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News Release (For Immediate Release)

February 8, 2017

Current Business Trends

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Growth Resumes

The holidays are over, and we are now into the back-to-work mode of 2017. According to the latest survey conducted during the last two weeks of January, NEW ORDERS, our index of business improvement, has returned to a normal pace of +8, up nicely from December's -5. Most of our other key indexes were also modestly positive. The PRODUCTION index edged up to +8 from +3. Activity in the purchasing offices, the index of PURCHASES, crept up to +6 from +3. The January index representing FINISHED GOODS INVENTORIES index came back to break-even at +0, but the fear of more price increases drove the RAW MATERIALS INVENTORIES index to rise to +11 from +4. Much as we suspected, the January numbers reflect the mood of the New Year. But many of our industrial groups are showing signs of topping out, so growth for the first quarter in West Michigan will probably be just modestly positive.

Looking at individual industrial groups, the auto parts suppliers continue to raise concern over the recent softening in auto sales but remain positive about the 2017 outlook. For the office furniture industry, most signs point toward sales topping out. Typical of past years, the January trend for the capital equipment manufacturers was modestly positive. The performance for the industrial distributors was also modestly better than December. Last but not least, our survey has a few firms tied in to the residential housing industry, and the strong housing market has fueled some significant growth for the Tier I and II suppliers that survived the housing crisis.

It was gratifying to see the business sentiment numbers for January continue to improve. The SHORT TERM BUSINESS OUTLOOK, which asks local firms about the perception of the next three to six months, rose to +28 from +20. Looking out three to five years, the LONG TERM BUSINESS OUTLOOK edged marginally higher to +47 from +45.

At the national level, the February 1 report from the Institute for Supply Management, our parent organization, continued to head in a decidedly positive direction. NEW ORDERS, ISM'S index of business improvement, came in at +16, up from +12 in December and +4 in November. The PRODUCTION index rose modestly to +14 from +11. ISM's EMPLOYMENT index turned in one of the best reports in two years and rose to +8 from +3. ISM's overall index for January jumped to +56.0 from 54.5. According to the survey author, the index of 56.0 is compatible with a 4 percent increase in the national GDP.

Another "strong start" report comes from the U.S. survey conducted by Markit, the British economics consulting firm. Growth in NEW ORDERS accelerated to a 28-month high. The Markit PMI for the U.S. came in at 55.0, up from 54.2 in December. Comments from Chris Williamson, the chief business economist at Markit, continue to be positive:

> "Despite exports being subdued by the strong dollar, order books are growing at the fastest pace in over two years on the back of improved domestic demand. With optimism about the year ahead at the highest since last March, the outlook has also brightened. Production is consequently growing at the strongest rate for almost two years, and inventories are rising at a rate not seen for nearly a decade as firms respond to higher demand, suggesting the goods-producing sector will make a decent contribution to first quarter GDP."

The February 1 report from the J.P. Morgan Global Manufacturing survey of 31 nations reported more optimism for improvement in the world economy. JPM's index of NEW ORDERS once again edged higher to 53.9 from 53.7. The PRODUCTION index backtracked slightly to 53.7 from 53.9. The J.P. Morgan Global Composite Purchasing Manager's Index remained unchanged at 52.7, a repeat of a 34-month high. The rate of improvement in business conditions hit a 70-month record in Austria, a three-month high in Germany, and remained elevated in the Netherlands despite easing to a three month low. Strong growth was also signaled in Spain (20-month high) and Ireland. The French PMI rose to a 68-month high. In contrast, the downturn in Greece accelerated. The U.K posted a 30-month high, and even Russia turned in the best performance in two years. David Hensley, the survey author, further noted:

> "Business conditions in the global manufacturing sector improved at a solid pace in January, with output, new orders, and employment all expanding at similar rates to December. With backlogs of work rising further and business confidence increasing, the sector looks firmly set to build on this solid start to the New Year during the coming months."

How long will the "Trump rally" last? As we have pointed out for the past two reports, at least some respondents feel that the post-election mood has resulted in a more optimistic outlook for 2017. A recent index of confidence among small businesses posted the greatest increase in the thirty-year history of the survey. The biggest incentive for small businesses is the possibility of corporate tax rates being lowered by historical proportions. Over the past 70 years, the tax code has grown extremely complicated, and most small businesses simply do not have large enough staffs to conglomerate all of the loopholes to reduce their tax rates below the widely-known statutory rate of 35 percent. Although the proposed percent rate is probably not realistic, a rate of 20 percent is more likely. The revenue should remain relatively stable because the tax loopholes and many pages of the tax code will be cut. However, it is the larger corporations that are successfully utilizing these loopholes, and their lobbyists will not allow them to disappear without a fight.

What about the proposal to repatriate the $2.6 trillion that multinational corporations are holding overseas? First, all firms will not want to bring all of their offshore money back, because they still plan to reinvest plenty of money around the world. For instance, about 64 percent of I.B.M.'s revenue comes from operations outside of the U.S. For Dow Chemical, 67 percent of the firm's business is offshore, and Intel, the world's leader in computer processing chips, receives a whopping 85 percent of their revenue from the rest of the world. Overall, both history and logic indicate that the lion's share of the repatriated money will be used to buy back shares rather than to grow top-line revenues and hire hundreds of new people. But short term, a one-time repatriation rate of, say, 10 percent could help offset the revenue impact of a tax cut.

According to the current data, there is little doubt that industrial inflation is on the rise. Our local index of PRICES rose to +30, up from +21 in December. JPM's December index of PRICES jumped to 61.9 from 61.0, a six-year high. Many of the increases can be attributed to the recent increase in oil prices. In addition, steel, aluminum and copper are all rising in price, and some buyers are worried that there is no end in sight. One fortunate fact: Unlike inflation 50 years ago, industrial inflation no longer automatically flows over into the consumer market.

Much as we expected, the sales statistics for automobiles have continued to moderate, and the year-over-year sales for January eased by 1.9 percent. For good reason, our automotive parts suppliers in West Michigan are beginning to be cautious. Looking at January sales, Ford posted a minor decline of 0.7 percent, followed by a 3.8 percent decline at General Motors, and a 10.9 percent drop at Fiat-Chrysler. For the other major brands, Honda rose 5.9 percent, Nissan added 6.2 percent, and Subaru gained 6.8 percent. The big loser was the 11.3 percent drop at Toyota. For a long time, we have expected that auto sales would eventually top out and begin to edge lower. So far, the decline seems to be very orderly, which should hopefully allow the auto part suppliers to readjust accordingly. But the rapid expansion among many of our local auto parts suppliers is probably over.

In summary, the current economic momentum is positive, which means that there is no recession on the horizon. Based on the current positive momentum, the overall economy should remain solid for the next few months. With all of this good news, what could possibly go wrong? Plenty. First, one major terrorist act that involved any part of the infrastructure (airlines, power grid, magnetic pulse) would mean that we would probably find ourselves in a recession overnight. Second, a fiscal default by any major country, such as China or even Greece, could weaken the world economy and possibly spill over into our domestic economy. Third, if the impending trade negotiations go poorly with Mexico or China and tariffs are imposed, a trade war could easily throw us into a recession. Last but not least, a new extended military action, such as bombing the nuclear sites in Iran, could destabilize world order. The President has indicated that he may take some kind of military action just to show that there is a "new sheriff in town." If this action were to escalate, it could easily put a damper on the economy and possibly spawn a recession. In the vernacular, President Trump is going to have to be very careful not to upset his own applecart.

JANUARY COMMENTS FROM SURVEY PARTICIPANTS

"The January thaw is here, and we are over the Holiday hump! The inquiries are back, and orders are up!"

"Nice 2016 and anticipate the same for 2017."

"We continue to prosper & thrive in the capital equipment industry."

"It seems that suppliers are taking advantage of a new calendar year to announce increases."

"We had a record December, but slow start to January. We are hoping to see some larger projects finally kick loose."

"The first quarter is always our slowest and so far that is still the case."

"Sales are still strong, and capacity is more in line over the past month than it has been. The flat to slightly down sales have allowed us to align capacity."

"Sales are steady. We saw another large increase in steel prices, and copper is now beginning to rise in price."

"Business is good now. We really think this will be a great year, but we think there could be some rough times ahead in the next few years."

"It was not a thrilling end to 2016, and December finished with a thud. The whole fourth quarter was quiet and very disappointing."

"Business looks strong for the first few months of 2017"

"We are building inventory for an upcoming program."

"Sabic resin situation continues to be a challenge for many companies."

"I'm hearing that polypropylene could soon go up in the double digits! I also hearing ABS increase letters are out there."

"We had a lower outlook for the New Year during the fourth quarter, but 2017 has started very strong."

"Business not to plan but still above last year."

"Orders are starting to pick up. We are looking forward to a great 2017."

"The China Steel Corporation monopoly on steel in Taiwan is causing us a huge challenge. They have increased steel pricing 3-8% for no reason."

"It's pretty stable month in regards to all issues. I believe we are seeing a post-holiday lull."

"Automotive is strong. Existing orders are increasing, and new orders are being launched."

January 2017 Survey Statistics

	UP	SAME	DOWN	N/A	Jan. Index	Dec. Index	Nov. Index	25 Year Average
Sales (New Orders)	26%	54%	18%	2%	+ 8	- 5	-13	+14
Production	20%	62%	12%	6%	+ 8	+ 3	+ 4	+14
Employment	15%	76%	9%		+ 6	+ 7	- 1	+ 8
Purchases	20%	66%	14%		+ 6	+ 3	+ 6	+ 7
Prices Paid (major commod.)	32%	66%	2%		+30	+21	+11	+15
Lead Times (from suppliers)	20%	75%	5%		+15	+11	+ 3	+11
Purchased Materials Inv. (Raw materials & supplies)	20%	63%	9%	8%	+11	+ 4	-12	- 4
Finished Goods Inventory	12%	79%	12%	5%	+ 0	- 7	- 2	- 8
Short Term Business Outlook (Next 3-6 months)	37%	55%	8%		+28	+20	+12	-
Long Term Business Outlook (Next 3-5 years)	49%	46%	2%	3%	+47	+45	+34	-

Items in short supply: Labor, some automotive grades of aluminum, sound castings, carbon steel, coated steel, Sabic resin.

Prices on the UP side: Corrugated, plasticizer, paraffinic oil, SEBS resin, steel, paper products, steel scrap, carbon steel, stainless steel, coated steel, copper, heavy duty trucks, liquid chlorides, sand, fuels, sodium hypophosphite, Chinese steel and wire rod, cold and hot rolled steel, glass.

Prices on the DOWN side: Polypropylene, carbon steel*, stainless steel*, chemicals, resins, oil, base metals (copper, nickel, tin & zinc), nylon, computers.

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

Latest Unemployment Reports

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

	Dec. 2016	Dec. 2015	Aug. 2009	20 Year Low
State of Michigan (Adj.)	5.0%	5.1%	14.6%	3.2%
State of Michigan (Unadj.)	4.4%	4.5%	14.1%	2.9%
Kent County	2.9%	2.7%	11.9%	2.1%
Kalamazoo County	3.4%	3.1%	11.1%	2.1%
Calhoun County	4.2%	3.9%	12.8%	2.7%
Ottawa County	2.8%	2.6%	13.3%	1.8%
Barry County	3.4%	3.3%	10.9%	2.2%
Kalamazoo City	4.3%	3.9%	15.2%	3.2%
Portage City	3.2%	2.9%	8.7%	1.3%
Grand Rapids City	3.9%	3.6%	16.1%	3.0%
Kentwood City	2.8%	2.6%	10.7%	1.4%
Plainfield Twp.	2.2%	2.0%	8.0%	1.4%
U.S. Official Rate (Dec.)	4.7%	5.0%	9.6%	3.8%
U.S. Rate Unadjusted	4.5%	4.8%	9.6%	3.6%
U.S. U-6 Rate**	9.2%	9.9%	16.7%	8.0%

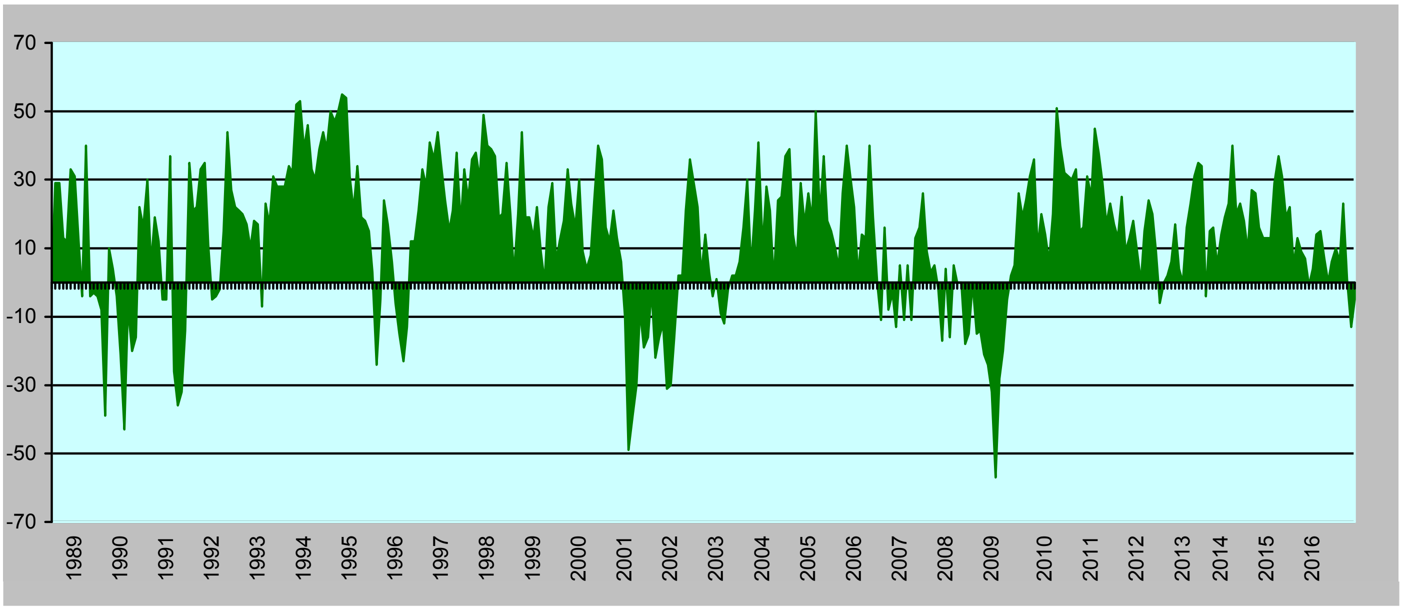
**U-6 for Michigan = 10.4% for Q3 of 2016

Index of New Orders: West Michigan

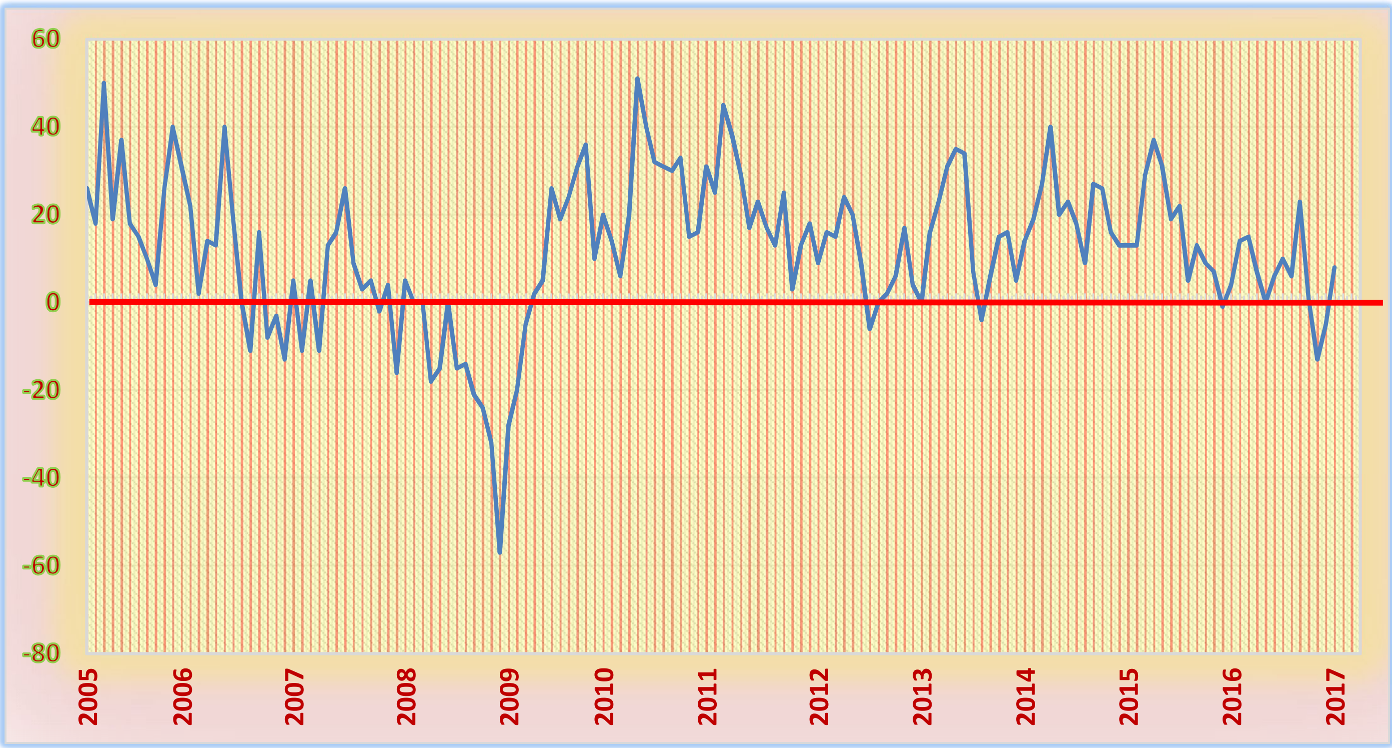
As the name implies, this index measures new business coming into the firm, and signifies business improvement or business decline. When this index is positive for an extended period of time, it implies that the firm or organization will soon need to purchase more raw materials and services, hire more 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	+8 for the month of January 2017
Previous Month	- 5 for the month of December 2016
One Year Ago	-+4 for the month of January 2016
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 - 2017

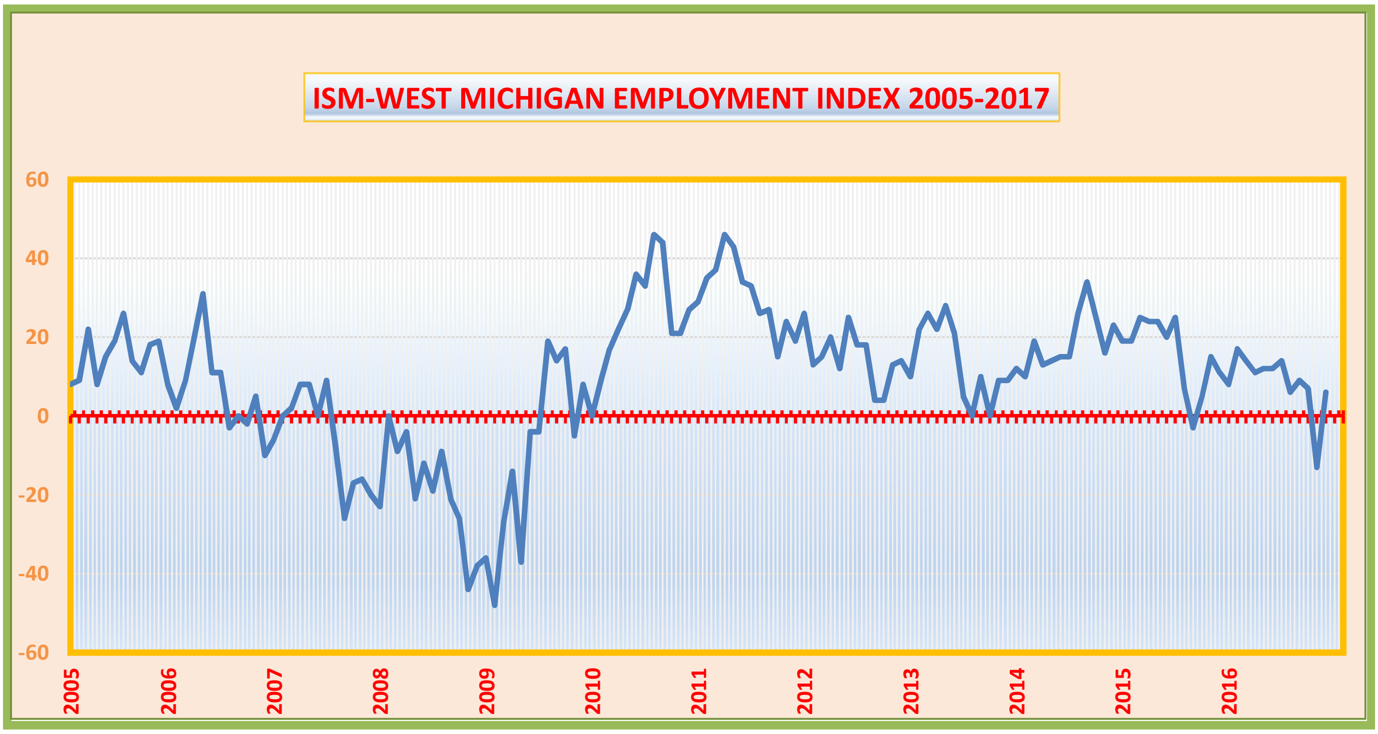


ISM-West Michigan Index of New Orders: 2005-2017 Only



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 BUSIESS 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.