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Current Business Trends

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STILL MODESTLY POSITIVE, BUT CONFIDENCE IS FADING

Key Participant Comments for May:

"We continue to have strong demand from automotive customers, and then they pull weeks out of the schedule. It has been difficult to plan with major swings in demand."

"Our government needs to change because the problems are not going to get any better, only worse where they are going."

"The big problem is we get bad information on delivery time and then we are late shipping our equipment. It's a bigger problem now than two years ago."

"Shipping costs are getting out of control."

"We are still struggling with a lack of labor."

Although the industrial economy for West Michigan remains modestly positive, confidence in the future continues to darken. NEW ORDERS, our index of business improvement, remained positive but backtracked to +14, down from April's +29. In a similar move, the May PRODUCTION Index, which is now termed "output" by many economists, eased to +7 from +23. Because of ongoing logistics problems, activity in the purchasing offices, our Index of PURCHASES, dropped to +0 from +20. The May index of LEAD TIMES posted at +41, a significant improvement over April's reading of +59. However, with numerous problems throughout the world's logistics network, lead times are still not expected to return to normal for many months. Overall, most survey respondent are still reporting modestly positive sales, but higher prices, rapidly rising transportation costs, and logistics bottlenecks are cutting into profitability for many firms. Most plans for expansion are now being put on hold, but many firms continue to wrestle with personnel shortages.

The U.S. Economy. At the national level, the U.S. economy remains stable, at least for now. The Institute for Supply Management's NEW ORDERS Index for May came in at +15, virtually unchanged from last month's +14. ISM's PRODUCTION (a.k.a., Output) Index posted at +7, down from April's +16. After statistical adjustments, ISM's composite index registered at 56.1, up slightly from 55.4. If a recession is coming, it is not yet being reflected in the current industrial market statistics.

As always, a slightly different view of the U.S. economy comes from the British international consulting firm now called S&P Global, or SPG. SPG's seasonally adjusted U.S. Manufacturing Purchasing Managers' Index came in at 57.5, down from a seven-month high of 59.2 posted in April. However, the "…rate of growth eased to the softest since January as expansions in output, new orders and stocks of purchases waned." Supply constraints and inflationary pressuresremained the major constraints, but significant order backlogs have resulted in more hiring. Chris Williamson, Chief Business Economist at S&P Global, commented:

> "A solid expansion of manufacturing output in May should help drive an increase in GDP during the second quarter, with production growth running well above the average seen over the past decade. However, the rate of growth has slowed as producers report ongoing issues with supply chain delays and labor shortages, as well as slower demand growth. A cooling in new orders growth was in part linked to customers pushing back on high prices, though also reflected shortages and growing concern about the outlook. Input cost pressures meanwhile intensified further during the month. Although delivery delays were the least widespread for 16 months, pricing power remained firmly in the hands of the supplier, with rising energy, wage and transportation costs adding to firms' cost burdens. The result was the steepest rise in costs since November, feeding through to yet another near-record factory gate price increase and serving as a reminder that inflationary pressures remain worryingly elevated."

The World Economy. Despite the ongoing duress from the Ukrainian War, COVID-19, and lockdowns in China, the J.P. Morgan worldwide manufacturing PMI for May upticked from 52.3 to 52.4 but remained near the all-important break-even point of 50.0. The report blamed the steep drop in production from mainland China as the major factor holding back the world index. Because of fallout from the ongoing war in Eastern Europe, the PMIs for Turkey and Poland also turned negative. The May PMI for Canada, our largest trading partner, edged up to 56.8 from 56.2, just slightly below March's survey-record high of 58.9. The May PMI for Mexico, our second largest trading partner, flipped back to a positive reading of 50.6 from April's 49.3. Because of the modest relaxation of COVID-19 restrictions, the PMI for China, our third largest trading customer, edged up to 48.1 from April's 46.0. Olya Borichevska, Global Economist at J.P. Morgan, noted:

> "After sharp declines in the global output PMI in March and April, May brought better news. The global output PMI increased 1.1-pts in May though this was mostly concentrated in China where the PMI bounced 4.7-pts, reversing a little bit less than half of the drop linked to the recent virus outbreak. Outside of China, the global PMI fell 0.7-pts suggesting loss of momentum though the level remained at a solid level. Other details from the surveys point to limited intensification in supply chain issues which is encouraging."

About 100 years ago in Europe, the war to end all wars, which we now call the First World War, was over. Most countries in Europe and even the U.S. naively believed that war was a thing of the past. Big mistake. In 1991, we declared an end to the Cold War, and most countries believed that Russia would now become part of the world community and buying oil and gas from Russia would help ensure the transition. Some politicians declared that NATO was no longer necessary. However, within a few years, a new Cold War was rekindled, and a new wave of militarism evolved which has now morphed into a "hot" war. It may be a little late, but most countries of Europe are now reevaluating their trade policies with Russia. Although all of the major economies in the Eurozone continue to post positive PMIs, most of these same countries in the survey have seen their PMIs restrained by the ongoing war. For instance, at 57.8, the May PMI for the Netherlands is still positive but down from April's 59.9. Hence, the May composite PMI for the entire Eurozone posted at a 16-month low of 54.6, down from April's 55.5. Chris Williamson further commented:

> "Euro area manufacturers continue to struggle against the headwinds of supply shortages, elevated inflationary pressures and weakening demand amid rising uncertainty about the economic outlook. However, the manufacturing sector's deteriorating health has also been exacerbated by demand shifting to services, as consumers boost their spending on activities such as tourism and recreation. The survey's output gauge is indicative of official manufacturing production falling slightly so far in the second quarter, and forward-looking indicators such as the orders-to-inventory ratio suggest the rate of decline will accelerate in coming months, absent a sudden revival of demand for goods. However, there is also an undercurrent of growing uncertainty about the economic outlook, linked to Russia's invasion of Ukraine, persistent inflationary pressures and supply disruptions, that is in turn driving increased risk aversion and caution among customers, which points to deeper underlying downside risks to the economic outlook."

Automotive. The sharp decline in auto production brought on by the chip shortage continues to be a drag on the West Michigan economy. West Michigan does not assemble automobiles and trucks, but manufactures numerous automotive components to supply assembly schedules around the world. By now, we had hoped that the situation would begin to show some modest improvement, but it has not. According to the June 1 edition of *Automotive News*, the May SAAR (Seasonally Adjusted Annualized Rate) came in at 12.7 million units, down by 1.8 units from April. Sales at American Honda have been among the hardest hit, falling by an astounding 57.3 percent in May. Honda now predicts that the company's lean inventories won't meaningfully improve until at least October 2023. Because of pent-up demand, "normal" inventory, with row after row after row of new Hondas at most dealers, should not be expected until mid-2024. Of the other firms still reporting monthly, year-over-year sales for Ford were down 4.4 percent, Toyota fell 27.3 percent, and beleaguered Subaru dropped 24.8 percent. The average for all of the reporting firms for May was down by 31.4 percent. Jesse Toprak, chief analyst at Autonomy, further commented:

> "The severe drought in vehicle inventories continued to clash with otherwise healthy consumer demand in May. We expect a gradual improvement in supply levels in the second half of the year. However, the wildcard is whether the demand side will still be as forceful when more vehicles are finally available in showrooms. Current market dynamics are forcing consumers to change their purchase and ownership patterns, which is resulting in a diversion of some demand to the used car market -- therefore running up the prices of pre-owned vehicles. In addition, we are seeing leasing rates dipping below 20 percent and forcing consumers to keep their existing vehicles longer since they can't find other reasonable options. There is a looming danger of demand not sustaining its current strength when we finally have ample supply. The OEMs may again have to utilize incentives under that scenario."

Industrial Inflation. Until the Ukrainian war began in February, the prices for many major commodities were beginning to stabilize. Had it not been for the decline in Chinese production brought on by the recent pandemic quarantine, many commodity prices would undoubtably be higher. In addition, our local index of LEAD TIMES for May eased to +41 from +59, a significant sign that the stress on pricing for SOME commodities may be easing. However, our local index of PRICES posted at +71 in May, up from April's +62. The May ISM national index of PRICES eased modestly to +65 from +69, although the index had been as low as +36 just four months earlier. In a more modest move, the J.P. Morgan world index of PRICES eased to 70.5 from 71.6. According to ISM's May report:

> "Prices paid by services organizations for materials and services increased in May for the 60th consecutive month, with the index registering 82.1 percent, 2.5 percentage points lower than the all-time high recorded in April (84.6 percent), which exceeded the seasonally adjusted figure of 83.9 percent registered in December 2021."

Business and Consumer Confidence. The current news cycle heavily influences consumer confidence, so it is no surprise to see the Conference Board's Index of Consumer Confidence edge lower to 106.4 in May, down from 108.6 in April. A more pessimistic reading comes from May's University of Michigan Consumer Sentiment Index, which dropped to 58.4 from 65.2. Compared to a reading of 82.9 only a year ago, it is fair to conclude that the consumer market is growing increasingly uneasy. According to the monthly report on the U.S. economy from S&P Global, business confidence has "…slipped to the lowest level since October 2020." For our West Michigan survey of the industrial economy, The SHORT-TERM BUSINESS OUTLOOK Index for May, which asks local firms about the business perception for the next three to six months, posted at +7, well below the April reading of +20. For the first time in the eight years of recording the LONG-TERM BUSINESS OUTLOOK Index, which queries the perception for the next three to five years, the index fell into negative territory at -2, down sharply from +29 reported last month. The significant drop in both of these indices indicates that many West Michigan firms are growing increasingly pessimistic.

GDP. Last month, we were dismayed by a Commerce Department report that the GDP (Gross Domestic Product) for the first quarter fell by an annualized rate of 1.4 percent. Many economists were quick to point out that the statistics were skewed by a huge quarterly trade imbalance as well as drops in private inventory investment and defense spending. However, the revised estimate that posted on May 26 came in at a negative rate of 1.5 percent, dashing all hopes of an upward revision. With 25 days left in June, most forecasters are predicting much better results for the second quarter. As of June 1, the Atlanta Fed's GDPNow second quarter estimate stands at a 1.3 percent growth rate. At 2.9 percent, the Blue-Chip consensus forecast is a little more optimistic. Conference Board forecasts a second quarter growth rate of 2.1 percent. Hence, the current second quarter growth consensus is somewhere around 2.0 percent.

Summary. Federal Reserve Chairman Jerome Powell recent stated that he is "… acutely aware of the need to return the economy to price stability and determined to use our tools to do exactly that." Hence, higher interest rates are coming, but Chainman Powell still hopes that the economy can be cooled slowly enough to avoid a recession. However, raising rates too slowly can revive a round of what was called "stagflation" about 45 years ago. During most of the mid-1970s, economic growth slowed and unemployment rose as a result of the Fed's attempt to restore faith in the dollar by posting higher interest rates. In an apparent contradiction, inflation kept climbing, and a psychology of perpetual inflation gripped both the consumer and industrial markets. At the industrial level, purchasing managers had to contend with quarterly and sometimes monthly announcements of price increases. Paul Volker recognized that the only way to break the cycle was to keep raising interest rates until the cycle was broken. Chairman Powell hopes that a series of half point increases will take hold before the inflation psychology gets out of hand. To many economists, the Federal Reserve has waited FAR too long to begin the process of bringing interest rates back to historical norms. However, it is worth remembering that the psychology of perpetual inflation has not yet taken hold, and with so much talk about a pending recession, a few upticks in interest rates may be sufficient to cool the rate of inflation. Needless to say, this is a proverbial slippery slope.

MAY COMMENTS FROM SURVEY PARTICIPANTS

“The resin market remains very volatile especially as manufacturing and natural issues arise.”

“One weird note: I was at a gas station in the Northwest suburbs of Chicago in a nice area. The gas station was out of mid and high-grade gas. They only had the high-volume regular gas. Not sure what that means, but it was near $6.00 per gallon.”

“Manufacturing is still like an amusement park ride, all ups and downs.”

“We continue to struggle getting materials, components and labor! Prices continue to increase. We are navigating the best we can to keep our customers supplied.”

“We’re in it for the long haul.”

“It seems like another port situation is brewing in China again.”

“Our government needs to change because the problems are not going to get any better, only worse where they are going.”

“For what we have been requesting from suppliers for the cyclical products and materials that we are seeking for summer work, we have been pretty fortunate. Nothing as of yet is a problem.”

“More favorable exchange rates are finally helping to cushion the blow for overseas raw material increases.”

“We are seeing delays in shipments due to components of machines not getting to the manufacturer, i.e., servo motors, computer chips, etc.”

“The big problem is we get bad information on delivery time and then we are late shipping our equipment. It’s a bigger problem now than two years ago. My bet that is gets to be a bigger problem with our administration now running our government.”

“Dry van freight prices seem to have stabilized, excluding increasing fuel surcharges.”

“Sales remain strong, but cost increases are hurting. We just did a price increase, but will need to do another soon.”

“We continue to have strong demand from automotive customers, and then they pull weeks out of the schedule. It has been difficult to plan with major swings in demand.”

“Inflationary pressures are significant.”

“Business quoting continues to be strong.”

“We are still struggling with a lack of labor.”

“Steady.”

“It briefly seemed as if the supply chain issues were improving with slightly better lead times, but that was short lived. Now, long lead times are even longer. It seems 2-4 weeks have been added to everything. That puts some out-of-stock electric motors at 18 weeks. VFD (Vendor Direct Fulfillment) orders are being quoted with November dates, i.e., 24 weeks from now.”

“We seeing shipping container costs start to stabilize, but prices for components and ultimately machines are increasing.”

“Shipping costs are getting out of control.”

May 2022 Survey Statistics

	UP	SAME	DOWN	N/A	May Index	Apr. Index	Mar. Index	25 Year Average
Sales (New Orders)	33%	48%	19%	0%	+14	+29	+29	+14
Production (Gross Output)	24%	50%	17%	9%	+ 7	+23	+19	+14
Employment	29%	52%	17%	0%	+12	+14	+18	+ 8
Purchases	24%	52%	24%	0%	+ 0	+20	+22	+ 7
Prices Paid (major commod.)	71%	29%	0%	0%	+71	+62	+57	+15
Lead Times (from suppliers)	48%	45%	7%	0%	+41	+59	+57	+11
Purchased Materials Inv. (Raw materials & supplies)	21%	62%	12%	5%	+ 9	+44	+31	- 4
Finished Goods Inventory	17%	50%	21%	12%	- 4	-17	-10	- 8
Short Term Business Outlook (Next 3-6 months)	24%	57%	17%	2%	+ 7	+20	+23	-
Long Term Business Outlook (Next 3-5 years)	24%	45%	26%	5%	- 2	+29	+29	-

Items in short supply: Resins, hardwood plywood, MDF (medium density fiberboard), silica, PG, citrates, glycerin, glass, microchips, some electronics, long shelf life food goods, polycarbonate, hub bearings, oil filters, durable equipment, packaging materials, roll stock paper, transportation, some stainless steel, electronic components, foundry capacity, some steel, silicone, textile products, aluminum, chemicals, electric motors, fasteners, brass fittings, rubber hose, sub-assemblies from APAC, variable frequency drives, garments, essential products to run waste water center, labor.

Prices on the UP side: Natural gas, steel, oil, brass components, corrugate, nylon tubing assemblies, standard fasteners, powder coat, fasteners, raw silicone, fuel surcharges, flatbed trucks, trucking, food costs, paper (chip pads), fuel, paint, iron castings, corrugated, HMA (hot mix asphalt), rubber/tar products, aggregates.

Prices on the DOWN side: Hot rolled steel, transportation (dry van only), ocean containers from China.

Latest Unemployment Reports

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

	Mar. 2022	Mar. 2021	Aug. 2009	20 Year Low
State of Michigan (Apr.)	4.3%	6.2%	14.6%	3.2%
State of Michigan (Unadj.)	4.2%	6.2%	14.1%	2.9%
Kent County	3.3%	5.4%	11.9%	2.1%
Kalamazoo County	3.6%	6.6%	11.1%	2.1%
Calhoun County	4.7%	7.2%	12.8%	2.7%
Ottawa County	3.0%	4.8%	13.3%	1.8%
Barry County	3.6%	5.5%	10.9%	2.2%
Kalamazoo City	4.5%	7.0%	15.2%	3.2%
Portage City	3.3%	5.2%	8.7%	1.3%
Grand Rapids City	4.3%	7.1%	16.1%	3.0%
Kentwood City	3.1%	5.1%	10.7%	1.4%
Plainfield Twp.	2.5%	4.1%	8.0%	1.4%
U.S. Official Rate (Apr.)	3.6%	6.0%	9.6%	3.5%
U.S. Rate (Unadjusted)	3.8%	6.2%	9.6%	3.4%
U.S. U-6 Rate (Apr.)**	6.9%	11.7%	22.9%	7.3%

**U-6 for Michigan = 8.7% for Q2 of 2021 thru Q1 2022

Index of New Orders: West Michigan

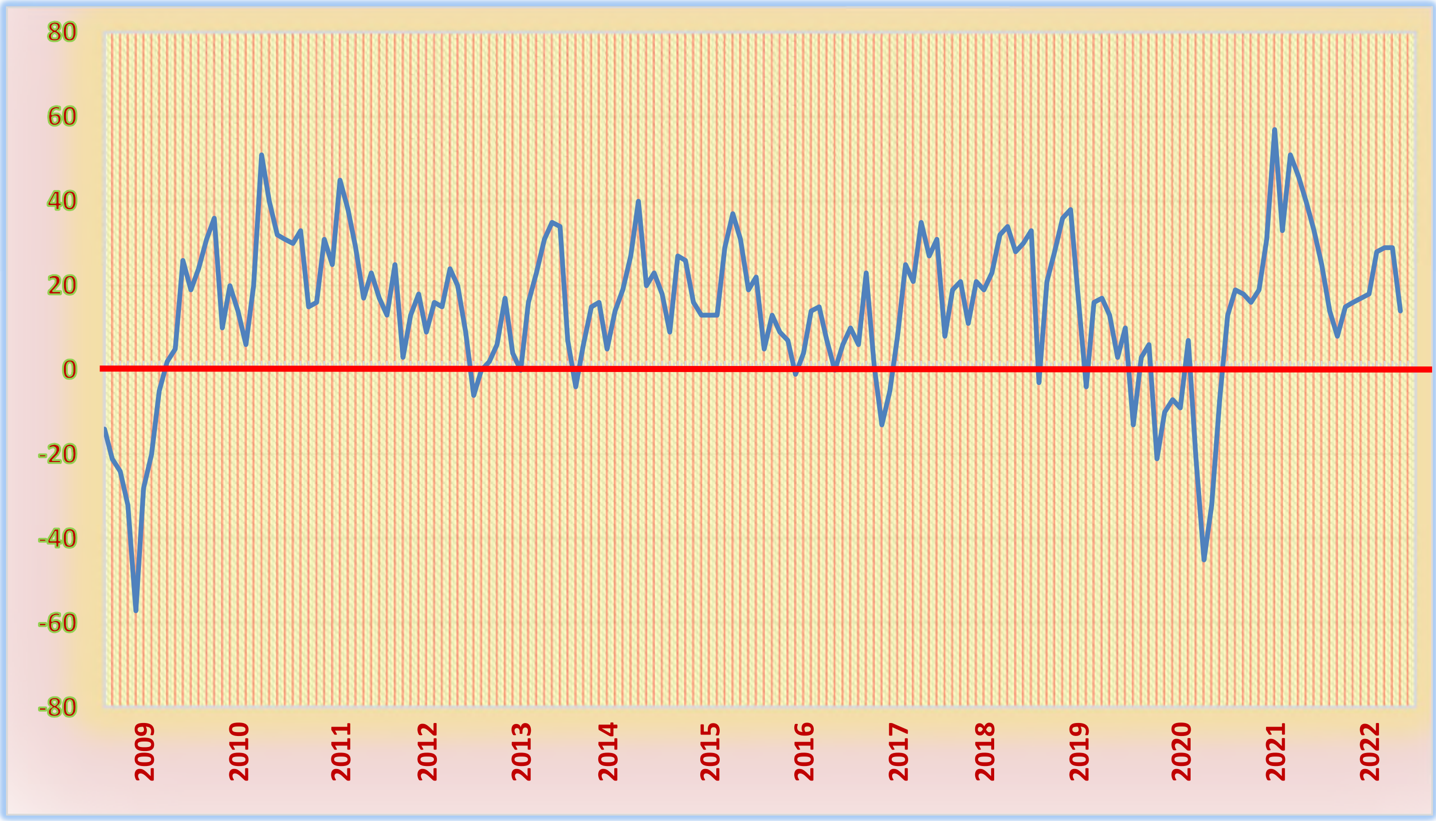
As the name implies, this index measures new business coming into the firm, and signifies business improvement or business decline. When this index is positive for an extended period of time, it implies that the firm or organization will soon need to purchase more raw materials and services, hire more 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	+ 14 for the month of May, 2022
Previous Month	+ 29 for the month of April, 2022
One Year Ago	+ 51 for the month of May, 2021
Record Low	- 57 for the month of December 2008
Record High	+ 57 for the month of January 2021

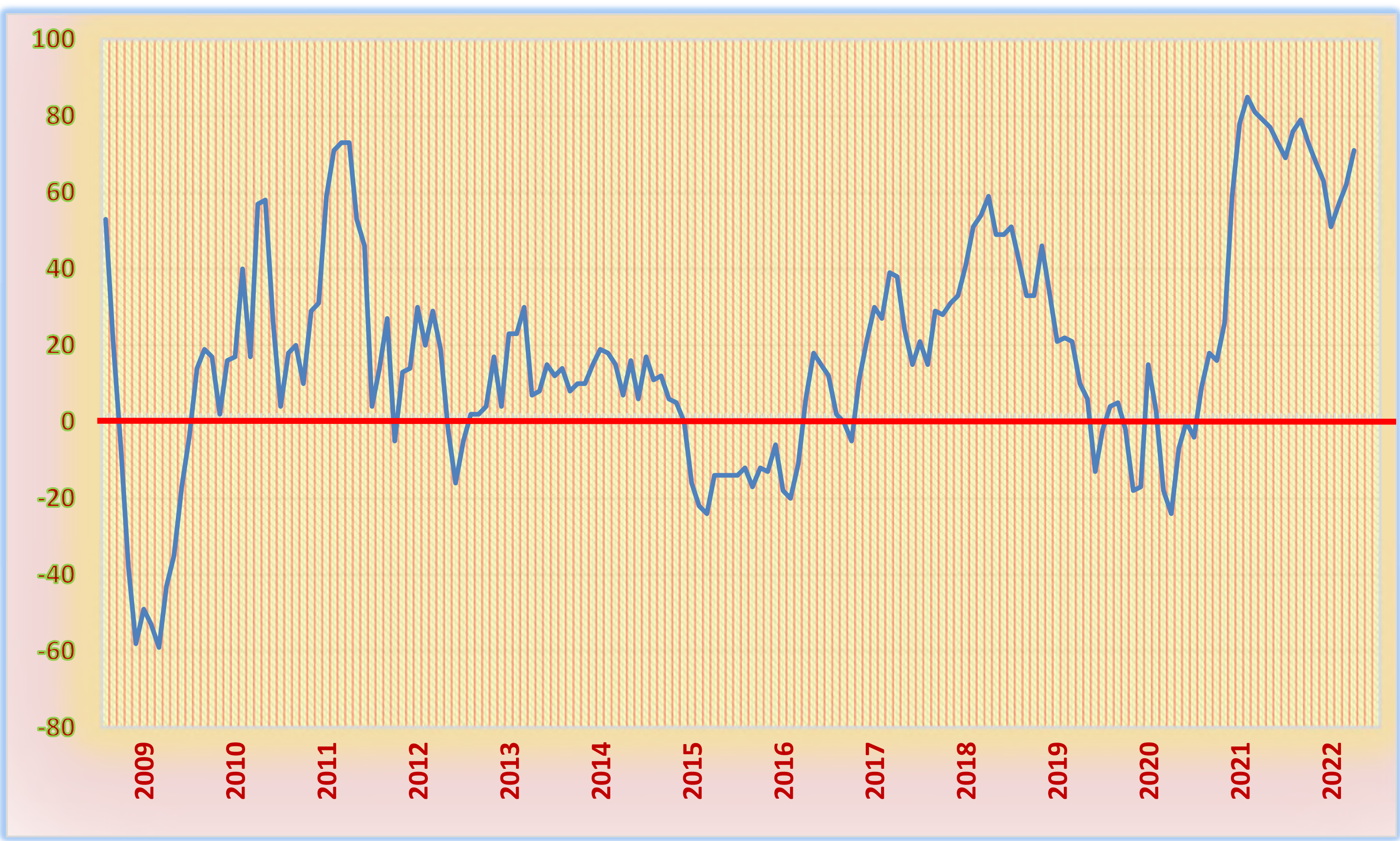
Great Recession
First Recovery + 3 in April 2009

COVID-19 Recession
First Recovery +12 in July 2020

ISM-West Michigan Index of New Orders: 2008-2022

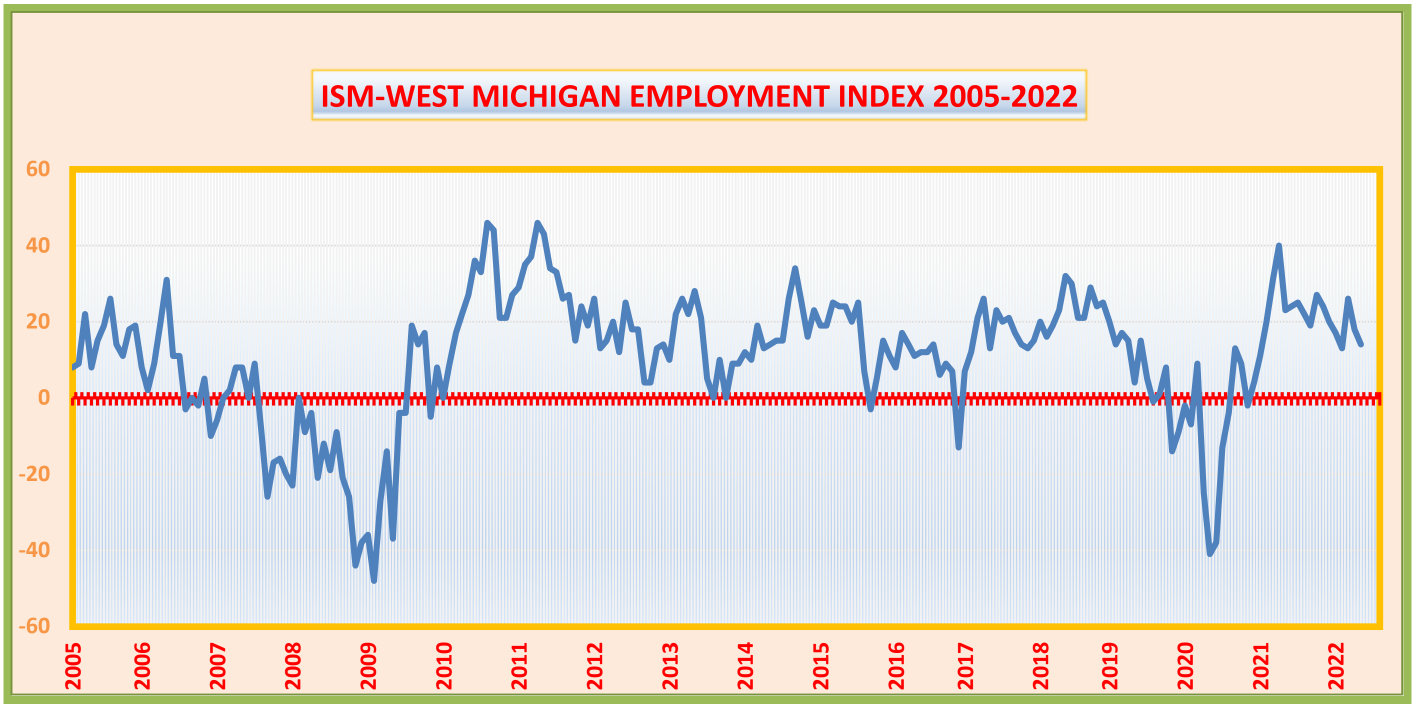


ISM-West Michigan Index of PRICES: 2008-2022



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 measures 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.