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Public Sector Reports

ECONOMIC FORECAST

INTRODUCTION

As expected, the national economy slowed significantly during the fourth quarter of 1989, as the consumer sector failed to provide the hoped-for impetus necessary to maintain the growth rates experienced during the first three quarters. Real GNP rose at an annual rate of only 0.5 percent during 1989 IV, compared to 3 percent in the third quarter, and the weakness was spread across nearly all sectors.

For all of 1989, GNP rose at an inflation-adjusted rate of 2.9 percent, the second smallest annual increase since 1982. Despite the poor fourth-quarter showing, 1989 proved to be a good year economically. Income growth was the highest since 1984 (9 percent); the unemployment rate was low (5.3 as compared to 5.5 percent in 1988); and while inflation accelerated somewhat during the year, the Federal Reserve Board (the Fed) was able to maintain some degree of price stability. Inflation averaged 4.7 percent for the year.

In Michigan, employment and wages were relatively stable during the fourth quarter. Nonagricultural and wage and salary employment rose by 0.5 percent during the quarter (over the level experienced in 1988 IV); **for all of 1989**, employment in the state increased by 1.7 percent, the same rate of growth recorded last year. Michigan's unemployment rate held steady during the quarter, averaging 7.4 percent, the same as in 1989 III. The rate rose drastically in January, however, to 8.4 percent, precipitated by massive auto layoffs.

One possible reason for continued sluggishness in the consumer sector was the failure of lending institutions to reduce their interest rates (such as the prime rate) despite the continued easing of credit by the Fed. The M2 money supply rose by 7.9 percent from June to August, but the first decline in the prime rate (from 10.5 percent to 10 percent) since August did not occur until late January 1990. If the Fed and, in turn, the major lending institutions continue to allow interest rates to fall, a recession during 1990 likely will be avoided, and the economy will continue to grow moderately.

We continue to forecast average GNP growth of 2 percent for 1990, with faster growth in the second half of the year (see Exhibit 1). Prices should remain relatively stable, and inflation should average about 4.5 percent nationally. We expect that the slowdown in the first half of 1990 will result in annual growth rates of 2 percent in employment and 6.5–7 percent in income; the unemployment rate will increase to an average of 5.6 percent.

The sluggishness in the auto industry will take its toll on the Michigan economy. We expect that unemployment will average 8 percent during the year, that there will be only moderate income growth (5 percent), and that employment will rise one percent. Inflation in the state should be slightly below the national rate, averaging about 4 percent for 1990.

THE NATIONAL ECONOMY

GNP, Income, and Employment

Review

The economy slowed sharply in the fourth quarter as real GNP increased at an annual rate of only 0.5 percent (preliminary), compared with a 3 percent increase in the third quarter (see Exhibit 2). The weakness was spread throughout the economy. Consumption, which accounts for about 65 percent of GNP, was almost unchanged, due in part to the slump in automobile sales. Business investment declined at an annual rate of about 3 percent. The largest gain was in inventories, up $10.7 billion; without that increase GNP would have declined at an annual rate of 0.5 percent. The high inventories are not a good sign, as a sharp rise in demand will be required in early 1990 to clear stock before new goods are produced. As a result, some economists are calling 1989 IV a recession quarter. The only other area of increase in GNP was in residential investment, which had declined in the three previous quarters.

For all of 1989, real GNP rose 2.9 percent, the second smallest increase since 1982; in 1986 GNP grew 2.7 percent.

Compared to 5 percent in the third quarter, U.S. personal income grew at an annual rate of 7.4 percent in 1989 IV, but the increase was only 6 percent in December. The fastest growing sectors were finance, insurance, and real estate (6.9 percent above 1989 III) and services (5 percent higher). Manufacturing earnings increased only one percent (refer to Exhibit 13). **For all of 1989**, personal income rose 9 percent,

MICHIGAN FORECAST AT A GLANCE

Employment—Steady
Unemployment—Up
Personal Income—Up
Prices—Stable
Auto Sales—Down
Auto Production—Down
Housing—Steady
Interest Rates—Down

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Exhibit 1

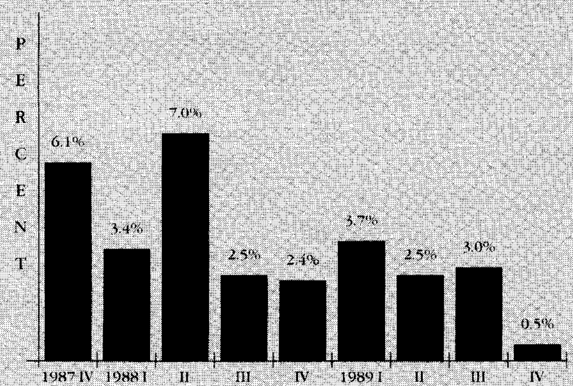
Summary Forecast

	1988 (actual)	1989 (actual)	1990 (estimate)
U.S. GNP, 1982 $ (percentage change)	3.8%	2.9%	2.0%
U.S. motor vehicle sales (millions)	16.1	15.1	14.3
Michigan wage and salary employment (percentage change)	1.7%	1.7%	0.8%
Michigan unemployment rate (percentage)	7.6%	7.3%	8.0%
Michigan personal income (percentage change)	7.4%	6.0%[a]	5.0%
Michigan motor vehicle production (millions)	3.2	3.3[a]	3.1
Detroit – Ann Arbor consumer price index (percentage change) (1982–1984 = 100)	4.0%	5.2%	4.0%

[a]Estimate

Exhibit 2

U.S. Gross National Product, Quarterly Changes at Annual Rates, 1987 IV–1989 IV



SOURCE: Council of Economic Advisors, *Economic Indicators*, selected issues.

the largest gain since 1984. The strongest growth was in nonwage income, particularly interest and transfer payments; wage and salary payments increased 8.3 percent.

U.S. wage and salary employment growth slowed in 1989 IV; only 471,000 jobs were added, compared with an average increase of about 650,000 in each of the three previous quarters. December employment rose by 142,000, better than expected, due to strong growth in the services sector. Manufacturing continued to be a drag on employment growth, declining 2.1 percent (annual rate) in 1989 IV. Motor vehicle employment lost 27,000 jobs between quarters, a 12.4 percent annual rate of decline. Manufacturing employment has dropped every month since March, and in December it was 104,000 below a year ago. As always, services recorded the largest increase, 3.7 percent (see Exhibit 3).

For all of 1989, wage and salary employment was up 2.8 percent, compared with 3.3 percent in 1988. Services employment grew 5 percent, while in manufacturing the growth was only 1.1 percent (the 1989 average for manufacturing was above the 1988 average, although employment declined throughout 1989).

Exhibit 3

U.S. Wage and Salary Employment and Percentage Changes, 1989 IV and 1989 (seasonally adjusted)

Sector	1989 IV (thousands)	Percentage Change from 1989 III (annual rate)	Percentage Change from 1988 IV	1989 (thousands)	Percentage Change from 1988
Manufacturing	19,511	−2.1%	−0.2%	19,613	1.1%
Services	27,305	3.7	4.6	26,889	5.0
Retail and wholesale trade	26,001	2.1	2.4	25,806	2.7
Government	17,843	0.9	1.9	17,730	2.1
Other	18,706	2.8	1.4	18,538	2.6
Total	109,366	1.7%	2.1%	108,576	2.8%

SOURCE: Bureau of Labor Statistics, U.S. Department of Labor, "The Employment Situation," *News*, selected issues.

The U.S. civilian unemployment rate averaged 5.3 percent in 1989 IV, unchanged from the previous quarter (see Exhibit 4). The December rate was also 5.3 percent. One positive sign in 1989 IV is that the unemployment rate for adult men, generally viewed as a leading indicator for changes in the economy, remained at 4.6 percent. **For all of 1989** the unemployment rate averaged 5.3 percent, down from 5.5 percent in 1988 and the lowest rate since 1973.

Outlook

Despite the weakness in 1989 IV GNP, there are a number of positive economic signs. The index of leading indicators was strong in December, employment growth slowed but is still strong enough to keep the unemployment rate stable, and the manufacturing sector showed renewed strength in December as durable goods orders increased. On the negative side, auto sales continue weak, interest rates are edging upward, and unemployment claims are rising.

The consensus forecast is for growth of 1.8 percent in GNP in 1990. Our forecast is for a 2 percent increase, with the second half of the year stronger than the first. Employment is expected to rise less than 2 percent in 1990, compared with a 2.8 percent increase in 1989, and the unemployment rate is forecast to average 5.6 percent. U.S. personal income is estimated to increase 6.5–7 percent in 1990, down from 9 percent in 1989.

Because of the weakness in the economy, a mild recession in 1990 would not be a surprise, but there appears to be enough strength in the economy to avoid one. One danger is that the Fed will overreact to inflation and keep credit too tight.

Leading Indicators

November's modest rise following October's decline in the government's index of leading economic indicators started off the final quarter of 1989 on a disturbing note. The index, consisting of 11 indicators designed to predict the direction of the economy for the next six to nine months, declined by 0.3 percent in October and rose by only 0.1 percent in November. The relatively large rise (0.8 percent) in the December index was encouraging, however, and suggested that the pace of the economy may indeed pick up during the first two quarters of 1990, despite fears of a recession.

The December rise in the index was especially promising because it evidenced renewed strength in the manufacturing sector, which had been a cause for some concern during the last two quarters of 1989. This renewed vigor was displayed by large December increases in plant and equipment orders and in durable goods backlogs, both of which experienced modest rises in November after posting declines in October. In addition, the average workweek for production workers remained steady in December, following several consecutive months of decline. Another hopeful note was the increase in the money supply for the third straight month; this was the only positive index category in each month of 1989 IV. On the negative side, weekly unemployment claims rose in both October and December, while materials prices declined sharply in the last two months of the year, indicating soft demand for the goods that these materials produce.

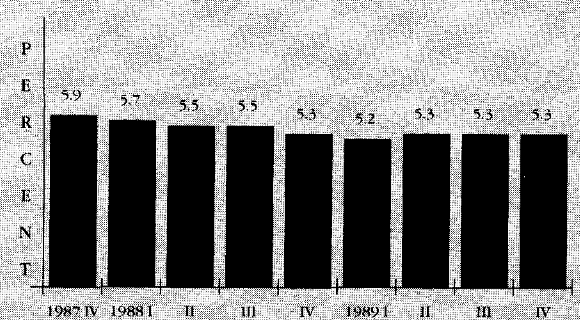
Monetary Policy

Review

While the Fed continued the gradual reduction in the federal funds rate during 1989 IV, other rates were slow to respond. The rate of interest on federal funds (charged by the Fed on loans to its member banks and the rate over which the Fed has most influence) fell from 9.2 percent at the beginning of 1989 IV to 8.4 percent by year-end (see Exhibit 5). It continued to decline in January 1990, falling to 8.2 percent by the end of the month. But other rates, such as the prime and that for long-term securities, which arguably have the most influence over business investment and consumer pur-

Exhibit 4

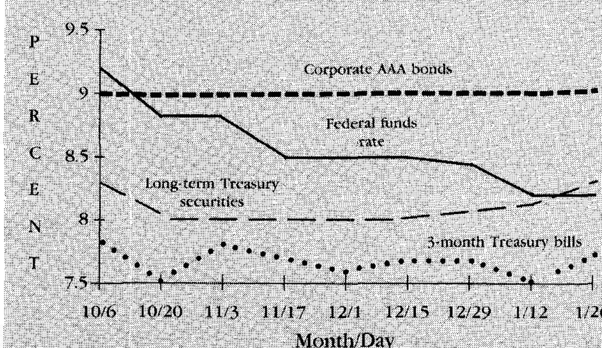
Quarterly U.S. Unemployment Rates, 1987 IV–1989 IV (seasonally adjusted)



SOURCE: Council of Economic Advisors, *Economic Indicators*, selected issues.

Exhibit 5

Selected Interest Rates and Yields on Securities (average daily rates)



SOURCE: Federal Reserve Bank of St. Louis, *U.S. Financial Data*, November 24, 1989, and January 25, 1990.

chases, remained flat during 1989 IV. This may have contributed to the quarter's persistent sluggishness, particularly in the consumer sector. The decline in the prime rate (charged by banks on loans to their most favored customers) in late January 1990 to 10 percent, the first drop in seven months, could stimulate growth in the first part of this year.

Also in late January, Fed Chairman Alan Greenspan, appearing before the Joint Economic Committee of Congress, reiterated his often stated position that further rate reductions will depend upon signs of more weakening in the economy and/or slowing inflation. This position has been supported recently by two Fed governors, Vice Chairman Manuel Johnson and Wayne Angell, both of whom have been leading proponents of monetary ease. In a *Wall Street Journal* interview in early January they stated they no longer favor rate reductions unless there are signs of a recession (which both deemed unlikely) or a decline in long-term bond rates, which would dampen inflationary fears. The White House responded with a public statement asserting that the Fed should reduce rates in order to avert a recession. This was an unusual step for the administration to take, as displeasure with Fed policy usually is expressed through informal statements, not public announcements, and it points to further tension between the two bodies.

Outlook

With new goods orders and home sales showing favorable signs, and since Alan Greenspan considers the current inflation rate of about 4.5 percent "unacceptable," it is not likely that monetary policy will stray from the path followed over the last seven months. Although the Fed probably will be under additional pressure in an election year to reduce rates, it is not apt to yield unless signs of recession occur, which Fed analysts give a 20 percent probability in the next six months.

Fiscal Policy

Review

Deficit figures for both December and the end of the first quarter of FY 1990 (October through December 1989) are somewhat disturbing and will intensify the wrangling over the FY 1991 federal budget. During FY 1990 I the federal budget deficit stood at $69.69 billion, a rise of $2.1 billion (3.1 percent) from the same period in FY 1989 and nearly 70 percent of the $100 billion Gramm-Rudmann ceiling for the current fiscal year. Figures for calendar year (CY) 1989 showed that while spending declined by 1.3 percent ($103.8 billion) from the previous CY, revenue declines were greater, amounting to $89.1 billion (4.9 percent below the level posted at the end of December 1988), due to drops in both personal and corporate income tax collections. Deficit projections for FY 1990 cannot be inferred from these figures alone, as much of the government's revenue is collected following the April 15 personal income tax filing date. The bipartisan Congressional Budget Office (CBO) projects a deficit of $138 billion for the current FY, while the administration (through the Office of Management and Budget) estimates that the budget will fall within the ceiling set by Gramm-Rudmann for FY 1990.

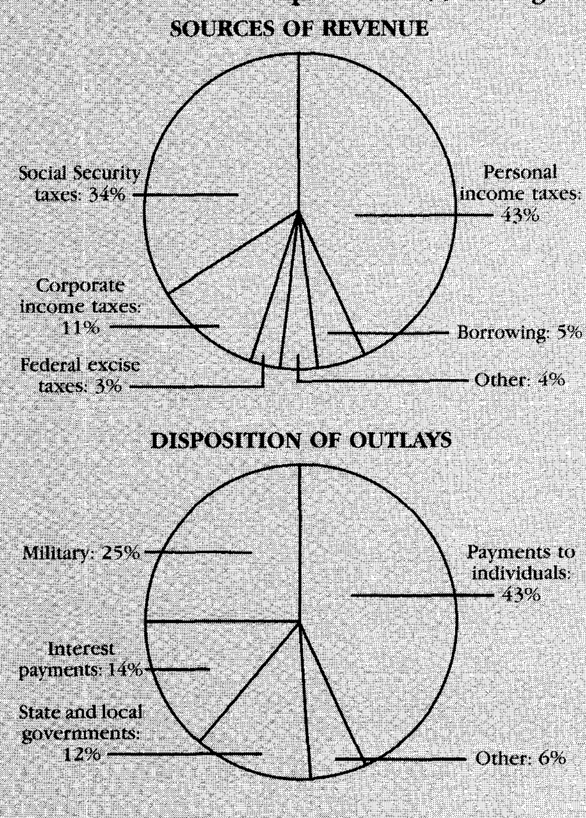
The FY 1990 I deficit figures provided the backdrop to President Bush's proposed budget for FY 1991. The $1.23 trillion total includes a 3 percent ($36.1 billion) increase in spending and a 9 percent ($96.7 billion) rise in revenues, which meets the $64 billion deficit ceiling mandated for 1991. Exhibit 6 shows the proposed distribution of the total outlay and the sources of the projected $1.17 trillion in revenues.

Highlights on the expenditure side include spending increases of 41 percent ($2.8 billion) on antidrug programs, 24 percent ($2.9 billion) for NASA (primarily for research and exploration), and 6.3 percent ($1.4 billion) for education. Reductions include $7 billion less for Medicare (through reduced payments to doctors and hospitals and slower payments to providers), savings of $2–3 billion in reduced agricultural subsidies, and an equal amount saved due to larger federal government employee payments for such items as health care and the suspension of inflation-related rises in pension benefits.

The projected added revenues of $15.7 billion include $5 billion from a proposed capital gains tax cut; another $5 billion from other fees and revenues, including a 2 percent increase (to 10 percent) in the federal tax on airline tickets (projected to raise an additional $500 million); $1.5 billion

Exhibit 6

President Bush's Proposed FY 1991 Budget



SOURCE: Office of Management and Budget.

from renewal of the soon-to-expire 3 percent federal tax on long-distance phone calls; and $3.8 billion from levying the Social Security tax on state and local government workers currently not being assessed.

The president's budget assumes an inflation-adjusted growth rate of 2.6 percent during FY 1990 (which compares to 1.8 percent projected by the CBO and the Blue Chip Economic Indicators), a 3.3 percent growth rate in FY 1991, and interest rates on 90-day Treasury Bills of approximately 5.8 or 5.9 percent (the CBO estimates 7.2 percent).

A recent development likely to figure in the budget eventually passed by Congress is a proposal by Senator Daniel Moynihan (D-New York) to slash Social Security taxes by $55 billion. The senator is a long-time opponent of including the Social Security fund surplus in the budget, which artificially reduces deficit totals to meet Gramm-Rudmann targets. The CBO estimates that if the $65 billion surplus were not included in the FY 1990 budget, the deficit would balloon to $203 billion (as opposed to the current CBO projection of $138 billion and the OMB estimate of $100 billion, both of which include the surplus). Numerous proposals to cut Social Security taxes and/or change the treatment of the surplus now have been suggested, and some such stipulation may be linked to any reduction of the capital gains tax rate.

Outlook

The administration's proposed budget already has received criticism from congressional Democrats for such "gimmicks" as another speed-up of payroll tax collections from employers and a much derided $3 billion savings projected to accrue from operating improvements at the Internal Revenue Service. The president's recommendation to cut the capital gains tax has received bipartisan support, although the form of and conditions for such a reduction vary widely. Senator Moynihan's proposal to cut Social Security taxes, however, likely will put a crimp in this and other administration and congressional tax proposals. While there is likely to be much rhetoric in an election year, any hard decisions aimed at meeting the FY 1991 Gramm-Rudmann targets probably will not be made before November 6.

International Trade

Review

The merchandise trade deficit continued to worsen during the first two months of 1989 IV but improved in December, most likely the result of the continued decline in the value of the dollar and a slowing U.S. economy. **For all of 1989** the deficit stood at $108.6 billion, 8.4 percent less than the $118.5 billion deficit posted in 1988, and the lowest yearly deficit since 1984.

Although October exports of U.S. goods grew slightly from the level recorded in September (up 1.1 percent, to $31.1 billion), imports continued to expand as well, rising to a record $41.2 billion, a 5.1 percent rate of increase. The October figures were not as distressing as they first seemed; the export rise occurred in the face of a strike at Boeing (a major producer of aircraft, a leading U.S. export), and imports of automobiles, usually a strong category, declined. An offsetting factor was the 8.5 percent rise in the price of imported oil, up by 71 cents per barrel (to $17.09), although import volume held firm at 8.3 million barrels per day.

The trade picture worsened substantially in November, however, when a $10.5 billion trade deficit was posted, the highest of the year. The major cause was a 2.7 percent drop in exports (to $30.2 billion), led by the decline in aircraft exports that resulted from the continued strike at Boeing. Imports fell again, however, decreasing by 1.7 percent (to $40.7 billion) as the result of the quarter's general economic slowdown. The $7.2 billion deficit posted in December was the result of an increase in imports, although exports rose as well, due to a slowing economy and the end of the Boeing strike.

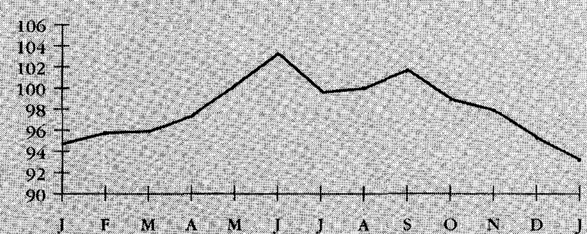
A large part of the credit for the 1989 IV trade showing was the declining value of U.S. currency on foreign markets. After reaching a yearly high in August, the dollar began to drop in September, triggering an upswing in exports during the fourth quarter. As shown in Exhibit 7, the dollar continued to fall throughout 1989 IV, and by the end of January 1990 it hit 93.1, its lowest monthly average in the past twelve months.

Outlook

The relatively good showing by exports—despite the Boeing strike—is encouraging, and the continued fall in the value of U.S. currency overseas during the fourth quarter should stimulate further improvements in merchandise exports during 1990 I and II. Sharp declines in the trade deficit will be hard to achieve, however, and will depend in large part upon the extent to which U.S. consumers demand imported goods.

Exhibit 7

The Trade-Weighted Value of the Dollar, Monthly Averages, January 1989-January 1990



SOURCE: Federal Reserve Bank of St. Louis, *U.S. Financial Data*, various issues.

NOTE: Monthly data are averages of weekly figures. Data are weighted averages of the foreign currency price of the U.S. dollar, computed using ten industrial country currencies.

Motor Vehicle Sales and Production

Review

Motor vehicle sales hit the skids in the fourth quarter, falling 14.7 percent below the year-ago level. Passenger car sales dropped 16.8 percent, with both domestics and imports experiencing roughly the same decline. The import share was 30.2 percent, compared with 29.7 percent in 1988 IV. Truck sales in the last quarter fell 10.6 percent below the year-ago level (see Exhibit 8).

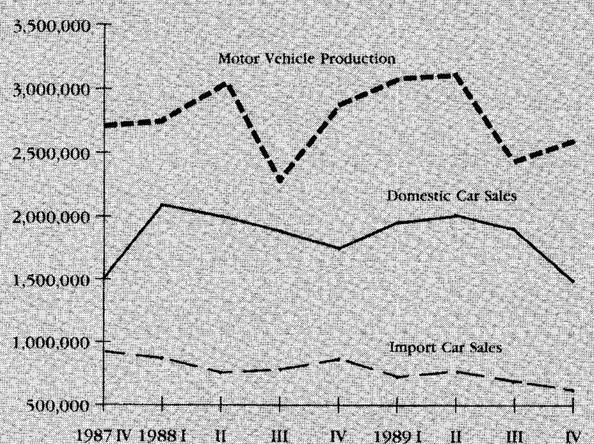
For all of 1989, motor vehicle sales decreased 5.8 percent from the 1988 level, from 16 million to 15.1 million units. Passenger car sales dropped 6.5 percent, with imports down 7.5 percent and domestics down 6.1 percent. The import share fell slightly in 1989, to 28 percent, compared to 28.3 percent in 1988. Truck sales declined 4.2 percent in 1989. Among the major manufacturers, only Isuzu recorded an increase (14.3 percent).

Motor vehicle production fell 14 percent in 1989 IV from the year-ago level, as automakers attempted to bring production into line with slumping sales. Passenger car production was off 15.3 percent, and truck production was down 11.6 percent. **For all of 1989**, motor vehicle production totalled 10.9 million units, 2.9 percent less than the 1988 level. Passenger car production fell 5.1 percent, and truck production declined one percent.

One noteworthy development in 1989 was the sharp increase in production by foreign transplants (foreign-owned U.S. plants), from about 800,000 units in 1988 to more than a million in 1989. Production was down for all U.S. manufacturers, with Chrysler's 15 percent decline the largest.

Exhibit 8

Motor Vehicle Production and Sales of Domestics and Imports, Quarterly, 1987 IV–1989 IV



SOURCE: *Automotive News,* various issues.

Import Share: 1989 IV–30.2; 1988 IV–29.7; 1987 IV–34.1.

% change between 1988 IV and 1989 IV: Production, –14.0%; Domestic sales, –17.3%; Import sales, –15.5%.

Outlook

The outlook for 1990 is not promising. The economy will suffer significantly, and consumer confidence will weaken. After six consecutive strong years, the auto industry is due for a downturn. Although truck sales increased 14.5 percent and passenger car sales 4.9 percent in January 1990 (compared with a very weak January 1989), sales likely will decline about 10 percent in the first half of the year. Sales should be stable or down only slightly in the second half of 1990.

We expect motor vehicle sales to total 14.3 million units in 1990, down 5.3 percent from 1989. Passenger car sales should reach 9.5 million units (compared to 10.1 million in 1989), and truck sales are estimated at 4.8 million units (5 million in 1989). The import share for passenger cars is likely to increase from 28 percent in 1989 to about 29 percent in 1990. Passenger car production probably will decline more sharply than sales this year, as inventories were very high in January 1990 (92 days).

Housing and Construction

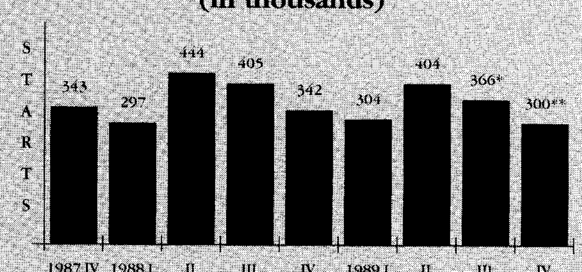
Review

The housing industry held fairly steady during 1989 IV. Total starts of new, privately owned housing units rose in October to 130,100 (up 34 percent from September) but then fell in both November and December, to 96,900 and 72,900 units, respectively. After seasonal adjustments, this translates into an annual rate of 1.423 million units through October, 1.342 million through November, and 1.235 million through December, for an average of 1.333 million starts during 1989 IV. This figure is down only slightly from the 1.338 million average annual starts through 1989 III (see Exhibit 9). **For all of 1989,** housing starts were 1.336 million, down 8 percent from the 1988 level of 1.518 million.

One sign that the housing industry may be emerging from the doldrums was found in the 1989 IV building permit data.

Exhibit 9

New Privately Owned U.S. Housing Units Started, 1987 IV-1989 IV (in thousands)



SOURCE: Bureau of the Census, U.S. Department of Commerce, "Housing Starts," *Current Construction Reports,* various issues.

*Revised

**Preliminary

Authorizations for privately owned housing units rose in October, to a seasonally adjusted 1.356 million, and held fairly steady throughout the quarter; the decline in November was only one percent (to 1.342 million permits) and in December a mere 0.4 percent (1.337 million permits). For the quarter, this represented a 2.5 percent rise in the total number of permits issued, to 4.035 million, compared to 3.928 million in 1989 III; this was the first increase in permits since 1989 I. The number of housing permits issued suggests the extent of future construction, and an increase in authorizations indicates more housing starts are likely during the next quarter.

A good showing in the November construction data raised the quarter's performance to just slightly below that of 1989 III. The value of new construction put into place in October was $414.6 billion, a decline of $1.6 billion (0.4 percent) from September's mark of $416.2 billion, but it rose in November to $417.3 billion, then declined again in December to $414.6 billion, the same level posted in October. Fluctuations in the October and November construction data were attributable to the public sector, while private residential and commercial construction remained fairly constant. In December, declines in these two categories were partially offset by a particularly strong showing in the public sector, at its highest mark in more than six months and 2.6 percent above its December 1988 level.

As always, please note that monthly housing statistics may show irregular variations; it may take three months for a true trend to emerge.

Outlook

Past efforts by the Fed to lower interest rates are beginning to have wider effects; the decline in the prime rate in January 1990 likely will spread to mortgage rates soon. The rise in authorized housing permits seems to indicate that decisions to build new homes are waiting for just such an event. If mortgage rates fall, and if public sector construction remains steady, housing and construction should begin to post some gains in 1990 I, with further progress likely in 1990 II.

Prices

Review

Inflation remained moderate in 1989 IV: The U.S. CPI grew at an annual rate of 3.8 percent between the third and fourth quarter. Overall prices were held down by small increases in food and beverages (3.5 percent), housing (1.6 percent), and transportation (1.4 percent), due mainly to an 18 percent decline in motor fuel prices. Apparel prices rose 15.8 percent at an annual rate (due mainly to seasonal factors), and the indices for other goods and services and medical care also jumped sharply (see Exhibit 10).

For all of 1989 (1988 IV to 1989 IV), the CPI was up 4.7 percent, the largest annual rise since 1981. The major categories recording increases well above average were medical care (8.4 percent), other goods and services (8.4 percent), and motor fuel, which is part of the transportation category (7.6 percent). Apparel prices rose only 1.5 percent, as competition from foreign manufacturers continued to exert downward pressure. Comparing 1989 to 1988, there was little difference in both annual average and fourth-quarter price changes, although both apparel and transportation prices were slightly higher on average in 1989. (Refer to Exhibit 10.)

Also included in Exhibit 10 is the 1979–89 increase for each major component. Medical care (121.1 percent) and other goods and services (114.4 percent) recorded the largest growth. Apparel prices increased only 40 percent. The index for all items rose 70.8 percent.

The producer price index (PPI), which generally foreshadows changes in consumer prices, grew at an annual rate of about 4 percent in the fourth quarter, after rising less than one percent in 1989 III. A 10.8 percent (annual rate)

Exhibit 10
U.S. Consumer Price Index and Percentage Changes, by Major Component, 1989 IV, 1989, and 1979-89

Component	Relative Importance (December 1988)*	1989 IV	Percentage Change, 1989 IV from 1989 III (annual rate)	Percentage Change from 1988 IV	Percentage Change, 1989 Average over 1988 Average	Percentage Change, 1979-89
Food and beverages	16.2%	126.7	3.5%	5.2%	5.7%	72.0%
Housing	42.3	124.6	1.6	3.8	3.8	75.0
Apparel and upkeep	6.4	121.3	15.8	1.5	2.8	40.0
Transportation	17.2	114.9	1.4	4.0	5.0	61.8
Motor fuel	3.1	87.3	−18.0	7.6	9.4	NA
Medical care	6.0	153.7	8.0	8.4	7.7	121.1
Entertainment	11.9	128.7	4.4	5.2	5.2	64.9
Other goods and services		152.2	8.3	7.9	7.9	114.4
All items	100.0	125.9	3.8	4.7	4.8	70.8
Special Index: Energy	7.3%	93.7	− 3.5%	5.0%	5.6%	43.5%

SOURCE: Bureau of Labor Statistics, U.S. Department of Labor, *News*, selected issues. Calculation by Public Sector Consultants, Inc.
*Indicates the item's contribution to the total market basket.

jump in food prices more than offset a 6.8 percent decline in energy prices. Excluding those two categories, the PPI increased at an annual rate of 3.6 percent in the fourth quarter.

Producer prices jumped 21.6 percent (annual rate) as food and energy prices surged. All other prices increased at an annual rate of only 1–2 percent, however, and prices are likely to settle back to more normal rates in the next few months.

For all of 1989 (1988 IV to 1989 IV), the PPI rose 5.1 percent, the largest increase since 1981. One favorable sign, however, is that the annual rate was 7.9 percent in the first half of the year but only 1.8 percent in the second half. Food prices were up 5.5 percent in 1989, well above the average increase of 2 percent for the past seven years. Energy prices rose 9.6 percent in 1989, following a 3.6 percent decline in 1988.

Outlook

Despite a quickening inflation rate in 1989, the outlook remains favorable. Producer prices have slowed in recent months, largely in response to the sluggish economy, and prices should continue to slow. Our forecast is for an increase of 4.5 percent in the CPI in 1990.

THE MICHIGAN ECONOMY

Employment and Income

Review

Michigan nonagricultural wage and salary employment increased only 0.5 percent above the year-ago level in 1989 IV, continuing the long slide; employment rose 2.9 percent in the first quarter, 2.5 percent in the second, and 1.8 percent in the third. The increase of about 64,000 jobs between the third and fourth quarter was smaller than normal. Job growth continued to slow in almost all sectors. It fell 2.7 percent in manufacturing, due largely to a 6.5 percent decline in motor vehicle employment, as poor auto sales resulted in temporary layoffs. In construction the decline was 0.6 percent, as the five-year boom in Michigan comes to an end; the average growth from 1983 to 1988 was 9.1 percent. Government employment was down only 0.8 percent from the year-ago quarter, due to a one-time surge in local employment in November 1989. The only major sector still posting solid gains was services, primarily in business and other services, but the 2.9 percent increase in 1989 IV was down from the 3.7 percent registered in the third quarter (see Exhibit 11).

For all of 1989, wage and salary employment in the state was up 1.7 percent from the previous year, the same increase

Exhibit 11

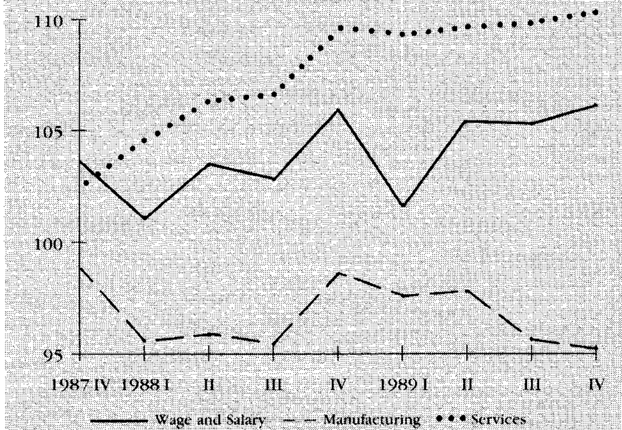
Michigan Wage and Salary Employment, by Sector, 1988 IV, 1989 IV, and 1989 and Five-Year Growth Rates

Sector	1988 IV (thousands)	1989 IV (thousands)	Percentage Change	1989 Average	Percentage Change, 1989 from 1988	Average Annual Growth Rate, 1983-88
Mining	10.6	10.1	4.8%	11.0	4.8%	3.1%
Construction	142.5	141.6	−0.6	136.0	1.9	9.1
Manufacturing	959.3	933.1	−2.7	943.0	−0.4	1.5
Durable	732.7	708.7	−3.3	720.0	−0.5	1.1
Furniture and fixtures	34.2	34.3	0.3	34.0	0.9	8.7
Machinery, exluding eletrical	121.4	121.9	0.4	123.0	3.1	0.4
Fabricated metal products	119.2	117.5	−1.4	118.0	0.5	1.7
Motor vehicles and equipment	299.5	280.1	−6.5	288.0	−2.4	−0.3
Nondurable	226.6	224.4	−1.0	233.0	−0.4	−2.8
Food and kindred products	45.6	43.2	−5.3	43.0	−4.0	−0.3
Chemical and allied products	41.8	42.9	2.6	42.7	2.9	0.8
Printing and publishing	43.5	43.8	2.6	43.0	1.7	4.5
Rubber and miscellaneous plastic products	48.5	48.0	−1.0	48.0	1.1	9.3
Transportation, communications, and public utilities	156.0	155.5	−0.3	154.0	−0.5	2.1
Wholesale and retail trade	912.9	936.5	1.5	915.0	3.0	4.4
Finance, insurance, and real estate	185.7	188.9	1.7	188.0	1.4	4.1
Services	866.3	891.6	2.9	882.0	3.4	4.8
Personal	42.1	42.2	0.2	43.0	3.1	4.7
Business	190.8	197.4	3.5	194.0	4.1	12.4
Health	280.4	283.6	1.1	283.0	1.6	1.6
Other	125.7	136.8	8.8	133.6	10.2	8.8
Government	660.2	655.1	−0.8	633.0	1.2	1.9
Total nonagricultural employment	3,893.4	3,912.3	0.5%	3,862.0	1.7%	3.3%

SOURCE: Michigan Employment Security Commission, *Monthly Report on Employment, Hours, and Earnings*, various issues.

Exhibit 12

Michigan Employment, Percentage Change, 1987 IV–1989 IV (1987 I=100)



SOURCE: Michigan Employment Security Commission, *Monthly Report on Employment, Hours and Earnings*, various issues.

Exhibit 13

Unemployment Rates for Eleven Large States, 1989 III and 1989 IV (seasonally adjusted)

	1989 IV	1989 III
Michigan	7.6	7.3
Texas	6.7	7.0
Illinois	6.6	5.9
Ohio	6.2	5.1
Florida	5.7	5.5
New York	5.2	5.0
Pennsylvania	5.1	4.3
California	5.0	5.0
New Jersey	4.6	4.4
Massachusetts	4.5	4.3
North Carolina	3.0	3.7
U.S.	5.3	5.3

SOURCE: Bureau of Labor Statistics, U.S. Department of Labor, *News*, various issues.

as in 1988. The fastest growing sectors were mining (4.8 percent) and services (3.4 percent). Manufacturing employment declined 0.4 percent, but this was an improvement over the 2.7 percent drop in 1988. As shown in Exhibit 12, the growth gap between manufacturing and services jobs continues to widen. Manufacturing employment is about 5 percent below its 1987 I level, whereas services employment is about 10 percent above its 1987 I level. Employment in construction rose only 1.9 percent and in finance, insurance, and real estate grew just 1.4 percent, in both cases a sharp drop from 1988 growth rates. (Refer to Exhibit 11.)

The Michigan unemployment rate averaged 7.4 percent in the fourth quarter, unchanged from 1989 III. The rate jumped to 8.4 percent in January 1990, the highest level since March 1988. As shown in Exhibit 13, Michigan had the highest unemployment rate among 11 large states in the fourth quarter of 1989. **For all of 1989**, the unemployment rate averaged 7.1 percent, down from 7.6 percent in 1988.

Michigan personal income (seasonally adjusted) rose 1.4 percent between the second and third quarter (latest data available), down from a revised 2.2 percent increase between the first and second quarter (see Exhibit 14). The U.S.

Exhibit 14

Michigan and U.S. Personal Income and Changes from Previous Period, 1989 III and 1989 II (dollars in millions at seasonally adjusted annual rates)

	Michigan		United States		Percentage Change, 1989 II to 1989 III	
	1989 III[a]	1989 II[b]	1989 III[a]	1989 II[b]	Michigan	United States
Earnings	$119,831	$118,308	$3,225,279	$3,162,084	1.3%	2.0%
Construction	5,848	5,815	200,221	199,132	0.6	0.5
Manufacturing	40,984	41,115	639,037	632,836	– 0.3	1.0
Transportation and public utilities	6,145	6,061	211,855	211,586	1.4	0.1
Wholesale and retail trade	17,605	17,358	520,841	512,807	1.4	1.6
Finance, insurance, and real estate	5,368	5,122	234,889	219,689	4.8	6.9
Services	26,806	25,553	821,252	781,970	4.9	5.0
Government	15,500	15,459	501,266	494,219	0.3	1.4
Other	1,573	1,823	95,917	109,845	13.7	–12.7
Other labor and proprietor's income	20,075	20,184	592,467	599,969	– 0.5	– 1.3
Dividends, interest, and rent	27,993	27,487	786,328	776,314	1.8	1.3
Transfer payments	25,298	24,900	636,723	627,048	1.6	1.5
Total personal income	$165,919	$163,641	$4,433,078	$4,352,603	1.4%	1.8%
Addendum:						
Wages and salaries	$99,756	$98,124	$2,632,832	$2,562,115	1.7%	2.8%

SOURCE: Regional Economic Information System, Bureau of Economic Analysis, U.S. Department of Commerce, January 1990.
[a]Preliminary.
[b]Revised.

Department of Commerce revised 1989 II personal income in Michigan from $160,979 million to $163,641 million, the largest adjustments being for earnings in manufacturing and services. Revisions in these data are not unusual, but in this instance they were particularly large.

The two strongest sectors were services and finance, insurance, and real estate, which increased 4.9 percent and 4.8 percent, respectively. As in the second quarter, the weakest sectors in 1989 III were manufacturing (-0.3 percent), construction (0.3 percent), and government (0.6 percent).

Personal income in the third quarter was 7.2 percent above the year-ago level, and wages and salaries were 5.3 percent higher than the previous year.

Outlook

Michigan wage and salary employment is forecast to increase less than one percent in 1990. Manufacturing jobs will continue to decline, with much of the weakness concentrated in the motor vehicle sector. Construction employment also will remain weak in 1990. Services again will be the fastest growing sector, and growth will be above average in government due to temporary hiring of census workers.

In the first three quarters of 1989, Michigan personal income was an average 7.9 percent above the year-ago level, and wages and salaries rose 6.5 percent, according to data from the U.S. Department of Commerce. (Fourth-quarter statistics are not yet available.) On the basis of personal income tax withholding data, however, these numbers appear inflated. The increase in withholding collections suggests growth of only 5 percent in wages and salaries, which translates into a rise of about 6.5 percent in personal income. Growth in 1989 IV is likely to be slower than in the first three quarters. Assuming the figures are revised downward by Commerce, as expected, we project about 5 percent growth in Michigan personal income in 1990.

Consumer Prices

Review

As measured by the Detroit-Ann Arbor CPI (released every two months), Michigan consumer prices declined at an annual rate of one percent during October and November 1989, compared with an annualized increase of 11.8 percent during August and September. The sharp slowdown was due mainly to large drops in apparel and motor fuel prices, both of which fell at an annual rate of 28.2 percent (see Exhibit 15). Housing prices also fell, by 2.5 percent. The largest hikes were for entertainment (7.8 percent) and food and beverages (7.4 percent).

December consumer prices in Michigan were 5.2 percent above the December 1988 level, the largest annual rise since 1981. The increases in the various major categories did not show wide variation, ranging from 5.7 percent for other goods and services to 3.6 percent for apparel and upkeep. **For all of 1989** (average annual basis), the CPI was 5.3 percent above the 1988 level. There was little difference in annual average and December-to-December changes, except for apparel and transportation (and the motor fuel component), which grew considerably faster on an annual average basis. (Refer to Exhibit 14.)

Exhibit 15 also includes 1979–89 price increases in Michigan for each major component. Medical care (99.6 percent) and other goods and services (96.9 percent) recorded the fastest growth during the 1980s. Apparel prices increased only 37 percent. The index for all items rose 71.3 percent during the 1980s, almost the same rate as nationwide.

Outlook

Despite the relatively large increase in the Michigan CPI in 1989, there is little danger that inflation will surge in 1990. The economy will be too weak this year to support significant price hikes in most sectors. Housing prices in the state are likely to be particularly weak in 1990. The major upward

Exhibit 15

Detroit–Ann Arbor Consumer Price Index and Percentage Changes, by Major Component, December 1989, 1989, and 1979-89

Component	December 1989	Percentage Change from October 1989 (annual rate)	Percentage Change from December 1988	Percentage Change, 1989 average over 1988 average	Percentage Change, 1979-89
Food and beverages	123.0	7.4%	4.4%	5.2%	47.2%
Housing	123.5	− 2.5	5.8	4.5	72.8
Apparel and upkeep	122.8	−28.2	3.6	6.4	37.0
Transportation	118.3	− 0.6	4.9	6.8	66.5
Motor fuel	86.6	−28.2	5.9	10.4	NA
Medical care	150.8	3.6	4.9	4.9	99.6
Entertainment	124.1	7.8	5.2	5.2	45.9
Other goods and services	142.0	1.8	5.7	5.9	96.9
All items	124.4	− 1.0	5.2	5.3	71.3
Addendum:					
All items less energy	128.5	1.0%	5.2%	5.2%	69.0%

SOURCE: Bureau of Labor Statistics, U.S. Department of Labor, *News*, selected issues. Calculations by Public Sector Consultants.

pressure probably will come from the energy sector, as oil prices have shown considerable strength in recent months. The forecast for 1990 is that the Detroit CPI will increase about 4 percent, slightly lower than the national rate of inflation, reflecting the relative weakness in the Michigan economy.

Housing and Construction

Review

Michigan's overall construction picture continued its weak showing relative to last year, but some signs of strength added luster to the year-end figures.

While the January through November value of construction (the latest data available) was less than that for the same period in 1988, in both October and November the showing was stronger than in the previous year. November's posting looked especially good; Detroit area and statewide residential construction as well as nonresidential construction in metro Detroit topped last year's marks. The November figures brought the state's residential construction to within 2.5 percent and nonresidential construction to within 8.2 percent below the January-November 1988 levels. This is an improvement over the January-September 1989 figure, which showed statewide residential and nonresidential construction were, respectively, 11.5 percent and 10.5 percent less than for the previous year period.

Residential housing permits also rebounded during the year's final quarter; in Detroit, 1,898 permits were authorized in October, 1,942 in November, and 1,010 in December, for a total of 4,850. Compared to the same month in 1988, the October 1989 figure was up 11.4 percent, November 66.3 percent greater, and December a whopping 44.1 percent more. Statewide, 4,812 residential construction permits were issued in October (22.4 percent above the year-ago mark), 4,412 in November (52.1 percent higher), and 2,373 in December (7.5 percent greater).

Outlook

While primary interest rates (such as the federal funds rate) have declined over the last six months, banks have been reluctant to follow suit until they are sure that the trend is permanent. The January 1990 decline in the prime rate (to 10 percent from 10.5 percent) indicates that the major lending institutions are becoming convinced that the Fed is indeed loosening its grip on credit. The effect on mortgage rates should begin to appear during 1990 I, allowing the housing market to remain stable through the first half of this year.

Regional Economies

Review

Employment growth slowed sharply statewide in 1989 IV. Only one MSA, Ann Arbor, improved on its third-quarter performance. The top two labor markets in employment growth were unchanged from 1989 III: Flint posted a 4.3 percent increase, and the Upper Peninsula registered 4 percent (see Exhibit 16). Employment growth was slowest in Muskegon (-1.5 percent) and Battle Creek (0.5 percent).

Exhibit 16

Wage and Salary Employment, Unemployment, and Percentage Changes, Major Michigan Labor Markets, 1988 IV and 1989 IV (thousands)

Labor market	Employment 1988 IV	Employment 1989 IV	Employment Percentage Change	1989 Employment	Employment Percentage Change from 1988	Percentage Unemployment Rate 1989 IV	Unemployment Percentage Point Change, 1988 IV to 1989 IV	1989 Unemployment Rate
Flint	165.6	172.8	4.3%	168.4	0.9%	10.9%	−0.7%	10.4%
Upper Peninsula	106.2	110.4	4.0	108.0	5.4	8.0	0.4	8.2
Grand Rapids	340.4	347.7	2.1	340.1	5.2	5.7	0.6	5.3
Saginaw-Bay-Midland	159.6	163.0	2.1	158.8	1.0	7.0	0.7	7.0
Jackson	54.4	55.5	2.0	54.6	6.2	7.0	0.0	6.8
Lansing-East Lansing	216.6	220.3	1.7	214.2	4.3	6.0	0.8	5.6
Kalamazoo	111.7	113.6	1.7	110.7	4.0	5.1	0.4	5.0
Ann Arbor	178.1	180.1	1.1	175.3	2.7	4.5	1.1	4.1
Detroit	1,936.0	1,955.6	1.0	1,938.0	3.7	7.1	0.2	7.0
Battle Creek	59.6	59.9	0.5	59.3	2.1	8.2	1.8	7.4
Benton Harbor	66.9	67.2	0.4	66.7	2.9	7.7	1.2	7.4
Muskegon	58.7	58.4	−0.5	57.7	1.4	9.2	0.6	8.9
MICHIGAN	3,893.4	3,912.3	0.5%	3,862.0	2.9%	7.3%	0.5%	7.1%

SOURCE: Bureau of Research and Statistics, Michigan Employment Security Commission.

For all of 1989, the fastest growing labor markets were Jackson (6.2 percent), the Upper Peninsula (5.4 percent), and Grand Rapids (5.2 percent). Three areas had increases of less than 2 percent in 1989: Flint (0.9 percent), Saginaw-Bay-Midland (one percent), and Muskegon (1.4 percent). Although Flint was one of the slowest growing labor markets for the year, it recorded the fastest employment growth in the second half of 1989.

Unemployment rates in 1989 IV ranged from 4.5 percent in Ann Arbor to 10.9 percent in Flint, but the latter was the only labor market posting a fourth-quarter unemployment rate below the 1988 IV level. The largest year-to-year increase was a jump of 1.8 percentage points in Battle Creek. **For all of 1989**, unemployment rates ranged from 10.4 percent in Flint to 4.1 percent in Ann Arbor.

Outlook

The regional outlook is unchanged from last quarter. Those labor markets most heavily dependent on automobile employment—Flint, Detroit, and Saginaw-Bay-Midland—are likely to experience the slowest economic growth. Lansing also will feel the effects of auto layoffs, but its diversified economy will provide a cushion. Jackson and the Upper Peninsula are not expected to do as well as in 1989. Grand Rapids, Ann Arbor, and the Detroit suburbs should record the fastest employment growth in 1990.

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