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West Michigan Economic Forecast for 2002

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- The Confidence Index for the Grand Rapids economy shows a dramatic decline from 77% last year to 63.5%
- No employment growth is projected for 2002
- Sales growth is expected to grow at a tepid 1.5% for 2002
- 80% of the respondents expect the recession to be over by December 2002

Introduction

We conducted our eighth survey forecast for the Grand Rapids MSA (Kent, Ottawa, Muskegon, and Allegan Counties) in November 2001. A survey instrument was mailed to the CEOs of 715 organizations based on a representative sample, and 110 organizations responded. We tried to ensure that the sample represented different sectors of the regional economy and the geographical diversity of the region. The results of the survey need to be interpreted with caution because of the small sample size and the dispersion in the responses.

In order to give some sense of the variation in the responses, the data are presented in a histogram format to show the entire distribution of responses.

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. (Figure 1) Recall that this confidence index is scaled from zero percent (no confidence at all) to one hundred percent (complete confidence).

Before we consider the present expectations, some historical perspective is in order. During our surveys of the region for the last six years, when the economy was growing steadily, the confidence index continued to depict a high level of confidence, generally upwards of 80% for the private sector.

Figure 1

West Michigan Confidence Index 2002

1 Hari Singh is Chair of the Economics Department. Nancy Boese is the Regional Director of the Small Business Development Center. Special thanks to Steffany Dunker and Joseph Kleasley, graduate research assistants at Seidman Business Services, who provided invaluable support.
In the previous survey, the Confidence Index had fallen to 77% in December 2000 amid widespread anecdotal evidence that the economy had slowed to a crawl. Now we know that the economy entered a recession in March 2001. With the economy already in recession, the September 11 terrorist attacks and the subsequent disruption in airline and other services and the decline in consumer confidence further weakened the economy.

Unfortunately, we did not monitor the confidence level of the region during the last recession of 1990–91, so there is no good benchmark to compare the present value of the confidence index. But observing the fluctuation of the index over the last six years, we know it is highly sensitive to business expectations. With the national unemployment rate rising from 5.6% in November to 5.8% for December, and the national Gross Domestic Product (GDP) falling by 1.3% (seasonally adjusted annualized basis) in the third quarter of 2001, the decline in the Confidence Index to 63.5% doesn’t come as a surprise. Gross Domestic Product is expected to contract further in the last quarter of 2001.

The Federal Reserve Bank has moved aggressively to reduce the short-term interest rate (Federal Funds Rate) eleven times this year from 6.5% to 1.75%, the lowest rate since 1961. However, we know that the Federal Reserve Bank is only able to control the short-term interest rate. The long-term interest rate—the one that matters for business investment and consumer borrowing to buy cars and homes—is driven by expectations of inflation. The bond market, predicting a recovery next year and consequently higher expectations of inflation, has continued to put upward pressure on long-term rates. Paradoxically, the bond market’s positive outlook about future recovery is dampening the present possibility of a strong upturn. The Federal Reserve Bank has tried to indicate that inflation is expected to be low to reassure bond investors. Also, it has signaled that the recession is bottoming out to boost the stock market.

The downward shift of Grand Rapids respondents’ expectations is a microcosm of what is happening at the national level. In December 2000, West Michigan respondents were 75% confident about the performance of the regional economy in 2001. The current confidence index of 63% is significantly lower than the 75% projected in December 2000. Given the somber mood of the nation and all the intervening factors that occurred in 2001, the current confidence of 63% reflects economic expectations at the trough of a recession. The respondents’ confidence for 2002 of 69% indicates guarded optimism.

In summary, the West Michigan economy is going through a significant downturn—but there are latent signs of an upturn next year.

**Employment**

Respondents had projected employment growth for 2001 at approximately 2.2%. We have all heard of the well-publicized lay-offs by major corporations in the West Michigan area. The Grand Rapids metropolitan unemployment rate was 4.9% for October 2001 and rose to 5.3% for November 2001. Figure 2 indicates projected employment growth for 2002. Overall, the respondents do not expect any significant employment growth for 2002.
It is interesting to note that the unemployment rate in the Grand Rapids area peaked at 5.3% during July 2001. Most of the layoffs in the input/supply manufacturing sector occurred early in the cycle. However, since employment is a laggard indicator, job losses often continue even when a recovery is under way. The nationwide unemployment rate of 5.8% is expected to worsen, perhaps by an additional one percent, before employment improves. In all likelihood, the employment prospects in West Michigan during the first half of next year will be slightly worse compared to the 5.3% unemployment for November 2001. But the increase in employment opportunities in the second half of 2002 will probably offset the job losses that may occur in the first half of 2002. Consequently, an expectation that job growth during 2002 will be close to zero makes sense in the context of what we know today. The near zero growth in employment will mask considerable variation in job opportunities across different industries.

Sales
Last year respondents projected that sales would increase around 3%. The results of the current survey indicate that respondents have lowered their expectations of sales for 2002 to around 1.5% (Figure 3). Sales over the holiday season have held up quite well—particularly in the automobile sector as a result of the 0% financing incentive offered by the major automotive companies. However, a significant portion of this holiday season’s spending has borrowed from next year’s consumer demand. The modest expectation of 1.5% for 2002 is consistent with the decline in the confidence index and the decline in job opportunities. Note that our sales numbers are for the sales of all goods/services produced in the West Michigan economy.

Export growth
Respondents that export generally expected a growth of exports of 5% higher in the late 1990s. However, one feature of the current slowdown is its global synchronization. The prospect for any recovery in Japan does not look good. Asia and Latin America are also suffering a significant slow down. The prospects for robust growth in the European Common Market are dim. The growth in global output is expected to be around 1%—a common red light for a global recession. In this context, the expectation for growth in exports is volatile and likely to be modest at best (Figure 4).

In general, what does year 2002 have in store for us? The regional economy in Grand Rapids will continue to mirror national trends.

Only 28% of the respondents expect to be out of the recession by June 2002, but 80% expect to be out of the recession by December 2002. Perhaps what the respondents mean by the recession ending is the regaining of the good times we had in the late 1990s.

Recent reports suggest that some of the increases in labor productivity in the late 1990s—the key to keeping employment costs and inflation in check—were cyclical. However, most economists believe that productivity growth without the cyclical effect could be around 2%-3% in good times. This indicates that the economy can grow at around 4% without generating significant inflationary pressure. The fundamental foundations of the economy are intact.

**Respondents’ Anticipated Change in Sales for 2002 (All Sectors)**

**Figure 3**

- Less than 0%: 14 responses
- From 0% to .99%: 15 responses
- From 1% to 2%: 34 responses
- From 2.01% to 3%: 20 responses
- More than 3%: 19 responses
Although we are in the midst of a recession at this time, incipient signs of recovery are already evident. Housing sales have rebounded and the prospects for the manufacturing sector are getting better. Durable goods orders have picked up lately. The manufacturing index of the Institute for Supply Management has risen to 48.2 for December 2001. Paradoxically, the fact that this recession began in March 2001 may actually be good news. Past history indicates that recessions typically last 9 to 12 months. This normal timetable suggests that the recession should end by March 2002.

The more difficult question to answer is when we will regain a robust economic growth rate of 4%. The effect of the aggressive reductions in interest rates will be felt next year; the cumulative impact will probably peak around the second and third quarter of 2002. One key to recovery is consumer confidence. Consumption expenditures account for 67% of the national output. The economy cannot regain a robust growth rate unless consumers are confident about their future prospects. With the relatively good news from the war in Afghanistan and a rebounding stock market, consumer confidence is beginning to build. Business optimism cannot be far behind. However, both consumer and business expectations are likely to be tempered by further job losses. The Blue Chip consensus forecast expects a modest growth of 0.4% in real output in the first quarter of 2002.

On the basis of what we know presently, barring any unforeseen negative shock and given the momentum of the impact of the interest rate reductions, a recovery by spring of 2002, and a robust GDP growth of 4% in calendar year 2003 are reasonable expectations. The West Michigan economy will follow this national trend.

Acknowledgments
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West Michigan Respondents' Anticipated Ending for Recession
(In percentage of responses)

Figure 4