

# Midwest Economy: Gearing Up

Robert Kavcic, Economist

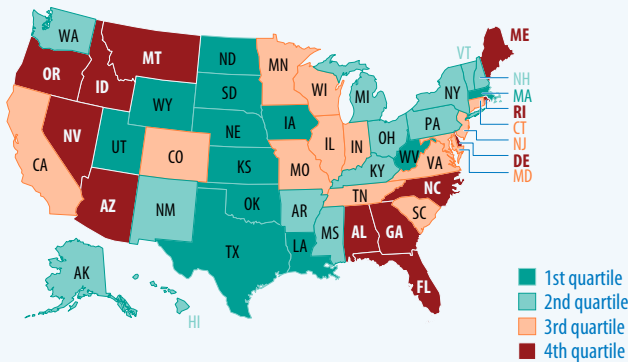
U.S. economic growth picked up around the turn of the year, with real GDP expanding 2.8% in the fourth quarter and early January readings on employment, auto sales and manufacturing looking firm. Economic trends, however, vary significantly by region—Chart 1 sketches out state economic performance across the country<sup>1</sup>.

Performance is generally strongest in states that have a relatively high exposure to energy, as exploration and drilling activity in the Bakken formation continue to fuel growth. Agriculture-heavy states in the Midwest are also

performing well, with farmland values rising at a very strong clip. Some manufacturing-intensive states are also seeing activity pick up. While the level of manufacturing payrolls is still extremely depressed, employment in the sector grew at the fastest pace in 13 years in 2011, and auto production is rebounding sharply after a volatile year. Finally, while there's mounting evidence that the housing market is scraping bottom, prices have gained little traction in most states, and construction remains depressed despite a pickup in multi-unit starts. Those states that saw the most dramatic boom-bust housing cycles (Nevada, Arizona, Florida and California) continue to lag overall economic performance.

**The Midwest region, with its hand in a number of different economic jars, continues to perform relatively well, and should be poised to outperform somewhat in the year ahead.** The broad Midwest economy is made up of two very distinct pieces as far as economic performance goes. In the Western Midwest (WMW—Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota), energy- and agriculture-rich economies have fuelled very strong relative economic performance in recent years, while in the Eastern Midwest (EMW—Illinois, Indiana, Michigan, Ohio and Wisconsin), the auto-intensive manufacturing sector was hard hit during the recession. Indeed, according to our state performance ranking, WMW states occupy 4 of the top 5 spots in the country (*Table 1*), with an average ranking of 13/50, while EMW states carry a much weaker average rank of 28/50.

**CHART 1**  
**THE LAY OF THE ECONOMIC LAND**  
State Economic Performance Ranking<sup>1</sup>



Source: BMO Capital Markets

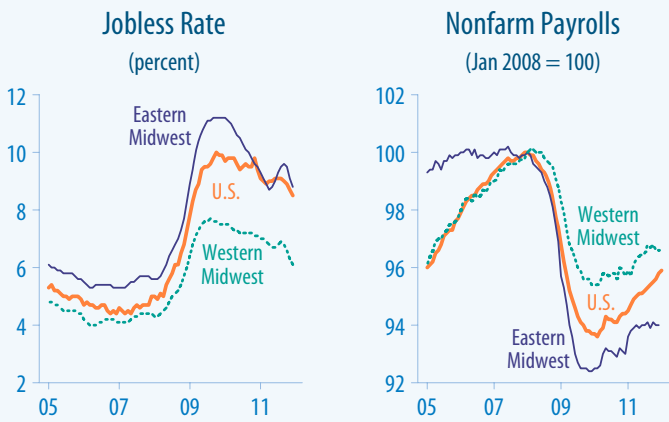
**TABLE 1**  
**SIZING UP THE MIDWEST**  
(ranking out of 50)<sup>1</sup>

State Economic Performance

Western Midwest		Eastern Midwest	
North Dakota	1	Ohio	17
Iowa	3	Michigan	21
South Dakota	4	Illinois	28
Nebraska	5	Wisconsin	34
Kansas	12	Indiana	38
Missouri	31		
Minnesota	36		
<b>Average Rank</b>	<b>13.1</b>	<b>Average Rank</b>	<b>27.6</b>

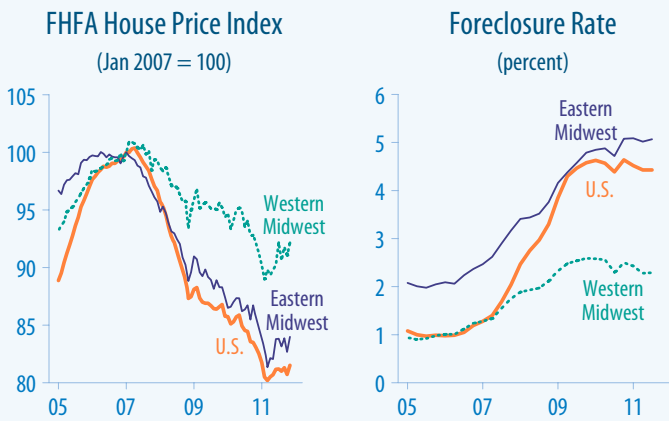
<sup>1</sup> States are ranked based on their relative standing across a range of indicators: Philly Fed Coincident Index, FHFA house prices, exports and the jobless rate. A full ranking table can be found in the latest version of State Monitor: <http://bmonesbittburns.com/economics/reports/20120209a/sm201202.pdf>

**CHART 2**  
**MIDWEST BREAKDOWN – LABOUR MARKET**



Eastern Midwest = IL, IN, MI, OH, WI Western Midwest = IA, KS, MN, MO, NE, ND, SD

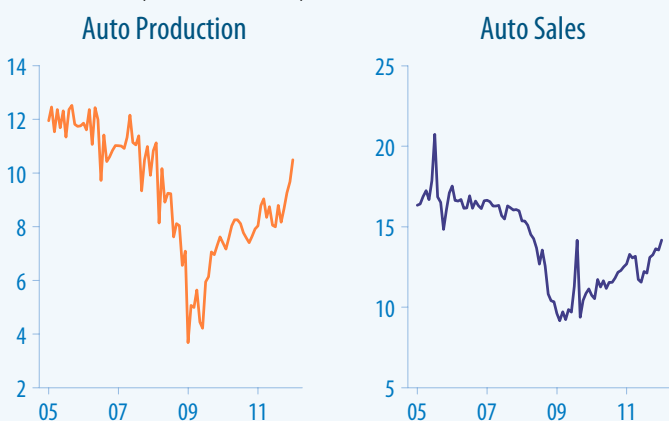
**CHART 3**  
**MIDWEST BREAKDOWN – HOUSING MARKET**



Eastern Midwest = IL, IN, MI, OH, WI Western Midwest = IA, KS, MN, MO, NE, ND, SD

**CHART 4**  
**AUTO-SECTOR REVIVAL**

United States (mlns of units : s.a.a.r.)



As a result, while the Midwest region overall has experienced better-than-average economic performance during the recession and recovery, it has largely been thanks to the WMW states, which have disproportionately benefited from record mining and agriculture output. In the labour market for example, the WMW jobless rate sat at just 6.1% in December, well below the EMW states (8.8%) and the national average of 8.5% (Chart 2). Payrolls have also outperformed significantly in these states. Meantime, the WMW was more of an observer than active participant during the housing bubble, with many states now seeing near-record home prices and surging farmland values (Chart 3). On the flip side, much higher foreclosure rates have had a more severe impact on home prices in the EMW, particularly in Michigan and Illinois.

Fortunately for the relatively beleaguered EMW states, the U.S. auto sector is gaining momentum. U.S. auto sales totalled 14.2 mln annualized units in January, the highest level since May 2008, even eclipsing the cash-for-clunkers high in August 2009. Meantime, factories are ramping up production with auto output hitting the highest level since early-2008 (Chart 4). This is certainly good news for Midwest manufacturers in auto-intensive states like Michigan, Ohio, Illinois and Indiana. Importantly, the strength in the auto sector looks sustainable. After cratering below 10 mln annualized units during the recession, there is significant pent up demand with the average age of the U.S. vehicle fleet at a record high of more than 10 years. Asian manufacturers are also increasing U.S. production, in part due to a strong yen—Honda is doubling the capacity of its plant in Indiana, and could add 1,000 jobs—while the Big 3 are investing in their U.S. operations. Granted, much of the activity is taking place in lower-cost southern states like Alabama and South Carolina, but a revived U.S. auto sector is still a clear positive for Midwest producers and parts suppliers.

**The Bottom Line:** Economic performance varies significantly across the U.S., and the Midwest is poised to modestly outperform. Energy- and agriculture-heavy states in the western flanks of the region should maintain their strong relative performance, while a strengthening auto sector will help revive growth in the east.

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