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Grand Rapids Economic Forecast 2006

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- Business Confidence has suffered a marginal decline and is expected to be flat for 2006
- Employment growth is expected to be very modest, at best 0.5% for 2006
- Overall sales are expected to grow at a rate comparable to last year, around 3% for 2006
- Exports continue to be a bright spot; expected growth is 5% for 2006

Introduction

Our latest survey forecast for the greater Grand Rapids economy (Kent, Ottawa, Muskegon, and Allegan Counties) was conducted in November 2005. A survey was mailed to the CEOs of 675 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, 151 organizations responded. The results of the survey need to be interpreted with caution because of the small sample size.

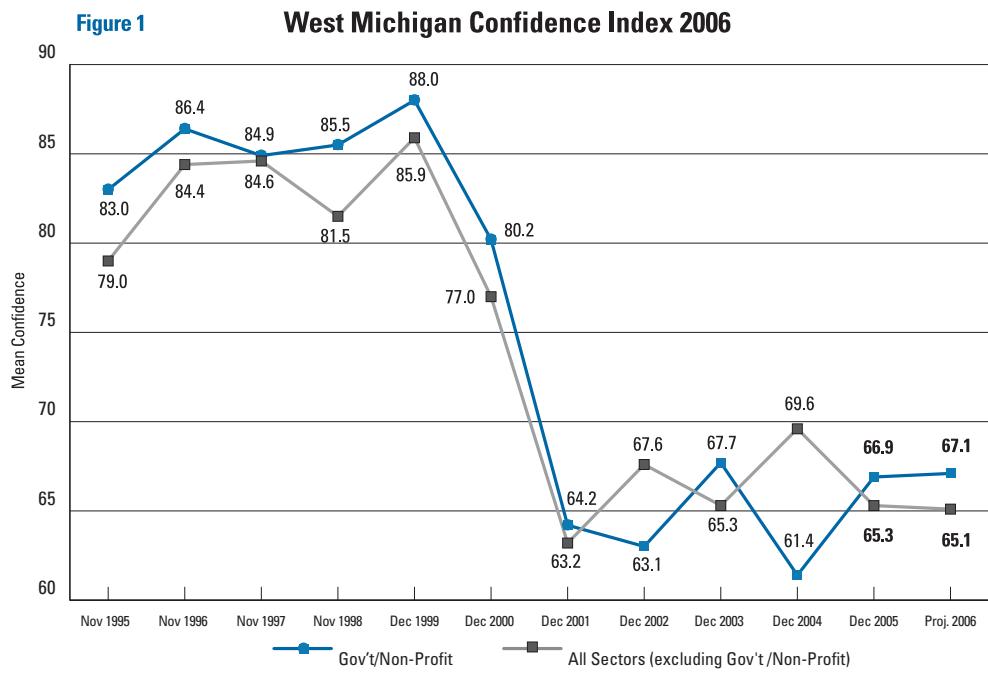
A brief methodological note is in order. Although we discuss the survey results in terms of averages, the data are also presented in a histogram format to show the entire distribution of responses. The employment, sales, and export numbers are more volatile as *raw averages* (when calculated without 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 examine both the raw averages and the mean values generated without the outliers. 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 % (no confidence at all) to one hundred % (complete confidence). The current results need to be interpreted in a larger historical context. During our surveys of the region for the last ten 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 69.6% at the end of 2004, amid economic evidence that the economy was growing slowly. The results this year indicate that business confidence of the private sector is relatively lower at 65.3%. In past years, respondents have typically expected at least a marginal improvement in confidence for the following year. This year their expectations for 2006 are virtually flat at 65.1%. 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 (compared to the private sector) but their projection for 2006 is also flat. To some extent pragmatic optimism has been replaced by the notion that things are not likely to improve for awhile. In 2005, expectations of higher



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interest rates, rising energy prices, the uncertainty due to the war on terrorism, and weak job growth prospects due to restructuring have further depressed expectations.

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 2006. Overall, the growth in employment for 2006 is projected at 0.76% with outliers and at 0.50% without outliers.

Consider this expectation in the context of what we know about the regional and national economy at this time. Traditionally, the regional and national economies have followed similar trends in terms of the business cycle. However, this year the actual economic situation in Michigan is relatively worse compared to the national economy. West Michigan has traditionally relied more on the manufacturing sector. The manufacturing sector continues to decline as more consolidation in the

Our survey indicates that fewer respondents (64%) are likely to hire new workers in 2006 compared to last year when the corresponding number was 70%. Most respondents who intend to hire expect to employ permanent workers (76%) as opposed to temporary workers (24%). However, given that new job applicants will enter the labor market, *net job opportunities* will be scarce.

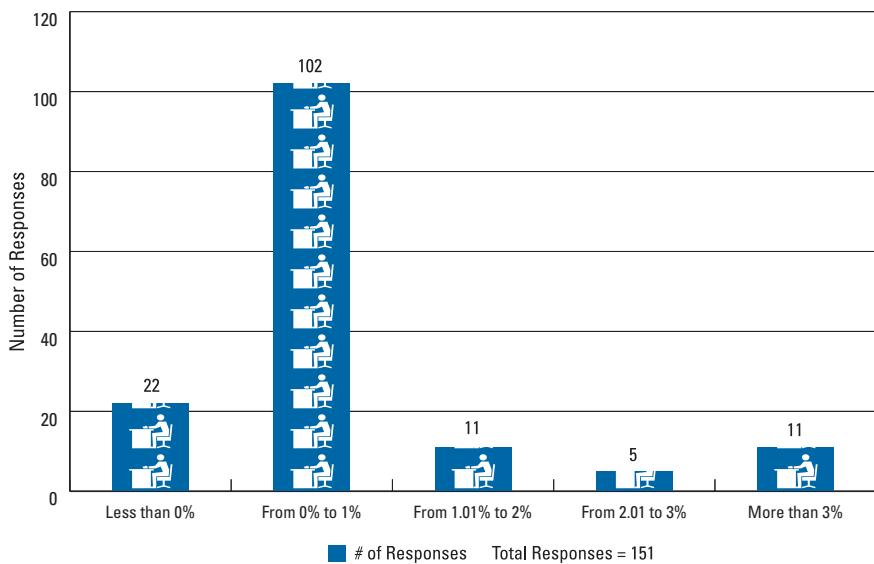
Sales

Sales projections made by respondents for last year were 3.2%. Sales over the holiday season have held up quite well. The projected average sales growth for 2006 is 3.3% without outliers and 2.6% with outliers (Figure 3). 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

Only about a quarter of respondents in the private sector export their output. The expected growth in exports has generally averaged higher than 5% in the late 1990s. Last year, exports were projected to grow at 4.4% without outliers and at 6.3% with outliers. In 2006, exports are expected to grow at 4.7% without outliers and 6.9% with outliers (Figure 4). Given the volatility 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. Overall, export growth projections are similar to last year's expectations. Compared to domestic sales, export growth is still a bright spot for the regional economy. Since the expected growth of exports is based on a much smaller sample, it should be viewed with caution.

Figure 2 Respondents' Anticipated Change in Employment for 2006
(All Sectors)



workforce takes place, particularly in auto and auto-related industries. American auto manufacturers are losing market share and are saddled with high legacy costs. "The Michigan Economic Outlook for 2006–07" by University of Michigan economists George Fulton and John Crary predicts unemployment in the state to rise to 7.6% within a year, with manufacturing taking the major brunt of the adjustment process. Although the west side of the state will have relatively less negative impact compared to the east side, consolidation and job losses in manufacturing will still continue in West Michigan; however, more jobs will continue to be created in the services sector.

Employment growth in West Michigan during 2005 has been approximately one half of one %. The labor market in West Michigan has been showing very modest growth in 2005 and is not likely to improve significantly in 2006.

Figure 3 Respondents' Anticipated Change in Sales for 2006
(All Sectors)

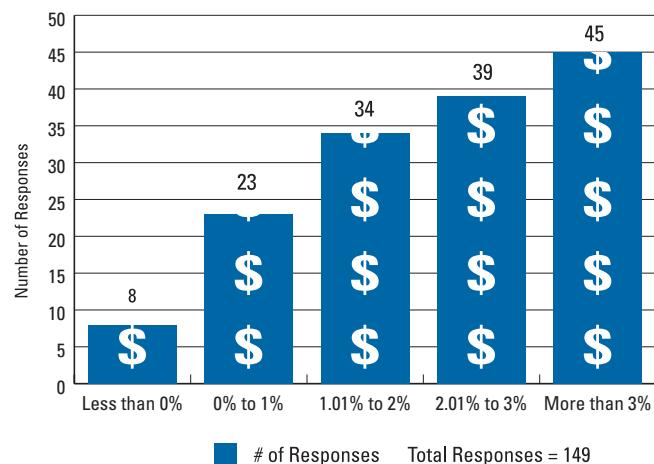
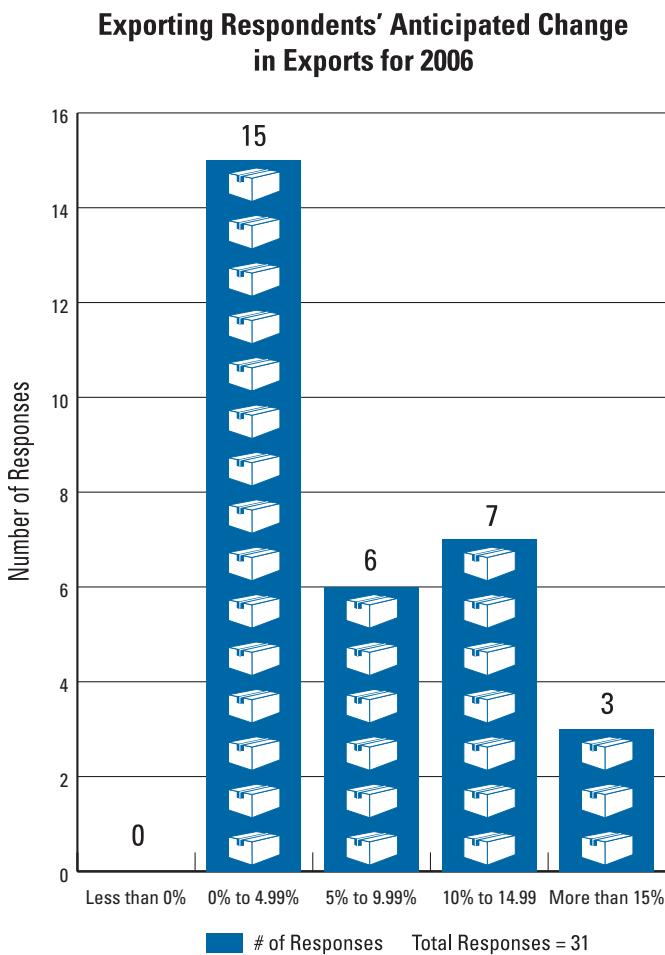


Figure 4



Expectations about when we will achieve a robust regional growth rate of 5% appear to have become more pessimistic. Last year, 32% of the respondents expected a robust growth rate of 5% within the next year. This year, only 16% expect a robust growth within one year. On the other hand, last year 39% of the respondents believed that we will achieve this robust growth after two years. This year, a higher percentage (47%) expect to achieve a robust growth rate after two years. These results indicate that, compared to last year, significantly more pessimistic expectations have set in about the return of good economic times. This result corresponds to the reduction in business confidence for 2006 compared to previous years.

What is the final word on the national and regional economy? At the national level, there is considerable fiscal stimulus. However, the FED is expected to continue to raise interest rates in a preemptive manner to reduce the risk of future inflation. Barring any unforeseen negative shocks, the expected real growth in output for 2006 will be approximately 3.5%. As we have seen in 2005, there will be considerable variation in GDP growth in the quarterly estimates. If this projection is realized, GDP would have expanded robustly for four 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.

At the regional level, given the fact that West Michigan has traditionally relied more heavily on manufacturing, and economic consolidation is likely to continue, the outlook is less optimistic. Employment growth will be, at best, modest (0.5%), and sales growth will be tepid and comparable to last year's performance (3%). For those who seek external markets, export growth is a relatively bright spot (5%).

In conclusion, some brief comments about the long-term strategy for Michigan follow. The survey results demonstrate that some industries are able to capitalize on an expanding export market. More firms need to aggressively seek export opportunities. In spite of the recent problems in the manufacturing sector, eventually this sector will be more lean and competitive; however, new job opportunities in manufacturing are likely to be limited. At the same time, new industries and opportunities are emerging in other sectors: health care, bio-tech, construction, and specialized services. State resources need to be leveraged to position Michigan strategically in these growth sectors of the future. Whether we are seeking to re-vitalize the manufacturing sector or expand into the industries of the future areas, both strategies have a common platform: a highly skilled work force is critical. Expanding education and training opportunities should be a top national and state priority.

Acknowledgments

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

Figure 5

When respondents anticipate a consistent growth rate around 5% (in % of responses)

