Fiscal Update: January 1997

Employment

Trends in the Labor Market

Michigan's unemployment rate fell 0.1 percentage points to 4.7% in November, remaining below the national average -- which jumped 0.1 percentage points to 5.3%. The 1996 year-to-date average unemployment rate in Michigan also stands at 4.7%. This is a significant improvement over last year's 5.4%, itself a very solid figure. The U.S. rate also dropped from a year ago, but the change was not so dramatic -- falling 0.2 percentage points to 5.4%.

- Year-to-date average unadjusted wage and salary employment in Michigan is 66,000 jobs higher than the average employment level of 1995. The increase is primarily due to employment gains in the service and government sectors.

- Average wage and salary employment has remained fairly steady over the past year in the manufacturing sector, with November 1996 manufacturing employment unchanged from the November 1995 level. Employment increases in the service sector can be partly attributed to the business services industry (reflecting an increase in the use of temporary employees and out-sourcing) and the retail trade industry (which is 20,000 jobs higher than this time last year). Employment in health-related services increased slightly.

The National Economy

Composite Indices

In predicting the future path of the economy, economists traditionally look at three types of indices: the composite index of leading economic indicators, the composite index of coincident economic indicators, and the composite index of lagging economic indicators. The value of each index is derived from several economic indicators and is now calculated by The Conference Board, Inc., New York, N.Y.

- The composite index of leading economic indicators rose for the ninth consecutive month. It reached 103.6 in October. This is 0.1 percentage points above last month, and represents a 3.2% increase since the beginning of the year. The growth of the leading index has been slowly declining over the last six months, from a high of 0.4 in April to October's low of 0.1. This suggests the economy will continue to grow during the next few months, but at a moderate rate.

- The composite index of coincident economic indicators declined for the first time in eight months, falling 0.1 percentage points to 121.8. Declines in both the industrial production index and the personal income components were responsible. The manufacturing and trade sales component was not available. Since the decline in the coincident index was mild, and because the leading index is still increasing, the economy is expected to remain in a sustained, yet relatively slow, growth phase.

- The composite index of lagging economic indicators has declined in three of the last six months, and decreased in October by 0.1 percentage points to 102.3. This confirms the solid but unspectacular growth experienced in the first half of 1996.

Components of Gross Domestic Product

Gross domestic product (GDP) measures the total value of all final goods, services, and structures produced in the United States. GDP growth is the standard measure of the performance of the economy, and has four main components: personal consumption expenditures, gross private domestic investment, government purchases of goods and services, and net exports (exports less imports) of goods and services.

Final estimates indicate real GDP increased by a moderate 2.1% in the third quarter of 1996, down from the upbeat 4.7% growth rate of the second quarter. Strong third-quarter growth in investment was tempered by modest growth in consumption expenditures, net exports, and government expenditures.

- Growth in investment expenditures rose by 21.4% in the third quarter. Growth in fixed investment increased by 10.6%, boosted by an 20.9% increase in investment in producers' durable equipment. Business inventory investment also increased, whereas residential investment declined.

- Total government expenditures decreased by 0.6% in the third quarter. Federal expenditures decreased 3.5% (primarily due to decreases in defense spending) and state and local spending rose by 1.1%. Net exports (exports minus imports) decreased from -$114.7 billion in the second quarter of 1996 to -$137.4 billion in the third quarter. Exports decreased by 0.9%, and imports rose by a strong 9.3%.

- Consumption expenditures remained more or less steady with a growth of only 0.5% in the third quarter -- the slowest growth rate in over a year and well below the average 3.5% growth rate of the previous two quarters. Nondurable goods expenditures increased only slightly and durable goods expenditures decreased, which is not surprising considering the extent to which consumers are in debt. Although spending on services increased, it was unusually restrained (1.3%) and thus contributed to the limited growth of total consumption expenditures.

Interest Rates

Beginning in 1997, the composite index of leading economic indicators will be revised to include a measure of the interest rate spread. This is a measure of the difference between long- and short-term interest rates (10-year treasury bond rate minus federal funds rate), and is often referred to as the yield curve. The long-term rate is usually considered to be the expected future short-term rate, so a downward sloping yield curve indicates the Federal Reserve Board (FED) is expected to lower the federal funds rate in the future. Since the FED often (but not always) does this when there is danger of a slowdown in the economy, a downward sloping yield curve tells us that a slowdown in economic growth may be expected in the future. In other words, interest rates are closely linked to the behavior of monetary policy, and the yield curve has proven to be a fairly good indicator of the future performance of the economy because of this link.

As the graph (*in published document*) shows, the yield curve is often a good indicator of recessions (R), especially after 1970. The yield curve declined from 1993 through 1995, indicating the possibility of a future downturn in the economy. However, it increased in the first three quarters of 1996, so the outlook is not entirely clear.

The Michigan Page

Personal Income and the Auto Industry

Growth in state tax revenue is largely determined by growth in state personal income. Michigan's personal income has out-paced the Great Lakes average growth rate in three of the last four quarters.

- The U.S. Department of Commerce reported that Michigan's personal income totaled $238.5 billion in the second quarter of 1996, an increase of 3.0% over the first quarter (the U.S. increased 1.6%), and a strong turnaround from the 1.0% decrease of the previous quarter.

- Real disposable income is an indicator of future expenditures in the durable goods sector. This sector, comprised of light vehicles and other goods, is an important contributor to the Michigan economy. Real disposable income for the U.S. increased by 4.8% in the third quarter of 1996, clearly out-pacing the revised 1.3% increase in the second quarter. This is well above the pace of the first half of 1996 when the average growth rate was 1.7%, and it may indicate a reversal in the recent trend of decreased expenditures on durable goods.

- Calendar year (CY) 1996 U.S. car and light truck sales totaled over 15.1 million units, up 2.5% over CY 1995 levels. Light trucks were once again the primary engines of growth, posting a 7.9% gain over 1995 levels; cars decreased by 1.2%. Domestic vehicles were responsible for both the increase in light truck sales and the decrease in car sales, whereas Japanese vehicle sales remained steady and European sales increased in both segments of the market. Overall, market share for the "big three" decreased from 73.2% to 72.9%. CY 1996 total U.S. production failed to attain CY 1995 levels, due in part to the GM brake plant strike in March. Despite this, and because GM is car-heavy, light truck production was 0.5% above CY 1995 levels, whereas car production declined 4.3%. Total production declined 2.1%.

For a copy of this report (with accompanying graphics and footnotes) prepared by Stephen Marasco under the direction of the HFA economist, please contact Mitch Bean or call the HFA office at 517.373.8080.
