Economic Bulletin

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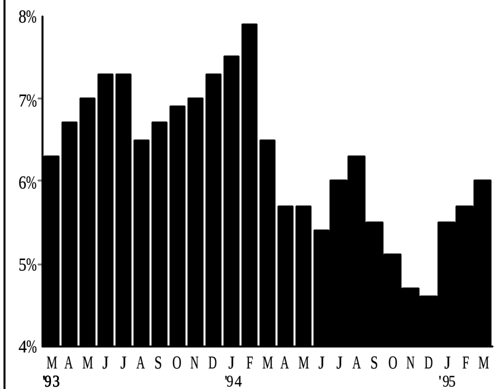
GOOD news The Conference Board reported that its consumer confidence index rose 1.6 percentage points in March after falling slightly each of the last two months. The latest reading of 101 marks the fourth 100-plus reading in the last five months and represents a 16.5 percent increase over the March 1994 reading. Consumers expressed more confidence in current conditions than in future expectations, and the number of respondents who thought "jobs were plentiful" increased from recent readings.

BAD news The U.S. unemployment rate rose 0.1 percent in March to 5.5 percent. The number of unemployed workers nationally now stands at 7.2 million. Establishments added 203,000 jobs in March, down from February's increase. Employment has increased by 3.1 million over the past 12 months. The service and construction sectors posted strong gains in March, while the retail trade and manufacturing sectors reported modest losses. The decline in factory jobs was the first since September 1994.

◆ The Michigan unemployment rate increased for the third consecutive month. The March rate of 6 percent was 0.4 percentage points higher than February. In March 1994 the rate measured 6.6 percent. Statewide unemployment increased 23,000, as employment dropped 8,000 and the work force increased by 15,000. Michigan had the third highest unemployment rate among the 11 largest states; Ohio continued to have the lowest rate, 3.8 percent.

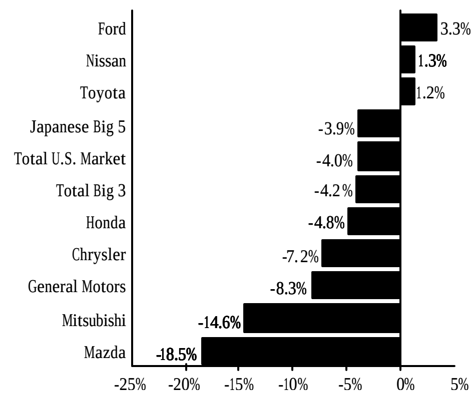
◆ U.S. vehicle sales fell for the third straight month in March. The seasonally adjusted annualized rate of 15.1 million units was 5.1 percent off the torrid 15.9 million pace registered in March 1994. Vehicle sales were down 4 percent for the first quarter. March car sales fell 8.9 percent and truck sales were virtually flat. Ford posted a 3.4 percent gain amid record-breaking truck sales, while General Motors and Chrysler posted 9 percent decreases. Nissan was the only Japanese auto maker reporting a sales increase. Market share of U.S. and Japanese auto makers declined 0.2 percent each; European auto makers gained 0.4 percent from a year earlier.

Michigan Monthly Unemployment Rates (seasonally adjusted)



SOURCE: Michigan Employment Security Commission.

Percentage Change in Vehicle Sales (1994 I to 1995 I)



SOURCE: *Wall Street Journal.*

IN THIS ISSUE

April 1995

MONTHLY FOCUS

MIDWEST ECONOMY LESS VULNERABLE

The Federal Reserve Bank of Chicago recently published a report that found the Midwest's economy is less vulnerable to economic downswings than in the past.[1] The Midwest, including Illinois, Indiana, Iowa, Michigan, and Wisconsin, has traditionally been viewed as a region that suffers more economically than other states during national economic slowdowns. This reputation is based on the region's past performance during recessions of the 1970s and 1980s when its employment, manufacturing, housing, and retail sales suffered much more than those of the rest of the nation.

Evidence of a Turnaround

This article presents ample evidence that the region is becoming much less sensitive, although not immune, to national economic downturns. For example, during every year between 1986 and 1994, job growth in the Midwest exceeded the national average, even during the 1990–91 recession. Also, the gap has been closing between the region's unemployment rate and the national rate. The exhibit shows Michigan's unemployment rates, which were much higher than the national average during the recession of the early 1980s but only slightly higher during the recession of the early 1990s.

Reasons Behind the Turnaround

Manufacturing, which was responsible for the Midwest's disproportionate decline during earlier recessions, has ironically contributed to its improved performance during the most recent recession. The turnaround in the national economy, stronger export markets, and pent-up consumer demand for cars and other big-ticket items gave the region's manufacturers a boost.

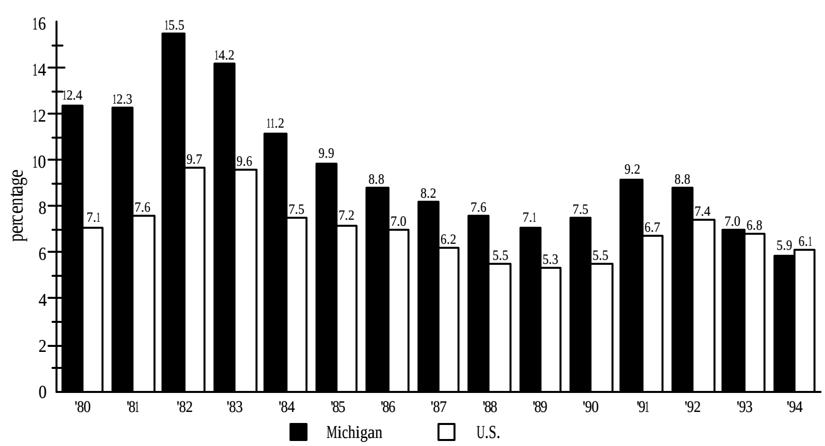
Midwest manufacturers also made great strides in improving productivity and quality, causing their share of national manufacturing employment to increase. Although the Federal Reserve report did not discuss diversification, it is likely that the region's slightly reduced reliance on manufacturing also helped it to withstand the last recession.

Conclusion

Will the Midwest continue its impressive performance? Part of the region's improvement is due to fortunate external conditions, such as low interest rates and relatively low energy prices. The effects of these conditions, which are beyond the region's control, are unlikely to hold indefinitely. However, the region's manufacturers have made lasting improvements in productivity and product quality, and these will help to sustain them in coming years.

While the outlook for the Midwest is very bright in 1995, only the next recession will tell whether the region's newfound ability to withstand recession is a lasting one.

Unemployment Rates in Michigan and the United States, 1980 to 1994



[1] Federal Reserve Bank of Chicago, *Chicago Fed Letter*, "The Midwest Economy: Still a Swan," issue no. 92 (Chicago, Ill.: The Fed, April 1995).

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NEWS FROM THE STATE CAPITOL

INCENTIVE PROGRAM PASSES

Negotiations between House Democrats and Gov. John Engler have given the Michigan Economic Growth Authority (MEGA) enough votes to pass the House. MEGA, a program to induce businesses to locate and expand in Michigan, is modeled on programs of Michigan's closest economic competitors. It will award 20-year business tax credits to in-state manufacturing and mining companies creating at least 75 new jobs and out-of-state companies creating 150 new jobs.

Insufficient Republican support for the program placed Democrats in a position to bargain with the governor for their MEGA votes. Governor Engler agreed to several amendments to the incentive program, including a two-year instead of a four-year sunset, a requirement that companies in enterprise zones and some other developing areas need create only 25 jobs to be eligible, and a requirement that businesses make "good faith" efforts to employ Michigan residents.

With Democratic support thus won, SBs 350 and 351 passed with enough votes for immediate effect. Immediate effect was very important because MEGA may influence the current decisions of three companies considering whether to locate or expand in Michigan. The Senate approved the House changes to MEGA and Lt. Gov. Connie Binsfeld signed the bills into law.

OFFICE CREATED TO CUT RED TAPE

Governor Engler has signed Executive Order 1995-6 establishing a new office of state government—the Office of Regulatory Reform (ORR). The office, which was first suggested by the Secchia Commission and promised in the governor's January 17 State of the State address, was created to streamline state administrative rules. These apply to most end-users of state government, from citizens registering their cars to businesses applying for liquor licenses.

Currently, the various departments of state government develop rules to administer state policies. These rules are often required by law and are updated as the need arises, such as when federal laws change. The governor's executive order created the first Michigan agency to improve state regulations and created some new rules of its own. For example, from now on state agencies seeking approval of new administrative rules must show that the benefits of new regulations outweigh their costs. They also must show that the rules do not create requirements that the legislation never intended. The governor's order also will allow the public to ask the ORR to review existing rules that are burdensome or no longer necessary.

It is unclear when Michigan businesses and citizens will soon notice the effects of less "red tape." The focus of the new office is primarily on new rules being submitted for approval, meaning that improvements would not be noticed for some time. However, state agencies soon will be asked to review existing rules and identify those that are obsolete or that duplicate those of other departments. If it follows through on this arduous task, state government could be more user-friendly for Michigan citizens, businesses, and local governments.

PUBLICATIONS OF INTEREST

Economics and Statistics Administration, Bureau of the Census, *Exports from Manufacturing Establishments: 1990 and 1991* (Washington, D.C.: Government Printing Office, December 1994). 202 / 783-3238

This annual publication provides statistics on export-related employment from manufacturing and the value of these exports. The data are shown by state and industry group (such as electronic or transportation equipment). Also, a breakdown by industry group for each state is provided, so the reader could compile a profile of manufacturing exports in each state. The reader could also determine the employment generated by and value of almost any type of exported product.

The Secchia Commission, *Toward a User-Friendly Government* (Lansing, Mich., December 1994).

This document summarizes the findings of the Secchia Commission, which was created by Gov. John Engler to study ways to make Michigan state government more effective and "user friendly." The governor vowed in his 1995 State of the State address to implement the ideas in the commission's report. Included are 48 pages of recommendations that range from civil service reform to streamlining government rules. It also provides opinions of Michigan residents and a list of laws, rules, and regulations that the commission found to be counterproductive. To order, call 517 / 335-7801; also available through Internet from the Michigan Department of Education.

MICHIGAN REVENUE REPORT

The Department of Treasury is still not publishing monthly revenue reports. However, The Senate Fiscal Agency put together some revenue numbers for the October–February period. (See the exhibit below.)

Income and use tax collections are running close to projections, while sales and Single Business Tax (SBT) collections are running well below projections. Total collections are running considerably below the consensus forecast.

The slowdown in collections is due partly to the recent weakness in motor vehicle sales—February sales tax collections on motor vehicles (SOS) were 18.4 percent below the year-ago level (adjusted for tax rate change).

February 1995 Revenue Collections (preliminary, dollars in millions)

February 1995 Tax Revenue	February 1995 Gross	February 1995 New	February 1995 Baseline	Percentage Change From Yr. Ago (baseline)	Percentage Change FY-to-Date (baseline)	FY 1994–95 Consensus Est. Base % Chg. (1/12/95)	February 1994
Income Tax							
Withholding	$421.3	–$23.4	$435.7	15.1%[a]	9.0%	8.0%	$378.6
Quarterly	4.1	–0.1	4.3	53.6	3.9	4.8	2.8
Annual	6.6	–0.3	6.9	–1.4	3.4	3.8	7.0
Subtotal Gross Income Tax	423.0	–23.9	446.9	15.1[a]	8.5	7.5	388.4
Sales Tax	322.7	105.4	217.3	0.6	4.8	6.9	216.1
Use Tax	65.2	24.3	40.9	7.3	7.8	7.2	38.1
Cigarette Tax	50.0	33.7	16.3	–39.2	–29.8	–20.3	26.8
SBT	202.7	–8.4	211.1	–10.5	–2.9	8.7	235.8
Insurance	22.8	0.0	22.8	36.5	2.5	5.6	16.7
Subtotal SBT + Insurance	225.5	–8.4	233.9	–7.4	–2.5	8.4	252.5
Estate / Inheritance Tax	20.3	0.0	20.3	1,591.7	28.5	21.4	1.2
Intangibles Tax	1.8	0.0	1.8	–43.8	–19.6	5.8	3.2
Severance Tax	1.5	0.0	1.5	150.0	–3.2	–7.5	0.6
TOTAL	1,110.0	131.1	978.9	5.6	4.5	7.3	926.9
S-U-W	800.2	106.3	693.9	15.4	7.5	7.6	632.8
Sales Tax - SOS	46.5	15.5	31.0	–18.4			38.0
Sales Tax - All Other	276.2	89.9	186.3	4.6			178.1

[a]No adjustment needed for Thursdays or Fridays.

Special Insert
April 1995

MICHIGAN ECONOMIC FORECAST

INTRODUCTION

The U.S. economy grew at an unsustainably high rate in the fourth quarter of 1994 but has since cooled off. The Federal Reserve Board raised interest rates in January—the seventh such move in a year—but refrained from doing the same in March as it became clear that economic growth had slowed. It remains to be seen whether the Fed has successfully engineered a “soft landing” for the economy, a period of slow (2.25–2.5 percent) economic growth where inflation is kept in check and unemployment stabilizes.

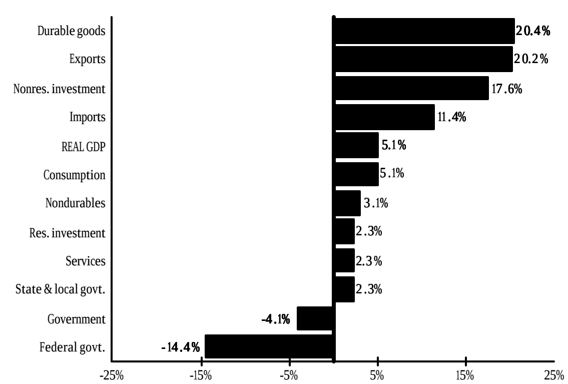
If the soft landing is successful, then the economic expansion, currently in its 49th month, should continue unhindered, albeit at a slower pace. Job growth remains strong—the national economy added nearly 800,000 jobs between December and March—and consumer confidence remains high. Further moves by the Fed, however, could choke off housing-related activity, which last year accounted for 10.5 percent of growth in the gross domestic product (GDP). The slowdown has eased inflationary pressures for the most part; however, inflation should rise above last year’s 2.7 percent level due to fast-rising intermediate goods prices and higher import prices driven by a weak dollar.

GROSS DOMESTIC PRODUCT (GDP)

GDP, the value of all goods and services produced in the economy, grew at a revised 5.1 percent annualized rate in the fourth quarter. The fourth-quarter surge brought GDP growth to 4.1 percent for 1994. While the fourth-quarter results defied the Fed’s attempts to ward off growth-driven inflation (by raising interest rates), economic growth appears to have slowed significantly in the first quarter and eased the Fed’s inflation fears.

Growth in personal consumption of durable goods (e.g., furniture, cars, appliances) led all sectors, up 20.4 percent from the previous quarter, and the trade sector and nonresidential investment also posted healthy increases. (See Exhibit 1.) Export growth was nearly double import growth. Nondurables, services, and housing investment grew sluggishly (2–3 percent), and the government sector experienced negative growth. Notably, federal government purchases declined 14.4 percent for the quarter and 5.3 percent for the year.

EXHIBIT 1
Percentage Change in Selected Components of GDP, 1994 III–1994 IV



SOURCE: Bureau of Economic Analysis.

Outlook

The economy has slowed considerably due largely to the drop in vehicle and housing sales precipitated by higher interest rates. First-quarter growth should range between 2.2 and 2.5 percent, and growth for the year should measure 2.5–2.7 percent.

Growth in consumption will remain sluggish in the first half of 1995 because much of the fourth-quarter consumption spending was financed by debt. Exports will expand as the global economic recovery continues to progress; however, imports will be hurt by the weakened dollar. Residential and nonresidential investment should experience moderate growth as interest rates stabilize.

EMPLOYMENT AND INCOME

U.S. nonfarm payroll employment increased by 2,902,000 jobs in 1994 or 2.6 percent (this number may be revised upward), the largest increase since 1988. The services and retail trade sectors led the way with respective increases of 1,525,00 and 592,000 jobs—the business service sector was particularly strong. Manufacturing employment rose by 60,000 jobs, the first increase since 1989. The job market remained fairly strong in the first quarter of 1995, as employment rose by an average of 239,000 per month, slightly below the 1994 monthly average of 242,000.

The U.S. unemployment rate averaged 6.1 percent in 1994, down from 6.8 percent in 1994. The fourth-quarter rate was 5.6 percent, down from 6 percent in the second quarter. The unemployment rate declined further to 5.5 percent in the first quarter of 1995.

The Michigan labor market in 1994 had its best year since 1985, as wage and salary employment increased by 136,000 jobs, or 3.4 percent. Nearly 38 percent, or 51,000, of the new jobs were in the services category, with 23,000 in business services (an 11.2 percent increase). Surprisingly, the second largest gain was in manufacturing, 41,000 new jobs, a 4.5 percent increase. This was the first increase since 1989 and the largest annual increase since 1984.

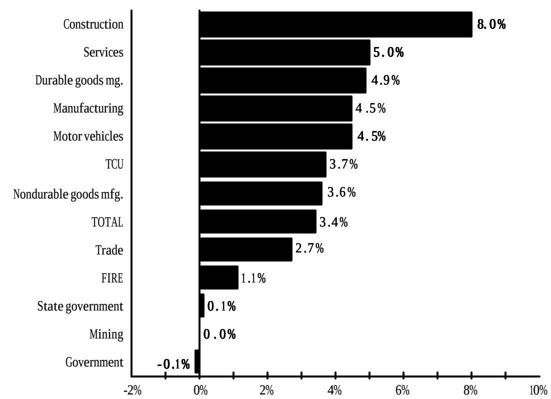
Much of this growth was generated by the motor vehicle industry. Direct employment in the motor vehicles and equipment sector was up by only 12,000 jobs, but many of the new jobs in other sectors, such as fabricated metals, were tied to motor vehicle production. The trade and construction sectors added 24,000 jobs and 11,000 jobs, respectively. Government unemployment was unchanged from 1993. (See Exhibit 2.)

Employment growth continued strong in the first two months of 1995, increasing by 153,000 jobs, or 3.8 percent above the year-ago level. The strongest sector was construction, with employment jumping 14.3 percent, likely due to milder weather this year than last. Manufacturing continued strong, as employment increased 4.8 percent. The services sector continued to account for the largest share of the increase, 51,000 jobs, one-third of the total increase. The percentage increase for services was 5.2 percent. Government employment continued to show little growth, increasing only 0.5 percent, and state government employment declined 2 percent.

The Michigan unemployment rate averaged 5.9 percent in 1994, down from 7 percent in 1993 and the first time since 1966 that the Michigan rate has been below the U.S. rate for the year. The unemployment rate averaged only 4.3 percent (seasonally adjusted) in the fourth quarter, the lowest quarterly average in more than 20 years. Due in part to reduced auto production, the unemployment rate jumped to 5.7 percent in the first quarter of 1995.

U.S. personal income increased 6.1 percent in 1994 compared with only 4.3 percent in 1993. Adjusted for inflation the increase was 3.4 percent, the best performance since 1988. The annual rate of increase in personal income was a robust 8.6 percent in the fourth

EXHIBIT 2
Michigan Wage and Salary Employment by Sector, Percentage Change 1994 II–1994 III



FIRE: Finance, insurance, and real estate
TCU: Transportation, communications, and utilities
SOURCE: Michigan Employment Security Commission (special release) and Public Sector Consultants' estimates.

EXHIBIT 3
Michigan Personal Income, Selected Components, 1989–94 (III) (dollars in millions)

Year	Total Personal Income	Wages and Salaries	Manufacturing Wages	Services Wages	Transfer Payments	Dividends, Interest, and Rent
1989	$162,358	$98,939	$34,581	$19,511	$23,271	$27,837
1990	169,808	102,804	34,193	21,254	25,250	29,603
1991	175,244	103,703	33,406	21,950	29,890	29,690
1992	185,665	110,141	35,175	24,058	31,763	29,209
1993	194,687	115,372	37,073	25,518	34,172	29,681
1994 II	209,514	124,091	40,765	27,570	35,731	32,957
1994 II	213,685	126,823	42,323	28,082	35,973	33,914
Percentage change 1993 II to 1994 II	8.0%	8.8%	15.3%	7.4%	2.7%	11.6%
Percentage change 1994 I to 1994 II (annual rate)	7.5%	9.0%	12.6%	9.5%	3.9%	14.4%

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

quarter, up from the modest third-quarter rate of only 5.2 percent.

Michigan personal income turned in a solid performance in the third quarter of 1994 (latest data available), increasing at an annual rate of 8 percent (seasonally adjusted). (See Exhibit 3.) Wages and salaries increased at an annual rate of 8.8 percent, led by strong gains in construction (16.6 percent) and manufacturing wages (15.2 percent). Wage and salary growth was held back by slow to modest growth in government; finance, insurance, and real estate (FIRE); and retail trade payrolls. The increase in personal income was dampened by a modest 2.7 percent increase in transfer payments (Social Security, welfare, and unemployment). Income from dividends, interest, and rent jumped 11.6 percent due to rising interest rates.

Outlook

We expect economic growth to begin to slow in 1995, both nationwide and in Michigan, due to higher interest rates, the effect of increased federal taxes, and a slowdown in motor vehicle sales as pent-up demand no longer drives sales. This has already begun to have an effect, as auto sales in the first quarter fell 4 percent from the year-ago level. One positive sign for continued employment growth is that overtime hours in manufacturing remain very high, 4.8 hours in the fourth quarter, the highest level since World War II.

We project a 1.75 to 2 percent increase in U.S. payroll employment in 1995, down from 2.6 percent in 1994. The U.S. unemployment rate is forecast at about 6 percent in 1995, down slightly from 6.1 percent in 1994, but up from the first-quarter average. For Michigan we are projecting only a 1.5–2 percent gain in wage and salary employment in 1995, down from 3.4 percent in 1994. We expect the Michigan unemployment rate to remain in the 5.75–6.25 percent range in 1995.

Our forecast for U.S. personal income growth is 5.5–5.75 percent in 1995 compared with growth of 6.1 percent in 1994. Michigan personal income is expected to rise a robust 7.5–8 percent in 1994, due in large part to increased overtime hours in the motor vehicle industry as well as stronger than projected employment gains. We expect personal income growth to slow to about 5.5–6 percent in 1995.

AUTOMOBILE SALES

In 1994 U.S. sales of cars and light trucks reached 15.1 million units, an 8.4 percent increase over 1993 sales and the best year since 1988. Last December we forecast that sales would increase again in 1995—to about 15.5 million units—before dropping somewhat in 1996. The first-quarter results, down 4 percent from a year earlier, have led us to revise our forecast downward.

From January to March vehicles sold at a seasonally adjusted annualized rate of 15 million units—about equal to 1994 total sales but well short of the 15.6 million unit pace recorded in the first quarter of 1994. The first-quarter results were mixed, with truck sales increasing 0.5 percent and car sales slipping 7 percent. Likewise, sales were up among auto makers with a strong presence in trucks (Ford and Chrysler) and down among those with a heavy presence in cars (GM and Honda).

Outlook

The rise in interest rates has finally begun to drag down sales, and pent-up demand for new models has been widely satisfied. These negatives are offset by strong consumer confidence, wide availability of new models, and auto makers' revival of incentive programs including rebates and subsidized leases. We continue to believe 1995 sales will exceed last year's sales, but only by 100,000–150,000 units. Our forecast of 15.25 million units counts on a strong second quarter, another record year for truck sales, and the stabilization of interest rates.

HOUSING

The U.S. housing market began to show weakness in January and February after posting its best results in six years in 1994. Annual housing starts and new home sales increased 13 percent and one percent, respectively. Higher interest rates have hurt the market this year. Two months into 1995 new home sales are down 10 percent, single-family housing starts are down 5.5 percent, and there is a six-month supply of new and existing homes on the market.

Michigan housing starts increased 7 percent in 1994 to 34,200 units, the highest level of activity for the 1990s. Housing starts are up nearly 9 percent for the first two months of 1995, but, unlike the rest of the nation where current growth has occurred in multifamily units, Michigan starts have been concentrated in the single-family category.

Outlook

The combination of rising new home prices, higher interest rates, and a large existing housing inventory will slow the housing market in 1995. Buyers are being forced to find more creative ways to make housing more affordable; adjustable rate loans accounted for 59 percent of new mortgages in January 1995, up from 24 percent a year earlier. Nationally, we expect housing starts to remain unchanged from last year's level of 1.46 million units, and in Michigan we forecast a modest 1–2 percent increase in housing starts.

MONETARY AND FISCAL POLICY

In January the Federal Reserve Board raised the federal funds rate and the discount rate 0.5 of a point each. The Fed chose not to raise rates at its March meeting despite pressure from international markets to prop up the slumping dollar. The federal funds rate now stands at 6 percent, up from 3 percent in February 1994. Long-term rates peaked in late December around 8 percent and have recently fallen to the 7.4–7.5 range. This should help the housing market recover somewhat.

As promised, the Republican House leadership spent their first hundred days in power voting on the ten components of the "Contract with America." Their push for a balanced-budget amendment fell short in the Senate, but the line-item veto passed both houses. Used effectively, this tool should allow the president to cut inefficient and unwarranted spending programs from future budgets and help curb the deficit.

Tax proposals have begun to dominate the legislative agenda. A capital gains tax cut is likely, as is relief for middle income families with children. Several flat tax and consumption tax (national sales tax) proposals have been floated in an effort to rewrite tax law to encourage more savings.

Outlook

The Fed appears to have engineered a soft landing for the economy and is not likely to raise short-term rates as long as growth moderates in the 2–3 percent range. Interest-sensitive sectors—autos, housing, and durable goods orders—will be hurt by further rate hikes. Long-term (30-year Treasury bonds) rates should stabilize around 7.5 percent.

The president and Congress will enact some sort of tax cut in keeping with campaign promises. A reduction in the capital gains rate would satisfy the Republican leadership and advocates of reducing taxes on savings; however, major overhauls such as a flat tax or a national consumption tax do not have broad support. While the president and Congress continue to speak forcefully about deficit reduction, neither is ready to make the cuts in entitlements needed to prevent future growth in the deficit.

PRICES

The U.S. consumer price index (CPI-U) rose at a seasonally adjusted annualized rate of 3.2 percent in the first quarter, after rising 2.7 percent for all of 1994. Excluding food and energy, the first-quarter annualized increase was 4.1 percent, with transportation (6.3 percent), medical care (3.8 percent), and housing (3.6 percent) exceeding the overall average.

Michigan consumer prices (as measured by the Detroit-Ann Arbor CPI, released every two months) decreased 0.8 percent between October and December 1994 (unadjusted annualized rate) but rebounded sharply in February. The 7.4 percent annualized increase was driven by large jumps in apparel, transportation, and nondurable goods prices. Overall prices increased 4 percent between February 1994 and February 1995.

The producer price index for finished goods, which serves as an indicator for future consumer prices, increased at a 2.6 percent seasonally adjusted annualized rate in the first quarter following a 2.2 percent increase in the fourth quarter of 1994. The core index, finished goods excluding food and energy, advanced at the same 2.6 percent rate despite energy prices rising 9.1 percent. The producer price index for intermediate materials and supplies rose at a 9.2 percent rate in the first quarter following a fourth-quarter increase of 6.9 percent.

Outlook

The inflation rate has moderated at or below 3 percent for the past three years. The first quarter results show a slight uptick in inflation that should persist through 1995. Producer prices, especially strong intermediate goods prices, will help spur the higher inflation rate this year just as weak producer prices have kept inflation down since the recovery began in 1991. Rising import prices due to a weak dollar will also contribute to the trend. The Detroit CPI will decelerate from the February surge but increase slightly faster than the rest of the nation due to stronger wage pressures in Michigan. We forecast a 3.4 percent increase in the U.S. CPI and a 3.5 percent increase in the Detroit CPI for 1995.