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West Michigan Current Business Trends

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WEST MICHIGAN ECONOMY REBOUNDS

Key Take-Aways from January 2023 Statistics:

- **Sharp Rise in NEW ORDERS for West Michigan**
- **National Economy Continues to Soften**
- **Local Layoffs are Still Minimal**

Key Index Results:	Jan.	Dec.
NEW ORDERS Index (business improvement)	+18	-24
PRODUCTION Index (aka "output")	+21	-10
EMPLOYMENT Index	+13	+14
LEAD TIMES Index	-16	-14

Key Participant Comments for January:

"Automotive and heavy diesel markets remain strong."

"Sales in December were very sluggish. January is faring better, but not overwhelmingly so. Office furniture seems to be slowing down more consistently."

"Markets continue to be uncertain with customers' orders changing week-to-week due to unexpected down time."

"There is optimism for the second half of the year provided that Fed rate increases plateau sometime in the first half.

"Aluminum and steel mills are reporting lower demand across the board as inventories continue to correct."

The Local Economy. Historically, our local statistics have frequently bounced around. Even though our data edged sharply lower in December, we saw a significant reversal in this month's survey. January is often considered a back-to-work month, but the primary driver appeared to be new business coming into our automotive parts producers, and to a lesser degree, the local aerospace subcontractors. Leading the uptick was the NEW ORDERS Index, our closely-watched index of business improvement, which bounced to +18 from -24. In confirmation of the trend, the January PRODUCTION Index came in at +21, up from -10. Activity in the purchasing offices, our PURCHASES Index, rebounded to +11 from December's thirty-month low of -19. As a clear indication that most of the bottlenecks in the supply chain have been resolved, the LEAD TIMES Index eased to -16 from December's -14. Overall, the current survey numbers constitute a great start for 2023. Even though the direction of the economy for the rest of 2023 is still unclear, we can still expect our automotive parts producers to offset much of the weakness in other industries, especially office furniture. That said, our survey numbers may still bounce around until the threat of a recession or an actual recession has passed.

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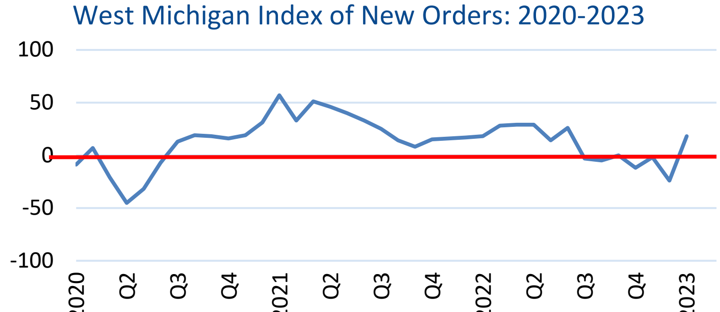
The U.S. Economy. Although our current West Michigan numbers are positive, the January statistics from the Institute for Supply Management (ISM) continued to be negative. ISM's NEW ORDERS Index posted at -18, down from -16. ISM's January PRODUCTION (a.k.a., Output) Index fell to -10 from -9. However, ORDER BACKLOG, another key ISM index, remained negative but recovered to -13 from -17. NEW EXPORT ORDERS recuperated to -1 from -8, and IMPORT ORDERS edged up to -5 from -10. After statistical adjustments, ISM's Composite January Manufacturing PMI posted at 47.4, down from December's 48.4.

West Michigan Index of New Orders: 2020-2023



The survey from the British-based international consulting firm of S&P Global paints a slightly different picture of the U.S. industrial economy. The January S&P Composite Index remained well below the 50.0 break-even point but improved modestly to 46.9 from 46.2. Although S&P's index of Order Backlogs dropped sharply, the index of Business Confidence ticked higher, primarily because of improved stability in the supply chains. However, just like our local survey, the S&P Employment Index remains modestly positive. Chris Williamson, Chief Business Economist at S&P Global Market Intelligence, said:

> "Despite rising in January, the PMI remains at one of the lowest levels recorded since the global financial crisis, indicating a worryingly steep rate of decline in the health of the goods producing sector. Production has now fallen for three successive months, signalling a sharp fall in output which is now becoming increasingly evident in the official statistics and suggesting that the manufacturing sector has become a major drag on GDP. New orders are also slumping as demand from both domestic and export customers comes under increasing pressure from a mix of inflation and slower economic growth. The drop in orders also means that excess capacity is developing, which has in turn meant companies have scaled back their hiring and purchasing, and are also increasingly focusing on reducing their inventory levels. Improved supply chains and weaker demand should meanwhile help keep a lid on manufacturing price pressures in the months ahead, though a slight uptick in the survey's input cost and selling price gauges in January suggests that the road to lower inflation could be bumpier than previously anticipated, reflecting still elevated prices for many raw materials relative to pre-pandemic levels and sustained upward wage pressures."

<u>The World Economy</u>. The January J.P. Morgan Worldwide Manufacturing PMI remained negative but upticked to 49.1 from 48.7. In a similar move, JPM's New Orders Index rose to 47.8 from 46.4, and January's Output Index rose to 49.0 from 48.5. There are now nine countries in JPM's survey posting significantly positive PMIs, namely India, Thailand, Philippines, Russia, Indonesia, Mexico, Canada, France, and Italy. The December PMI from Canada, our largest trading partner, returned to a positive PMI of 51.0, up nicely from December's 49.2. By contrast, the PMI for Mexico, our second largest trading partner, eased to 48.9, down significantly from December's six-month high of 51.3. Despite all of the talk about China reopening, the January PMI for our third largest trading partner posted 49.2, a tad below the all-important break-even point of 50.0. The JPM report further noted:

> "Manufacturers' business confidence continued to revive at the start of 2023, with optimism hitting a ten-month high. The cyclically-sensitive new orders-to-finished goods stock ratio also climbed to a seven-month record. The level of incoming new business fell for the seventh consecutive month in January, albeit to the least marked extent since last August. A similar trend was signalled for new export business, where the pace of contraction was a six-month low. The continued downturn in new order intakes nonetheless meant that spare capacity remained in global industry, as highlighted by a solid decrease in backlogs of work at factories. Staffing levels edged higher at the start of 2023, after falling in each of the prior two months. Supply chain pressures continued to ease, with average vendor lead times lengthening to the lowest extent in three years."

Although business conditions for the Eurozone remain negative, the January PMI posted at 48.8 from 47.1, the strongest the index has been in five months. The risk of a recession continues to cloud the outlook, and Chris Williamson further commented:

> "Although euro area manufacturers continued to report falling output and deteriorating order books in January, sustaining the sector's downturn for an eighth successive month, the picture is considerably brighter than the lows seen back in last October heading into the winter. Not only has the rate of output decline moderated now for three consecutive months, but business optimism about the year ahead has also surged higher over the past three months. Worries over gas supply constraints and soaring gas costs have given way to a much more stable looking energy market in Europe, albeit thanks in part to state subsidies and mild weather. At the same time, broader supply chain constraints have eased considerably, helping many companies reduce their backlogs of work and ramp up production. The lifting of COVID-19 restrictions in mainland China has meanwhile added to the sense that the global drag from the pandemic has passed. All of which has helped bring down broader inflation pressures and lifted confidence that the worst of the cost-of-living squeeze is over. However, demand remains lacklustre with few signs of any serious growth drivers on the horizon. The economy has also yet to feel the full impact of higher interest rates, which look set to rise further in the coming months, presenting a potentially challenging outlook for economic growth."

<u>Automotive</u>. Once again, there is optimism that the ongoing automotive chip shortage may be nearing an end. Deliveries for cars and light trucks in January rose 4.5 percent, primarily because of higher shipments to fleet buyers, especially the rental car companies. The SAAR (Seasonally Adjusted Annualized Rate) for January posted at 16.2 million units, well above the major forecasts. During the pandemic, many of the rental car companies sold off significant parts of their fleets in order to stay afloat, and with air travel now returning to normal, they are scrambling to replenish their airport fleets amid the production restrictions brought on by the chip shortage and other supply chain disruptions. Of the firms that are still reporting monthly, year-over-year sales at beleaguered Honda rose by 14.3 percent, Hyundai-Kia 14.8 percent, and Subaru gained a paltry 0.5 percent. For a second successive month, Ford sales rose 1.8 percent. Toyota sales fell by 14.8 percent, casting doubt on the firm's claim that their chip shortage has been resolved. TrueCar analyst Zack Krelle further noted:

> "Consumers continue to face rising new-vehicle prices across the industry. However, the pace has slowed as inventory for many high-demand vehicles grows.

Fewer vehicles are seeing markups, particularly for import brands which faced pronounced scarcity during the peak of the shortages."

Industrial Inflation. Last month, the West Michigan Index of PRICES finally turned negative at -2, down from November's +10. For January, the index came in flat at +0. Many major commodities had been falling in price, but recent upticks in copper and aluminum pricing have halted the decline. The January ISM national index of PRICES remained negative at -11, but upticked from December's -21. At the international level, the J.P. Morgan world index of PRICES remained well above the 50.0 equilibrium point and moved higher to 57.1 from 56.8. Commenting on the latest inflation numbers, Annabel Fiddes at S&P Global Market Intelligence said:

> "After having seen intense price and supply pressures since the onset of the pandemic, the latest indicators provided further signs that these pressures have eased noticeably as we start 2023. Reports of price rises were the second-lowest in just over two-and-a-half-years in January, with energy cost pressures moderating to the lowest since July 2021 and reports of higher electricity costs hitting the lowest since April 2021. Semiconductors and electrical items recorded the most severe price pressures of the monitored categories, with reports of inflation running at or near six times the respective average. Supply chain pressures moderated to the lowest since October 2021. Seven categories saw supply shortages ease, most notably packaging and iron. However, reports of oil shortages rose to a seven-month high."

West Michigan Unemployment. Despite ongoing recession fears, the employment situation in West Michigan remains surprisingly strong. The January index of EMPLOYMENT posted at +13, virtually unchanged from last month's +14. Only 5 percent of the January survey respondents reported layoffs. The Michigan unemployment rate for December held steady at 4.3 percent, a full percentage point above the national average. Most of our local economies are reporting some modest increases in unemployment upticks, but the overall unemployment rates for most West Michigan counties remain well below the rest of the state. The lowest local rate is currently in Ottawa County (2.9 percent), followed by Kent County (3.1 percent), Kalamazoo County (3.5 percent), and Barry County (3.6 percent). Given the nature of the current business cycle we may see unemployment rates slowly rise. We still don't see significant increases in West Michigan unemployment until early summer, if then.

Business and Consumer Confidence. If there is a recession coming, it is not reflected in either business or consumer confidence. The January 31 report from the Conference Board Consumer Confidence Index posted a minor drop to 107.1 from December's 109.0 reported. Although the University of Michigan's index of Consumer Sentiment remains low from a historical perspective, the January report upticked to 64.9 from 59.7. Again, survey authors applauded the "move in the right direction." At the local level, the West Michigan survey of the SHORT-TERM BUSINESS OUTLOOK Index for January, which asks local firms about their business perceptions for the next three to six months, posted at +6, up significantly from last month's reading of -12. However, the LONG-TERM BUSINESS OUTLOOK Index, which queries the perception for the next three to five years, retreated to +10 from +31.

GDP. This month's big news came from the January 26 press release from the Bureau of Economic Analysis, which posted a preliminary estimate of fourth quarter 2022 GDP growth of 2.9 percent, only marginally below the final estimate of 3.2 percent growth for the third quarter. Just like previous months, the Atlanta Fed's GDPNow model, which predicted the number to be 3.8 percent, came in closer than any of the other major forecasts. The other forecasts we reported last month, namely 1.1 percent, 1.0 percent, and 0.7 percent, were off by a mile. With attention now turning to the estimates for the first quarter of 2023, the GDPNow model is currently predicting a growth rate of 0.7 percent. The author sites the impact of higher interest rates potentially beginning to restrict overall economic growth. By contrast, Conference Board is currently forecasting a first quarter growth rate of 1.7 percent. It is still early in the first quarter, so most estimates will continue to be revised.

Summary. At last week's meeting, the Federal Reserve raised interest rates another quarter point to a target rate of 4.75 percent. Reading the accompanying press release, it becomes apparent that further increases are expected for several more meetings. We know that the fight to control inflation will continue, but even the Fed seems uncertain about how long it will take for the rates to finally take hold. Furthermore, many lower income workers are feeling squeezed by higher costs for rent, food, and fuel, and are now demanding higher wages. We may see a flurry of strikes as many of the current labor contracts expire. There hasn't been inflation driven by a traditional wage-price spiral in almost 40 years, but if prices don't begin falling soon, that's exactly where we may be headed. As we've mentioned many times, about 40 percent of the CPI is driven by the cost of housing. Even though the housing market is cooling and the national average of the cost of rent is finally falling, it will take at least 18-24 months for the lower prices to fully wash through the system. For most economists, including those at the Federal Reserve, these are confusing times. However, if an ongoing inflation psychology finally takes hold with the average consumer, it may take a Fed-induced recession similar to the early 1980's to bring inflation back to the stable 2-3 percent we enjoyed for the past 40 years.

JANUARY 2023 Survey Statistics

	UP	SAME	DOWN	N/A	Jan. Index	Dec. Index	Nov. Index	25 Year Average
Sales (New Orders)	34%	50%	16%	0%	+18	-24	- 2	+14
Production (Gross Output)	30%	54%	9%	7%	+21	-10	+ 7	+14
Employment	18%	75%	5%	2%	+13	+14	+20	+ 8
Purchases	14%	63%	23%	0%	+11	-19	- 2	+ 7
Prices Paid (major commodities)	23%	54%	23%	0%	+ 0	- 2	+10	+15
Lead Times (from suppliers)	9%	66%	25%	2%	-16	-14	- 5	+11
Purchased Materials Inv. (Raw materials & supplies)	16%	57%	25%	2%	- 9	-10	-20	- 4
Finished Goods Inventory	18%	50%	23%	9%	- 5	- 12	- 9	- 8
Short Term Business Outlook (Next 3-6 months)	20%	66%	14%	0%	+ 6	- 12	-22	-
Long Term Business Outlook (Next 3-5 years)	34%	50%	14%	2%	+10	+31	+22	-

Items in short supply:

Garments and consumables, some chemicals, electronics, electronic components, aluminum tubing, larger tiles (24 x 48), anything Asian, all container items, engineered fasteners, aluminum, steel, reducers, motors, fasteners, labor, cabinet makers, experienced wood CNC equipment operators/programmers.

Prices on the UP side:

Steel, stainless steel, labor, brass, copper, fuel, aluminum, fasteners, fuel surcharges seem to have bottomed and are creeping back up, chemicals.

Prices on the DOWN side:

Steel *, stainless steel*, metal surcharges, corrugated, lumber, ocean containers, polypropylene, ABS, nylon 6, polycarbonate, polypropylene, freight and transportation (base rates), oil-based products, Nitrile Gloves, gasoline, natural gas, corrugate, plywood.

**Item reported as both up AND down in price*

Latest Unemployment Reports:

(Except as noted, data are NOT seasonally adjusted)

	Dec. 2022	Dec. 2021	Aug. 2009	20-Year Low
State of Michigan (Dec.)	4.3%	5.1%	14.6%	3.2%
State of Michigan (Unadj.)	3.8%	4.2%	14.1%	2.9%
Kent County	3.1%	3.2%	11.9%	2.1%
Kalamazoo County	3.5%	3.5%	11.1%	2.1%
Calhoun County	4.5%	4.8%	12.8%	2.7%
Ottawa County	2.9%	2.9%	13.3%	1.8%
Barry County	3.6%	3.4%	10.9%	2.2%
Kalamazoo City	4.4%	4.4%	15.2%	3.2%
Portage City	3.2%	3.3%	8.7%	1.3%
Grand Rapids City	4.1%	4.3%	16.1%	3.0%
Kentwood City	2.9%	3.1%	10.7%	1.4%
Plainfield Twp.	2.5%	2.4%	8.0%	1.4%
U.S. Official Rate (Dec.)	3.3%	3.7%	9.6%	3.5%
U.S. Rate (Unadjusted)	3.4%	3.9%	9.6%	3.4%
U.S. U-6 Rate (Dec.)**	6.5%	7.2%	22.9%	6.7%

***U-6 for Michigan = 6.8% for all of 2022*

JANUARY COMMENTS FROM SURVEY PARTICIPANTS

"Sales in December were very sluggish. January faring better, but not overwhelmingly so. Office furniture seems to be slowing down more consistently."

"Order books are very soft as customers continue to right-size inventory positions to new (lower) demand levels. There is optimism for the second half of the year provided that Fed rate increases plateau sometime in the first half. Aluminum and steel mills are reporting lower demand across the board as inventories continue correction. Some pricing concessions are beginning to occur in an effort stimulate demand, but consensus is that even with steep discounts there is not sufficient demand to justify more inventory downstream."

"Automotive and heavy diesel markets remain strong. Forecasting has continued to be all over the place. Some parts we can't make enough to keep up and some deliveries were pushed out at the beginning of the year. We anticipate continued 2023 Q1 improvement over 2022 Q1 in top line sales. Expense control is key."

"We had an increase in price for machines coming from Europe because of increases in steel, chip and wiring harness pricing.

"There are rumors about paint price increases on the horizon because of rising raw material (resins) inputs."

"Markets continue to be uncertain with customers' orders changing week to week due to unexpected down time."

"We are seeing a slight increase in bsiness from the last quarter (2022 Q4). Nothing to write home about, but at least we're trending in the right direction."

"Orders are good, currently just not growing."

"Our government needs to get spending under control or things are going to get worse."

"Not much change from previous month. We're keeping a close eye on the situations in China and starting to plan for alternative sources."

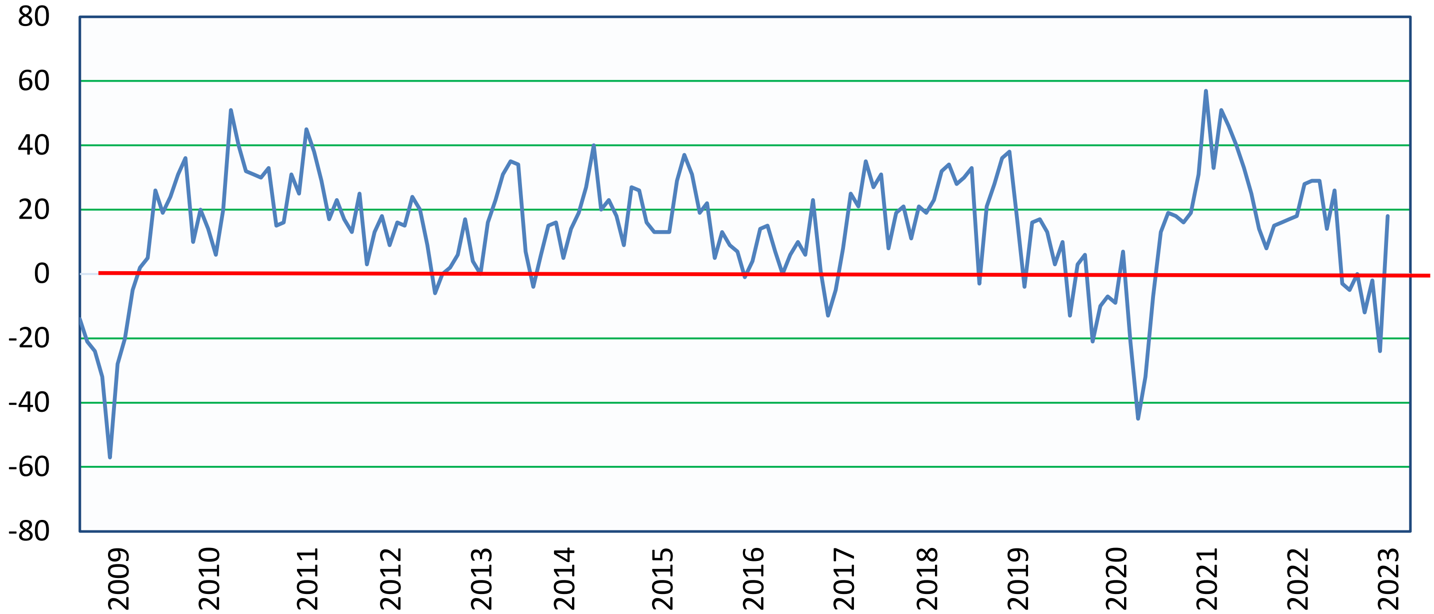
"We have seen a 15% decrease in our production schedule for the month of January."

"IT equipment (servers) have an extended lead time beyond what we initial expected."

"What is in short supply changes every day or week on the parts that you can't get. This week, it's gas shut-off valves."

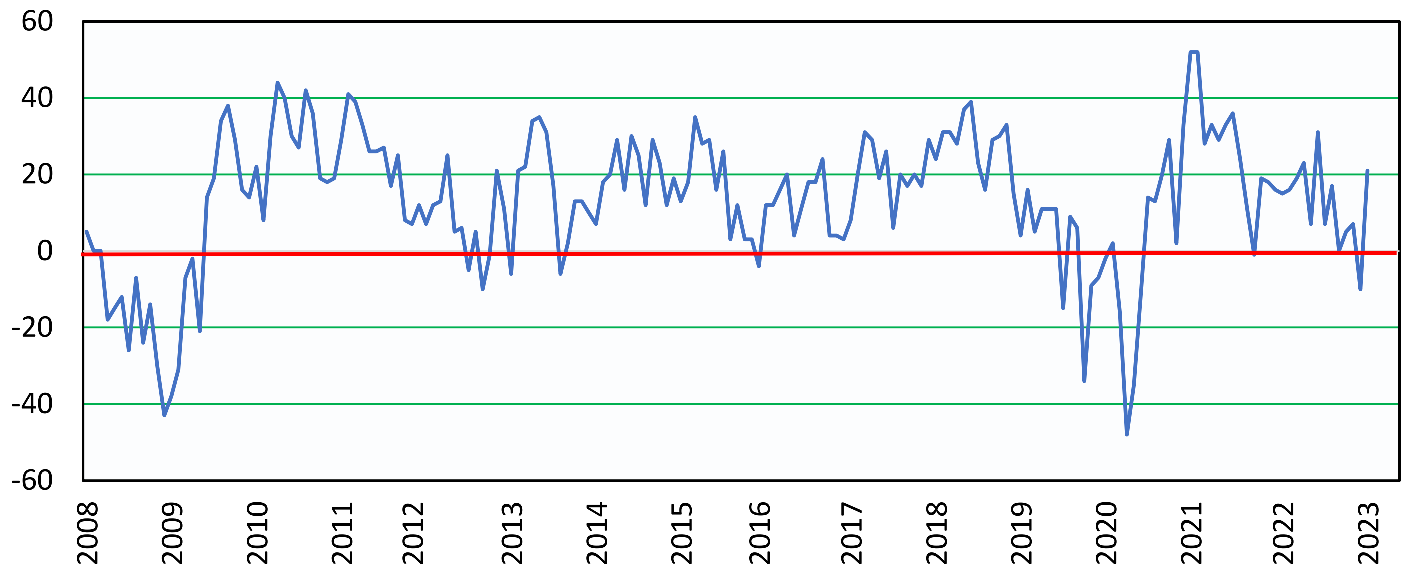
West Michigan Index of New Orders: 2008-2023

As the name implies, the NEW ORDERS 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.



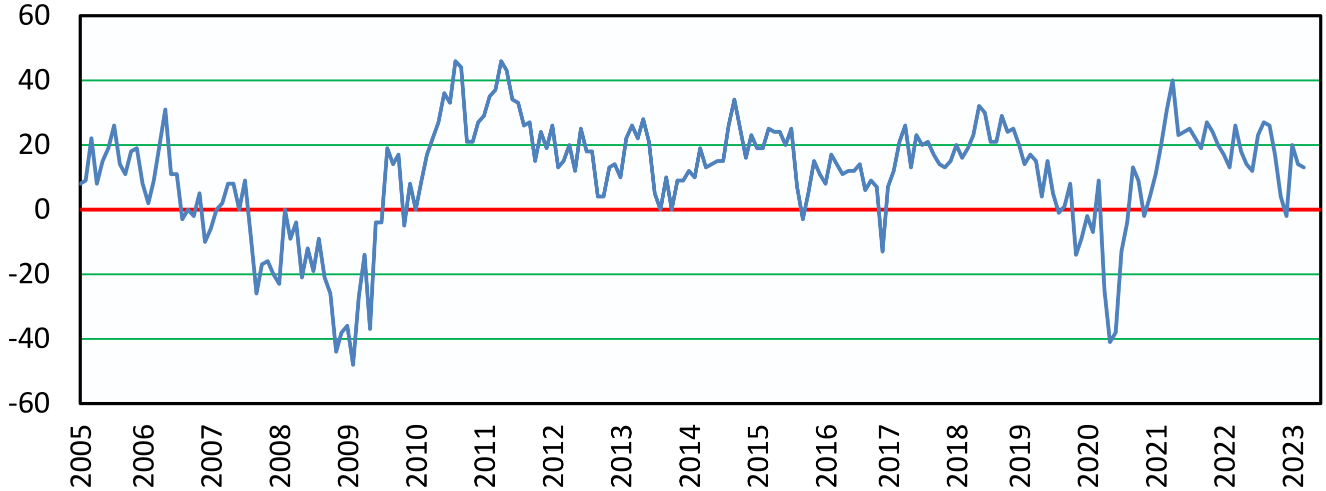
West Michigan Index of Production (Output): 2008-2023

As new orders come in and materials arrive at the loading dock, production schedules are posted to meet the customer's needs. Although production schedules respond to demand, they also respond to seasonal factors such as holidays as well as bad weather, materials shortages, or other external influences.



West Michigan Index of Employment: 2005-2023

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.



Michigan Future Business Outlook: 2013-2023

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.