



ECONOMIC FORECAST

This forecast reviews the 1987 state and national economies and examines fourth-quarter activity. Michigan's international trade sector, especially the new Canada-U.S. free trade agreement, receives special attention.

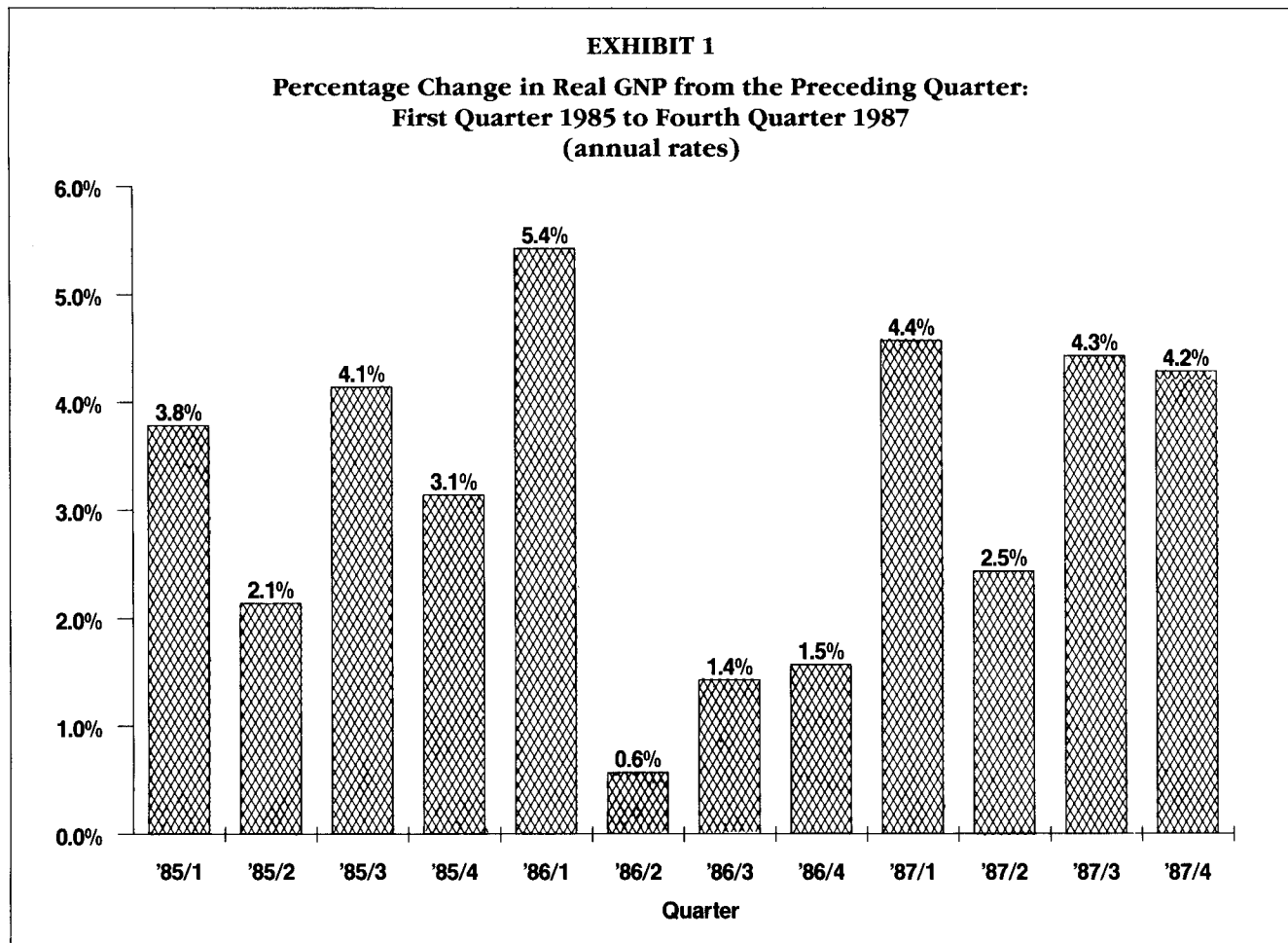
OVERVIEW

The gross national product (GNP) increased at a rate of 4.2 percent in the final quarter of 1987, according to the preliminary tabulation in late January by the Bureau of Economic Analysis. Most of this rise resulted from an accumulation of goods on retailers' shelves as consumers cut back on spending. For 1987 as a whole, GNP grew by only 2.9 percent, the same as in 1986 and very slightly below the 1985 figure of 3.0 percent. Because of spending imbalances that

occurred during the last three months of 1987, the first quarter of 1988 is expected to be largely corrective, placing a damper on the nation's economic growth. For 1988 as a whole, GNP is expected to grow at a rather unimpressive rate of 2.7 percent, meaning that the economy will be relatively weak. Exhibit 1 depicts quarterly GNP growth since 1985.

Provisional data for Michigan suggest that the state economy behaved with surprising vigor during the last three months of 1987. Unexpected buoyancy here in automotive and automotive-related production triggered a buildup of inventories.

Reducing accumulated inventory of most goods will largely shape the GNP growth figure for the first quarter of 1988. Correction is particularly needed in the automotive industry; this means that Michigan will have



to bear this adjustment in addition to plant closings and other structural changes taking place in vehicle manufacturing in North America.

NATIONAL ECONOMY

Consumers reduced their spending in the last three months of 1987. Outlays for durable goods dropped at an annual rate of 20.4 percent between the third and fourth quarters, and spending on nondurables dipped by 4.5 percent. Although purchases of services edged ahead at an annual rate of 3.8 percent, overall spending by consumers declined 2.7 percent. (These trends were evident even before the October crash on Wall Street.) These figures are "real" in the sense that they have been adjusted for changes in the price of goods and services. Since factory production did not decline at a rate commensurate with consumers' decisions to cut back, inventories piled up on retailers' shelves. Thus, although consumer spending is expected to improve during the first quarter of 1988, inventories still will be out of line, and production cuts and layoffs already are taking place in some industries.

An improvement in the trade deficit relieved some of the pressure of excessive production during the final

three months of 1987. The trade imbalance in goods and services stood at \$130.7 billion, an improvement of \$7.7 billion from the third-quarter figure (1982 dollars).

Looking at other spending, producers' investment in equipment declined by \$6.2 billion; nonresidential construction gained by \$2 billion; residential construction grew by \$2.8 billion; federal government nonmilitary purchases grew by \$18.8 billion; state and local government purchases grew by \$5.1 billion; and military spending slipped by \$500 million.

The immediate outlook for GNP is a decline during the first quarter as a result of inventory correction. Any further decline in inventories during the spring likely will be more than balanced by growth in producers' investment in fixed equipment and by further improvement in the trade balance. The third and fourth quarters likely will show growth in most major categories of GNP. Overall growth for the year is projected at 2.7 percent.

Inflation continues to be manageable. The overall level of prices of goods and services that comprise the GNP increased 3.0 percent in 1987 compared with a gain of 2.6 percent in 1986, 3.2 percent in 1985, and 3.7 percent in 1984. Price changes (inflation rates) since 1985 are shown in Exhibit 2. Prices are expected to rise by 3 percent in 1988.

GLOSSARY

Conference Board: A management information service for business executives that compiles data, conducts surveys and research, and analyzes trends.

Durable Goods: A product with an expected life of more than one year.

Expansionary Policy: Government policies that stimulate the economy such as increased spending or lower taxes.

Gross National Product (GNP): The total market value of all final goods and services produced in the economy in one year.

GNP Implicit Price Deflator: A comprehensive index of inflation used to adjust earnings in the United States.

Index of Leading Indicators: Eleven categories of data compiled monthly by the Bureau of Economic Analysis in the U.S. Department of Commerce that are used to predict future economic activity.

Outsourcing: Use of imported components in the production process.

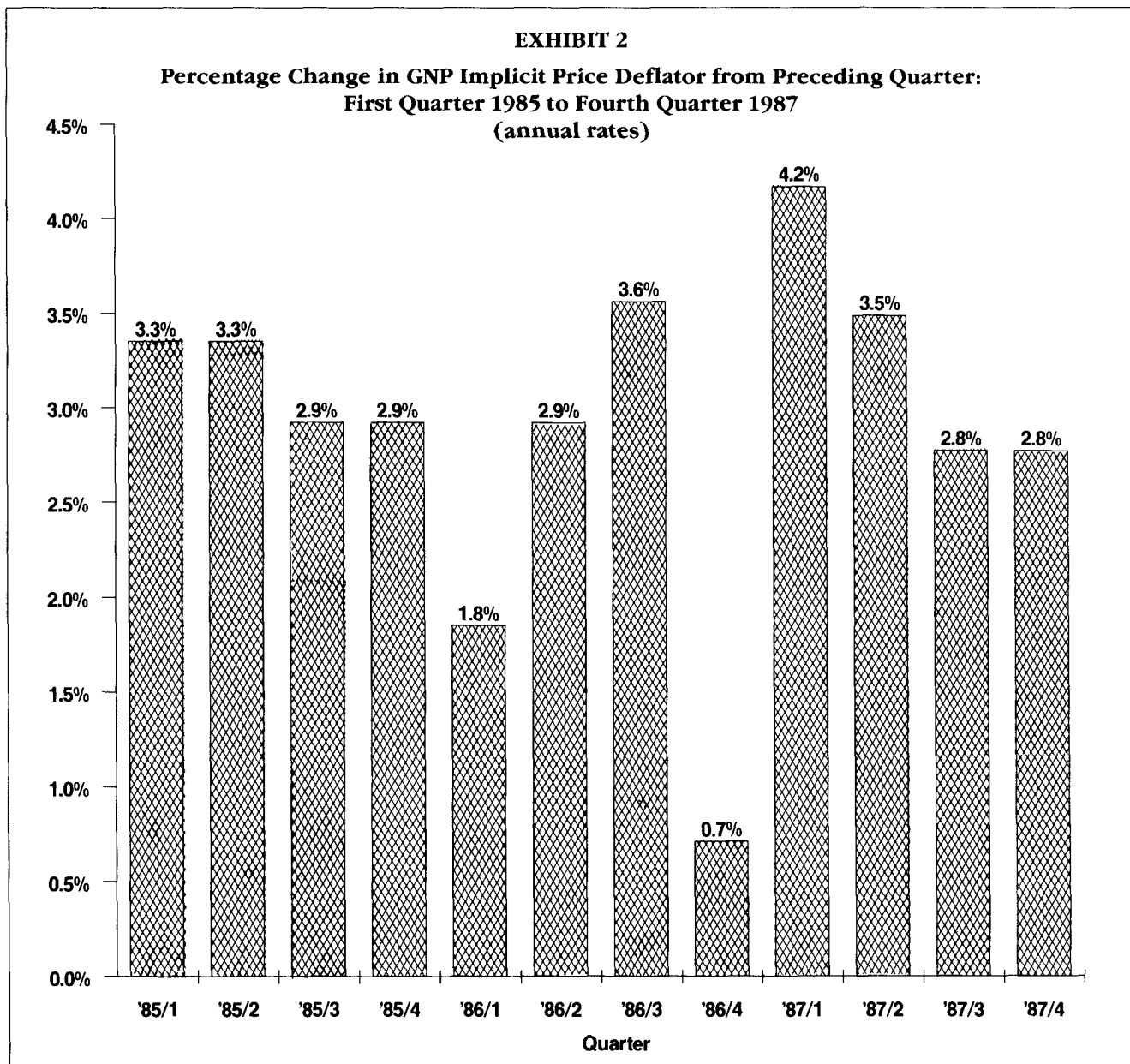
Personal Income: Earnings, dividends, interest, rent, and transfer payments received by households.

Structural Adjustment: Changes in the labor intensity of production.

International Trade

The export picture brightened considerably during the last quarter of 1987; sales of a wide variety of manufactured products and farm commodities rose. The favorable developments in exports of motor vehicles, chemicals, aircraft, and machinery reflect the depressed condition of the U.S. dollar compared with other currencies. At the end of January, for example, the dollar was equivalent to 128 Japanese yen or 1.68 West German deutsche marks. In 1985, on average, one U.S. dollar would purchase 238 yen or 2.94 deutsche marks. In other words, whereas in 1985 a Japanese importer could buy only \$4.20 with 1,000 yen, by the end of January 1988 that amount could purchase about \$7.81. From the point of view of the Japanese and Germans, dollar devaluation has dramatically reduced the prices they must pay for American goods and services compared with imports from other countries and with goods and services produced at home.

Americans must pay more for imported goods because of the rising prices of the currencies that we must buy to pay for them; the dollar does not buy as much overseas as it did. The dollar value of imports has continued to rise, nonetheless, in part because foreigners have been unwilling to parallel the rising value of their own currencies with a commensurate boost in prices of their exports to America. They have cut profit margins in efforts to maintain market share in passenger vehicles and a number of other markets.



Also, not all currency adjustments have been as dramatic as those between the dollar and the yen or the mark. For example, the U.S. dollar will purchase \$1.27 Canadian dollars now compared with \$1.37 in 1985, a decline of less than 7.5 percent against the currency of our most important trading partner.

The value of imports rose from \$575.6 billion in the third quarter to \$584.5 billion in the fourth. (Figures are stated in 1982 dollars at annual rates.) Fourth-quarter exports, similarly valued, grew by \$16.7 billion, from \$437.1 billion to \$453.8 billion. Thus, in the fourth quarter, the trade deficit declined by \$7.7 billion, from \$138.4 billion to \$130.7 billion.

America's big problem is the huge trade deficit with Japan—well over \$50 billion—the bulk of which is in automotive products. We have become increasingly dependent on foreign sources for parts as our industry

has dwindled and as Japanese companies transplanted to this country have started to absorb increasing volumes of components from Japan, Mexico, and elsewhere.

Cutting our deficit with Japan will require reconstructing our own industrial supplier base, so ravaged during the 1979-1983 downturn in manufacturing activity. It also will require Americans to pay greater attention to marketing U.S. brands of goods and services in the international marketplace.

Meanwhile, West Germany and Japan have embarked on expansive fiscal and monetary policies to bolster their own flagging economies. This will work to the advantage of the United States by generating demand for our goods and services in those countries. Britain, France, and Canada also are expected to buy more exports from the United States this year

Monetary Policy

The release of fourth-quarter GNP figures with the news that an inventory buildup was responsible for most of the gain and the November foreign trade figures sent a sigh of relief through Wall Street. The thinking is that

- the surge in inventories will have to be worked off during the first half of 1988; thus, production will lag, the U.S. economy will be sluggish, and there will be no buildup of inflationary pressures;
- there are prospects of steady-to-falling energy prices and of low-to-modest price gains generally; and
- we finally have turned the corner on paring the trade deficit, meaning that a crisis on foreign exchanges is not imminent.

This is interpreted to mean that the Federal Reserve Board is free to pursue an expansionary policy (release more money into the economy) without concern that the resulting lower interest rates will overstimulate the economy and rekindle inflation.

On the money demand side, weakness in construction activity is helping to push down interest rates by reducing demand for funds to finance construction projects. If merchants are successful in reducing their inventories, the demand for money will further slacken. The combination of money growth in the face of weak demand has caused interest rates to ease recently; in the weeks ahead, interest rates are expected to continue their modest declines.

Fiscal Policy

On December 23, President Reagan signed two bills that set the federal budget for the fiscal year that began in October 1987. The bills call for a variety of small military and nonmilitary cutbacks and tax increases. Because the U.S. economy is weaker than expected, however, the overall federal budget deficit is not likely to change much from last year's level.

Because 1988 is an election year, the current Congress and President Reagan are unlikely to grapple seriously with the budget deficit. At the same time, the pressure to deal with the deficit is increasing due to a growing reluctance by foreigners to increase their holdings of U.S. debt and a rising concern in Washington and on Wall Street about our heavy dependence on foreigners as a source of borrowed money. A related concern is the rising amount of annual interest paid to foreigners who hold U.S. debt. At latest count this had doubled, to \$23.5 billion last year, from the 1980 level. According to *The Wall Street Journal*,

the government's dependence on foreign debt is just a subset of a larger addiction to foreign lending that afflicts the entire U.S. economy. Foreign capital has helped ease

the pressure of U.S. capital markets, starved by a lack of domestic savings. But it has caused a dramatic change in America's economic position.

In last year's third quarter, for the first time in more than fifty years, foreigners earned more on their U.S. investments than Americans earned on their investments abroad. The shortfall was just \$267 million, but it was ominous. In 1986, the last year for which figures are available, the Commerce Department found that foreign-held assets in the U.S. outstripped American-held assets abroad by a whopping \$263 billion.¹

The high rate of government debt is responsible, in part, for America's uncommonly low rate of personal savings, as a stimulative fiscal policy encourages higher levels of consumption (that is, higher spending and lower savings).

Leading Indicators

In December 1987, preliminary figures indicated that the government's index of leading economic indicators declined for the third consecutive month. Based on nine of the eleven indicators, the index was down 0.2 percent. In November, the index of eleven indicators dropped by 1.2 percent, almost all of which was attributed to happenings on Wall Street. The October decline was 0.1 percent. Prior to October the index had been positive, and strongly so, for several months.

The December decline was led by a drop in residential building permits. Other major contributors were a rise in prices of materials sensitive to the business cycle, a jump in average weekly initial claims for state unemployment insurance, a drop in prices of common stocks on the New York Stock Exchange, and a shorter average workweek for production workers in manufacturing industries.

Pluses were recorded for new contracts and orders for plants and equipment, the percentage of companies receiving slower deliveries from vendors, new orders to manufacturers for consumer goods and materials, and the nation's money supply. The December tallies for inventory changes and for business and consumer borrowing were not available at this writing.

Investment

Nonresidential construction, known officially as "fixed investment in nonresidential structures," gained modestly in the fourth quarter of 1987. This followed a third-quarter gain as this component of the GNP continued its recovery from the depressed level of the first half of the year. The peak for this component was reached in 1985; since then, it has declined by 17 percent.

Although, fixed investment in producers' durable equipment declined in the last three months of 1987,

¹Walter S. Mossberg, "The Cost of Paying the Foreign Piper," *The Wall Street Journal*, January 18, 1988.

it is expected to improve in 1988. This component, which reached a new peak in the third quarter of last year, has risen by 6 percent since 1985.

The weak dollar is having a pronounced, positive effect on U.S. manufacturing: orders for machine tools and other capital goods for export surged last year, and durable goods orders generally have been rising rapidly. With orders growing more rapidly than production, backlogs have been increasing. Excess capacity, which plagued manufacturers during much of the first half of this decade, is fading in many industries and in many parts of the country. More orders and backlogs mean more investment in plants and equipment.

Last fall the Bureau of Economic Analysis conducted a survey of businesses regarding their capital spending plans for 1988. The survey suggests that businesses will invest about 7 percent more in new plant and equipment in 1988 than they did in 1987. The increase is "real," that is, adjusted for price inflation in the capital goods sector. Following are highlights of the survey:

Estimates of real spending for 1988 indicate an 8.6 percent increase in manufacturing—3.4 percent in durables and 13.4 percent in nondurables; the latest estimate of real spending in manufacturing for 1987 indicates an increase of 3.1 percent from 1986. In nonmanufacturing, estimates indicate a 6.5 percent increase for 1988; the latest estimate of spending for 1987 indicates an increase of 1.9 percent from 1986. The largest increase for 1988 is estimated for "commercial and other"; increases are also estimated for mining and transportation. A small decline is estimated for public utilities.²

Unlike other manufacturers of durables, motor vehicle manufacturers expect to reduce their investment in new plants and equipment because most of the necessary investments for the next few years have already been made. Electric utilities, aircraft producers, and manufacturers in stone, clay, and glass industries also expect to reduce investment in 1988. Steelmakers and nonferrous metal producers, however, plan hefty increases in capital spending. Among the beneficiaries of the slumping dollar, which has reduced the volume of steel imports into this country, are Detroit-area steel makers, who have received a badly needed boost.

Income, Saving, and Consumption

Personal income increased by .7 percent in December following a decline in November. For the year as a whole, personal income increased by 6 percent, slightly below the increase for 1986. Disposable personal income, more commonly known as take-home pay, increased by 5.2 percent in 1987 after a gain of 6.4 percent in 1986. Factory payrolls rose by 2.9 percent in 1987 following a 2.1 percent increase in

1986. Workers in primary metals, farm machinery and equipment, and aircraft and parts factories were among those who fared best in earnings gains.

The rate of personal saving, although still uncommonly low, has been rising of late. After falling to a depressed figure of 2.8 percent in August, personal saving as a percentage of disposable personal income was 4.7 percent in December. For the year as a whole, Americans saved 3.8 percent of their disposable personal income, the lowest since 1947, when we saved an average of 3.1 percent of take-home pay. The 1986 figure was 4.3 percent; 1985, 4.5 percent. As mentioned earlier, the national debt is responsible, in part, for low personal savings in the United States. Other contributing factors are increased Social Security taxes and a buy-in-advance psychology that has carried over from the high inflation period of the 1970s and early 1980s.

The Consumer Research Center at The Conference Board conducts a survey of consumer sentiment and buying plans each month. The most recent survey found that consumer confidence, which portends consumption levels, improved again in January. On a base of 1985 = 100, the January 1988 figure was 110.9 compared with 107.7 in December and 100.8 in November 1987. This is well above the level of a year ago, indicating increasing confidence. Consumer confidence has increased most in the west central states, but it also is vastly improved in the Great Lakes states.

Although the index of buying plans for new cars had improved steadily between August and December, it declined in January. This index recorded its recent peak in September at 108.7. The October, November, and December levels were 104.9, 102.5, and 90.9, respectively. Plans to buy used cars have slumped since September. Plans to buy homes and home appliances improved in January after a downward slide since last fall.

The Conference Board figures suggest that although consumers will continue to watch their spending in the months immediately ahead, they are prepared to maintain the new car buying patterns that prevailed last summer.

MICHIGAN ECONOMY

As mentioned in the overview, preliminary data suggest that the state economy was surprisingly vigorous in the last three months of 1987. This is in marked contrast to the third quarter, when the state economy generally was weak.

- Labor and proprietors' earnings in Michigan declined during the third quarter, the second consecutive quarter of decline. In this category, Michigan's performance has lagged behind the national average since the second quarter of 1986.

²Bureau of Economic Analysis, *U.S. Department of Commerce News*, BEZA 87-59 (Washington, D.C.: December 16, 1987).

EXHIBIT 3
Labor and Proprietors' Earnings in Michigan and the United States,
By Broad Economic Sector: Second and Third Quarter 1987
(dollars in millions)

Sector	Michigan			United States		
	Second Quarter	Third Quarter	Percentage Change	Second Quarter	Third Quarter	Percentage Change
Agriculture	\$732	\$731	-0.1%	\$54,337	\$47,761	-12.1%
Agricultural services, forestry, and fisheries	274	270	-1.5	13,465	13,312	-1.1
Mining	557	583	4.7	35,792	36,926	3.2
Construction	4,603	4,737	2.9	173,997	174,659	0.4
Nondurable goods manufacturing	6,619	6,618	-0-	205,491	208,505	1.5
Durable goods	30,785	29,533	-4.1	350,546	354,164	1.0
Transportation and public utilities	5,539	5,558	0.3	186,399	188,656	1.2
Wholesale trade	5,743	5,799	1.0	171,616	173,914	1.3
Retail trade	9,123	9,255	1.4	265,994	270,118	1.6
Finance, insurance, and real estate	4,733	4,832	2.1	204,887	209,513	2.3
Services	20,733	21,053	1.5	627,532	642,237	2.3
Federal civilian payrolls	1,570	1,579	0.6	87,084	87,553	0.5
Federal military payrolls	372	376	1.1	42,268	42,394	0.3
State and local government payrolls	11,119	11,256	1.2	300,292	305,999	1.9
TOTAL EARNINGS	\$102,504	\$102,180	-0.3%	\$2,719,702	\$2,755,710	1.3%

SOURCE: Bureau of Economic Analysis, Regional Economic Information System.

- A state-by-state comparison by the Bureau of Economic Analysis reveals that third-quarter wage and salary disbursements in durable goods manufacturing declined sharply in the face of a modest gain nationally. Only Idaho, Montana, and Wyoming experienced sharper losses in heavy manufacturing than did Michigan. Nearby, Indiana, Illinois, and Wisconsin had above-average increases, while Ohio registered a small decline. Michigan also was one of the laggards in nondurable goods manufacturing, government, and services. Construction industries in this state continued to outperform the national average as did mining, wholesaling, and transportation. Third-quarter earnings data are shown in Exhibit 3.

- Michigan personal income (earnings, interest and dividend income, retirement benefits, unemployment and welfare benefits, and other income that accrues to households) increased 0.4 percent in the third quarter, well below the national gain of 1.4 percent. For the twelve-month period ending in the third quarter of 1987, Michigan experienced only a 2.9 percent increase in personal income compared with 5.9 percent nationally; Texas and Michigan were tied for 45th place among the fifty states in the ranking of personal income growth. California grew fastest, followed by Connecticut, New Hampshire, and Florida. Alaska and Wyoming showed losses.

Employment

Total employment in Michigan has been falling since September, but the September level was unusually high; the decline probably represents, in part, the withdrawal of seasonal part-time and temporary employees and the self-employed who had flooded the market during the summer. For 1987 as a whole, Michigan civilian employment averaged about 4,154,000, an improvement of 3.6 percent over 4,007,000 in 1986. For the nation, employment growth was 2.1 percent in 1987.

Michigan wage and salary employment growth during the fourth quarter matched the national figure (Exhibit 4). Callbacks from layoff in the Michigan automotive industry offset declines in finance, insurance, real estate, transportation, communication, and public utilities. Michigan durable goods manufacturers, other than automotive, posted a modest gain in comparison with those industries nationally, and retailers added a substantial number of workers in the fourth quarter.

The exceptionally strong construction industry has been the outstanding sector of the Michigan economy for several months. Although its growth rate slowed somewhat in the last quarter, this sector continues to be the leader.

Within durable goods manufacturing industries, those associated with construction in one way or another are performing well: furniture and fixtures, plumbing equipment manufacturers, structural steel

EXHIBIT 4
Michigan and United States Wage Employment,
Third and Fourth Quarter 1987
(employment figures in thousands of jobs)

Sector	Michigan			United States		
	Third Quarter	Fourth Quarter	Percentage Change	Third Quarter	Fourth Quarter	Percentage Change
Mining	11.0	10.9	-0.9%	751	762	1.5%
Construction	135.0	138.4	2.5	4,999	5,087	1.8
Nondurable goods	222.4	226.9	2.0	7,896	7,692	0.8
Durable goods manufacturing	724.7	730.3	0.8	11,237	11,358	1.1
Motor vehicles and equipment	295.9	298.4	0.8	833	836	0.4
Other durable goods	428.8	431.9	0.7	10,404	10,522	1.1
Transportation, communication, and public utilities	149.3	147.1	-1.5	5,385	5,451	1.2
Wholesale trade	178.4	179.6	0.8	5,806	5,451	0.8
Retail trade	662.4	673.8	1.7	18,281	18,417	0.7
Finance, insurance and real estate	181.0	179.6	-0.8	6,620	6,656	0.5
Services	799.3	806.4	0.9	24,263	24,498	1.0
Government	605.9	614.0	1.3	17,038	17,225	1.1
TOTAL	3,669.5	3,707.0	1.0%	102,278	103,267	1.0%

SOURCES: Michigan Employment Security Commission, special release; Bureau of Labor Statistics, special release.

fabricators, and manufacturers of concrete. Except for structural steel, Michigan's steel industry still is considerably more depressed than its national counterparts, no doubt a result of its close association with vehicle manufacturing. The motor vehicle industry in this state still is deeply depressed, even though there was some recovery in the last quarter of 1987. In fact, most of our durable goods industries show employment declines compared with a year ago, whereas there are employment gains in the nation as a whole. (See Exhibit 5.)

In nondurable goods manufacturing, Michigan shows year-to-year declines in food processing industries, textiles and apparel (the bulk of which is interior trim for vehicles), and paper and allied products. Our plastics industry, publishers, and chemical producers are performing at better-than-average rates. Plastics is one of the more dynamic industries in this state because of the specialty items manufactured here to replace metal in smaller automobiles. The growth of plastics is partly responsible for the depression in the state's metals industries. Unfortunately, average earnings in plastics production are well below those in the metals industries.

Michigan's ground transportation industries are slumping these days because of their dependence on the automotive industry. The airlines industry also shows signs of contraction. Public utilities are depressed. In the general category of transportation, communication, and public utilities, only the communication sector in this state is expansive.

Employment in business services in Michigan has declined, reflecting the redeployment of Electronic Data Systems employees whose missions have been accomplished. (EDS is the giant computer services firm purchased by General Motors Corporation a few years ago.)

Tourism

Available data suggests that 1987 was an excellent year for Michigan's travel and tourism industries. Employment in lodgings industries here posted good gains, reflecting a substantial expansion in hotel-motel construction that started in 1985. Employment in amusement and recreation services also increased sharply during the year, as did employment in the restaurant industry.

Data from Michigan State University's Travel, Tourism and Recreational Resource Center show that highway traffic counts throughout the state in 1987 were well above the 1986 figures. Double-digit percentage gains were recorded in the Upper Peninsula, northern lower peninsula, and southern areas in both the number of state park camp permits issued and in the number of overnight stays in state parks.

Retail Sales

Sales by Michigan retailers increased by 2.3 percent during the first eleven months of 1987 over the same period in 1986. In the Great Lakes region, Indiana had the greatest increase (6.0 percent) and Wisconsin had the largest decline (-3.4 percent).

EXHIBIT 5
Michigan's Share of Wage and Salary Employment by Industry Group
and Employment Growth: December 1986-December 1987

Industry Group	1986 Annual Employment†			Percentage Growth, December 1986- December 1987	
	Michigan (thousands)	United States (thousands)	Michigan as % of United States	Michigan	United States
	Mining	10.1	783	1.3	5.0
Construction	115.3	4,904	2.4	17.2	4.0
Manufacturing					
Nondurable goods	218.2	7,750	2.8	2.8	2.5
Durable goods	780.0	11,244	6.9	-5.1	1.9
Transportation and public utilities, excluding U.S. Post Office	147.8	5,244	2.8	-1.5	3.3
Wholesale trade	176.6	5,735	3.1	1.1	2.5
Retail trade					
Building materials and garden supplies ^a	23.6	701	3.4	8.3	3.7
Department stores ^a	84.5	1,978	4.3	2.2	2.8
Other general merchandise stores ^a	9.6	385	2.5	-3.7	3.0
Food stores	89.2	2,873	3.1	-0.7	2.5
Auto dealers and service stations	72.5	1,943	3.7	0.3	2.2
Apparel and accessory stores ^a	37.4	1,075	3.5	5.4	2.0
Furniture and home furnishings stores ^a	25.6	791	3.3	0.7	5.0
Eating and drinking places	219.2	5,879	3.7	6.4	2.1
Miscellaneous retail ^a	75.4	2,246	3.4	10.4	1.9
TOTAL RETAIL TRADE	637.0	17,845	3.6	4.2	2.3
Finance, Insurance and Real Estate					
Finance	79.2	3,152	2.5	3.9	2.3
Insurance	57.7	1,945	3.0	3.2	4.1
Real estate	27.7	1,200	2.3	16.0	4.6
TOTAL	170.6	6,297	2.7	5.3	3.2
Services					
Hotels and other lodgings places ^a	26.7	1,401	1.9	7.3	4.4
Laundry, cleaning, and garment services ^a	13.5	386	3.5	—	6.1
Other personal services ^a	22.6	718	3.1	-5.7	4.2
Business services	166.8	4,781	3.5	-2.8	6.4
Auto repair, services, and garages ^a	28.0	762	3.7	5.6	3.5
Miscellaneous repair services ^a	11.5	320	3.6	3.5	2.4
Amusement and recreation services ^a	26.4	915	2.9	8.5	1.8
Private hospitals ^a	132.2	3,038	4.4	-0.6	4.4
Other health services excluding hospitals ^a	132.0	3,512	3.8	1.2	5.8
Legal services ^a	22.2	748	3.0	3.9	4.7
Private educational services ^a	34.9	1,428	2.4	-2.2	-0.4
Museums and membership organizations ^a	65.3	1,576	4.1	3.1	1.0
Other services ^a	104.8	3,514	3.0	5.2	4.5
TOTAL SERVICES	786.9	23,099	3.4	1.0	4.6
Government					
Federal	60.1	2,899	2.1	1.8	2.6
State	147.1	3,888	3.8	8.1	2.1
Local	389.4	9,923	3.9	1.4	1.9
TOTAL NONAGRICULTURAL EMPLOYMENT	3,639.2	99,610	3.7	1.4	3.0

SOURCES: Michigan Employment Commission, special release; Bureau of Labor Statistics, *Supplement to Employment and Earnings* (Washington, D.C.: June 1987); and Bureau of Labor Statistics, *Employment and Earnings*, December 1987.

^aOctober 1986 to October 1987.

For the nation as a whole, retailers showed sales gains of 3.8 percent during the first eleven months of 1987 (see Exhibit 6). The pattern of changes in retail sales reflects the general lack of uniformity in economic growth among the states.

For Michigan, sales tax data indicate sizeable gains for building and hardware dealers, restaurants, grocery stores, lodging establishments, sporting goods stores, and furniture stores. Department stores, variety stores, meat and fish markets, and beer and liquor stores reported sales declines in 1987.

Construction

Although Michigan construction industries exhibited considerable strength through year end, the boom cannot last forever. Construction is a volatile activity both in Michigan in the nation.

The number of permits for residential building slipped in 1987 after four successive growth years. (See Exhibit 7.) The number of permits for factories dropped by 27.5 percent. The number of permits for non-residential rehabilitation also declined, as did those for

EXHIBIT 6

Percentage Change in Retail Sales in Detroit, Michigan, and the United States, November 1986-November 1987

	Detroit/Ann Arbor ^a		Michigan		United States	
	Nov. 1986- Nov. 1987	1st 11 Months 1986- 1st 11 Months 1987	Nov. 1986- Nov. 1987	1st 11 Months 1986- 1st 11 Months 1987	Nov. 1986- Nov. 1987	1st 11 Months 1986- 1st 11 Months 1987
Durable goods, total	NA	NA	2.2%	1.6%	3.9%	3.4%
Department stores	-0.6%	2.2%	1.3	4.1	4.9	5.4
GAF ^b total	-1.6	-1.9	-6.1	-4.1	3.3	6.4
Nondurable goods	0.1	1.7	2.1	2.8	2.7	4.1
TOTAL	2.6%	3.4%	2.1%	2.3%	3.2%	3.8%

SOURCE: Bureau of the Census, *Monthly Retail Trade*, November 1987.

^aThe Detroit/Ann Arbor Consolidated Metropolitan Statistical Area is comprised of Lapeer, Livingston, Macomb, Monroe, Oakland, St. Clair, Washtenaw, and Wayne counties.

^bGAF represents stores that specialize in department store types of merchandise, including furniture and apparel stores.

EXHIBIT 7

Valuation and Number of Residential and Nonresidential Units Authorized in Michigan Permit Issuing Places, by Category: 1979-1987

Category	1979	1980	1981	1982	1983	1984	1985	1986	1987 ^a	Percentage
										Change
Number of Units										
Residential homes	49,209	28,976	18,917	14,377	21,683	27,758	37,675	47,295	47,070	- 0.5
Transient hotels, motels, tourist courts, and cabins	2,204	1,629	724	859	1,018	1,869	5,149	3,857	5,167	34.0
Industrial buildings	1,450	789	634	479	630	857	1,149	1,315	953	-27.5
Office, bank, and professional buildings	739	542	459	310	438	531	627	626	615	-1.8
Stores and other mercantile buildings	1,509	934	787	620	776	1,083	1,211	1,366	1,516	11.0
Additions, alterations, and conversions, except residential	12,805	12,714	12,511	11,491	13,519	14,518	15,068	15,589	13,186	-15.4
Valuation (millions)										
Residential homes	\$1,899.9	\$1,164.1	\$821.8	\$593.2	\$1,105.9	\$1,342.2	\$1,833.7	\$2,440.5	\$2,619.1	7.3%
Transient hotels, motels, tourist courts, and cabins	43.1	51.8	19.6	8.6	12.7	86.9	130.9	101.6	108.3	6.6
Industrial buildings	528.1	322.1	366.9	312.4	158.2	331.0	555.5	525.0	452.6	-13.8
Office, bank, and professional buildings	222.6	260.8	211.9	121.0	209.5	353.9	408.0	512.5	412.1	-19.1
Stores and other mercantile buildings	296.3	158.1	149.0	72.3	117.2	174.2	250.1	373.6	437.3	17.1
Additions, alterations, and conversions, except residential	189.1	537.3	412.7	349.9	432.7	600.3	702.9	859.1	825.7	-3.9

SOURCE: Bureau of the Census, special release.

^aPreliminary.

office, bank, and professional buildings. On the positive side, the Michigan lodgings industry is adding capacity at a record rate, and the number of permits for mercantile establishments finally exceeded the 1979 figure.

The data pertain to building permits, not starts. Permits may expire unused. Starts may be delayed for one reason or another. The figures are imperfect as a portent of construction activity. The data do suggest, however, that construction may level out or even turn down in the months ahead inasmuch as total permits for 1987 are well below those for 1986.

Michigan's International Trade

In 1984 (the most recent year for which data are available), 193,000 Michigan jobs were directly and indirectly tied to exporting manufactured products, according to the U.S. Bureau of the Census. This figure represents 4.9 percent of total Michigan civilian employment that year. Using the percentage figures as indices of export dependence, Michigan was tied with Indiana and more dependent than any other state except Connecticut (6.0 percent), Ohio (5.1 percent), and Massachusetts (5.0 percent). Nationwide, 3.8 percent of the civilian work force depended on exports.

The bulk of Michigan's export jobs are automotive related and materialized as a result of a 1965 automotive agreement with Canada. The agreement, dubbed Autopact, allows companies to ship cars and parts freely between the United States and Canada. Duties and other trade barriers against most vehicles and parts are disallowed under Autopact.

Congress and Canada's Parliament are considering expanding free trade between our two countries to include most goods and services. The new agreement would not abolish the border; authorities on both sides would retain authority to search entrants and to stop the flow of weapons, drugs, and so forth. Inasmuch as the agreement is provisional and the details remain to be worked out, not much can yet be said about it. To predict the effect on Michigan, a model of our comparative advantage would have to be developed. (Comparative advantage, essentially, means that which we do best in the marketplace.)

In general, Michigan's emerging comparative advantage seems to be in producing specialty items such as electrogalvanized steel and esoteric plastics. Comparative advantage in the routine mass production of standardized commodities such as plastic milk bottles and sheet steel for appliances is shifting to Canada. Michigan's steel and plastics industries, and our materials producers generally, would likely become more specialized if the agreement is signed, increasing their shipments of certain items to Canada. Canada, in turn, would have better access to the U.S. market for its mass production items. The manufacturing decisions

would be made by multinational corporations who manage the bulk of trade. Consumers would benefit through lower prices in both countries.

We could expect to export more tart cherries, navy beans, asparagus, pickles, and wine to Canada. Because Michigan's agriculture is highly specialized, the pact would be good news for producers of those products, but apple, peach, and peat moss producers could expect more competition.

Canada's vast timber resources could create tough competition for some of the less efficient firms in our wood-based industries. This is especially true for paper mills, but producers of hardwood for flooring would benefit from access to Canada's booming construction industries.

Small and medium-sized businesses on both sides of the border would experience opportunities for growth because of access to the other country's markets. This is true not just for goods producers but also for service industries. It is this least encumbered, most unpredictable, most risk-taking class of business that offers most promise for job creation in the two countries. Small businesses, especially those in service industries, seem particularly likely to benefit if they are located near the border.

Coming back to the motor vehicle industry, Autopact was born during a period of relative economic tranquility on this continent. Few imports disturbed either country's automotive industry. This changed in the early 1980s when Honda began making cars, and Nissan, trucks. Since then, Toyota joined GM in producing cars in California, Mazda has initiated production in Michigan, Toyota is planning an assembly plant in Kentucky, Mitsubishi is going into Illinois, and Subaru into Indiana. Not to be outdone, Canada attracted transplants that will build Hondas, Subarus, Toyotas, and Hyundais.

In the United States, the transplants are located in foreign trade zones, designated areas that enjoy exemption from U.S. customs taxes (duties) until their products leave the area. They escape duties altogether if the products leave the country from the foreign trade zone.

On their side, the Canadians have reinstated duty remissions or rebates as a way to subsidize the transplants. Under this scheme, companies that both export from and import to Canada enjoy a rebate of duties paid on their imports to the extent that imports add value in Canada and then are exported. In essence, this is a subsidy provided for vehicles exported to the United States from Asian transplants in Canada.

Washington is vexed because it had a similar duty remission scheme that led to Autopact in the first place, but the plan was rescinded as a result of Autopact. In the U.S.-Canada Free Trade Agreement, the parties have agreed to phase out the competition to provide location incentives to third-country automobile companies.

Automotive Sales and Production

Chrysler has announced its intention to close its Kenosha, Wisconsin body and assembly plants this summer. General Motors has announced the indefinite closure of its Leeds, Missouri assembly plant. Last year, GM closed assembly plants in Detroit, Pontiac, and Norwood (Ohio) and mothballed its Framingham, Massachusetts plant. Some GM plants that make components for vehicles also were shuttered permanently. Chrysler and GM still have more assembly plants than they need. Ford's Dearborn Assembly plant also is on the endangered list because of its age and size.

In 1987, the volume of new vehicle sales in this country was 15.2 million, compared with 16.3 million in the record year, 1986. The U.S. Department of Commerce forecast for 1988 new car and truck sales calls for an increase of 500,000 over the 1987 level. A further gain of 300,000 units is forecast for 1989.

Even if this sanguine sales prediction is borne out, it means a flat year for U.S. automotive production because of the rising volume of non-Japanese imports. Even if production is flat, traditional domestic production will decline to make way for rising assembly in the foreign transplants in Ohio, Tennessee, California, and Michigan. Assembly at the transplants is expected to increase by about 200,000 in both 1988 and 1989. Transplant assembly volume will be supported by a rising number of engines, transmissions, and other components manufactured outside this country.

Around the State

Ann Arbor was the fastest growing metropolitan area in 1987. The University of Michigan, services, retailing, and construction industries in the area were fast growing. Saginaw/Bay City/Midland was second in growth, spurred by services, local government, retailing, and nondurable goods manufacturing industries. Kalamazoo was third as a result of rapid growth in

retailing, services, and Western Michigan University. In all three, employment gained by more than 3 percent in 1987.

Employment in Benton Harbor and Grand Rapids grew by between 2 and 3 percent during the twelve-month period; in the Battle Creek, Muskegon, Lansing, Jackson, and Detroit areas it grew from one to 2 percent. Employment in Flint declined. The Upper Peninsula registered an employment gain of 1.5 percent, slightly above the state average of 1.4 percent.

(The above comparisons are based on December 1987 wage and salary employment data compared with December 1986, as released by the Michigan Employment Security Commission.)

OUTLOOK

Although the Michigan economy did fairly well during the last quarter of 1987, the first half of 1988 promises to be bleak. The effect of slow vehicle sales, huge inventories, plant closures, and rising productivity is reflected in January employment figures. For the state of Michigan, the number of jobholders declined by better than 100,000 from the December level. The unemployment rate has jumped from 7.2 percent in November to 8.7 percent in December to 10.2 percent in January. (The rate fell to 8.4 percent in February.) Although recovery is expected in the second half of the year it will be sluggish. It seems doubtful that the level of Michigan employment will return to the September 1987 peak at any time this year.

Michigan earnings, adjusted for inflation, are expected to decline a sharp 2.7 percent in 1988, following a 0.1 percent decline in 1987. Michigan employment will fall 1.1 percent in 1988, the first decline since 1982. In contrast, U.S. employment is expected to rise 2.1 percent above the 1987 level. The Michigan unemployment rate is projected to average 9.7 percent in 1988 compared with a U.S. rate of 5.9 percent. Details of the economic forecast are shown in Exhibit 8.

EXHIBIT 8
Broad Economic Indicators, Michigan and the United States,
Actual and Projections: 1986-1988

Indicator	1986	1987	1988 (est.)	Percentage Change	
				1986-1987	1987-1988
Earnings (current \$ in millions)					
Michigan	\$100,335	\$103,100	\$103,300	2.8%	0.2%
United States	\$2,574,512	\$2,750,000	\$2,890,000	6.8	5.1
Earnings (1987 \$ in millions)					
Michigan	\$100,335	\$100,200	\$97,500	-0.1	-2.7
United States	\$2,574,512	\$2,672,000	\$2,726,000	3.8	2.0
Civilian employment (thousands)					
Michigan	4,007	4,154	4,110	3.6	-1.1
United States	109,600	112,440	114,800	2.1	2.1
Vehicle production (thousands)					
Michigan	3,408	3,402	3,100	-0.2	-8.8
United States	11,300	10,900	10,300	-3.5	-5.5
Unemployment rate (% of civilian work force)					
Michigan	8.8%	8.2%	9.7%	—	—
United States	7.0%	6.2%	5.9%	—	—

SOURCES: The 1986 and 1987 data on earnings are from Bureau of Economic Analysis, U.S. Department of Commerce, Washington, D.C.; on civilian employment and unemployment rate from special release, Bureau of Labor Statistics, Department of Labor, Washington, D.C.; on vehicle production from special release, Motor Vehicle Manufacturers Association, Detroit.

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