Economic Bulletin

GOOD news New cars and light trucks sold at a seasonally adjusted annualized rate of 15.4 million units in November, up 4.3 percent from strong sales in November 1993. The pace was the fastest since March. Truck sales, led by a surge in demand for sport-utility vehicles, posted single-month records while increasing 9.8 percent. Car sales increased only 0.5 percent. The Big Three auto makers' combined market share inched up 0.1 percent and the Japanese makers' share declined 0.5 percent from November 1993 levels.

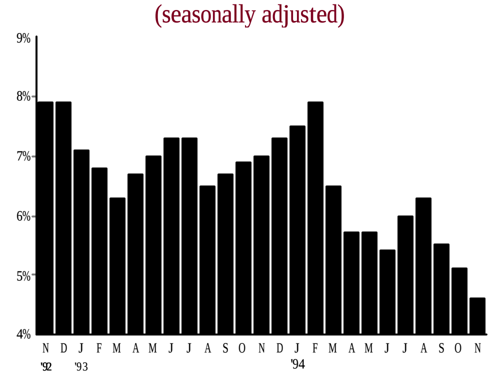
◆ The Michigan unemployment rate fell half a point to 4.6 percent in November, its lowest level in the 24 years of the current measurement system. The number of unemployed individuals totaled 220,000—a 20-year low and a 110,000 drop from November 1993. November marked the seventh month this year that Michigan has registered a lower unemployment rate than the nation. In November 1993 the unemployment rate measured 7 percent following three consecutive increases.

◆ The national unemployment rate declined from 5.8 percent in October to 5.6 percent in November. Government surveys indicated that 272,000 unemployed individuals found work, while establishments reported adding 350,000 new jobs in November. Among the sectors reporting large gains were manufacturing (51,000), construction (71,000), and services (147,000).

◆ The Conference Board's index of consumer confidence jumped 12 percent in November to 101.3. The index had fallen one to two points in each of the previous four months. The monthly survey of 5,000 households revealed that consumers are happy with current economic conditions and have high expectations for economic growth in the coming six months. Analysts pointed to the congressional election results to explain the unusually large increase.

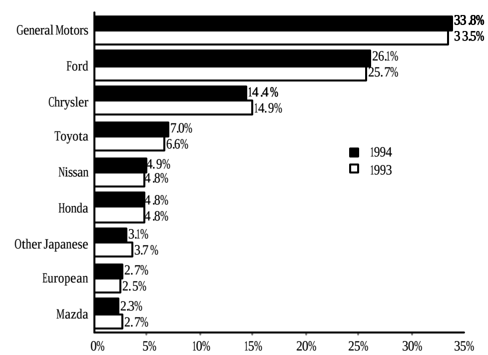
BAD news The index of leading economic indicators decreased 0.1 percent in October, its first decline since July 1993. Six of the eleven indicators were down, including building permits, stock prices, and orders for plant and equipment. Analysts felt that the slight drop in the index—designed to measure the health of the economy several months into the future—reflected the widely held belief that economic growth will slow to a more moderate pace next year.

Michigan Monthly Unemployment Rates
(seasonally adjusted)



SOURCE: Michigan Employment Security Commission.

Market Share, by Maker
November 1993 and November 1994



SOURCE: Wall Street Journal.

IN THIS ISSUE

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December 1994

MONTHLY FOCUS

INFORMATION HIGHWAY ENERGIZES RURAL DEVELOPMENT

When most people think of rural American, computers and fiber optic cable are rarely part of the image. In a recent *Wall Street Journal* article, however, Bill Richards challenges our traditional "low-tech" view of small-town life.[1] Rural areas are beginning to turn to technology to put them on an even playing field with urban areas, and in many cases they are successfully overcoming the remoteness that can be a barrier to rural growth.

Nebraska Takes the Lead

Richards cited Nebraska as a test case in using a fiber optics system, nicknamed "the fiber," as a rural economic development tool. Facing population declines in 83 of its 93 counties in the late 1980s, officials of this rural state decided to encourage telephone companies and other businesses to invest heavily in fiber optics systems. This "experiment" seems to have paid off—about 6,700 miles of fiber-optic cable have been installed, all but 20 counties are growing in population, and unemployment is as low as 1.5 percent in some communities.

Rural Business

Although Nebraska's rural reversal was no doubt assisted by an improving national economy, fiber optics deserve some of the credit. Telecommunications allowed many rural businesses to reap the benefits of inexpensive rural land and life in the countryside while having the communication ability to compete with their big-city rivals.

More Americans are doing business from small towns, at least partially due to fiber optics. An official from Iams, a major employer in Aurora, Nebraska, said that fiber optics was one of the top three reasons it moved into the area. Also, recent research at the University of Washington revealed that a "proliferation of accountants, management consultants, and architects are moving to small towns."

Rural Populations

Some researchers have gone as far as to say that rural telecommunications will alter the traditional shape of social organization because people will locate based on quality of life factors rather than on proximity to economic centers. While such a radical change is far from certain, statistics show a reversal of the rural population declines in the 1980s. In 1990 and 1991 a total of about 900,000 people moved to the countryside, and 400 rural counties with negative population growth rates in the 1980s are now growing.

Telemedicine / Distance Learning

Telecommunications is helping Nebraska's rural communities obtain education and medical services on a par with those in urban and suburban areas. "Telemedicine" gives rural residents access to the Mayo clinic and other specialists nationwide. With assistance from local doctors, images of orthoscopic examinations are sent through cables, and the images examined on video by medical specialists.

"Distance learning" allows rural Nebraska schools to offer curricula that a typical small town would usually not be able to offer. For example, unable to afford a foreign language teacher, Sand Hill High School in Dunning, Nebraska, offered its students Spanish by interactive television. Absent the fiber, students would have had to transfer out of Sand Hill to take foreign language.

The Downside

Richards points out that the information highway could siphon off jobs as well as bring them to rural America. By enabling companies to conduct business from a distance, telecommunications has eliminated some branch offices in rural areas, particularly for banks and insurance companies. Also, the financial investment in

(Continued on page 3.)

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[1] Bill Richards, "Linking Up: Many Rural Regions Are Growing Again; A Reason: Technology, "Wall Street Journal (New York: Dow Jones & Company, Inc.), November 21, 1994, p. A1.

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NEWS FROM THE STATE CAPITOL

SBT REFORM LIKELY IN 1995

Gov. John Engler is expected to introduce a package of Single Business Tax (SBT) reforms in January. Last summer Michigan legislators revised the SBT, which raises about $1.2 billion annually, by lowering the tax rate and raising the filing threshold. The governor's package is expected to propose further amendments to the SBT, although the specific changes have yet to be decided.

Some of the options that likely will be considered are changing the apportionment formula, further cutting the rate, and tempering the influence of employee wages and salaries on the tax. The administration may also expand the small-business credit.

There is support in both parties for some type of SBT reform, and reform is more likely now than ever before. This is in part because of the new Republican majority in the House, which marks the first time in the SBT's 20-year history that Republicans have controlled both chambers and the executive branch of state government.

"ROMULUS LOOPHOLE" TO BE CLOSED

Lawmakers are working to close a loophole in the new school finance system that allowed one school district to tax businesses above the expected 24-mill maximum. Under the new system, school districts are allowed to levy automatically on homeowners enough "hold-harmless" mills to keep their funding from falling below 1993–94 levels. They are also allowed to ask voters to levy up to three "enhancement" mills for school improvements, applied both to homestead and nonhomestead (primarily business) property.

The Romulus School District surprised lawmakers when it found a loophole that allowed it to levy 27 mills on businesses. The district lowered the number of hold-harmless mills it needed and added the three enhancement mills to keep its funding above 1993–94 levels. This effectively shifted to businesses three mills that would have been paid by homeowners.

Senate Bill 1307 would prevent districts from levying enhancement mills until all hold-harmless mills have been levied. The law will not require Romulus to remove the three enhancement mills but will prevent other districts from using the "Romulus loophole." Since this is the first year in which Proposal A reforms are in effect, this is not likely to be the last loophole lawmakers will need to close.

(Continued from page 2.)

telecommunications is substantial and could be a hurdle for many small towns.

Conclusion

While the information highway is not the cure-all for rural areas, it is a strategy that many rural communities might be wise to investigate. Although we are only beginning to understand the implications of rural America going "on line," it is certainly an issue that will gain attention in coming years.

PUBLICATIONS OF INTEREST

U.S. Department of Commerce, Bureau of the Census, ***1992 Census of Agriculture, Michigan*** (Washington, D.C.: Government Printing Office, 1994). 800 / 523-3215

The recently released *Census of Agriculture*, which is produced every five years, provides a detailed set of data on farms and farm production. It provides a historical profile of Michigan agriculture that details farm size, farm type, farm labor, production expenses, and other indicators. Also included are statistics on farmers and farm labor, government payments to operators, farm credit, land use, off-farm employment, and production and sales statistics. Similar statistics are provided for all Michigan counties.

Michigan Agricultural Statistics Service, Michigan Department of Agriculture, ***Michigan Agricultural Statistics 1994*** (Lansing, Mich.: MASS, 1994). 517 / 334-6001

This annual statistical report provides data on current and past conditions in Michigan's agricultural sector. It provides a history of the number and size of farms, the value of farm land, production and prices of farm output, and farm income. It also provides detailed information on the production and sales of many specific agricultural commodities.

NOTE: Due to continued problems with a new computer system, October and November revenue collection data were not available from the Department of Treasury in time to be included in this issue. October and November data will be reported on in next month's edition of the *Bulletin*.

PUBLIC SECTOR CONSULTANTS publishes **Public Sector Reports** and the **Health Legislation Analysis Service**, which includes the ***Health Policy Bulletin*** and the ***Health Care Legislation Abstracts***; offers strategic and tactical counsel and issue management for retainer clients; undertakes specialized research studies; provides public involvement and meeting and conference planning services; and produces research and reference works.

Special Insert
December 1994

M I C H I G A N
E C O N O M I C
F O R E C A S T

INTRODUCTION

Despite the Federal Reserve's efforts to slow growth, the economy is moving at a faster-than-expected clip both nationally and in Michigan. The Fed's six interest rate increases this year have not yet slowed the stream of positive economic indicators: November's index of consumer confidence, at 101.3, is the highest since 1990; the national economy added 350,000 jobs last month; personal income and consumer spending have experienced their greatest increases in months; businesses are enjoying record profits; and factory production is higher that it has been since 1983. Despite worries of growth driving up prices, inflation remains at bay.

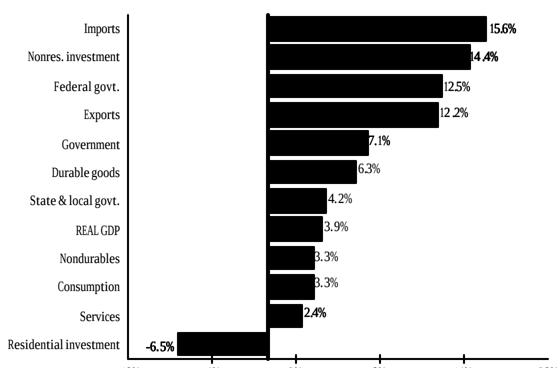
While these indicators are certainly promising, the current recovery still is not keeping pace with previous recoveries and is expected to slow next year. It is also unclear how long growth without inflation can last, but we see no signs of a resurgence in inflation. The rate of inflation has averaged about 3.5 percent over the last decade, and even with good economic growth, we don't believe the inflation rate will exceed that level.

GROSS DOMESTIC PRODUCT (GDP)

GDP, the value of all goods and services produced in the economy, grew at a revised 3.9 percent pace in the third quarter of 1994, up from an initial estimate of 3.4 percent. Third-quarter growth was slightly slower than the second quarter's surprising 4.1 percent and higher than the first quarter's 3.3 percent growth. This is faster than expected by the Federal Reserve, which was hoping to slow growth to around 2.5 percent to head off inflation.

Unlike last quarter, when much of the growth was due to a buildup in inventories, this quarter's growth was spread more evenly throughout the economy. (See Exhibit 1.) Businesses invested 14.4 percent more in plant and equipment (nonresidential investment) in the third quarter than in the second, and consumers spent 6.3 percent more on big-ticket items (durable goods). Although outpaced by imports, the value of American exports increased 12.2 percent in the third quarter. Services grew only 2.4 percent and housing (residential investment) fell 6.5 percent, the only component of GDP to decline.

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



SOURCE: Bureau of Economic Analysis.

Outlook

The economy should continue to grow at a moderate rate in the fourth quarter, between 3.3 and 3.5 percent. A strong Christmas season would push GDP growth into the high end of the range. Growth for the year should be between 3.6 and 3.7 percent.

We expect economic growth to slow in 1995, both nationally and in Michigan, when the effect of higher interest rates has worked its way through the economy, and the effects of increased federal taxes and slower motor vehicle demand take hold. GDP growth should be around 2.5 percent in 1995.

EMPLOYMENT AND INCOME

U.S. nonfarm payroll employment jumped by 873,000 jobs in the third quarter of 1994, a good performance but not as strong as the second quarter. The services and retail trade sectors led the way with respective increases of 413,000 and 225,000 jobs—the business service sector was particularly strong. Manufacturing employment increased by 50,000, about the same increase as in the previous quarter, and government added 88,000 jobs, all in state and local government. The job market continued strong in November as employment rose by 350,000, with 82 percent of the new jobs in services and retail trade. The U.S. unemployment rate averaged 6 percent in the second quarter, down from 6.2 percent in the first quarter.

The Michigan labor market continued to improve in the third quarter as increased 3.2 percent above the year-ago quarter compared with a 2.1 percent gain in the first quarter and a 2.8 percent gain in the second quarter of 1994. The number of new jobs added in the last year is 129,000. There was little change in the growth rates for most categories, except manufacturing and government. Manufacturing employment increased 5.3 percent compared with a 4.1 percent gain in the second quarter, and government employment fell 0.2 percent after increasing 0.8 percent in the second quarter. The largest gains were 5.3 percent in manufacturing—motor vehicle employment jumped 8.8. percent—and 4.8 percent in construction employment.

Services employment continued strong, increasing 4.2 percent, slightly above the second-quarter growth rate. The business services sector continued strong, with employment increasing 9.1 percent. The best performing industry in this category, as in the second quarter, was personnel supply services, which increased 13.8 percent to about 95,000 jobs. The weakest sector was government, as employment fell 0.2 percent below the year-ago quarter. (See Exhibit 2.)

Total employment remained strong in October, increasing 3.8 percent above October 1993. Motor vehicle employment was up 10 percent in October, as the industry continues to drive the recovery.

The Michigan unemployment rate averaged 5.9 percent in the third quarter, up from 5.6 percent in the second. The rate dropped to 5.1 percent in October and 4.6 percent in November, however, the lowest unemployment rate since the late 1960s. The annual rate will be below the U.S. rate for the first time since 1966.

U.S. personal income increased at an annual rate of only 4.8 percent in the third quarter after jumping 7.5 percent in the second quarter. The annual rate of increase for the first three quarters of 1994 was 5.9 percent. This compares with a 1993 increase of only 4.3 percent.

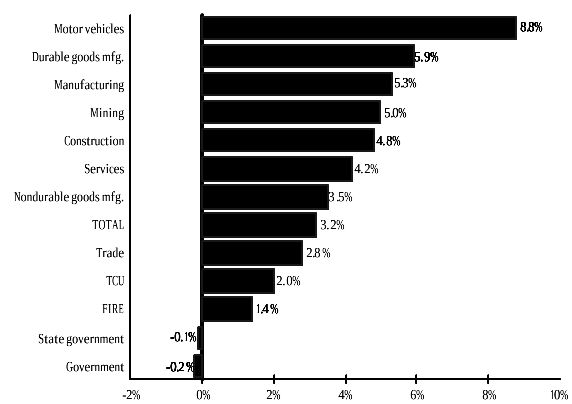
Michigan personal income turned in a solid performance in the second quarter of 1994 (latest data available), increasing at an annual rate of 6.1 percent. (See Exhibit 3.) Wages and salaries also increased at an annual rate of 6.1 percent, led by an 11 percent gain in services income. The increase in personal income was held back by a modest 3.3 percent increase in transfer payments (social security, welfare, and unemployment). Income from dividends, interest, and rent jumped 10.7 percent due to rising interest rates.

Outlook

We expect economic growth to begin to slow in 1995, both nationally 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

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.

EXHIBIT 3

Michigan Personal Income, Selected Components, 1989 to 1994 II (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	$23,270	$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	115,332	37,073	25,518	34,172	29,681
1994 I	205,777	124,397	42,585	27,041	35,439	29,701
1994 II	208,919	126,294	42,661	27,788	35,731	30,497
% change 1993 II to 1994 II	7.5%	9.2%	14.6%	9.1%	5.5%	3.0%
% change 1994 I to 1994 II (annual rate)	6.1%	6.1%	7.1%	11.0%	3.3%	10.7%

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

longer drives sales. One positive sign for continued employment growth is that overtime hours in manufacturing remain very high, 4.6 hours per week in the third quarter, just slightly below the second-quarter level, which was the highest level since World War II.

We project a 2.6 percent increase in U.S. payroll employment in 1994 and 1.75 to 2 percent in 1995. The U.S. unemployment rate is forecast at about 6.2 percent in 1994, with a modest drop to 6 percent in 1995. For Michigan we are projecting a 2.8 percent increase in wage and salary employment in 1994 (up from our previous estimate of 2.3 percent), but only a 1.5–2 percent gain in 1995. The Michigan unemployment rate is expected to be 5.9 percent in 1994, down from our previous forecast of 6.25 percent, and below the U.S. rate of 6.1 percent. We expect the Michigan unemployment rate to remain in the 5.75 to 6.25 percent range in 1995.

Our forecast for U.S. personal income growth is 6 percent in 1994 and 5.5 to 5.75 percent in 1995. In our last quarterly forecast we projected a 6.5 percent increase in Michigan personal income for 1994. We are revising that estimate up to 7.5–8 percent, 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

The third-quarter increase in motor vehicle sales matched that of the second quarter—5.3 percent—but fell short of the 18.3 percent first-quarter gain (year-to-year growth). Gains in truck sales (8.3 percent) continued to outpace gains in car sales (3.5 percent). The annualized sales rate for the third quarter averaged 14.7 million units.

Higher loan interest rates have yet to discourage buyers this year. October and November sales reflected the continued strong demand for pickups, minivans, and sport-utility vehicles and pent-up demand for new model-year cars. The monthly sales rates of 15.3 million units in October and 15.4 million units in November mirrored the results of the first quarter. December sales should follow the same pattern, an 8–10 percent rise in truck sales, and a 2–4 percent increase in car sales.

Outlook

December vehicle sales should increase 5–6 percent over December 1993 levels and put the 1994 total at 15.1 million units. This represents an 8.6 percent gain over 1993 sales. Annual sales would have been even higher had it not been for persistent supply bottlenecks throughout the first half. The elimination of production problems, continued employment and income gains, and the recent surge in consumer confidence will overshadow rising interest rates to push next year's sales up for the fourth consecutive year. We continue to forecast that unit sales will reach 15.5 million in 1995, a 2–3 percent increase over 1994.

MONETARY AND FISCAL POLICY

In November the Fed raised both the federal funds rate and the discount rate .75 of a point each. The short-term rates now stand at 5.5 percent and 4.75 percent, respectively; both rates began the year at 3 percent. The Fed's action—more aggressive than expected—was not accompanied by statements that this would be the last move in interest rates for a while, leading many to believe that the Fed is prepared to intervene again in the near future. The Fed remains concerned about inflation being driven by higher intermediate good prices and higher wages due to labor shortages.

The year-long, Democrat-led push for sweeping health care reform died in October. With the Republicans taking over both houses of Congress, the focus of fiscal policy has moved from reforming the health care system to enacting the "Contract with America," which includes a push for a balanced-budget amendment, lower taxes, and welfare cuts. A bipartisan commission, charged with finding ways to cut entitlement spending, has complicated the coming fiscal policy debate by recommending that home mortgage interest deductions be pared and the age of eligibility for social security benefits be raised.

Outlook

The Fed will raise interest rates again, by as much as 0.5 percent in the first quarter of 1995. Minor adjustments will follow later in the year, with the total increase for 1995 being .75–1 percent. That will place the federal funds rate in the 6.25–6.5 percent range. Long-term (30-year Treasury bonds) rates will rise from the current 8 percent level to a peak somewhere in the 8.25–8.5 percent range and subsequently fall back to the 7.75–8 percent range by late next year.

Congress will enact some sort of tax cut, either a reduction in the capital gains rate or a credit for families, although a more comprehensive reform of the federal tax system will also be discussed. To get President Clinton to sign on, the tax cuts will be accompanied by spending cuts that preserve the current deficit reduction package. Barring further changes, the deficit will begin to grow again in FY 1996 (next October).

PRICES

The **U.S. consumer price index (CPI-U)** rose at an unadjusted annualized rate of 3.8 percent in the third quarter, after rising at a 3 percent rate during the first half of 1994. In October the rate of increase slowed to about 1.2 percent, due to a large drop in energy prices. The October 1993 to October 1994 general price increase measured 2.6 percent (2.9 percent excluding the more volatile food and energy segments), while the increase in medical care prices measured 5.1 percent.

Michigan consumer prices (as measured by the Detroit-Ann Arbor CPI, released every two months) increased at a slower pace between August and October (1.8 percent, unadjusted annualized rate) than in either of the previous two-month intervals. Excluding food and energy, local prices rose at a 6.6 percent annualized rate. Apparel, medical care, and residential rents all registered sharp increases. Between October 1993 and October 1994 the overall Michigan price index rose 2.7 percent and the medical care index rose 6.5 percent.

The **producer price index for finished goods** declined at a 6 percent seasonally adjusted annualized rate in both September and October. The October numbers showed the same rate of decline for the core index, finished goods excluding food and energy. The core prices for intermediate and crude goods, which are not as good an indicator of future consumer prices, increased 7.2 percent and 14.4 percent (seasonally adjusted annualized rate), respectively, between July and October. The Fed has cited these sharp increases as grounds for raising interest rates.

Outlook

Inflation will remain well-behaved through the end of the year. Including an expected increase in December energy prices (due to new insurance requirements for oil tankers dropping oil at U.S. ports), the 1994 rate of inflation will be about 3 percent nationally, and 3.2 percent in Michigan.

In 1995 we expect inflation to pick up slightly from the 3 percent rate of the last two years. Tight labor markets will finally force employers to offer higher wages to attract new workers. This is especially true in Michigan, where the number of unemployed individuals hit a 20-year low in November.

Continued increases in intermediate and crude producer prices will also produce inflationary pressures; however, intense global competition will keep producers from fully passing these price increases on to consumers. The U.S. CPI will increase about 3.4 percent in 1995, and the Detroit CPI will increase about 3.6 percent.

HOUSING

The housing market is cooling off due to higher interest rates, but growth has not stalled. Sales of new single-family homes rose 1.3 percent in October (the latest month for which data are available) to 726,000. This is down from 5.6 percent growth in September. Sales of existing homes rose 0.5 percent to 3.9 million in October following a 1.2 percent increase in September. The effects of higher interest rates were even more apparent in October's housing starts, which fell 5.2 percent.

The Michigan housing industry is weathering higher interest rates slightly better than the nation as a whole. Third-quarter housing starts grew 7.5 percent over 1993 levels (an average of 2.5 percent per month). Growth has cooled, however, from the impressive 12.1 percent growth in the second quarter of 1994 (an average of 4 percent per month) and 17.7 percent growth in the first quarter (an average of 5.9 percent per month). Increases in construction employment also slowed slightly in the third quarter to 4.8 percent above the year-ago level from the second quarter's rate of 5.3 percent.

Outlook

Higher interest rates and waning pent-up demand will continue to take the edge off home sales in 1995 in Michigan and nationwide. Mortgage rates have jumped from below 7 percent early in the year to above 9 percent at the present time. This will clearly affect home buying. But an increase to 10 percent, which we do not expect, would be required to sharply curtail home buying. New home sales should grow 1–1.3 percent per month in the third quarter of 1994 and 1–2 percent per month in 1994.

Michigan housing starts should grow 6–6.5 percent in the fourth quarter and around 4.5 to 5.5 percent in 1995. However, employment and income growth that is stronger than the national average should provide Michigan's housing industry with some cushion.