ECONOMIC CONDITIONS AND OUTLOOK

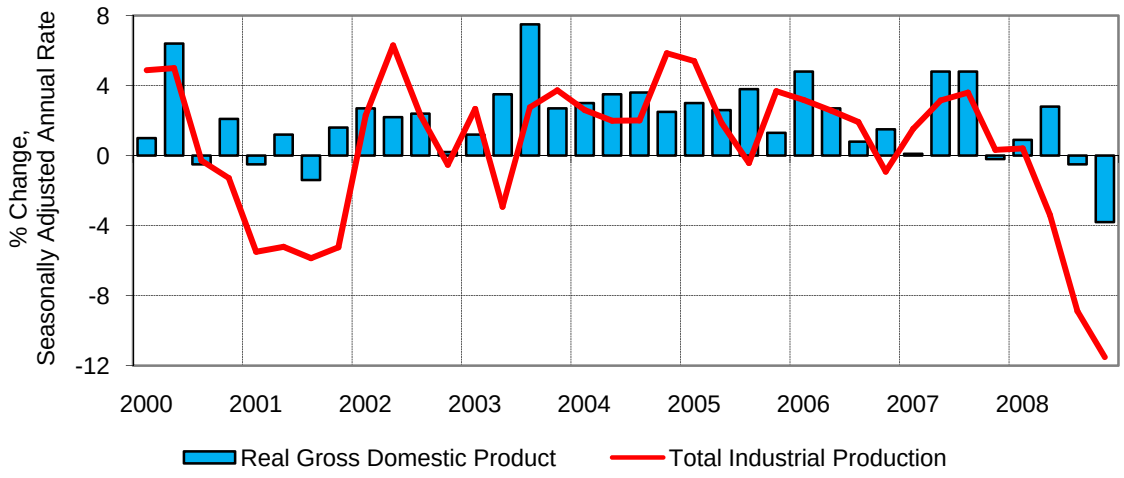
State of the Economy

The nation's economy has been in recession since December 2007, ending an expansion that lasted six years following the previous recession in 2001. The downturn in the economy steepened in last year's second half. The current recession will be long and now appears likely to be deep compared with other post-World War II downturns. Ohio's economy has also weakened, following a recovery earlier in the current decade that was anemic compared with much of the rest of the country.

National

The recession is in part a consequence of the ongoing correction in housing markets, where low interest rates and easy credit availability for years following the 2001 recession drove home prices up to unsustainable levels. Many loans were packaged and sold to investors, whose net worth was subsequently eroded by deflation of the housing bubble and resulting rising numbers of nonperforming loans. The demise of high-profile financial institutions, most notably Lehman Brothers in September, brought credit markets to a virtual standstill. The two large investment banks remaining of the five in existence at the beginning of last year were converted to commercial bank holding companies. Uncertainty regarding the values of nonperforming and underperforming financial assets on others' balance sheets, and consequently of the survival prospects of prospective counterparties, made banks and other financial institutions reluctant to enter into financial transactions with one another. In this environment, the high value placed on cash in hand, coupled with rising uncertainty about borrowers' prospects, led to toughened standards for lending to businesses and consumers. Though financial market conditions have improved somewhat, credit for consumers and businesses remains constrained. These exceptional circumstances in financial markets, added to an ongoing downturn in real economic activity, in the United States and in many foreign countries, have resulted in a recession expected to be especially severe as compared with post-World War II business cycles.

Chart 1: United States Output Measures



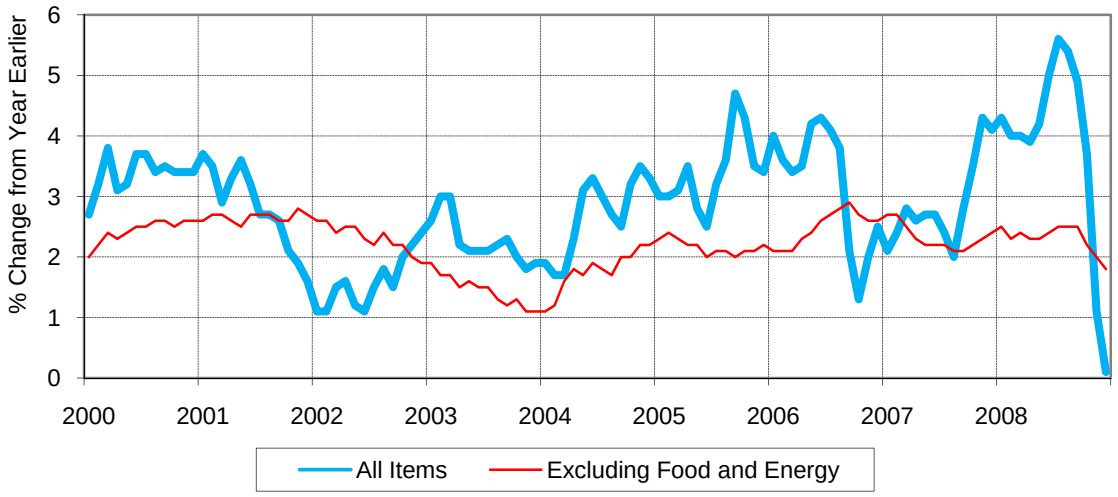
The federal government, along with numerous other governments around the world, responded to the widening financial crisis and economic downturn with programs aimed at supporting financial markets and household and business spending. Tax rebates to individuals last year, most of which were disbursed in the second quarter, may have helped to support consumer spending at a stronger pace than if there had been no rebates. Inflation-adjusted consumer spending nevertheless slowed decisively in the second half of the year. As financial market conditions deteriorated in September and the fourth quarter, the U.S. Treasury used half of the $700 billion Troubled Asset Relief Program (TARP) funds to recapitalize banks and, later, to support General Motors and Chrysler. Another huge federal fiscal stimulus program proposed by the new administration is now being legislated. The Federal Reserve, through various programs, injected massive amounts of funding into capital markets, lowered its short-term interest rate target to a range of zero to 0.25%, purchased large amounts of securities in support of housing markets, initiated programs to support other extensions of credit to households and businesses, and may begin injecting additional money into credit markets through purchases of longer term U.S. Treasury securities.

Though the economic peak that marks the onset of the current recession was in the fourth quarter of 2007, inflation-adjusted (real) gross domestic product (GDP) is currently estimated to have risen in the first half of 2008 before declining in the second half of the year. Consumer spending fell throughout the second half of 2008, residential fixed investment dropped for the twelfth consecutive quarter, and business fixed investment slowed in the third quarter and plunged in the fourth quarter. Inventories accumulated in the fourth quarter, adjusted for inflation, an indication that further downward adjustments in production are likely as businesses struggle to bring their inventories into alignment with reduced sales. Exports of American goods and services fell sharply in the fourth quarter after growing every quarter since 2003. Imports fell for the fifth consecutive quarter. Government spending continued to grow through year-

end, though the fourth quarter increase was more than accounted for by higher federal outlays, as state and local government spending fell slightly.

As economic activity in developed economies around the world turned down, and as growth of less developed economies slowed, demand pressures on resources eased and prices of many commodities fell. Crude oil prices fell by more than two-thirds from peaks last summer. Other commodity prices also declined. Retail gasoline prices dropped by more than half. Weakening demand for other finished goods and services virtually eliminated inflationary pressures, and raised concerns about deflation, in which consumers and businesses anticipate lower prices in the future and so defer spending hoping to buy later at those lower prices. Such deferred spending by large numbers of people would further erode demand.

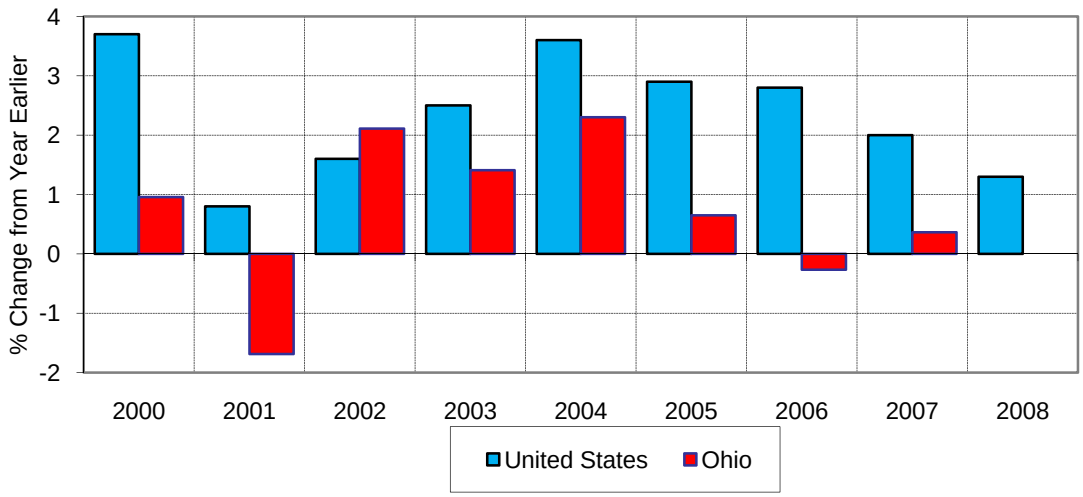
Chart 2: Consumer Price Index



Ohio

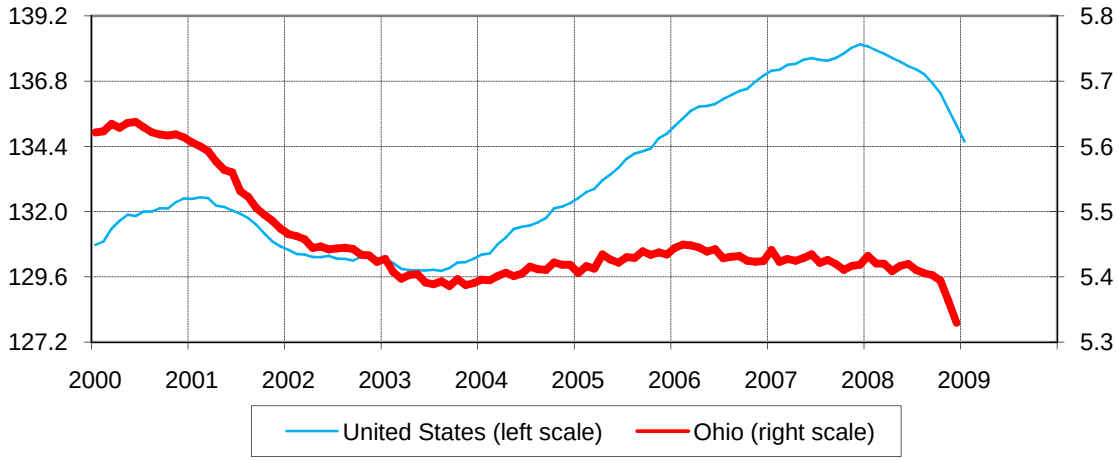
Inflation-adjusted (real) gross domestic product is the broadest measure of statewide economic activity. GDP has risen more slowly in Ohio than nationwide every year since 1998, with the exception of 2002. The state's share of national output has trended lower since the 1960s.[1]

Chart 3: Real Gross Domestic Product



Nonfarm payroll employment in Ohio and the nation fell sharply in late 2008. The decline continued for the nation in early 2009. In the year to December, employment in Ohio declined 89,000 (1.6%). Nationwide, employment dropped by

Chart 4: Total Nonfarm Payroll Employment
Millions, Seasonally Adjusted

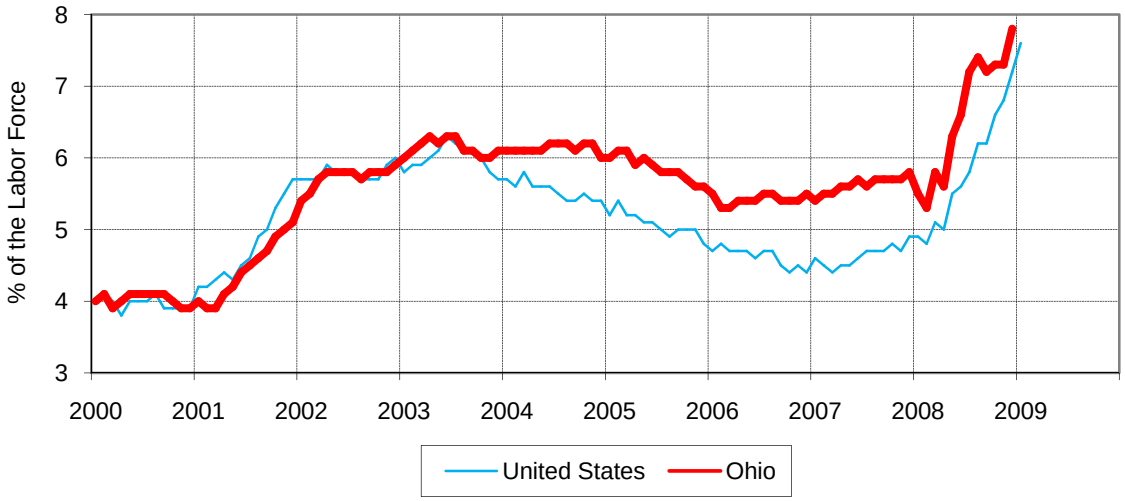


[1] Estimates of state gross domestic product are available from the U.S. Bureau of Economic Analysis only annually and with a long lag; the most recent history currently available from the source agency is for 2007.

3.0 million (2.2%) during 2008, and fell 0.6 million in January 2009. Following the 2001 recession, nonfarm payroll employment in both the state and the nation continued to decline until 2003. Total payroll employment nationwide then rose 6.4% from the 2003 low, peaking in December 2007. Total payroll employment in Ohio climbed much less, rising only 1.2% from the 2003 low, to a peak in February 2006, and has been trending lower ever since.

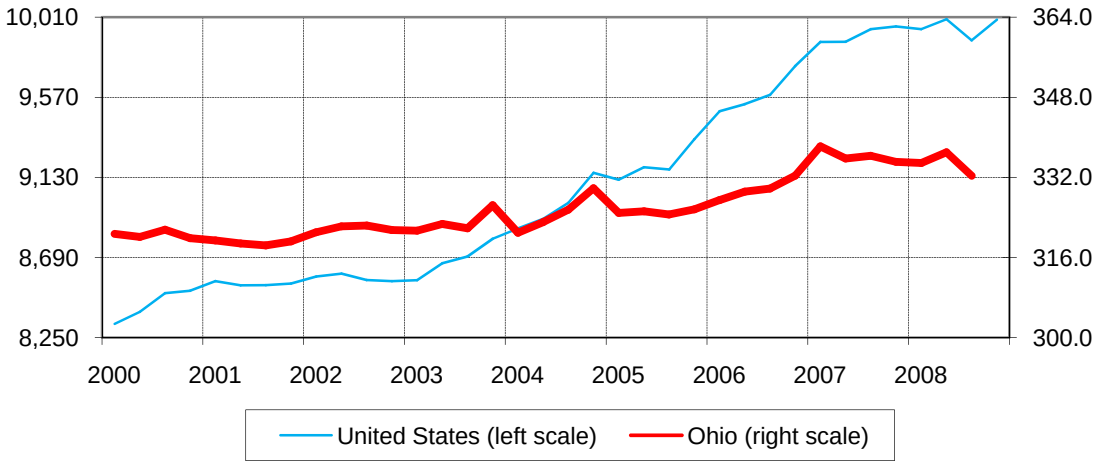
Unemployment as a percent of the labor force, in the nation and in Ohio, has climbed sharply as the recession worsened. Ohio's unemployment rate has been above that for the United States since 2003. The nation's unemployment rate rose in January to 7.6%, up from a low of 4.4% in late 2006 and early 2007. Ohio's unemployment rate climbed to 7.8% in December, up from a low of 5.3% in early 2006 and in February 2008.

Chart 5: Unemployment Rate



Personal income, adjusted to exclude increases that just offset inflation, has flattened in the nation and declined in Ohio, after increases earlier in the current decade. Growth of personal income in Ohio, for which data are available only through last year's third quarter, has trailed that of the nation for many years. Personal income rose briefly in last year's second quarter reflecting part of the money distributed under the federal fiscal stimulus program. Inflation-adjusted personal income in Ohio fell in the third quarter of 2008 to 1.7% below the peak in the first quarter of 2007. Nationwide, inflation-adjusted personal income rose in last year's fourth quarter as lower prices more than offset a fall in the income's dollar value.

Chart 6: Personal Income
Billions of 2000 Dollars



Housing permits data clearly show the precipitous decline in residential building. Construction activity nationwide has been falling since 2005. In Ohio, residential building barely recovered early in the current decade before turning down in 2004 through 2008. Housing prices have fallen throughout Ohio during the past year and in a majority of local markets around the country, and have plunged in numerous metropolitan areas in California, Florida, Nevada, and Arizona.

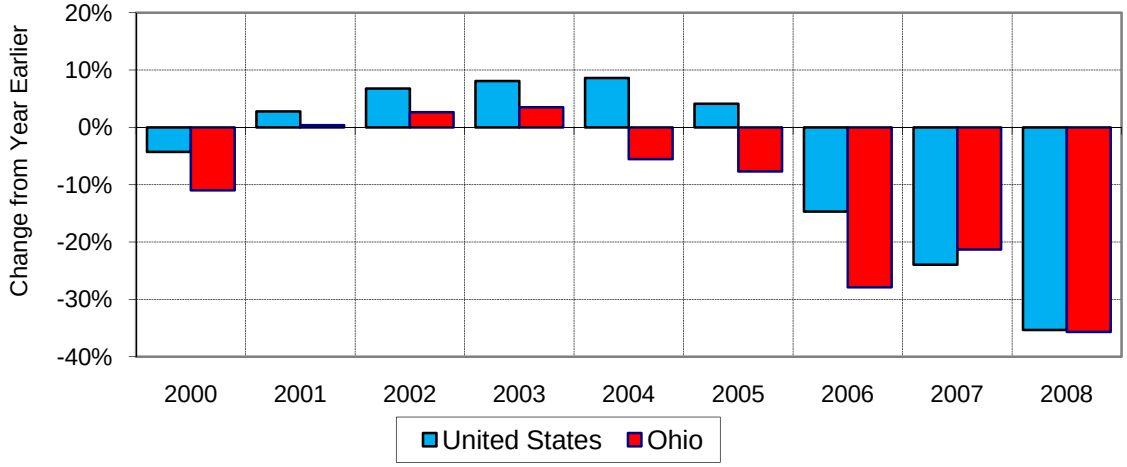



Chart 7: New Privately Owned Housing Units Authorized by Building Permits