



institute for
supply management

Institute for Supply Management

Greater Grand Rapids, Inc.
P. O. Box 230621
Grand Rapids, MI 49523-0621

CURRENT BUSINESS TRENDS

Dr. Brian G. Long, C.P.M.
Director, Supply Chain Management Research
Seidman College of Business
Grand Valley State University
(616) 331-7491

August 15, 2008

Moderately down. That's the latest word on the Greater Grand Rapids economy, according to the data collected in the third and fourth weeks of July. Our index of business improvement, which we record as NEW ORDERS, retreated to -15 from +0. The PRODUCTION index eroded to -26, down from -12. Activity in the purchasing offices, our index of PURCHASES, remained negative at -21, just slightly lower than the -20 we reported last month. The index of LEAD TIMES moderated to +2 from the +5 we recorded last month. We are now in our fourth month of negative statistics, so it is probably time to fully acknowledge that the Greater Grand Rapids area is in some state of recession. Given the fate of the rest of Michigan, our numbers have been remarkably resilient up until now. However, with all of our key indexes now coming in as double digit negative numbers, there is no way to sugar coat the current situation.

Looking at individual industries, the auto parts manufacturers are still leading the way down, partially because of weak sales and partially because of extended shut-downs for model changeover. A couple of firms that have contracts for truck components are justifiably concerned about the future. Just as last month, a couple of office and steel furniture firms reported improved orders, but sales for other firms are starting to soften. Two of our capital equipment firms reported receiving some new business this past month, but the sales were to customers either in Mexico or in the southern industrial belt. Industrial distributors were generally flat, which is often typical of summer.

Turning as we always do to the national level, the August 1, 2008 press release from the Institute for Supply Management, our parent organization, came in modestly negative, largely because ISM's all-important index of NEW ORDERS fell to -10 from +4. The PRODUCTION index remained unchanged at +4. Perhaps because of a statistical fluke, the EMPLOYMENT index improved, and edged up to +3 from -9. ISM's composite manufacturing index eased to 50.0, down from 50.2. ISM's non-manufacturing index remained below the break-even 50.0 mark, but came back to 49.5, up from 48.2.

The international economy is not doing as well. J.P. Morgan's Global Manufacturing Report dated August 1, 2008 eroded to 49.0, down from 49.5. Weaker NEW ORDERS were reported in most of the European countries, the U.S., the U.K., and Japan. However, all of the BRIC countries posted increases. The international survey of EMPLOYMENT improved in the U.S., China, and Japan, but declined in almost every country in the Eurozone. Spain was especially hard hit. JPM's survey of the service sector fared no better, and came in at 48.9, down from 49.3.

As we turn to the auto industry, it sounds like a broken record to say that things continue to get worse. Sales for the entire industry for 2008 YTD are now down 10.5%. For the month, Chrysler sales fell 28.8%, GM fell 26.1%, and Ford declined 14.7%. Even Toyota, which once seemed to be immune to downturns, fell 11.9%. Of the major brands, the 1.6% decline at American Honda was the smallest. After owning Chrysler for only a year, Cerberus is now rumored to be looking for someone to buy the company-- even if it means selling at a substantial loss. If it cannot be sold, Chrysler may be the first of the Detroit three to wither away.

Although the slowing economy and tighter credit conditions are often cited as major factors causing the crisis in automotive sales, the biggest problem facing the industry is the poor mix of vehicles offered for sale. Suddenly, everyone seems to want small cars with high MPG ratings, while the dealer lots remain flooded with 8 MPG SUVs. For the past three years, the cost of gasoline has risen in the summer based on hurricanes or threat of hurricanes, and the spike in consumption brought on by summer vacations and recreation. Consumers treated these summer spikes as aberrations, and did little to change their driving habits or be dissuaded by low mileage vehicles. It has only been in the past few months that the higher prices at the pump have started to cause a change in behavior on the part of consumers. One of the most recent statistics reported a 5% year-over-year drop in gasoline consumption. We have to go back to the early 1970s when the world was shocked by the first Arab oil boycott to find this sharp of a drop. For the auto industry, we will now have to go through a slow, painful readjustment to begin building fuel efficient vehicles in plants previously used to produce SUVs and light trucks. Toyota has already announced plans to do just exactly that in one of its Texas plants. This production shift will cost billions. Toyota has the money to make the shift, but the Detroit Three do not.

Turning to inflation, we had hoped that August would be the peak for steel prices. No such luck. We are now in August, and we have no idea how high steel prices can go. Because of multiple buyouts and mergers among steel firms, one of our respondents to this survey has observed that the steel industry has evolved into a monopoly reminiscent of cartels and trusts of the late 1890s. Whereas prices would probably begin to fall if world consumption were to taper off, we don't know when that point in time may come. Any slackening of demand by the U.S. and Europe seems to be offset by the BRIC countries. This same observation can apply to other industries as well, including about half of the key industrial commodities currently skyrocketing in price. Plastic resins clearly fall into this category. The only good news is that base commodities like copper and aluminum ingot are starting to fall in price.

For the immediate future, all of this leaves us in a quandary. Aerospace firms, agricultural firms, and any firms that have significant exports are doing great and can absorb price increases, whereas our local auto manufacturers and auto parts firms are suffering to the brink of bankruptcy. For Michigan in particular, this does not bode well for the future. The price of gasoline will probably continue to moderate, but the damage has already been done. As we have noted in the past, our local economy has periodically lost jobs ever since the onset of the industrial revolution. These jobs were always replaced by other jobs, and the economy has continued to grow. The problem is attracting and bringing in the **new** jobs in at a rate **faster** than jobs are being lost. In short, the next few months are not going to be easy.

COMMENTS FROM SURVEY PARTICIPANTS

"Freight costs from ordering replacement parts from Europe are out of control. Freight costs alone are making my firm less competitive. Unfortunately, the parts I order cannot be purchased in the USA."

"It's a good thing we have the internet. It allows us to deal in machinery needs down South and in Mexico. That is where most of our business is coming from now."

"Business is steady, but not great. August and September are looking much better."

"Nothing left to say. Just keep your head down and push forward. There has to be light in the darkness somewhere."

"Automotive orders have dried up in July, as they normally do. It will be interesting to see if they will recover in August or if this is a longer term situation."

"I keep waiting for pricing to hit a ceiling, but yet it continues to go higher every month."

"Inflation is quite active among the supply base."

"Our whole economy is imploding!!!"

"I was hoping that we had reached the top on steel pricing, but that hope has been dashed."

"What are others doing to offset these increases in raw materials? When will the dollar regain its value vs. the Euro?"

"Our order intake is way down (more than normal for this time of year). Hopefully this will change after the election."

"Lower sales volume, higher raw material and operating costs, and contractually flat or falling selling prices are making this the toughest year in automotive since the early 1990's."

"Government's inflation numbers came out for the second quarter. Wow! What a jump."

"Many of our long term agreements will conclude in early Q4. We feel that we have been monitoring prices rather well, but lengthening lead time for some commodities has me concerned."

"We have had a couple large clients delay jobs. Also, one client is in bankruptcy. It has had a very negative affect on cash flow, and as a result, we are cutting where we can and doing layoffs."

"The global economy is difficult to read. There are many items of uncertainty. US economy changes every day depending on "who" says "what." How will the Olympics affect the economy?"

"New sales orders are down for the first time in a few years - at least for us"

"Parts and logistics cost for parts from China are moving up rapidly."

"I have never seen price increases coming at us so fast, and I've been doing this for more than 30 years"

"We're still trying to do more or maintain the same levels of service with less money!"

"Business is way down. Organizational changes and downsizing in the works. Sales for year are down about 20%."

"Stainless steel seems to have peaked in price. A lot of electrical, hydraulic, and pneumatic components are going up. Carbon steel continues to increase in price."

"Our increase in raw material inventory was planned."

	UP	SAME	DOWN	N/A	July Index	June Index	May Index	13 Year Average
Sales (New Orders)	24%	27%	39%	10%	-15	+ 0	-15	+16
Production	15%	32%	41%	12%	-26	-12	- 9	+16
Employment	10%	54%	29%	7%	-19	-12	-21	+10
Purchases	20%	34%	41%	5%	-21	-20	-15	+ 9
Prices Paid (major commod.)	71%	14%	5%	10%	+66	+73	+76	+13
Lead Times (from suppliers)	12%	71%	10%	7%	+ 2	+ 5	+18	- 7
Purchased Materials Inv. (Raw materials & supplies)	7%	44%	27%	22%	-20	- 8	+12	-10
Finished Goods Inventory	7%	46%	26%	21%	-19	-13	- 6	-11

Items in short supply: Some sizes of steel sheets, tempered glass, styrene, European grade specific steel, aluminum, copper, ceramics, some structural tubing & pipe, cast iron, salt, some filters, SEBS resin, butadiene, paraffinic oil.

Prices on the UP side: All types of fuel, freight, carbon steel sheets, cold rolled steel, regular steel, aluminum and aluminum sheets, corrugated packaging, fuel surcharges. resins, polypropylene, foil, foundry coke, busheling, foundry steel, all grades of scrap, plastics, glass, transportation, plastic resin, chemicals, oil, natural gas, nylon resin, Cycloy, ABS, nylon, packaging, electricity, dunnage, freight, travel, medium and high density fiberboard, plywood, corrugated, brass, nylon tubing, rubber hose, plastic bags, fabric, PVC, petro chemicals, all petroleum based oils & greases, polyurethane, paint, HDPE, guardrail, salt, sand, chlorides, SEBS resin, PVC resin, plasticizer, paraffinic oil, impact modifiers, steel fabrications, chemicals, adhesives, natural gas, diesel fuel, powdered paint, some plastic extrusions.

Prices on the DOWN side: Stainless steel, nickel, brass, some MRO supplies, computers, some technical tools, wages.