Economic Bulletin

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GOOD news

The **Michigan unemployment rate** in December remained unchanged from November's rate of 4.0 percent, placing the rate for all of 1997 at just 4.1 percent. The 1997 rate is the lowest jobless rate since 1966 and marks the fourth consecutive year the state's rate has been below that of the United States. The state also enjoyed a record number of jobs in 1997—the annual average employment was 4,677,000 jobs, up 2.2 percent from 4,572,000 in 1996.

◆ The **consumer price index**, the nation's primary measure of inflation, rose just 0.1 percent in December. For all of 1997, the inflation rate was just 1.7 percent, about half of 1996's 3.3 percent increase and the smallest rate since 1986. The core index—which excludes volatile food and energy prices—rose only 2.2 percent in 1997 following a 2.6 percent rise in 1996. While rock-bottom inflation means that consumers need to dole out less for purchases, it also means that cost-of-living adjustments for Social Security checks, salaries, and income-tax brackets will be lower than in previous years.

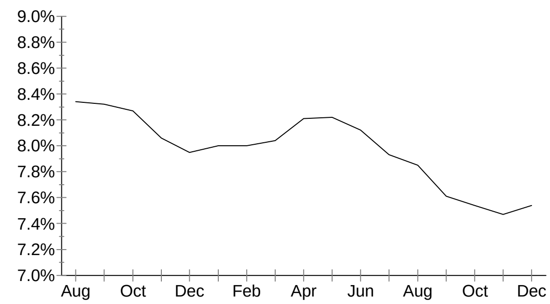
◆ The **U.S. unemployment rate** remained at 4.7 percent in January. Payrolls increased by a robust 358,000 jobs, following sharp gains in November and December. Payroll gains in manufacturing and construction were especially strong, increasing by 43,000 and 92,000 jobs, respectively. Jobs in the services sector (including retail trade and government) increased by 223,000.

BAD news

Sales of existing homes fell in December but hit a record-setting level for the year. December's seasonally adjusted annual home resale rate fell 2.1 percent to 4.29 million units from 4.38 million units in November. But the 1997 rate of 4.21 million units, which was 3.2 percent above the record 1996 rate of 4.08 million, was the highest rate since home resales were first tracked in 1968. The stellar 1997 performance is credited to a strong economy and low mortgage rates.

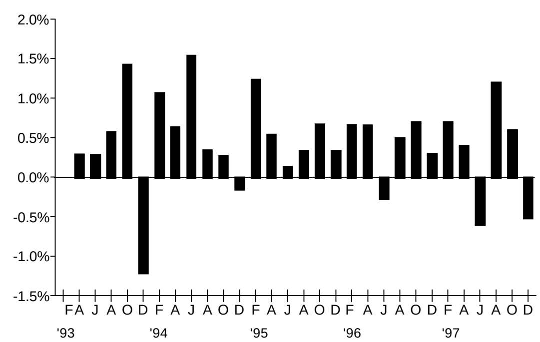
◆ Light **motor vehicle sales** in January fell 6.6 percent below the year-ago level. Car sales plunged 13.7 percent while light truck sales rose 2.4 percent. Sales for the Big Three were down 6 percent while sales of Japanese models dropped 14.5 percent. The decline is not as bad as it appears as sales were strong last January. On a seasonally-adjusted annual basis, sales were a solid 15.2 million units, about even with sales for all of 1997.

New Home Mortgage Rates, August 1996–December 1997
(Effective Rate)



SOURCE: Federal Housing Finance Board.

Detroit-Ann Arbor CPI, Percentage Change from Two-Month-Ago Period



SOURCE: Bureau of Labor Statistices.

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MONTHLY . . . . FOCUS

STATES' ECONOMIC GROWTH LINKED TO GOVERNMENT EMPLOYMENT

The Center for the Study of the States recently released a report on the growth of state and local government employment nationwide.[1] It found that this growth is strongly associated with the growth of a state's economy.

The study compared total employment growth (a proxy for economic growth) with state and local government employment growth. (See exhibit.) For all states, total employment increased 9.1 percent between 1990 and 1996, and state and local government employment increased at about the same rate—9.2 percent. Southern and western states, which enjoyed some of the nation's strongest economic growth, also experienced the highest growth in state and local employment. Interestingly, the results also show that Michigan government employment increased in the 1990s but at a much slower rate than total employment, 2.5 percent compared to 9.5 percent.[2]

[1] Samuel M. Ehrenhalt, *The New Geography of Government Jobs: Hiring in State and Local Government Shifts to South and West, and to Medium and Small States*, Center for the Study of the States, Nelson A. Rockefeller Institute of Government (Albany, NY), December 1997.

[2] These figures were compiled before the state's recent early retirement program went into effect.

Change in Total Employment and State and Local Government Employment, 1990–96

	Change in Total Employment (%)	Change in State/Local Employment (%)
U.S.	9.1	9.2
Alabama	11.5	10.0
Alaska	10.5	6.7
Arizona	27.8	30.1
Arkansas	17.6	15.8
California	2.2	6.2
Colorado	24.7	15.5
Connecticut	–2.5	8.7
Delaware	8.4	12.0
Florida	14.8	12.3
Georgia	17.9	10.9
Hawaii	0.2	10.2
Idaho	27.9	24.2
Illinois	7.3	8.6
Indiana	11.5	6.5
Iowa	12.6	6.4
Kansas	12.8	12.3
Kentucky	13.6	17.0
Louisiana	13.9	13.0
Maine	1.0	4.0
Maryland	1.6	3.9
Massachusetts	1.7	1.7
MICHIGAN	**9.5**	**2.5**
Minnesota	14.3	14.3
Mississippi	16.4	9.4
Missouri	9.3	13.9
Montana	20.8	11.3
Nebraska	14.3	8.1
Nevada	35.7	38.5
New Hampshire	10.2	10.6
New Jersey	0.1	1.2
New Mexico	19.6	19.7
New York	–3.6	–5.2
North Carolina	14.0	15.1
North Dakota	16.2	12.4
Ohio	8.5	6.4
Oklahoma	13.2	7.9
Oregon	18.3	14.1
Pennsylvania	2.7	5.7
Rhode Island	–2.1	–1.2
South Carolina	8.5	12.0
South Dakota	20.9	16.2
Tennessee	15.6	14.3
Texas	16.2	19.8
Utah	31.9	22.8
Vermont	6.7	5.6
Virginia	8.1	8.1
Washington	12.5	17.9
West Virginia	10.8	8.0
Wisconsin	13.5	13.1
Wyoming	11.5	7.8
TOTAL	9.1	9.2

SOURCE: Center for the Study of the States.

NEWS FROM THE STATE CAPITOL

ENGLER ANNOUNCES ROAD REPAIRS

Governor Engler announced a $1 billion road and bridge program, about double the amount earmarked for repairs during the last fiscal year. More than 80 percent of the money will be used for road and bridge repairs rather than new projects, and the program will make improvements to about 1,600 miles of highway and 250 bridges. Additional miles of improvements will be added to the program when projects funded by economic development grants and safety programs are announced.

The governor said the plan focuses on fixing the worst roads first and will increase the likelihood that 90 percent of the miles of Michigan roads will be rated good or fair by 2000. The four-cent per gallon gas tax increase that took effect last year was a key factor in the state's ability to make the repairs.

ROAD PRIVATIZATION HAS NOT PAID OFF

The Senate Fiscal Agency released a report concluding that privatizing road maintenance has not yet saved the state money. (See *Publications of Interest* below.) The report compared the costs of highway maintenance provided by the Michigan Department of Transportation (MDOT), county road commissions, and ABC Paving Company, which has maintained roads in the Lansing area since 1994. It concludes that many county road commissions provide highway maintenance at a lower cost than both MDOT and ABC Paving. The study found that the work of ABC Paving, which started partially as an experiment in privatization, cost nearly twice as much per mile as that of MDOT or county road commissions. The report, which had been requested by gubernatorial candidate Larry Owen, cautions that comparisons of road maintenance are difficult due to problems with the data.

STATE CLOSES YEAR WITH SURPLUS

The state closed its FY 1996–97 year with a general fund surplus of $85.2 million and a School Aid Fund surplus of $193 million. The surplus funds will be used to meet FY 1997–98 spending demands. Also, the Budget Stabilization Fund ("rainy day" fund) totaled $1.1 billion at year's end, although $566.7 million of that will be used to pay the Durant case settlement.

STATE BOND RATING IMPROVES

Standard & Poors raised the state's bond rating, which influences the interest rate for state borrowing, to AA+, the highest rating in nearly 20 years. The upgrade was due to settlement of the Durant case, employment gains, a high rainy day fund balance, and other factors.

INFORMATION OF INTEREST

Philip W. Alderfer, *The ABCs of Michigan Highways: The Privatization of Maintenance Contracting in the Department of Transportation*, Senate Fiscal Agency (Lansing, MI: SFA), January 1998. 517/373-2768.

This 12-page report examines the Michigan Department of Transportation's (MDOT) road maintenance privatization efforts and compares services provided privately with those provided by the state and county. It identifies the transportation districts in which road maintenance is provided privately ("contract counties") and discusses some of the difficulties in comparing road maintenance costs between districts. The report also provides background information about the state's contract with ABC Paving Company, which maintains 20 miles of roads in the greater Lansing area. It compares the cost per mile of maintenance among contract counties, MDOT, and county road commissions.

Bureau of the Census, *Statistical Abstract of the United States, 1997* (Washington, D.C.: GPO), 1996. 202/512-1800 or http://www.census.gov/stat_abstract/

This 1,000+-page annual publication is one of the most comprehensive government sources of U.S. data available. It covers population, education, health, vital statistics, law enforcement, income, employment, government finances, business conditions, American lifestyles, and other subjects. The 1997 edition includes 97 new tables covering such topics as hate crimes, pet ownership, and consumer finance. The *Abstract* also is available on CD and on-line.

PUBLIC SECTOR CONSULTANTS

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February 1998

MICHIGAN ECONOMIC FORECAST

INTRODUCTION

The economic good times continue in Michigan and nationwide. The U.S. economy shows no signs of significant weakening—consumer confidence remains high, solid employment growth continues, and fourth quarter gross domestic product was stronger than expected. Michigan continues to share in the good economic times—in 1997 the state enjoyed its lowest unemployment rate since 1966.

HIGHLIGHTS

- $ The current economic expansion has reached 84 months, and there are no indications of an end to the third longest expansion since World War II.
- $ The U.S. economy enjoyed a 4.3 percent growth rate in the fourth quarter of 1997, up from the third quarter's solid 3.3 percent growth.
- $ The Michigan and U.S. labor markets continue to exhibit low unemployment and strong job growth.
- $ Light motor vehicle sales rebounded in the last six months of 1997.
- $ Consumer prices remain well under control—the 1997 inflation rate was just 1.7 percent.
- $ The Asian crisis will slow economic growth in Michigan and the U.S., but the current economic expansion should continue well into 1998.

GROSS DOMESTIC PRODUCT

Gross domestic product (GDP), the primary measure of national economic growth, increased at a 4.3 percent annual rate in the fourth quarter of 1997, following a 3.3 percent increase in the third quarter. For the year, GDP growth was 3.8 percent, the strongest national growth rate since 1988, when the Federal Reserve deliberately stimulated growth to offset the 1987 stock market crash.

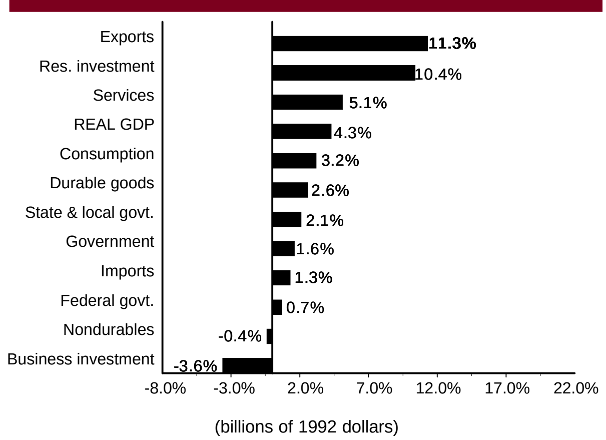
Growth increased in the fourth quarter primarily due to an acceleration in the service sector, which enjoyed a 5.1 percent increase, following a 3.9 percent increase in each of the previous four quarters. (See Exhibit 1.) The largest gain in percentage terms was in exports, which skyrocketed 11.3 percent, offsetting a 1.3 percent increase in imports. This marked a reversal from the previous quarter, when imports rose 14.6 percent while exports inched up only 4.4 percent. Residential investment also contributed to the increasing clip of fourth-quarter GDP growth, rising 10.4 percent in the fourth quarter after an increase of only 2.7 percent in the third quarter.

Outlook

Exports will no doubt cease to boost economic growth in the current quarter and for the next few quarters. The fiscal crisis in Asia will slow growth in U.S. exports—the falling value of Asian currencies will make American goods more expensive for consumers overseas and Asian goods cheaper for U.S. consumers. This will dampen the sales and production of automobiles and other American-made goods and cut one-half point or more off the growth of GDP. The Federal Reserve Board will continue to hold the line on interest rates, largely because inflation will remain moribund, and the Fed expects the Asian financial crisis to put downward pressure on the U.S. economy.

We expect continued economic expansion in the first quarter of 1998 and beyond but at a slower rate than in the fourth quarter of 1997. The U.S. unem-

EXHIBIT 1
Percentage Change in Selected Components of GDP, 1997iii to 1997 iv



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

ployment rate remains very low, consumer confidence continues high despite fears about the Asian economies, and the housing market remains strong, boosted by a good job market and falling mortgage rates. Despite these factors, the economic crises of our Asian trading partners will tap the brakes on U.S. economic growth. We predict GDP growth of between 2.5 percent and 2.8 percent for the first quarter of 1998 and a rate between 2.3 percent and 2.5 percent for 1998.

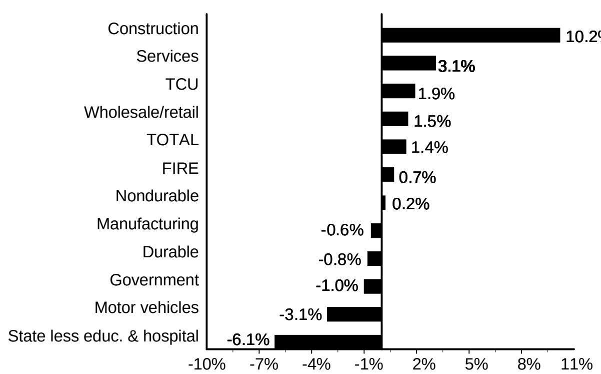
EMPLOYMENT AND INCOME

U.S. nonfarm payroll employment increased by 906,000 jobs in the fourth quarter of 1997, an annual rate of 3 percent, slightly above the growth rate of the last two quarters. The services sector led the way with an increase of 370,000 jobs. Manufacturing employment rose by 95,000 jobs, easily the largest gain of the year. For all of 1997, employment rose 2.3 percent compared with a 2 percent increase in 1996.

The **U.S. unemployment rate** averaged 4.7 percent (seasonally adjusted) in the second quarter of 1997, down from 4.9 percent in the third quarter. The unemployment rate remained at 4.9 percent in December. The rate for 1997 was 4.9 percent, down from 5.4 percent in 1996 and the lowest rate since 1973 (when the rate was also 4.9 percent).

Michigan wage and salary employment growth remained steady in the fourth quarter, increasing 1.4 percent above the year-ago quarter, up slightly from 1.3 percent in the third quarter. As shown in Exhibit 2, the strongest major sector in the fourth quarter, as in recent quarters, was construction, up 10.2 percent. Employment in the services sector increased 3.1 percent, aided by a 5.5 percent gain in the business services industry. Manufacturing employment declined 0.6 percent, with motor vehicle employment falling 3.1 percent from the year-ago quarter. State government employment, excluding education and hospitals, fell 6.1 percent from the year-ago quarter following a 7.5 percent decline in the second quarter due mainly to the state's early retirement program. Wage and salary employment increased only 1.5 percent in 1997 down slightly from 1.7 percent in 1996.

EXHIBIT 2
Michigan Wage and Salary Employment, 4th Quarter, 1997, % Change from Year-ago Quarter



SOURCE: Michigan Employment Security Agency.

The Michigan unemployment rate averaged 3.9 percent (seasonally adjusted) in the fourth quarter of 1997, up from a rate of 3.8 percent in the third quarter of 1997. For all of 1997 the unemployment rate was 4.1 percent (the lowest rate since the current method of estimation was started in 1970), down from 4.9 percent in 1996.

U.S. personal income increased at an annual rate of 6.3 percent in the fourth quarter of 1997, up from 4.6 percent in the third quarter. Detail is not available for the fourth quarter, but the strength is likely due to stronger growth in manufacturing income and continued strong growth in wages and salaries paid to workers in the services sector.

Michigan personal income growth increased at an annual rate of only 3.6 percent in the second quarter of 1997 (latest data available), down from a growth rate of 4.2 percent for all of 1996 (see Exhibit 3). Income growth was held back by manufacturing wages, which fell 2 percent (annual rate). Services wages continued strong, increasing at an annual rate of 6.5 percent. Personal income was down 4.2 percent from the second quarter of 1996, and wage and salary income was up 5 percent from the year-ago quarter, with only the services sectors recording an above-average gain.

Outlook

The economy shows no signs of significant weakening, with consumer confidence high, continued solid employment growth, and strong fourth quarter GDP growth. Motor vehicle sales have been weak but turned in the best performance of the year in December. The fiscal crisis in Asia will slow growth in U.S. exports and cut one-half point or more off the growth of GDP. The Federal Reserve Board continues to hold the line on interest rates, largely because inflation remains moribund; the consumer price index increased at an annual rate of only 1.7 percent for the twelve months ending December 1997. After debating rate increases in 1997, the focus is more likely to be on rate cuts in 1998. The current economic expansion has reached 84 months, and there are no indicators pointing to an end to the third longest expansion since World War II.

EXHIBIT 3
Michigan Personal Income, Selected Components, 1990–97ii (dollars in millions)

Year	Total Personal Income	Wages & Salaries	Manufacturing Wages	Services Wages	Transfer Payments	Dividends, Interest, & Rent
1990	$174,211	$102,788	$34,170	$21,339	$25,991	$31,640
1991	179,031	103,718	33,395	22,037	29,303	32,351
1992	188,535	110,181	35,164	24,155	30,912	32,016
1993	198,910	115,411	37,051	25,663	33,081	32,697
1994	214,473	124,950	41,753	27,503	33,575	35,862
1995	228,369	132,976	44,418	30,118	35,330	38,582
1996	238,032	139,438	45,326	32,417	37,139	39,899
1997ii	248,911	146,704	46,778	34,330	38,361	43,667
Percentage change 1996ii to 1997ii	4.2%	5.0%	2.8%	6.0%	4.0%	4.8%
Percentage change 1997i to 1997ii	3.6%	3.8%	-2.0%	6.5%	2.8%	4.5%

SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce; calculations by Public Sector Consultants, Inc.

U.S. payroll employment is expected to increase about 1.5–1.75 percent in 1998. The **U.S. unemployment** rate is expected to average 5.25 percent in 1998. **Michigan wage and salary employment** is expected to increase about 1.25 percent in 1998, down from 1.5 percent in 1997. The **Michigan unemployment** rate is expected to average 4.25 percent in 1998, up from the 1997 rate of 4.1 percent.

U.S. personal income increased 5.8 percent in 1997, about the same growth rate as in 1996. We are forecasting an increase of 5 percent in 1998. We predict **Michigan personal income** growth to be 4.5 percent to 5 percent in 1997 and in 1998.

MOTOR VEHICLE SALES AND PRODUCTION

Light motor vehicle sales continued to show improvement in the fourth quarter after a lackluster first two quarters. Fourth quarter sales increased 3 percent above the year-ago level following a 2 percent gain in the third quarter. **Truck sales** were up 4.9 percent in the fourth quarter while car sales increased 1.2 percent. The **Big Three** continued to lose market share in the fourth quarter, as Japanese models posted a sales gains of 4.2 percent compared with only a 1.1 percent increase for the Big Three.

Total **light vehicle sales** for 1997 were 15.16 million, up only 0.1 percent from 1996. **Truck sales** increased 3.9 percent, but passenger **car sales** were down 2.8 percent. Sales of Japanese models were up 3.9 percent while **Big Three** sales fell 1.5 percent. As a result, the Big Three market share fell from 72.9 percent in 1996 to 71.5 percent in 1997.

Fourth quarter **motor vehicle production** jumped 8.7 percent from the year-ago quarter as truck production surged 15.6 percent. For all of 1997 motor vehicle production was up 2.6 percent. Passenger car production dropped 2.4 percent, but truck production was up 8.1 percent.

Outlook

After a strong start in the first two months of 1997, **motor vehicle sales** weakened sharply through June but rebounded in the last six months of 1997, with December sales turning in the strongest performance of the year. A key factor in the earlier weakness is the large supply of late-model used cars, which depressed used car prices and provided an attractive alternative to a new-car purchase. In recent months, however, factory and dealer incentives, a decline in interest rates, increased consumer confidence (the highest since 1965 according to the University of Michigan Index of Consumer Sentiment), and the strong overall performance of the economy have boosted auto sales.

The **outlook for 1998** is for continued stability in motor vehicle sales, which have remained within 2 percent of 15 million units since 1994. Our projection is light motor vehicle sales of 15.4 million units, with truck sales at 7.1 million units and car sales at 8.3 million units. One concern for American manufacturers is that foreign manufacturers are beginning to make inroads in truck sales, which have largely been dominated by the Big Three. The Big Three share of truck sales slipped from 86.4 percent in 1996 to 84.8 percent in 1996 and is almost certain to fall more in 1998.

MONETARY AND FISCAL POLICY

The Federal Reserve Board has not raised **interest rates** since February 1997. Although the economy continues to expand, there has been no need for a rate hike, due to continued low inflation at both the consumer and producer levels. As a result, the **federal funds rate**, the rate at which banks lend to each other, remains at 5.5 percent. **Long-term rates** fell in the fourth quarter from the third quarter—Moody's Corporate Aaa bonds averaged 6.88 percent in the fourth quarter, down from 7.17 in the third quarter. December's **home mortgage rate** was one of the lowest rates of the 1990s, reaching 7.54 percent (effective rate on newly built homes). For the fourth quarter, mortgage rates reached a low 7.6 percent, down from 7.9 percent in the third quarter.

In late January, President Clinton delivered his **State of the Union** address, proposing several new initiatives. He urged Congress to place projected budget surpluses of $218.7 billion through 2003 into Social Security in order to head off projected shortfalls. He proposed spending $21.7 billion for child care programs, lowering the eligible age for Medicare to 55 from 65, spending $12.4 billion to help K–12 schools lower class size to an average of 18 students from 22 students, and other initiatives.

Outlook

We forecast that the Fed will not raise rates in the foreseeable future. Not only do all economic data indicate that it will not be necessary, but Federal Reserve Chairman Alan Greenspan is quoted as saying that the Asian crisis should help keep a lid on already-low inflation. Normally, such low unemployment as the nation is enjoying now would force the Fed to raise interest rates in order to slow the economy and head off inflation. All available signs, however, indicate that inflation will remain in check, avoiding the need for such a hike.

Although Clinton's popularity rose to its highest level ever after his State of the Union speech, that did not stop Republicans in Congress from voicing their objections. Members of the GOP have painted the President's proposals as "tax and spend" programs, saying that any budget surpluses should be returned to taxpayers rather than invested in Social Security. They also oppose his new child care, education, and other initiatives, preferring instead to keep the brakes on spending. These issues will be in the forefront of debate in coming months.

PRICES

The **U.S. CPI** rose at an annual rate of 1.6 percent in the fourth quarter, following a 1.6 percent increase in the third quarter. The fourth quarter's increase reflects surprisingly moderate inflation despite robust growth in the national economy. December's inflation figures, the most recent available, rose only 0.1 percent from the previous month. For all of 1997, the inflation rate was just 1.7 percent, about half of 1996's 3.3 percent increase and the smallest inflation rate since 1986. The core index—which excludes volatile food and energy prices—rose only 2.2 percent in 1997 following a 2.6 percent rise in 1996.

Inflation remained moderate in Michigan as well. The December **Detroit-Ann Arbor CP**I (produced bimonthly and latest data available) fell 0.5 percent from October's level and rose just 1.8 percent over the previous year's level. This followed a 2.7 percent increase in October 1997 over the year-ago rate.

Raising economists' eyebrows nationwide, **wholesale prices** fell 1.2 percent in 1997, the sharpest drop since 1986 when they were depressed by collapsing oil prices. The decline was not due to oil prices, however, but was economy wide—after adjusting for the volatile food and energy sectors, prices crept up just 0.1 percent last year. This means that producers experienced the lowest inflation when purchasing raw goods since the government began collecting such data in 1974.

Outlook

The current inflation picture defies all conventional economic wisdom. Normally, such low unemployment would force employers to raise wages to attract new workers, thereby driving up the prices of goods and services. Consumer prices, however, are rising more slowly than they have since 1986, and producer prices set a record low in 1997. It is possible that productivity gains, which increase the amount of output per labor hour, have enabled producers to raise wages without passing costs on to consumers. We predict that inflation will remain in check in the first quarter of 1998, hovering between 2 percent and 2.3 percent, and average about 2.25 percent for 1998.