

THE MICHIGAN ECONOMY--ON THE BRINK OF A RECESSION?

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Review

For the last two and one-half years, the U.S. economy has expanded at a moderate rate compared with the rapid expansion in 1983 and 1984. (See Exhibit 1.) In question is which way the economy will move in the next year or two. The current economic expansion is the third longest in the postwar period--57 months. (See Exhibit 2.) How much longer can it continue? One school of thought is that because economic growth has been moderate in the last two and a half years, the economy has not become overextended and the end of the recovery is not in sight. The performance of the leading economic indicators, the booming stock market, and the recent pickup in consumer spending would support this view. Another view is that the economic recovery is running out of steam and a recession is on the horizon. Supporters of this latter view point to the continuing high federal budget and trade deficits, the recent increase in interest rates, higher rates of inflation, the weakening housing market, and the heavy debt burden of the consumer.¹ (See Exhibit 3.)

Our view is that the expansion still has some life left, but the risks of a recession in the next two years are increasing. To quote Business Week:

Unflagging support from consumers has made this business expansion unusually long. But in one important way, the current cycle may be much like all the rest. Late in an expansion, slower income growth, rising inflation and interest rates, high debts, and low savings eventually pull consumer spending down. When that happens the good times are over.²

The outlook for Michigan is not promising. Michigan is still a manufacturing state, and the manufacturing sector has been weak nationwide. After increasing for four consecutive years, U.S. auto sales have turned down in 1987. Total auto sales for the first half of 1987 fell 12.1 percent below the year-ago level. Domestic passenger car sales fell an even sharper 14.6 percent. The share of sales captured by imports was 29.1 percent in the first half of 1987 compared with 27.9 percent in 1986. Particularly troubling is that imports have maintained their market share despite a 10 percent decline

¹The decline in consumer installment credit as a share of U.S. disposable income in the first half of 1987 can be attributed to the substitution of home equity loans for installment debt and the consumer's increasing unwillingness to take on new debt.

²"Business Outlook," Business Week, August 31, 1987.

in the value of the dollar in the past year. U.S. auto production fell 5.7 percent in the first half of 1987. Truck production increased 8.7 percent. Because auto sales have fallen faster than production, additional cutbacks in production will be necessary in the second half of the year. Michigan has fared better than the nation because state auto and truck production in the first half of 1987 increased 4.1 percent and 32.1 percent, respectively, above the year-ago level.

The Michigan unemployment rate has fallen from 15.5 percent in 1982 to an average of 8.4 percent for the first half of 1987. Employment growth, however, is slowing due to weakness in manufacturing. The only significant growth sectors in the past two years have been services, retail trade, finance, and construction. (See Exhibit 4.)

Manufacturing is Michigan's largest employment sector, but services is rapidly closing the gap. In 1978, the manufacturing sector provided 32.7 percent of Michigan wage and salary jobs compared with 16.7 percent for the services sector. In the first half of 1987, manufacturing provided only 26.6 percent of wage and salary jobs and services provided 21.7 percent. The trend away from manufacturing and toward services is reflected in a relative decline in Michigan per capita income.

Michigan personal income increased only two-thirds as fast as U.S. personal income from 1980 to 1986, due mainly to the³ severe impact of the recessions in the early 1980s on the Michigan economy. Since 1982, Michigan has done somewhat better, as personal income increased about 87 percent as fast as U.S. personal income (1982-1986). As a result, Michigan personal income per capita has fallen from 102.6 percent of the U.S. average in 1980 to 97.3 percent in 1986, ranking Michigan 20th among the states. (See Exhibit 5.)

Comparing Michigan to the other Great Lakes states, personal income in this state grew slower between 1980 and 1982, but slightly faster since 1982. Michigan per capita income is currently about 1.5 percent above the average for the Great Lakes region.

Outlook

U.S. auto sales should improve slightly in the second half of the year, but will fall far short of the incentive-stimulated sales in the second half of 1986. For calendar year 1987, U.S. auto sales are estimated at 10 to 10.2 million units, 12 to 14 percent below the 1986 level. Imports will capture about 30 percent of the market. Auto sales in 1988 are estimated at 9.7 to 10 million units, with the import share increasing slightly. Auto production will fall sharply in the second half of 1987 as high inventory levels are reduced. Truck production will increase slightly in 1987, the seventh consecutive annual increase. Both auto and truck production are expected to decline modestly in 1988. Because of the high inventory levels and the weak market, an auto strike this fall of moderate duration is unlikely to have much effect on the industry or on the Michigan economy.

³Adjusted for inflation, Michigan personal income increased only 7.6 percent between 1980 and 1986, less than half the rate of increase between 1974 and 1980.

The employment outlook for the next two years is not bright. Economic growth in general will be relatively weak and Michigan will lose an estimated 71,000 jobs by the third quarter of 1989 due to the plant closings announced by General Motors. As a result, wage and salary employment is expected to increase only 1 to 1.5 percent in 1988. One bright spot for the longer term is that the number of 16-to-24-year-olds is expected to fall about 10 percent by 1995, exerting downward pressure on the unemployment rate.

Despite a relatively strong first quarter, Michigan personal income is expected to increase only 3 to 4 percent in 1987 and increases will slow to 2.5 to 3.5 percent in 1988. In real terms, Michigan personal income is expected to decline slightly in both years. Over the longer term, personal income in Michigan will increase at a slightly slower rate than U.S. personal income and this state will continue to become poorer relative to the rest of the nation.

These factors do not mean that Michigan will not have periods of strong economic growth. We will continue to do well when the national economy does well. Also, as we become less dependent on manufacturing, our ups and downs will be less severe than in the past.

No one can predict with certainty when the next recession will occur, but we can be certain that there will be another recession in this state--and the chances of it occurring in the next two years are increasing. The implications of this economic outlook are that the state budget will be very tight for the next two or three years as revenue growth slows and, in the future, our ability to deliver a high level of public services will not be as great as it was in the 1960s and 1970s. We will have to accept a lower level of public services unless we are willing to increase the size of the public sector relative to the private sector. As choices are made, education and economic development are likely to receive a higher priority than human services programs. Michigan can continue to be a progressive and compassionate state, but we must use our resources carefully.

EXHIBIT 1

QUARTERLY CHANGE IN U.S. GROSS NATIONAL PRODUCT
(1982 dollars)

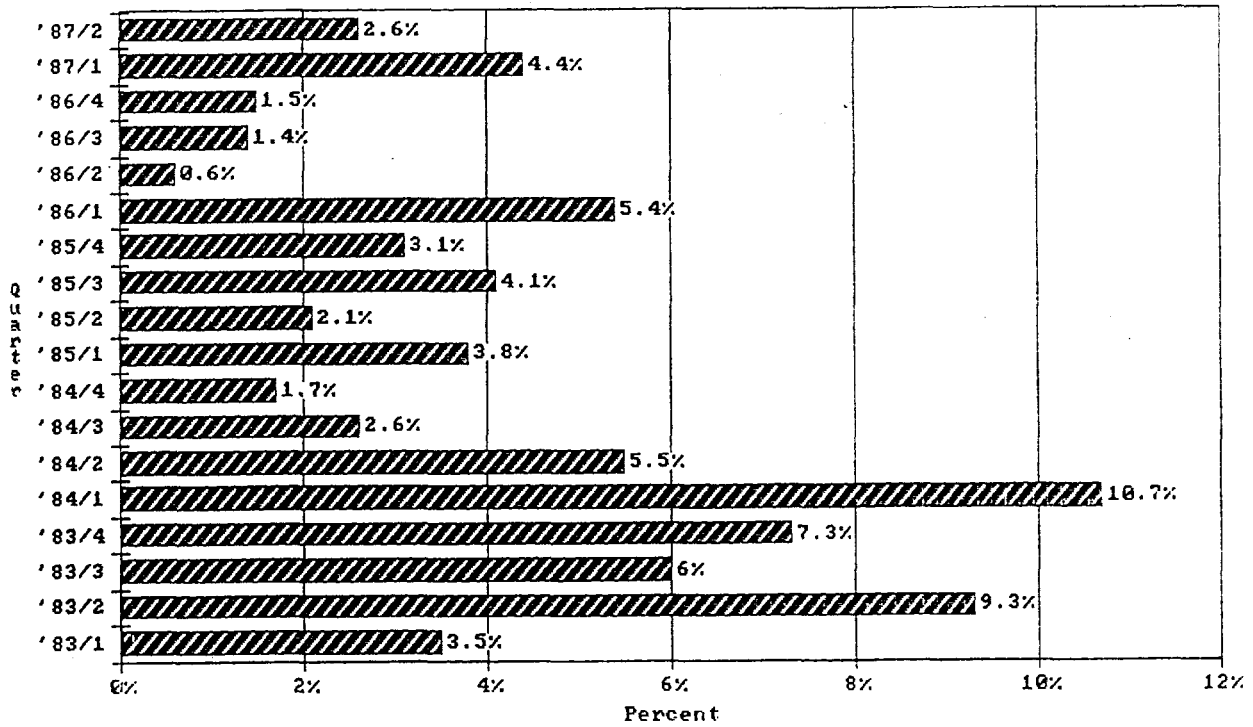


EXHIBIT 2

ECONOMIC EXPANSION, POST-WORLD WAR II

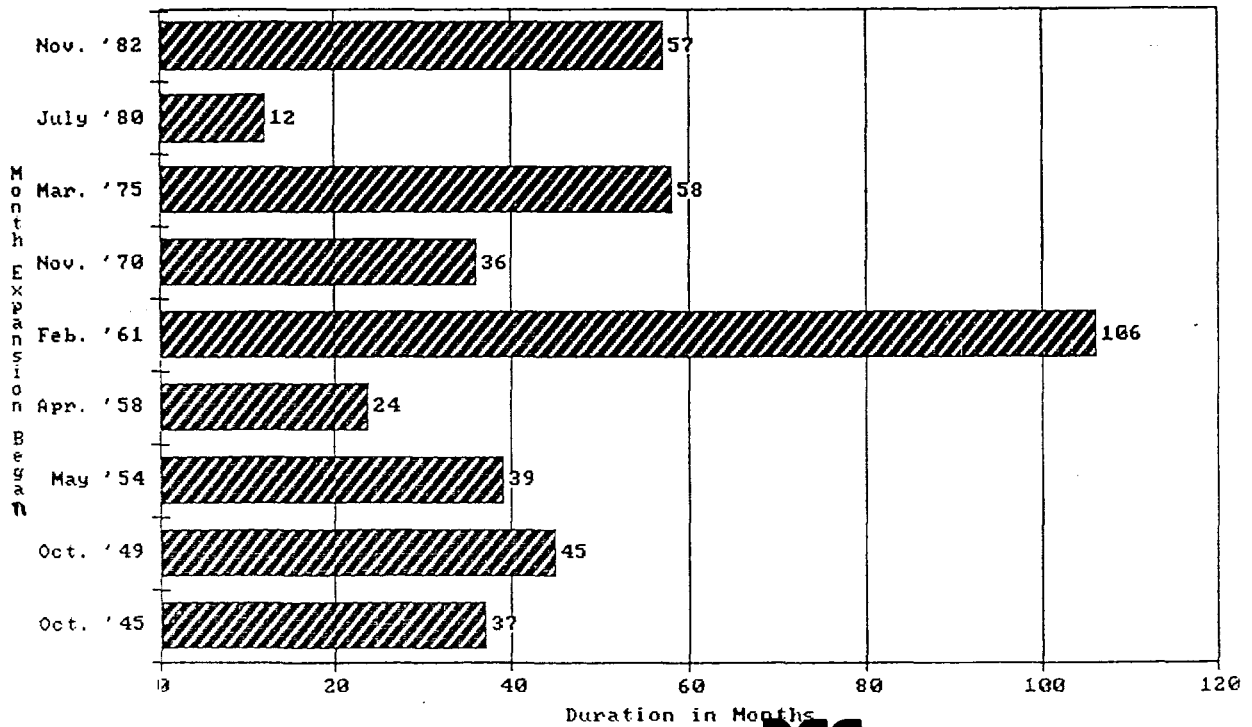


EXHIBIT 3

U.S. INSTALLMENT CREDIT AS PERCENTAGE OF U.S. DISPOSABLE INCOME

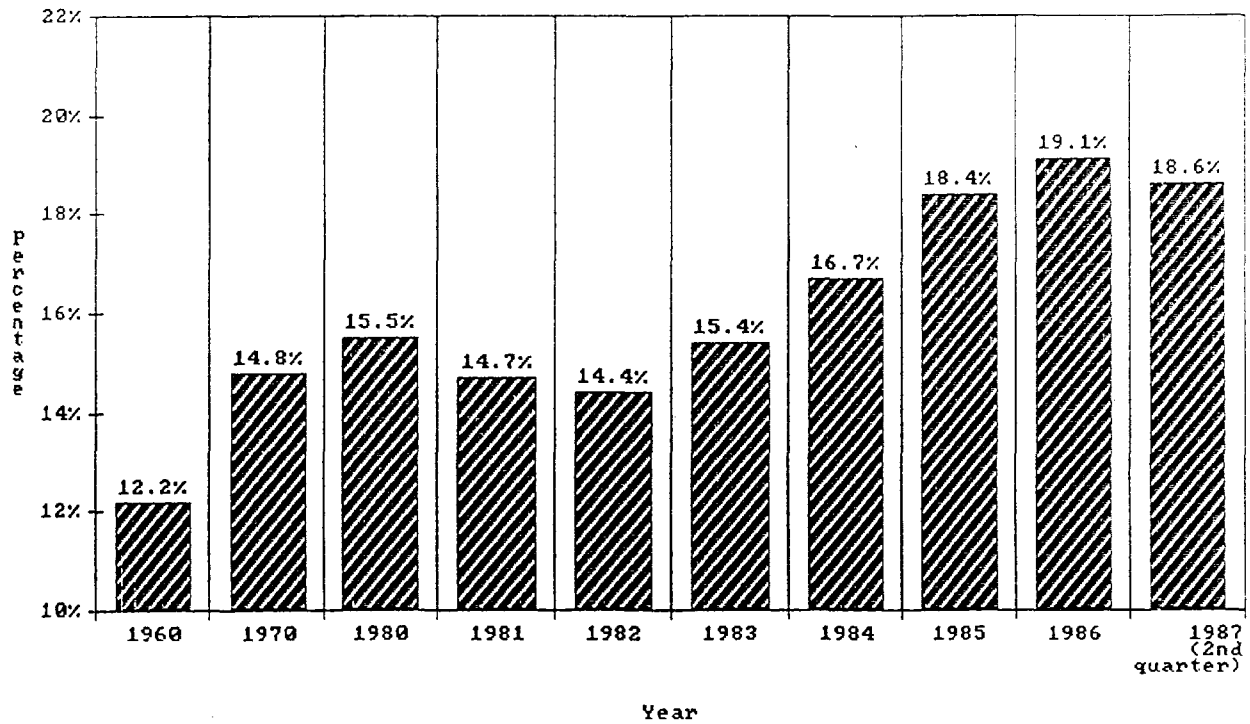


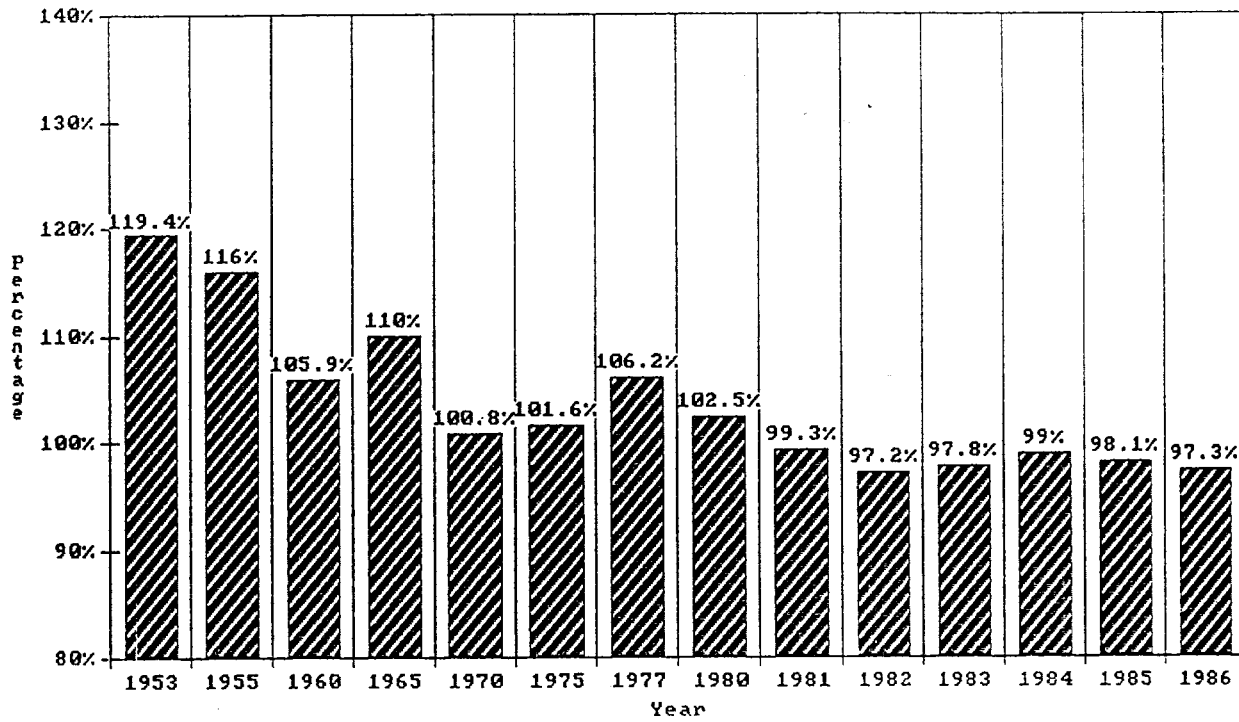
EXHIBIT 4

MICHIGAN EMPLOYMENT BY SECTOR, 1978-1986
(thousands)

Year	Total Employment	Wage and Salary Employment	Manufacturing Employment	Services Employment	Government Employment	Other Nonmanufacturing Employment	Addendum: Motor Vehicle Employment
1978	3,905	3,609	1,180	614	611	1,204	410
1979	3,977	3,637	1,160	627	621	1,229	393
1980	3,758	3,443	999	644	628	1,172	326
1981	3,776	3,364	979	650	598	1,137	319
1982	3,617	3,193	877	650	578	1,088	287
1983	3,679	3,223	880	675	570	1,097	300
1984	3,860	3,381	963	708	567	1,143	325
1985	3,920	3,505	984	745	580	1,195	334
1986	4,005	3,580	975	775	586	1,244	325

EXHIBIT 5

MICHIGAN PER CAPITA INCOME AS A PERCENTAGE OF U.S. PER CAPITA INCOME



NOTE: Percentage for 1953 is the postwar high.