Economic Bulletin

GOOD news

Michigan's unemployment rate fell to a seasonally-adjusted 3.5 percent in April, down slightly from March's rate of 3.9 percent. The rate had been between 3.9 percent and 4 percent since September 1997. The decline reflected an increase of 14,900 jobs. April's 3.5-percent rate was the lowest since 1970 and nearly one percentage point below the U.S. rate.

◆ The **U.S. unemployment rate** fell to a seasonally-adjusted 4.3 percent in April, down from 4.7 percent in March. April's rate was the lowest since February 1970, when it dipped to 4.2 percent. The economy generated 262,000 new jobs last month, following a decline of 24,000 jobs in March. Workers also enjoyed slightly larger paychecks in April than in March—**average hourly earnings** rose 4 cents to $12.67.

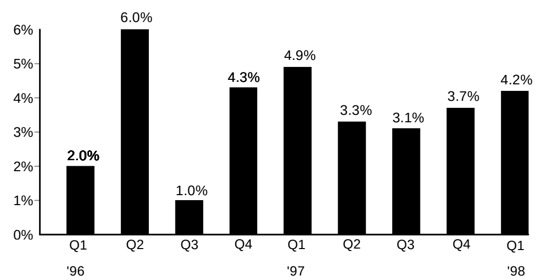
◆ **Gross domestic product (GDP)**, the primary measure of national economic growth, increased at a seasonally-adjusted 4.2 percent annual rate in the first quarter of 1998. This growth rate follows a 3.7-percent rate in the fourth quarter of 1997 and is the highest since a 4.9-percent increase in the first quarter of 1997. Consumer spending led the GDP growth, as personal consumption increased 5.7 percent. Large increases also were recorded in durable goods sales, residential investment, and business investment. (See Special Insert for more detail.)

◆ April light **motor vehicle sales** increased 6.1 percent, ending a string of three consecutive monthly declines. Car sales were up 2.2 percent, and light truck sales jumped 10.8 percent. Sales for the Big Three increased 5.7 percent, while sales of Japanese models gained only 2.3 percent. GM and Chrysler sales increased 8.2 percent; Ford sales inched up 0.8 percent. Light vehicle sales for the first four months of 1998 are up 0.6 percent, with car sales down 5.1 percent and light truck sales up 7.6 percent.

BAD news

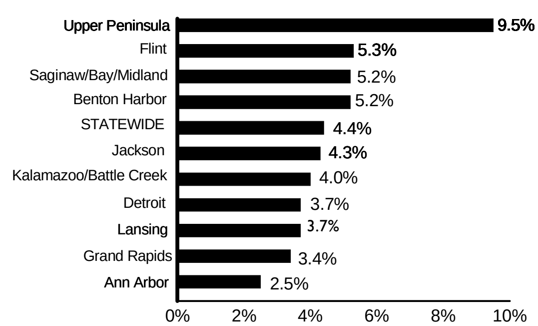
The U.S. Commerce Department announced that **new home sales** fell 5 percent in March from February, to a seasonally-adjusted annual rate of 828,000. The decline is due primarily to the way in which the government adjusts its data—good weather caused a surge in home buying early in the year, raising sales in February to unusually high levels. As a result, government figures show a drop in March over February's level. The decline does not necessarily indicate a cooling down of the housing market—the first quarter of 1998 saw the highest sales of any quarter since 1978.

Growth in U.S. GDP
(annual rate)



SOURCE: U.S. Department of Commerce.

Unemployment Rates in Major Michigan Labor Markets, March 1998 (unadjusted rates)



SOURCE: Michigan Jobs Commission.

IN THIS ISSUE

Public Sector Consultants, Inc.
600 W. St. Joseph
Suite 10
Lansing, MI 48933-2265
(517) 484-4954

May 1998

MONTHLY
. . . .
FOCUS

UNEMPLOYMENT PICTURE IMPROVES STATEWIDE

The Michigan Employment Security Agency (MESA) releases unemployment rates for each Michigan county on a monthly basis. Public Sector Consultants compared the counties' most recent (March 1998) unemployment rates with those from one year earlier and found that, of Michigan's 83 counties, all but 17 have lower or the same rates as they did last year.[1]

The exhibit shows changes in unemployment rates for the 25 counties with the largest rate increases and the 25 counties with the largest declines. Those counties that had higher rates in 1998 than 1997 (found in all parts of the state except the southeast) did not experience large increases—none were over one percentage point. Also, all of the top ten counties except Clinton are in the northern part of the state.

Many of the counties with the largest declines are in northern Michigan. Eleven of the 25 counties still had double-digit unemployment rates despite the decline.

---

[1]The MESA does not compile seasonally-adjusted monthly unemployment rates for counties. Public Sector Consultants, therefore, compared March 1998 to March 1997 in order to control for seasonal variances.

Change in Unemployment Rates for Selected Counties

25 Counties with Largest Increases in Unemployment

	March 1997 (%)	March 1998 (%)	Percentage Point Change	Rank
Keweenaw	14.0	14.7	0.7	1
Kalkaska	9.1	9.7	0.6	2
Gladwin	10.1	10.6	0.5	3
Clinton	3.2	3.7	0.5	4
Chippewa	10.6	11.1	0.5	5
Otsego	5.8	6.2	0.4	6
Menominee	7.3	7.7	0.4	7
Luce	10.2	10.6	0.4	8
Houghton	8.3	8.7	0.4	9
Antrim	8.2	8.5	0.3	10
Ingham	3.5	3.8	0.3	11
Calhoun	4.5	4.7	0.2	12
Eaton	3.2	3.4	0.2	13
Montmorency	17.9	18.0	0.1	14
Mackinac	23.2	23.3	0.1	15
Midland	4.4	4.5	0.1	16
Gogebic	9.6	9.7	0.1	17
Cheboygan	21.9	21.8	–0.1	18
Marquette	7.5	7.4	–0.1	19
Grand Traverse	5.5	5.4	–0.1	20
Ottawa	3.2	3.1	–0.1	21
Muskegon	5.2	5.1	–0.1	22
Branch	4.2	4.1	–0.1	23
Wexford	10.2	10.0	–0.2	24
Barry	4.1	3.9	–0.2	25
MICHIGAN	**4.2**	**4.4**	**0.2**	

25 Counties with Largest Declines in Unemployment

	March 1997 (%)	March 1998 (%)	Percentage Point Change	Rank
Presque Isle	20.6	16.9	–3.7	1
Ontonagon	15.5	12.3	–3.2	2
Mason	10.9	8.4	–2.5	3
Montcalm	9.1	6.6	–2.5	4
Huron	7.5	5.6	–1.9	5
Roscommon	12.3	10.5	–1.8	6
Schoolcraft	16.6	15.0	–1.6	7
Alger	9.4	7.8	–1.6	8
Manistee	11.1	9.5	–1.6	9
Alpena	11.1	9.6	–1.5	10
Alcona	11.6	10.2	–1.4	11
Oceana	12.4	11.0	–1.4	12
Van Buren	7.0	5.6	–1.4	13
Oscoda	11.8	10.5	–1.3	14
Lenawee	4.6	3.4	–1.2	15
Arenac	11.5	10.3	–1.2	16
Dickinson	7.9	6.8	–1.1	17
Clare	11.5	10.4	–1.1	18
Benzie	10.4	9.4	–1.0	19
Delta	10.2	9.2	–1.0	20
Ionia	6.1	5.1	–1.0	21
Gratiot	6.5	5.6	–0.9	22
Iosco	10.8	9.9	–0.9	23
Lake	11.9	11.0	–0.9	24
Ogemaw	11.6	10.7	–0.9	25
MICHIGAN	**4.2**	**4.4**	**0.2**	

NEWS FROM THE STATE CAPITOL

SENATE PASSES INCOME TAX CUT

During Gov. John Engler's January State of the State address, he proposed lowering the state's income tax rate from its current level of 4.4 percent to 3.9 percent over the course of five years. The Senate has passed legislation (SBs 1079–1083) encompassing this proposal. The bills would cut the income tax by 0.1 percentage points each year for five years beginning in 2000. For example, SB 1079 would reduce the rate from 4.4 percent to 4.3 percent on January 1, 2000, and SB 1080 would reduce it further to 4.2 percent in 2001. The bills now go to the House, where their fate is uncertain.

SUPERMAJORITY RESOLUTION FAILS

A resolution that would have made it much tougher for the legislature to raise taxes was defeated by the Senate. Senate Joint Resolution A requires that any proposed tax increase receive two-thirds support (a "supermajority") of the legislature in order to become law. The resolution, which amends the state's constitution, requires approval of two-thirds of both the Senate and House, rather than the usual simple majority, in order to pass. The Senate fell only three votes short of the 25 needed to pass. Given such a close vote, Senate leaders may call for another vote on the measure. Even if passed by both chambers, however, supermajority will not yet be law—voters also must give their stamp of approval.

FUNDING GUARANTEE REACHES HOUSE FLOOR

The House Tax Policy Committee reported out a resolution (HJR BB) that constitutionally guarantees schools and local governments funding increases in the future. The resolution, now on the House floor, changes the constitution to require that schools receive at least the same funding increase each year as that allocated to the state's general and school aid funds combined beginning in FY 1999–2000. If passed by both chambers, HJR BB requires voter approval since it modifies the constitution.

This month's *Economic Bulletin* and *Economic Forecast* were written by Laurie A. Cummings, Senior Consultant for Economic and Education Policy, and Robert Kleine, Vice President and Senior Economist.

INFORMATION OF INTEREST

United States General Accounting Office, *Consumer Price Index, More Frequent Updating of Market Basket Expenditure Weights is Needed,* (Washington, DC: GAO), October 1997. 202/512-6000.

This 70-page document discusses the market basket of goods and services that is used to calculate the Consumer Price Index (CPI). Currently, revisions are made to the market basket about once a decade to reflect changes in consumers' buying habits. The report examines the need to more frequently revise the market-basket expenditure weights (which allow the Bureau of Labor Statistics to specify the importance of each individual item in the market basket). It reviews the history of the CPI and examines the financial and budgetary effects of undertaking more frequent revisions. It also discusses the benefits of more frequent updates and the bureau's reasons for not yet providing them.

The Tobacco Institute, *The Tax Burden on Tobacco*, (Washington, DC: The Tobacco Institute), Volume 32, 1997. 202/457-4800.

This 259-page document is a compilation of charts and graphs examining all of the federal, state, and local taxes on tobacco and tobacco-related products. The foreword discusses current legislation to raise these taxes even more over the next few years and addresses some of the problems caused by these increases (i.e., smuggling). The majority of the tables provide historical as well as current (1997) information and are broken down by state. The data detail collection amounts, cigarette tax rate changes, tobacco sales information, and taxes as a percentage of cigarette retail prices.

MICHIGAN REVENUE REPORT

State revenue collections continued strong in April. Total collections increased 5.2 percent from the year-ago level. Revenue growth was dampened by weakness in the sales tax and the SBT. Sales, use, and withholding tax collections increased a solid 6.5 percent, the best gain since October.

Personal income tax withholding collections were up 5.9 percent in April following solid gains in the last three months. Gross collections were even stronger—up 7.8 percent—due to a 14.1-percent gain in annual payments. Early indications are that annual collections in May also will be very strong. The strength in annual payments is likely due to a sharp increase in capital gains.

Sales tax collections increased only 0.7 percent in April, the smallest gain in more than a year. Motor vehicle sales taxes were up 4.2 percent, but all other collections were unchanged from the year-ago level. Use tax revenue, which can vary widely from month to month, jumped 17.9 percent, offsetting a large decline in March. Year-to-date collections are still down 0.1 percent, well below the consensus forecast of a 5-percent increase.

SBT collections (including insurance) fell 7.1 percent in April from the year-ago level. Year-to-date collections are up only 0.4 percent compared with the consensus forecast of a 5-percent gain. At the current pace, SBT collections will fall about $100 million short of the consensus estimate.

Lottery sales were up 6.5 percent in April from the year-ago level. Sales have been remarkably steady this fiscal year, averaging about $143 million per month.

April 1998 Revenue Collections (millions)

Source	April Collections	Percentage Change Year-ago	Percentage Change Year-to-date	April 1997 Actual	FY 1997–98 Consensus Est. Less Tax Cuts (% Change)
Income tax					
Withholding	$479.6	10.0%	5.9%	$436.0	4.3%
Quarterly	95.6	2.5	15.0	93.3	4.4
Annual	436.5	14.1	15.5	382.5	–4.2
Subtotal: gross income tax	1,011.7	11.0	7.8	911.8	3.7
Sales tax	436.5	0.7	3.1	433.4	4.6
Motor vehicles	79.6	4.2	7.3	76.4	—
Other	356.9	–0.0	2.4	357.0	—
Use tax	100.1	17.9	–0.1	84.9	5.0
Subtotal: sales/use/withholding	1,016.2	6.5	3.5	954.3	3.9
Tobacco tax	42.0	–4.1	–4.0	43.8	–3.1
SBT	240.8	–4.3	0.4	251.6	5.0
Insurance	17.4	–33.8	–24.2	26.3	12.5
Subtotal: SBT + insurance	258.2	–7.1	–1.9	277.9	5.5
State education property tax	95.2	26.8	–1.4	75.1	5.0
Real estate transfer tax	16.1	40.0	18.9	11.5	0.6
Estate/inheritance tax	11.7	44.4	43.7	8.1	4.4
Intangibles tax	14.2	–65.2	–62.5	40.8	–39.6
Severance tax	2.4	33.3	–17.7	1.8	–2.9
TOTAL	$1,988.1	5.2%	3.5%	$1,889.1	3.9%
Gross lottery sales (prel.)	$151.3	6.5%	5.4%	$142.0	

SOURCE: Senate Fiscal Agency.
NOTE: November is the first month of the new fiscal year for all revenue sources except the lottery.

Special Insert
May 1998

MICHIGAN ECONOMIC FORECAST

INTRODUCTION

The economic good times continue in Michigan and nationwide. The U.S. economy shows no signs of significant weakening—consumer confidence remains high, solid employment growth continues, and first-quarter gross domestic product was stronger than expected. Michigan continues to share in the good economic times—its unemployment rate has been at or below 4 percent every month since the spring of 1997.

HIGHLIGHTS

- $ The current economic expansion has reached 87 months, and there are no indications of an end to the third-longest expansion since World War II.
- $ The U.S. economy enjoyed a 4.2-percent growth rate (GDP) in the first quarter of 1998, up from 1997's fourth-quarter growth of 3.7 percent.
- $ The Michigan and U.S. labor markets continue to exhibit low unemployment and steady job growth.
- $ Light motor vehicle sales have been weakening, as sales declined 2.8 percent in the first quarter. April sales were surprisingly strong, however.
- $ Consumer prices remain well under control—inflation rose at only a 1.1-percent annual rate in the first quarter of 1998 from the fourth quarter of 1997.
- $ Despite trouble in the Asian financial markets, the current economic expansion should continue throughout 1998.

GROSS DOMESTIC PRODUCT

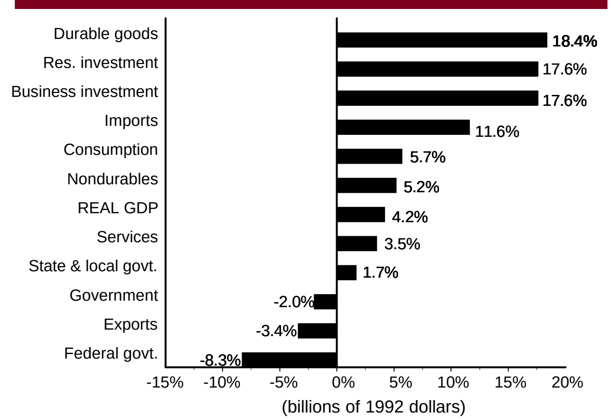
Preliminary estimates are that **gross domestic product (GDP)**, the primary measure of national economic growth, increased at a seasonally-adjusted 4.2-percent annual rate in the first quarter of 1998, following a 3.7-percent increase in the fourth quarter of 1997. The increase marked the economy's best performance in any given quarter since the first quarter of 1997.

The national economic growth in the first quarter was due to increases in several sectors. A hefty 5.7-percent rise in personal consumption—which accounts for over three-fourths of all economic activity—led the economy's growth. (See Exhibit 1.) Sales of big-ticket items (durable goods) skyrocketed 18.4 percent over the fourth quarter of 1997, likely fueled by lower interest rates that made it easier for consumers to borrow for large purchases. Similarly impressive gains were seen in housing (residential investment) and business investment, both of which enjoyed 17.6-percent increases. The only hint of bad news in the first quarter numbers is that imports climbed 11.6 percent and exports fell 3.4 percent. This likely is due at least in part to the Asian crisis, which has lowered the price of Asian and other goods relative to those of the United States.

Outlook

With consumer confidence high, continued solid employment growth, and strong first-quarter GDP growth, the economy shows no signs of significant weakening. The Federal Reserve Board continues to hold the line on interest rates, largely because inflation remains low; the consumer price index (CPI) increased at an annual rate of only 1.4 percent for the 12 months ended in March. Motor vehicle sales have been a concern, but April sales were up a surprising 6.1 percent from April 1997. The first-quarter decline in U.S. exports was offset by strong gains in consumer spending and business investment.

EXHIBIT 1
Percentage Change in Selected Components of GDP (Annual Rate), 1997iv to 1998i



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

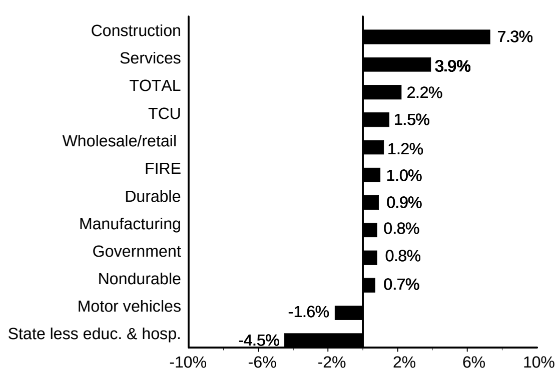
Two factors bolster chances that expansion will continue. Declining energy prices will help keep a lid on inflation and reduce the likelihood that the Fed will raise interest rates, and projected federal budget surpluses for the next decade will allow the federal government to stimulate the economy if signs of weakness appear.

We expect continued economic expansion in the second quarter of 1998 and beyond but at a slower rate than in the first quarter. The U.S. unemployment rate remains very low, consumer confidence remains high despite fears about the Asian economies, and the housing market remains strong, boosted by a good job market and falling mortgage rates. Despite these factors, the economic crisis of our Asian trading partners may yet tap the brakes on U.S. economic growth. We predict GDP growth of between 2.3 percent and 2.5 percent for the second quarter of 1998 and a rate between 2.5 percent and 2.8 percent for 1998. The consensus forecast for 1999 is for growth of 2.2 percent, but this could be conservative in view of the economy's current strength.

EMPLOYMENT AND INCOME

U.S. nonfarm payroll employment increased by 934,000 jobs in the first quarter of 1998, an annual rate of 3.1 percent, slightly above the growth rate in the last two quarters. The services sector led the way with an increase of 401,000 jobs (from the previous quarter). Manufacturing employment rose by 91,000 jobs, almost matching the large gain in the previous quarter. Construction employment was very strong, up 143,000 jobs, due largely to the mild weather in the first quarter. In April, nonfarm payroll employment increased by 262,000 jobs following a small decline in March.

EXHIBIT 2
Michigan Wage and Salary Employment, 1st Quarter, 1998, % Change from Year-ago Quarter



SOURCE: Michigan Jobs Commission.

The **U.S. unemployment rate** averaged 4.7 percent (seasonally adjusted) in the first quarter of 1998, unchanged from the previous quarter but down from 5.3 percent in the first quarter of 1997. The unemployment rate fell to 4.3 percent in April, the lowest rate since February 1970.

Michigan wage and salary employment improved significantly in the first quarter of 1998, increasing 2.2 percent above the year-ago quarter compared with growth of 1.4 percent in the fourth quarter of 1997. First-quarter growth exceeded rates for every quarter since the third quarter of 1995. As shown in Exhibit 2, the strongest major sector in the fourth quarter, as in recent quarters, was construction, up 7.3 percent. Employment in the services sector increased 3.9 percent, aided by a 4.6-percent gain in the business services industry. Manufacturing employment increased 0.8 percent despite a 1.6-percent decline in motor vehicle employment. State government employment, excluding education and hospitals, fell 4.5 percent from the year-ago quarter following sharp declines in the last three quarters of 1997.

The **Michigan unemployment rate** averaged 4 percent (seasonally adjusted) in the first quarter of 1998, unchanged from the previous quarter, but down from 4.5 percent in the first quarter of 1997. The April unemployment rate was 3.5 percent.

U.S. personal income increased at an annual rate of 6.5 percent in the fourth quarter of 1998. For all of 1997, personal income increased 5.8 percent. Wage and salary income increased 6.7 percent. The fastest-growing component was dividend income, which jumped 10.4 percent. The slowest-growing component was rental income, which edged up 1.1 percent.

Michigan personal income growth increased at an annual rate of 10.1 percent in the fourth quarter of 1997 (latest data available), up from an increase of only 0.9 percent in the third quarter and the fastest rate of growth among the 50 states (see Exhibit 3). This large increase was due mainly to a 27.4-percent jump in manufacturing wages and salaries, following a 6.6 percent decline in the third quarter. Services wages continued strong, increasing at an annual rate of 10.7 percent. Income growth was held back by slow growth in transfer payments (2.5 percent) and dividends, interest, and rent (2.9 percent). Personal income increased 4.4 percent in 1997 compared with a 4.3 percent increase in 1996. Wages and salaries increased 5.1 percent in 1997, but income growth was dampened by modest increases in transfer payments (4.2 percent) and dividends, interest, and rent (4.5 percent).

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

Year	Total Personal Income	Wages & Salaries	Manufacturing Wages	Services Wages	Transfer Payments	Dividends, Interest, & Rent
1990	$174,388	$102,788	$34,170	$21,339	$25,991	$31,627
1991	179,165	103,718	33,395	22,037	29,303	32,331
1992	188,714	110,181	35,164	24,155	30,912	32,016
1993	200,671	115,411	37,051	25,663	33,081	32,697
1994	215,250	125,010	41,726	27,511	33,438	36,563
1995	229,474	133,075	44,474	30,197	35,183	40,244
1996	239,269	140,100	45,483	32,565	36,930	41,939
1997	249,817	147,199	46,668	34,664	38,483	43,824
1997iv	255,246	151,417	48,534	35,667	38,852	44,380
Percentage change 1996iv to 1997iv	5.2%	6.0%	5.0%	7.1%	4.0%	4.7%
Percentage change 1997iii to 1997iv	10.1%	14.5%	27.4%	10.7%	2.5%	2.9%

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

Outlook

U.S. payroll employment is expected to increase about 1.5–1.75 percent in 1998. The U.S. unemployment rate is expected to average about 4.75 percent in 1998. Michigan wage and salary employment is projected to increase about 1.25 percent in 1998, down from 1.5 percent in 1997. The Michigan unemployment rate is expected to average 4.25 percent in 1998, up from the 1997 rate of 4.1 percent.

In our last report, we forecasted that U.S. personal income would increase 5.5 percent in 1997. The actual increase was 5.8 percent. We forecast an increase of 5–5.5 percent in 1998 and 1999 as we expect the economy to slow modestly in the second half of 1998. In our last report, we predicted that Michigan personal income growth in 1997 would be 4.5–5 percent. The preliminary increase for 1997 is 4.4 percent. Our forecast for both 1998 and 1999 is that Michigan personal income will increase about 4–4.5 percent. This modest slowdown will be largely the result of the expected weakness in motor vehicle sales.

MOTOR VEHICLE SALES AND PRODUCTION

Light motor vehicle sales weakened in the first quarter of 1998 as sales declined 2.8 percent. **Truck sales** were up 3.1 percent in the first quarter, while car sales dropped 7.5 percent. The **Big Three** gained market share—their sales fell 2.4 percent compared with a 10.3 percent decline for Japanese models. This reversed the trend of recent quarters. April motor vehicle sales increased 6.1 percent from the year-ago month. The annual sales rate in April was 15.3 million units, up from 15.1 million in the first quarter.

First-quarter **motor vehicle production** increased 5.6 percent from the year-ago quarter as truck production surged 11.4 percent. Passenger car production fell 0.5 percent.

Outlook

Motor vehicle sales were weaker than expected in the first four months of 1998. Some industry analysts are concerned that the automobile sector may be heading into an unexpected downturn. Some of the weakness is attributed to the effects of leasing, which has generated a large supply of good used cars that are being bought by low and middle-income consumers who would normally buy a small, new car. Also, after several years of solid vehicle sales combined with better-quality vehicles lasting longer, the replacement cycle has been stretched out.

In our last quarterly forecast, we projected 1998 motor vehicle sales of 15.4 million units. This is still possible, but it is more likely that sales will come in at 15.1 million units, slightly below 1997 sales of 15.16 million units. Our forecast is for truck sales of 7.1 million units and car sales of 8 million units. We expect motor vehicle sales in 1999 to be 14.9–15.1 million units.

MONETARY AND FISCAL POLICY

Although the economy continues to expand, there has been no need for the Fed to hike **interest rates** to slow the economy and head off inflation. This is because inflation remains low at both the consumer and producer levels despite continued economic growth. Interest rates on short-term loans remain low—for example, the **federal funds rate**, the rate at which banks lend to each other, remains at 5.5 percent. **Long-term rates** fell slightly in the first quarter from the fourth quarter of 1997—Moody's Corporate Aaa bond yield averaged 6.67 percent in the first quarter, down from 6.88 percent in the fourth. This was the third consecutive quarter in which the rate had fallen. April's **home mortgage rate** was one of the lowest in the 1990s, reaching 7.17 percent (effective rate on newly-built homes). For the first quarter, mortgage rates dipped to an average of 7.2 percent, down from 7.4 percent in the fourth quarter of 1997.

The big story on the federal front is the emerging expectation of a federal budget surplus. Higher-than-expected tax revenues due to a strong economy and surging stock market have led to projections that the federal government may have a $40–$60 billion surplus at the end of the fiscal year (September 30). If the projected increase holds true, the United States will have its first budget surplus since 1969.

Outlook

Normally, the low unemployment and solid economic growth the nation is now enjoying would lead the Fed to raise interest rates in order to slow the economy and head off inflation. The Fed has broken this pattern for several months now by leaving rates alone. It has done so simply because data have consistently shown inflation to be very low with no sign of rising. Despite the fact that data were released showing high employment growth in April, the Fed held rates steady at its May 19 meeting. We likely will not see a rate hike unless there is a significant increase in the CPI.

The potential budget surplus is certainly good news for federal budgeters. It will be at the heart of intense discussions in the coming months, however, as the Clinton administration and Congress debate the best use for the extra funds. White House officials have stated that the budget surplus should be used to help solve the anticipated shortfall in Social Security funds when the babyboomers retire. Many GOP lawmakers argue that the money should be refunded to taxpayers. Resolution of these and other differing views will not come easily.

PRICES

The **U.S. CPI** rose at an annual rate of only 1.1 percent in the first quarter of 1998, following a 1.6-percent increase in the fourth quarter of 1997. The first quarter's increase reflects surprisingly moderate inflation despite robust growth in the national economy. The moderation is due in part to falling gasoline prices, which plummeted 8.5 percent in the first quarter. Excluding the volatile food and energy sectors, prices rose at a slightly higher annual rate of 2.4 percent in the first quarter.

The April CPI (most recent available) rose at an annual rate of only 2.4 percent. While this increase is small, it was the largest since October. The core index—which excludes volatile food and energy prices—rose at an annual rate of 3.6 percent following a 1.2 percent rise in March.

Inflation remains moderate in Michigan. The April **Detroit-Ann Arbor-Flint CPI** (produced bimonthly and latest data available) rose 2 percent over the April 1997 rate. (Unlike the national CPI, Michigan's CPI is not seasonally adjusted. We are, therefore, comparing the data to that of one year ago in order to control for seasonal variances.) Excluding food and energy, Michigan prices rose 2.5 percent in April from the previous year. As in the rest of the nation, Michigan energy prices have been declining recently and were 1.3 percent lower in April than in February.

Wholesale prices, as measured by the **producer's price index** (PPI) fell every month during the first quarter of 1998, averaging a 4.4 percent decline (annual rate). Some, but not all, of the decline can be explained by falling energy prices; excluding food and energy prices, the PPI fell 1.2 percent. In April, however, prices rose 0.2 percent, the first increase in six months. Moderate producer prices bode well for future consumer inflation, since higher wholesale prices often lead to higher consumer prices in later months.

Outlook

The current inflation picture defies all conventional economic wisdom. Normally, such low unemployment would force employers to raise wages to attract new workers, thereby driving up the prices of goods and services. Consumer prices, however, have been rising more slowly than they have since 1986, and producer prices set a record low in 1997. One explanation is that productivity gains have enabled producers to raise wages without passing costs on to consumers. Some observers feel that April's slight increase in consumer prices marks the beginning of an inflationary trend. Our forecast, however, is that inflation will remain in check in the first quarter of 1998, hovering between a 2 percent and 2.3 percent annual rate, and average about 2.25 percent for 1998.