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Public Sector Reports

ECONOMIC FORECAST

INTRODUCTION

The U.S. economy was weaker in the second quarter than in the first, but developments at the end of the quarter and in July increased the chances of continued economic expansion and reduced the likelihood of a recession. The Federal Reserve Board has eased monetary policy, and most interest rates have fallen a full percentage point in the last few months. The reduction sparked a rebound in housing. After a period of weakness, employment also rebounded in June and July. Particularly encouraging was modest inflation; the annual rate of increase was 2.9 percent in June and July, which will allow the Federal Reserve to ease up even more. One area of concern continues to be consumer spending, particularly for motor vehicles.

Our forecast continues to be for slow economic growth, with GNP rising 2.5 percent in 1989 (the annual rate of increase in the first half of the year was 2.7 percent) and 2 percent in 1990. Recent developments, however, have increased the probability that growth will be stronger.

The Michigan economy also slowed in the second quarter, due in large part to weakness in the motor vehicle industry. Wage and salary employment rose 2 percent, compared with an increase of 2.5 percent in the first quarter. Production cuts due to sluggish auto sales will continue to put downward pressure on employment in the second half of 1989.

We continue to expect the Michigan economy to grow more slowly than the national economy in 1989 and 1990. Mostly minor revisions have been made to our forecast since the last quarterly report. The only significant change is the estimate for the 1989 Michigan CPI increase, which we have reduced from 6.1 percent to 5.4 percent. (The forecast is summarized in Exhibit 1.)

THE NATIONAL ECONOMY

GNP, Income, and Employment

Review

Economic growth, as measured by GNP, slowed sharply in the second quarter. Estimates show that real GNP—the total output of goods and services, adjusted for inflation—rose at a revised annual rate of 2.7 percent, down from the revised 3.7 percent (the original estimate was 3.5 percent) growth rate in the first quarter. The slowdown, however, may be more apparent than real, as the U.S. Department of Commerce estimates that 2.2 percentage points of the first-quarter growth represent a return to near-normal output levels for crops and livestock affected by last year's drought. (See Exhibit 2.)

Almost half the $17.1 billion growth in real GNP was from nonresidential investment, which increased at an annual rate of 8.2 percent. Residential investment fell $7 billion, as the housing industry was hurt by the year-long climb in interest rates that ended in March. Personal consumption continued to grow, rising at an annual rate of 2.2 percent ($7.2 billion), compared with $13.3 billion (2 percent) in the first quarter.

The U.S. Department of Commerce recently released GNP revisions for 1985 to 1988 that indicate stronger growth than previously estimated. The revised rates are 2.6 percent (1986), 3.7 percent (1987), and 4.4 percent (1988) (previously 2.8 percent, 3.4 percent, and 3.9 percent). A major factor in the revision was stronger export growth, which averaged 2.1 percent higher during the period than previously estimated. This means that the trade deficit was lower than originally thought (about $38 billion less over the three years).

U.S. personal income increased at an annual rate (seasonally adjusted) of 7.3 percent in 1989 II, down from a 12.7 percent rate of growth in the first quarter. The 1989 I figure was inflated by large farm support payments, retroactive Social Security benefits, and profit-sharing payments to automotive employees. Farm proprietors' income fell at an annual rate of about 44 percent in the second quarter. Real per capita disposable income fell 0.5 percent in 1989 II after increasing 5.7 percent in 1989 I. U.S. personal income increased at an annual rate of 10.1 percent in the first half of 1989, compared with a

MICHIGAN FORECAST AT A GLANCE

Employment—steady
Unemployment—up
Personal income—up
Prices—up
Auto sales—down
Auto production—down
Housing—steady
Interest rates—down

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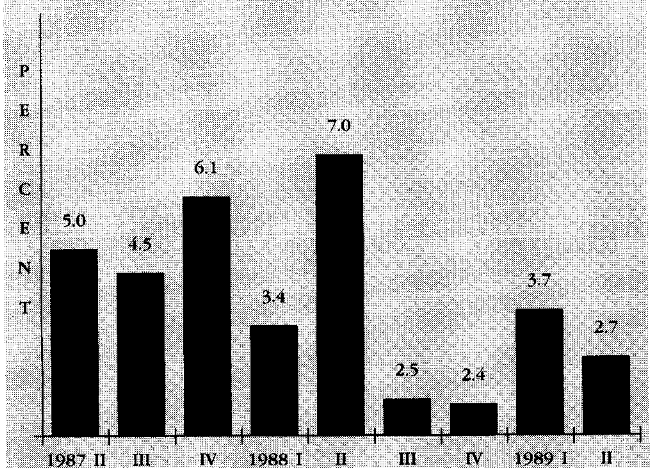
Exhibit 1

Summary Forecast

	1988 (actual)	1989 (estimate)	1990 (estimate)
U.S. GNP, 1982 $ (percentage change)	3.8%	2.5%	2.0%
U.S. motor vehicle sales (millions)	16.1	15.0	14.5
Michigan wage and salary employment (percentage change)	1.7%	2.0%	1.0%
Michigan unemployment rate (percentage)	7.6%	7.5%	7.8%
Michigan personal income (percentage change)	7.4%	6.0%	5.0%
Michigan motor vehicle production (millions)	3.2	3.3	3.1
Detroit-Ann Arbor consumer price index (percentage change) (1982–1984 = 100)	4.0%	5.4%	4.5%

Exhibit 2

U.S. Gross National Product, Quarterly Changes at Annual Rates, 1987 II–1989 II (1982 dollars)



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

7.6 percent increase in 1988. The personal savings rate declined to 5.4 percent from a revised 5.6 percent in the first quarter, but it remained well above the 1985–88 average of 4 percent.

The latest national employment data allay fears of a recession. The nonfarm category increased 169,000 between June and July, and the May to June increase was revised upward, from 180,000 to 250,000. Employment growth for 1989 II was only 2.3 percent (seasonally adjusted annual rate), compared with 3.8 percent in 1989 I, but the weakness occurred early in the quarter. The only sector recording above-average growth was services, which accounted for more than half the rise in total employment. (See Exhibit 3.)

The U.S. civilian unemployment rate averaged 5.3 percent in the second quarter, up from 5.2 percent in the first. (See Exhibit 4.) In July and August the unemployment rate stood at 5.2 percent, down from June's rate of 5.3 percent. The number of discouraged workers—persons who want to work but no longer are looking for jobs because they believe none are available—held steady at 870,000 in the second quarter.

Outlook

Slower inflation, the easing of monetary policy, and solid employment gains in June and July increased the likelihood that the economy can achieve a "soft landing" and avoid a recession.

Real GNP growth is expected to average 2–2.5 percent in the last two quarters of 1989. Employment growth will slow to less than 2 percent, and the unemployment rate will reach 5.5 percent by year-end.

Leading Indicators

Review

The index of leading indicators started out the quarter on a strong note, revised upward to 0.6 percent in April, but it declined during the next two months (by 1.2 percent in May and 0.1 percent in June). The index, which has fallen during four of the past five months, is designed to foretell the state of the economy during the next two or three quarters; three consecutive declines are interpreted as a signal that a recession may be ahead.

The increase in April was a result of across-the-board gains in almost all eleven index factors: The only negative variables were shaky consumer confidence, low materials' prices, and a rise in the money supply. The substantial drop in the May figure was the largest decline registered since November 1987 (the month after the stock market crash) and gave some cause for concern. The only positive contributors to the index that month were increases in building permits and stock prices; negative factors were declines in materials' prices and credit as well as an increase in the money supply.

Although the decline of 1.2 percent recorded in May marked the third drop in the index since February,

Exhibit 3

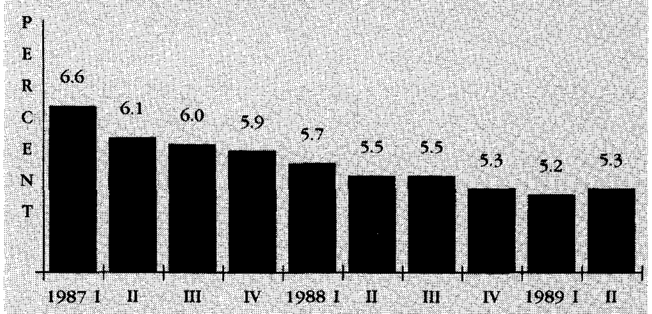
U.S. Wage and Salary Employment and Percentage Changes, 1989 II and July 1989 (seasonally adjusted)

Sector	1989 II (thousands)	Percentage Change from 1989 I (annual rate)	Percentage Change from 1988 II	July 1989 (thousands)	Employment Change from June 1989 (thousands)
Manufacturing	19,654	−0.1%	1.3%	19,658	3
Services	26,755	5.0	5.4	26,997	74
Retail trade	19,513	1.2	2.3	19,600	52
Government	17,675	2.2	2.0	17,667	−25
Other	24,702	2.2	2.4	24,807	65
Total	108,299	2.3%	2.8%	108,729	169

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

Exhibit 4

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



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

indications are that the economy will grow at a slow but steady pace for the remainder of the year. June's index originally had been estimated to decline by 0.1 percent but was revised upward to the unchanged figure. While the rise in July was small, the changes were evenly split among positive and negative factors. Monetary easing by the Federal Reserve Board (the Fed) in May (see discussion below) began to have an influence in June and July, as indicated by the positive effects of both money supply and credit in those months' indexes. A drop in materials' prices and a rise in unemployment claims were the largest negative factors in both June and July. The decline in the price of materials, which indicates that the demand for inputs is falling, also can be seen as rather positive, since it is evidence that inflation is slowing.

Monetary Policy

Review

During 1989 II the Fed initiated a policy of monetary ease in order to bring down interest rates and avoid a recession. There is now disagreement, however, between the Fed and members of the administration as to how far rates need to fall in order to accomplish the Fed's stated goal—slow economic growth with modest levels of inflation—without causing a recession. Administration officials, most notably Budget Director Richard Darman, think the policy has been and still is too restrictive, while Federal Reserve Board Chairman Alan Greenspan believes interest rates already have been reduced "significantly." While some results of the Fed's policy are showing up in current statistics, it probably is still too early for the full economic effects to be felt.

At 9.95 percent in April, the federal funds rate (the interest charged on short-term loans of reserves between banks) was the highest in more than a year. The Fed loosened its grip on the money supply in May and again in July. Evidence can be seen in the growth rate of the M2 money supply (which is considered more influenced by Fed actions and more stable than the M1 measure); between mid-May and the end of July, M2 rose at an annual, compounded rate of 9.7 percent.[1] Interest rates declined in response to this easing; in late May, the federal funds rate fell as low as 9.38 percent. When policy eased again in July, the Fed's bellwether interest rate dropped to 8.95 percent for the first time this year, and other rates followed suit (see Exhibit 5).

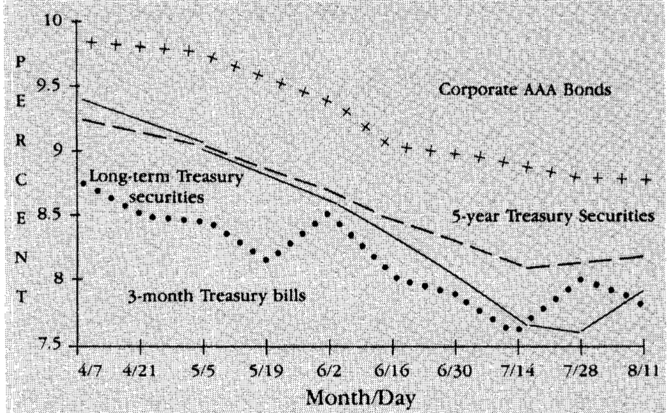
Outlook

Statistics late in the second quarter and for July and August seem to belie the early fears of recession and apparently bear out the Fed's forecast of slow growth. The economy seems to be responding to the general decline in interest rates, especially the housing industry (see discussion below). Whether rates will be allowed to decline any farther is in question, as Chairman Greenspan insists that the Fed is still concerned with keeping inflation under control. The period of tight money seems to have ended, however, and the Fed is likely to maintain interest rates at their current levels, with some gradual ease by the end of the year.

[1]M1 is the sum of currency held by the nonbank public in checking, checkable deposits, and travelers checks. M2 is the sum of M1 and short-term and/or small savings deposits.

Exhibit 5

Selected Interest Rates and Yields on Corporate Bonds (average daily rates)



SOURCE: Federal Reserve Bank of St. Louis, *U.S. Financial Data*, June 22 and August 10.

Fiscal Policy

Review

Estimates for the second quarter show that the budget deficit for FY 1989, which ends September 30, will be $148.3 billion; that would be $15.8 billion below the Office of Management and Budget February forecast of $164.1 billion. The downward revision was due primarily to an unexpected revenue gain of $13.2 billion, the source of which still has not been pinpointed by Treasury officials. The news is especially good since the revised figure is based on assumptions about the economy that are less optimistic than previously. The administration lowered its projection of economic growth from 3.5 percent to 2.7 percent for 1989 and from 3.4 percent to 2.6 percent for 1990. It also increased its estimate for rates on three-month Treasury bills from 7.4 percent to 8 percent for 1989 and from 5.5 percent to 6.7 percent for 1990. (A slowdown in economic growth normally reduces government income from tax receipts and increases income support payments, while higher interest rates raise interest payments on governmental borrowing made to pay for past deficits.)

The new deficit estimates mean that the Gramm-Rudman targets for FY 1989 likely will be met. There were fears that these would be jeopardized if Congress passed the bailout plan for thrift institutions proposed by House and Senate conferees. The original legislative proposal, which would have included the financing cost within the federal budget, was rejected after President Bush threatened a veto. The president suggested financing through bonds sold by private industry, thus excluding the bailout from the federal budget and exempting it from Gramm-Rudman targets. A compromise was reached that keeps $20 billion of the cost in the budget, the remainder to be financed according to the president's plan. It is estimated that over the next ten years the bailout will cost $150 billion, two-thirds in interest.

Another major issue now before Congress is the capital gains tax. Three separate plans are being discussed by the House Ways and Means Committee. Initially, it seemed that any effort to reduce the tax would languish or die in committee, due to strong opposition by its chair, Representative Dan Rostenkowski (D-Illinois), and House Speaker Tom Foley. Bargaining between congressional Democrats and the White House has created an atmosphere for compromise, however, and both Rostenkowski and Foley now endorse a plan that would leave rates intact but would index gains to inflation. President Bush's recommendation to exclude 45 percent of gains from taxation would create an effective maximum rate of 15 percent, including gains made on the sale of depreciable assets, such as real estate and timber. Representative Edgar Jenkins (D-Georgia) proposes an exclusion of 30 percent (creating an effective rate of 19.6 percent) and extending deductibility to profits made from the sale of all capital assets; the plan is receiving support from House Republicans. Any proposal is likely to meet with strong opposition from House Democrats, who argue that the rich would benefit inordinately. Those in favor of a change say that short-run revenues would be increased by stimulating asset sales and therefore the taxes collected on them.

Outlook

It seems likely that President Bush will be forced to modify his stance toward new taxes. The thrift bailout compromise will cost taxpayers an estimated $5 billion more than if financed solely by government securities; a capital gains tax cut likely will increase revenues the first year (due to a large volume of assets being sold in order to take advantage of the lower rates) but reduce collections thereafter (due to the decline in rates). In addition, before recessing for the summer, the House Ways and Means Committee expanded the earned income credit, which will increase tax refunds for the working poor and families with preschoolers; if enacted, it would cost the government approximately $5 billion annually. These programs, all of which are receiving bipartisan support, and the lower revenues likely to result from a slowing economy will swell the deficit, making some form of tax increase likely during late FY 1990.

International Trade

Review

The trade deficit took a roller coaster ride during the second quarter: Four-year lows in both April and June bracketed a sharp rise in May. April's revised deficit of $8.29 billion was 13.1 percent below the deficit posted in March, due to a slight increase in exports (0.8 percent) and a drop in imports (2.6 percent). Fueled by the rise in oil imports and the dollar's high value in 1989 I (see Exhibit 6), the deficit swelled in May by 21.6 percent; exports declined by 0.4 percent (to $30.46 billion), while imports rose by 4.4 percent (to $40.56 billion). In June the deficit declined again, to $8.17 billion, the lowest figure since December 1984. At $30.91 billion, exports were 5.1 percent above the May level, and imports declined across the board, falling to $39.08 billion (3.6 percent below the previous month). Exports grew at an annual rate of 21 percent during the first half of the year, while imports grew at a pace of 11 percent. The deficit for the second quarter was $25.73 billion (adjusted for inflation and seasonal fluctuation), down 4.8 percent from $27.02 billion in 1989 I.

Oil imports, a major contributor to the deficit, rose in April and May but declined substantially in June. The April expansion (to $4.04 billion from the March figure of $3.68 billion) was due solely to price increases, while May's rise (to $4.75 billion) was caused by both a hike of 57 cents per barrel in oil prices and an increase in the number of barrels brought into the country. In June, both prices and volume declined, reducing oil imports to $4.2 billion. At nearly $13 billion, 1989 II oil imports were up 24.9 percent from 1989 I and 29.5 percent from 1988.

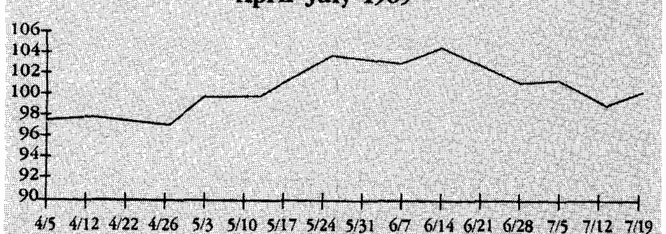
Outlook

The fate of the trade balance depends in part upon the extent to which the Fed continues its policy of monetary ease. The availability of money during the second quarter allowed the dollar to soften, but the effects on trade likely will not be seen until the end of 1989 and early 1990. Contracts signed when the dollar was low will not be delivered and recorded in the trade accounts for some months.

A favorable contributing factor to the trade balance is a slowing U.S. economy, which usually implies fewer imports and more exports if accompanied by a drop in domestic prices. Because the Fed is likely to maintain its current course to keep prices stable, and barring any drastic rise in oil prices, the trade balance should improve by the latter part of the year.

Exhibit 6

The Trade-Weighted Value of the Dollar, April–July 1989



SOURCE: Federal Reserve Bank of St. Louis, *U.S. Financial Data*, May 11, June 22 and August 3, 1989.

NOTE: Weekly data are averages of daily 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

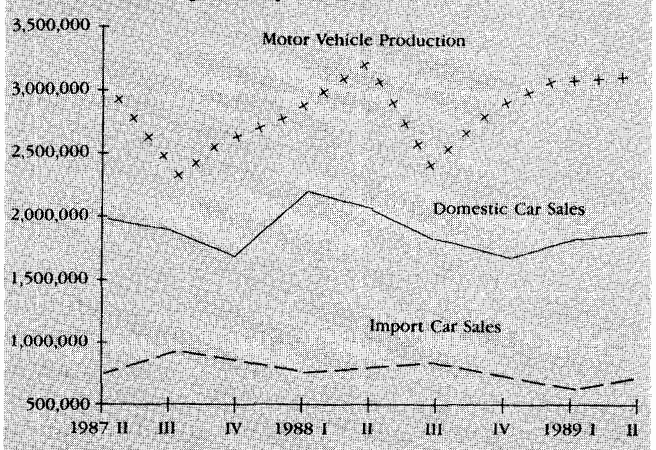
Passenger car sales in 1989 II were higher than in 1989 I but still were 2.2 percent below a year ago. Domestic sales declined 1.8 percent; imports fell 3.1 percent but increased their share of the market to 27.4 percent, compared to 25.5 percent in the first quarter. (See Exhibit 7.) Truck sales were down 4 percent after dropping 7 percent in 1989 I.

July passenger car sales fell 1.6 percent below last July's weak total, when few factory incentives were offered. Domestic sales rose 0.2 percent, offset by a drop of 5.8 percent for imports, due mainly to a 33 percent decline in Toyota sales. Among the Big Three, only Ford managed an increase.

Passenger car sales for the first seven months of 1989 were 6.2 percent below a year ago, and truck sales were down 4.7 percent. The slow car sales were reflected in second-quarter production declines to bring output and sales into balance after an increase of 9.7 percent in output during 1989 I. Production fell 5.6 percent (exceeding the projected decline of 3.2 percent). Despite sales declines in 1989 I and II, truck production increased 5.6 percent.

Exhibit 7

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



SOURCE: *Automotive News*, various issues.

Import Share: 1989 II—27.4%; 1988 II—276.; 1987 II—28.4.

% change between 1988 II and 1989 II: Production—9.9; Domestic sales—1.8; Import sales—3.1.

August auto figures were somewhat more encouraging, however; domestic car sales rose 14.2 percent (685,365 vehicles), and truck sales were up by 8.2 percent (384,658 trucks). The sharp increase in motor vehicle sales was credited to fears of price hikes expected in late September. Fourth-quarter auto production is scheduled at 1.723 million units, 9.2 percent below 1988 IV and the lowest total since 1982.

Two recent developments will have far-reaching effects on the future of the motor vehicle industry. The first occurred on July 26, when workers at the Nissan plant in Smyrna, Tennessee, rejected the UAW by a two-to-one margin. This large victory for Nissan's antiunion management signals a strong threat to the UAW's grip on auto production in the United States. The second event was Chrysler's decision to eliminate 2,300 white-collar jobs as part of a plan to cut costs by $1 billion.

Both developments are related to the large increase in Asian-owned assembly plants in the United States (transplants). There are now seven in this country and three in Canada, with planned production of about 2.4 million vehicles. Six of these opened in the last year. One result is that U.S. capacity is expected to exceed demand by about 2.7 million vehicles in 1990. In the first half of 1989, Japanese transplants accounted for 14.7 percent of U.S. passenger car production, up from 8.9 percent two years ago. These facilities are more efficient than most U.S. plants, and only three of the seven in the United States are unionized. The transplants have a $700-per-vehicle cost advantage over Big Three facilities, which is putting added pressure on U.S. plants to become more efficient; one result likely will be declining employment in the industry for the next few years.

Outlook

There is little reason to be optimistic about motor vehicle sales for the remainder of 1989. Although income gains have been strong, consumers are reluctant to spend. Manufacturer and dealer incentives will be generous, but their continued use has diluted their ability to influence consumers. This still will be a good year for the motor vehicle industry, but not as good as 1988, the second best year in its history.

We project passenger car sales to be down about 8 percent from year-ago levels for the rest of 1989, and sales for the year should total 10.1 million units. Truck sales, which are expected to decline about 5 percent during the remainder of the year, should total 4.9 million units for 1989. The import share of passenger car sales will fall to an estimated 28 percent, compared with 28.4 percent in 1988. Sales in 1990 are expected to decline 3.3 percent, to about 14.5 million vehicles.

Housing and Construction

Review

After a rough beginning, 1989 II housing and construction statistics began to improve in June, and favorable reports in July allayed worries of a recession. Although three months usually are considered the minimum necessary for a trend to develop, the two-month improvement is welcome, particularly since many statistics had declined for four consecutive months.

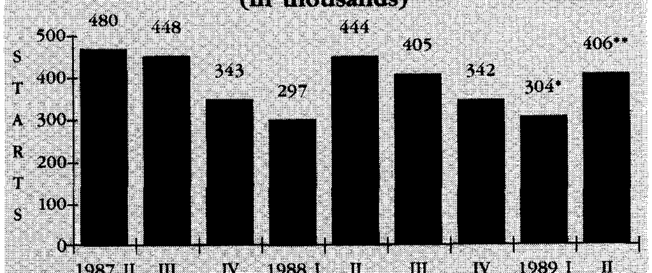
Housing starts, which fell by a revised 5 percent in April (to an annual 1.37 million units) and by 2.6 percent in May (to 1.31 million units), rebounded by 8.5 percent in June (to 1.4 million units) and by 0.8 percent in July (to 1.43 million units). (See Exhibit 8.) Starts of single-family units, for which an April gain of 5.1 percent was erased by an equal decline in May, rose in both June and July, by 0.2 percent and 6.3 percent, respectively. The May decline, the fourth this year, prompted many to predict a recession for late 1989, so the two-month gain is considered especially favorable.

Building permits, generally considered a precursor of future housing and construction, were up one percent in May but fell in June (by 3.5 percent, to 1.30 million units) and July (by 3 percent, to 1.27 million units). The latter decline was due primarily to a decrease in permits for apartment units, which had been high in previous months. Permits for single-family units rose by 3 percent in July (to 900,000), a signal that construction in this sector remains firm.

Spending on construction was fairly stable in the second quarter, falling 0.8 percent in April and 0.6 percent in June, but rising 0.6 percent (revised) in May. Actual outlays on construction totalled $415.9 billion in April, $418.2 billion in May, and $415.6 billion in June. In July (the latest statistics available), total spending on construction remained stable at $415.7 billion. (All figures are at seasonally adjusted, annual rates.) Construc-

Exhibit 8

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



SOURCE: Bureau of the Census, U.S. Department of Commerce, "Housing Starts," *Current Construction Reports*, #C20-89-3, April 1989, p. 4, and personal communication.

*Revised.

**Preliminary.

tion contracting, a predictor of spending, softened during the quarter; after a modest rise of 0.8 percent in April, it declined at annual rates of 5 percent in May and 2 percent in June, ending the quarter at $249.7 billion. Construction contracting for the first half of the year was down about one percent from the year-ago period.

Outlook

The housing and construction industries seem to have begun their rebound in response to lower interest rates. Because mortgage rates tend to lag behind changes in other interest rates, this rebound should continue. Thus, the housing market probably will remain fairly stable during the rest of the year, led by gains in the especially interest-sensitive residential housing and construction markets.

Prices

Review

The U.S. consumer price index (CPI) grew at an annual rate of 5.9 percent in 1989 II and was 5.2 percent above the year-ago level (see Exhibit 9). Transportation, apparel, medical care, and food and beverages led the advance. The large increase in the transportation component was the result of a 34.4 percent jump (annual rate) in energy costs, principally for motor fuel.

Despite the relatively large quarterly rise in prices, the good news was a slowdown in June and July; during both months the CPI increased at an annual rate of 2.9 percent. Prices for apparel and transportation were down in June, and food prices slowed. Apparel prices decreased at an annual rate of about 10 percent in July, and transportation prices fell about 7 percent as gasoline prices declined at an annual rate of 26.4 percent. For the first seven months of 1989 the CPI grew at an annual rate of 5.5 percent.

Producer prices (for finished goods), which generally foreshadow changes in consumer prices, grew at an annual rate of 7.7 percent in 1989 II. This sharp rise was due mainly to a large jump in energy prices, 72.4 percent at an annual rate. Excluding energy, producer prices increased at an annual rate of only 3.2 percent in the second quarter. Producer prices fell in June and July, largely because of declines in prices for energy and food. The 0.4 percent drop in July was the largest in three years.

Outlook

The prospects for slow rates of inflation for the last half of 1989 and for 1990 have improved in recent months. As anticipated, energy prices have declined from their spring highs, and economic growth has continued to be slow. Consumer prices are expected to increase about 4 percent for the remainder of the year, well below the 5.5 percent increase for the first seven months, and they are expected to range from 4–4.5 percent in 1990.

THE MICHIGAN ECONOMY

Employment and Income

Review

Michigan nonagricultural wage and salary employment continued to be sluggish in the second quarter, up only 2 percent above a year ago, compared with a 2.5 percent increase in 1989 I. Actual employment increased 62,800 from the first to the second quarter, but that is less than the normal seasonal rise. Employment growth

Exhibit 9

U.S. Consumer Price Index Percentage Changes, by Major Component, 1989 II and July 1989

	Percentage Change, 1989 II from 1989 I (annual rate)	Percentage Change, 1989 II from 1988 II	Percentage Change, July 1989 from June 1989*
Food and beverages	7.2%	6.3%	7.2%
Housing	3.6	3.6	1.2
Apparel and upkeep	10.6	3.2	15.6
Transportation	14.3	7.0	28.8
Medical care	7.2	7.3	6.0
Entertainment	4.5	4.9	7.2
Other goods and services	4.2	7.7	2.4
All items	6.6	5.2	8.4
Special index: Energy	34.4%	9.1%	68.4%

SOURCE: Calculations by Public Sector Consultants, Inc., from Bureau of Labor Statistics, U.S. Department of Labor, "Consumer Price Index: July 1989," *News*, May 18, 1989.
*Seasonally adjusted annual rate.

slowed in almost all industries but most dramatically in construction, which gained only 1.5 percent, compared with an increase of 9.7 percent in 1989 I. Manufacturing employment grew only 0.2 percent, compared to a first-quarter rise of 0.9 percent. Services employment did perk up, increasing 3.4 percent, compared with 2.3 percent in the first quarter, as business services continued to show good growth. (See Exhibit 10.) Employment was roughly unchanged between May and June. In July, actual total employment declined by 1.3 percent, due primarily to the 2.7 percent decline in durable goods manufacturing employment. The decrease in that sector was likely caused by retooling layoffs in the auto industry, which began earlier than usual this year.

The Michigan unemployment rate averaged 6.7 percent in 1989 II, down from an average of 7.2 percent in 1989 I; it jumped from 6.4 percent in May to 7.5 percent in June, then eased to 6.8 percent in July. The average rate was 7 percent in 1988 II. (See Exhibit 11.) On a seasonally adjusted basis, the Michigan unemployment rate rose from 6.5 percent in 1989 I to 6.7 percent in 1989 II. Although joblessness in Michigan has declined this year, the state still had the highest second-quarter rate among eleven large states. (See Exhibit 12.)

The U.S. Department of Commerce recently released 1989 I and revised 1988 IV estimates for personal income, and the data reflect slow but steady growth in the state's economy. Michigan personal income rose by 2 percent during 1989 I as compared to 3 percent nationally.

Earnings growth suggests that the state economy remains healthy but is beginning to slow. The largest percentage gains in Michigan earnings were recorded in the categories of other (38.2 percent), construction (3.9 percent), and wholesale and retail trade (2.9 percent). (See Exhibit 13.) The first category, which includes such sectors as mining and agricultural services, registered its large percentage gains due to increased farm earnings. The gain in construction earnings, which compared favorably to the 1.3 percent rate of increase posted nationally, rose despite a $321 million upward revision in value for 1988 IV. Wholesale and retail trade earnings also compared favorably to the U.S. statistic, which rose by 2.2 percent.

Other sectors of the economy remained sluggish, however. Services income fell by 0.5 percent, compared to a gain of 1.4 percent nationally, and earnings in the

Exhibit 10

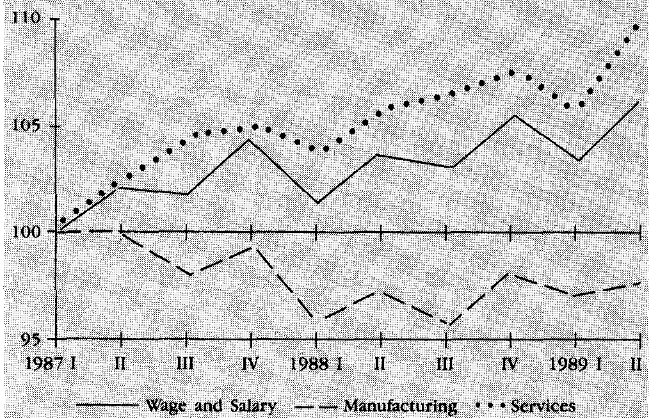
Michigan Wage and Salary Employment, by Sector, 1988 II, 1989 II, and 1988 and Five-Year Growth Rates

Sector	1988 II (thousands)	1989 II (thousands)	Percentage Change	Percentage Change, 1988 from 1987	Average Annual Growth Rate, 1983–88
Mining	10.7	10.9	1.6%	6.1%	3.1%
Construction	133.4	135.4	1.5	8.2	9.1
Manufacturing	950.6	952.2	0.2	−2.6	1.5
Durable	727.5	729.7	0.3	−3.8	1.1
Furniture and fixtures	33.2	34.9	5.1	7.7	8.7
Machinery, excluding electrical	118.7	123.6	4.1	−3.0	0.4
Metalworking	50.8	54.9	8.1	1.8	1.7
Motor vehicles and equipment	298.7	293.8	−1.6	−6.7	−0.3
Nondurable	223.1	222.5	−0.3	1.3	2.8
Food and kindred products	43.9	41.6	−5.2	−0.9	−0.3
Chemical and allied products	41.4	42.1	1.7	2.2	0.8
Printing and publishing	42.0	43.3	3.1	5.8	4.5
Rubber and miscellaneous plastic products	47.7	48.7	2.1	1.7	9.3
Transportation, communications, and public utilities	155.8	154.4	−0.9	1.6	2.1
Wholesale and retail trade	884.7	913.4	3.2	3.2	4.4
Finance, insurance, and real estate	185.8	188.2	1.3	3.2	4.1
Services	851.7	880.7	3.4	3.3	4.8
Personal	42.0	43.4	3.3	9.2	4.7
Business	183.3	191.2	4.3	3.6	12.4
Health	278.1	282.7	1.7	2.4	1.6
Other	121.1	133.9	10.6	9.0	8.8
Government	626.6	639.0	2.0	2.2	1.9
Total nonagricultural employment	3,798.8	3,874.1	2.0%	1.7%	3.3%

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

Exhibit 11

Michigan Unemployment
1987 I–1989 II (1987 I = 100)



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

Exhibit 12

Unemployment Rates for Eleven Large States, 1989 I and 1989 II

	1989 I	1989 II
Michigan	6.5	6.7
Texas	6.6	6.5
Florida	5.3	5.9
Illinois	5.6	5.5
Ohio	5.5	5.5
California	4.9	5.5
New York	4.8	5.4
Pennsylvania	4.2	4.3
North Carolina	3.4	3.9
Massachusetts	3.4	3.8
New Jersey	3.6	3.7
U.S.	5.1	5.2

SOURCE: Bureau of Labor Statistics, U.S. Department of Labor, "The Employment Situation: June 1989," *News*, July 7, 1989.

transportation and public utilities sector rose by only 0.3 percent; the U.S. figure was 1.7 percent. Even the 2.8 percent gain in finance, insurance, and real estate compared negatively to the national increase of 4.6 percent. Manufacturing income remained stable, rising 1.1 percent, compared to 1.5 percent nationally.

Outlook

Michigan wage and salary employment increased 2.2 percent above the year-ago level during the first seven months of 1989 (total employment grew 3.1 percent). Wage and salary employment is expected to rise 1–1.5 percent for the remainder of 1989 and about one percent in 1990. The unemployment rate is expected to reach 7–7.5 percent by the end of the year and to average between 7.5 percent and 8 percent in 1990.

On the basis of personal income tax withholding collections, Michigan wages and salaries grew an estimated 4.5 percent in the first half of 1989. Total personal income increased at an estimated 6–6.5 percent in the first six months, as nonwage income (transfer payments, dividents, interest and rent, and so forth), which comprises about 38 percent of personal income, rose considerably faster than wage and salary income. Personal income growth is expected to slow slightly—to 5.5–6 percent—in the second half of the year and to increase about 5 percent in 1990.

Consumer Prices

Review

Michigan consumer prices, as measured by the Detroit–Ann Arbor CPI, slowed sharply in June and increased only 1.8 percent (annual rate) from the April level. The main reasons for the slowdown were a decline of 24 percent in apparel prices and of 1.2 percent in food prices; there also was a drop in motor fuel prices from an annual rate of increase of 119.4 percent in April to 7.2 percent in June. Entertainment prices fell 1.8 percent. (See Exhibit 14.) For the first six months of 1989 prices rose at an annual rate of 6.4 percent, lead by increases of 11 percent in the transportation component and of 6.5 percent in the housing component. Excluding energy, all items rose at an annual rate of 4.9 percent.

Outlook

The outlook has not changed since our last forecast, but recent events confirm our expectation of slowing inflation. The CPI should grow at an annual rate of about 4 percent for the remainder of the year, which will result in an annual increase of 5.4 percent. The forecast for 1990 is for the inflation rate in Michigan to be roughly the same as nationwide: 4–4.5 percent.

Housing and Construction

Review

The performance of Michigan's housing markets in the first five months of 1989 is poor as compared with a year ago, but it must be kept in mind that the 1988 pace set a record. A weakening auto sector and high interest rates took their toll in the Detroit area, where housing and construction declined at a much greater rate than in the state as a whole.

Exhibit 13

Michigan and U.S. Personal Income and Changes from Previous Period, 1989 I and 1988 IV (dollars in millions and at seasonally adjusted annual rates)

	1989 I[a]		1988 IV[b]		Percentage Change from 1988 IV to 1989 I	
	U.S.	Michigan	U.S.	Michigan	U.S.	Michigan
Earnings	$3,138,910	$117,919	$3,080,019	$116,187	1.9%	1.5%
Construction	200,822	6,109	198,030	5,878	1.4	3.9
Manufacturing	622,080	40,623	612,507	40,160	1.6	1.1
Transportation and public utilities	210,995	6,048	207,377	6,027	1.7	0.3
Wholesale and retail trade	506,979	17,797	495,837	17,297	2.2	2.9
Finance, insurance, and real estate	225,608	5,076	219,916	4,938	2.6	2.8
Services	779,922	25,644	795,423	25,787	−1.9	−0.5
Government	480,470	14,984	470,121	14,917	2.2	0.4
Other	111,166	1,638	80,807	1,182	38.3	38.6
Dividends, interest, and rent	750,641	25,786	721,186	24,730	4.1	4.3
Transfer payments	617,653	24,442	596,904	23,694	3.5	3.1
Total	$4,297,169	$160,621	$4,198,095	$157,530	2.3%	2.0%
Addendum:						
Wages and salaries	$2,557,808	$98,804	$2,536,167	$97,773	0.8%	1.0%

SOURCE: Regional Economic Information System, Bureau of Economic Analysis, U.S. Department of Commerce, printout Table SQ5, July 1989.
a = Preliminary.
b = Revised.

Permits for residential construction in Michigan rose throughout the March–May period (the latest for which data are available). The March figure of 3,234 permits was 17 percent below the prior year. The 4,509 permits issued in April were 39.4 percent above the year-ago level. In May, 4,916 permits were issued, down 12.2 percent from May 1988. In metro Detroit, 1,641 permits were issued in March, 23 percent below the number issued the year before; the 3,005 permits in April were 22.2 percent above the previous year. In May there were 1,920 permits issued in the Detroit area, down 27.2 percent from the same month in 1988.

The state's construction figures were more encouraging; although lower than last year, the rate of decrease was comparable to the national average. Through May 1989 (the latest data available) the value of residential construction in Michigan was $1,254.9 million, down 2.9 percent from the first five months of 1988; the value of nonresidential construction was $1,317.8 million, 4.3 percent below the same period last year.

Exhibit 14

Detroit–Ann Arbor Consumer Price Index and Percentage Changes, June 1989

Components	June 1989	Percentage Change from April 1989 (annual rate)	Percentage Change from June 1988	Percentage Change from December 1988 (annual rate)
Food and beverages	120.3	−1.2%	5.2%	4.2%
Housing	120.5	4.8	4.4	6.5
Apparel and upkeep	121.1	−24.0	8.8	4.4
Transportation	119.0	5.4	7.9	11.0
Motor fuel	98.1	7.2	18.5	39.8
Medical care	146.2	4.8	6.3	3.3
Entertainment	119.5	−1.8	4.7	2.5
Other goods and services	137.4	8.4	7.1	4.4
All items	122.1	1.8	5.5	6.4
Addendum:				
All items less energy	125.2	1.2%	5.5%	4.9%

SOURCE: Bureau of Labor Statistics, U.S. Department of Labor, "Consumer Price Index: June 1989," *News*, July 19, 1989.

Exhibit 15

Wage and Salary Employment, Unemployment, and Percentage Changes, Major Michigan Labor Markets, 1988 II and 1989 II

Labor Market	1988 II	1989 II	Percentage Change	Percentage Unemployment Rate, 1989 II	Percentage Point Change, 1988 II to 1989 II
Kalamazoo	106,967	111,633	4.4%	4.8%	0.5%
Jackson	52,400	54,633	4.3	6.5	−1.8
Flint	162,933	168,800	3.6	9.2	−5.3
Grand Rapids	328,133	339,000	3.3	4.9	0.1
Benton Harbor	65,500	67,500	3.1	6.9	0.6
Detroit	1,887,333	1,941,333	2.9	6.7	−0.4
Ann Arbor	170,233	175,067	2.8	3.8	0.2
Battle Creek	57,833	59,267	2.5	7.0	0.3
Lansing	210,833	215,933	2.4	5.2	0.0
Saginaw-Bay-Midland	154,067	157,200	2.0	6.7	−0.3
Muskegon	57,567	57,667	0.2	8.7	0.4
Upper Peninsula	103,475	107,167	3.6	8.3	0.0
MICHIGAN	3,798,600	3,874,667	2.0%	6.7%	−0.3%

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

Outlook

The Michigan housing industry is not expected to improve much during the second half; a weakening auto sector and fears of a recession likely will temper construction plans. Lower interest rates, especially for mortgages, should allow the market to remain stable or experience only slight declines.

Regional Economies

Review

Employment growth in 1989 II slowed statewide except in three MSAs; Kalamazoo, Saginaw-Bay-Midland, and Flint improved on their first-quarter growth. In Flint, the 1989 I decline of 0.6 percent was followed by a rise of 3.6 percent in 1989 II, due mainly to an increase of 4.4 percent in manufacturing employment. That category dropped almost 26 percent in Flint between 1986 and 1988 owing to cutbacks at General Motors, but the reductions have virtually ended, and a modest recovery is under way. The strongest growth in 1989 II was registered in Kalamazoo (4.4 percent) and Jackson (4.3 percent), the slowest in Muskegon (0.2 percent). (See Exhibit 15.)

The unemployment rate in the second quarter ranged from 9.2 percent in Flint to 3.8 percent in Ann Arbor. Three MSAs recorded a reduction compared to a year ago: Flint (−5.3 percent), Jackson (−1.8 percent), and Saginaw-Bay-Midland (−0.3 percent). The largest increases were 0.6 percent in Benton Harbor and 0.5 percent in Kalamazoo.

Each of our quarterly forecasts will focus on one regional economy in the state, in this case the Upper Peninsula (U.P.). Hit hard by the recession of the early 1980s and slow to recover, the U.P. has done better than the overall state economy in the past 30 months. From 1978 to 1983, employment in the U.P. fell 8.7 percent, compared to a statewide drop of 10.7 percent. Mining and construction were especially affected, while services and wholesale and retail trade managed increases. (See Exhibit 16.) From 1983 to 1986, employment rose only 6.9 percent in the U.P. but 11.1 percent statewide. Again, mining and manufacturing were weak, while wholesale and retail trade and services recorded above-average increases. In 1986 the unemployment rate was 13.4 percent in the U.P. (8.8 percent for the state).

The U.P. economy has gained ground in the past 30 months. Employment grew 8.3 percent from 1986 to 1988 (6.1 percent statewide), and in the first half of 1989 economic growth was faster in the U.P. than the state as a whole (refer to Exhibit 15). The unemployment rate gap had narrowed sharply by 1988 (8.8 percent in the U.P. and 7.6 percent in the state). As shown in Exhibit 16, the main contributors to job growth since 1986 have been lumber and wood products, mining, construction, trade, and services. Government, which provides almost 30 percent of all employment, increased only 2 percent from 1986 to 1988. The paper and allied products sector did not add employment during that period, but a new paper machine at Quinnesee Champion International will create 1,500 construction jobs and about 200 permanent manufacturing jobs at the plant.

Construction employment should continue strong in the U.P., as projects worth more than $650 million are either under way or planned. These include new prisons

Exhibit 16

Percentage Change in Employment by Sector, Upper Peninsula, 1978–83, 1983–86, 1986–88

Sector	Percentage Change, 1978–83	Percentage Change, 1983–86	Percentage Change, 1986–88	Share of Total Employment, 1988
Mining	−60.9%	6.7%	12.5%	3.5%
Construction	−46.0	−20.5	14.3	3.8
Manufacturing	−13.9	1.5	6.5	14.2
Durable	−21.2	1.1	10.0	9.5
Lumber and wood	−3.2	3.1	15.2	3.6
Primary metals	−46.5	−12.5	14.3	0.8
Fabricated metals	−25.0	50.0	0.0	0.6
Machinery, excluding electrical	−48.1	−7.7	0.0	1.2
Transportation equipment	42.9	−16.7	10.0	1.1
Nondurable	2.1	2.1	0.0	4.7
Food and kindred products	0.0	−25.0	0.0	0.6
Paper and allied products	11.5	3.3	0.0	3.0
Printing and publishing	−11.1	0.0	−12.5	0.7
Transportation, communications, and public utilities	−5.9	0.0	4.1	4.9
Wholesale and retail trade	−3.4	8.0	10.2	22.8
Finance, insurance, and real estate	6.7	6.1	5.7	3.6
Services	9.8	8.1	6.3	17.7
Government	0.0	2.4	2.0	29.5
Total nonagricultural employment	−8.7%	6.9%	5.4%	100.0%[a]

SOURCE: Calculated by Public Sector Consultants, Inc., from data provided by the Michigan Employment Security Commission.

[a]Total employment in 1988 was 104,200.

in Alger, Baraga, and Chippewa counties (at $42 million each) as well as the $300-million expansion at the Champion plant in Dickinson County, referred to above. In the five U.P. counties for which data are available, permits for new, privately owned housing units for the year through May (the latest information) are 37.5 percent higher than the same period in 1988 and 42.2 percent above the same period in 1987 (see Exhibit 17). The greatest number of permits were issued in Marquette County—79 permits thus far this year. In addition, tourism has been strong in the U.P. for the past few years, which will continue to support employment growth in the services and trade sectors.

Exhibit 17

Housing Permits Authorized in Selected Upper Peninsula Areas, May 1987–89 and Year to Date Totals

	1989		1988		1987	
County	May	Year to Date	May	Year to Date	May	Year to Date
Delta[a]	20	31	14	34	8	26
Dickinson[b]	13	29	18	35	17	41
Houghton[c]	13	26	6	9	3	7
Keewenaw	0	0	0	1	1	1
Marquette[d]	55	79	19	61	19	41

SOURCE: Bureau of the Census, U.S. Department of Commerce, Housing Units Authorized by Building Permits: May 1989, May 1988, and May 1987, *Current Construction Reports*, #C40-8905 (July 1989), #C40-88-5 (July 1988), #C40-88-5 (July 1987), pp. 44–47.

[a]Includes the entire unincorporated area except Masonville Township.

[b]1989 data include entire county; 1987 and 1988 data do not include Kingsford city.

[c]Includes entire county except the cities of Hancock and Houghton, Duncan and Stanton townships, and Calumet village.

[d]Includes entire area except Ishpeming and Sands townships.

Outlook

Among Michigan's regions, Ann Arbor, Grand Rapids, and the Detroit area (excluding the city) should remain at the top of the economic growth list in 1989 and 1990. Growth likely will slow from first-half rates in Jackson, and the modest recovery in Flint may falter as auto sales weaken in the last half of 1989 and in 1990.