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Current Business Trends

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Summer Doldrums

Once again, summer is over. According to our latest survey of the West Michigan economy conducted during the last two weeks of August, NEW ORDERS, our index of business improvement, remained positive but backtracked +6 from +10. In a similar move, the PRODUCTION index tapered to +6, down from +18. The index of PURCHASES, which tracks activity in the purchasing offices, fell sharply to -3, down from +14. The inventory indexes representing both FINISHED GOODS and RAW MATERIALS continue to show inventory accumulations well above normal. However, despite the dubious numbers from earlier in the year, the Southwestern Michigan economy remains slow but stable. In addition, most of the comments from this month's survey participants are positive, even though there is at least some uncertainty about the last few months of the year. For corporate America, August is a month when big decisions are often deferred. In the waning days of summer, we are drawn to summer activities and summer vacations. For automotive, the major manufacturers switch production to the new model year in July and August and also take a week or two of downtime to balance inventories. September is a back-to-work month, so we will hope to see some improvement in our next report.

Looking at local industrial groups, Mike Dunlop's quarterly survey of the office furniture industry released on August 16 came in at an optimistic 56.03, only a little below the July 2005 record of 59.72. Our office furniture survey respondents are less optimistic, and tend to depict the current market as somewhat saturated. Two survey respondents noted that office furniture sales may drift slightly lower in coming months. In a similar vein, the auto parts producers are beginning to feel the pinch from declining auto sales in certain segments, such as traditional economy cars. For most automotive suppliers, business conditions are still good, but there is a feeling that the last half of the year will be a little less robust. Most industrial distributors are stable, but three of this month's respondents turned in strong results. The capital equipment industry remains checkerboard because of the large variations from industry to industry.

The business sentiment numbers for August remain positive, and the overall pattern was little changed. The SHORT TERM BUSINESS OUTLOOK, which asks about the perception of the next three to six months, was virtually unchanged at +15, down from +16. The LONG TERM BUSINESS OUTLOOK for July, which depicts the outlook for the next three to five years, rose modestly to +46 from +39.

The September 1 report from the Institute for Supply Management, our parent organization, came in more pessimistic than expected. NEW ORDERS, ISM'S index of business improvement, dropped to -4, down sharply from July's +12. In a similar move, the PRODUCTION index backtracked to -3 from +8. ISM's EMPLOYMENT index, which held steady at an anemic +2 for three consecutive

months, fell to a negative reading of -3. ISM's overall index dropped 3.2 percentage points to 49.4, slightly below the all-important 50.0 break-even point. Many years ago, a drop of this nature in the ISM index would have been a cause for concern. However, ISM's database is no longer as solid as it should be, and this month's report is most likely a statistical fluke.

A much more positive view of the U.S. economy comes from the September 1 press release from Markit.com, the international economics consulting firm. The seasonally adjusted Markit PMI came in at 52.0, a little slower than July's 52.9 but still comfortably above the neutral 50.0 value. NEW ORDERS, EMPLOYMENT, and PURCHASES were all positive, but at a slower pace. However, the PRODUCTION index rose well above the July levels. Markit's chief economist further noted:

"Despite the PMI falling in August, the survey suggests the third quarter is shaping up to be the best quarter so far this year for manufacturing, with output growth picking up compared to the first half of the year on the back of improved export sales. The overall rate of expansion remains only modest, however, and the upturn fragile. Weak domestic demand remains a drag on order books. Concerns about the outlook have also resulted in a marked reduction in the rate of job creation."

Turning to the world economy, the J.P. Morgan Global Manufacturing survey of 31 nations released on September 1 noted that the world economy "...remained in low gear in August." JPM's index of NEW ORDERS remained positive but edged lower to 51.0 from 51.4. The PRODUCTION index increased to 52.1 from 52.0. The J.P. Morgan Global Composite Purchasing Manager's Index tapered to 50.8, down from 51.0. Among the major economies of the world, Japan, South Korea, and Malaysia all posted modest increases. In Europe, the Northern countries including Germany, the Netherlands, and Austria, are providing the main power to the expansion, but elsewhere the picture is looking more subdued. France and Italy are in decline. After the dust settled from the Brexit vote, the August PMI for the U.K. came in at 53.3, up considerably from two months ago. Otherwise, the survey author and chief economist for Markit further noted:

"The August survey was a bit of a disappointment since it failed to deliver on improvements from July. The sluggish trends in new orders remains the main constraint and this will need to improve if global IP growth is to progress in the latter part of this year."

For the most part, industrial inflation remains subdued. Locally, our index of PRICES came in at +2, well below last month's +12. At the national level, ISM's index of PRICES eased to +6 from +10. Except for steel and a few types of plastic resins, prices for most other industrial commodities

remain remarkably stable. Commodity prices are also influenced by changes in currency valuations, and the G-20 governments have now pledged to "avoid" devaluing their currencies to boost exports. The group further pledged opposition to "...protectionism on trade and investment in all its forms." Needless to say, this is an election year, and this discussion is just beginning. The recent G-20 summit also addressed the issue of excess steel capacity, which has resulted in steel being "dumped" on the world market, especially by China. The prices for most grades of steel had been down considerably. In retaliation for "dumping," the U.S. and other nations have slapped stiff import tariffs on Chinese steel. Over the past two months, almost every grade, shape, and type of steel is now up in price. Fortunately, other major commodities like copper are not impacted and are still stable in price.

Like it or not, automotive sales continue to be a benchmark for future economic health for West Michigan. The latest report from Automotive News posted a 3.5% decline in U.S. auto sales for August. However, U.S. auto sales are reported as "cars and light trucks." Unfortunately, almost all of the sales expansion for the past two years come from the sales of trucks and crossovers, not from traditional two and four-door sedans. In fact, sales for the typical family sedan are now down 26% over a year ago. For the individual Detroit manufacturers, Ford sales declined 8.8%, and GM slipped 5.2%. Because of the overwhelming popularity of Jeep, Fiat Chrysler eked out a 2.9% gain. For the other major brands, Toyota eased 5.0%, Nissan slid 6.5%, and Honda tapered by 3.8%. Because dealer inventories have now climbed to two-year highs, even the aggressive Labor Day sales incentives are unlikely to spark stronger sales. Subprime auto loans are again being pushed, and cashback incentives continue to grow. As the Automotive News editor notes:

"In an absolute sense, auto sales remain very strong. But the August results add to a growing

narrative that 2015 sales were back-loaded, 2016's are front-loaded, and this year will miss becoming a seventh-straight year of growth."

The employment picture for the West Michigan industrial economy remains positive, although it was disappointing to see our EMPLOYMENT index slip back into single digits. For August, our West Michigan index eased to +6, down from +14. Of the 83 Michigan counties, Ottawa County's unemployment rate now stands at 3.6%, the second lowest in the state. Kent County took fourth place at 3.4%. Allegan County was sixth at 3.9%, and Kalamazoo County posted twelfth at 4.4%.

From comments from our survey participants, we know that the shortage of workers has inhibited our economic growth in West Michigan for the past three years. It now appears that the situation is getting worse. Several firms have put expansion plans on hold because they do not believe they can find enough QUALIFIED workers to perform the necessary tasks. As one survey respondent put it, "Everyone I speak with in the West Michigan area is struggling to find and retain good employees."

So where do we stand? First, it is worth repeating that there is no indication that we are sliding toward a recession. If anything, the latest round of statistics from our local survey and other PMI surveys around the world have depicted stable but slow business conditions. Some countries, like Nigeria, Brazil, Russia, France, and South Africa, are having trouble, but others like the United States, Germany, and Ireland are keeping the world economy afloat. China remains a concern, but the August PMI from Caixin came in at the break-even point of 50.0. With a pattern of slow growth around the world, it is not surprising to see West Michigan continuing to depict the same boring pattern of slow growth we have been reporting for the past seven years. But slow growth is still better than no growth.

AUGUST COMMENTS FROM SURVEY PARTICIPANTS

"We are busy this month. At this time, September and October look slower."

"Typical summer. We now wait for the next fiscal year."

"Our backlog is good thought the fourth quarter, but new PO's are showing signs of softening."

"We are seeing a little softening in our forecast for September and the fourth quarter."

"Stamping and fastener suppliers are facing pressure on material lead times stretching out, especially for steel products. Everyone I speak with in the West Michigan area is struggling to find and retain good employees. It's a real issue!"

"We are starting to receive price reductions on some components by moving some purchases to India and China from the U.S."

"We have a large IMTS machine tool show coming up next month and are already seeing competition trying to win orders with very low pricing well before the show! We should see an uptick in orders because of the show."

"Since the large trucking industry is down, our sales and orders have drastically decreased since January of 2016. The front office personnel will be taking a decrease in pay to make up for the last two months of losses. We will also be making cuts out on the production floor."

"Orders are good, but it is hard to find operators to run the machines."

"Polypropylene suppliers are announcing increases in excess of the index. Our key customer took two weeks downtime this year, so our sales are down and inventories are up for this time of year compared to the last couple of years."

"August was a very good month for us. Sales are twice as high as last year."

"Our business has come back to our budgeted plans after a few months of softer schedules."

"It's been a very busy summer! We're hoping to get all of the construction projects completed before the snow flies."

"Business is pretty flat compared to last month, and last month was slow. It's kind of in the blahs right now."

"We're flat this month."

"Our short term sales outlook is down due to some regional aircraft orders slipping out to the back half of the year. Employment down as management is holding back on hiring until it becomes more certain that the sales will be back."

"Aluminum continues to maintain longer than normal lead times."

"The medical business has really picked up, and the machine tool business is beginning to come back."

"Companies that have spent large amounts of capital in the last year are currently setting back and digesting what they have bit off. This will be short term and will not affect their longer term plans."

"The third quarter ended strong, and the fourth quarter forecast is solid."

"For us, the summer slowdown is being felt in August. We heard that auto inventories on dealer lots have two months of supply for the first time in years. This could be a sign the auto sector is cooling a bit."

"The end of the year is coming quick, and releases appear to be strong."

"Sales are still soft, no improvement is expected anytime soon."

"We pulled many orders from September into August to make the month look good."

"Bullish is our attitude."

"We are very busy. Our production is running 24/6 to keep up. Production workers are in short supply."

August 2016 Survey Statistics

	UP	SAME	DOWN	N/A	Aug. Index	July Index	June Index	25 Year Average
Sales (New Orders)	30%	44%	24%	2%	+ 6	+10	+ 6	+14
Production	25%	50%	19%	6%	+ 6	+18	+11	+14
Employment	19%	68%	13%		+ 6	+14	+12	+ 8
Purchases	24%	55%	21%		- 3	+14	- 7	+ 7
Prices Paid (major commod.)	8%	86%	6%		+ 2	+12	+15	+15
Lead Times (from suppliers)	11%	83%	6%		+ 5	+ 3	+10	+11
Purchased Materials Inv. (Raw materials & supplies)	25%	54%	13%	8%	+12	+11	+11	- 4
Finished Goods Inventory	26%	60%	6%	8%	+20	+ 9	+10	- 8
Short Term Business Outlook (Next 3-6 months)	32%	51%	17%		+15	+16	+26	-
Long Term Business Outlook (Next 3-5 years)	48%	47%	2%	3%	+46	+39	+35	-

Items in short supply: Ultem, aggregates, construction supplies and equipment, quality production employees, galvanized steel, factory labor, steel tube, electrical components.

Prices on the UP side: Nylons, polypropylene, steel, stainless steel, cold rolled steel, coated steel, plasticizers, paraffinic oil, aggregates, construction supplies, slag stone, fuels, refrigerants, aluminum, aluminum ingot, lumber, base metals, wages, electronic components, wood products.

Prices on the DOWN side: Hot rolled steel, salt, steel,* carbon steel, cold rolled steel.*

*Note: All items marked with an asterisk are reported as BOTH **up** AND **down** by different survey participants.

Latest Unemployment Reports

(Except as noted, data are **NOT** seasonally adjusted)

	July 2016	July 2015	Aug. 2009	20 Year Low
State of Michigan (Adj.)	4.5%	5.2%	14.6%	3.2%
State of Michigan (Unadj.)	5.4%	6.4%	14.1%	2.9%
Kent County	3.8%	4.4%	11.9%	2.1%
Kalamazoo County	4.4%	5.2%	11.1%	2.1%
Calhoun County	5.0%	6.0%	12.8%	2.7%
Ottawa County	3.6%	4.2%	13.3%	1.8%
Barry County	4.2%	4.7%	10.9%	2.2%
Kalamazoo City	4.9%	5.8%	15.2%	3.2%
Portage City	3.6%	4.3%	8.7%	1.3%
Grand Rapids City	4.5%	5.4%	16.1%	3.0%
Kentwood City	3.2%	3.8%	10.7%	1.4%
Plainfield Twp.	2.5%	3.1%	8.0%	1.4%
U.S. Official Rate (June)	4.9%	5.3%	9.6%	3.8%
U.S. Rate Unadjusted	5.3%	5.6%	9.6%	3.6%
U.S. U-6 Rate**	9.7%	10.3%	16.7%	8.0%

**U-6 for Michigan = 10.8% for Q2 of 2016

Index of New Orders: West Michigan

As the name implies, this index measures new business coming into the firm, and signifies business improvement or business decline. When this index is positive for an extended period of time, it implies that the firm or organization will soon need to purchase more raw materials and services, hire more people, or possibly expand facilities. Since new orders are often received weeks or even months before any money is actually paid, this index is our best view of the future.

Latest Report + 6 for the month of August 2016

Previous Month +10 for the month of July 2016

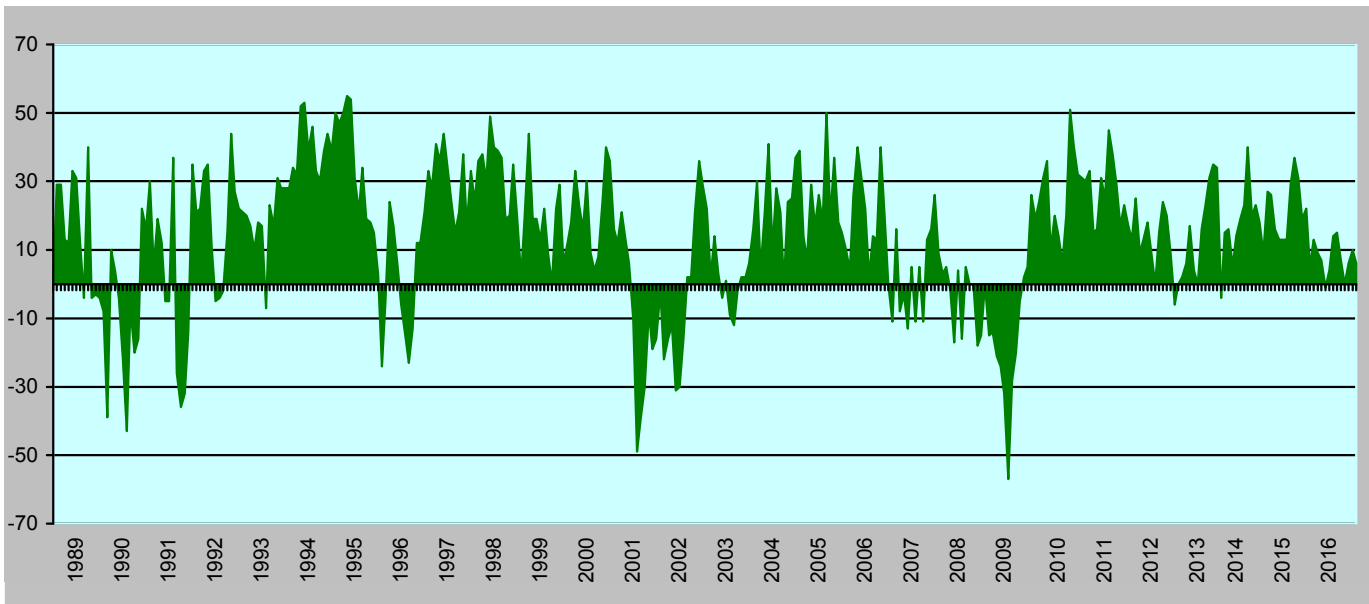
One Year Ago + 5 for the month of August 2015

Record Low - 57 for the month of December, 2008

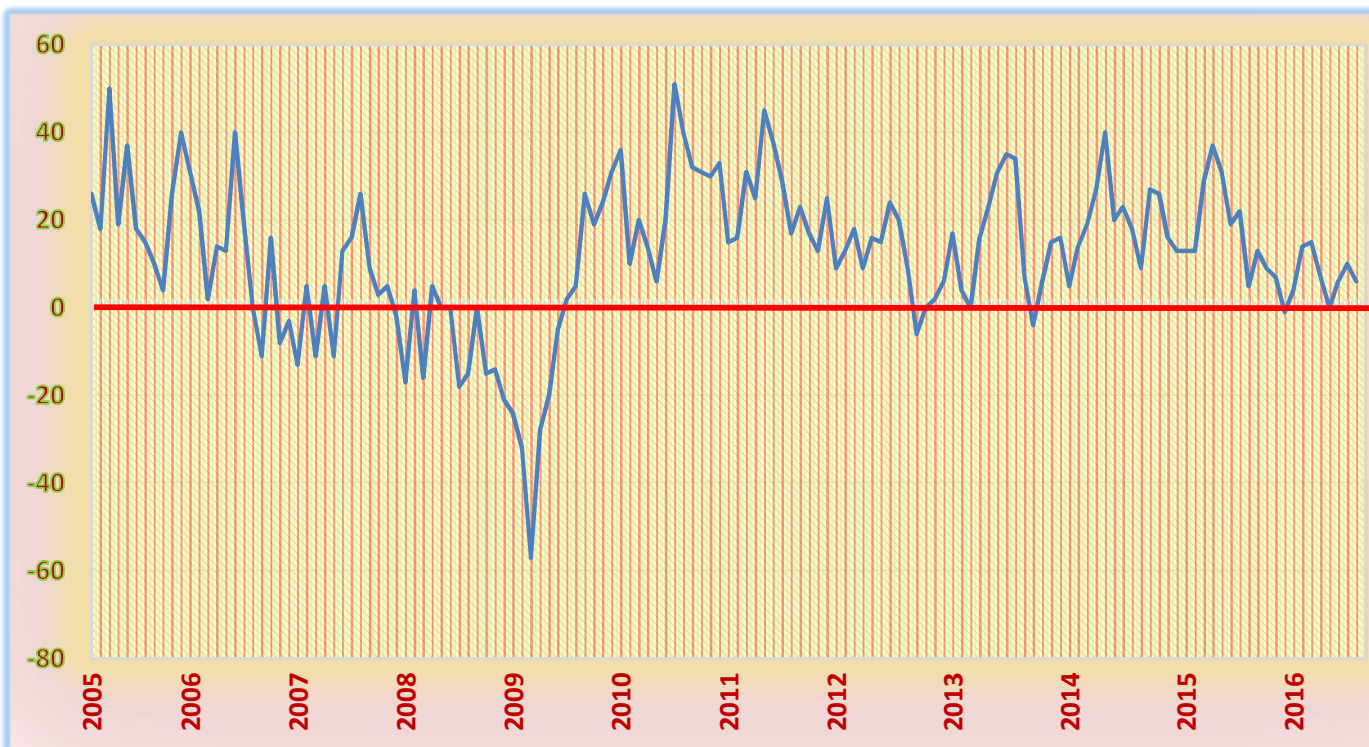
Record High + 55 for the month of September, 1994

First Recovery + 3 in April of 2009 and forward

ISM-West Michigan Index of New Orders 1988 - 2016

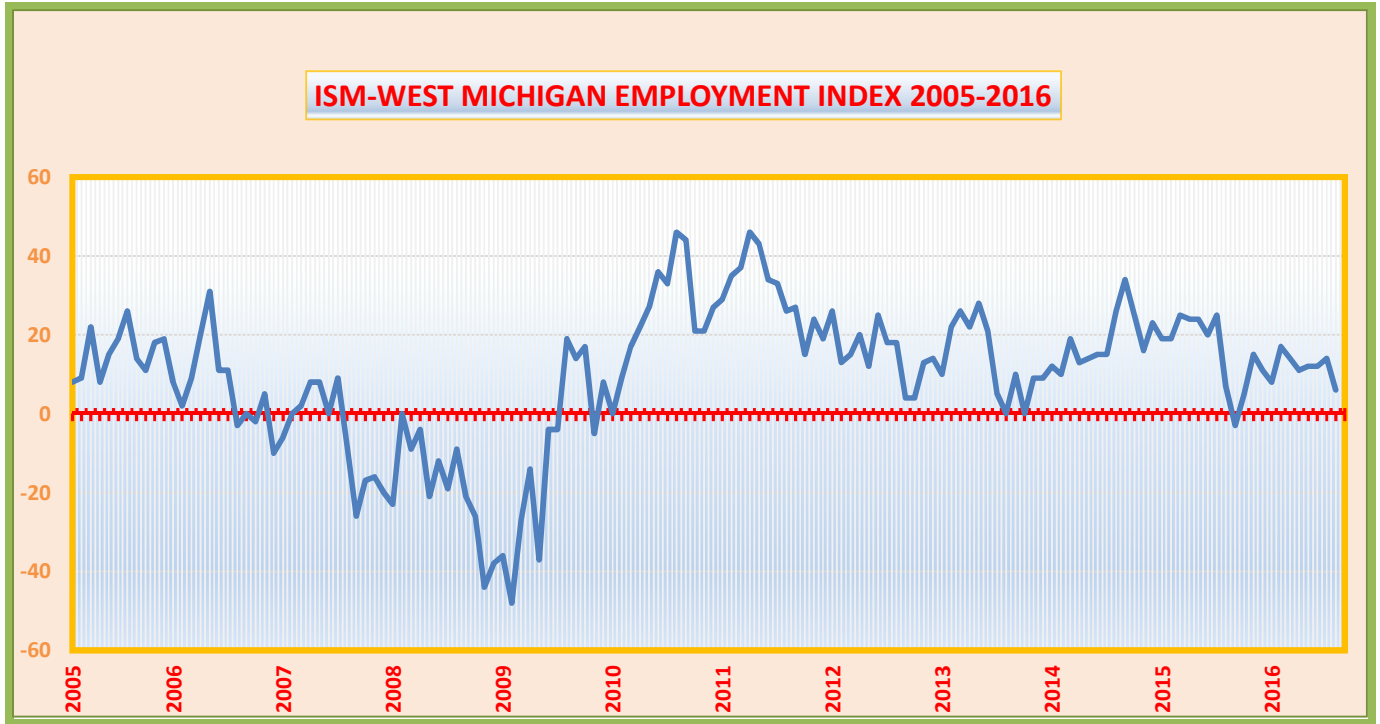


ISM-West Michigan Index of New Orders: 2005-2016 Only



ISM-West Michigan Index of Employment

The index of EMPLOYMENT measures the firm's increases and decreases in staffing, including permanent workers and temps. After economic downturns, it measure new hires as well as previous workers called back to work. When this index is positive for an extended period of time, it almost always signals a reduction in industrial unemployment for West Michigan. Normally, there is about a month or two in lag time between this report and the payroll numbers being reflected by the government statistics. However, almost all employment indexes are laggards, meaning that firms often wait until upticks in orders are confirmed before adding staff, and conversely laying off staff only after a downturn in orders appears to be certain for the foreseeable future.



ISM-West Michigan Future Business Outlook

The indexes of LONG TERM BUSINESS OUTLOOK and SHORT TERM BUSINESS OUTLOOK provide a glimpse at current and future attitudes of the business community. Traditionally, most businesses are more optimistic about the long term, although current event can result in perceptions changing very rapidly. Both short and long term attitudes reflect current business conditions, and are usually higher when sales, production, and employment are positive.

