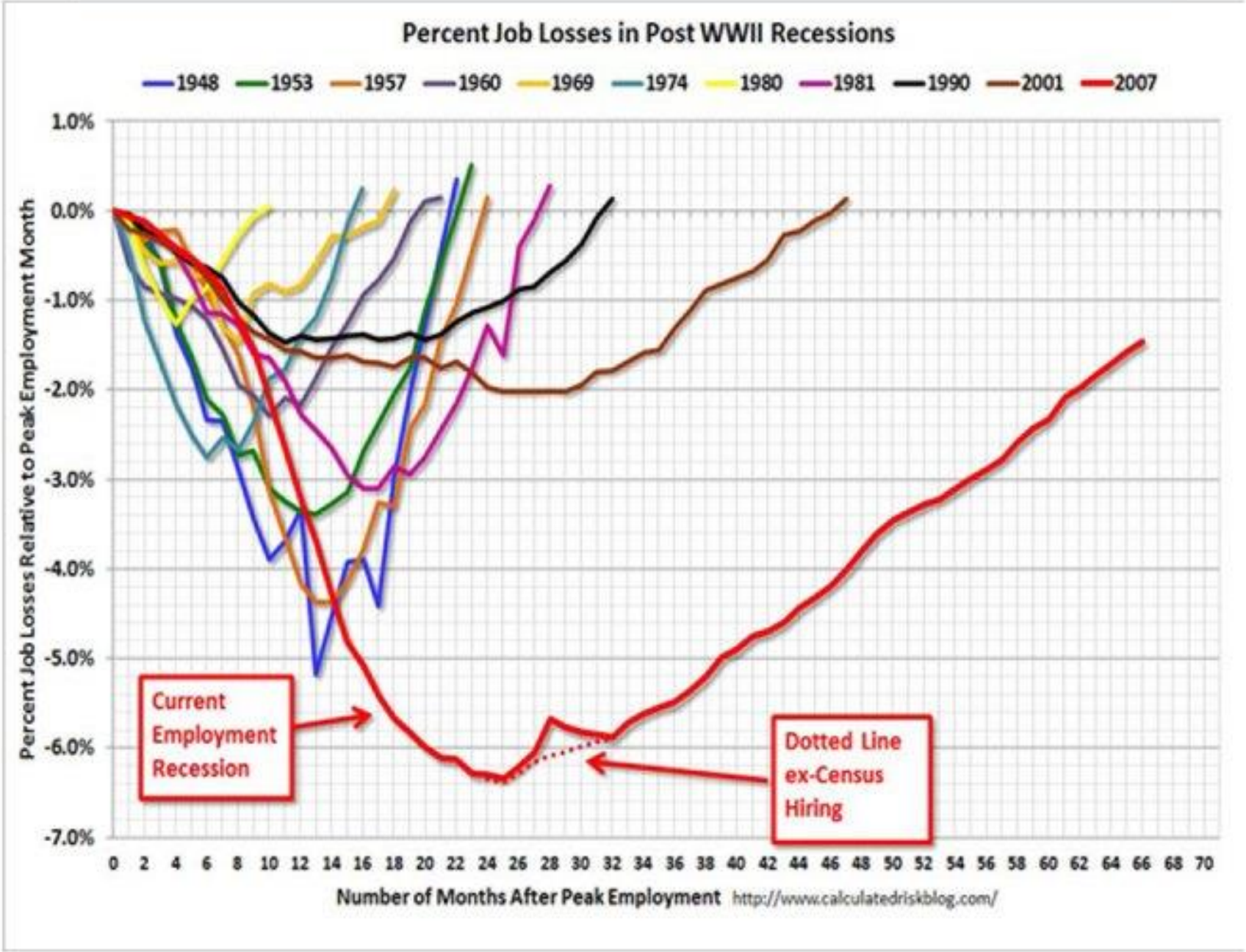
The Bounceback Effect in GDP



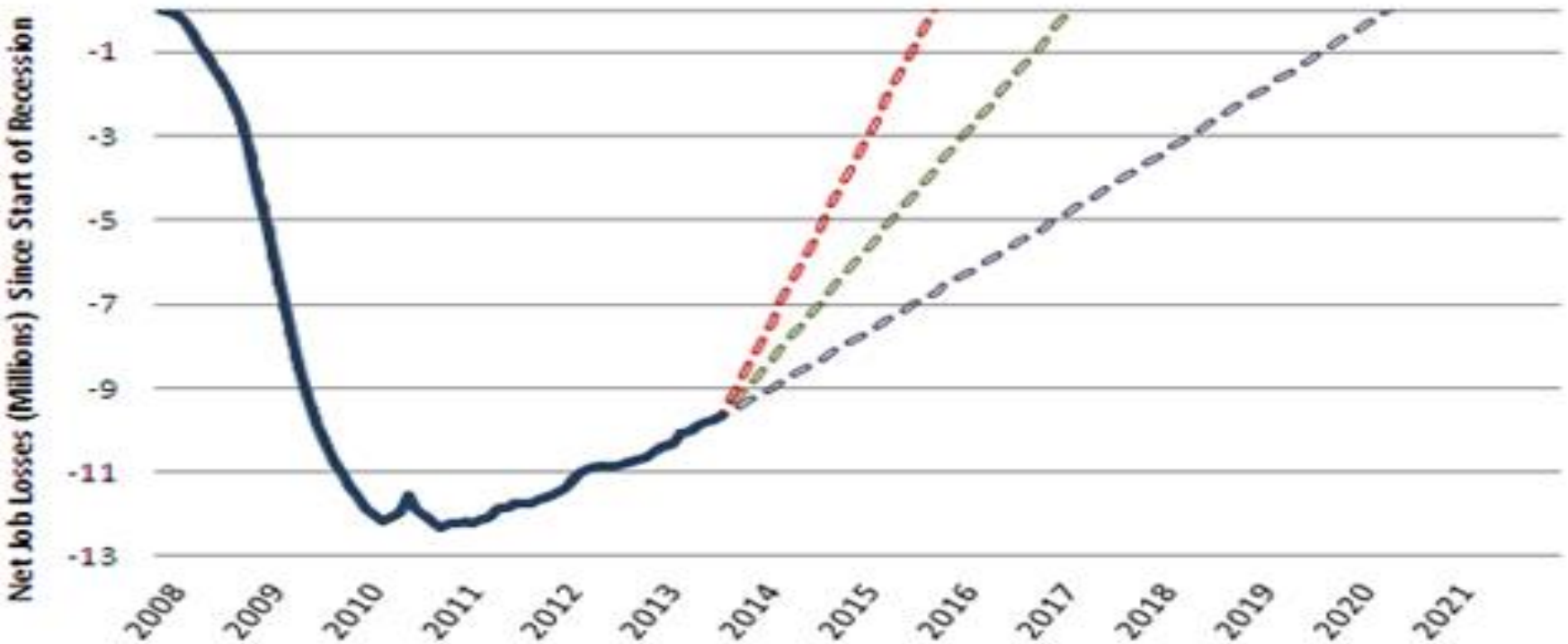
NOTE: Shaded bars indicate U.S. recessions.

SOURCES: Bureau of Economic Analysis; author's calculations.

Markets Chart of the Day



The Evolution of the Jobs Gap To Date and in the Future Under Different Rates of Job Creation (Through July 2013)



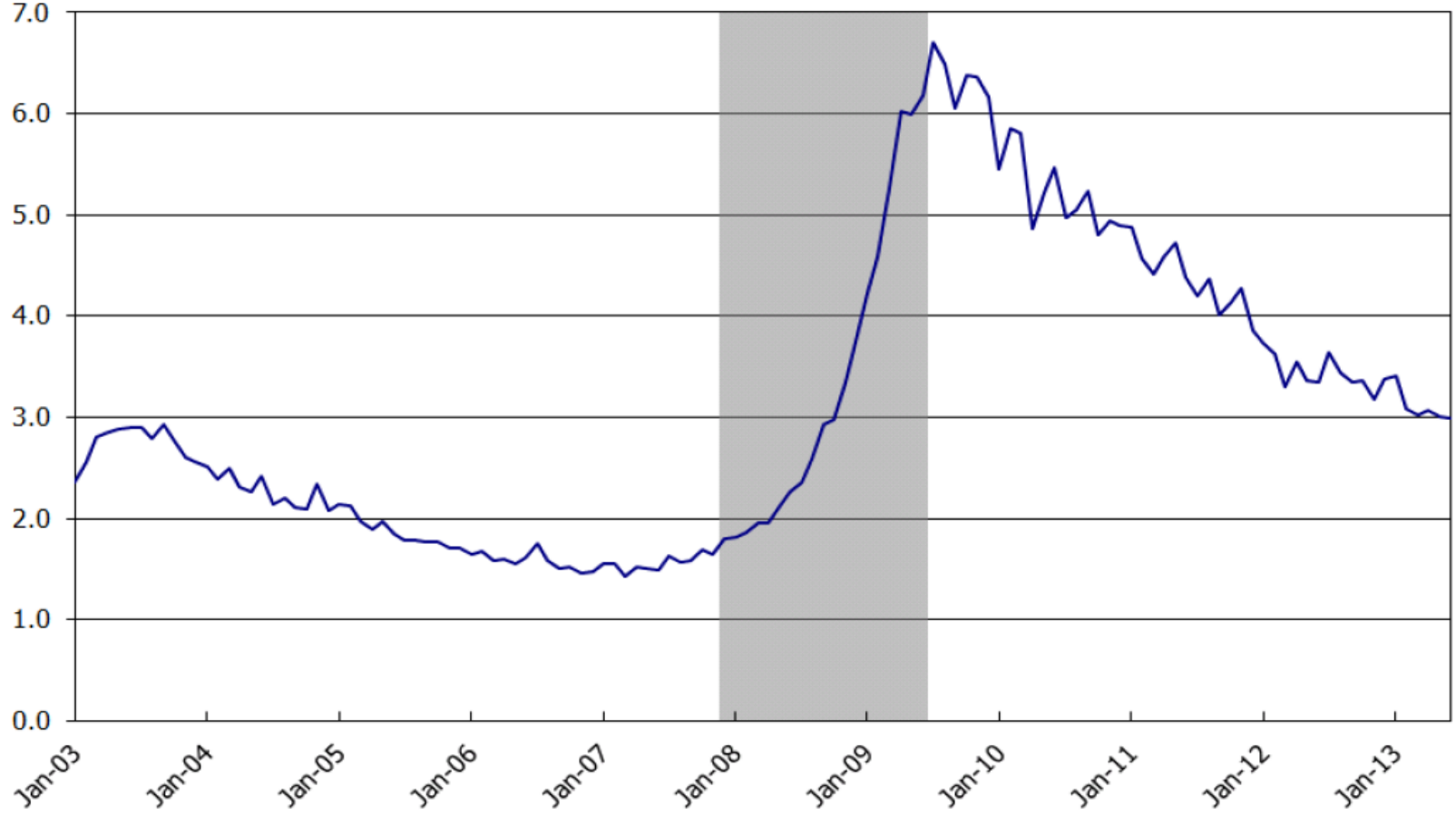
Average monthly job creation for best year in 2000s (208,000 jobs per month in 2005)

Average monthly job creation for best year in 1990s (321,000 jobs per month in 1994)

Maximum number of jobs created in a month in 2000s (471,000 jobs in one month)

THE HAMILTON PROJECT

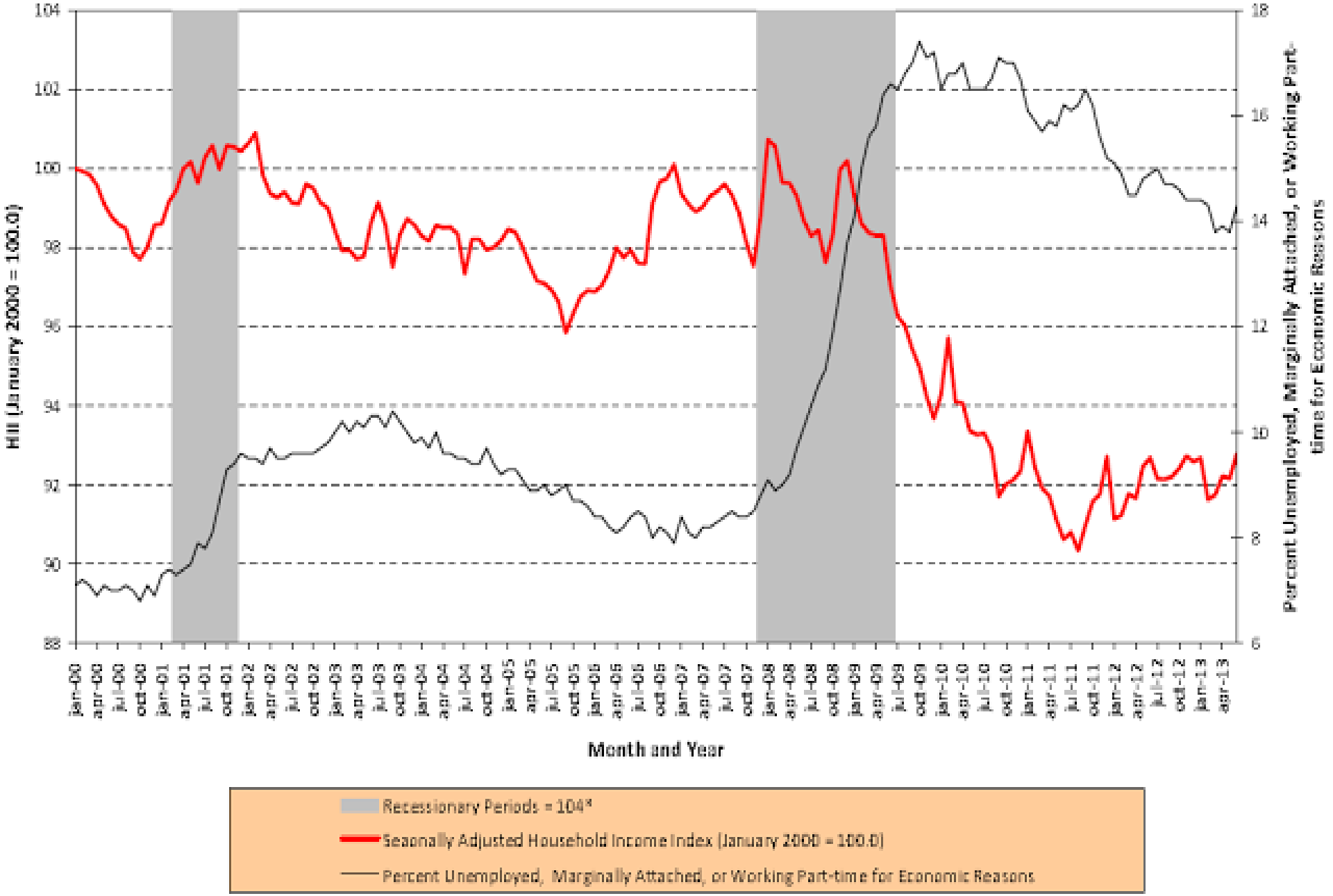
Chart 1. Number of unemployed persons per job opening
Seasonally adjusted

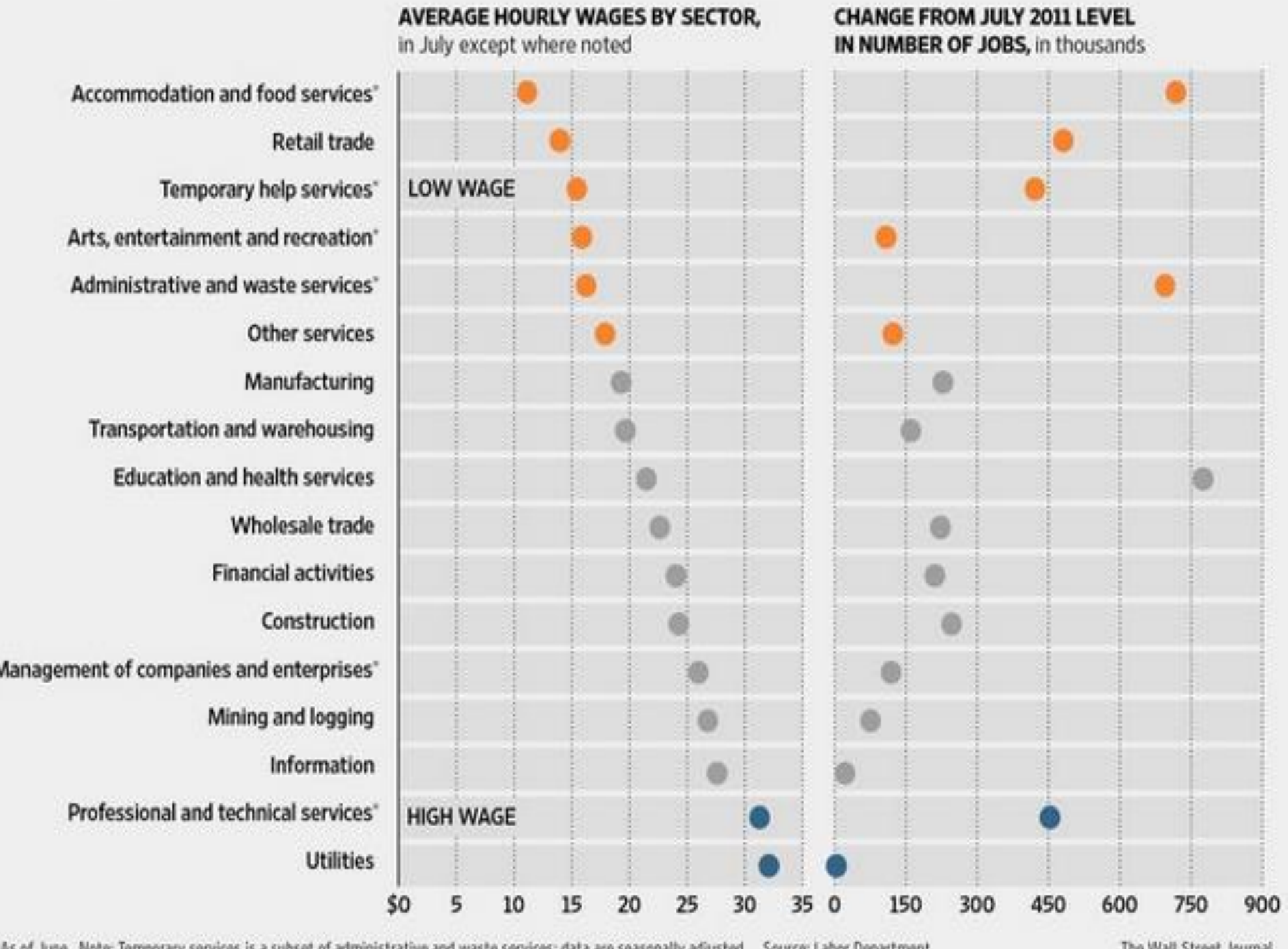


Source: Bureau of Labor Statistics, Current Population Survey and Job Openings and Labor Turnover Survey, August 6, 2013.

Note: Shaded area represents recession as determined by the National Bureau of Economic Research (NBER).

Median Household Income Index (HII) and Percent Unemployed, Marginally Attached, or Working Part-time for Economic Reasons by Month, January 2000 to June 2013




AVERAGE HOURLY WAGES BY SECTOR, in July except where noted
CHANGE FROM JULY 2011 LEVEL IN NUMBER OF JOBS, in thousands
Accommodation and food services*
Retail trade
Temporary help services*
Arts, entertainment and recreation*
Administrative and waste services*
Other services
Manufacturing
Transportation and warehousing
Education and health services
Wholesale trade
Financial activities
Construction
Management of companies and enterprises*
Mining and logging
Information
Professional and technical services*
Utilities
LOW WAGE
HIGH WAGE
$0 5 10 15 20 25 30 35
0 150 300 450 600 750 900
As of June. Note: Temporary services is a subset of administrative and waste services; data are seasonally adjusted. Source: Labor Department
The Wall Street Journal

THE CREDIT CRISIS & RECOVERY OUTLOOK: THIS IS NOT YOUR FATHER'S RECESSION

But we *are not now and never have been* in a recession.

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THE CREDIT CRISIS & RECOVERY OUTLOOK: THIS IS NOT YOUR FATHER'S RECESSION

We are in a banking crisis.

And banking crises are much longer and much deeper than recessions and do not respond to the policy tools that work in a recession.

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THIS IS NOT YOUR FATHER'S RECESSION

- **Recession:** A significant decline in economic activity… lasting more than a few months.

- **Banking crisis:** A country's corporate and financial sectors experience a ***large number of defaults***… great ***difficulties repaying contracts***…***non-performing loans increase sharply*** and all or most of the aggregate ***banking system capital is exhausted***. This situation may be accompanied by ***depressed asset prices***…on the heels of run-ups before the crisis (see Laeven and Valencia).

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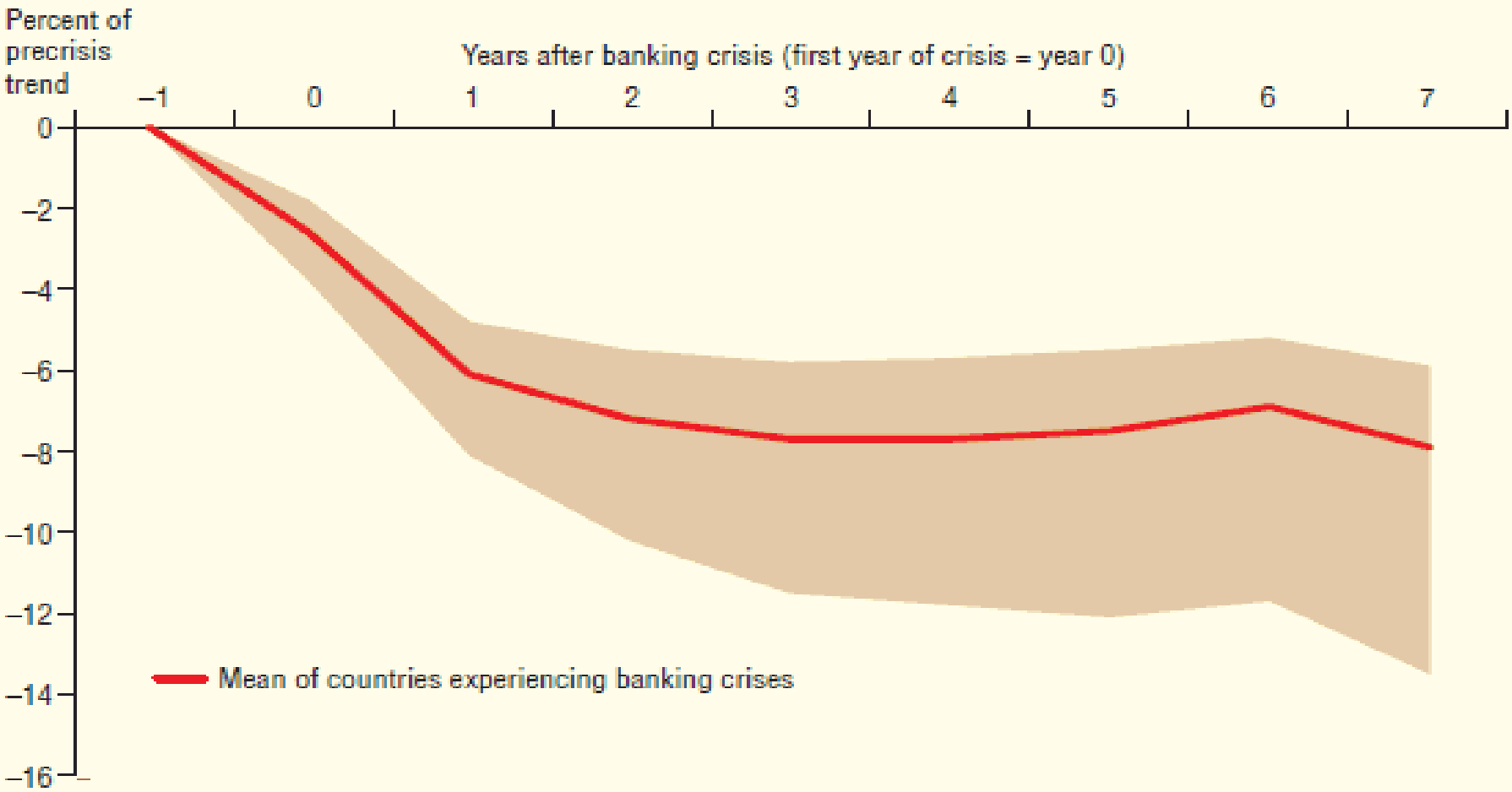
THIS IS NOT YOUR FATHER'S RECESSION

- **Recession:**
  - Bank stress/failures follow the beginning of the recession.
  - Bank capital remains adequate to maintain banking system liquidity, does not pose systemic threat to banking system.

- **Banking crisis:**
  - Bank stress/failures and a credit crisis precede the recession.
  - Bank capital is inadequate to maintain banking system liquidity, creating a systemic threat to banking system.
  - Bank lending/economic growth are affected for a much longer period of time.

Chart 2

GDP Falls Below Trend After Banking Crises



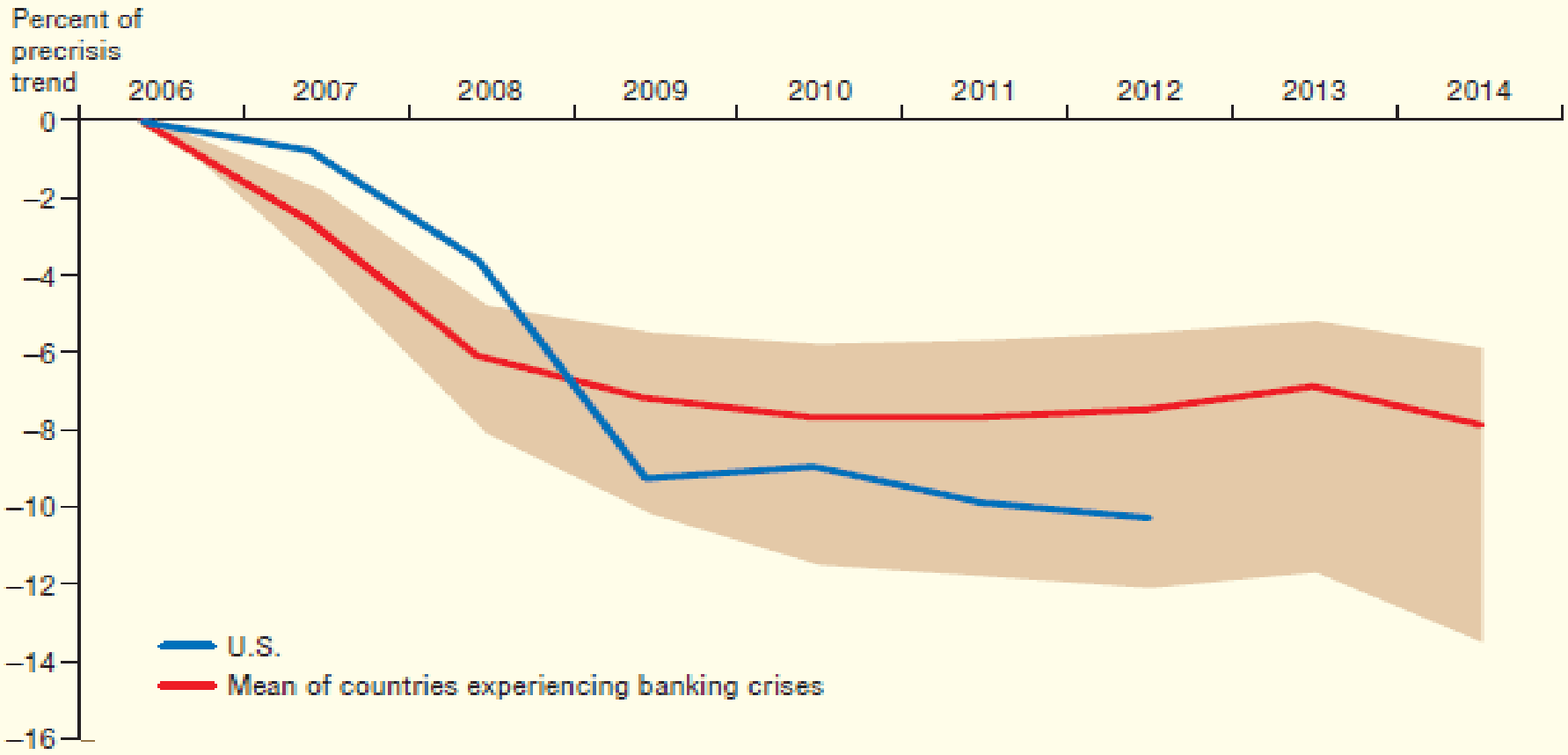
NOTE: Shaded area is the 90 percent confidence interval for the mean.

SOURCE: *World Economic Outlook*, International Monetary Fund, October 2009.

Chart 3

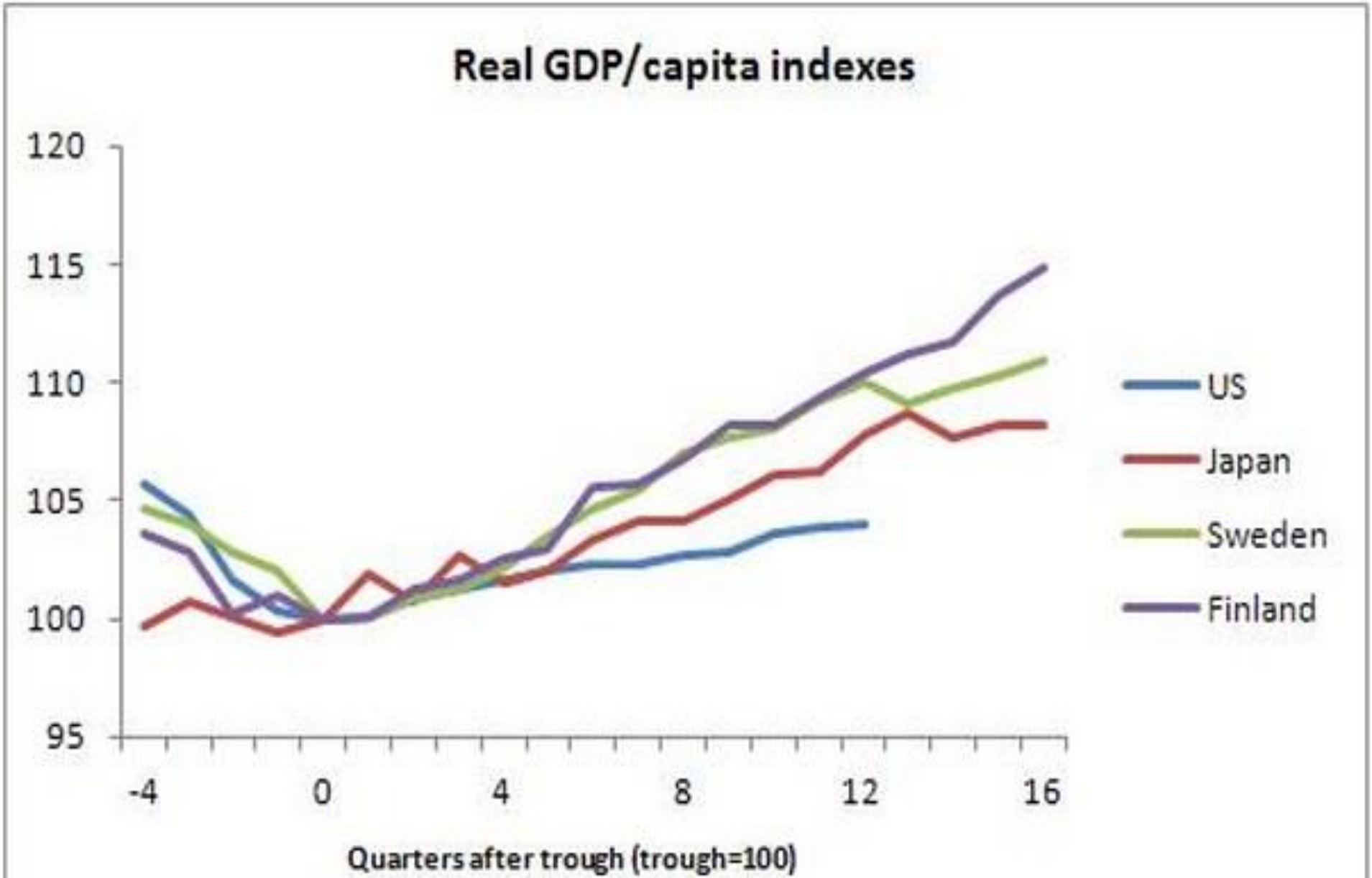
U.S. Postcrisis GDP Resembles Average Experience

A. Selecting 2007 as first year of the crisis in the U.S.



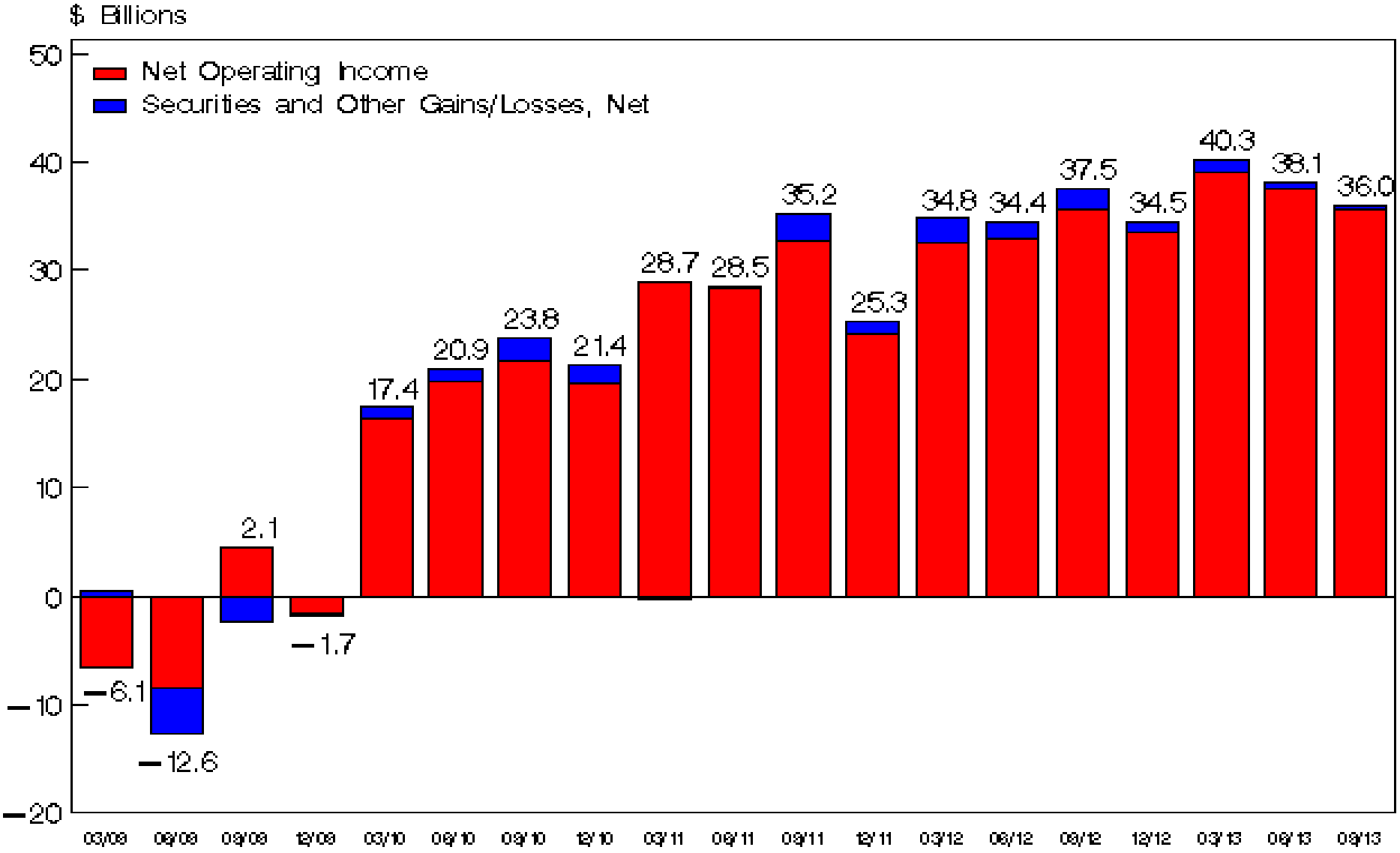
B. Selecting 2008 as first year of the crisis in the U.S.

WEAKEST RECOVERIES SINCE 1970 EACH RESULTED FROM A BANKING CRISIS



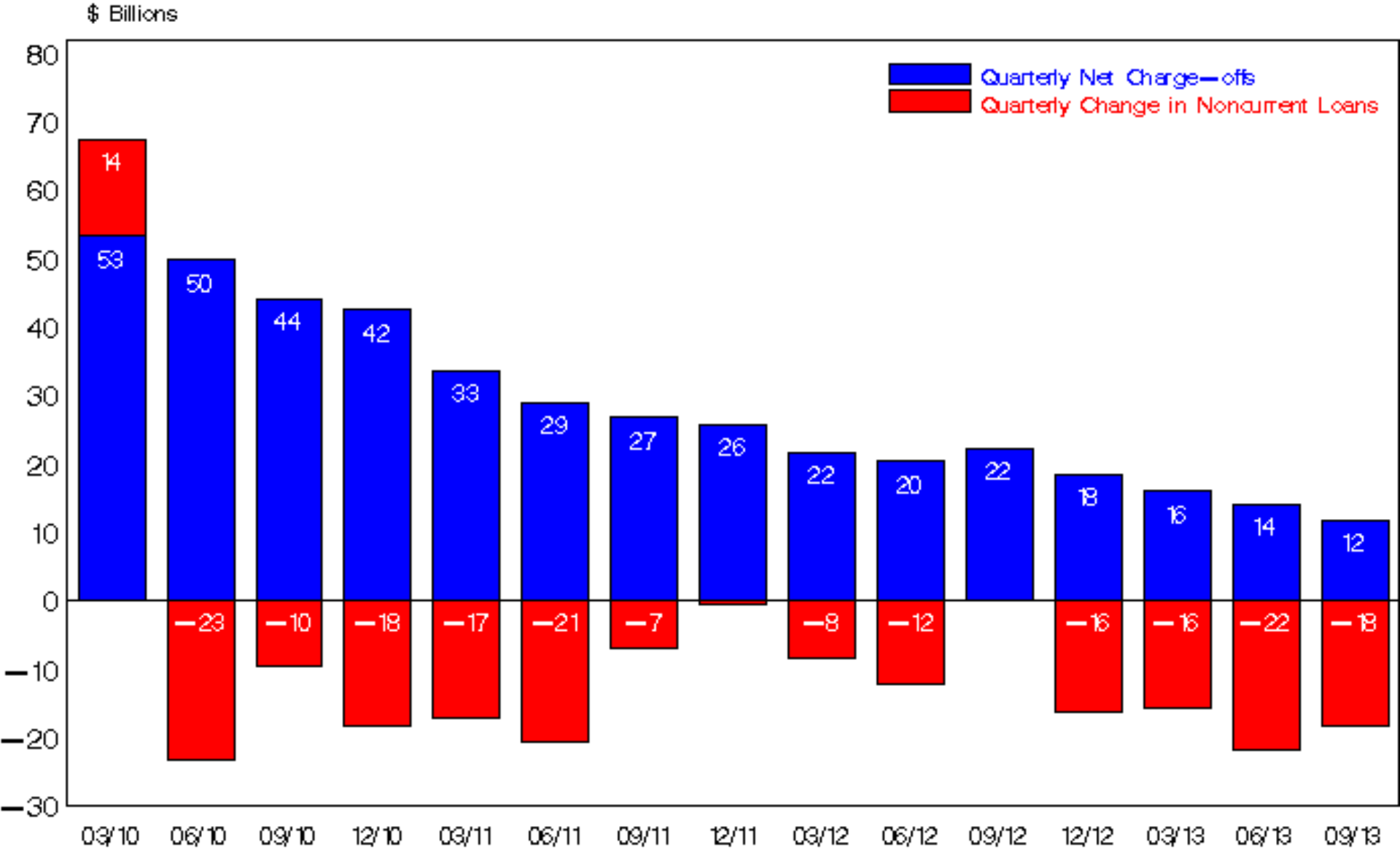
Quarterly Net Income

2009–2013



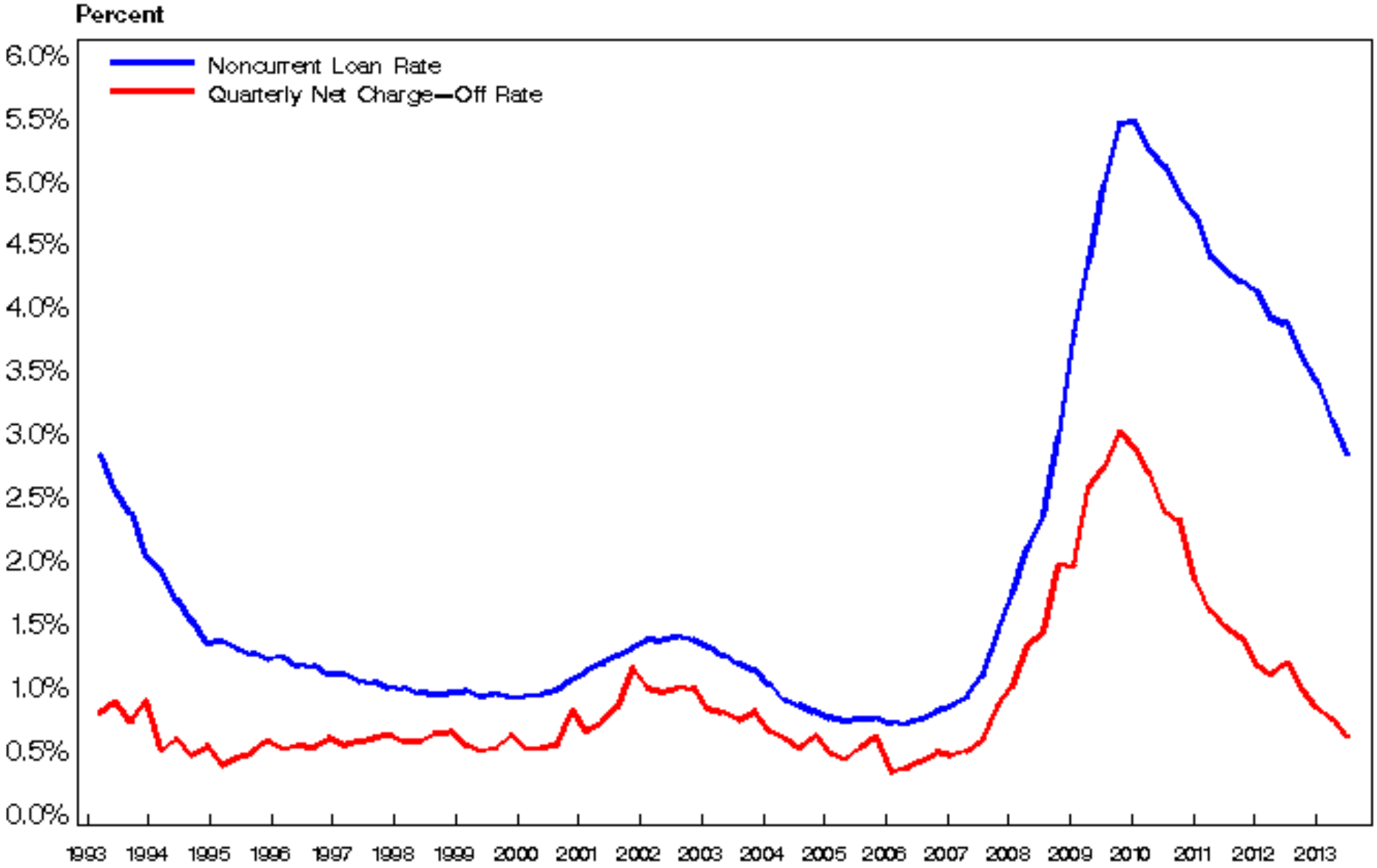
Quarterly Net Charge–Offs and Change in Noncurrent Loans

2010 – 2013



Noncurrent Loan and Quarterly Net Charge—Off Rates

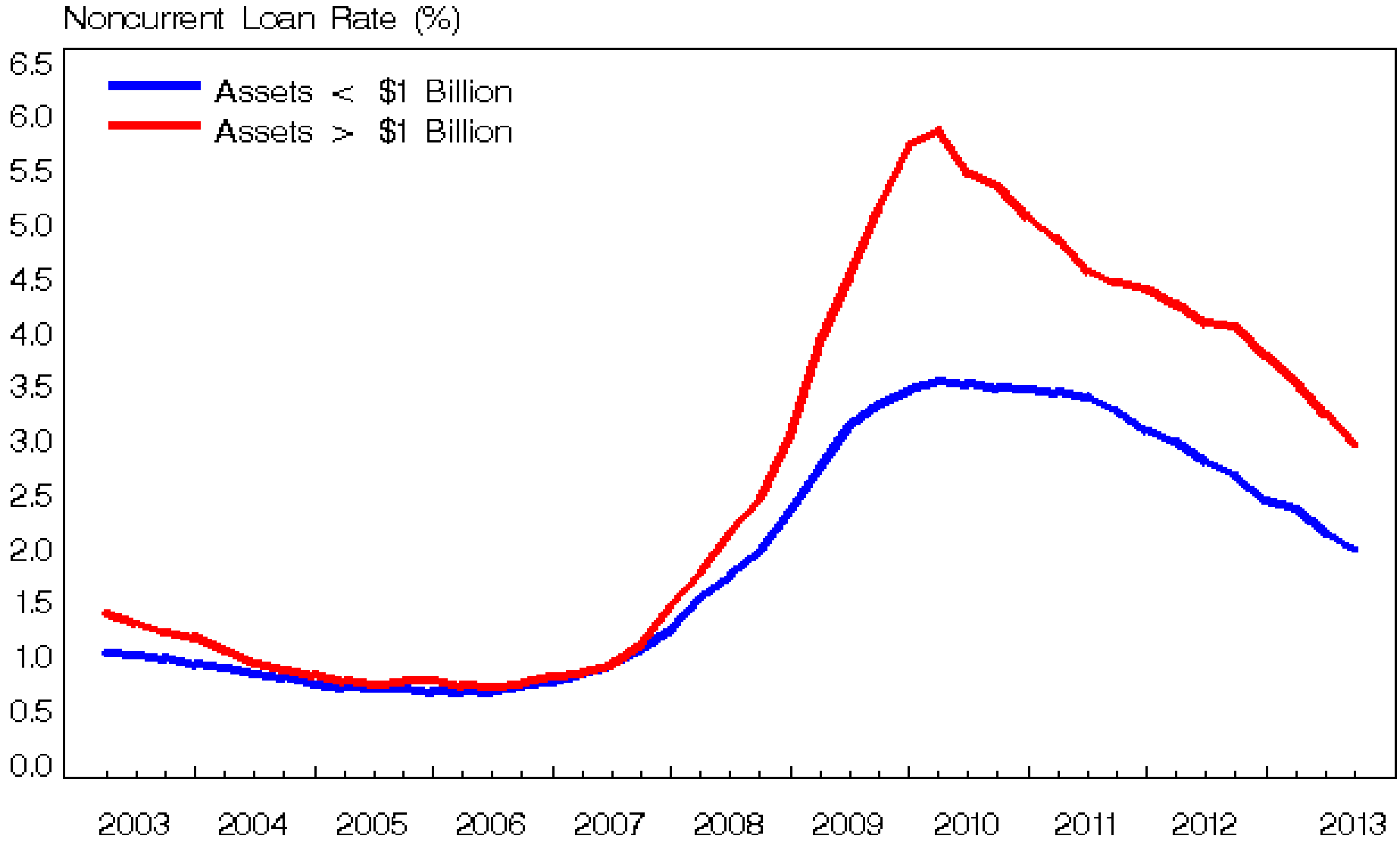
1993—2013



Noncurrent Loan Rates

By Asset Size

2003 – 2013



The New York Times
DealB%k
Edited by Andrew Ross Sorkin

OCTOBER 23, 2013, 6:17 PM

Jury Finds Bank of America Liable in Mortgage Case

By LANDON THOMAS JR.

Updated, 9:20 p.m. | Bank of America, one of the nation's largest banks, was found liable on Wednesday of having sold defective mortgages, a jury decision that will be seen as a victory for the government in its aggressive effort to hold banks accountable for their role in the housing crisis.

Moreover, the jury also found a top manager at Bank of America's Countrywide Financial unit liable, pinning some — if not all — of the responsibility for the bad acts on an individual.

During the trial, federal prosecutors accused Rebecca Mairone, a top manager at Countrywide at the time, of having opted for quantity over quality in its mortgage-writing program, which resulted in the bank's churning out to unqualified buyers housing loans that were destined to fail.

Federal lawyers claimed that Ms. Mairone, who now works at JPMorgan Chase, led a program nicknamed the "hustle," derived from the initialism HSSL, or the "high-speed swim lane." The program linked bonuses to how fast bankers could

THE WALL STREET JOURNAL.

MARKETS

J.P. Morgan to Agree to 'London Whale' Fines

Bank to Admit Wrongdoing as Part of SEC Settlement

By ANDREW ACKERMAN, SCOTT PATTERSON and ROBIN SIDEL

Updated Sept. 16, 2013 8:50 p.m. ET

Regulators are expected to hit J.P. Morgan Chase & Co. with at least $700 million in penalties as part of a settlement related to the bank's handling of the London Whale trading loss. Colin Barr reports on the News Hub. Photo: AP.

WASHINGTON— J.P. Morgan Chase & Co. is expected to take a big step toward resolving the "London whale" trading fiasco, agreeing to pay at least $800 million in penalties and admit wrongdoing as part of a broad regulatory settlement over its handling of the matter, according to people familiar with the situation.

Regulators in the U.S. and U.K. are expected to fault J.P. Morgan for deficient internal controls and disclosing incorrect information related to the 2012 trades, the people said. The trades resulted in more than $6 billion in losses at the largest U.S. bank.

JPMorgan Said to Reach Record $13 Billion U.S. Settlement

By Tom Schoenberg, Dawn Kopecki, Hugh Son and Dakin Campbell -
Oct 20, 2013

JPMorgan Chase & Co.'s record $13 billion deal to end U.S. probes of its mortgage-bond sales would free the nation's largest bank from mounting civil disputes with the government while leaving a criminal inquiry unresolved.

The tentative pact with the Department of Justice increased from an $11 billion proposal last month and would mark the largest amount paid by a financial firm in a settlement with the U.S. The deal wouldn't release the bank from potential criminal liability, at the insistence of U.S. Attorney General Eric Holder, according to terms described by a person familiar with the talks, who asked not to be named because they were private.

"To not get the waiver from criminal prosecution is not good," said Nancy Bush, a bank analyst who founded NAB Research LLC in New Jersey. "What we're looking for in a settlement of this size is certainty from things like the criminal prosecution of a company. The Street wants certainty."

JPMorgan Chief Executive Officer Jamie Dimon, 57, personally discussed the deal with Holder after markets closed Oct. 18 as the banker sought to end probes that have beset his firm and resulted in its first quarterly loss under his watch. The agreement, which isn't yet final, includes $4 billion in relief for unspecified consumers and $9 billion in payments and fines, according to another person briefed on the terms.

The payouts would cover a $4 billion accord with the Federal Housing Finance Agency over the bank's sale of mortgage-backed securities, that person said. The deal, which may be announced in the coming week, also resolves pending inquiries by New York Attorney General Eric Schneiderman, the people said.

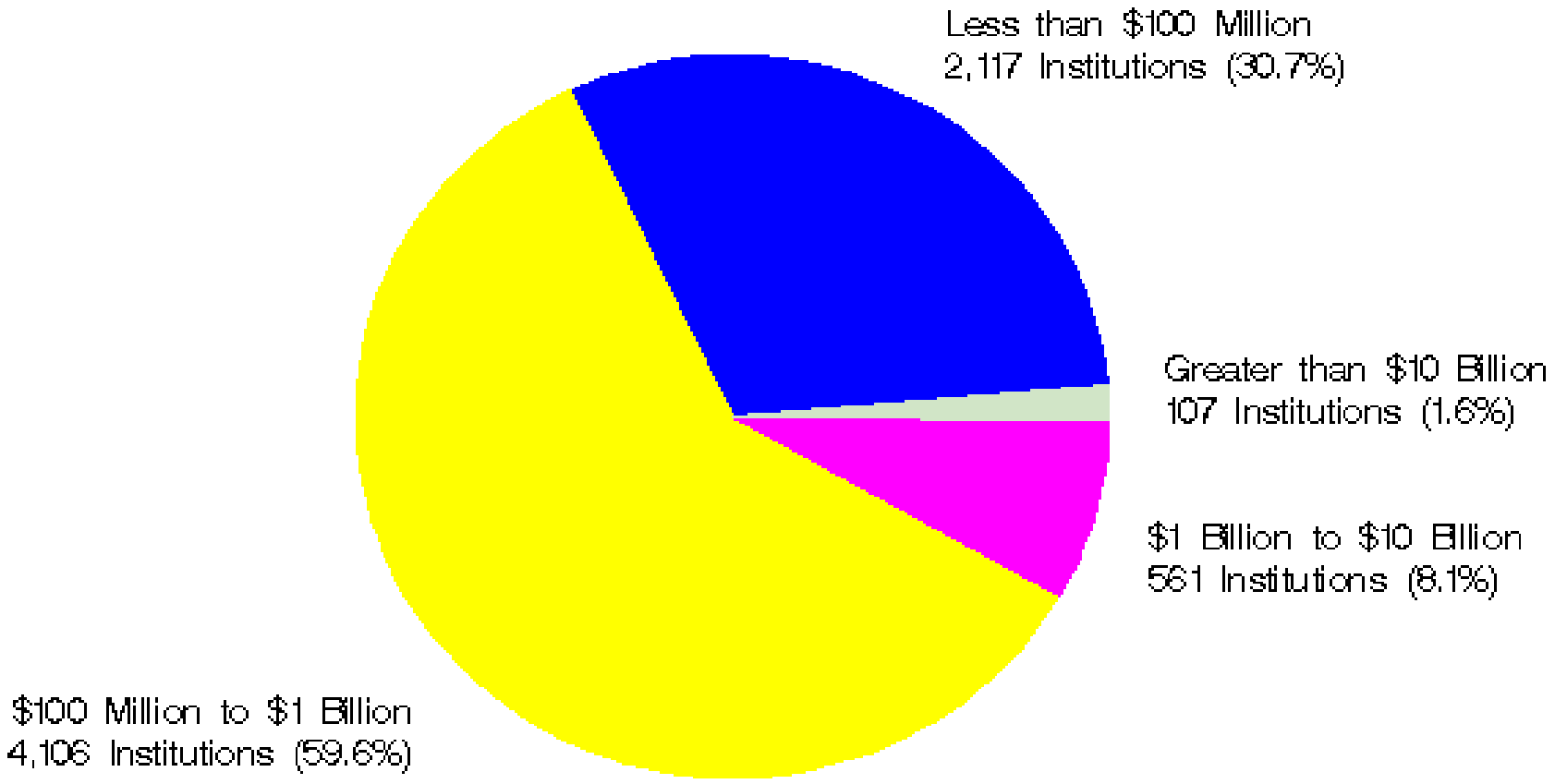
Dwarfing Pay

The settlement would amount to more than half of JPMorgan's record $21.3 billion profit last year, or 1.5 times what the firm's corporate and investment bank set aside to pay employees during this year's first nine months. Only seven companies in the Dow Jones Industrial Average earned more than $13 billion in 2012, according to data compiled by Bloomberg. Some portions of the deal, such as relief to homeowners, would probably be tax deductible for JPMorgan.

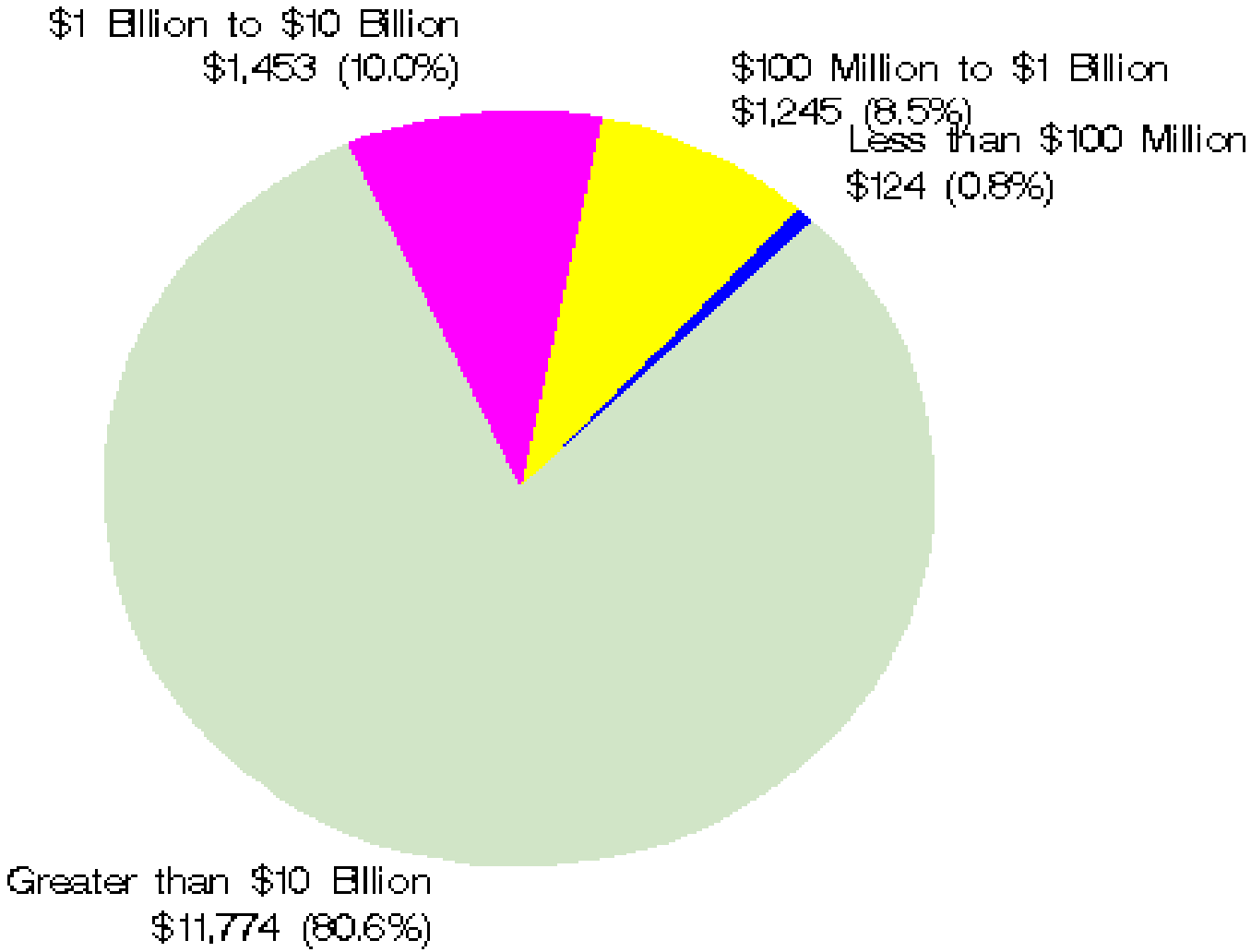
The outline of the tentative accord was reached during a telephone call between Holder, Dimon, JPMorgan General Counsel Stephen Cutler and Associate U.S. Attorney General Tony West, said the person. The settlement's statement of facts is still being negotiated.

Number of Institutions By Asset Size

September 30, 2013

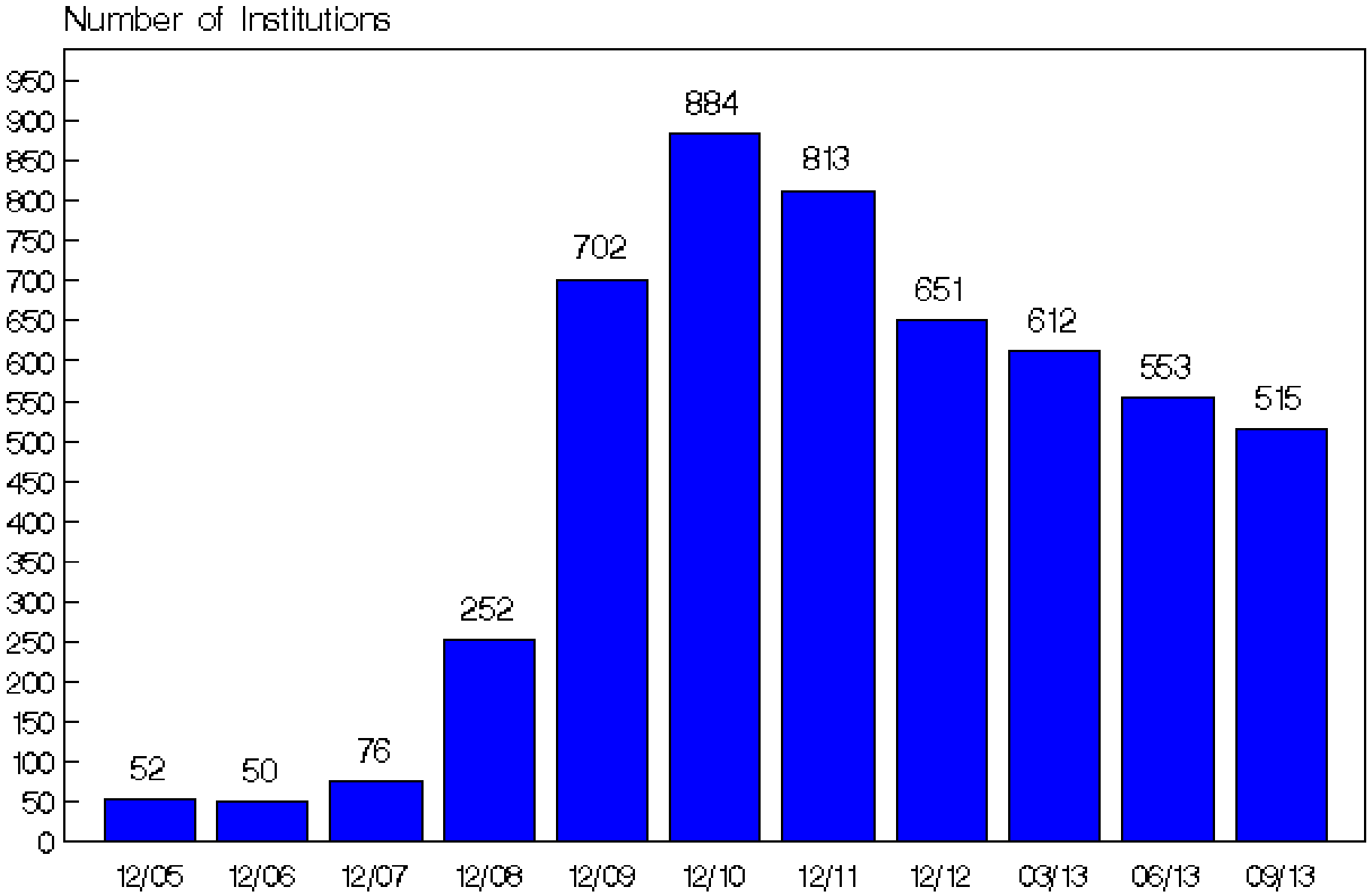


Industry Assets By Asset Size
September 30, 2013
($ Billions)



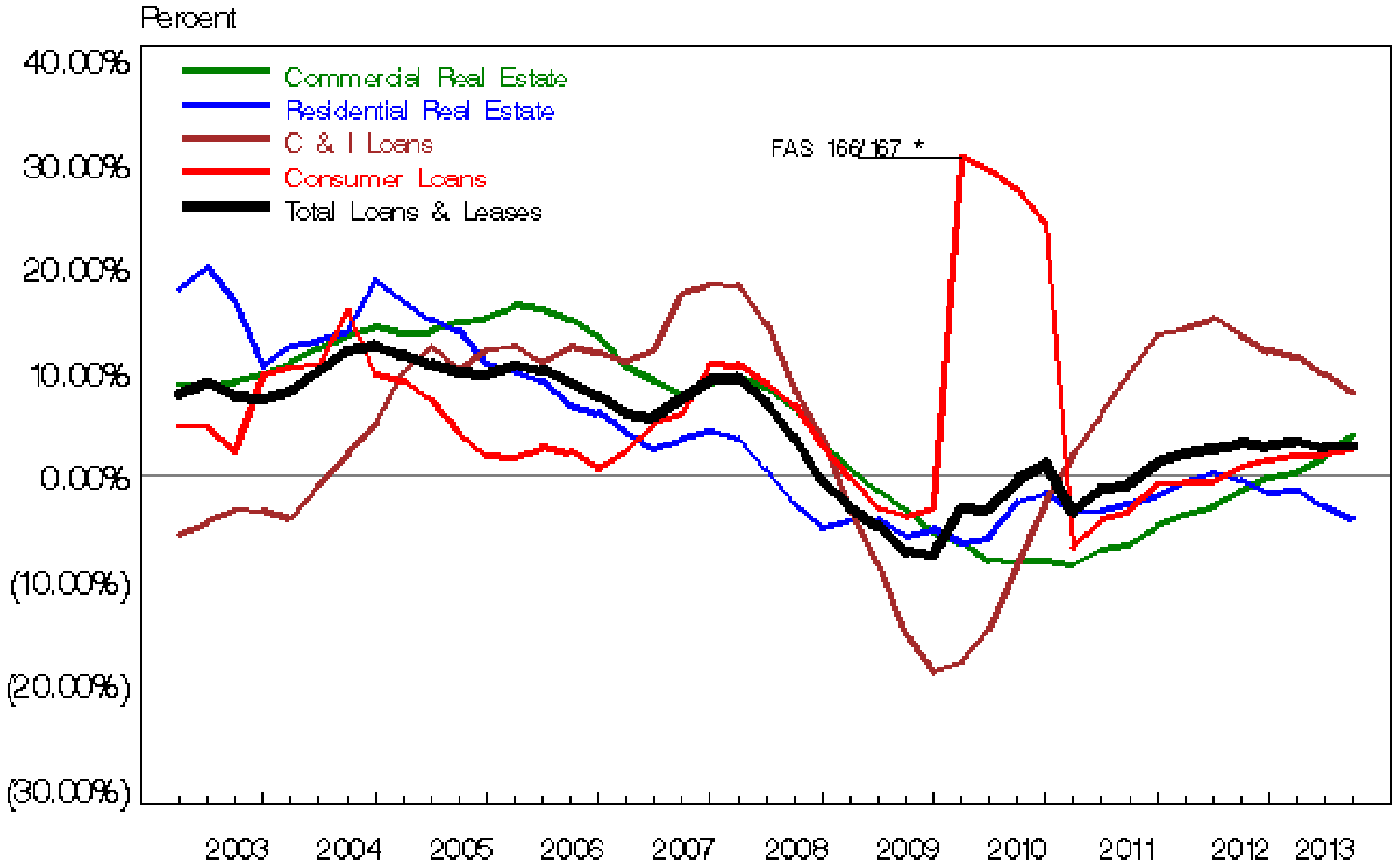
Number of FDIC–Insured "Problem" Institutions

2005–2013



Twelve—Month Loan Growth Rates

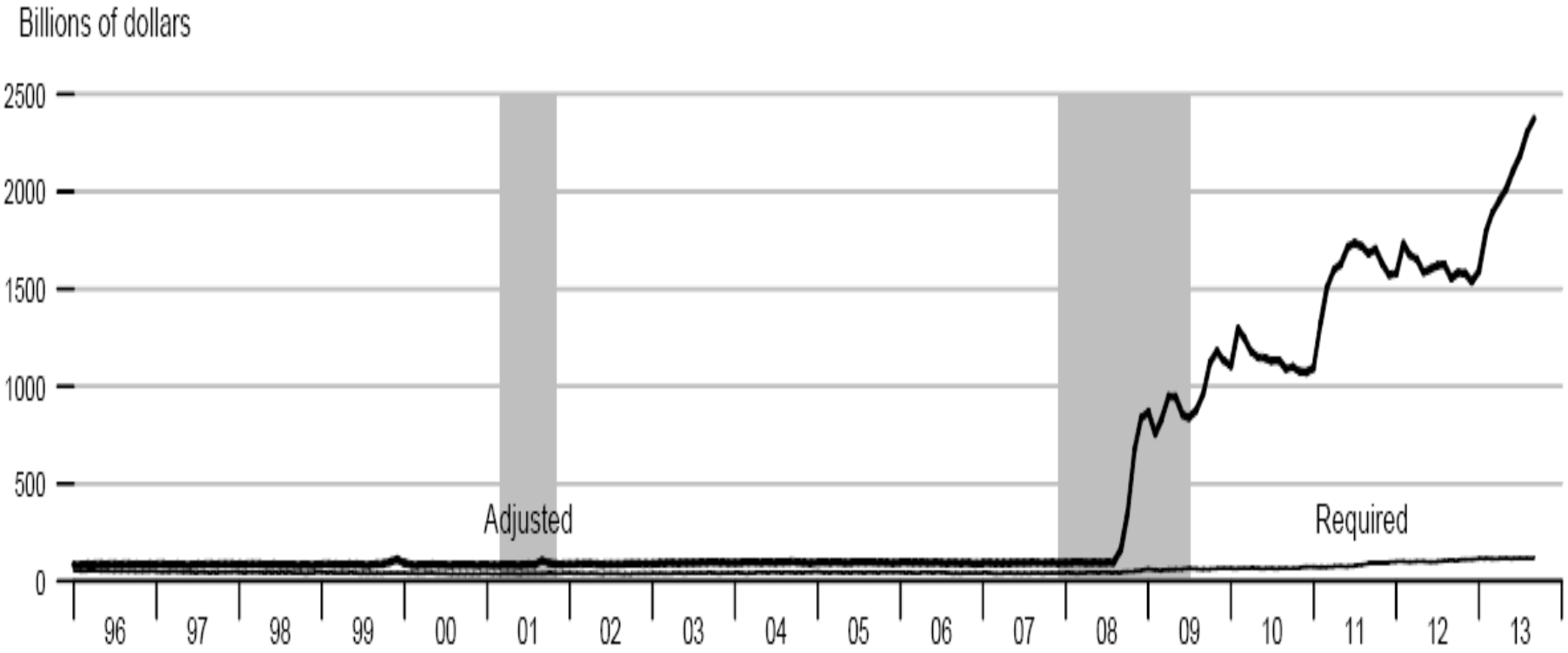
2003 — 2013



Monetary Trends

updated through
11/05/13

Adjusted and Required Reserves



WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND "TAPERING"

The fundamental equation of monetary economics

$M * V = P * Y$, where:

- M = Monetary base
- V = Velocity of money
- P = Price level
- Y = Output of goods and services in the economy

If V and Y are constant (Y at full employment), then an increase in M will result in an increase in P (inflation).

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WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND "TAPERING"

The fundamental equation of monetary economics

M * V = P * Y, where:

M = Monetary base

V = Velocity of money

P = Price level

Y = Output of goods and services in the economy

But what if V is not constant (decreases)? Then P will decrease if the M does not increase.

What determines V? Two factors: (1)Firm/consumer cash holding habits and (2) bank lending practices.

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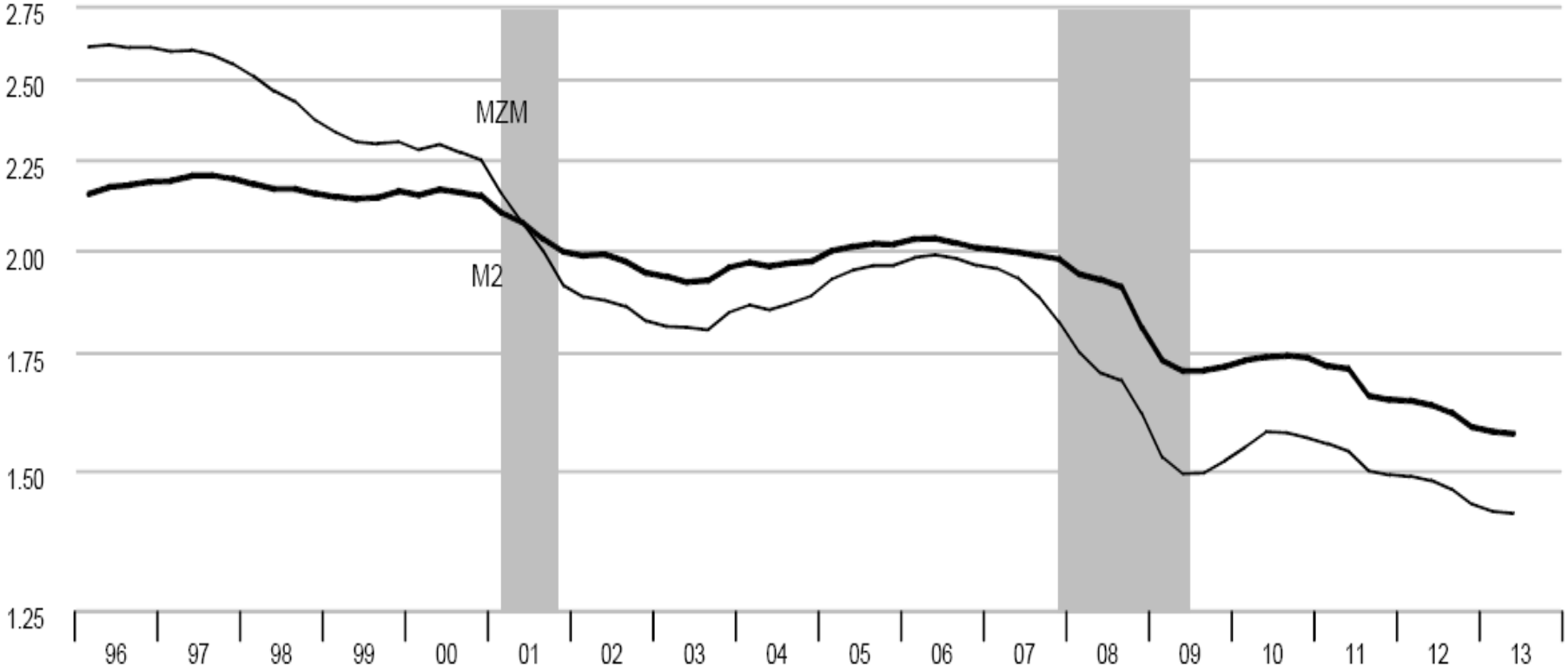
Velocity

Nominal GDP/MZM, Nominal GDP/M2 (Ratio Scale)



WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND "TAPERING"

The fundamental equation of monetary economics

M * V = P * Y, where:

M = Monetary base

V = Velocity of money

P = Price level

Y = Real output of good and services

But if Y (output) is not at full capacity, then P will not increase if the M increases.

What is happening with Y relative to capacity?

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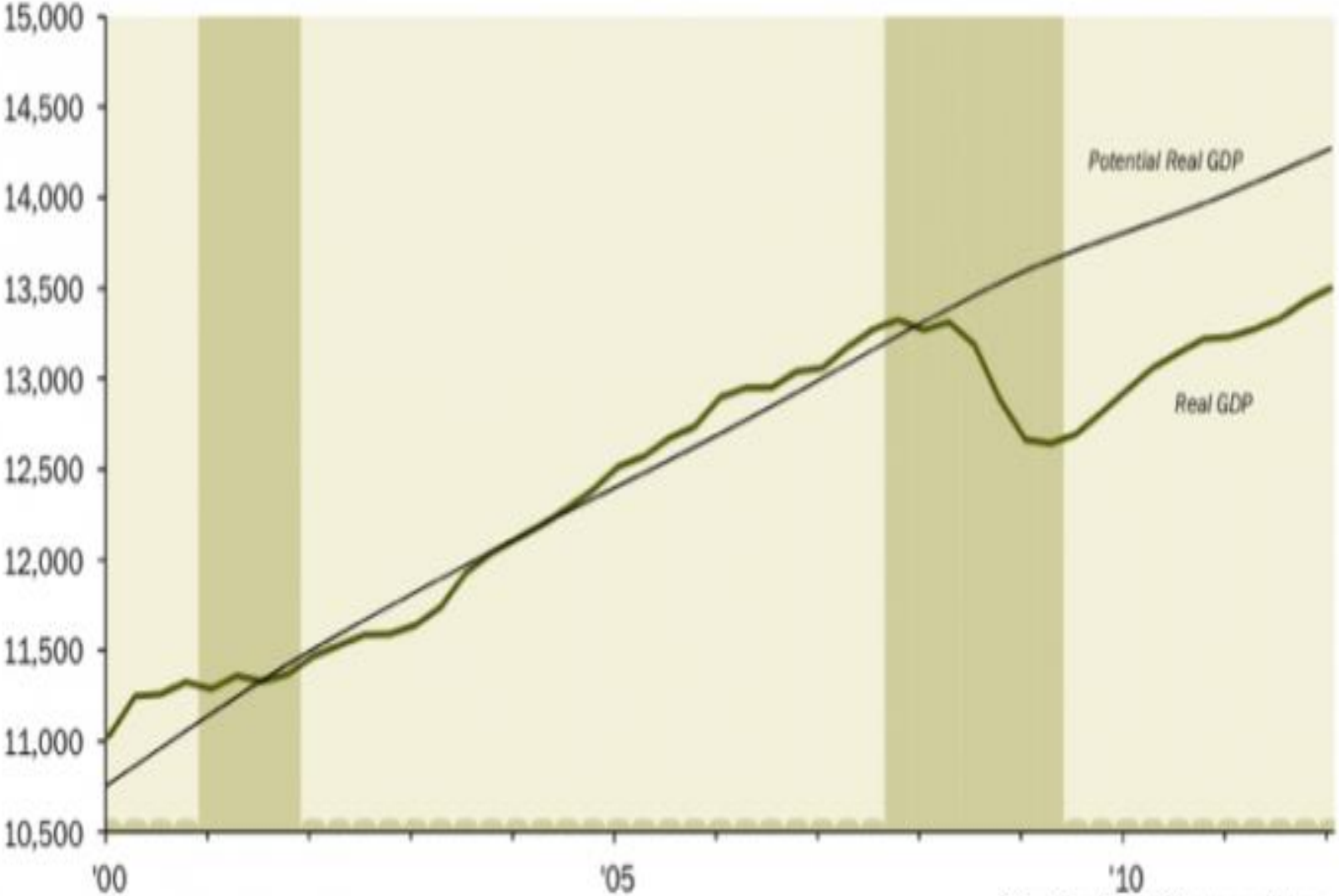
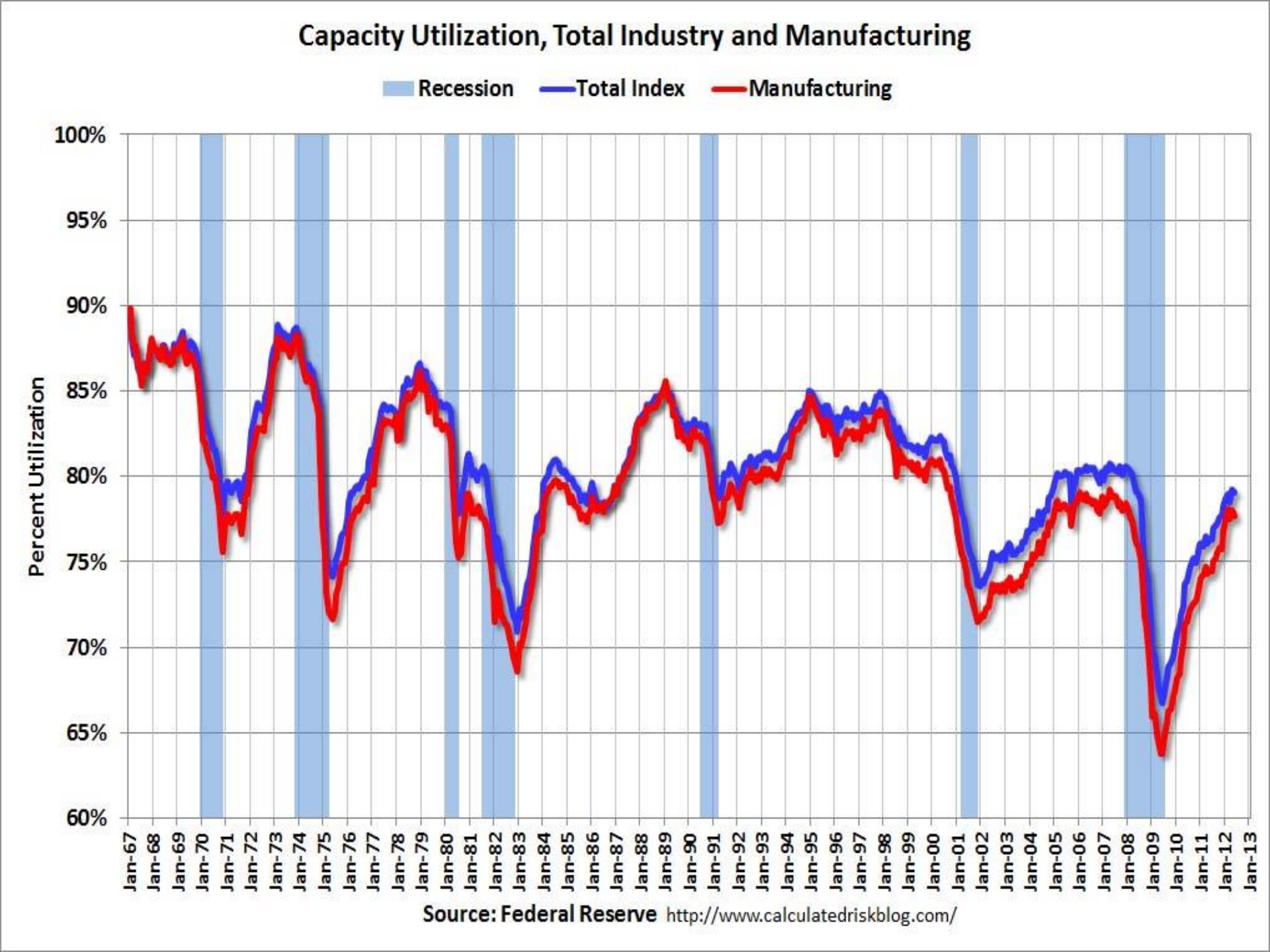
CHART 4: TREMENDOUS EXCESS CAPACITY IN THE U.S. ECONOMY

United States: Real GDP and Real Potential GDP

($ billion, 2005)



Gluskin Sheff + Associates


Capacity Utilization, Total Industry and Manufacturing
Recession
Total Index
Manufacturing
Percent Utilization
100%
95%
90%
85%
80%
75%
70%
65%
60%
Jan-67
Jan-68
Jan-69
Jan-70
Jan-71
Jan-72
Jan-73
Jan-74
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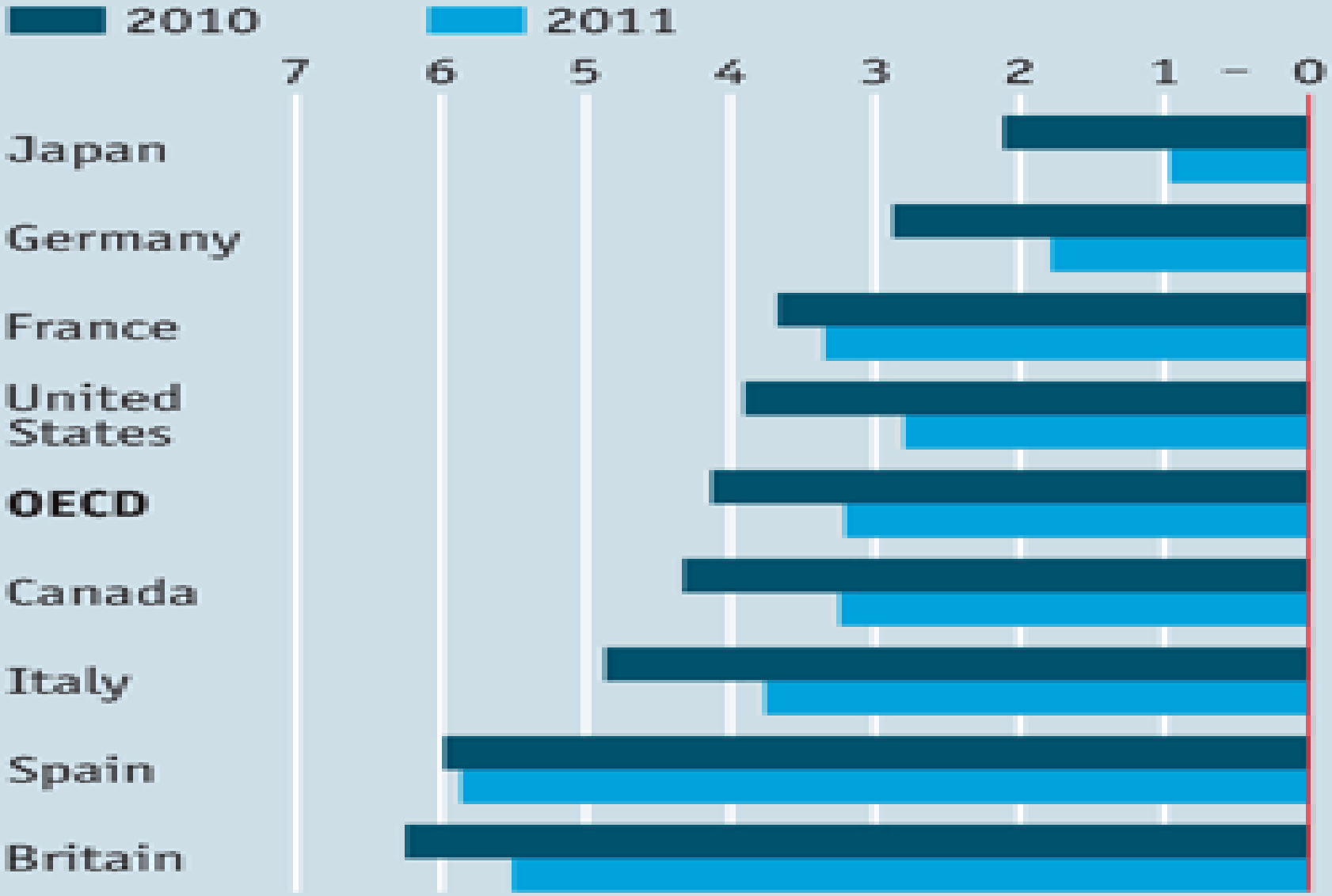
Jan-13
Source: Federal Reserve http://www.calculatedriskblog.com/

Yawning

Output gap* as % of potential GDP, forecast



Source: OECD

*Difference between actual and potential GDP

WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND "TAPERING"

The fundamental equation of monetary economics

M * V = P * Y, where:

M = Monetary base

V = Velocity of money

P = Price level

Y = Real output of good and services

Summary:

V is DECREASING.

Y is BELOW CAPACITY.

Where is the inflationary threat from M?

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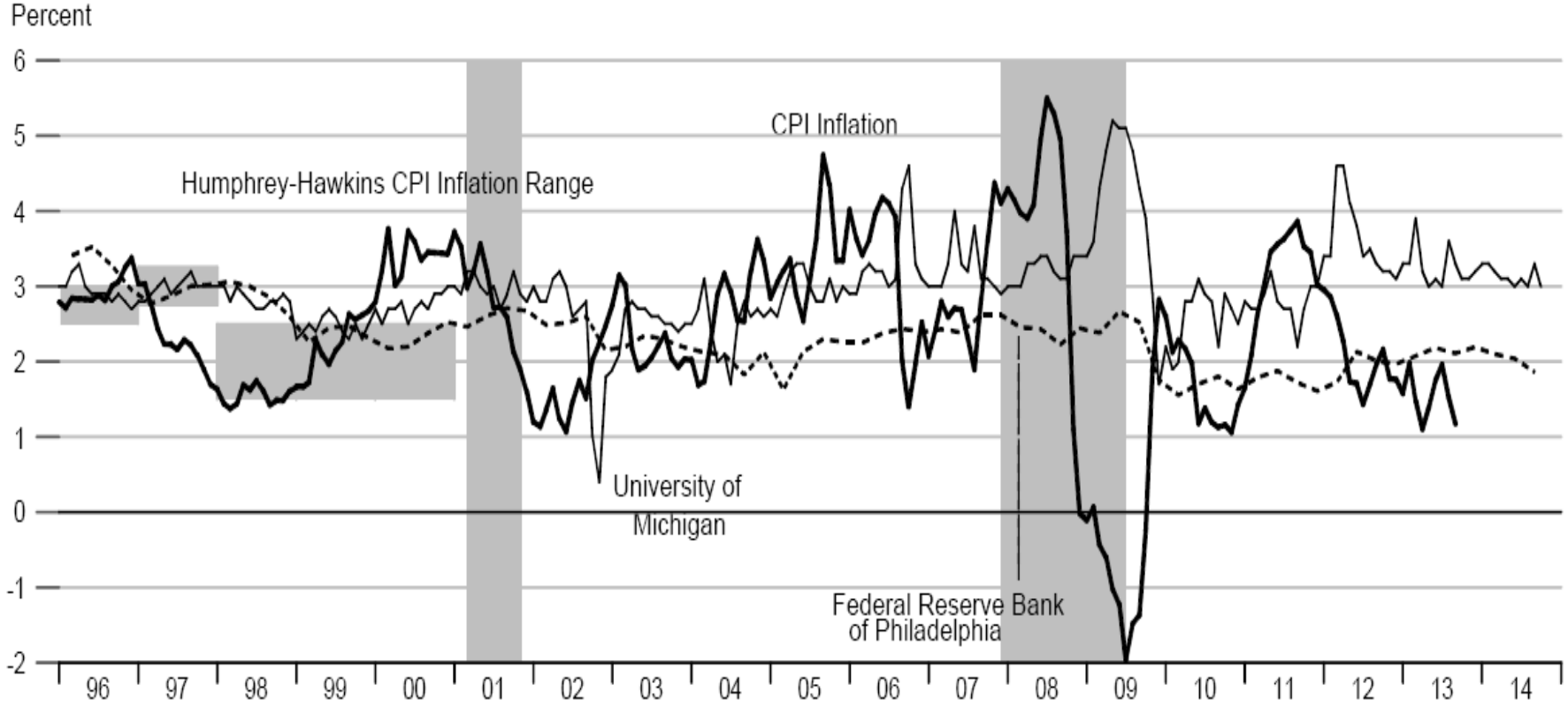
CPI Inflation and 1-Year-Ahead CPI Inflation Expectations



The shaded region shows the Humphrey-Hawkins CPI inflation range. Beginning in January 2000,the Humphrey-Hawkins inflation range was reported using the PCE price index and therefore is not shown on this graph.

OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

- This is not your father's recession – income growth will remain slow
- Employment growth is will remain slow
- We remain focused on the wrong issue (inflation being right around the corner)
- This is a global phenomenon

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OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments

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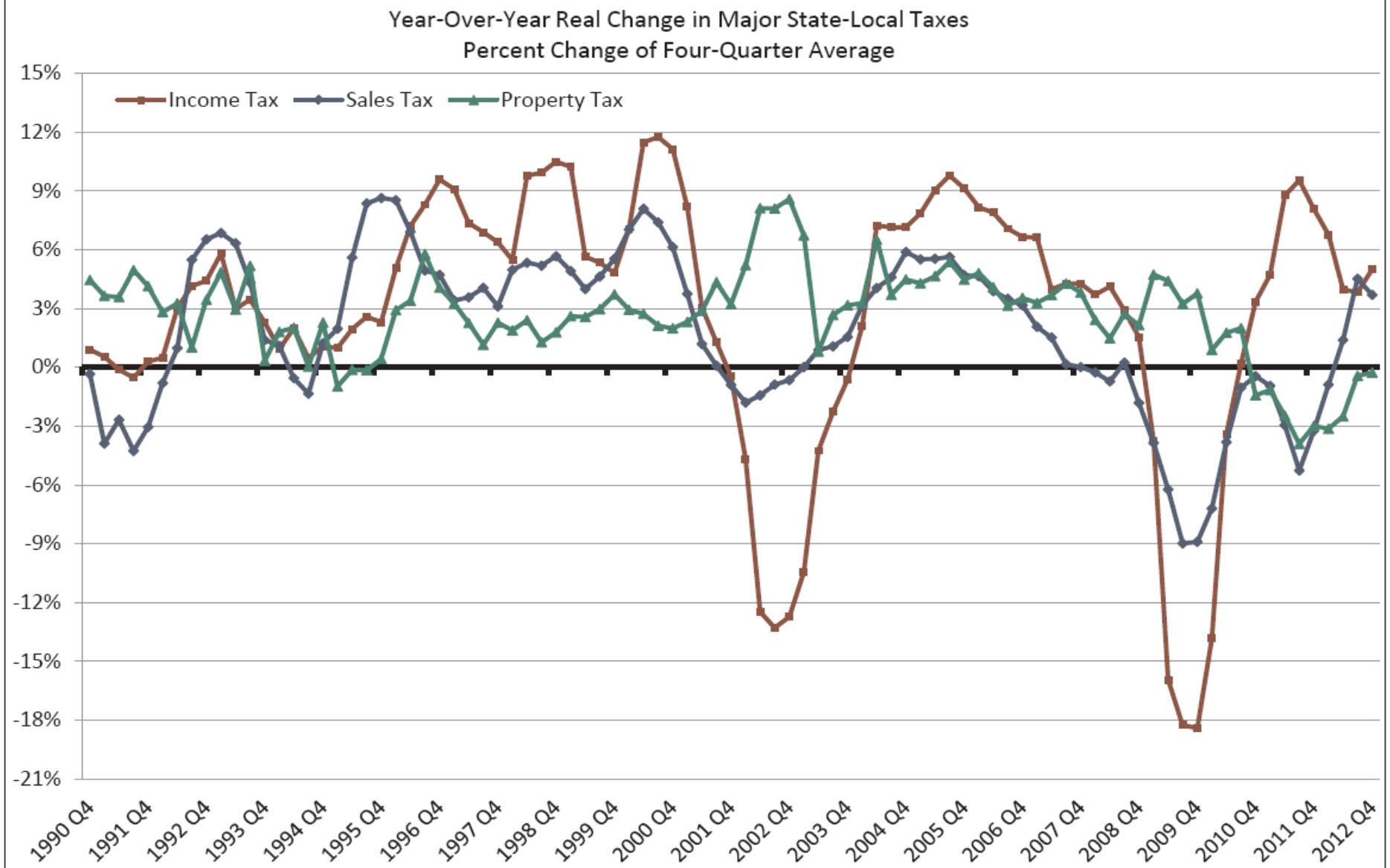
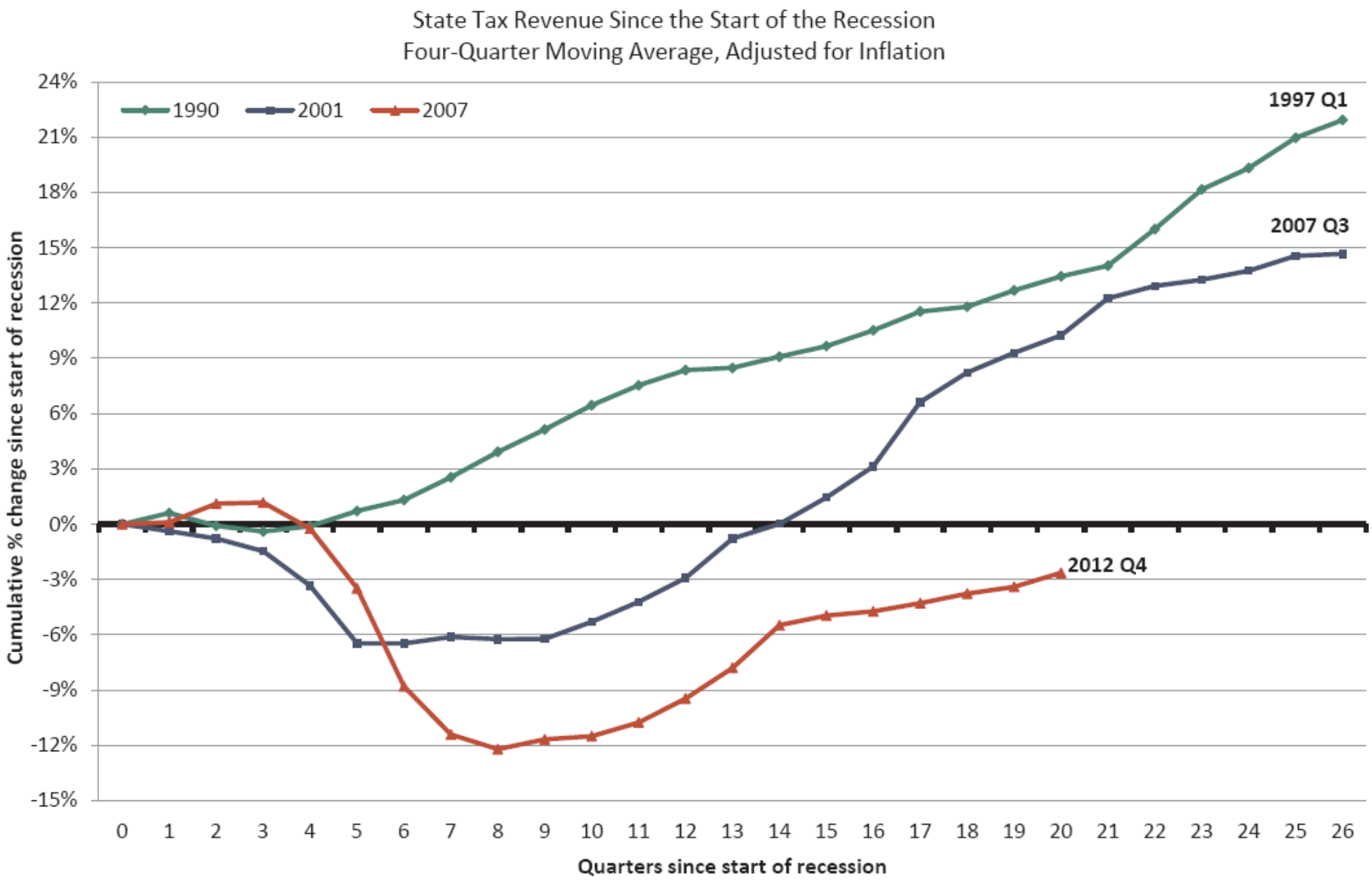
Figure 3. Continued Growth In Personal Income and Sales Tax Collections



Sources: U.S. Census Bureau , Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).

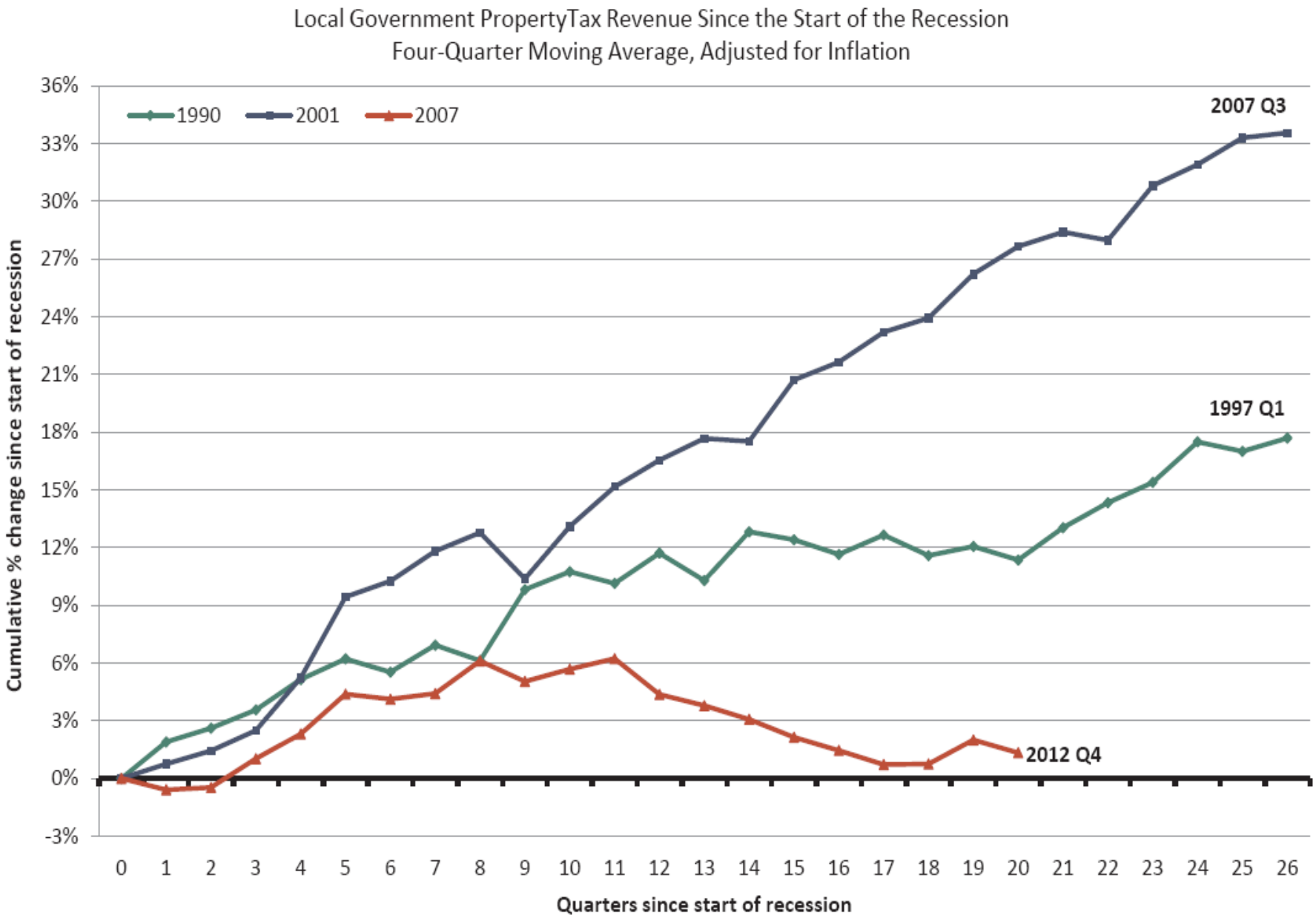
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

Figure 9. State Tax Revenue Recovery Is Weak and Slow



Sources: U.S. Census Bureau , Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).
Notes: (1) 4-quarter average of inflation-adjusted tax revenue; (2) No adjustments for legislative changes.

Figure 13. Local Government Property Tax Revenues Are Weak Compared to Past Two Recoveries



Sources: U.S. Census Bureau , Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).

OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments

- Once again, this is not your father's recession – state and local tax revenue growth will remain slow

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OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments

Outlook for health care and economic development

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HEALTH CARE AND STATE/LOCAL ECONOMIC DEVELOPMENT

Health care will become a source of competitive advantage among states just as much as taxes, utility costs, work force quality, etc.

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Employment Size of Firms

Table 2a. Employment Size of Employer and Nonemployer Firms, 2008

Introductory text includes scope and methodology. These data are also available by industry and state. Table includes both establishments with payroll and nonemployers. For descriptions of column headings and rows (industries), click on the appropriate underlined element in the table.

Employment size of enterprise	Firms	Establishments	Paid employees	Annual payroll ($1,000)	Sales or Receipts ($1,000)
All firms	**27,281,452**	**28,952,489**	**120,903,551**	**5,130,509,178**	**n/a**
Nonemployer firms	21,351,320	21,351,320	n/a	n/a	962,791,527
Employer firms	**5,930,132**	**7,601,169**	**120,903,551**	**5,130,509,178**	**n/a**
Firms with 1 to 4 employees (or with no employees as of Mar 12)	3,617,764	3,624,614	6,086,291	232,062,907	n/a
Firms with 5 to 9 employees	1,044,065	1,056,947	6,878,051	222,504,912	n/a
Firms with 10 to 19 employees	633,141	667,463	8,497,391	293,534,352	n/a
Firms with 20 to 99 employees	526,307	705,430	20,684,691	774,589,335	n/a
Firms with 100 to 499 employees	90,386	359,902	17,547,567	706,476,693	n/a
Firms with 500 employees or more	18,469	1,186,813	61,209,560	2,901,340,979	n/a
Firms with 500 to 749 employees	6,060	72,676	3,681,760	156,491,764	n/a
Firms with 750 to 999 employees	3,038	48,005	2,617,087	114,635,897	n/a
Firms with 1,000 to 1,499 employees	3,044	64,556	3,720,654	167,658,791	n/a
Firms with 1,500 to 1,999 employees	1,533	45,062	2,653,392	121,800,728	n/a
Firms with 2,000 to 2,499 employees	904	36,081	2,011,244	94,406,916	n/a
Firms with 2,500 to 4,999 employees	1,934	120,416	6,726,611	329,188,349	n/a
Firms with 5,000 employees or more	1,956	800,017	39,798,812	1,917,158,534	n/a
Firms with 5,000 to 9,999 employees	975	121,835	6,773,466	337,598,036	n/a
Firms with 10,000 employees or more	981	678,182	33,025,346	1,579,560,498	n/a

n/a - Receipts data are available for employers only for the years for which an economic census is taken (2007, 2002, 1997).

Exhibit 2.2

Percentage of Firms Offering Health Benefits, by Firm Size, 1999-2013

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
FIRM SIZE															
3-9 Workers	55%	57%	58%	58%	55%	52%	47%	49%	45%	50%	47%	59%*	48%*	50%	45%
10-24 Workers	74	80	77	70*	76	74	72	73	76	78	72	76	71	73	68
25-49 Workers	88	91	90	87	84	87	87	87	83	90*	87	92	85*	87	85
50-199 Workers	97	97	96	95	95	92	93	92	94	94	95	95	93	94	91
All Small Firms (3-199 Workers)	**65%**	**68%**	**67%**	**65%**	**65%**	**62%**	**59%**	**60%**	**59%**	**62%**	**59%**	**68%***	**59%***	**61%**	**57%**
All Large Firms (200 or More Workers)	**99%**	**99%**	**99%**	**98%**	**97%**	**98%**	**97%**	**98%**	**99%**	**99%**	**98%**	**99%**	**99%**	**98%**	**99%**
ALL FIRMS	**66%**	**68%**	**68%**	**66%**	**66%**	**63%**	**60%**	**61%**	**59%**	**63%**	**59%**	**69%***	**60%***	**61%**	**57%**

* Estimate is statistically different from estimate for the previous year shown ($p<.05$).

Note: As noted in the Survey Design and Methods section, estimates presented in this exhibit are based on the sample of both firms that completed the entire survey and those that answered just one question about whether they offer health benefits.

This story is part of
AFFORDABLE CARE ACT

Obama to launch new health care law campaign

Obamacare isn't perfect, but it's a decent fix: Column

Two states, different experiences under health care law

Adjoining states face differences with health care law

Donovan Slack, Gannett Washington Bureau *5:44 a.m. EST November 10, 2013*

Minnesota has signed up far more people at lower rates on its state-run health insurance exchange than neighboring Wisconsin, which has struggled with the troubled federal government site.

(Photo: screen grab)

WASHINGTON -- When Joe Atkins hunkered down to draft legislation outlining how Minnesota would implement the Affordable Care Act, he had no idea the results would be so dramatic.

The Gopher State is now enrolling individuals through its health-insurance exchange by the thousands and at premium rates that are among the lowest in the country.

STORY HIGHLIGHTS

- Minnesota, Wisconsin have vastly difference experiences with Affordable

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Health

9:29 AM THU NOVEMBER 21, 2013

Will Work For Health Insurance: The 'Job Lock' Conundrum

By TODD BOOKMAN

Richard Polonsky is an organizational consultant, and can, if prompted, easily talk like one.

Listen 3:52

"Being an outsider to an organization, I think people tend to listen to you more than when you are part of the organizational structure," says Polonsky.

Based in Bedford, he has spent a career advising companies and non-profits on

Credit Todd Bookman / NHPR Enlarge image

Richard Polonsky, with his dog Bella, at home in Bedford.

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HEALTH CARE AND STATE/LOCAL ECONOMIC DEVELOPMENT

Provisions of the ACA that will affect the economic development issue among states

- **Small Business Options Program (SHOP)**
  - Employers with less than 50 employees can purchase group insurance on the Health Insurance Marketplace in 2014
  - SHOP open to employers with less than 100 employees in 2016
  - States' option to open SHOP for all employers after 2016
- **2017: States have option of multistate compacts**

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ECONOMIC OUTLOOK FOR 2014 AND BEYOND: SOME CONCLUSIONS

Slow economic growth is likely to continue and exacerbate federal, state and local government budget issues

Tax revenue growth at state and local levels is likely to continue to be limited

The health care issue will continue to affect state and local governments as employers and as competitors in the economic development game

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