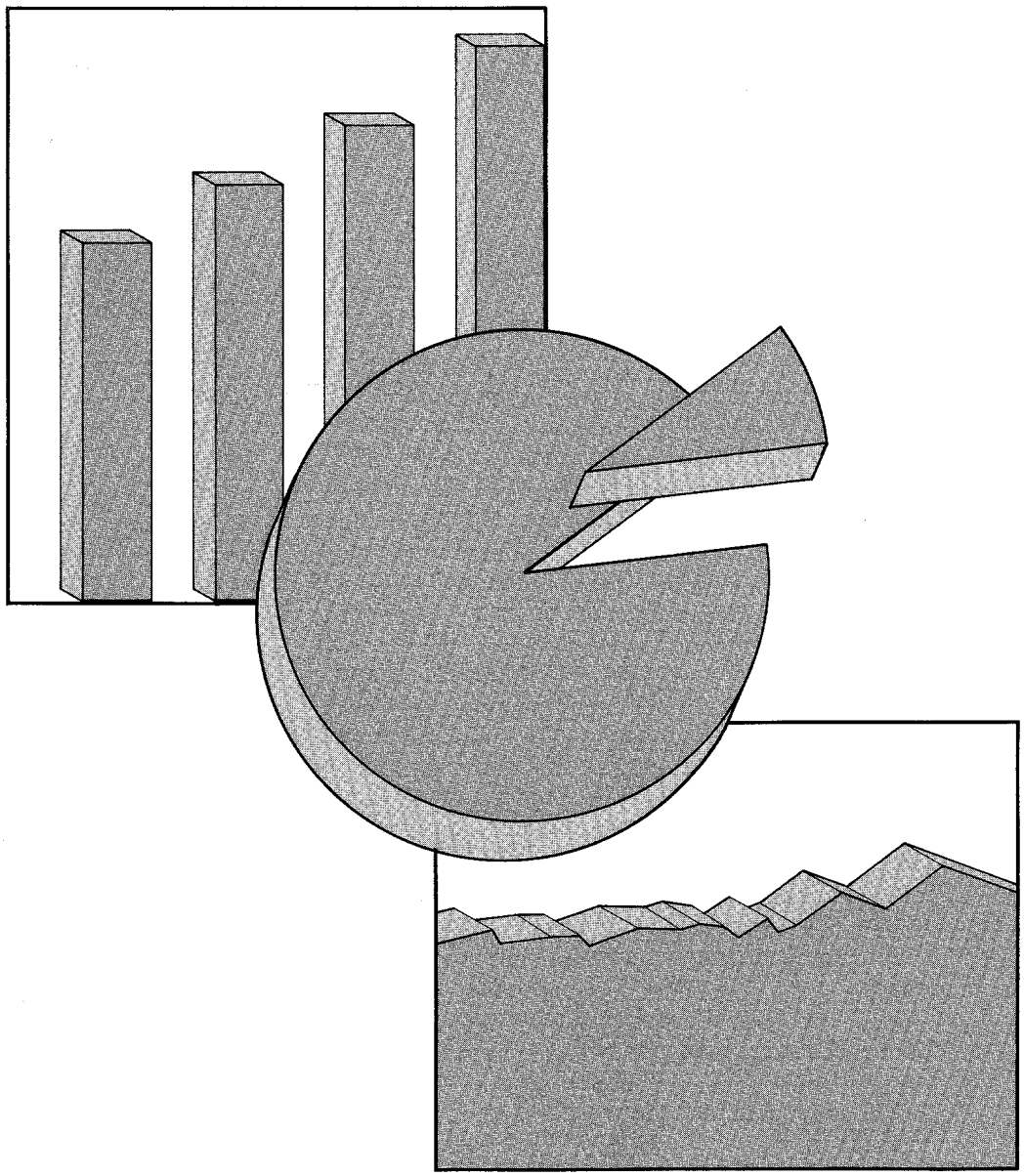
Winter Quarter 1986

Winter Quarter Economic Forecast



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Economic Forecast—Winter Quarter 1986

OVERVIEW

Michigan posted a substantial gain in *employment* in December, for the third month running. The strong fourth quarter followed a summer in which the rate of growth stayed about the same. In fact, summer employment in the state was below that reached during the first quarter of 1985. National employment has risen steadily since July. In December, the national *unemployment rate* was 6.9 percent, the lowest since March 1980. For Michigan, December's unemployment figure of 7.6 percent was the best since July 1979.[1]

First quarter 1986 *vehicle production* will likely be slightly ahead of the last quarter 1985 figure, even on a seasonally adjusted basis. With the continued phase-in of GM's Willow Run, Flint, and Detroit/Hamtramck assembly plants, Michigan should improve its share of car production. Truck production will suffer during the first quarter, however. Vehicle production adjustments will be necessary in the second quarter because of current inventory build-up in the face of sales declines.

Everything considered, Michigan will likely hold, for 1986, its 1985 share of assembly and employment in vehicle manufacturing and automotive components factories.

Because vehicle production still dominates Michigan's economy, this will be reflected in the state's economic activity: 1986's first quarter is likely to post a gain of more modest proportion than that of the final quarter of last year.

On a more positive note, private residential and nonresidential *building contracts* in Michigan exceeded $5 billion in 1985, compared with $4 billion in 1984. Contractors also are benefiting from substantial gains in public building activity. A wide range of other industries also exhibit a robustness that promises to more than offset the plateau in the automotive and supplier industries.

Nationally, the economy grew at a rate of 2.4 percent during the last quarter of 1985. This quarter should show a gain in *gross national product* (GNP), inflation adjusted, of around 3 percent. Inventory adjustments during the second and third quarter will produce a slowdown in GNP growth. For the fourth quarter, federal spending cuts required under the Gramm-Rudman act will start to bite into what otherwise would have been 4 to 5 percent economic growth. We expect the foreign trade pattern to improve; this, coupled with declining interest rates, will limit the downside effects of Gramm-Rudman. For the year as a whole, GNP should show a gain of 2.5 to 3.0 percent over the 1985 level. The revised growth rate for 1985 was 2.3 percent.

Overall economic growth in Michigan during the first half of 1986 is likely to lag behind performance during the recent quarter. It should be noted that Michigan's economic performance during the current three-month period will seem torpid only in comparison with the last quarter of 1985, a period of exceptional robustness. We will also probably trail the U.S. growth rate during the first half of 1986. This year will show appreciable growth compared with the first nine months of 1985, particularly the spring and summer. During the last half of 1986, and into 1987, Michigan's growth rate is expected to parallel that of the nation as a whole.

LEADING INDICATORS

Although aberrations in the index of leading economic indicators are common, these eleven indicators, taken together, typically lead the business cycle. That is, their peaks lead business cycle peaks by several months, and their troughs lead troughs in the general level of business activity. For example, changes in contracts and orders for plant and equipment presage a rise or fall in production of capital goods, an important component of total national production. Another example is workweek length; increased demand for goods results in an increase

[1]Employment data for January were released just prior to publication. The Michigan unemployment rate was 8.5 percent, up from a revised 7.8 percent in December. Total employment in Michigan declined 41,000 in January. The U.S. employment rate fell to 6.7 percent in January.

in hours worked by the existing work force. Later, if demand proves to be buoyant, more workers are hired. As demand trails off, reductions in the length of the workweek usually precede layoffs, signaling a downturn.

During December, the latest figures available, the index of leading indicators rose by .9 percent after gains of .2 percent, .6 percent, and .4 percent, respectively, in each of the previous three months. Gains in building permits, prices of common stocks, and the length of the average manufacturing workweek were primarily responsible for the rise. Other of the leading indicators that boosted the index are vendor performance (companies reported slower deliveries from their suppliers, presumably due to increased demand), an increase in the nation's supply of money, rising prices of sensitive materials, and growing numbers of contracts and orders for plant and equipment. Registering decreases were new business formations, new orders for consumer goods and materials, outstanding consumer and business credit, and initial unemployment claims.

Generally speaking, it requires several months of strength or weakness in the leading index to presage general strength or weakness in the economy. The recent pattern in the leading indicators suggests a moderately expansive U.S. economy in the months ahead and no recession, at least during the first half of 1986.

MONETARY POLICY

Serious efforts to reduce the size of the federal budget deficit will begin to cut into government demand for goods and services during the second quarter of 1986. Such actions, imposed by the Gramm-Rudman act will reduce the need for the Federal Reserve System to contain inflationary pressures. Monetary policy is likely to be expansionary, meaning further reductions in interest rates. There still is considerable slack, or unused capacity, in the U.S. economy. This means that a stimulative monetary policy to counter the economic impact of declining government deficits is not likely to be inflationary.

Declining U.S. interest rates coupled with government intervention in international foreign exchange markets have produced a sharp decline in the value of the U.S. dollar. In February 1985, for example, a dollar would purchase 260 yen; in mid-January, the figure was around 200, a decline of 30 percent in less than a year. The turnabout has increased prices of foreign imports while reducing prices of our exports. A declining dollar value on foreign exchanges makes American manufacturers, farmers, and other goods producers more competitive both here and overseas. It also reduces the price of services relative to those in other countries. Ultimately, the new pattern of currency exchange rates will produce more jobs in this country, but at the cost of higher prices for foreign-made goods and for intangibles such as overseas travel.

The adjustment was inevitable because Americans have been on a buying binge as a result of the high-flying dollar. The trade deficit, well in excess of $100 billion last year, simply could not continue.

ENERGY

In the United States, the average cost of crude petroleum to the refiner was $26.70 per barrel during 1985, a decline of 7 percent from 1984 and 24 percent from the 1981 average. The decisions of Organization of Petroleum Exporting Countries to increase production in hopes of recapturing worldwide market share will be reflected in lower prices for gasoline, home heating oil, jet fuel, and so forth. The implications for markets for new cars and trucks are obvious.

Electricity prices are likely to go up as utility rates increase to accommodate new investments in generating facilities, particularly nuclear generating plants. The cost of electricity is a very small proportion of total production cost for most goods and services, however.

All things considered, energy will provide price relief during 1986, increasing the freedom of monetary authorities to pursue an expansionary policy.

VEHICLE PRODUCTION AND SALES

Notwithstanding the ambitious first quarter production plans of U.S. car and truck makers, almost no one expects assembly during 1986 to exceed the 1985 level of 11.7 million units. There are two basic reasons for pessimism: sales of imports are climbing and, after three successive years of sales gains, the total market is, at best, flat.

The sale of imports will increase. These will be cars with domestic nameplates, but built overseas, and vehicles built overseas by foreign companies both well established and new in the American market.

Employment in the U.S. industry is almost certain to decline during 1986 as a result of the pressure to close the productivity gap between U.S. and Japanese car manufacturers. The productivity record of the U.S. industry from 1977 through 1981 was dismal, but has improved in recent years as revealed in the numbers in Table 1. If the 7 percent annual rate of productivity gain since 1981 were extended to 1986, the result would be a job decline of about 50,000 from 1985 levels in the vehicle and parts manufacturing industry.

U.S. vehicle production is likely to slip 750,000 units below the 1985 figure. To maintain profits in the face of fierce price competition, domestic producers need to increase productivity, meaning reduce employment. The same scenario is likely for automotive suppliers. We can also expect more imports of components for assembly in U.S. vehicles, particularly from Mexico, Brazil, and the Far East. Consequently, automotive employment will surely decline in 1986 from the 1985 level—a figure well below the previous peak of 1978.

CONSTRUCTION

Building permit data are collected by the Bureau of the Census. The latest figures reveal the considerable strength of construction in Michigan during the past three years (Table 2).

Homebuilding, the largest single category of building permits, has tripled in valuation since 1982. Rehabilitation of nonresidential structures has doubled in value. While the value of permits for new industrial building in 1985 was not quite double the 1982 level, the value of office building permits nearly quadrupled. After office buildings are completed, their white collar professional occupants are usually classified in the industry known as business services, also a rapidly expanding sector of the Michigan economy.

A closer look at motel-hotel construction seems worthwhile. Though it accounts for a relatively small component of construction activity in this state, it is exhibiting substantial growth compared with the depressed 1981, 1982, and 1983 levels, and even with 1979 and 1980. This growth in the lodgings industry represents potential for tourism and business travel in the "winter-water wonderland" and for the restaurant, entertainment, and other businesses that depend on the travel dollar.

TABLE 1

Indexes of Motor Vehicles and Equipment Output per Employee-Hour: 1977-84 (1977=100)

Year	Blue Collar Workers	White Collar Workers	Total
1977	100.0	100.0	100.0
1978	99.3	99.4	99.3
1979	99.3	92.9	97.8
1980	97.9	72.5	90.8
1981	98.1	79.0	93.1
1982	103.6	79.3	96.9
1983	112.2	101.9	109.6
1984	115.1	113.0	114.6

SOURCE: Bureau of Labor Statistics, special release.

TABLE 2

Valuation of Residential and Nonresidential Units Authorized in Michigan Permit Issuing Places, by Category: 1979, 1982, and 1985 and Percentage Change 1982-85

Category	1979	1982	1985	1982-83	1983-84	1984-85
Residential homes	$1,899.9	$593.2	$1,757.2	71.3%	30.4%	32.7%
Transient hotels, motels, tourist courts, and cabins	43.1	8.6	136.0	47.7	584.3	56.5
Industrial buildings	528.1	312.4	555.3	-49.4	109.2	67.8
Hospitals and other institutional buildings	62.7	34.6	30.7	53.2	37.5	-57.9
Office, bank, and professional buildings	222.6	121.0	454.9	73.1	68.9	28.5
Stores and other mercantile buildings	296.3	72.3	250.5	62.1	48.6	43.8
Additions, alterations, and conversions						
Housekeeping residential buildings	233.1	204.8	285.0	30.0	-3.6	11.0
All other building structures	189.1	349.9	711.8	23.7	38.7	18.6

SOURCE: Bureau of the Census, special release.

Nationally, the U.S. price index for residential construction increased by about 7.7 percent between 1982 and 1985; nonresidential building was up by 2.1 percent. Comparatively, most of the 1982-85 gains shown for Michigan in Table 2 represent real increases in building permits issued for homes, factories, offices, stores, and so forth.

The outlook for construction in this state continues to be bright in light of low interest rates, high incomes, the influx of specialists from GM's acquisitions of Hughes Aircraft and Electronic Data Systems, and a generally pent-up demand for structures after several lean years.

RETAIL TRADE

During 1985, Michigan was one of the leading states in retail sales growth, registering a gain of more than 10 percent above the 1984 figure (Table 3). The favorable development was especially pronounced in durable goods categories and particularly in the third quarter of the year. (Figures are not yet available for the last two months of 1985, so the fourth quarter performance is unknown.)

These national figures, based on a sample of retail establishments, find support in data from the Michigan Department of Treasury. Treasury figures reveal a 19 percent gain in sales tax collections from Michigan car dealers for fiscal year 1984-85 compared with 1983-84. (Michigan fiscal years begin on October 1 and end on September 30.)

Michigan sales tax collections from furniture stores and building materials dealers posted gains of better than 14 percent, and collections from gasoline service stations gained 11 percent. For restaurants, gains were about 8.5 percent. The other retail categories recorded weaker performances, although the gains were between 8 and 10 percent.

In the nonretail sectors, motels sales tax collection increased 8.5 percent; garages, 11.2 percent; utilities, 2.2 percent; wholesalers, 15.9 percent; and business services, 21.3 percent.

Furniture, appliance, and building materials dealers should continue to exhibit good sales gains during 1986. With the record number of new motel or hotel rooms, the lodgings industry, restaurants, and service stations also should post a substantial gain. An exception to this optimistic picture is auto sales; car dealers are quite unlikely to match 1985's rate of sales gain.

TABLE 3

Percentage Change in Retail Sales: 1983-85 (from previous year)

	1983	1984	1985[a]	1983-85
Northeast	10.2%	11.0%	6.6%	30.4%
Midwest	7.6	10.6	7.0	27.3
South	10.6	10.7	5.9	29.7
West	9.4	9.4	6.8	27.8
Michigan	9.1	9.8	10.7	32.6
Ohio	7.1	9.8	10.7	30.2
Indiana	6.1	16.2	1.6	25.3
Illinois	6.7	6.9	6.5	21.5
Wisconsin	6.6	10.8	10.4	30.4
TOTAL	7.2%	9.9%	8.2%	27.5%
U.S.	9.5%	10.5%	6.5%	28.9%

SOURCE: Bureau of the Census, *Monthly Retail Trade,* October 1985, and *Revised Monthly Retail Sales and Inventories,* January 1975 through December 1984.

[a]First ten months of 1984 and 1985.

WINNERS AND LOSERS: EMPLOYMENT

Employment data for October and November of 1984 and 1985 were used to develop the list of Michigan's top growth industries (Table 4). Michigan's "winningest" industry in 1985 was one of its smallest—air transportation, which showed an increase in employment of 27 percent. Michigan has become a major hub for Republic Airlines, and the state has improved its place in the route structures of other airlines.

TABLE 4

Ranking of Top 15 Michigan Industries According to Percentage Change in Wage and Salary Employment: 1984-85

Industry	Employment[a] 1979	Employment[a] 1985	Percentage Change[b] 1983-84	Percentage Change[b] 1984-85
1. Transportation: air	7.3	10.1	15%	27%
2. Manufacture of electrical distributing equipment	2.0	2.2	6	22
3. Construction: heavy	23.0	19.6	-9	21
4. Manufacture of concrete, gypsum, and plaster products	6.5	5.0	5	20
5. Manufacture of office and computing machine	7.6	8.2	2	20
6. Services: business	94.2	141.2	13	19
7. Construction: general building	36.4	27.0	8	16
8. Manufacture of plumbing and heating equipment	2.4	2.5	0	14
9. Service: lodgings	26.5	27.6	5	11
10. Retailing: miscellaneous	64.9	79.3	4	10
11. Retailing: car dealers and service stations	71.8	72.1	8	10
12. Services: automotive repair	22.2	25.1	12	8
13. Construction: special trade	80.1	60.3	6	8
14. Finance: nonbank credit agencies	20.4	22.5	5	7
15. Services: health (other than hospitals)	104.9	132.0	2	7

SOURCE: Developed from Michigan Employment Security Commission, special release.

[a]Thousands of jobs, 1979 annual average and November 1985.

[b]Percentage change, 1983-84 annual average and October and November 1984-October and November 1985.

Also high among Michigan's gainers between 1984 and 1985 were construction and associated industries, such as the manufacture of electrical distribution equipment; concrete, gypsum, and plaster products; and plumbing and heating equipment.

Business services has been an expanding sector as newly built office structures accommodate their tenants. Business services has become a major Michigan industry, with prospects of continued growth due to the large number of office buildings planned and under construction. Office and computing machine manufacturing is a small, but growing, Michigan industry. Another of Michigan's growth industries of recent years, office furniture and fixtures and public building furniture, also posted gains in employment, but not at the rate of those industries shown in Table 4. This latter group has provided a major economic stimulus in the western side of the state.

Car dealers and garages, the lodgings industry, and miscellaneous retailers also added employees at exceptional rates during 1985. Two other high-growth industries were credit agencies and health services other than hospitals. Growth in the latter came at the expense of hospitals, which lost employment during 1985. The demand for care in a hospital setting has been declining in recent years as health clinics and other health services entered the field.

The biggest loser in terms of changes in wage and salary employment was the beverage industry. Both Stroh and Vernors closed their plants during 1985. The other major Michigan losers, in order of percentage loss in employment, were textile manufacturers, hardware goods manufacturers, fabricated metals manufacturers, toy makers, food processors, foundries, sawmills, nonferrous rolling mills, transportation equipment other than automotive, household furniture, paper box manufacturers, investment companies, producers of industrial, inorganic chemicals, and the refrigeration service industry. Automotive employment just held its own during the October-November 1985 period.

Overall, the employment data reflected a weakening in the manufacturing sector as the year wore on, a weakness that is likely to carry into 1986. During 1986, the principal growth in employment will occur in construction, services, retail trade, and wholesale trade.

AROUND THE STATE

Among the state's metropolitan areas, Ann Arbor exhibited the greatest year-to-year growth between November 1984 and November 1985 (a 7.4 percent gain in wage and salary employment). Area construction, retail trade, services, and growth in state government (including higher education) provided impetus, more than offsetting a decline in automotive employment.

Lansing was second in growth (3.9 percent) due to increased construction, automotive, services, and local government employment. The Saginaw area was third (3.4 percent), led by construction, services, and retail trade. The Detroit area posted a 3.2 percent gain compared with the statewide average of 3.1 percent. In this area of the state, construction, retail trade, and services exhibited good growth in the face of a decline in manufacturing employment.

Employment in construction, mining, services, and local government declined in the Upper Peninsula. Consequently, there was a dip in employment even though manufacturing industries posted gains. Battle Creek and Jackson posted anemic employment gains.

Building permits data also show a mixed bag for construction around the state. Oakland County is a beehive of activity, particularly in office and residential construction. The City of Detroit, with 12 percent of the state's population, hosts above 14 percent of the state's nonresidential rehabilitation construction activity and about 8 percent of residential rehabilitation. Only about 5 percent of total building permits for new stores were issued in Detroit during the past two years, and the city has only a tiny fraction of permits for new factories and office buildings.

All in all, the economic recovery in Michigan has been uneven, and that pattern promises to continue into 1986. The inner cities still are losing job base, on balance, because that is where most of the antiquated factories are located and because of population drain to the suburbs. New jobs emerging in the service industries are insufficient to counterbalance the losses in the declining sectors.

OUTLOOK

Third quarter personal income data for 1985, released at the end of January 1986, reveal that Michigan was sixth among the 50 states and the District of Columbia in economic growth. Not only did vehicle production in this state exceed the level anticipated earlier, but the income growth and other spinoff effects were also stronger than predicted. Michigan's economic growth rate for all of 1985 was about one-third above that for the nation as a whole, notwithstanding that employment growth in the Wolverine State was below the national average. This is another way of saying that the earnings growth for those who were employed in Michigan was spectacular. Workers are doing very well financially.

Vehicle sales in 1986 almost surely will fail to match the 1985 record of 15.7 million. But 1986 will be a very good year in comparison with most others; sales of 15.2 million are possible, with 11.4 million of those being domestic, compared with 12.2 million last year.

For Michigan, much of the job growth during 1986 will be generated by expansion in the lower paying retail and service sectors. Good statistical gains in employment are expected when the summer of 1986 is compared to the summer 1985 doldrums caused by the languid labor market.

The expected behavior of the broad economic indicators is shown in Table 5.

TABLE 5

Projections of Michigan and the United States Broad Economic Indicators, 1985 and 1986

				Percentage Change	
	1984	1985	1986	1984-85	1985-86
Earnings (current $ in millions)					
Michigan	81,382	89,000	95,400	9.4%	7.2%
United States	2,141,000	2,307,000	2,470,000	7.8	7.1
Earnings (1984 $ in millions)					
Michigan	81,382	85,900	89,400	5.6	4.1
United States	2,141,000	2,227,000	2,315,000	4.1	4.0
Civilian Employment (thousands)					
Michigan	3,871	3,930	4,025	1.5	2.4
United States	105,005	107,150	109,300	2.0	2.0
Vehicle Production (thousands)					
Michigan	3,000	3,400	3,300	13.0	-2.9
United States	10,900	11,700	11,000	6.5	-6.0
Unemployment Rate (% of civilian work force)					
Michigan	11.2%	9.9%	9.0%	—	—
United States	7.5%	7.2%	7.0%	—	—

SOURCE: 1984 data on earnings from *Regional Economic Analysis*, U.S. Department of Commerce, Washington, D.C.; on civilian employment rate from special release, Bureau of Labor Statistics, Department of Labor, Washington, D.C.; on vehicle production from special release, Motor Vehicle Association, Detroit.

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