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Institute for Supply Management

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CURRENT BUSINESS TRENDS

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The growth rate turns modest. That's the latest word on the Greater Grand Rapids industrial economy, according to the data collected in the last two weeks of July, 2011. NEW ORDERS, our index of business improvement, edged lower from +23 to +17. In a similar move, the PRODUCTION index eased to +21 from +26. Activity in the purchasing offices, our index of PURCHASES, backtracked to +23 from +29. The only modest uptick this month came from the index of EMPLOYMENT, which rose to +37 from +34. Overall, our local statistics are actually stronger than the rest of the country, and we are still on track for continued economic growth. However, the second half of the year is now growing more questionable.

Turning as we always do to our local industry groups, it is the office furniture and automotive sectors that are keeping the statistic positive. For our automotive parts producers, the annual uptick for the 2012 model year is well underway, but production schedules for the rest of calendar 2011 are not as optimistic as they were a few months ago. The office furniture market remains positive, although some firms are still doing better than others. For the third month in a row, industrial distributors came in fairly positive. Just as last month, some capital equipment firms reported a decline in business conditions, while others remain stable. Balancing all of this are the respondent comments at the end of this report, which remain positive although not as euphoric as a few months ago.

At the national level, the results are still positive but anemic. The August 1, 2011 press release from the Institute for Supply Management, our parent organization, reported that NEW ORDERS remained positive but backtracked significantly to +1 from +11. ISM's PRODUCTION index fell to +4 from +16. The EMPLOYMENT index came in at +11, but was considerably below last month's +24. ISM's overall index of manufacturing fell to 50.1, the lowest the index has been since May of 2009. Despite last month's modest uptick, this month's statistics continued to soften, much as we have seen over the past several months. In general, these numbers are in line with the recent GDP growth numbers of 0.4% for the first quarter of 2011 and 1.3% for the second quarter. So far, the third quarter does not look any better.

At the international level, the J.P. Morgan Global Manufacturing report released on August 1 continued to backtrack to a 25 month low. JPM's worldwide index of NEW ORDERS sank below the break-even point of 50.0 to 49.9, down from 50.9. In addition to the US, the countries that are backtracking include most of the Eurozone, most of the BRIC countries, as well as (surprise) China and India. The only country really bucking the trend is Japan, largely because of the massive earth quake rebuilding effort. The survey author is far less optimistic than last month, and notes that "...the global manufacturing sector drifted closer to stagnation in July." The JPM international index of PRICES retreated to 57.7 from 60.8. JPM's overall index eased significantly to 50.6 from 52.3, resulting in the weakest report since the recovery began.

Since our last report, Congress has passed a framework for a modest deficit reduction package along with an extension of the debt ceiling. Unfortunately, a promise for six trillion dollars worth of reductions that was touted a few weeks ago was downgraded to a small fraction. As expected, our creditors around the world were also expecting a more robust package, and their displeasure has been reflected in the financial markets.

Why is the world economy slowing? Many factors are in play. First, countries like China that are having inflation problems are methodically raising interest rates trying to quell the upward escalation of consumer prices. On the industrial side of the world markets, much of the speculation has gone out of the commodity markets, and prices for most industrial commodities are now moderating. Since slower economies mean less demand, the price of commodities will probably continue to drift lower. This is especially true of the market for most types of steel.

A second more serious problem relates to the fact that much of the ENTIRE world has made unfunded promises for retirement pensions and healthcare that they are simply not going to be able to meet in their present form. We have seen numerous protests throughout Europe over the past few years as politicians try to take modest steps toward realistic reform. We have seen another bailout for Greece which does little to solve the long term problem. We continue to see the phrase of "...kick the can down the road" in local, national, and international newspapers.

Is this a "new" discovery? Of course not. Economists have been warning of this problem all over the world for at least the last thirty years. Now that the baby boomers all over the world are now starting to retire the problem is coming to the forefront. This situation in Greece is now starting to spread to other countries, and investors around the world are now beginning to understand just how difficult it is going to be to fix these problems without bankrupting the entire world economy. In short, investors are looking long term, and they are becoming uneasy. The United States, who the world looks to for leadership, has provided none. If, in fact, the world does sink into another recession, it will be because of the worldwide debt situation.

Turning to July auto sales, inventories are still low because of the impact of the Japanese disaster. Sales at GM were up a modest 8%, Ford gained 6%, and Chrysler rose 20%. The major Japanese transplants continued to slide, with Toyota down 23% and down Honda 28%. Nissan posted a very small gain of 3%. For the entire industry, sales were up only 1%. Even though the Japanese firms plan to be back to full capacity by September, the forecasts for fall sales are not as strong because of the slowdown of the overall economy.

Industrial inflation continues to wane. In the Greater Grand Rapids survey, the index of PRICES fell to +23 from +46. In a similar move, the Southwestern Michigan index dropped to +39 from +46. ISM's index of PRICES declined significantly to +18 from +36. Just as last month, the prices for almost all grades and types of steel are still moderating or falling. The price of oil has bounced around in recent weeks, but the markets appear to be adjusting to crude oil in the \$95 range, give or take.

To confuse the situation, some commodities may actually go up in price even though market conditions soften. Copper is a good example of a commodity that is increasingly becoming a "reserve" commodity and a place to store money outside of the financial markets. Gold, silver, and platinum have traditionally been used for this purpose, but some world investors, especially the Chinese, have decided that copper, palladium, and most of the rare earth elements can be used as a safe haven during times of economic upheaval. So instead of putting money in "iffy" dollars, or Yen, or Euros, some investors are buying copper.

In summary, the world economy continues to slow, and the US economy is following suit. The good news is that the numbers are still modestly positive, and there is no clear evidence that we are in for anything worse than a period of frustrating stagnation rather than another recession. Unfortunately, bank credit will remain tight and will probably get tighter, and the housing market will show no sign of recovery. Stay tuned.

COMMENTS FROM SURVEY PARTICIPANTS

"The economy still seems to be very fragile. Interest rates worry me. If they go up substantially it will kill a lot of progress and stymie the rest."

"The economy is slowing. We are going back at those that raised prices and ask them to lower them. The argument is that the problems they cited to raise prices have largely abated."

"We have more new orders this month, but things do seem to be slowing down somewhat from the first quarter."

"We had a record month in June, so business is a little slower this month. The next few months still look very strong."

"The commercial heavy truck build is running at a level far above estimates. We primed our supply base and are keeping our heads above water. If nothing changes, this will be on a level with the highest production numbers ever reached with continued expansion next year."

"Our customers are generally busy but we haven't seen so much negativity and anxiety since the financial crisis."

"Only prices that were not previously raised are being raised 'late to the party.'"

"Inquiries are still trickling in, and orders are slow to follow."

"This is always our busy time of year. It is much better than we thought we would have been last November."

"Although we still slowed down a bit the first two weeks of July, it is nothing like the total shutdown that used to take place in automotive."

"Record demand continues. Normal bookings backlog is four to six weeks. Heavy demand has now pushed bookings out eighteen weeks."

"The world economy is very fragile. Any major problems worldwide could change the whole picture for the worse. We need to keep the speculators from their kneejerk reactions to any little change. This just adds more confusion to the current economic issues."

"We are having a very good year, but are unsure how long the ride will last. Sales are tapering back some."

"Supplier on-time deliveries are suffering due to the high volume of work being sub-contracted."

"A little more than 3 months left of the 2011 budget, and hopefully there will be some revenue increases for the 2012 budget."

"Ordering has been stable. EUR and GBP are damaging. We are now challenging suppliers for improved performance."

"Automotive schedules have slowed a little, but new domestic schedules are strong for the third quarter."

"We've had a great month again. We're starting to see more determined pricing pressures."

"The lead time is going out on everything."

| | UP | SAME | DOWN | N/A | July Index | June Index | May Index | 20 Year Average |
|--|-----|------|------|-----|------------|------------|-----------|-----------------|
| Sales (New Orders) | 41% | 33% | 24% | 2% | +17 | +23 | +17 | +29 |
| Production | 39% | 37% | 18% | 6% | +21 | +26 | +26 | +13 |
| Employment | 45% | 47% | 8% | | +37 | +34 | +43 | + 8 |
| Purchases | 41% | 39% | 18% | 2% | +23 | +29 | +25 | + 7 |
| Prices Paid (major commod.) | 35% | 45% | 12% | 8% | +23 | +46 | +53 | +35 |
| Lead Times (from suppliers) | 22% | 71% | 6% | 2% | +16 | +29 | +38 | +11 |
| Purchased Materials Inv. (Raw materials & supplies) | 25% | 53% | 12% | 10% | +13 | +13 | +16 | - 5 |
| Finished Goods Inventory | 18% | 54% | 12% | 16% | + 6 | + 2 | - 7 | -10 |

Items in short supply: Zinc, purge thinner, Asian electronic parts, powder metal (due to failure of GKN/Hoganeas plant), bearings, rare earth based components, outsourced machining, butadiene, some steel, specialized filters and fittings, PTFE resin.

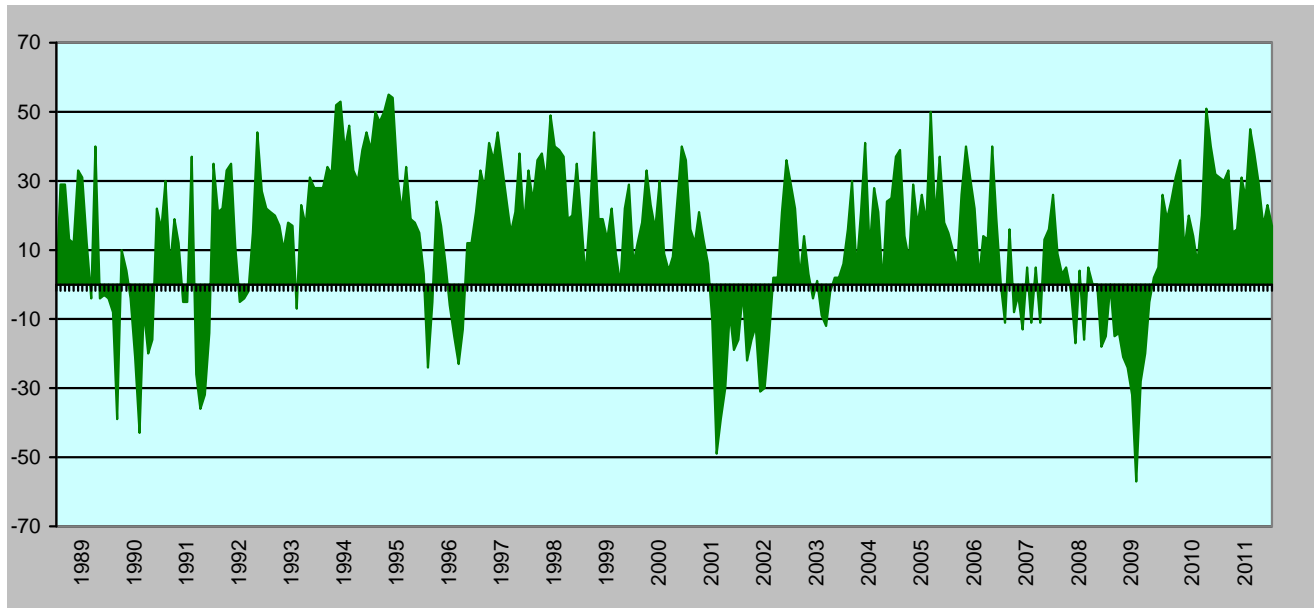
Prices on the UP side: Acetone, surcharges for gas (if you let them take advantage), white WPF maple veneer, MDF, particleboard core, aluminum sheets, powder paint, electronic components, petroleum based products, resins, rubber products, copper pipe & wire, brass, motors, energy, oil and oil dependent items, black pigment, paraffinic oil, SEBS resin, PVC and ABS resins, steel surcharges, salt, trucking services, aggregates, diesel fuel, limestone, rare earth metals, steel rod, scrap steel, some carbon steel, resin based packaging, some polypropylene resin.

Prices on the DOWN side: Poly bags, steel, steel tubing, sheet steel, stainless steel, carbon steel, both HRS & CRS, some polypropylene resin, plasticizer, asphalt prices, overseas transportation.

Index of New Orders - Greater Grand Rapids 1988 - 2011

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 +17 for the month of July, 2011
Previous Month +23 for the month of June, 2011
One Year Ago +31 for the month of June, 2010
Record Low -57 for the month of December, 2008
Record High +55 for the month of September, 1994



Index of New Orders: 2005-2011 Only

