

The Hard Truth

The 2006 data for Gross Domestic Product (GDP) by State confirm what most of us suspected. Michigan remains stuck in a one-state recession. Last year, Michigan was the only state that did not grow. Its real GDP contracted by 0.5 percent, while the nation expanded 3.4 percent.

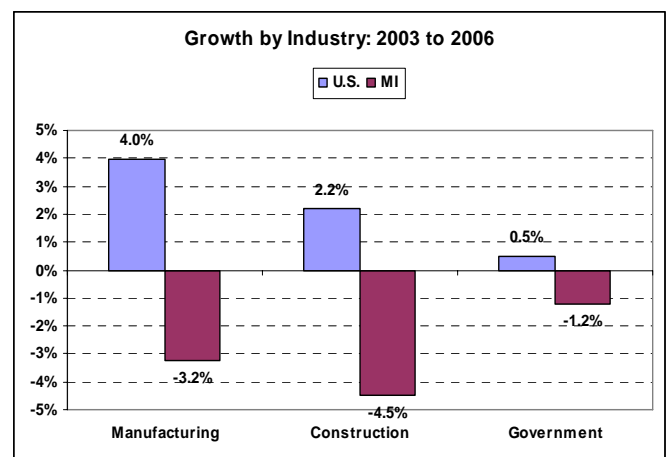
Michigan's one-state recession is now three years old and counting. From 2004 through 2006, its real GDP contracted at a 0.3 percent compound annual rate. Over those 3 years, the next worst state, Ohio, grew at a 1.6 percent compound annual rate while the nation recorded a 3.4 annual rate of growth.

Looking back over longer time spans is just as disheartening. For example, in the six years after 2000, Michigan has recorded a 0.0 compound annual rate of growth in real GDP compared to 2.8 percent for the nation and 1.1 percent for Ohio, the state with the second most sluggish growth.

Reflecting this dismal growth record, Michigan is rapidly becoming a relatively poor state. From 2003 to 2006, per capita real GDP in the state fell from 96 percent of the national average to only 89 percent. In 2003, it ranked 23rd in per capital real GDP but 35th in 2006.

Eight sectors in Michigan showed cumulative declines in real terms between 2003 and 2006. However, the weakness was concentrated in just three industries: manufacturing, construction, and government. Those three sectors accounted for more than 80 percent of the net declines from 2003 to 2006 even though they only accounted for about

35 percent of the state's real GDP. Of the eight industries that showed net declines over those 3 years, the decline in manufacturing alone accounted for 60 percent of the total drop.



As the chart above shows, the experience in Michigan was not at all typical of national trends. Manufacturing output in real terms grew at a 4.0 percent compound annual rate nationally, while it contracted at a 3.2 percent compound annual rate in Michigan. Likewise, construction and government both grew nationally, while they contracted in Michigan.

What the data highlight, of course, is the damage being done by the ongoing restructuring of the Michigan-based auto industry. That sector has been accounting for a declining share of the state's GDP for a long time. Forty years ago, it accounted for about 25 percent of the total. Now it accounts for only about 6 percent of Michigan GDP. But the recent adjustments have been particularly

aggressive, as the Detroit Three and their suppliers have had to adjust to the 12 percent slide in their market share over just the past six years.

Reflecting these adjustments, employment in auto and auto parts manufacturing is down another 20,000 or 8 percent from April 2006. Employment in autos in Michigan has fallen to 295,000, which is only 4 ½ percent of total nonfarm jobs in the state. That is down from 5 percent a year ago and 7 percent in April 2000. The good news is that the state economy is becoming more diversified and less dependent on autos. But obviously, the rapid contraction of the auto industry has had a devastating impact on the overall Michigan economy and probably accounts for the great bulk of the 26,600 jobs lost outside the auto sector over the past 12 months.

No sector in Michigan has been more distressed than homebuilding. Over the first four months of 2007, residential building permits are running 45 percent lower than during the comparable months of 2006. But permits already fell 29 percent in 2005 and 31 percent in 2006. That means permits in Michigan this year are on a pace to be down more than 70 percent from 2004. In my judgment, this is partly a reflection of the job and income losses of recent years. But it also is a symptom of the heightened uncertainty pervading the state. Until people see some stability emerge in the local economy, some signs that the pace of out-migration is slowing, and that a reasonable balance is emerging between homebuyers and sellers, the local real estate market will remain very weak.

The hard truth is that the Michigan economy remains in a one-state recession. A lot needs to go right for the state economy to bottom out. First and foremost, the national economy needs to reaccelerate, as I believe it will. Second, the Detroit Three car companies need to reach a constructive settlement with the United Auto workers that creates a real opportunity for those companies to return to sustained profitability. And third, the Detroit car companies need to

significantly slow the loss of their share of the light vehicle market. But even if all of that occurs, the recovery in the near term will be gradual. The state is going through a difficult and protracted structural adjustment, not a short-lived cyclical downturn.

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Michigan Brief

