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News Release (For Immediate Release)

July 7, 2014

Current Business Trends

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West Michigan: Slow Growth Continues

Slow growth continues. That's the latest word on the West Michigan economy, according to the data collected during the last two weeks of June, 2014. NEW ORDERS, our index of business improvement, edged up to +23 from +20, still down from April's +40, but still respectable. The PRODUCTION index jumped back to +30 from +16, which corresponds with the June uptick recorded in previous years. The EMPLOYMENT index remained in double digits at +15, up from +14. Purchasing office activity, our index of PURCHASES, rose nicely to +19 from +9. The RAW MATERIALS inventory index jumped to +14 from +0, but the index of FINISHED GOODS INVENTORY flattened to +0.

Reviewing performance for our individual industry groups, the automotive components manufacturers remain strong, although a couple firms seem to have been disappointed with business that was supposed to materialize but didn't. The office furniture business remains stable but flat, and contrary to some forecasts, is not vastly exceeding last year's performance. Smaller office furniture firms are doing better than their larger counterparts. Industrial distributors came in with a mixed performance. Capital equipment firms are stable, but some are doing very well at this stage in the business cycle. The comments from the survey respondents, for the most part, remain positive.

At the national level, the July 1, 2014 press release from the Institute for Supply Management, our parent organization, reported that the U.S. economy remains stuck in a pattern of slow growth. ISM's index of NEW ORDERS backtracked slightly to +15 from +21. In a similar move, PRODUCTION eased to +19 from +26. At +9, it is disappointing to see ISM's EMPLOYMENT index slide back to single digits. ISM's overall Index of Manufacturing retreated modestly to 55.3 from 55.4. Reflecting the same pattern, ISM's Nonmanufacturing index eased to 56.0 from 56.3.

The U.S. statistics from Markit.com, the British international economics consulting firm, are more optimistic. Markit's index of NEW ORDERS rose to 61.2 from 58.8. The production index, which they report as OUTPUT, rose to a four year high of 61.0. The survey author noted, "Business was booming at U.S. goods producers in June.... numbers rose at some of the fastest rates we've seen since the recession..." The survey author also confirms that the smaller firms (1-99 employees) are still not participating in the rally.

At the international level, J.P. Morgan's Global Manufacturing PMI rose to a four month high of 52.7, although the survey author notes that this level is still not spectacular. The Chinese PMI, which had raised caution for world economic stability, rebounded to 50.7 from 49.4, a 13 month high. At 51.5, Japan also

flipped back to positive, up from 49.9. For diffusion indexes such as these, 50.0 is the break-even point. Conversely, the Eurozone PMI eased to 52.8 from 53.5. Of the countries having difficulties, Ireland, Spain, and Italy all turned in strong performances. Germany appears to be stabilizing at a PMI rate of 54.0, but France continues to sink under pressure from both the government and the unions. The situations in the Ukraine and in Iraq are still dampening enthusiasm more so in Europe than in the United States.

On a more pessimistic note, our statistics for business optimism took an unexpected drop. The SHORT TERM BUSINESS OUTLOOK index fell to +21, down from +32 in May. An equal drop was noted in the LONG TERM BUSINESS outlook index, which eased to +36 from +49. Perhaps because of the geo-political situation in the world and the pessimistic news from Washington, the long-term index is now well below the +64 we reported less than a year ago.

This month's big stir came from the revision of the first quarter GDP rate down to -2.9%, the biggest drop since the fading days of the Great Recession. As a result, the IMF has now downgraded the 2014 estimate of growth down to 2.0% for the year, and the Federal Reserve has lowered its estimate to 2.25%. Regrettably, both estimates are still probably high. Do the math. To average 2.25% for the year, the remaining three quarters would have to average almost 4%. There is little doubt that the second quarter will look much better than the first, but 4% growth for the next three quarters seems doubtful.

Needless to say, the markets have generally ignored the ominous GDP drop, and generally for good reason. Glancing at our own statistics, we seen no evidence of a significant decline in the first quarter. Some firms said that deliveries were delayed a few days by the bad weather, and others noted some local spot shortages in steel because of ice on Lake Michigan. Nothing we have seen justifies a 2.9% GDP drop.

Second, the system for computing GDP was rather quietly changed last year, and the resulting revision was supposed to yield a higher GDP for the past six years. By moving the goal posts, it is possible that the new system got tangled up in itself, and generated a number that exaggerated the drop. Even with the revision, the current method of computing GDP does NOT adequately account for the activity in the industrial market. Alan Greenspan knew this, and that is why he had enough additional insight to become chairman of the FED. What this really suggests is that GDP is not an especially good measure of economic health or measure of economic activity. It may have been fine in the 60's or 70's, but the world has changed.

Many economists are now starting to notice the impact of firms moving their headquarters to foreign countries to reduce corporate taxes. Locally, we saw Perrigo make the move a few months ago, and we watched Pfizer threaten to make a similar move over the past few weeks. In the case of Pfizer, they openly admitted that the move to buy AstraZeneca was primarily for tax purposes. The insiders of these corporations have become very frustrated with failed attempts to enact corporate tax reform, which some economists feel have been an economic detriment for the past forty years. At 35%, our corporate tax rate is the second highest in the world, although the average effective rate is actually close to 20% because of an *unending* series of tax loopholes targeted at SOME industries in political favor. This is why General Electric has been able to make billions and still pay no corporate tax, while the demonized pharmaceutical industry pays most of the full 35%. Significant movement on tax reform in an election year on this issue is nearly impossible, but it will need to be addressed in the next Congress.

As of this writing, the Detroit Tigers are in sole possession of first place in the American League-Central Division. It is a safe bet that half the Michigan population knows this. At the same time, it is an equally safe bet that less than 1% of the Michigan population knows that Kent County has the lowest unemployment rate (5.2%) among all 83 Michigan counties-- and is in sole possession of first place. Locally, second place is claimed jointly by Barry and Ottawa Counties at 5.3%. Kalamazoo County eased to 11th place, posting a 6.1% unemployment rate for May. It is important to remember that these numbers are not seasonally adjusted, the samples are small, and month-to-month changes may consequently bounce

around a lot. Focusing on reality, the statistics on the Tigers constitute the results of games in far-off stadiums, but lower local unemployment numbers mean people's lives are better for most of West Michigan.

Auto sales for May were up only 1% for the industry as a whole, but part of the tepid performance is blamed on the 24 vs. 26 sales days compared to 2013. The SAAR rate, a.k.a., the Standardized Adjusted Annual Rate, rose to 17.0 million cars. Unfortunately, this is a seasonal adjustment, and like most seasonal adjustments, is based on business paradigms of the past and do not always accurately reflect today's world. Otherwise, sales show signs of stabilizing at the current level, which is a sustainable and PROFITABLE rate for both the manufacturers and automotive suppliers. For car sales in May, Chrysler led the way with a 9% increase, followed by Nissan at 5%, Toyota at 3%, and GM at 1%. Losers included Ford and Honda, both down 6%. Volkswagen, which continues to have dealership issues, lost 8%. Comments from our auto parts manufacturers in the survey also point toward stabilization. One participant also noted that the July "model changeover" production dip is probably becoming a thing of the past in the modern world.

As we enter the summer of 2014, will the slow growth continue? In all probability, yes. There is no reason to believe that the current pattern will change for the next six months or so. The big upset would come from an expansion of the wars in Iraq or in the Ukraine, or a terrorist act at home. Regrettably, we still have hundreds or even thousands of people around the world who lay awake nights trying to figure out how to destroy the United States and its people. We often put too much faith in the large oceans that separate us.

JUNE 2014 COMMENTS FROM SURVEY PARTICIPANTS

"Business seems to be picking up recently."

"We're very busy, and are starting to experience capacity issues."

"Business is good."

"We're a little busier month than we expected. It has left us short-handed due to vacations!!"

"The first half of May was down, but we had a small rebound toward the end of the month. We expect to see our normal June/July slowdown."

"Sales are a little slow on some programs, but should pick up as summer goes along."

"We have a solid, steady forecast through October."

"We have a shortage of custom, special tooled parts due to tool wear. The economy still does not dictate making investments for upgrades."

"Business is holding steady...even going into what is normally a slower July shut-down for our OEM customers."

"The pricing of aluminum and stainless steel continue to be big concerns for us."

"Truck availability has been a definite problem lately. It has greatly impacted our ability to get raw materials delivered to us on time."

"Bleach folding cartons (SBS) from our key supplier are going up \$50 per ton effective July 1."

"Freight in the full truck load market has become more difficult to secure."

"We are anticipating a price increase from our European Suppliers in July. The Euro to the Dollar ratio has been bad for quite a while, and we believe they will have a price increase to help with margins."

"Stainless steel continues to have long lead times, and may continue to pose an issue. With the higher demand, higher pricing may follow suit."

"Capital equipment sales are doing well for us, and we expect sales to continue to increase in 2015."

"Business is strong, and some steel mills are not performing to expectation. They are getting materials to us JIT."

"Pricing on used machinery is up, but availability is down. Delivery on new equipment is up, and so are the prices."

"We have more work than we have money and bodies to do it! This should be an interesting summer."

"It is the fiscal year end for us. Management is throttling purchasing to decrease inventories, because sales are soft."

"We finally got that big month we've been waiting for. May was up 16% over April. IF the month doesn't die, June should exceed May."

"We are getting busy. The third quarter is usually our busiest time."

"World events appear to be changing by the hour."

"We have lots of work and lots of quotes, but new orders have slowed down."

"We are seeing a slight downturn in orders, but a continued steady supply of requests for quotes."

June 2014 Survey Statistics

	UP	SAME	DOWN	N/A	June Index	May Index	Apr. Index	20 Year Average
Sales (New Orders)	36%	48%	13%	3%	+23	+20	+40	+29
Production	36%	51%	6%	7%	+30	+16	+29	+13
Employment	22%	71%	7%		+15	+14	+13	+ 8
Purchases	29%	59%	10%	2%	+19	+ 9	+13	+ 7
Prices Paid (major commod.)	12%	79%	6%	3%	+ 6	+16	+ 7	+35
Lead Times (from suppliers)	16%	81%	3%		+13	+14	+20	+11
Purchased Materials Inv. (Raw materials & supplies)	23%	62%	9%	6%	+14	+ 0	+ 8	- 5
Finished Goods Inventory	17%	56%	17%	10%	+ 0	+ 1	- 7	-10
Short Term Business Outlook (Next 3-6 months)	30%	61%	9%		+21	+32	+35	-
Long Term Business Outlook (Next 3-5 years)	42%	51%	6%	1%	+36	+49	+44	-

Items in short supply: Machine shop components, trucks, labor, some resin, construction equipment, experienced equipment operators, stainless steel sheets, electronic components, castings for machined components.

Prices on the UP side: Steel, metals, stainless steel, transportation and freight, aluminum, labor, steel, carbon plate steel, fuel, polypropylene, corrugated, heavy construction equipment, salt, gravel, sand, pallets, source controlled sub-assemblies.

Prices on the DOWN side: Rubber, polypropylene*, copper, certain grades of scrap steel, carbon steel*.

*These items are reported as both up AND down in price.

Latest Unemployment Reports

(Note: Data are **NOT** seasonally adjusted)

	May 2014	Apr. 2014	Aug. 2009	20 Year Low
State of Michigan	7.3%	7.3%	14.8%	3.1%
Kent County	5.2%	4.8%	11.9%	2.1%
Kalamazoo County	6.1%	5.6%	11.1%	2.1%
Calhoun County	6.3%	6.0%	12.8%	2.7%
Ottawa County	5.3%	6.0%	13.3%	1.8%
Barry County	5.3%	5.7%	10.9%	2.2%
Kalamazoo City	8.5%	7.8%	15.2%	3.2%
Portage City	4.7%	4.3%	8.7%	1.3%
Grand Rapids City	7.3%	6.8%	16.1%	3.0%
Kentwood City	4.7%	4.4%	10.7%	1.4%
Plainfield Twp.	3.4%	3.2%	8.0%	1.4%
Holland City/Allegan	2.3%	2.5%	3.7%	0.9%
U.S. National Official Rate	6.3%	6.3%	9.7%	3.6%
U.S. U-6 Rate*	11.8%	12.8%	16.7%	8.0%

*U-6 for Michigan = 15.2% for first quarter of 2014

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 +23 for the month of June, 2014

Previous Month +20 for the month of May, 2014

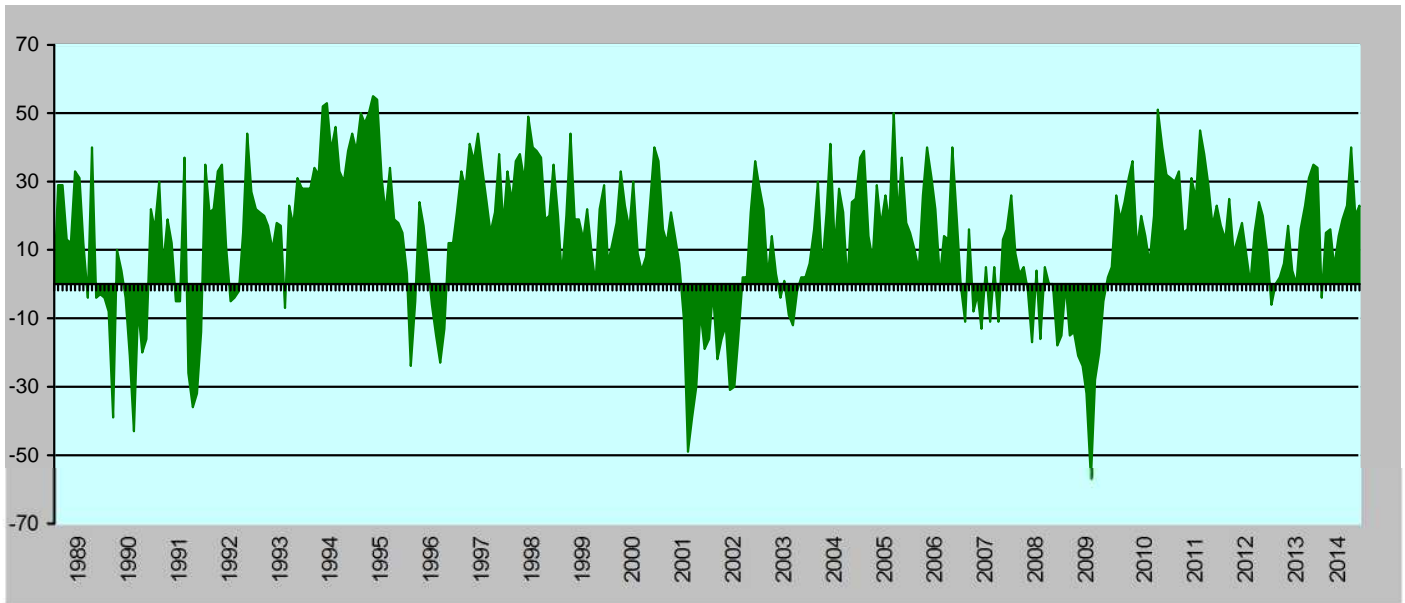
One Year Ago +34 for the month of June, 2013

Record Low -57 for the month of December, 2008

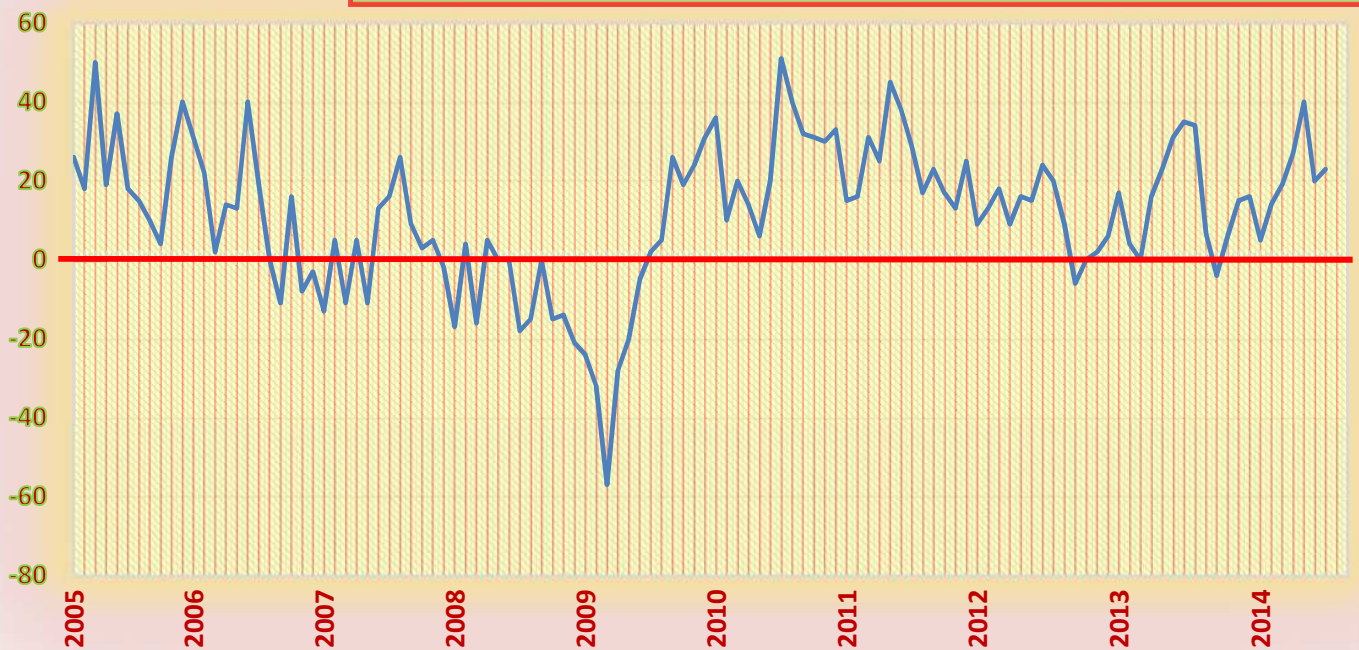
Record High +55 for the month of September, 1994

First Recovery +3 in April of 2009 and forward

ISM-West Michigan Index of New Orders 1988 - 2014



ISM-West Michigan Index of New Orders: 2005 - 2014 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 downturn in industrial unemployment for West Michigan. Normally, there is about a month in lag time between this report and the payroll numbers being picked up 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 lay off staff only after a downturn in orders appears to be certain for the foreseeable future.

