

The Truth Hurts

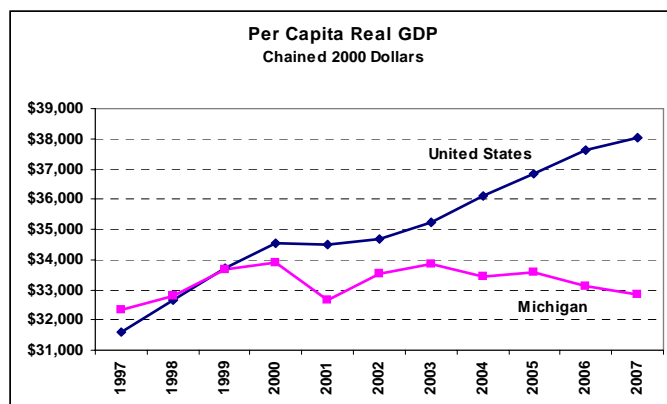
The latest data on Michigan underscore the immense challenge that the state faces to restore its economic health. Back in June, the Commerce Department finally published its estimate that real GDP in the state fell by 1.2 percent in 2007. That marked the fourth consecutive year of recession. Since 2003, cumulative real GDP growth in Michigan has ranked last among the states, declining by 3 percent, while the national economy advanced by 12 percent.

Two of its immediate neighbors, Indiana and Ohio, were the next two worst performing states over the past four years. Indiana and Ohio grew only 2 and 3 percent, respectively, as measured by the cumulative rise in real GDP since 2003. Some of the common characteristics that are retarding growth in all three states are a significant overweight in auto production, a vulnerability to international competition from off-shore manufacturers, and sluggish population growth.

Real GDP reflects increases both in output per person and in the number of people working. Therefore, sluggish trends in real GDP growth may for some jurisdictions understate economic success if the main source of underperformance is due to weak population growth. Per capita real GDP, by contrast, is a measure of output per person and therefore reflects the potential for an increasing standard of living. Accordingly, it is in my judgment the best single indicator of economic success.

Thus, it is disappointing that Michigan also has been a lagging performer as measured by per capita

real GDP. As the chart above illustrates, per capita real GDP in the state increased by about 2 percent over the past ten years, while it rose 20 percent at the national level. Ten years ago, Michigan ranked 16th among the states, with its per capita real GDP 2 percent above the national average. In 2007, Michigan had fallen to 36th among the states, with a level of per capita real GDP that was 14 percent below the national reading. And over those 10 years, Alaska was the only state that had a smaller net increase in per capita real GDP than Michigan.



With somewhat more than half of the year already in the books, it is pretty obvious that 2008 will be the fifth consecutive year of recession for Michigan. The state level labor market data have recently shown some seemingly contradictory month-to-month movements, with the unemployment rate surging higher at the same time that nonfarm jobs have recorded back-to-back monthly increases. But the broader pattern is that the Michigan labor markets are clearly softening. The 8.5 percent unemployment in June was up 1.4 percentage points from a year ago June, and the 7.6 percent average

for the first half of 2008 is up 0.4 percentage points from the average for 2007. Likewise, nonfarm jobs in June were down 1.1 percent from 12 months earlier, and the average number of jobs in the first half of 2008 is 1 percent below the average for 2007.

As has consistently been the case in the prior four years, the state's key auto and auto parts manufacturing industry is under intense pressure again in 2008. The weakness in the national economy has, as usual, depressed vehicle sales. But to make matters intensely worse for the Michigan-based auto companies, who rely heavily on sales of SUVs and light trucks, the surge in gasoline prices has sparked a dramatic shift in preference in favor of smaller, fuel-efficient vehicles. So while US light vehicle sales in the second quarter were down 12 percent from the second quarter of 2007, the sales of the three big Michigan-based auto companies were down by 22 percent.

In effect, the Detroit Three are getting a considerably smaller share of a rapidly shrinking pie. All three companies have been forced to accelerate their plans to shift their production away from light trucks and toward smaller cars. All three are shutting down or retooling their truck factories while slashing, yet again, the size of their salaried work forces.

A year ago, it appeared that the Detroit Three were nearing a return to profitability and that the drag on the Michigan economy resulting from their structural adjustments would begin to fade. Now, in the wake of the consumer reaction to the surge in gasoline prices, all three companies are facing more prolonged financial losses and the necessity to intensify their structural adjustments. Thus, the headwind from the auto sector in Michigan is intensifying, and the ongoing downturn in that sector will continue to ripple through the rest of the state's economy. The clear prospect is that the state will continue to significantly underperform the

national economy over the balance of 2008. We are projecting that real GDP for Michigan will decline another 1.5 percent in 2008, lagging U. S. growth by 3 percentage points.

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