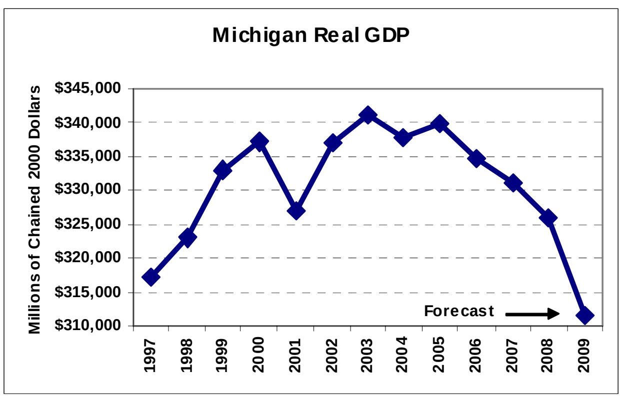
CONTEXT
MICHIGAN ECONOMIC BRIEF
Comerica Bank
2009: No. 2 *June 18, 2009*

Searching for a Bottom

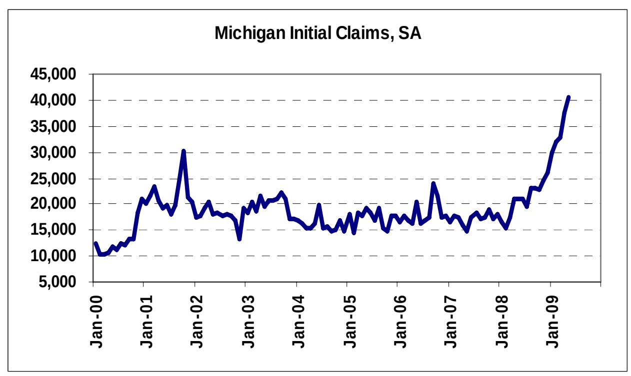
Earlier this month, the Commerce Department reported that real GDP in Michigan declined 1.5 percent in 2008. Michigan underperformed the 0.7 percent rise in U.S. real GDP by 2.2 percentage points, and only three other states (Alaska, Florida, and Delaware) showed bigger declines last year.

The chart below shows that real GDP in the state peaked in 2003. Since then, the cumulative drop in Michigan real GDP has been 4.4 percent, while nationally real GDP rose 12.7 percent. No other state came remotely close to matching the persistent underperformance that Michigan has experienced. Two of Michigan's neighbors, Ohio and Indiana, had the next weakest outcomes. But in contrast to Michigan, they had cumulative increases in real GDP since 2003 of 1.8 and 3.2 percent, respectively.



The underperformance of the Michigan economy was widespread across industries. By far the weakest sector, of course, was durable manufacturing, reflecting the woes of the state's auto sector. In Michigan, the real output of durable manufacturers contracted by 16 percent over the past five years, while nationally durable manufacturing output surged by 25 percent, a performance gap of 41 percentage points. The weakness in durable manufacturing spilled over to most other sectors with particularly onerous impacts on construction and on professional and technical services. However, two sectors in Michigan (agriculture and mining) noticeably outperformed their national counterparts over the past five years.

Almost certainly, Michigan is in the process of generating a much bigger drop in real GDP in 2009. Reflecting the free fall in activity that already occurred in 2008Q4 and 2009Q1, the national economy is on track for a 3 percent decline in 2009 compared to 2008. With auto sales particularly hard hit by the disruptions in financial markets and the national recession, Michigan inevitably will underperform again in 2009. Our forecast is that Michigan real GDP will contract 5 percent this year. That would be 2 percentage points worse than the national economy and would result in a cumulative drop in real GDP of at least 9 percent in the six years since 2003.



Labor market data confirm that Michigan is continuing to underperform. Over the first five months of 2009, nonfarm payrolls in the state have declined at a 9.5 percent annual rate, not quite double the 5.2 percent rate of decline seen nationally. Likewise, the state unemployment rate was 14.1 percent in May, 4.7 percent above the national reading. The unemployment rate has increased 3.9 percentage points since December, 1.7 percentage points more than the national reading. And labor market conditions show no sign of stabilizing in Michigan. Applying our seasonal factors, initial claims for unemployment insurance in May were up 55 percent since December, while nationally they were up 15 percent.

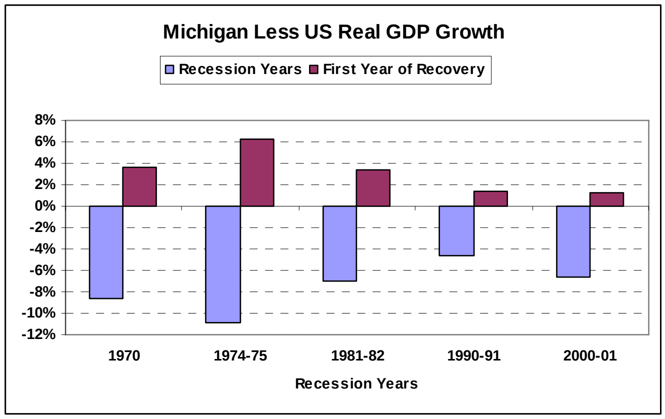
As usual, auto sector jobs are playing a huge role in the Michigan labor markets. Jobs in auto and auto parts manufacturing have declined by roughly 40,000 over the first five months of 2009. Some of those job cuts reflect unusually large and lengthy summer furloughs designed to pare inventories and, therefore, will prove temporary. But the bankruptcies at GM and Chrysler will result in numerous permanent jobs cuts that still are to be implemented later this year and next. We are forecasting that auto and auto parts manufacturing jobs are headed for a decline of as much as 50,000 this year, which would easily surpass past annual cuts in both absolute and percentage terms. An outcome in line with our forecast would reduce auto manufacturing jobs to around 100,000 or to only about 2.5 percent of total jobs in Michigan.

Michigan also will lose at least another 5,000 jobs at new car dealers. Chrysler and GM together have identified 100 dealerships in Michigan (13 percent of the new car dealers in the state) that they want to close. On average each Michigan dealer employs about 50 people. The risk is that the number of job losses at dealers will grow if Ford also trims its dealer network and GM announces a second round of closings.

In gauging the potential for a turnaround in the Michigan economy, nothing is more important than the timing and vigor of the recovery of the national economy. And in that regard, the evidence of stabilization is increasingly widespread. Home sales and starts have bottomed. Goods inventories are declining in absolute terms and relative to sales. Credit is becoming more available and less expensive for many household and business borrowers. The stock market has rebounded impressively from its March lows. Government stimulus spending is accelerating. Job losses and claims for unemployment insurance are declining. Consumer and business confidence is on the rise.

The national economy probably will bottom out some time in the third quarter, and as part of that rebound, light vehicle sales should strengthen. After averaging about 9.6 million units at an annual rate in the first half of 2009, I am forecasting that light vehicle sales will strengthen to about an 11 million unit annual rate in the second half. That sort of moderate rebound would create a much needed lift to auto company revenues and allow them to increase production and hourly employment.

The key point to remember, however, is that Michigan is not going to benefit nearly as much as it has in the past from a national recovery and a rebound in auto sales. In past business cycles, Michigan tended to contract more sharply than the national economy during downturns, and rebound more strongly in the subsequent upturn. But as the chart below illustrates, in more recent business cycles, the subsequent rebounds have become more muted. And if anything, given the reduced share of light vehicle sales and the smaller portion of the Michigan economy accounted for by autos, the rebound we will see in 2010 is likely to be even less impressive than it was in the last two recoveries.



In other words, the future of Michigan lies mostly outside the auto sector. Michigan will continue to have a disproportionately large auto sector. But most of the growth in employment and production in the years ahead is likely to be concentrated in the knowledge intensive industries that will dominate growth in the national economy.

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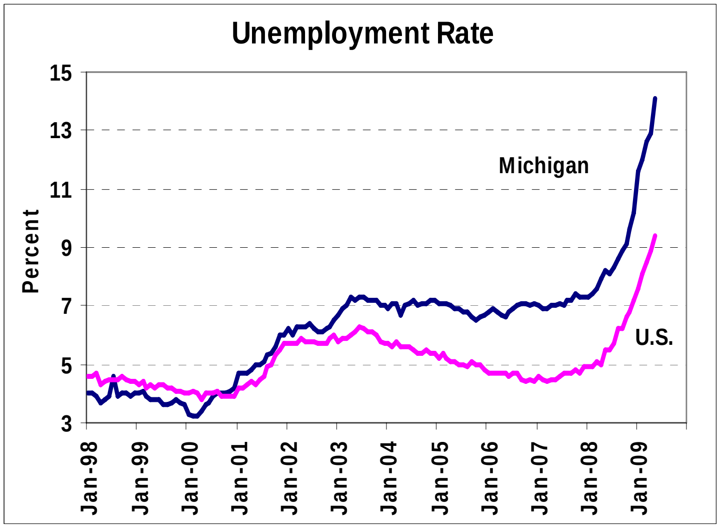
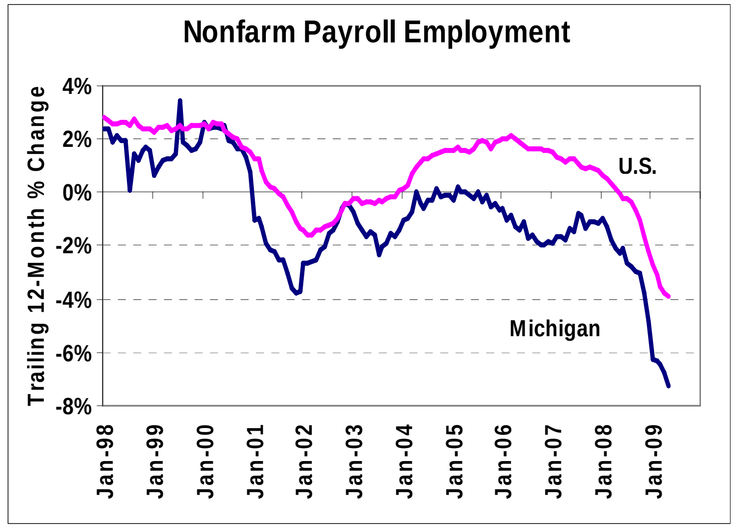
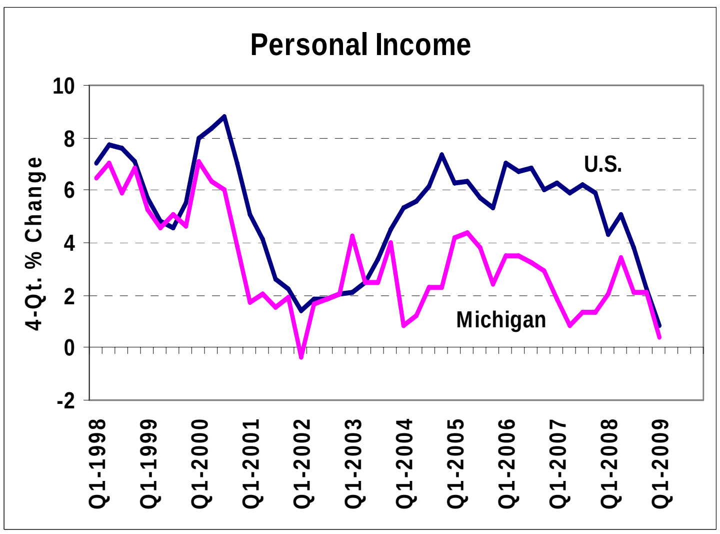
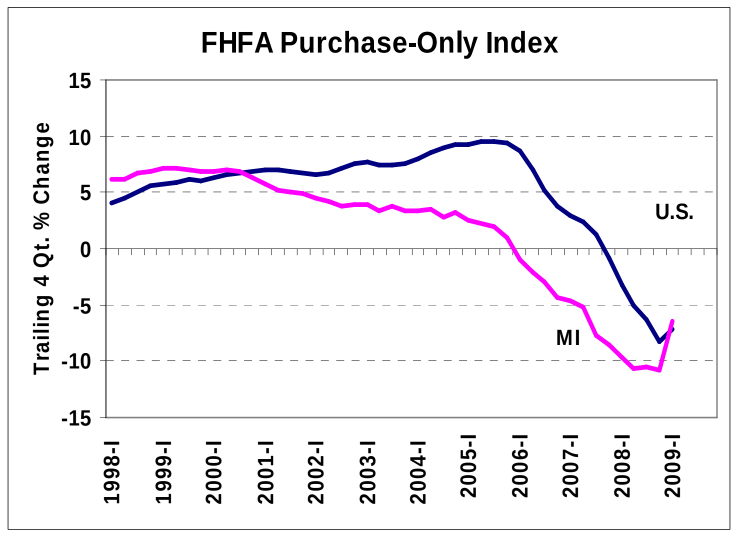
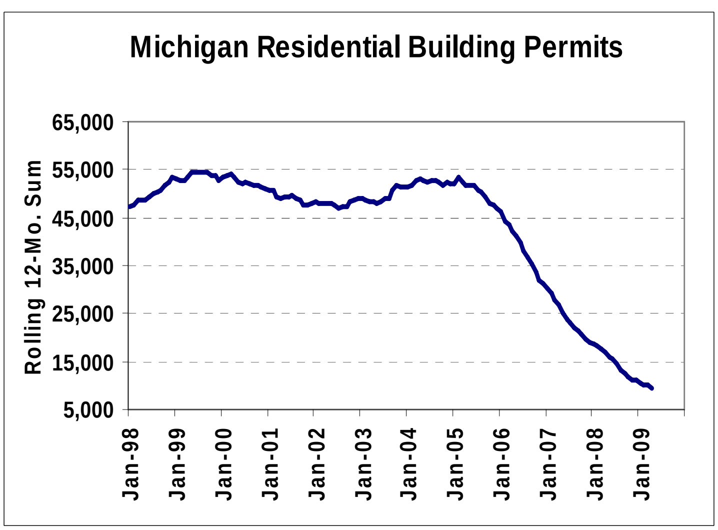
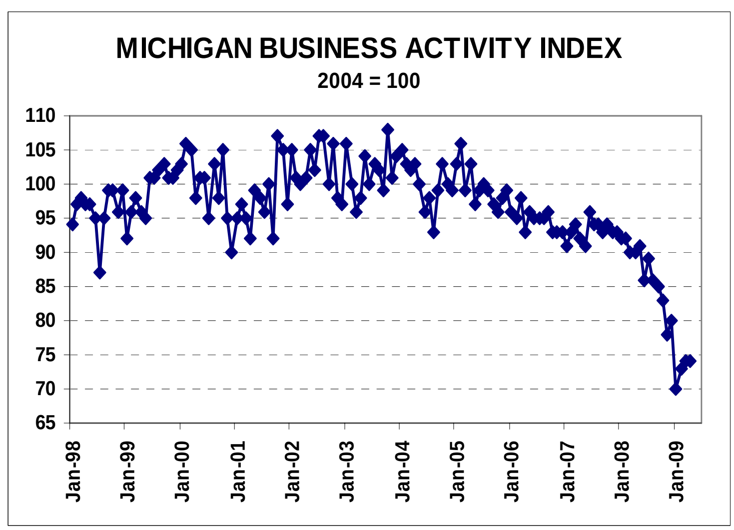

Unemployment Rate
Percent
Michigan
U.S.
15
13
11
9
7
5
3
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
Jan-08
Jan-09


Nonfarm Payroll Employment
Trailing 12-Month % Change
U.S.
Michigan
4%
2%
0%
-2%
-4%
-6%
-8%
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
Jan-08
Jan-09


Personal Income
4-Qt. % Change
U.S.
Michigan
10
8
6
4
2
0
-2
Q1-1998
Q1-1999
Q1-2000
Q1-2001
Q1-2002
Q1-2003
Q1-2004
Q1-2005
Q1-2006
Q1-2007
Q1-2008
Q1-2009


FHFA Purchase-Only Index
Trailing 4 Qt. % Change
U.S.
MI
15
10
5
0
-5
-10
-15
1998-I
1999-I
2000-I
2001-I
2002-I
2003-I
2004-I
2005-I
2006-I
2007-I
2008-I
2009-I


Michigan Residential Building Permits
Rolling 12-Mo. Sum
65,000
55,000
45,000
35,000
25,000
15,000
5,000
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
Jan-08
Jan-09


MICHIGAN BUSINESS ACTIVITY INDEX
2004 = 100
110
105
100
95
90
85
80
75
70
65
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
Jan-08
Jan-09