Institute for Supply Management
Greater Grand Rapids, Inc.
P. O. Box 230621
Grand Rapids, MI 49523-0321

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Current Business Trends

By Brian G. Long, Ph.D., C.P.M.
Director, Supply Chain Management Research
Grand Valley State University (269) 870-0428

WEST MICHIGAN ECONOMY TURNS MODESTLY NEGATIVE

- **Inventory Liquidation Increases**
- **Automotive Shows Continued Improvement**
- **World Economic Decline Accelerates.**

Key Participant Comments for October:

"Our quoting levels remain high and constant; however, new orders are taking longer to come in."

"Everything changes from day-to-day and week-to-week of what's hard to get and what the prices are going to be. You don't know if you are going to get a shipment until it lands on your deck."

"Real demand destruction is occurring, and we are operating in an over-supplied market for the first time in several years. Layoffs will be necessary if demand does not recover."

"Our business is about the same as last month but down significantly from 3-4 months ago."

"The market is hard to read right now. Most customers remain somewhat optimistic but orders show a softening in the near term."

The Local Economy. It comes as no surprise that the West Michigan industrial economy has finally turned negative. According to the data collected in the last two weeks of October, NEW ORDERS, our index of business improvement, dropped to -12 from +0. However, the October PRODUCTION Index, which is now termed "output" by many economists, upticked modestly to +5 from +0. Activity in the purchasing offices, the index of PURCHASES, continued downward to -12 from -7. For the first time in over three years, the LEAD TIMES Index turned marginally lower at -5, down from +16. Just like last month, the market for office furniture has continued to soften, but pent-up demand for new cars will mostly likely keep our West Michigan auto parts suppliers and the assembly lines running for the foreseeable future. The comments from our survey participants have now turned increasingly tenuous, and some firms are openly bracing for an impending recession.

The U.S. Economy. The monthly business survey report from the Institute for Supply Management continued the gradual softening that began four months ago. ISM's NEW ORDERS Index for October posted at -7, down slightly from September's -5. In contrast, ISM's October PRODUCTION (a.k.a., Output) Index upticked to +2 from +0. Order Backlogs, another key ISM index, dropped to -9 from +2. However, because of statistical and seasonal manipulation, ISM's Composite October Manufacturing PMI came in at 50.2 and remained marginally above the all-important break-even point of 50.0.

A similar view of the U.S. industrial economy comes from the British-based international consulting firm now called S&P Global. The S&P Composite Index came in at 50.4, down from September's 52.0. Because of the easing of some supply chain bottlenecks, the Output Index turned modestly positive, but New Orders turned negative for the first time in several months. Although some commodities have fallen in price, many of S&P's survey respondents continue to be concerned about inflation. Siân Jones, Senior Economist at S&P Global Market Intelligence, further noted:

> "October PMI data signalled a subdued start to the final quarter of 2022, as U.S. manufacturers recorded a renewed and solid drop in new orders. Domestic and foreign demand weakened due to greater hesitancy among clients as prices rose further and amid dollar strength. As such, efforts to clear backlogs of work, rather than new order inflows, drove the latest upturn in production. Confidence in the outlook waned as underlying data also highlighted efforts to cut costs and adjust to more subdued demand conditions in the coming months. Input buying fell sharply and resilience in employment stumbled, as the pace of job creation eased to only a marginal rate. On a more positive note, input costs rose at the slowest pace in almost two years amid signs of reduced disruption in supply chains. Lower demand for inputs was a contributing factor to this, however. Nevertheless, softer hikes in costs were reflected in a slower uptick in output charges, as firms sought to pass on cost savings where possible to try and boost sales."

The World Economy. At 49.4, the J.P. Morgan Worldwide Manufacturing PMI signaled a third successive month of contraction. The report further noted that the New Orders Index fell to 46.6 from 47.7, and the Output Index eased to 48.6 from 48.8. Several other indexes from JPM also fell below the all-important 50.0 break-even point. The PMI from Canada, our largest trading partner, fell to 48.8, primarily because of continued weakness in New Orders and Production. Fortunately, in Mexico, our second largest trading partner, the October PMI remained marginally positive at 50.3. While China, our third most important trading partner, saw their October PMI remain marginally negative though improving slightly to 49.2 from 48.1. Bennett Parrish, Global Economist at J.P. Morgan, further noted:

> "The global manufacturing output PMI remained in contraction territory in October. The output index ticked down by 0.1pt to 48.6, its lowest level for 28 months. The index for new orders also lost ground, falling to its lowest level for close to 11 years (excluding the pandemic months). With business optimism and the orders-to-

inventory ratio also both dipping to their lowest levels in two-and-a-half years, the outlook for production remains downbeat."

The war in Ukraine and the uncertainty over rising energy prices helped drive the October PMI for the Eurozone down to 46.4 from 48.4. The disruption in the Nord Stream Pipeline from Russia continues to keep the cost of natural gas historically high, but the spot price has now fallen to around $6.00 1/MMBtu, down over 90 percent from September's spot price of $69.90 1/MMBtu. Except for Ireland, all of the major European economies are now reporting negative PMIs. Joe Hayes, Senior Economist at S&P Global Market Intelligence noted:

"The Eurozone goods-producing sector moved into a deeper decline at the start of the fourth quarter. The PMI surveys are now clearly signalling that the manufacturing economy is in a recession. In October, new orders fell at a rate we've rarely seen during 25 years of data collection – only during the worst months of the pandemic and in the height of the global financial crisis between 2008 and 2009 have decreases been stronger. Factors that are likely to aggravate the downturn include inflation, which remains stubbornly elevated despite continued evidence that supply-chain pressures are receding. Sentiment among manufacturing firms remained rooted in negative territory once again in October, suggesting that firms foresee these challenging conditions to stretch out long into 2023. Developments in the energy markets will remain a key focus for euro area manufacturers through the winter. The spate of mild weather across Europe so far bodes well and has helped bring wholesale gas prices down. However, we remain mindful of the risk that atypical cold weather could ramp up the need for energy rationing, causing widespread disruption to manufacturing production."

Automotive. The supply of computer chips for the auto industry continues to modestly improve, resulting in the year-over-year October sales posting a modest 5.9 percent growth rate. The SAAR (Seasonally Adjusted Annualized Rate) for October came in at 14.9 million units, a significant improvement but still below the pre-pandemic SAAR of 16 million cars and light trucks. Of the firms that are still reporting monthly, year-over-year sales at Toyota jumped by 27.7 percent, reflecting a second month of double-digit sales growth. Last February, a Toyota spokesman projected that the firm expected to be back to full production by April. Although Toyota's chip shortage lasted an additional five months, it appears that they may have turned a corner. October sales at Subaru gained 31.9 percent, and Hyundai-Kia sales improved by 8.0 percent. By contrast, sales at Honda fell 16.0 percent, and Ford lost 10.1 percent. Thomas King, president of J.D. Power's data and analytics division, commented:

"We expect to see some deterioration in per unit pricing and profitability in the coming months. However, nearly 50 percent of new vehicles are still being sold above MSRP, the industry is recalibrating to a more durable pricing environment. With increasing interest rates, affordability is being tested. We're seeing consumers faced with the reality that to afford the same vehicle at the same monthly payment as last year, they are forced to increase their down payment, which is creating new affordability challenges. We are paying close attention to how the industry will react to these concerns. Perhaps there will be more incentives, longer finance terms, or a combination of these."

Industrial Inflation. Although the recent wave of falling prices for most major commodities appears to be good news, history warns that participators across-the-board price drops in the industrial market have been the precursor to recessions. For October, our local index of PRICES came into single-digit positive range falling to +7 from +26. At the national level, ISM national index of PRICES came in at -7, down from September's reading of +3. However, for the world market, the October J.P. Morgan world index of Prices remains stuck at 61.1. Commenting on the latest results, Laura Denman at S&P Global Market Intelligence said:

"Amid downturns in output and demand on a global scale, October data signalled softer price and supply pressures across the global manufacturing sector. Reports of higher prices were the lowest since July 2020 with nearly all monitored commodities posting fewer mentions than in September - some goods even registered a decline in prices. That said, they were signs that the ongoing energy crisis is not yet resolved as signalled by reports of higher energy prices remaining historically sharp, at around 8.5 times the normal level. Concurrently, there was evidence that supply pressures were continuing to ease with reports of raw material shortages the lowest in two years. Despite this, several key commodities registered a higher number of supplier shortages reports in October, such as semiconductors, stainless steel and polypropylene. Furthermore, whilst remaining comfortably below the survey peak recorded in May, reports of transport shortages ticked up in October to a four-month high."

West Michigan Unemployment. According to the local index of EMPLOYMENT, only 12 percent of our survey respondents reported adding new employees for the month of October. Additionally, 14 percent of the respondents reported staff reductions, resulting in our overall index turning negative at -2 for the first time in 30 months. The Michigan unemployment rate for September (latest month available) held steady at 4.1, the lowest the rate has been since January 2020. Among the local counties with falling unemployment rates are Ottawa County (3.0 percent), Kent County (3.2 percent), and Kalamazoo County (4.7 percent). It is wise to remember that unemployment statistics are laggards, and we are likely to see employment rates start to rise soon.

Business and Consumer Confidence. Confidence for both businesses and individuals tends to offer a clue to future spending behavior. Needless to say, the constant barrage of news continuing to warn of a possible recession in the near future is having an impact on all measures of confidence. According to the Conference Board's Index of Consumer Confidence, consumers are starting to worry. CB's October index now stands at 102.5 (1985=100), down from the revised 107.8 reported in September. By contrast, the University of Michigan's October Consumer Sentiment Index inched up 1.3 points to 59.9. Although any improvement is welcome, U of M's index is still FAR below the reading of 72.8 reported only one year ago. For our West Michigan survey of the industrial economy, confidence continues to edge slightly lower. The SHORT-TERM BUSINESS OUTLOOK Index for October, which asks local firms about the business perception for the next three to six months, posted at -14, a slight drop from September's -12. The LONG-TERM BUSINESS OUTLOOK Index, which queries the perception for the next three to five years, remained single-digit positive and eased to +5 from +17.

GDP. For the first two quarters of 2022. GDP growth for the U.S. came in modestly negative. On October 27, the U.S. Bureau of Economic Analysis headlined the business news with an announcement that the estimated GDP growth rate for the third quarter posted at 2.6 percent, very close to the Atlanta Fed's GDPNow prediction of 2.7 percent. Looking ahead to the 2022 fourth quarter, the GDPNow model is predicting a gain of 3.6 percent. A less optimistic forecast of 2.0 growth comes from the OECD. A pessimistic forecast from the Conference Board calls for GDP to modestly decline at a rate of 0.8 percent. With the current divergence in forecasts, it is understandable why the New York Federal Reserve decided to abstain from GDP forecasting until the economy stabilizes. All of the forecasters are assuming that the unemployment rate will edge up very slowly, which seems logical given the abundance of current job openings. Most forecasters also assume that the Ukrainian war will not end in the fourth quarter, and that there will be no other major surprises from bad actors like North Korea or China.

Summary. Primarily because of rising interest rates, the West Michigan economy will continue to slowly soften. There is no sign that inflation will be tamed anytime soon, so we should expect an additional rate hike when the Fed's open market committee (FOMC) meets again in January. Unfortunately, the Federal Reserve fully admits that hiking interest rates is a "blunt instrument" for controlling inflation. Any industry tied to borrowing, especially residential construction, is already feeling the pinch. In addition, rising interest rates are causing the market for existing homes to falter. Consumers with low-rate mortgages will find it more difficult to move because of the significantly higher cost of a new mortgage. Interest rates for auto loans and credit cards will inhibit spending on credit for almost everything, and the 8 percent inflation rate will be a double whammy. Because the U.S. Dollar Index (DXY) currently stands at 112.8, up from 98.1 only a year ago, goods purchased overseas are now averaging 13 percent higher in price. Compared to the other major reserve currencies, namely the Pound, Euro, and Yen, the dollar has obviously been gaining strength, primarily because of the attraction of the interest rate hikes recently posted by the Federal Reserve. Although the central banks from the other industrialized nations are also raising interest rates to fight inflation, many of the world's money managers still prefer the stability of the U.S. dollar. It is counterintuitive to think that a strong dollar in not good for the U.S. economy, but that is now becoming the dilemma of higher interest rates.

OCTOBER COMMENTS FROM SURVEY PARTICIPANTS

"Automotive demand is rather high for certain items and very up and down as Supply chains open up then constrict. Major concerns about long lead time items such as steel and limiting our financial risk if the demand slows based on struggling economy."

"Our business is about the same as last month but down significantly from 3-4 months ago."

"Business is still "off plan," and we're still having some customer pull back from strong forecast."

"The market is hard to read right now. Most customers remain somewhat optimistic but orders show a softening in the near term."

"We have few changes from September to the October outlook."

"We are still having issues with components for machinery, computer chips, ball screws, foundry good, and steel items."

"Everything changes from day-to-day and week-to-week of what's hard to get and what prices are going to pay. You don't know if you are going to get a shipment until it lands on your deck. It seems like everybody's in the same boat."

"Not too many things at this time are going down in price. In general, prices have either leveled off or are continuing to increase."

"Orders are slowing down."

"Demand conditions are deteriorating beyond factors that are attributable to rebounding from COVID bottlenecks and rapid price increases. Real demand destruction is occurring and we are operating in an over-supplied market for the first time in several years. Layoffs will be necessary if demand does not recover."

"Our quoting levels remain high and constant; however, new orders are taking longer to come in. Buyers seem to be waiting until the last minute to cut POs."

"We are still struggling to retain employees."

"I feel like we are going to be in a big recession, and it may be bigger than any of us have lived through."

"We continue to see strong sales and have not been able to work down our record backlog. There are some signs at our other divisions that a slowdown is coming, so we are changing long term outlook to down."

"It looks like we are in for a bit of a slowdown. New Orders are not where they were in mid-summer."

"Just when it appeared the availability of electric motors was improving, a whole different group of ratings became hard to get."

"Order pacing has slowed and is expected to remain lower than anticipated."

October 2022 Survey Statistics

	UP	SAME	DOWN	N/A	Oct. Index	Sept. Index	Aug. Index	25 Year Average
Sales (New Orders)	10%	68%	22%	0%	-12	- 0	- 5	+14
Production (Gross Output)	19%	57%	14%	10%	+ 5	- 0	+17	+14
Employment	12%	74%	14%	0%	- 2	+ 4	+26	+ 8
Purchases	14%	60%	26%	0%	-12	- 7	+ 2	+ 7
Prices Paid (major commod.)	26%	55%	19%	0%	+ 7	+26	+26	+15
Lead Times (from suppliers)	24%	47%	29%	0%	- 5	+16	+16	+11
Purchased Materials Inv. (Raw materials & supplies)	10%	56%	29%	5%	-19	+ 7	+28	- 4
Finished Goods Inventory	19%	55%	21%	5%	- 2	+ 7	+19	- 8
Short Term Business Outlook (Next 3-6 months)	7%	72%	21%	0%	-14	-12	+ 2	-
Long Term Business Outlook (Next 3-5 years)	24%	52%	19%	5%	+ 5	+17	+28	-

Items in short supply: Steel, steel-based products, stainless round bar, Carbide, some aluminum items, domestic aluminum castings, domestic aluminum extrusions, electronics, electrical panels, electronic board parts, electronic components, fasteners, finished goods assemblies, motors, explosion proof electric motors, reducers, sprockets, computer chips, ball screws, foundry and steel items, perishable meat items, sodium gluconate, freight (mainly rail and vessel space), labor, labor, and labor.

Prices on the UP side: Corrugated, packaging, motors, drives, paper, rubber hose, steel from Korea, electronics, some pipe fittings and flanges, all raw materials, fuel, diesel, any petroleum-based product, grain, sugar, freight, stainless steel, stainless steel long bar, corrugated, specialty resins.

Prices on the DOWN side: Steel (HR and CR) *, carbon steel, stainless steel*, wire rod, scrap steel, Container freight from China to US West Coast, ocean freight, polypropylene, ABS, PC, Nylon 6 - 6/6, aluminum*, copper, plastics*, brass, lumber.

*Item reported as both up AND down in price.

Latest Unemployment Reports

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

	Sept. 2022	Sept. 2021	Sept. 2009	20 Year Low
State of Michigan (Sept.)	4.1%	5.7%	14.6%	3.2%
State of Michigan (Unadj.)	3.7%	5.2%	14.1%	2.9%
Kent County	3.2%	4.0%	11.9%	2.1%
Kalamazoo County	3.7%	4.4%	11.1%	2.1%
Calhoun County	4.7%	5.6%	12.8%	2.7%
Ottawa County	3.0%	3.4%	13.3%	1.8%
Barry County	3.3%	3.6%	10.9%	2.2%
Kalamazoo City	4.6%	5.4%	15.2%	3.2%
Portage City	3.4%	4.0%	8.7%	1.3%
Grand Rapids City	4.3%	5.3%	16.1%	3.0%
Kentwood City	3.1%	3.8%	10.7%	1.4%
Plainfield Twp.	2.4%	3.0%	8.0%	1.4%
U.S. Official Rate (Sept.)	3.5%	4.7%	9.6%	3.5%
U.S. Rate (Unadjusted)	3.3%	4.6%	9.6%	3.4%
U.S. U-6 Rate (Sept.)**	6.7%	8.5%	22.9%	6.7%

**U-6 for Michigan = 6.9% for Q4 of 2021 thru Q3 2022

Index of New Orders: West Michigan

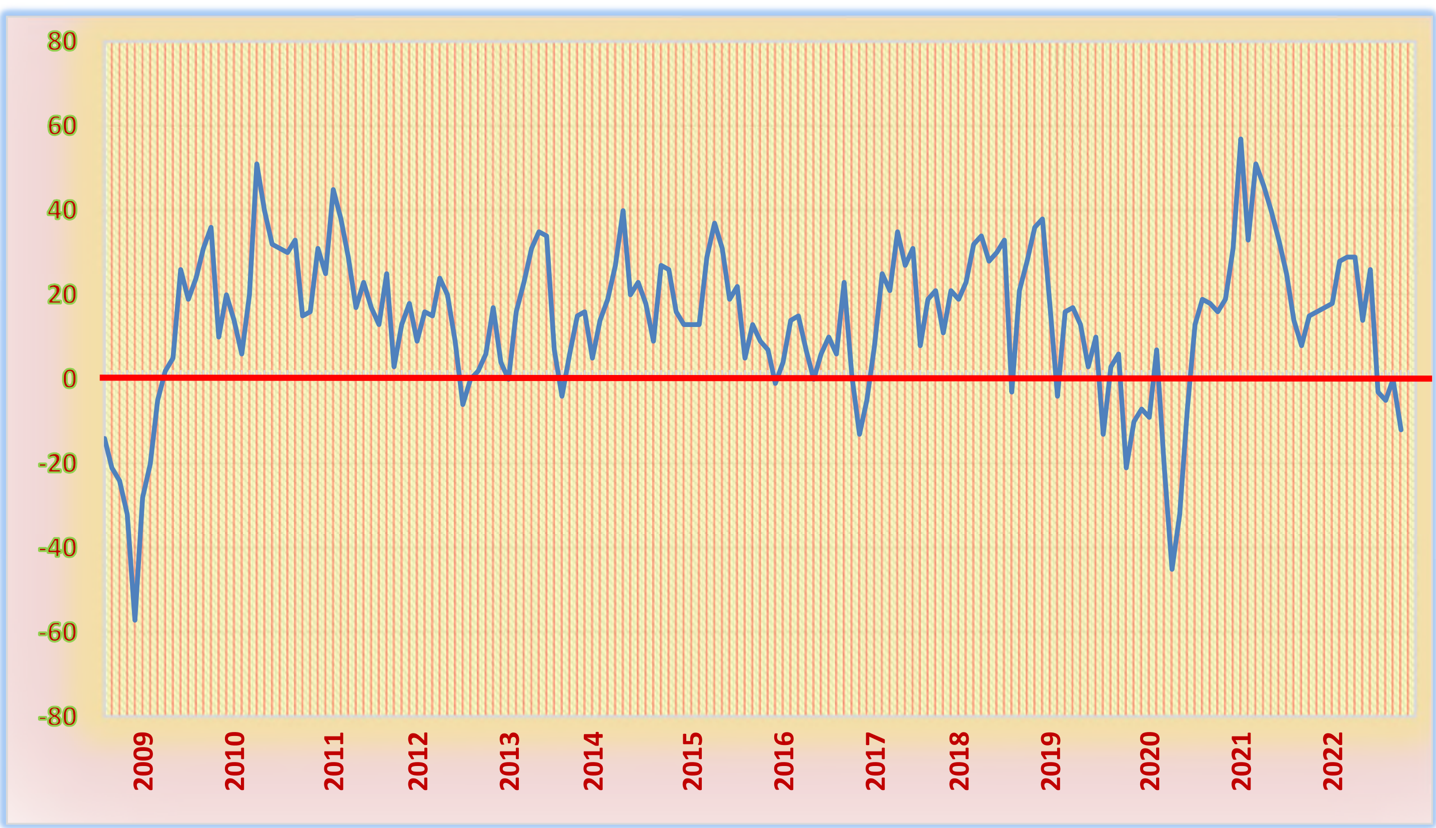
As the name implies, this index measures new business coming into the firm, and signifies business improvement or business decline. When this index is positive for an extended period of time, it implies that the firm or organization will soon need to purchase more raw materials and services, hire more 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	- 0 for the month of October, 2022
Previous Month	- 0 for the month of September, 2022
One Year Ago	+ 46 for the month of October, 2021
Record Low	- 57 for the month of December 2008
Record High	+ 57 for the month of January 2021

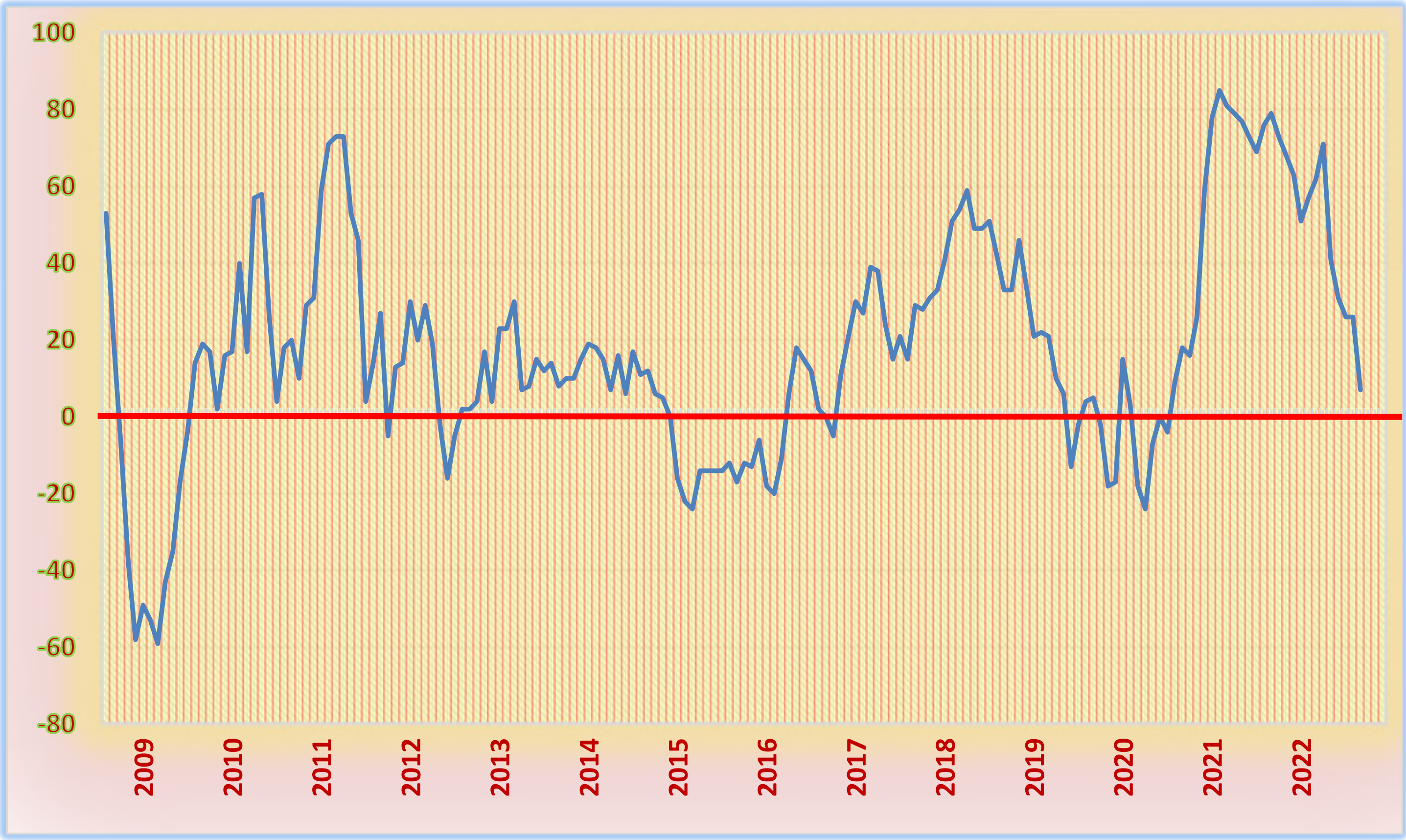
Great Recession
First Recovery + 3 in April 2009

COVID-19 Recession
First Recovery +12 in July 2020

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

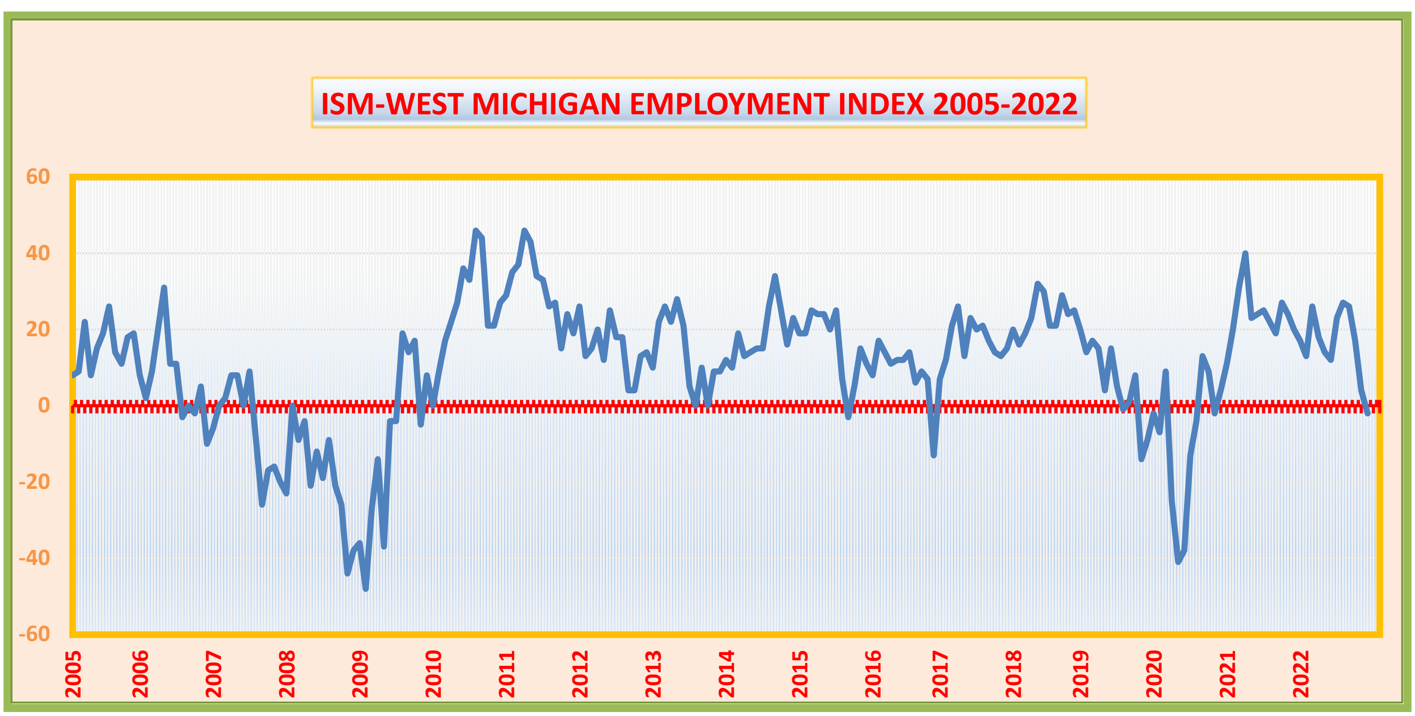


ISM-West Michigan Index of PRICES: 2008-2022



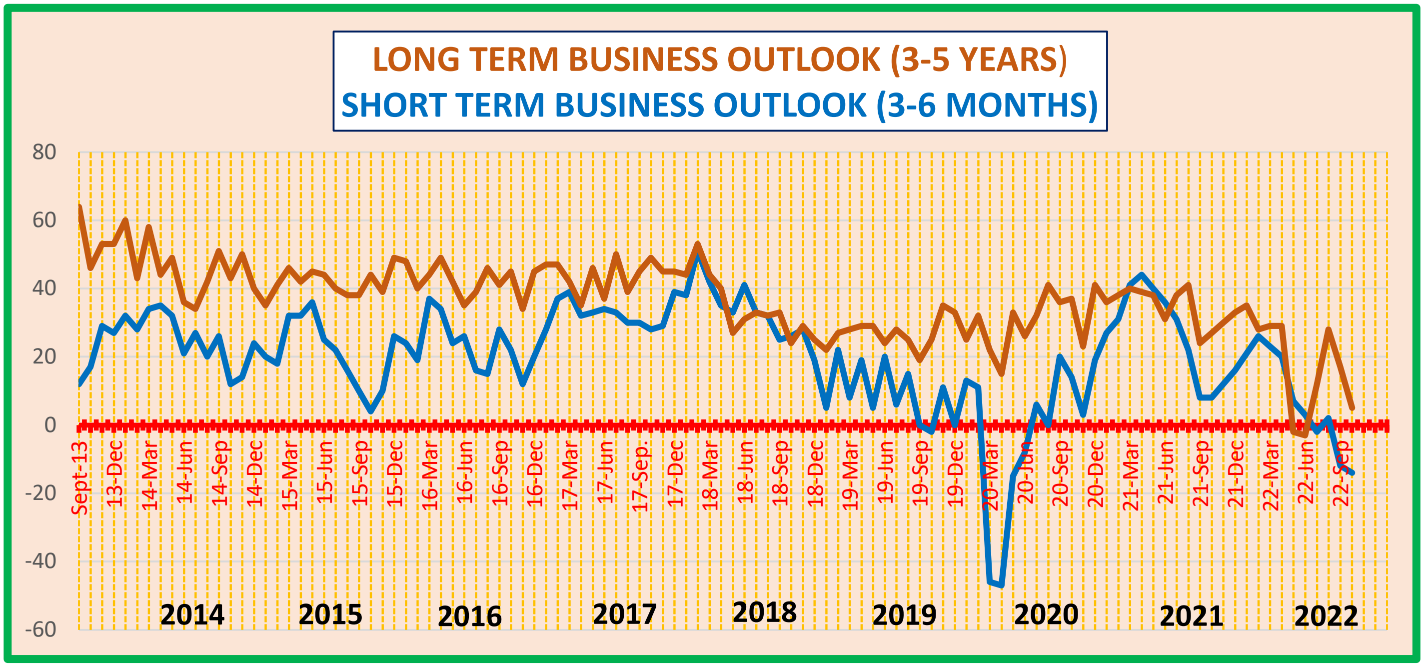
ISM-WEST MICHIGAN INDEX OF EMPLOYMENT

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.



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