

CURRENT BUSINESS TRENDS

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Still slightly negative. That's the latest word on the Greater Grand Rapids economy, according to the data collected in the third and fourth weeks of November. NEW ORDERS, our index of future business activity, remained negative at -3, although slightly better than the -8 we reported last month. The PRODUCTION index slipped marginally to -11 from -9. Activity in the purchasing offices remained subdued at -14, down from -17. With all of these negative numbers, it is at least gratifying to see the EMPLOYMENT index improve modestly to +5 from -2. All in all, this is not the kind of numbers that we would like to be reporting. However, at this time, we have no evidence that we are in for anything more than a slowdown.

As we look at individual industries, most of our groups are fairly mixed. Our local auto parts producers were either sharply down or sharply up, depending on the customers they are supporting. The same pattern was evident in the office furniture business, with a couple of firms reporting business conditions as very good, but other firms still struggling. For the capital equipment firms, the reports were flat. One of these firms noted that most of their orders were being shipped out of state, and questioned what the future holds for Michigan. Although the results for industrial distributors came in mixed, the bias was to the up side.

Turning to the national level, the December 1 press release from the Institute for Supply Management, our parent organization, confirms that the industrial economy has turned modestly negative. ISM index of NEW ORDERS continued its slide to -5, down from -1. The PRODUCTION index declined to -4 from +2. For the third consecutive month, the EMPLOYMENT index remained at -3. ISM's overall index slid below the all-important level of 50.0 to 49.5 for the first time in 41 months, depicting a contracting economy at the industrial level. In semi-confirmation, J.P. Morgan's Global Report on Manufacturing, which computes an average of business condition for 23 industrial nations, came in with an index of 53.3, the lowest reading in 15 months. However, for the non-manufacturing sector, the index reported in ISM's December 5 press release came in at 58.9, just slightly ahead of the 58.5 index reported last month. Since any level ahead of 50.0 depicts growth, the report notes that the service sector is still growing at a modest rate.

Just as we do every year at this time, we look ahead to what the New Year will bring for the Southwestern Michigan economy. Here are the major factors to be considered:

Automotive. After robbing Peter to pay Paul with generous sales incentives for the past three years, the Big Three have run out of steam for selling cars. Orders for our local auto parts producers for the first quarter of 2007 have been cut by as much as 20% from the original estimates. Just like last year, the reverse is true for auto firms like Denso and TRMI, who continue to set sales records and expand capacity.

Industrial Inflation. For the last few months, the prices for some key commodities like plastic resins, copper, aluminum, and steel have moderated. Other commodities like zinc and nickel are still five times the price levels of three years ago. Barring unforeseen trauma in the major oil producing countries, the price of oil should continue to moderate at around \$60 per barrel. Given the continued moderation of the world economy, industrial inflation should stay in check for the first half of the year. However, another bad hurricane season in 2007 could cause huge problems.

Consumer Inflation. Most consumers are already enjoying the dividend created by the lower cost of gasoline. The dollar has only fallen about 6% against the Chinese Yuan, which will continue to keep Chinese goods cheap. The good news is that cheap goods reduce inflation. The bad news is that it costs American jobs. Natural gas, which is already back up to about \$8, could go higher if the winter heating season turns out to be unusually cold. Just as last year, the cost of medical care will continue to escalate at an alarming rate. Bottom line: Consumer inflation for 2007 will run about 3.5%

Interest Rates. After seventeen consecutive hikes in the Fed Funds rate, the attempts to increase lending rates are finally successful, and mortgage rates as well as other lending rates have edged up. Unless there is an unforeseen and sustained surge in inflation, the Federal Reserve will probably hold rates steady for the first half of the year.

Real Estate. Sales will continue to slow for the first half of the year. Nationwide, our region of the country is not as overbuilt as others. However, with so much national media talk about massive price drops in other regions of the country, would-be buyers will continue to demand lower prices. The showdown in new construction will be a drag on the economy, but not nearly enough drag to cause a recession.

Retail Sales. It appears that retail sales for the Christmas season will be acceptable, but will run below the overly optimistic expectations of some forecasters. The ability to borrow against home equity for consumer purchases has nearly reached its upper limit. After the first of the year, the higher cost of credit card interest, along with the slowing economy, will probably begin to cut into retail sales.

Unemployment. Regrettably, the national unemployment rate will probably weave higher throughout 2007. The unemployment picture for Michigan will remain negative, and probably escalate with plant closures. Although there will be new jobs in some sectors, these gains will be offset by the loss of manufacturing jobs. The decline in market share for Chrysler, Ford and GM will continue, and foreign name plates like Honda and Toyota will continue to expand.

Overall Economy. For 2007, we expect the growth rate for the industrial sector to remain flat for our region of the state. The lower cost of oil and oil products will offset the negative impact of the housing slump. The lower cost of some key industrial commodities will improve the profitability of some local firms. Automotive in Michigan will continue to slide. The biggest threats of a recession will come from (1) the falling value of the dollar, and (2) the ever-present threat of a terrorist attack. Odds of a recession in 2007: One in three.

COMMENTS FROM SURVEY PARTICIPANTS

"Takeover jobs are our saving grace. Profits are expected to be between 2.0% and 3.0%. The company goal is to be at 12%."

"Things are slowing down for us. However, this will still be our best year ever."

"Our backlog is dropping, and we need new orders soon."

"What will automotive do after the holidays? Will it be a slow startup?"

"We have moved production to four 10 hour days, and will close production the weeks of Thanksgiving and Christmas. We met our sales goal at the last major show, but have to wait until February shows to determine if these adjustments will be all that is needed."

"The fourth quarter has been a roller coasters ride in automotive. We had layoffs in October, and are working 6 and 7 days a week in November. If the pattern holds, the outlook for December is bleak."

"The transportation funding is stagnant. Our raw materials, operating fluids, and supplies are up, and staffing levels are down. Service levels to the public are expected to be reduced."

"We have had record annual sales, but it still feels like we're struggling. Profits are elusive and fleeting."

"We remain active reviewing RFIs and RFPs from our customers. Hopefully, some of these will come to fruition and help solidify late 2007 and 2008."

"Our sales are driven by the housing market, which is falling."

"We are very busy with new integration and moving of our world headquarters to Kentwood,"

"Any orders we are getting for capital equipment are being shipped south to Alabama, Tennessee, Georgia or Mexico. This is sad for Michigan!"

"Our sales are strong through the rest of 2006."

"Metals remain volatile. The forecast for automotive over the next few months is down."

"We are working on budgets for the next year. It looks like materials will continue to increase, and budgeting is up 5%."

"Prices related to the building industry are very competitive."

	UP	SAME	DOWN	N/A	Nov. Index	Oct. Index	Sept. Index	13 Year Average
Sales (New Orders)	31%	32%	34%	3%	- 3	- 8	+16	+16
Production	23%	34%	34%	9%	-11	- 9	+ 4	+16
Employment	28%	49%	23%		+ 5	- 2	+ 0	+10
Purchases	23%	40%	37%		-14	-17	- 2	+ 9
Prices Paid (major commod.)	14%	80%	6%		+ 8	- 4	+ 9	+13
Lead Times (from suppliers)	9%	82%	9%		+ 0	- 2	+ 9	- 7
Purchased Materials Inv. (Raw materials & supplies)	20%	49%	20%	11%	+ 0	+ 0	+ 0	-10
Finished Goods Inventory	14%	52%	23%	11%	- 9	-13	- 4	-11

Items in shot supply: Some stainless steel, particleboard, fiberglass, zinc, engines.

Prices on the UP side: Stainless steel, some plastic resin, some copper, powder paint, aluminum & zinc die-castings, brass, aluminum and aluminum extrusions, diodes, filters, emulsions products, bituminous products, some steel.

Prices on the DOWN side: Carbon steel, polyethylene, some copper, some steel, some plastic resin, acetone, particleboard, computer items, building materials,