

Economic Outlook for 2010: *A Shaky Start to Hopefully a Long Expansion*

George A. Erickcek

Brad R. Watts

W.E. Upjohn Institute for Employment Research

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A special thanks to

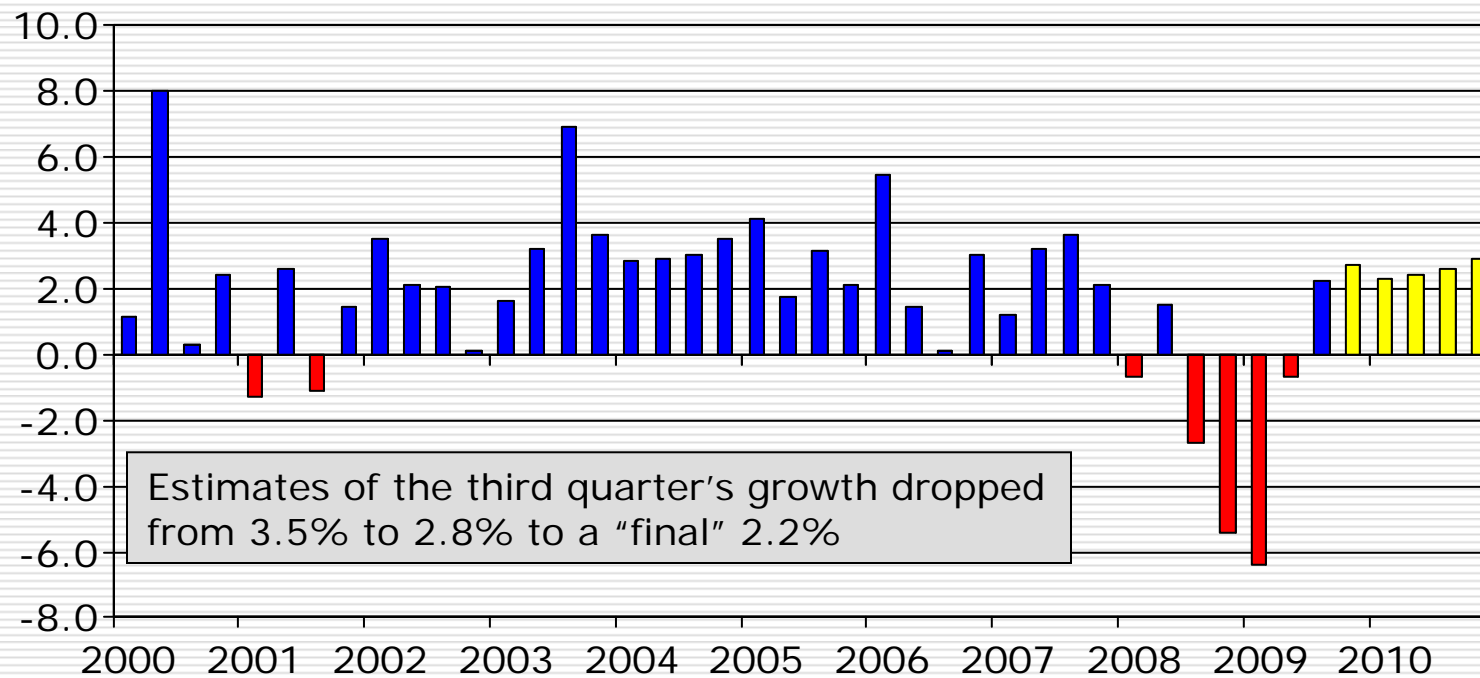
Keystone Community Bank

Agenda

- Why 2010 is looking better and better—*Yet the double-dip scenario is in the shadows.*
- The state will likely not get an invitation to the nation's party—*in fact, it is still waiting for the 2002 invitation.*
- Kalamazoo 2010-2011 forecast—*After a very painful but thankfully short visit of last year's guess.*
- What keeps me up at night—*Double dips, education, and exports.*

Nationwide, GDP increased by 2.2 percent in the third quarter.

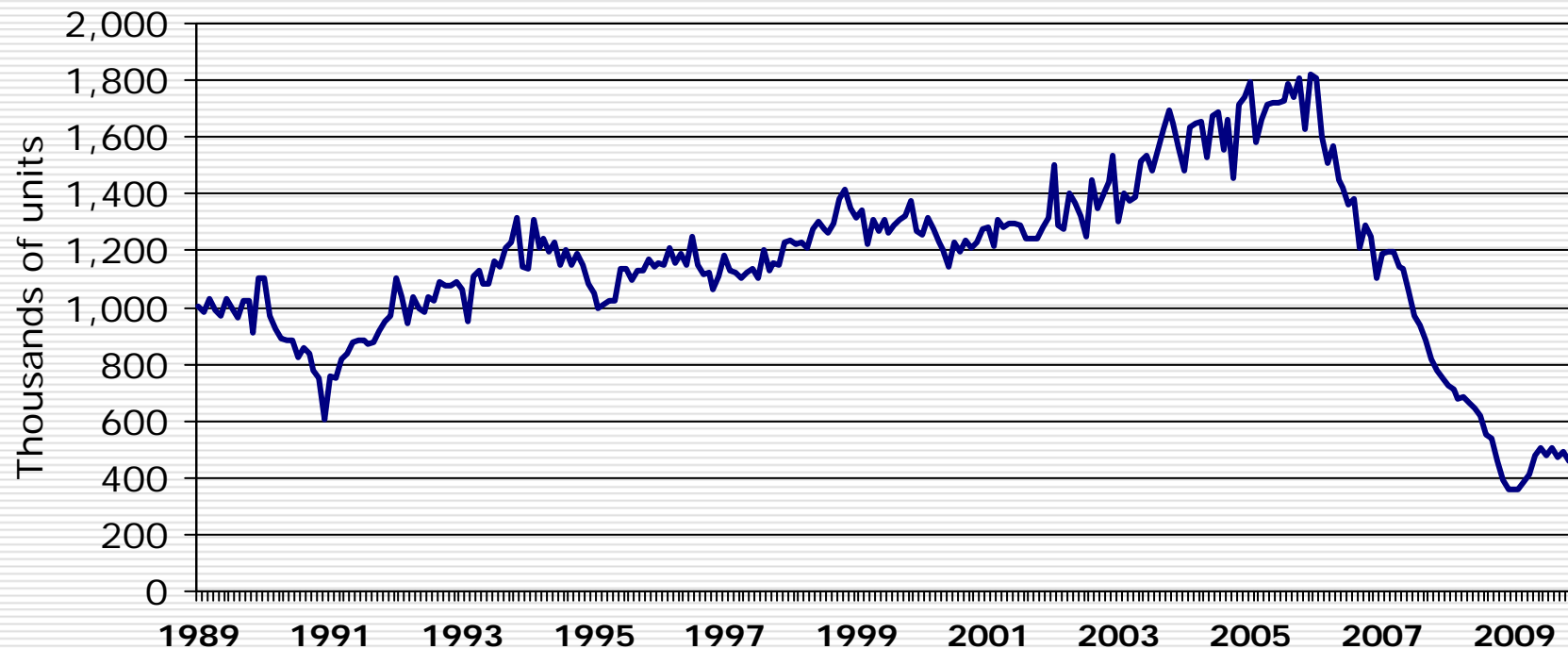
Annualized Percent Change in GDP



Source: BEA, Philadelphia Federal Reserve Survey of Professional Forecasters.

Single-Family Housing Starts—*Was starting to turn around; however...*

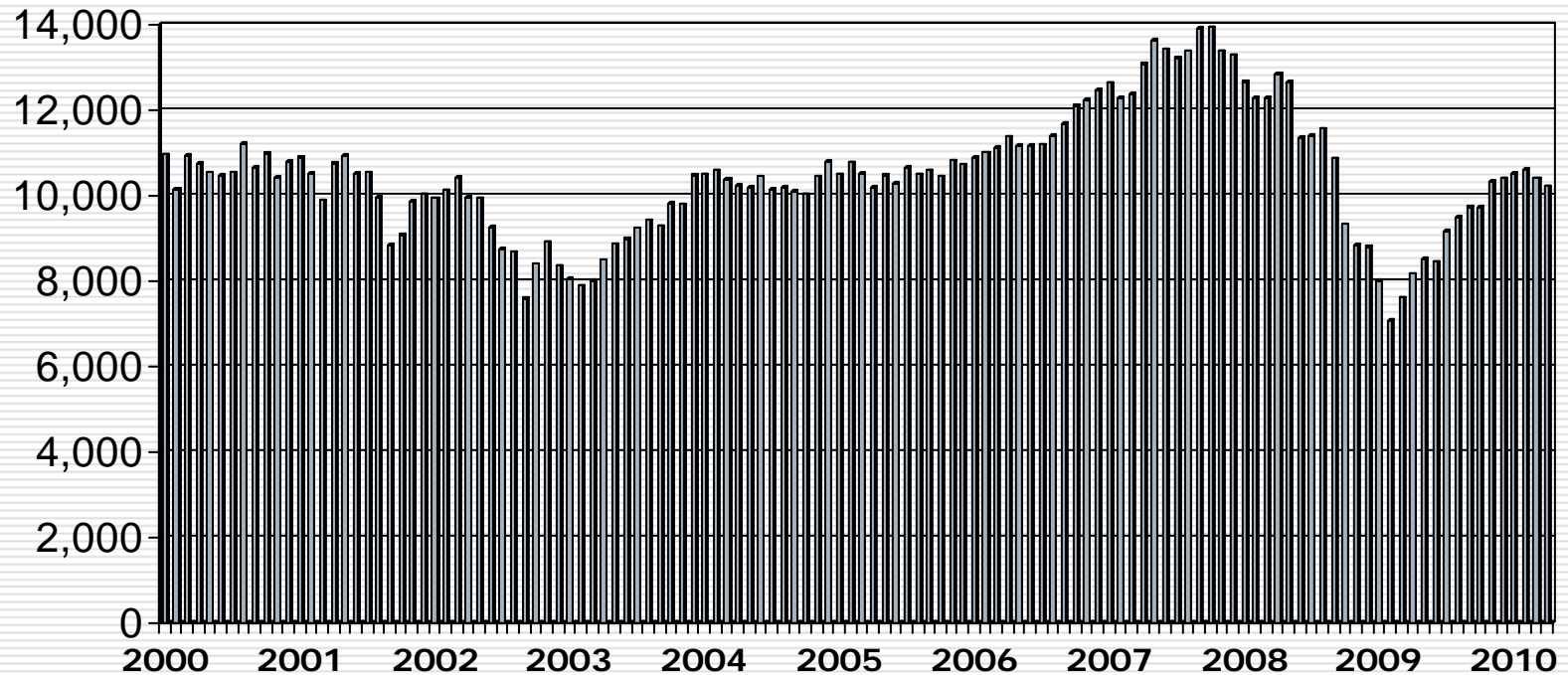
Seasonally Adjusted Annual Rates



U.S. Census

The stock market has enjoyed a nine-month run: *up until last week*

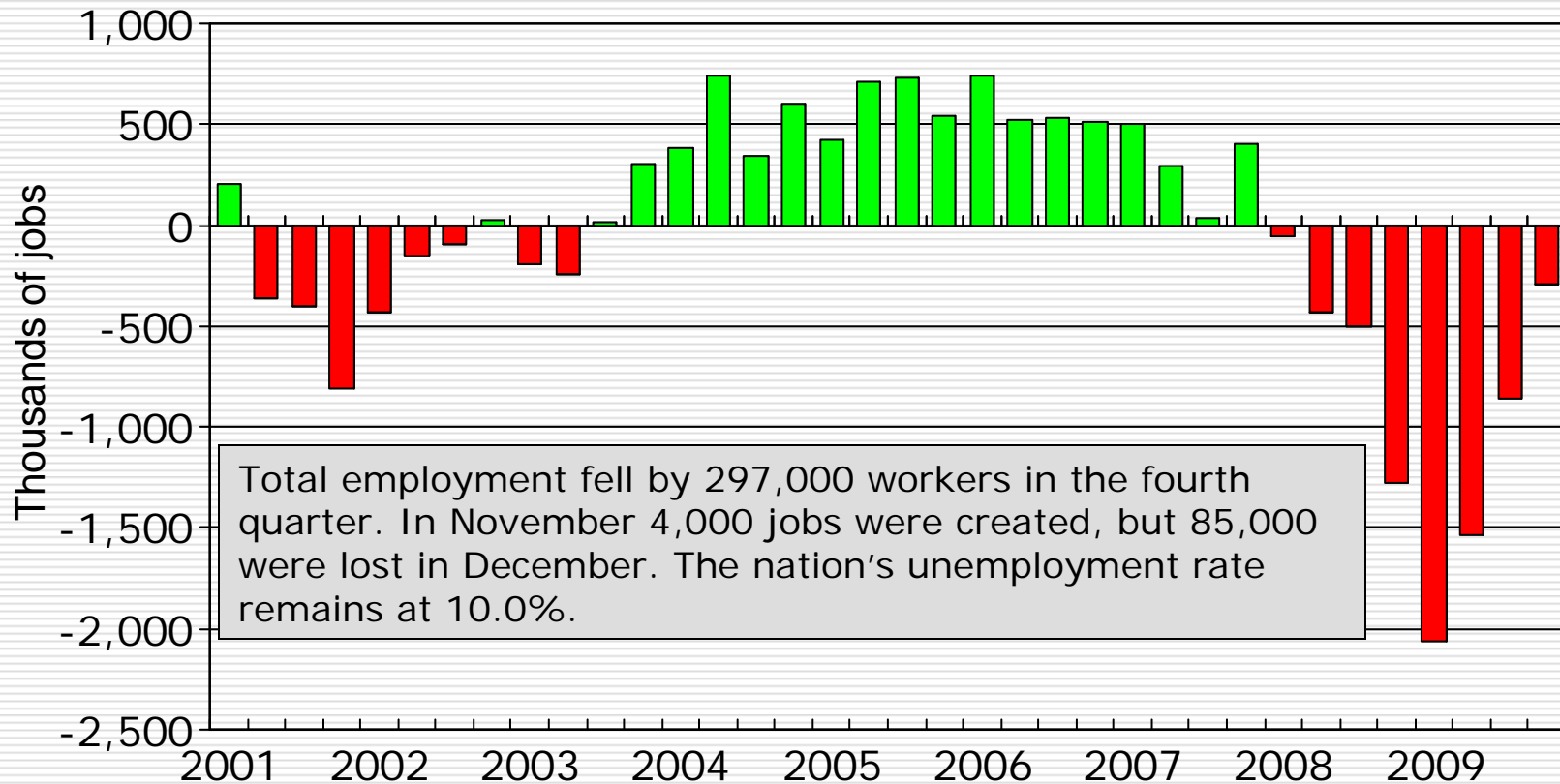
Dow Jones Index



Ok, so the good news is “so so” where is the bad news?

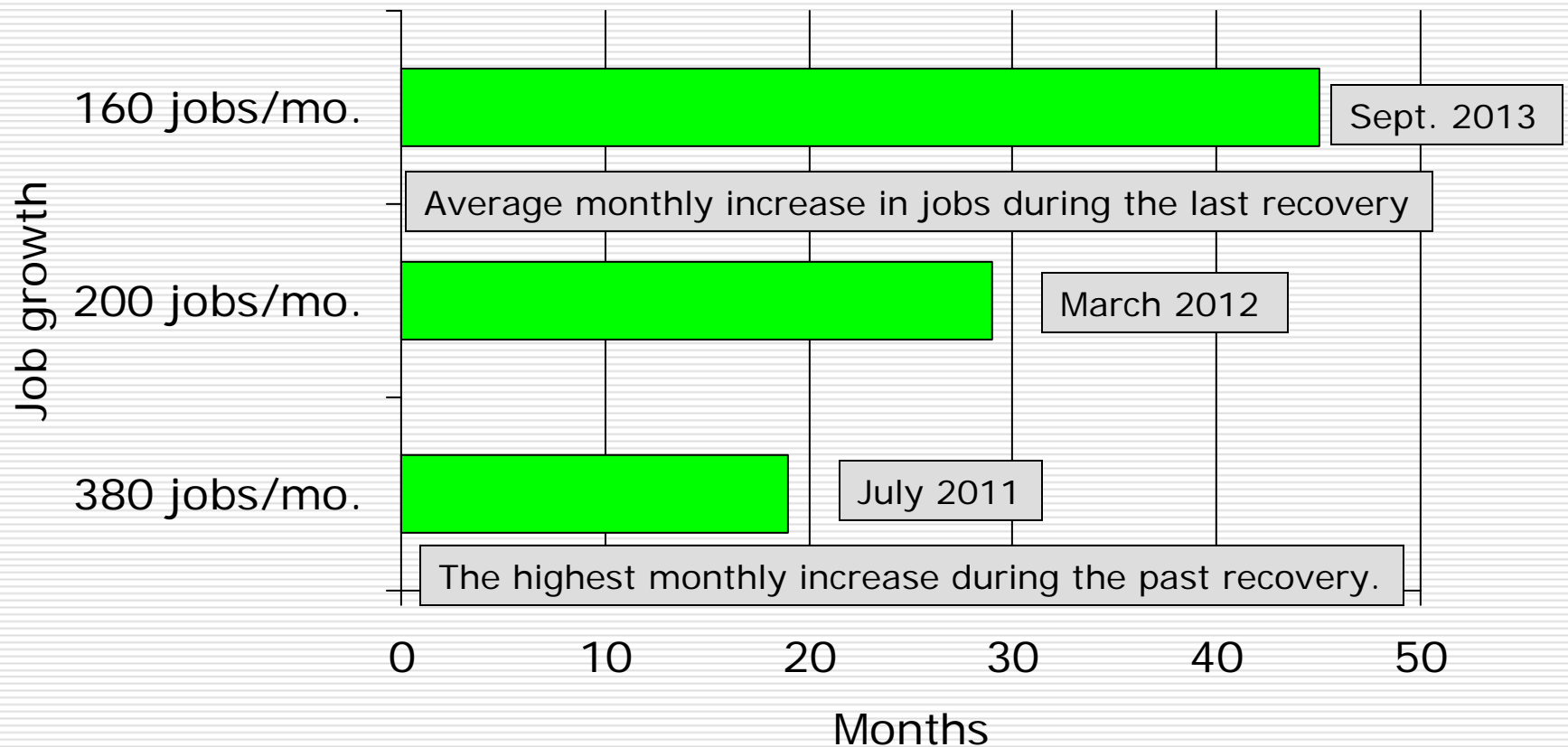
- ❑ Banking system—*The banks have a lot of money to lend but are not.*
- ❑ Employment outlook— *The rate of decline is slowing, but we may not return to pre-recession levels until 2011 or later.*
- ❑ Consumer confidence—*Will slowly improve but is dependent upon employment.*
- ❑ The auto industry—*2010 is expected to be better than the latter half of 2009.*

Nationwide, the rate of employment decline is slowing.

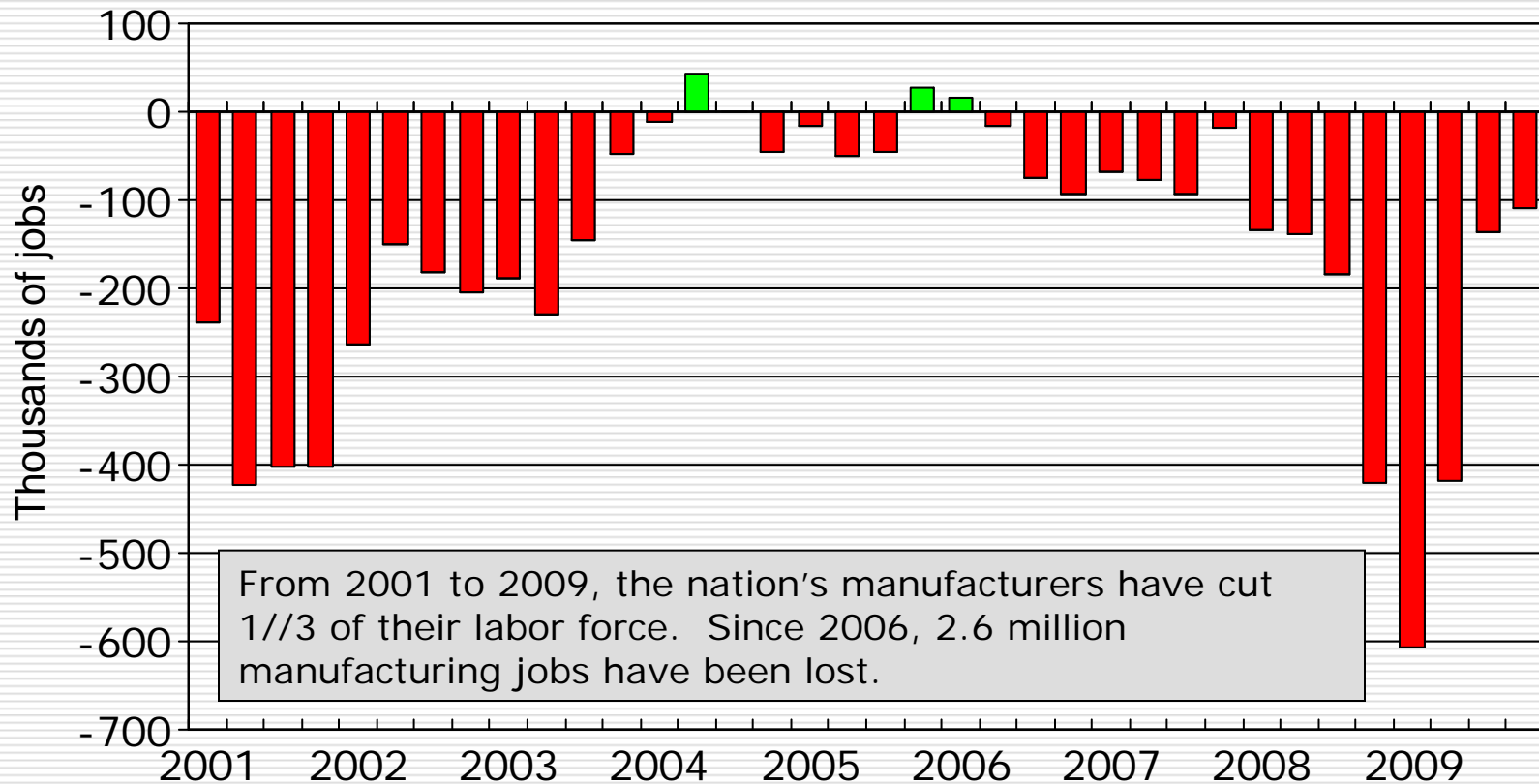


Source: BLS.

How long will it take for employment to reach its pre-recession level?



Manufacturing employment decline is slowing as well.

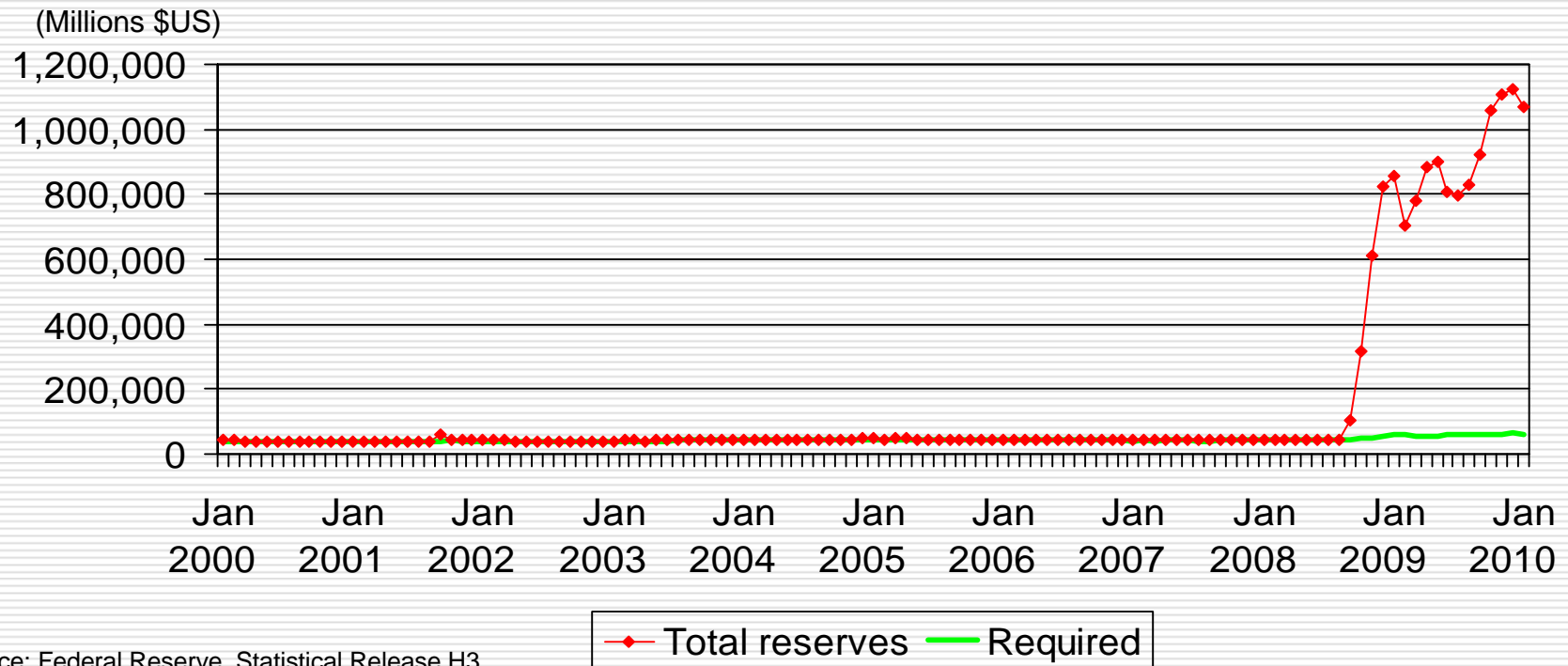


From 2001 to 2009, the nation's manufacturers have cut 1/3 of their labor force. Since 2006, 2.6 million manufacturing jobs have been lost.

Source: BLS.

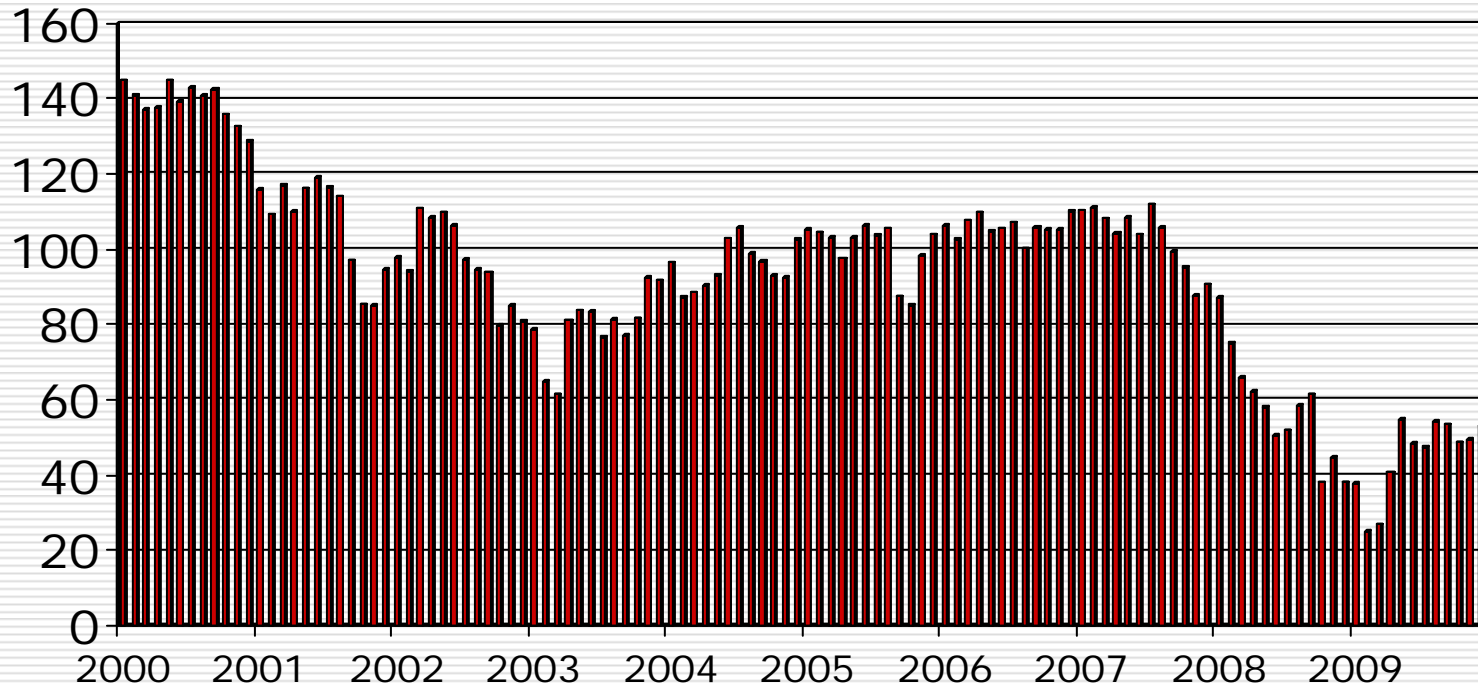
Banks have a trillion dollars to lend out but they are not.

Aggregate U.S. Depository Institution Reserves
(Adjusted for seasonality and changes in reserve requirements)



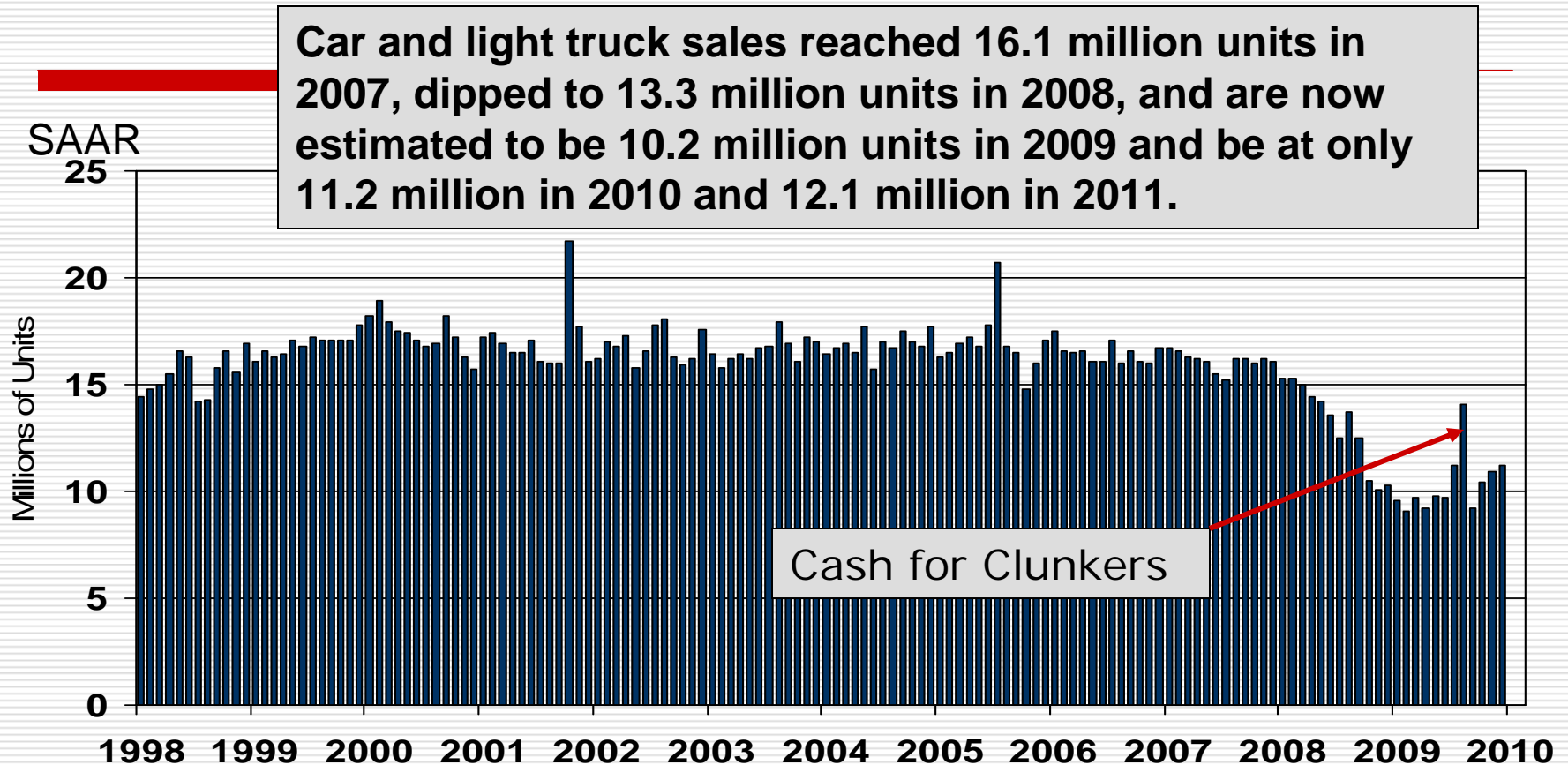
Consumers' confidence is still low.

Consumer Confidence (1995=100)



Source: Conference Board.

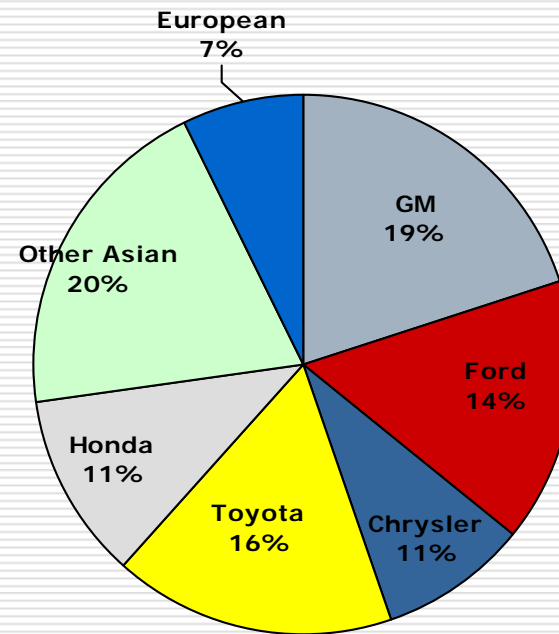
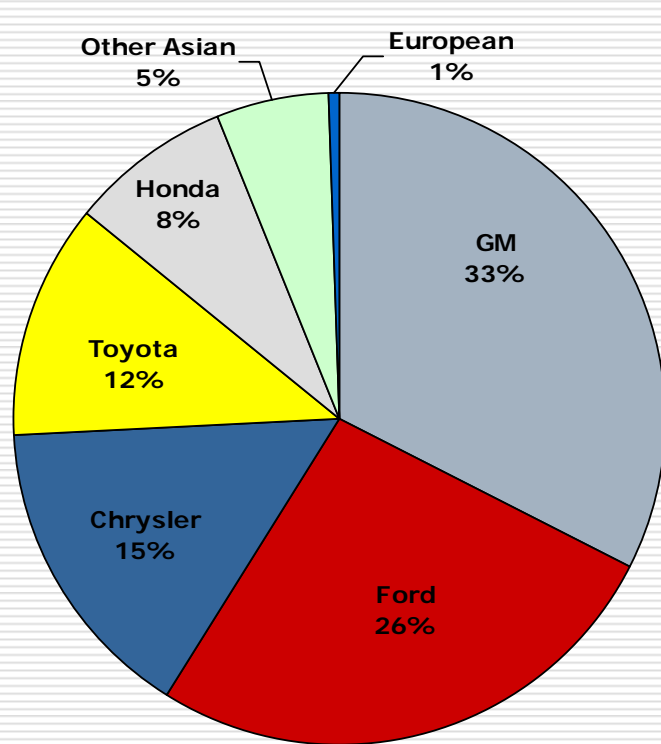
The showrooms are still pretty quiet.



Source: BEA.

Fueled by cash-for-clunkers, sales hit a 14.1 million unit rate in August but have fallen back since. Sales were up to a 11.2 million unit pace in December.

Loss of market share: In 2001, the Detroit Three controlled 74%; in 2009 it fell to 44.7%.



Source: *Wards AutoWorld*.

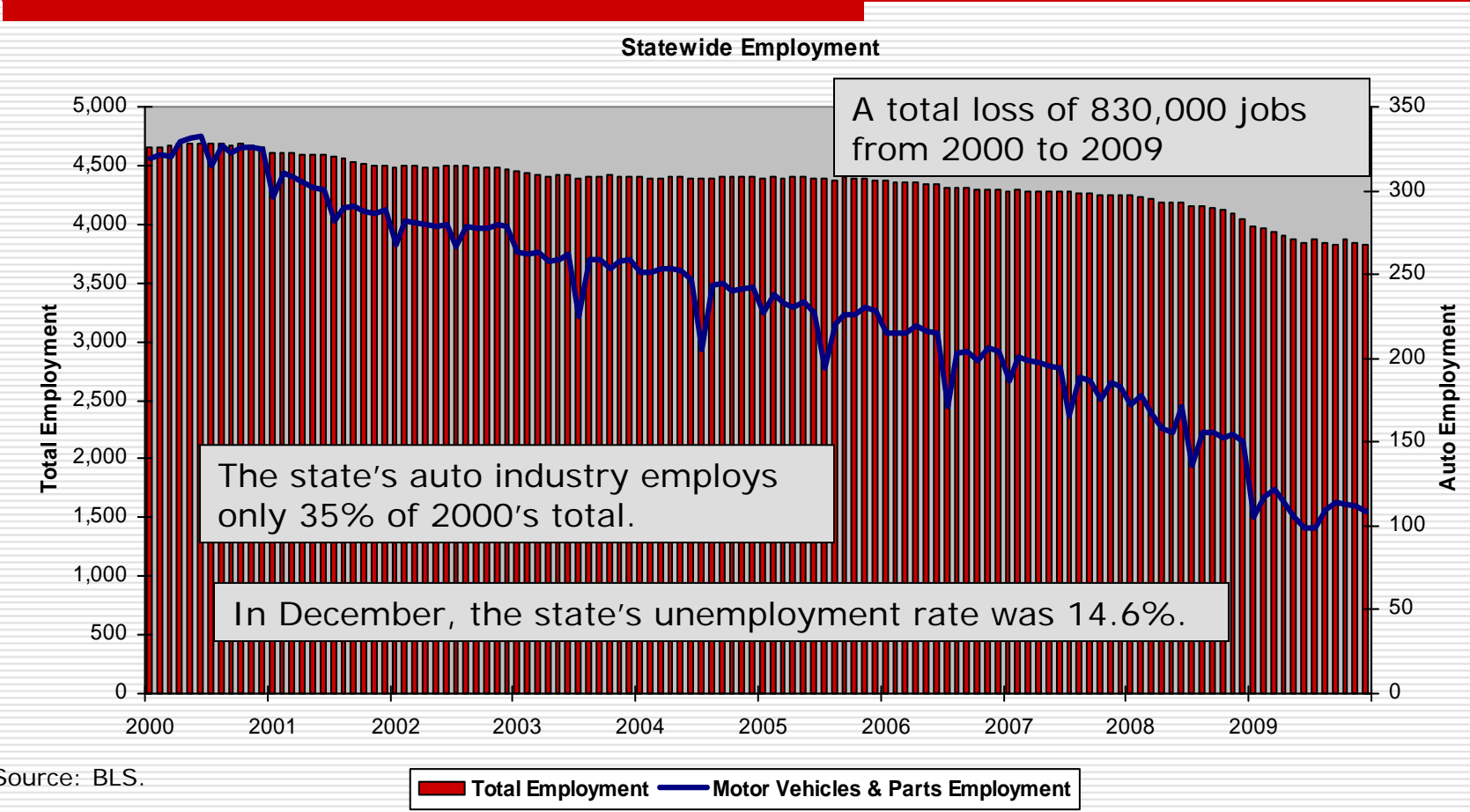
2001

2009

Only 3 of the top 10 selling vehicles are made by Detroit.

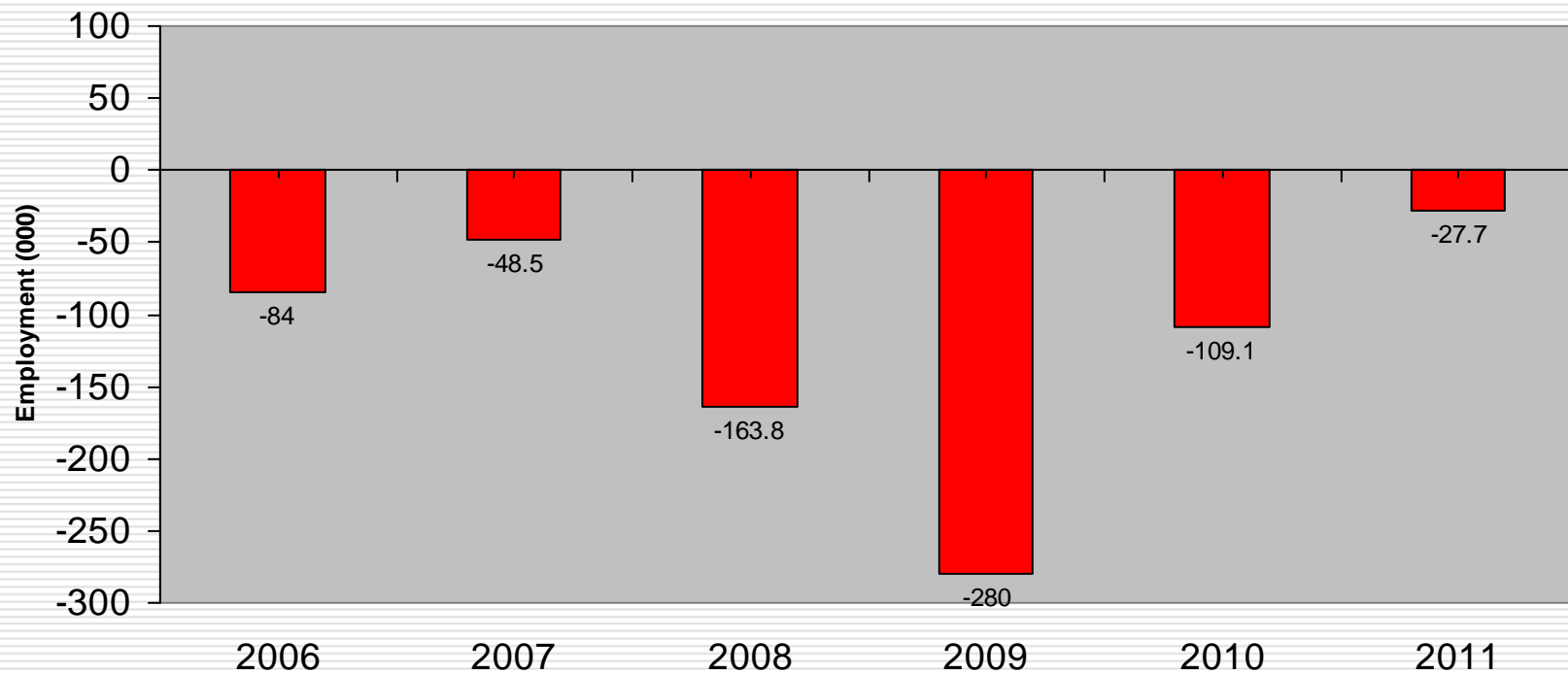
2009 Best Selling Vehicles		
Ford	F Series	413,625
Toyota	Camry	356,824
GM	Silverado	316,544
Toyota	Corolla/Matrix	296,874
Honda	Accord	287,492
Honda	Civic	259,722
Nissan	Altima	203,568
Honda	CR-V	191,214
Ford	Fusion	180,671

With the national slowdown, the state's turnaround is further postponed.



Total employment has declined for 10 straight years and is expected to decline in 2010 and 2011.

Change in Total Employment



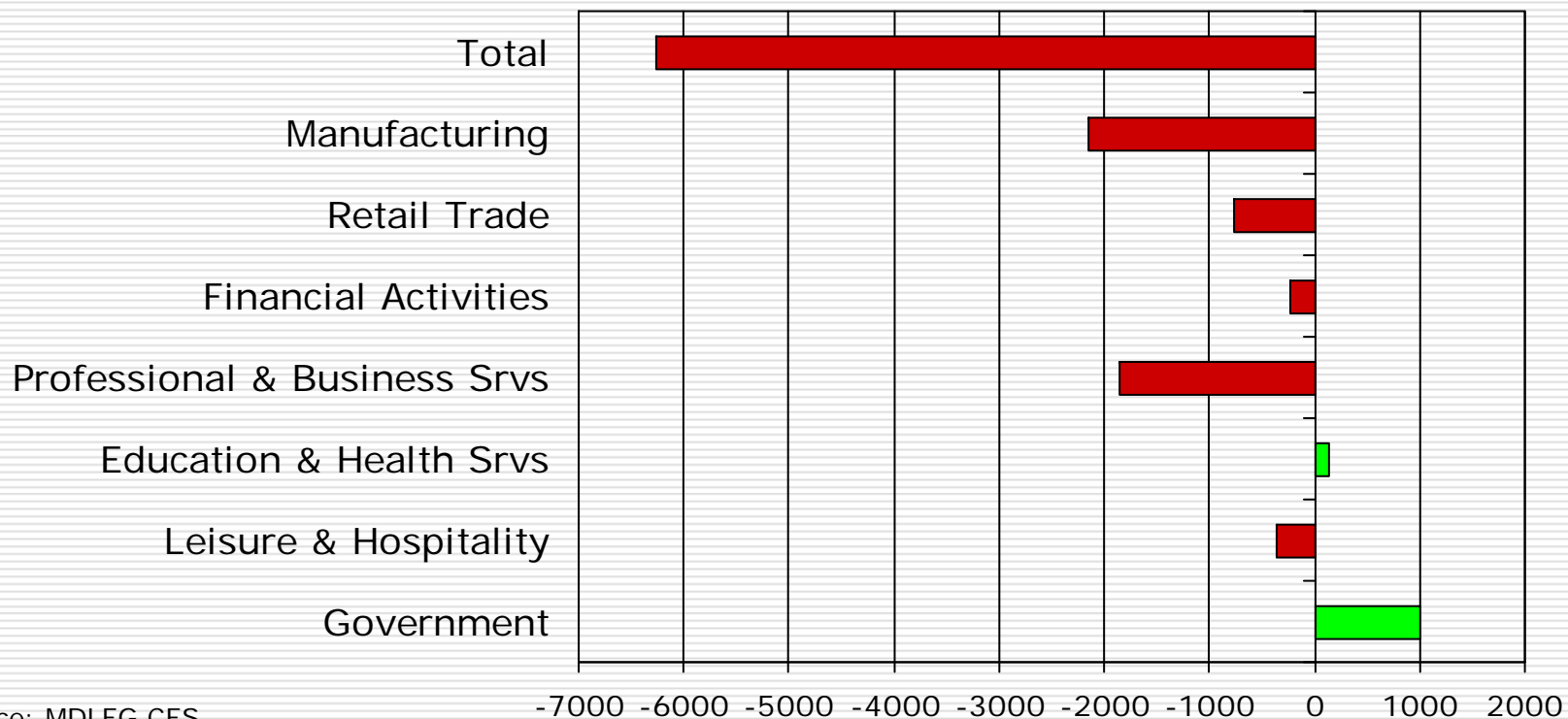
Source: University of Michigan, Nov 2009.

Kalamazoo County—*2009 was not a good year.*

- ❑ Serious employment declines. In November unemployment stood at 11.4%
- ❑ Too many people are moving out.
- ❑ Housing prices are still retreating.
- ❑ Residential construction is at a standstill.

Employers cut more than 6,200 jobs from their payrolls in 2009.

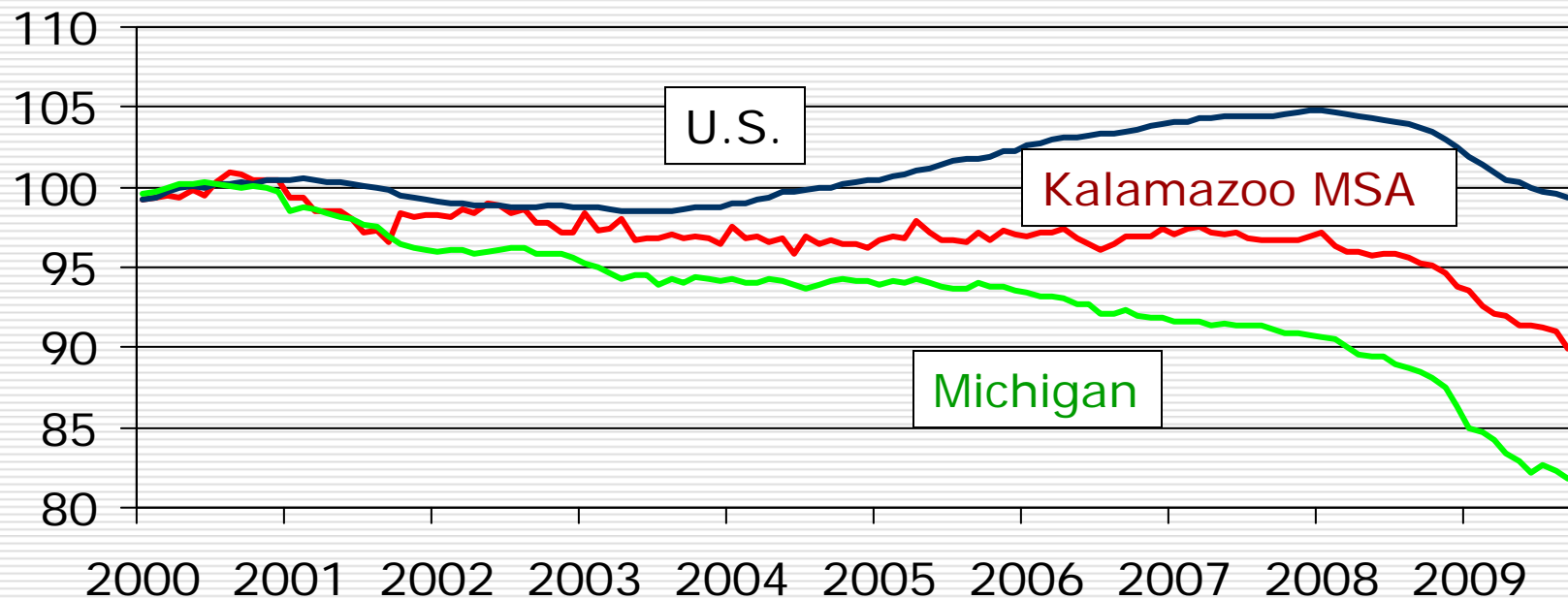
**Kalamazoo MSA Change
2008 to 2009**



Source: MDLEG CES

Kalamazoo MSA remains stuck between the U.S. and the state

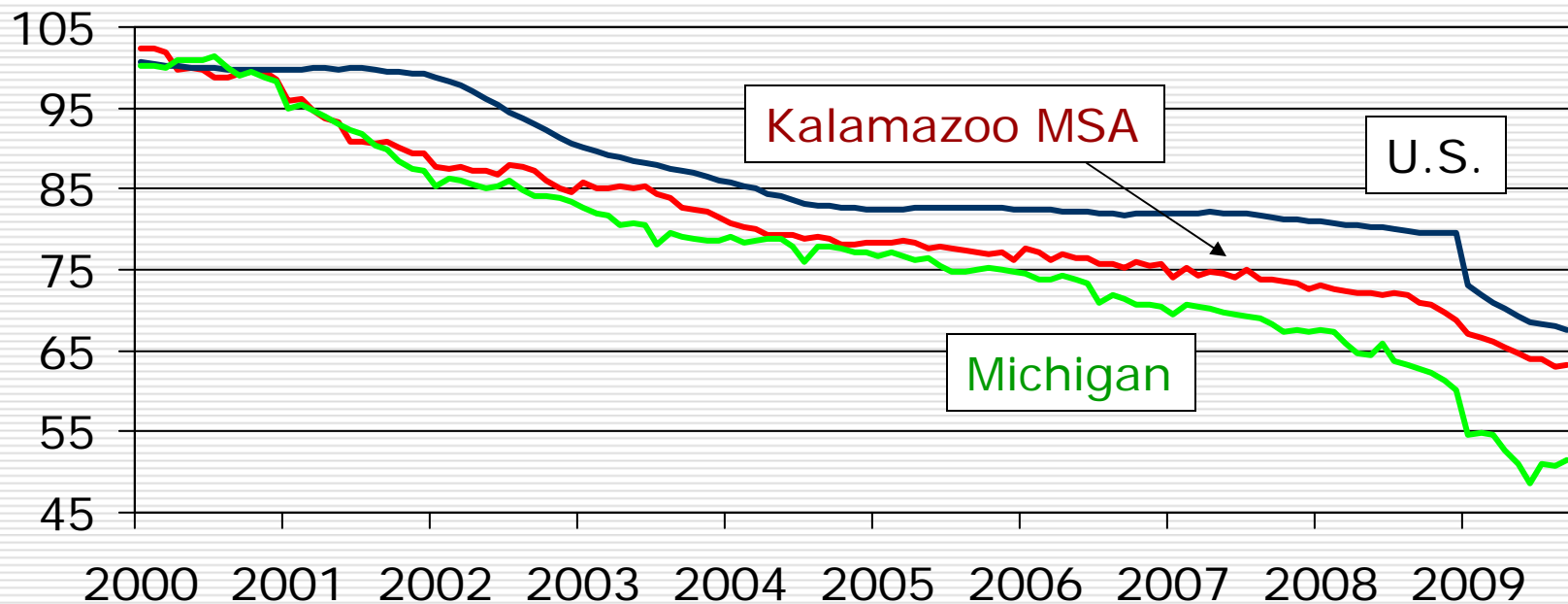
Index of Total Employment
(100 = 2000 average)



Source: W.E. Upjohn Institute and BLS.

This holds true in manufacturing as well as...

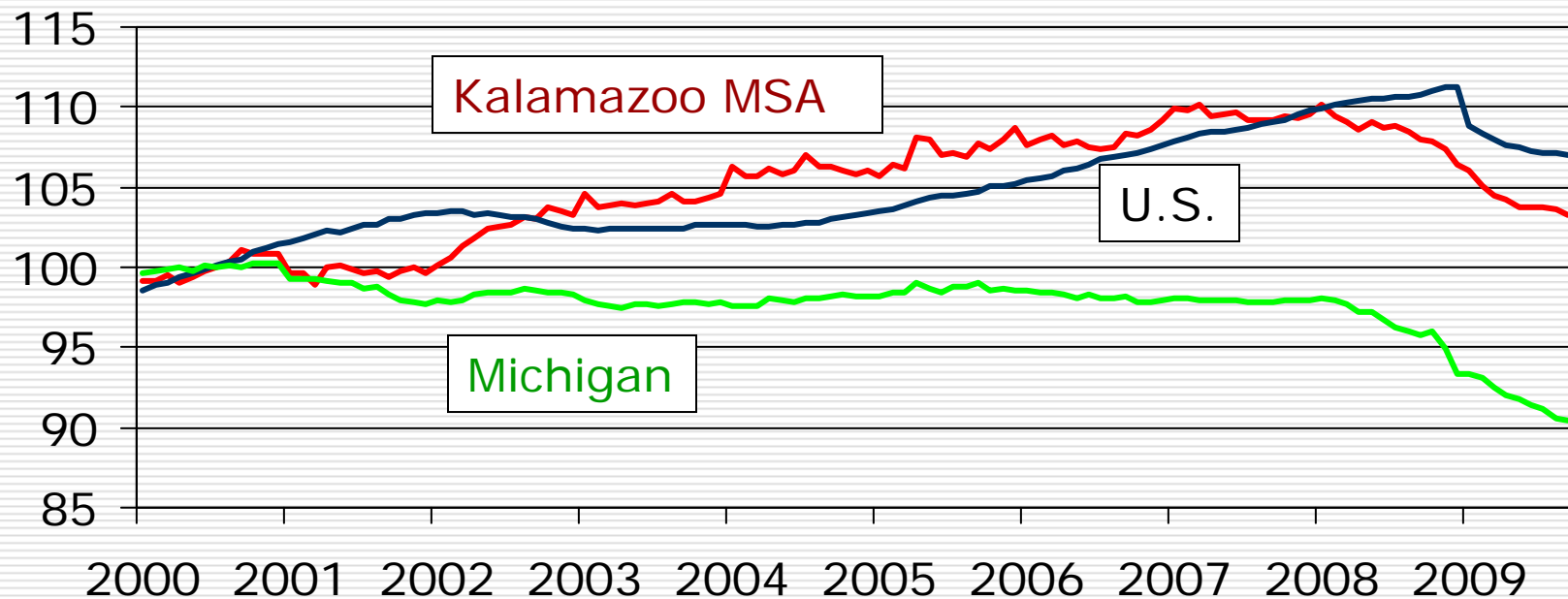
Manufacturing Employment Index (100 = 2000 average)



Source: W.E. Upjohn Institute and BLS.

Services. Although before 2008, the MSA was doing better than the nation.

Private Service-providing Employment Index
(100 = 2000 average)



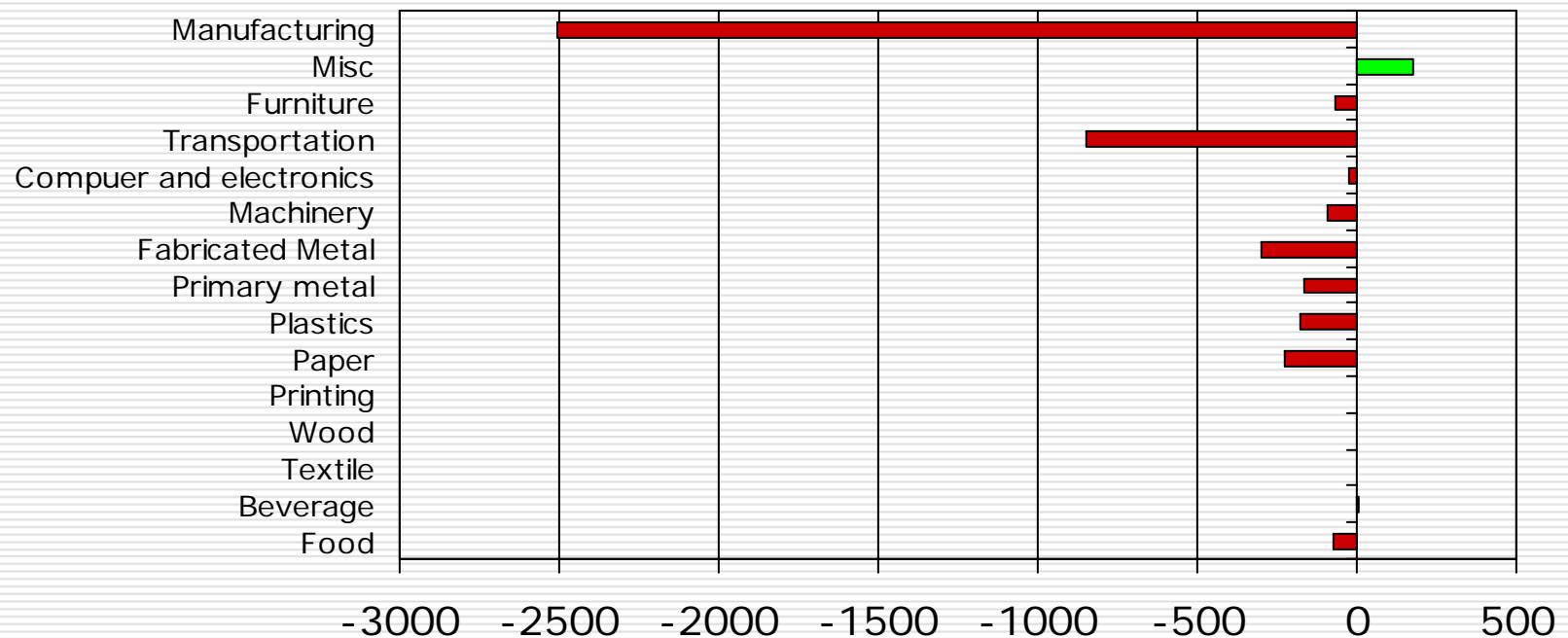
Source: W.E. Upjohn Institute and BLS.

For a more detailed look at local employment trends, we must look at an older data set:

Employment change from Q1 2008 to Q1 2009

Employment declines occurred across most manufacturing industries.

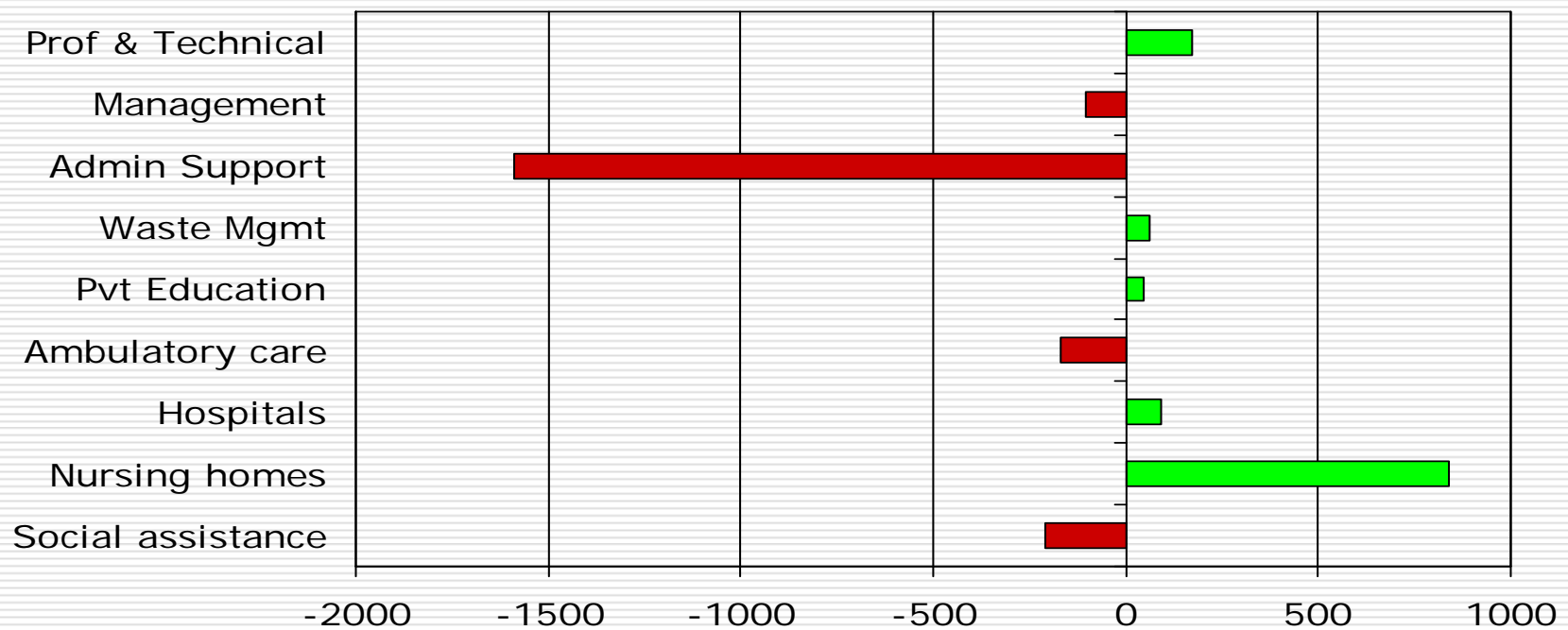
Detailed Manufacturing Employment Change Q1 2008 to Q1 2009



Source: MDLEG, ES-202 data.

Health care providers continue to add workers; however, most other sectors are pretty quiet.

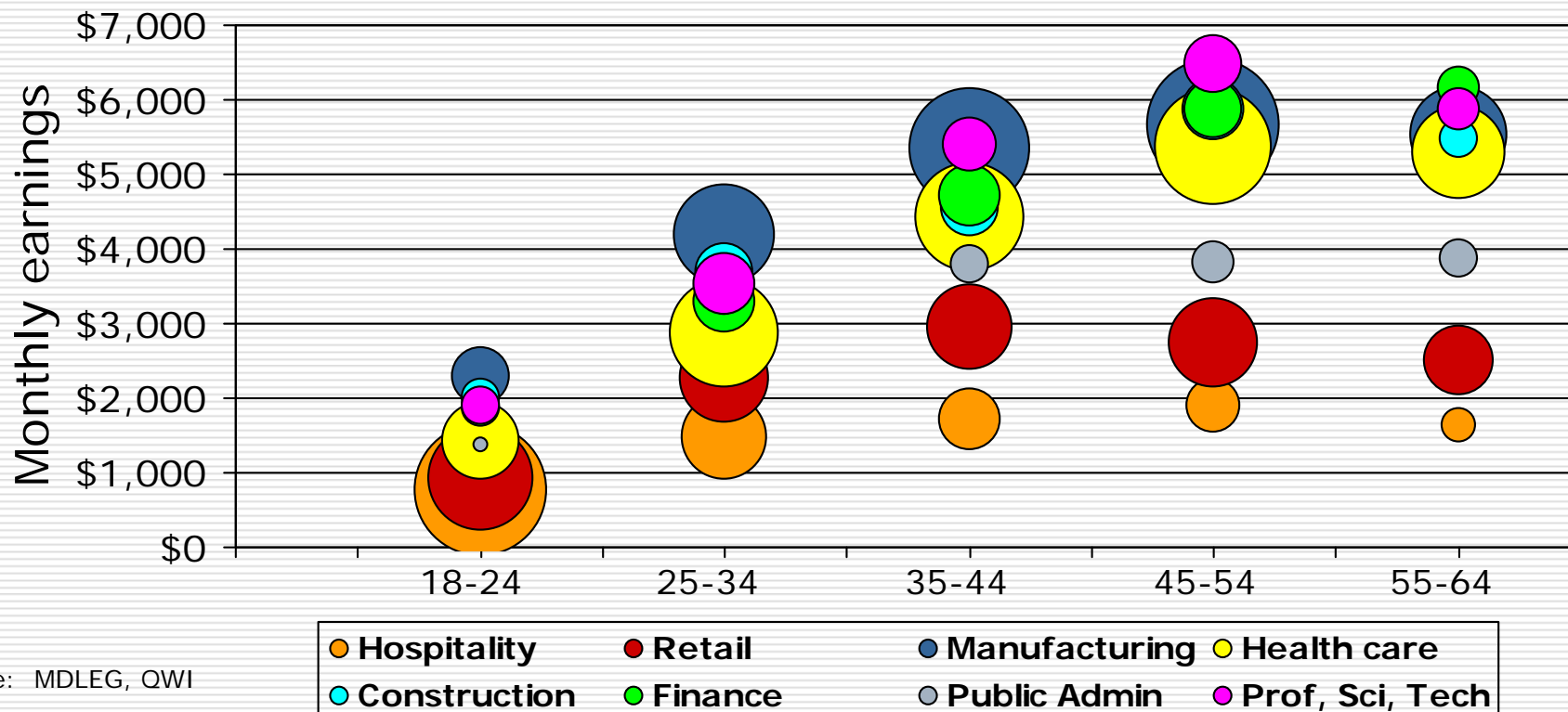
Detailed Professional and Business Services and Health and Education Services
Employment Change, Q1 08-Q1 09



Source: MDLEG, ES-202 data.

Manufacturing and health care are the county's major sectors.

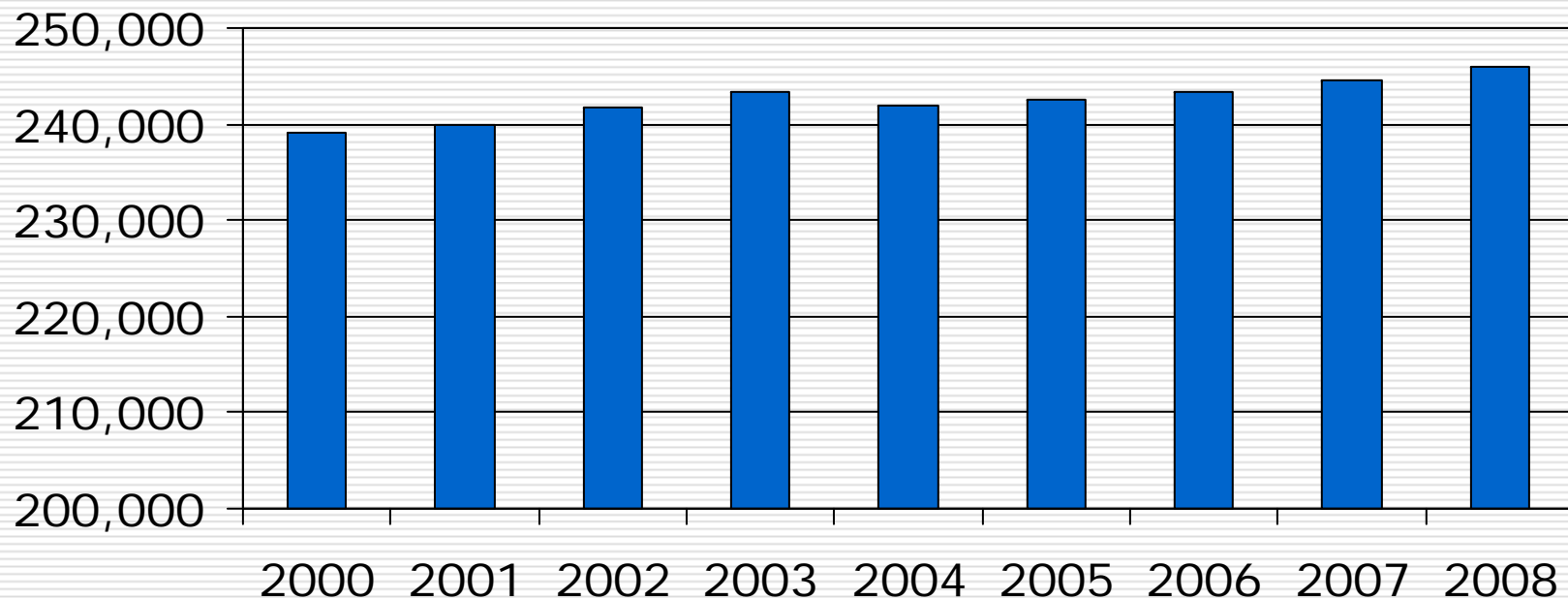
Earnings and Employment, Q4 2008



Source: MDLEG, QWI

Population growth has been modest

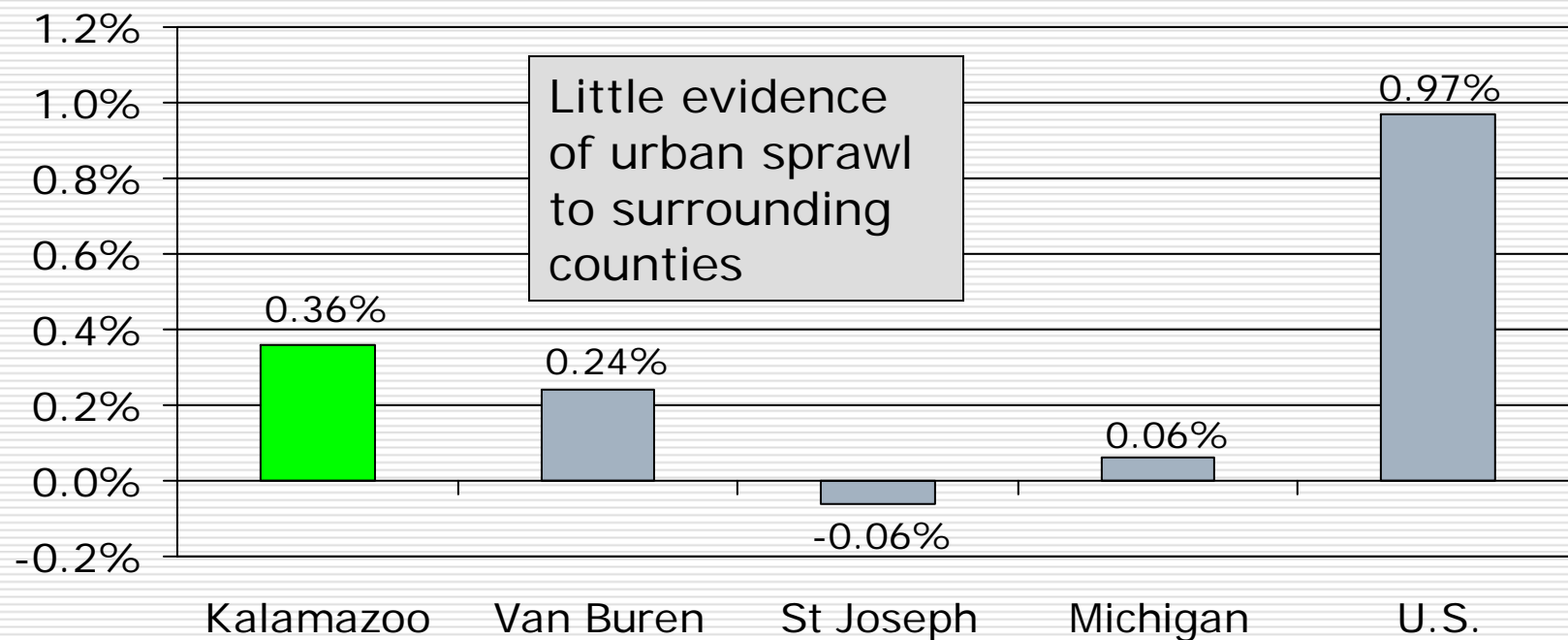
Kalamazoo County Population Estimates



Source: U.S. Census Bureau, annual population estimates.

The county's population is growing at about 1/3 the national rate

Annual Average Population Growth Rate, 2000 to 2008



Source: U.S. Census Bureau, annual population estimates.

Where do the migrants go? The trends have changed, and net losses have increased.

Net Migration Flows with Kalamazoo Co.

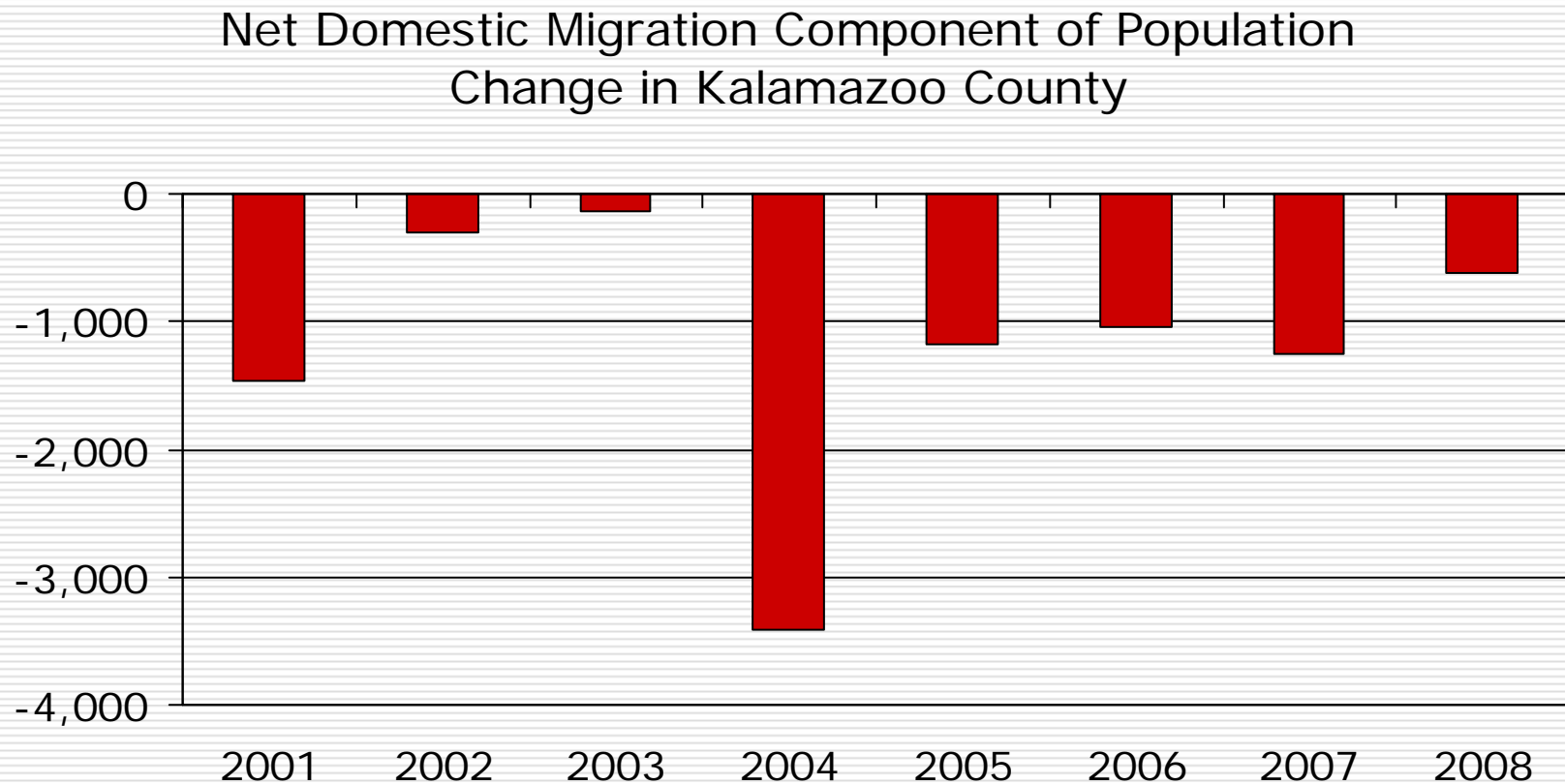
Source or Destination	2001-2002	2007-2008
Total	-49	-998
Neighboring Counties:		
Allegan	146	66
Barry	1	79
Calhoun	43	90
St. Joseph	69	61
Van Buren	-170	146
Rest of Michigan	406	502
Other States	-586	-1,943
International	131	1

Suburban migration slowed in 2008; was it gas prices or the housing market?

Source: IRS migration data.

Kalamazoo County has historically gained residents from other parts of Michigan, only to lose even more population to other states.

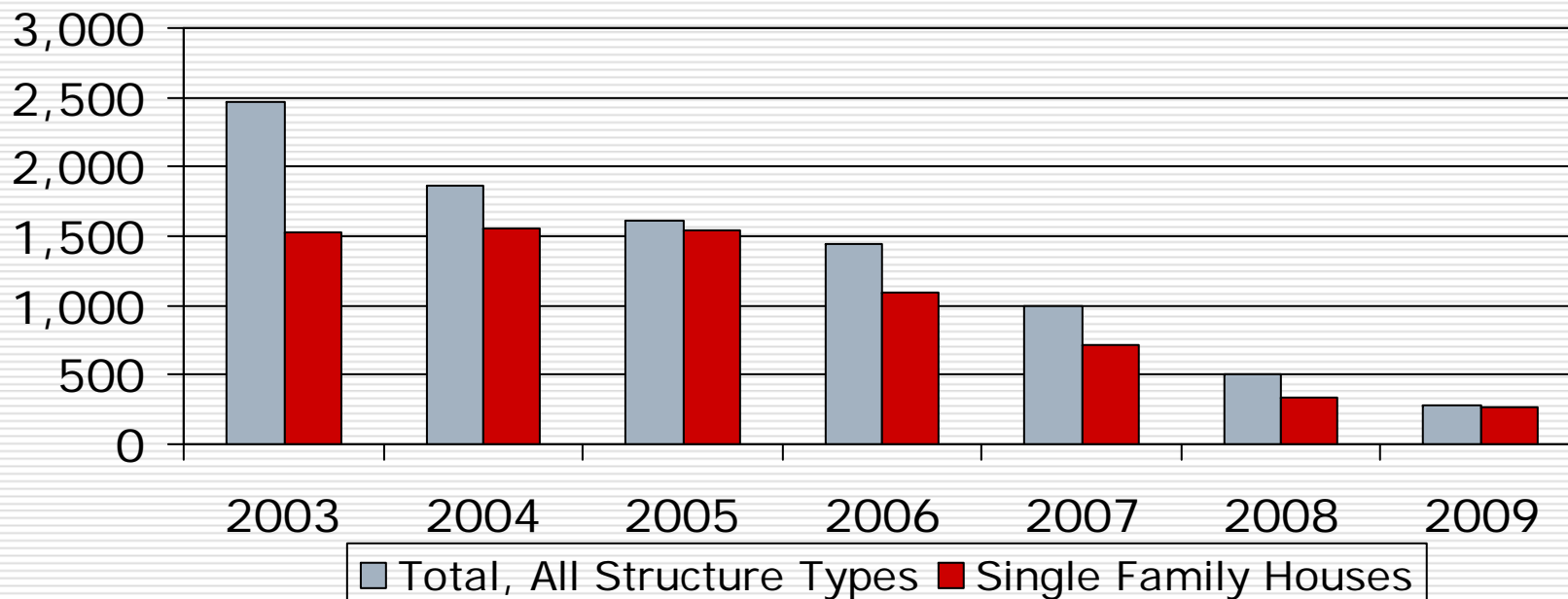
The county has suffered seven years of steady out-migration in domestic moves.



Source: U.S. Census, annual population estimates.

Not surprisingly, housing activity has remained quiet.

Housing Units Authorized by Building Permit in Kalamazoo MSA

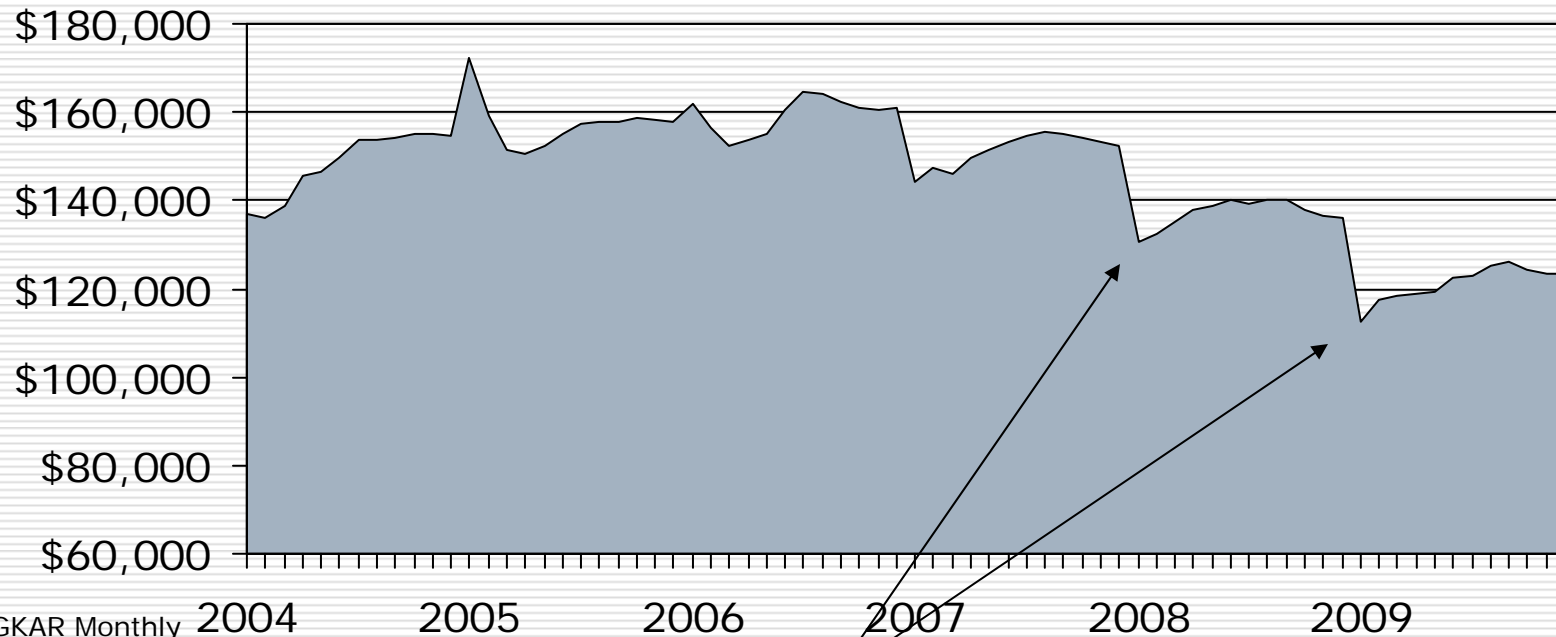


Source: U.S. Census Bureau: Manufacturing, mining, & construction statistics.

Note: 2009 is estimated year-to-date through November 2009 only.

Average existing home prices have not increased on a year-over-year basis since December 2006.

Kalamazoo Area Average Monthly Existing Home Sales Price

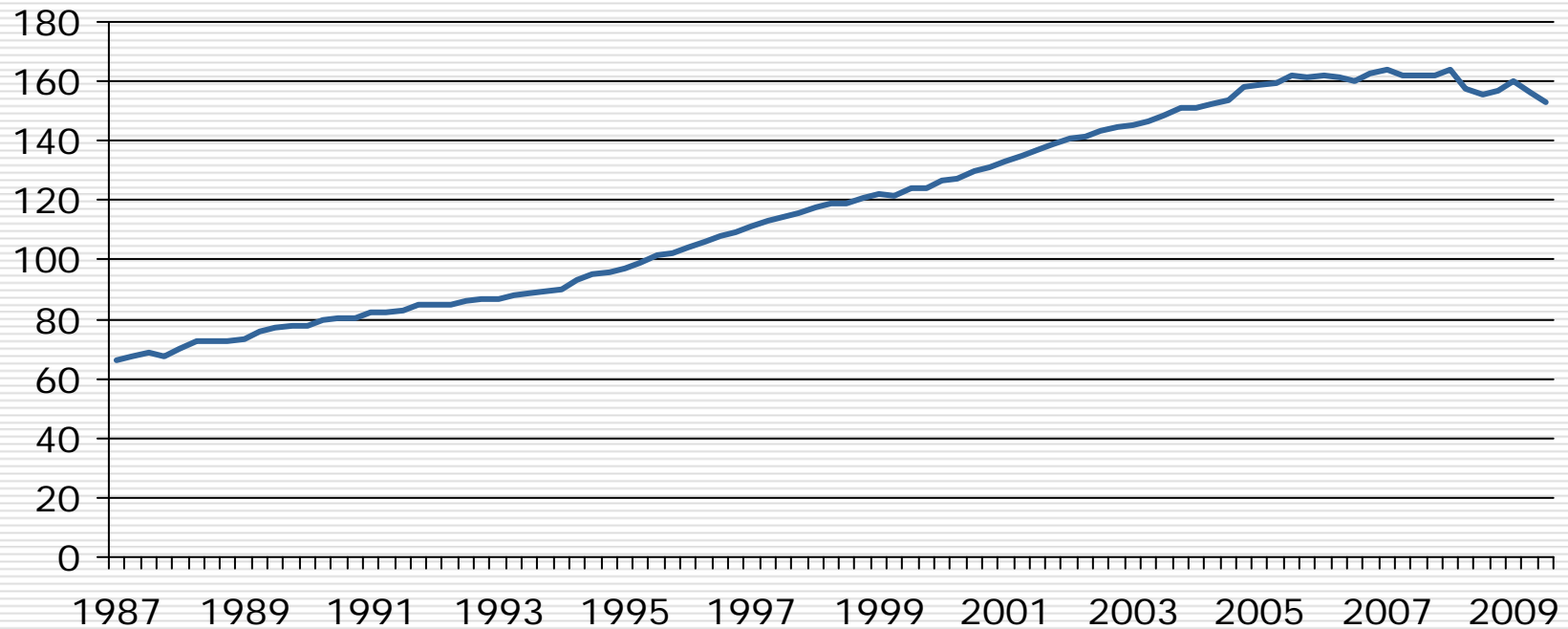


Source: GKAR Monthly Cumulative Sales Reports.

Home prices have always been seasonal; however, during the past few years expectations have been "re-set" at the beginning of the year.

Housing prices are still soft even when you control for the house.

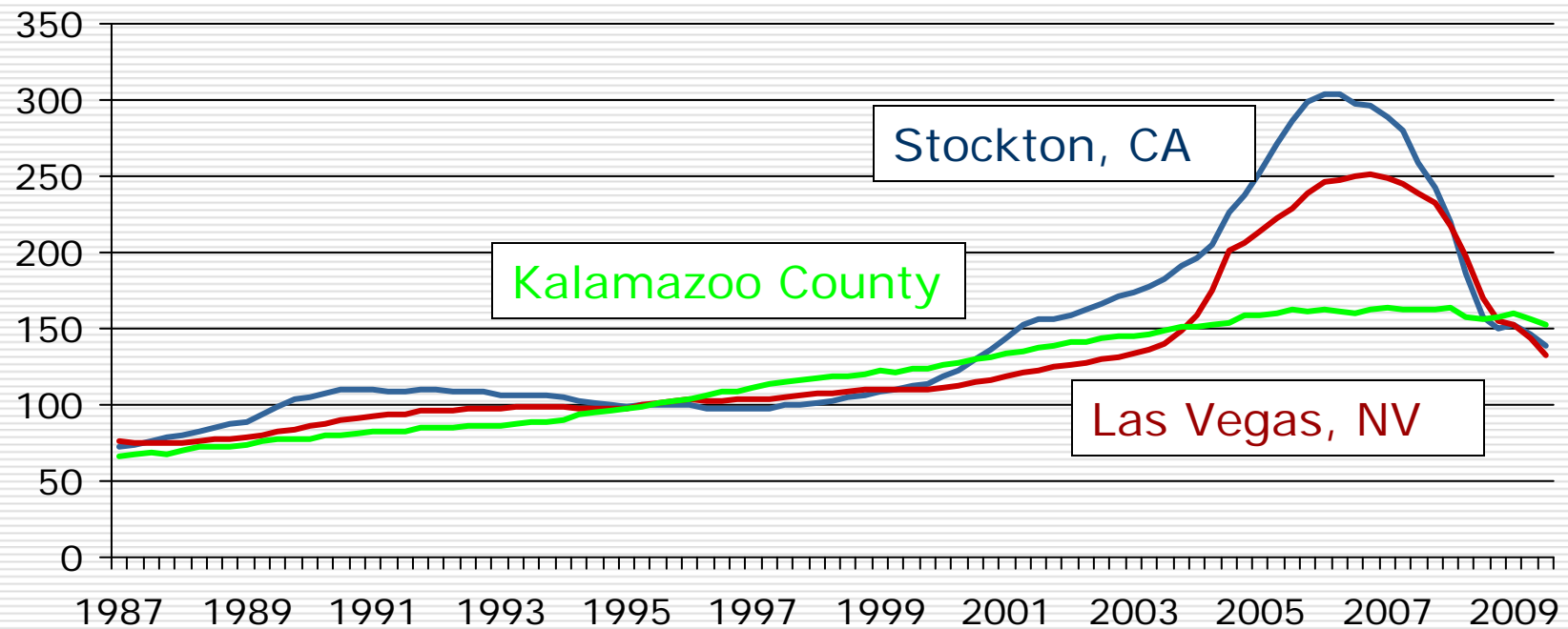
Kalamazoo MSA Housing Index
1995 = 100



Source: FHFA

Still, there are places that are much worse.

Crisis Metro Housing Index
1995 = 100



Source: FHFA

Only a few areas of Kalamazoo County saw increased single-family home construction activity during 2008.

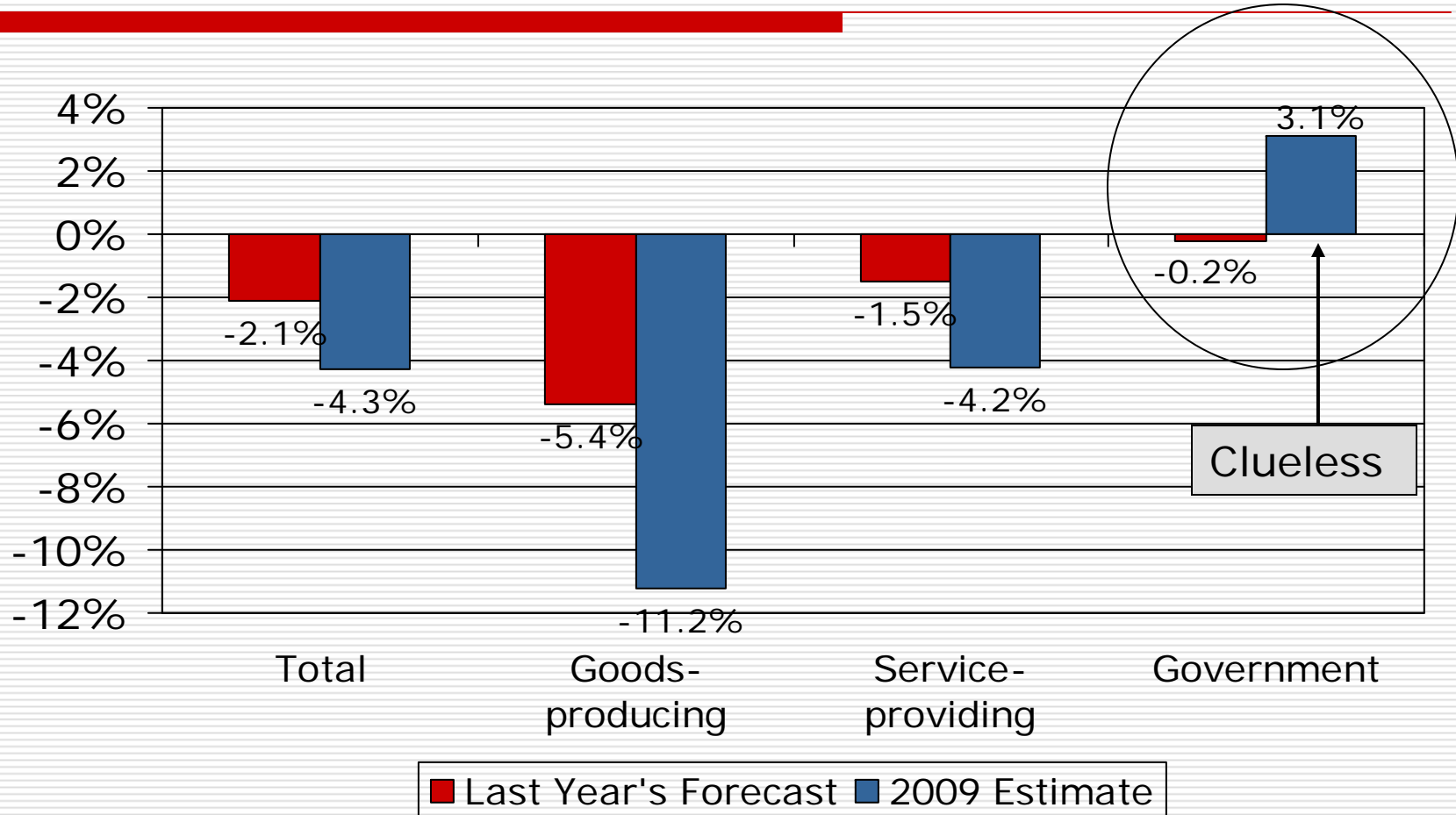
Single Family Residential Building Permits

Jurisdiction	2008 Permits	Change from 2007	Pct. Change
Richland Township	51	27	112.5%
Comstock Township	27	9	50.0%
Schoolcraft Township	20	9	81.8%
Kalamazoo City	19	7	58.3%
Ross Township	6	2	50.0%
Wakeshma Township	6	2	50.0%
Parchment City	1	1	-
Climax Village	0	0	-
Prairie Ronde Township	2	0	0.0%
Richland Village	3	0	0.0%
Schoolcraft Village	0	0	-
Augusta Village	0	-1	-100.0%
Charleston Township	4	-1	-20.0%
Climax Township	0	-2	-100.0%
Alamo Township	3	-3	-50.0%
Galesburg City	0	-4	-100.0%
Pavilion Township	7	-5	-41.7%
Oshtemo Township	84	-8	-8.7%
Brady Township	4	-8	-66.7%
Cooper Township	13	-11	-45.8%
Texas Township	82	-17	-17.2%
Portage City	37	-44	-54.3%
Vicksburg Village	52	-45	-46.4%
Kalamazoo Township	7	-49	-87.5%

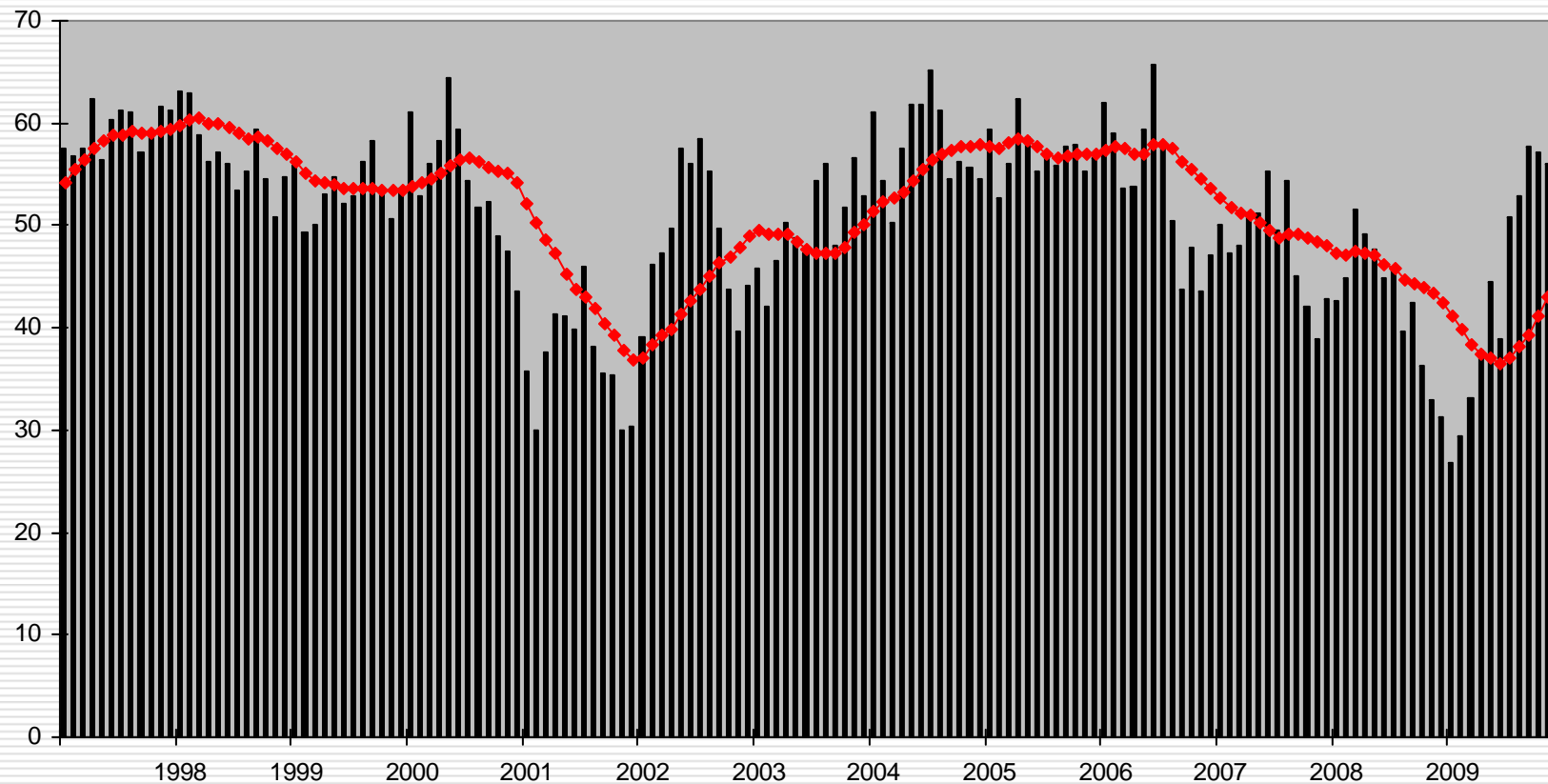
Somewhat surprising given the Promise

So, how did we do last year?

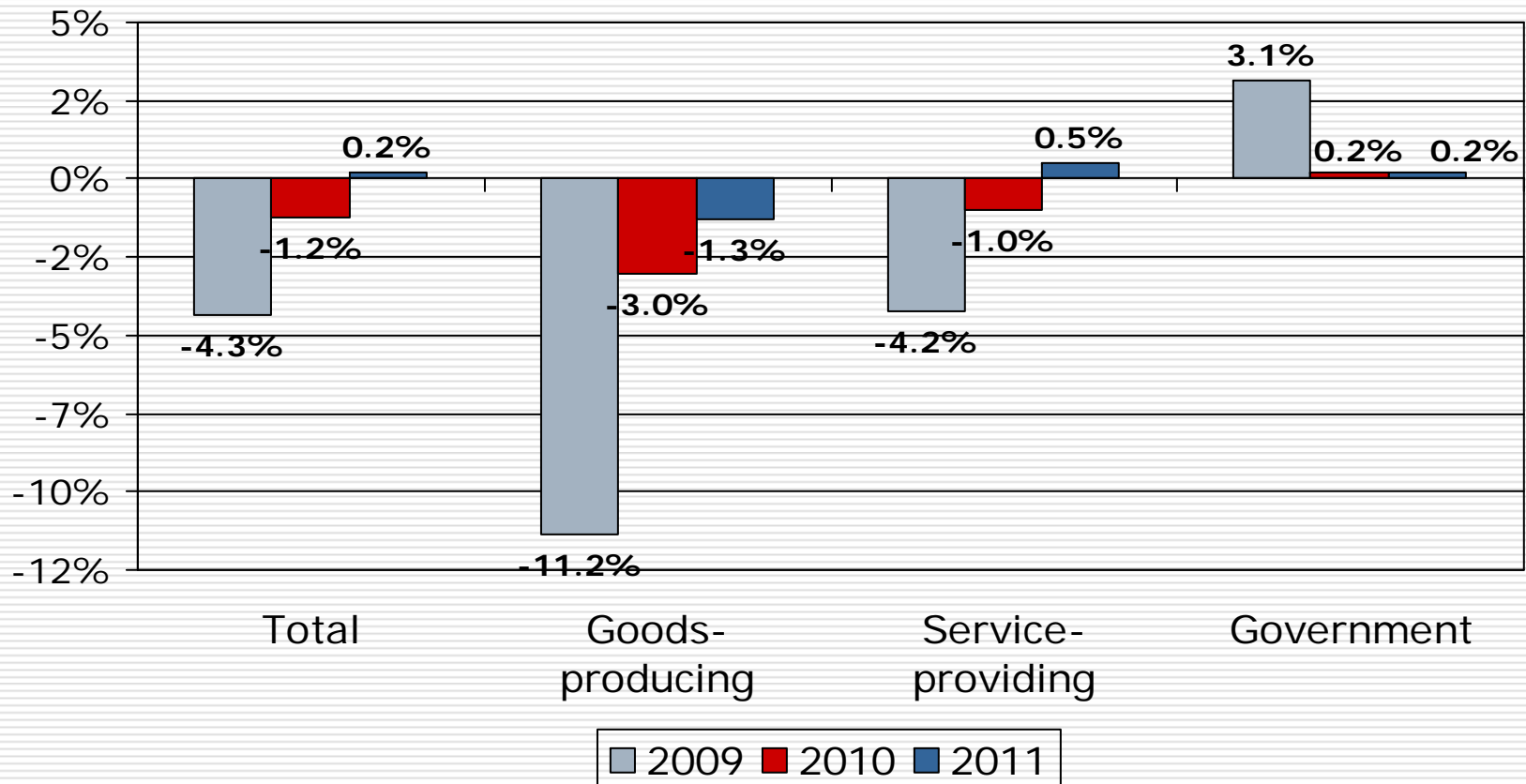
Not great.



Polling of Purchasing Managers is positive.



2010 and 2011 Forecast for Kalamazoo County—*Not out of the woods yet.*

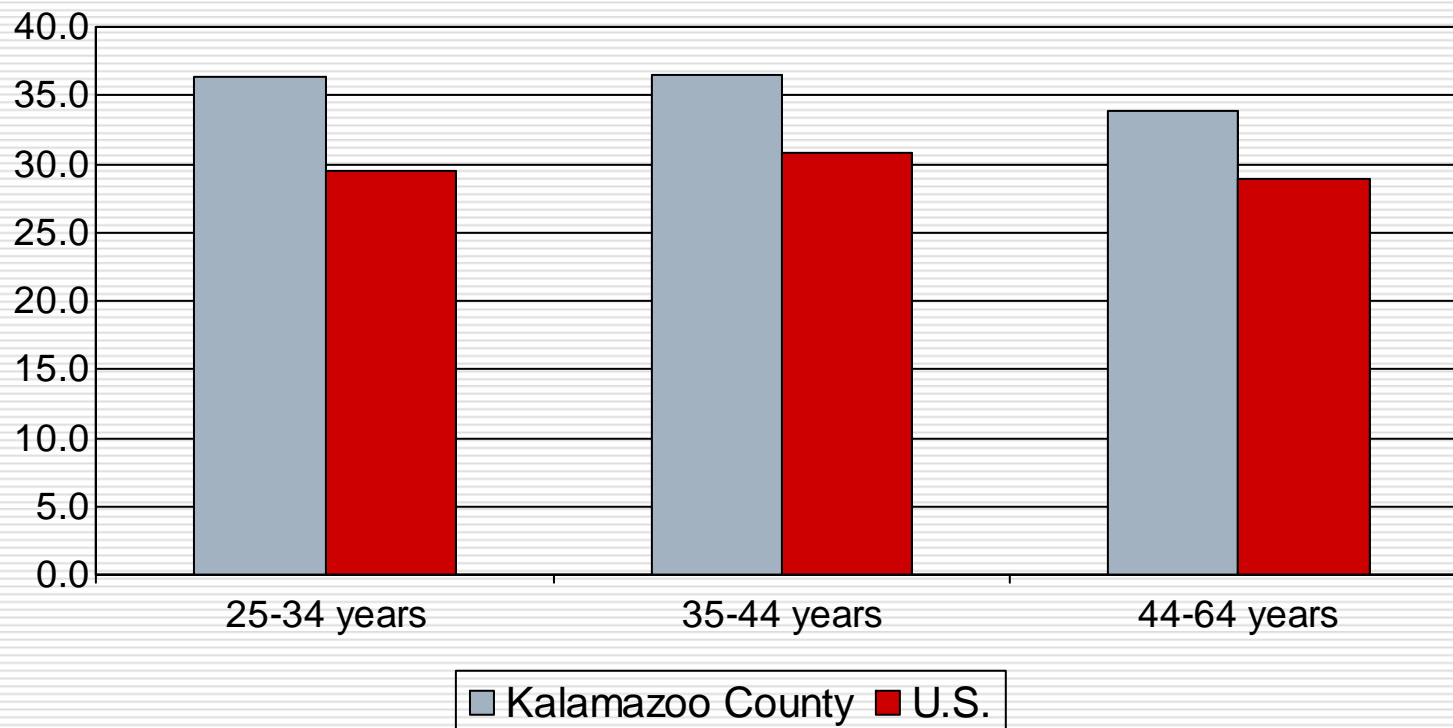


So, what keeps me up at night?

- Fear of the double-dip
 - What if current economic growth is simply inventory restocking?
 - Consumers are not in a good mood.
- Stagnation in education achievement.
- Competing on price alone.

We have hit a ceiling in education achievement.

Percent with a Bachelor's Degree or Higher in 2008

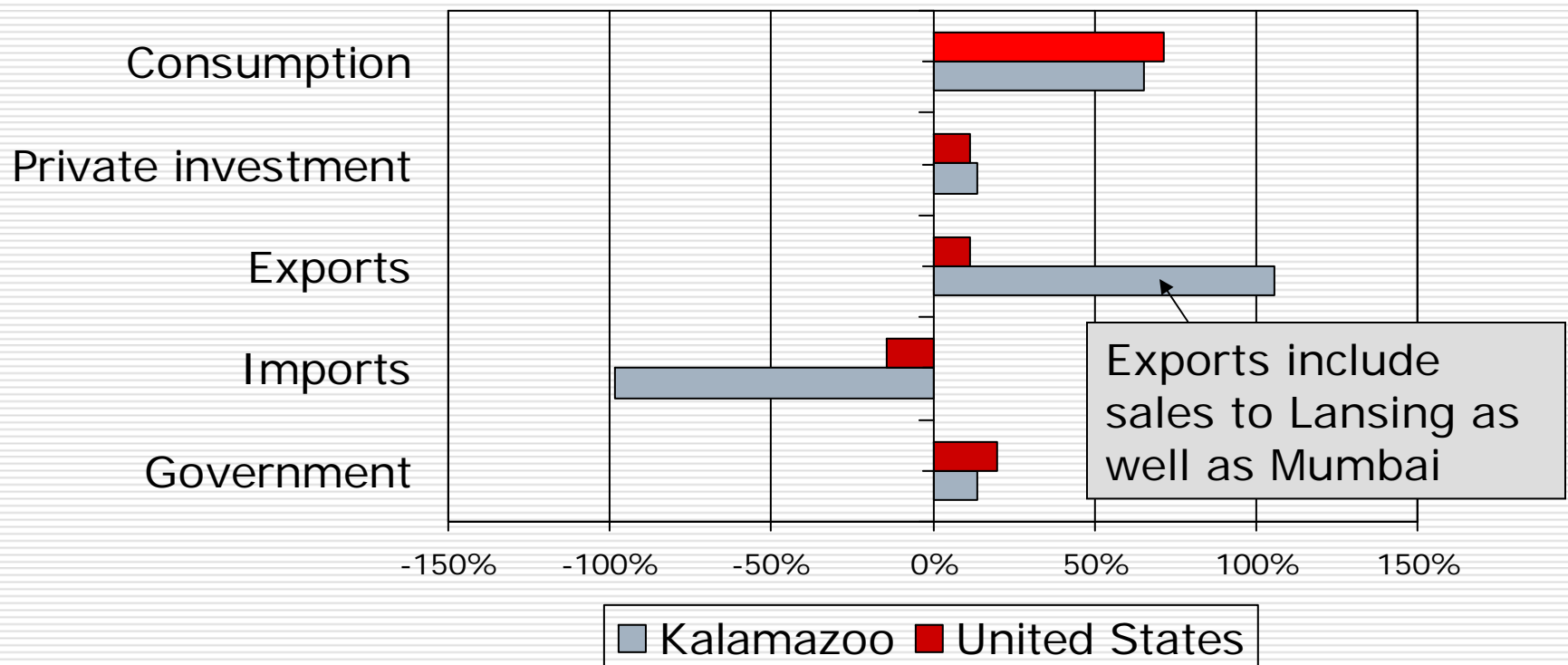


Challenges

- Nationwide,
 - Approximately only 20% of all full-time community college students complete their coursework in three years.
 - Only 50% of full-time, four-year college students get their Bachelor degree in six years.
- Why:
 - Financial stress
 - Lack of career counseling

Kalamazoo MSA is much more dependent on exports than the greater U.S.

Components of Gross Domestic Product



Like most small countries, the Kalamazoo MSA depends upon trade.

□ Growth options:

- Export more
- Import less: become more self-sufficient
- Attract more consumers

□ Questions to answer:

- What do we export?
- Who depends on exports?

We are still highly dependent on manufacturing export

Kalamazoo County's Export Employment Base		
Industry	Export Employment	Percent of Total Export
Manufacturing	20,133	33.7%
Health care	5,324	8.9%
Leisure & Hospitality	4,176	7.0%
Finance	3,675	6.2%
Prof & Bus Service	2,539	4.3%
Education	2,424	4.1%
Retail	1,886	3.2%

What does the region export?

Pharmaceuticals, motor vehicle parts, and medical instruments.

- Top five industries account for 54% of the regions exports
 - Chemical (drugs)
 - Auto and truck parts
 - Misc. mfg (medical instruments)
 - Food products
 - Machinery

- Top 10 account for 70%
 - Paper
 - Wholesale
 - Utilities
 - Health care
 - Fabricated metals

Who depends upon the region's exports?

- Everyone, but 38 percent of the MSA's private sector's workers depend directly on exports including
 - 2,670 administrative support
 - 2,540 professional and business services
 - 2,000 educational services
 - 5,320 healthcare workers, and of course
 - 4,440 chemical workers

Policy Options for the Kalamazoo MSA

- Import substitution
 - Can't put up tariffs.
 - Can build better networks—buy locally.
- Attract more consumers
 - Can't lower taxes and maintain services.
 - Hard to provide better public services without raising taxes.
 - Quality of life factors are hard to move.

Leaves only one major option: *Increase exports.*

- Nearly all of the region's sectors export.
- Different markets
 - 27.0% of export employment depends on regional sales (*selection and expertise*)
 - 60.7% on national markets
 - 12.3% on international markets
 - Cost, quality, and design/innovation with, I believe, a growing importance on the latter.

Competing on value and not price:

Importance of Design

In our ongoing research on Design, we have found so far:

- Design is risky, but inaction can be fatal.
- Design can beat out engineering.
- Design is expensive; being an industry leader invaluable.
- Design is customer-focused, while it is too easy to become provider-focused.
- It is easier to lose Design than to regain it.

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Michigan section at

www.upjohninstitute.org

Or e-mail me: erickcek@upjohn.org