

CURRENT BUSINESS TRENDS

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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 September. NEW ORDERS, our index of business improvement, slid to -2, down from +5. The PRODUCTION index also eased to -5 from +0. However, the worst statistics came from the EMPLOYMENT index, which sank to -26 from -8. Activity in the purchasing offices, which we report as our index of PURCHASES, remained negative at -11 only slightly better than the -17 we reported last month. Although two successive down months still does not constitute a trend, we must now be more vigilant as we march toward the end of the year.

Looking as we always do at individual industries, at least some of our current weakness can be attributed to automotive. Several of our major industrial groups, especially office furniture, capital equipment, and industrial distribution, remain stable at their current levels. It almost goes without saying that any firm connected to construction or building products is feeling the pinch of reduced activity. It is also noteworthy that almost any firm that is selling outside of Michigan is doing quite well.

Turning to the national economy, it is not really a surprise to find that the national economy is doing better than the Michigan economy. The October 1 press release from the Institute for Supply Management, our parent organization, posted modest improvement. ISM's index of NEW ORDERS edged up to +9 from +6, despite predictions that the index might be flattening. In a similar move, the PRODUCTION index rose to +15 from +8. The EMPLOYMENT index came back to +0, up from -1. Because of statistical adjustments, ISM's composite manufacturing index moderated to 52.0, down from 52.9. For the service sector, ISM's composite non-manufacturing index edged lower to 54.8, down from 55.8.

At the international level, the economy continues to moderate primarily due to the global impact of the lingering sub-prime lending crisis. In the October 1, 2007 J.P. Morgan report on global manufacturing, the author noted that the current data show evidence that the global manufacturing sector has "...entered a new phase of slower expansion." Countries showing upticks included Germany, Italy, Brazil, and India. Countries reporting slower growth included Japan, UK, France, and Turkey. In the service sector, JPM's index of global services remained positive, but eased to 54.9, down from 56.5. Overall, the tone of both reports was much less bullish than recent months, although no mention was made of the dreaded "R" word.

A recent editorial in the Kalamazoo Gazette was entitled, "If You Seek a Dysfunctional Peninsula, Look About You." On October 1, the state government shut down briefly for a few hours in order to force a decision on new taxes to balance the state budget. Few business expect any significant impact from the increase in personal income tax. Unfortunately, the decision was made to extend the state sales tax to the service sector. Many businesspeople are OUTRAGED over the imposition of a heretofore untaxed portion of our state economy. For some businesses who must pay this new tax, it will mean millions of dollars in new taxes that were not predicted or budgeted. For the service providers, it means additional costs of installing new software and otherwise gearing up for a new reporting and collection system. All of this will cost Michigan more jobs.

Since our last report, we have gotten past two very short strikes in automotive. Although most people from both labor and management are pleased with the outcome, it is still obvious that the Big Three still need to begin building cars that people want to buy, and begin restoring confidence in the traditional brand names. According to Automotive News, Ford sales for the month of September were down 20.4%, and Chrysler saw a 5.4% drop. General Motors managed a very modest gain of 0.3%. Overall auto sales were down 2.8% for September, which clearly indicates that the whole auto sector is slowing.

Turning to inflation, our current numbers continue to depict modest price pressure for most non-petroleum industrial goods. At the national level, ISM's index of PRICES eased to +18 from +26. For Southwestern Michigan, the index edged up to +20 from +13. For the Greater Grand Rapids survey, the index was virtually unchanged at +15, up from +14. Because of the high price of oil, petrochemicals and most plastic resins are still escalating in price to record levels. Because of an oversupply, gasoline and diesel fuel have remained lower in price than expected. Most of the oversupply appears to have come from gasoline brought in from offshore refineries in anticipation of at least one major hurricane causing refinery disruptions. With only a few weeks to go in the current hurricane season, these inventories are now being put out on the market. Some analysts still warn of possible spot shortages as reformulated gasoline regulations shift formulation for the winter season, although no problems have arisen to date.

Despite the optimism brought about by our current inflation numbers, the falling dollar has the impact of increasing the relative price we must pay for all commodities that we import. Hence, the industrial purchasers are concerned that the price of key commodities like lead, copper, and aluminum may soon start edging up. However, the economic impact of the falling dollar is partially offset by the general slowing we are seeing in the entire world economy. We are hoping that the dollar will stabilize at the current levels, and that more interest rate cuts will not be necessary.

Summary. Although the possibility of a recession cannot be ruled out, the odds are better than 50/50 that we will experience no more than an economic slowdown for the better part of the next nine to twelve months. The housing fiasco and the sub-prime bust have a long way to go before they have run their course, but other sectors of the economy, especially those relating to exports, are still doing very well.

COMMENTS FROM SURVEY PARTICIPANTS

"High oil costs combined with tight capacities continue to drive up raw material costs."

"There are many opportunities in the wings. We are awaiting the new fiscal year."

"Furan resin prices have increased by 30% since June of this year!"

"It appears we finished the year very close to projections. Next year appears to have tremendous potential, possibly doubling our gross sales. We are still maintaining tight control on all spending."

"It looks like some major programs will launch in the fourth quarter. That should make us very busy."

"Our sales are normally very strong this time of year. However, this month we're going to be down 15%."

"Our sales were down slightly. We are still very busy."

"Status quo will run through the end of the year. We are optimistic about an upturn in January."

"The effects of the slower housing and construction market are catching up with us."

"Invoices have increased, but mostly for used equipment. There is a lot of competition out there for 'any' inquiry!"

"With the uncertainty of the State budget funding, we are doing our best to contain costs and delay projects while still maintaining a good level of service."

"Our customers are demanding price concessions, and we are trying to find them. Manufacturing continues to go offshore."

"Oil is setting record highs. Our last quarter is always slow."

| | UP | SAME | DOWN | N/A | Sept. Index | Aug. Index | July Index | 13 Year Average |
|--|-----|------|------|-----|----------------|---------------|---------------|--------------------|
| Sales (New Orders) | 24% | 47% | 26% | 3% | - 2 | + 5 | + 3 | +16 |
| Production | 21% | 47% | 26% | 6% | - 5 | + 9 | + 3 | +16 |
| Employment | 6% | 62% | 32% | | -26 | - 8 | + 0 | +10 |
| Purchases | 15% | 59% | 26% | | -11 | -17 | + 3 | + 9 |
| Prices Paid (major commod.) | 18% | 79% | 3% | | +15 | +14 | +15 | +13 |
| Lead Times (from suppliers) | 9% | 79% | 12% | | - 3 | + 5 | + 6 | - 7 |
| Purchased Materials Inv. (Raw materials & supplies) | 18% | 55% | 18% | 9% | + 9 | - 2 | +15 | -10 |
| Finished Goods Inventory | 12% | 58% | 21% | 9% | - 9 | - 5 | + 6 | -11 |

Items in shot supply: Casting, forgings, plasticizers, paraffinic oil, some filters, fasteners.

Prices on the UP side: Some corrugated, pvc resin, pp, gas, casters, carbon black, polyethylene, brass, linerboard, polystyrene, chemicals, surfactants, solvents, ethylene, pulp, paper, food items, cleaning supplies, gasoline, low carbon steel, asphalt (hot & cold mixes), salt, grader blades, contractual service, adhesives, some plastic extrusions, copper, FA resin, oil, parts from China.

Prices on the DOWN side: Some stainless steel, paraffinic oil, nickel, switching devices, plumbing supplies, some resins, propylene, aluminum, some corrugated, computers & computer services, steel.