

Winter 2004

West Michigan Economic Forecast 2004

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West Michigan Economic Forecast 2004

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- **Business Confidence, employment, and sales are expected to increase modestly in 2004**
- **The Confidence Index, currently at 65% for the Grand Rapids economy, is projected at 71% for 2004**
- **In spite of painful structural adjustments, employment prospects will continue to build in 2004**
- **Sales growth is expected to grow at a tepid 2.6% for 2004**
- **47% of the respondents expect a consistent robust growth rate of 4% after December 2004**

Introduction

Our latest survey forecast for the Grand Rapids MSA (Kent, Ottawa, Muskegon, and Allegan counties) was conducted in November 2003. A survey was mailed to the CEOs of more than 600 organizations based on a representative sample. We tried to ensure that the sample represented different sectors of the regional economy and the geographical diversity of the region. Eventually, 102 organizations responded. The results of the survey need to be interpreted with caution because of the small sample size.

The data are presented in a histogram format to show the entire distribution of responses. A brief methodological note is in order. The employment, sales, and export numbers are higher in terms of their *raw averages* (when calculated without adjusting for outliers or responses above two standard deviations). Since the averages of a small sample are overtly influenced by extreme numbers, it is advisable to rely on the mean values generated without the outliers. Consequently, our discussion is based on the adjusted mean values. The histograms, however, depict the entire distribution of responses. Since individual responses varied significantly, the data should be interpreted with caution.

Confidence Index

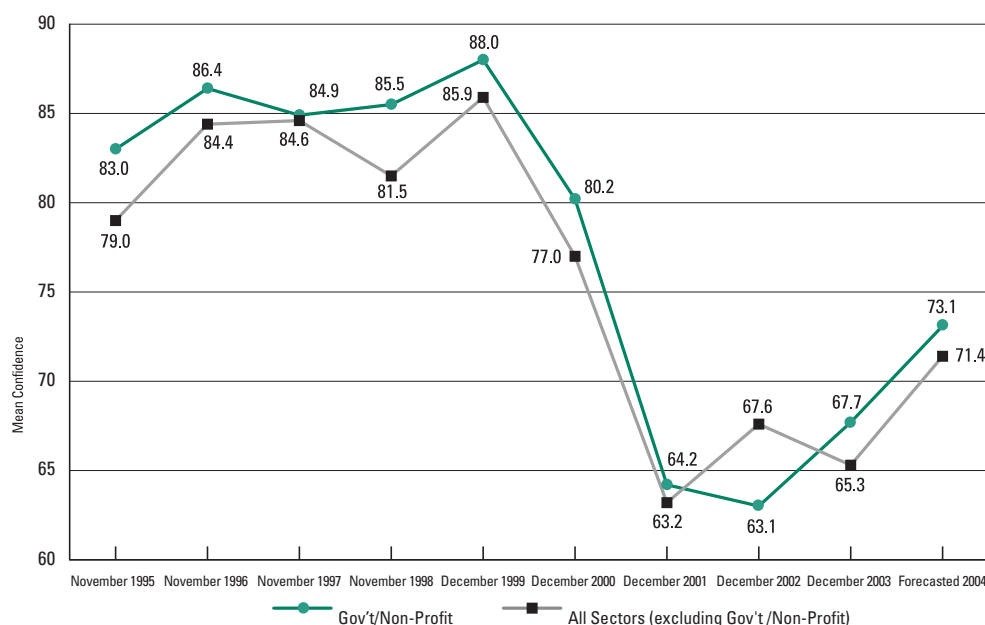
A major goal of our survey is to historically track the overall business confidence of the Grand Rapids metropolitan area by a confidence index. Recall that this confidence index is scaled from zero percent (no confidence at all) to one hundred percent (complete confidence).

We need to place the current results in a larger historical context. During our surveys of the region for the last nine

years, when the economy has been growing steadily, the confidence index has continued to depict a high level of confidence, generally above 80% for the private sector.

In the previous survey, the confidence index had risen modestly to 67% at the end of 2002 — amid widespread economic evidence that the economy was growing slowly. Prior to that, the September 11 terrorist attacks in 2001 and the subsequent disruption in airline and other services, and the related decline in consumer confidence had bruised business expectations. Ongoing corporate scandals, the uncertainty due to the war on terrorism, and weak job growth prospects have continued to depress expectations. The results this year indicate that business confidence of the private sector is still at a low level of 65% but is projected to grow to 71% during 2004.

Figure 1 West Michigan Confidence Index 2004



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In a broad context, these results are similar to what we obtained last year: somewhat pessimistic about the current situation but pragmatically optimistic about the future. We continue to base our analysis on the forecasts made by the private sector. The government and nonprofit sector is slightly more optimistic this year than the private sector.

Observing the fluctuation of the index over the last nine years, we know it is sensitive to business expectations and the national business cycle. The regional and national economies have picked up in the second half of 2003. The aggressive reduction of interest rates by the Federal Reserve Bank, the federal tax cuts, and increased outlays in federal government expenditures have laid the foundations for faster economic growth. Consumer and business confidence have been improving as reflected in the rising trend in the stock market. Manufacturing has been slow to recover, but the manufacturing index (reported by the Institute of Supply Management) for December 2003 has risen to 66.2 (an index above 50 indicates expansion). In line with the national business cycle, the West Michigan economy has consolidated over the significant downturn and is poised to grow at a faster pace in 2004.

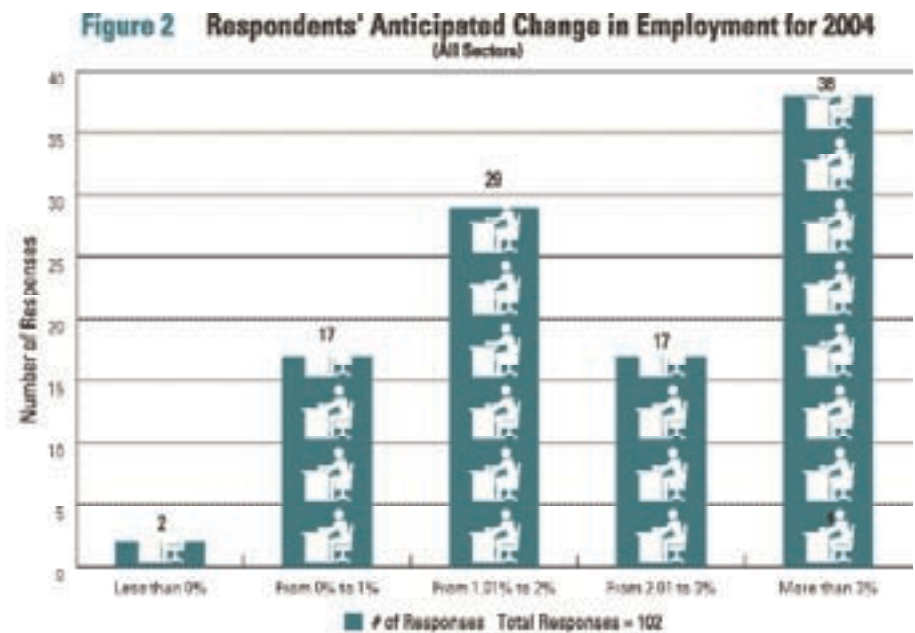
Employment

Amid the well-publicized layoffs by major corporations in the West Michigan area, the respondents did not expect any significant employment growth for 2003. Figure 2 indicates projected employment growth for 2004. Overall, the projected growth in employment for 2004 (after adjusting for extreme responses or outliers) is projected at 2.1%, with considerable variation across organizations and sectors. This employment projection seems quite optimistic.

It is important to place this expectation in the context of the business cycle and ongoing structural changes in the economy. Employment prospects that occur during the normal expansion process of a business cycle are presently moderated by two significant structural changes in the economy. First, the spurt in productivity growth is good news for long-term business sustainability but bad news for employment in the short run. Second, besides the outsourcing of manufacturing jobs that has been going on for a long time, there is a new trend of service sector jobs migrating offshore. A projection by Forrester Research, a consulting group, estimates that 3.3 million jobs may be outsourced abroad by 2015. In the short term, these structural changes are, no doubt, painful. Both the rise in productivity and increased outsourcing activity imply that the employment prospects will not improve dramatically in the next year in spite of stronger economic growth.

However, as basic-skill jobs move offshore, existing national resources will ultimately shift to jobs that create more economic value. An analysis by McKinsey indicates that one dollar of cost shifted offshore brings a net benefit of about \$1.13 to the United States. These benefits arise because of increased exports, repatriation of profits, and the freeing up of resources that can be used in more productive ventures. These trends also indicate that innovation in high tech manufacturing and specialized service jobs will continue to be the engine for future economic growth and create a foundation for new job opportunities. In order to capitalize on these new job opportunities in high tech manufacturing, health, bio-technology, and education sectors, significant resources will have to be devoted to job training.

The West Michigan economy is in the midst of experiencing these structural changes. Job opportunities in manufacturing and the government sector will be limited; but growth in health, construction, education, and specialized service sectors will provide new job opportunities.



Since employment is a laggard indicator, some job losses will continue even as the recovery process consolidates. Although the unemployment rate for the Grand Rapids MSA is higher than the national average, it dropped from 7.2% in October to 6.8% in November 2003. The total number of workers employed in the area has increased marginally, from 569,925 in January 2003 to 579,182 in November 2003. Employment opportunities are likely to pick up in 2004. A projected employment growth between 1% and 2% is pragmatically optimistic. Employment prospects will improve but a dramatic turnaround is unlikely. The modest growth in employment will mask considerable variation in job opportunities across different industries.

Sales

Sales projections made by respondents for last year were around 1.8%. Sales over the holiday season have held up quite well. An average sales growth of 2.62% expected for 2004 (Figure 3) after discounting outliers is consistent with the moderate rise in the confidence index and job opportunities in the Grand Rapids area. In times of robust economic growth, sales have grown at an annual rate of 5%. The expectations of our respondents indicate that it may take some time before this higher trend growth rate is achieved. Note that our sales numbers refer to the nominal sales of all goods/services produced in the West Michigan economy.

Export Growth

From respondents who export their output, the expected growth of exports generally averaged higher than 5% in the late 1990s. However, one feature of the present slowdown is that it has been synchronized at the global level. In spite of the weaker dollar and better prospects for worldwide growth, the adjusted mean export growth rate of 6.8% projected for 2004 is quite optimistic (Figure 4). It is not surprising that expectations for growth in exports are volatile and uncertain. Since the expected growth of exports is based on a sample of only 69 responses, it should be viewed with caution.

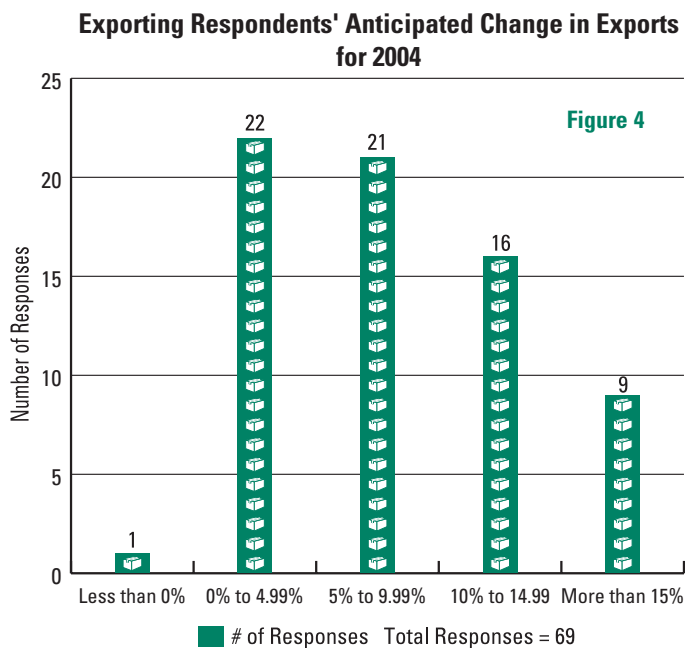
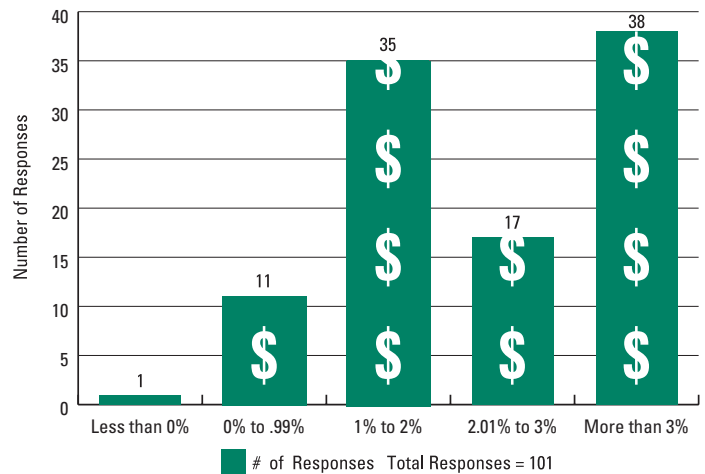


Figure 3

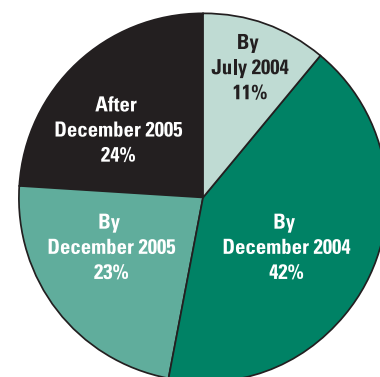
Respondents' Anticipated Change in Sales for 2004 (All Sectors)



A significant number of respondents (47%) expect a consistent growth rate of 4% to be achieved after December 2004, indicating that there is considerable underlying pessimism about the good times returning soon. Barring any unforeseen negative shock and given the ultimate impact of the interest rate reductions, the federal tax cuts and increased federal expenditures, an annual growth of 4% in national GDP for 2004 is a reasonable expectation, on the basis of what we know presently. As we have seen in 2003, there will be considerable variation in GDP growth in the quarterly estimates. This projected growth is certainly sustainable over the expansion phase of the business cycle. The West Michigan economy will follow this national trend.

When Respondents Anticipate a Consistent Growth Rate around 4% of Real Output (in percentage of responses)

Figure 5



Acknowledgments

We are very grateful to all the organizations that participated in the survey.