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Grand Rapids Economic Forecast 2005

Hari Singh
*Grand Valley State University*, singhh@gvsu.edu

Nancy Boese
*Grand Valley State University*, boesen@gvsu.edu

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Grand Rapids Economic Forecast 2005

Hari Singh, Ph.D., and Nancy Boese, M.B.A.
Seidman College of Business

- Business confidence, employment, and sales are expected to increase modestly in 2005
- The Confidence Index, currently at 70% for the Grand Rapids economy, is projected to be 74% for 2005
- Employment growth is projected at 1.7% for 2005
- Overall sales are expected to grow at 3.2% for 2005
- Only a third of the respondents expect a consistent robust growth rate of 5% by December 2005

Introduction

Our latest survey forecast for the Grand Rapids MSA (Kent, Ottawa, Muskegon, and Allegan Counties) was conducted in November 2004. A survey was mailed to the CEOs of more than 660 organizations based on a representative sample. An additional e-mail survey was sent to 380 small scale organizations. We tried to ensure that the sample represented different sectors of the regional economy and the geographical diversity of the region. Eventually, 161 organizations responded. The results of the survey need to be interpreted with caution because of the small sample size.

Although we discuss the survey results in terms of averages, the data are also 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 more volatile as raw averages (when calculated without adjusting for outliers — that is, responses beyond one standard deviation). Since the average of a small sample is 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 all the observations. Since individual responses vary significantly, the outliers in the data should be interpreted with caution.

Confidence Index

A primary 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).

The current results need to be interpreted 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 was at 65% at the end of 2003, amid economic evidence that the economy was growing slowly. In 2004, high energy prices, the uncertainty due to the war on terrorism, and weak job growth prospects have continued to depress expectations. The results in 2004 indicate that business confidence in the private sector was relatively higher at 69.6% and is projected to grow to 73.5% during 2005.

In a historic 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 less optimistic this year (compared to the private sector), presumably due to severe fiscal constraints.

We have observed over the last ten years that the index is sensitive to business expectations and the national business cycle. National real output (GDP) has grown at approximately 4% in 2004. Last year we projected a growth rate of 4% in GDP. Although fiscal policy is still in an expansionary mode, the Federal Reserve Bank has begun to increase interest rates at a “measured” pace. Consumer and business confidence have been improving, as reflected in the rising trend in the stock market. Growth in the manufacturing sector has been subdued. In line with the national business cycle, the West Michigan economy has been growing at a modest pace.

Employment

Amid well-publicized layoffs by major corporations in the West Michigan area, the regional labor market has been repairing at a slow pace. Figure 2 indicates projected employment growth for 2005. Overall, the growth in employment for 2005 (after adjusting for extreme responses or outliers) is projected at 1.7%, with considerable variation across organizations and sectors. This employment projection seems quite pragmatic.

Consider this expectation in the context of the business cycle and ongoing structural changes in the national economy. First, even three years after the recession officially ended in November 2001, job growth has been at best modest. Although fluctuations in the monthly payroll data have been quite volatile in 2004, on average approximately 185,000 jobs have been created every month. Given that 150,000 jobs are needed to keep abreast with the increase in new job seekers, net growth in job opportunities has been scarce. Second, productivity growth has slowed significantly, indicating that corporations are not able to continuously increase the productivity of existing workers. This trend augurs well for increased opportunities for new hiring.

At the regional level, the job market is beginning to show an improving trend. Our survey indicates that 70% of the respondents expect to hire at least some new workers. Approximately 81% of the respondents who are going to hire new workers expect temporary workers to be less than 20% of the new labor pool. There is widespread anecdotal evidence that firms are always trying to substitute capital equipment in place of labor to reach their output goals. Our survey indicates that a vast majority of the employers are not planning to substitute capital equipment for labor (71%). Of those that are substituting capital for labor, 78% indicate that this substitution will be for less than 5% of their labor force. These expectations bode well for the regional labor market.

Sales

Sales projections made by respondents for last year was 2.6%. Sales over the holiday season have held up quite well. An average sales growth of 3.2% expected for 2005 (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 are for the nominal sales of all goods/services produced in the West Michigan economy.
Export growth

The expected growth in exports generally averaged higher than 5% in the late 1990s for respondents who export their output. In view of the weaker dollar and better prospects for worldwide growth, the adjusted mean export growth rate of 4.4% projected for 2005 is realistic. The unadjusted raw average growth is 6.34% with outliers (Figure 4). Given the fluctuations in exchange rates and uncertain prospects for worldwide growth, it is not surprising that expectations for growth in exports are volatile. The adjusted average growth is probably more reliable. Since the expected growth of exports is based on a smaller sample, it should be viewed with caution.

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Expectations about when we will reach a robust regional growth rate of 5% appear to be quite pessimistic. Only one-third of the respondents (32%) expect a 5% consistent growth rate by the end of 2005. However, a significant number of respondents (39%) feel that we are in a period of long term slow growth. These results indicate that there is a significant underlying pessimism about good economic times returning soon.

Our regional economy generally follows the structural pattern of the national business cycle. In 2005, the stimulus from the tax cuts is likely to dissipate and high energy prices may continue to act as a drag on growth. Given the fact that real interest rates are close to zero (after adjusting for inflation), the Federal Reserve Bank is expected to continue to raise interest rates in a preemptive manner to reduce the risk of future inflation. Most economists expect real growth in output to slow in 2005. As we have seen in 2004, there will be considerable variation in Gross Domestic Product (GDP) growth in the quarterly estimates.

Barring any unforeseen negative shocks, an annual growth of 4% in national GDP for 2005 is a reasonable expectation. This is slightly more optimistic than The Economist (January 1, 2005 edition) consensus forecast of 3.5%. If this projection is realized, GDP would have expanded at a 4% annual growth rate for two consecutive years — certainly a sustainable growth pattern over an expansion phase of the business cycle. An improving job market is expected to create at least 2 million jobs next year. The West Michigan economy will follow this national trend of continued consolidation of real output growth and modest improvements in job prospects.

Acknowledgments

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