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West Michigan Current Business Trends

March 6, 2023

BACK TO NEGATIVE GROWTH

Key Take-Aways from February 2023 Statistics:

- **Significant Drop in NEW ORDERS**
- **National Economy Continues to Soften**
- **Local Layoffs are Still Minimal**

Key Index Results:	Feb.	Jan.
NEW ORDERS Index (business improvement)	-17	+18
PRODUCTION Index (aka "output")	- 7	+21
EMPLOYMENT Index	+12	+13
LEAD TIMES Index	-19	-16

Key Participant Comments for February:

"Some automotive customers beginning to push out and reduce demand leaving us with excess stock or raw material and components."

"Sales are down across the board.

"Our business is stable right now, which is a good thing!"

"We're still steady, but our record dollar sales are being driven by price increases. The actual unit volume is flat."

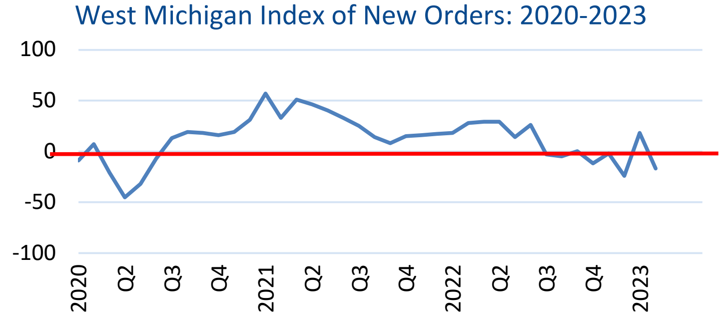
"We are watching the office furniture industry closely. Some market indicators suggest a softening in the coming months as backlogs are reduced or eliminated."

The Local Economy. As 2023 continues to unfold, the back-to-work euphoria of January has faded, and our February data edged lower. NEW ORDERS, our index of business improvement, retreated to -17, down from January's +18, but more in line with December's -24. In confirmation of the trend, the February PRODUCTION Index fell to -7 from +21. Activity in the purchasing offices, our PURCHASES Index, flattened to -2, down from January's +11. As a clear indication that supply chains are normalizing, the LEAD TIMES Index, which had been at a record level of +93 only 22 months ago, came in at -19, a slight improvement from January's reading of -16. It is worth repeating that most of the bottlenecks in the supply chain have been resolved, although the spot markets for a few commodities are still unresolved. Overall, we had expected business condition to soften in 2023, and this month's report is a confirmation of that trend. We expect interest rate sensitive industries to retreat, but are still expecting that the pent-up demand for automotive will keep the West Michigan economy positive. The outlook for our local aerospace firms will remain positive, but the prospects for the office furniture business remain far less certain. However, even if the markets for office furniture remain soft, a major collapse like we've seen in other downturns is unlikely.

The U.S. Economy. The February statistics from the Institute for Supply Management (ISM) continued to be negative, but ISM's NEW ORDERS Index posted at -2, a sharp improvement over January's pessimistic reading of -18. ISM's February PRODUCTION (a.k.a., Output) Index recovered to -5 from -10. ORDER BACKLOG, another key ISM index, remained negative but recovered to -10 from -13. NEW EXPORT ORDERS turned statically flat at +0, up marginally from January's -1. After statistical adjustments, ISM's Composite February Manufacturing PMI posted at 47.7, up from January's 47.4.

The survey of U.S. purchasing managers conducted monthly by the British-based international consulting firm of S&P Global often offers a slightly different view of the U.S. industrial economy. However, this month's report tracked fairly close to the ISM report. The February S&P Composite Index still remained well below the 50.0

West Michigan Index of New Orders: 2020-2023



break-even point but improved modestly to 47.8 from 46.9. The New Orders index continued to soften, and the report attributed the decline to “destocking” by many customers. In other words, the shortages experienced by many firms worldwide resulted in some firms hording scarce commodities, and now living off their inventors rather than ordering more stock. Because of improved stability in the supply chains, the S&P index of Business Confidence ticked higher. The S&P Employment Index also ticked modestly higher. Chris Williamson, Chief Business Economist at S&P Global Market Intelligence, said:

> “U.S. manufacturing remained under intense pressure in February. Although the PMI rose slightly, it continues to signal the steepest downturn outside of pandemic lockdown months since 2009. Moreover, some of the improvement in output could merely be attributed to faster supplier delivery times, which quickened to the greatest extent since 2009 to facilitate higher production and enable factories to work through previously placed orders. The worry is that new order inflows continue to fall sharply as many companies report disappointing sales, linked in part to a sustained trend towards cost-saving inventory reduction and low levels of confidence at their customers, both at home and abroad. None of this points to a healthy economic situation. There was some brighter news in that factory jobs growth picked up slightly amid reports of greater success in filling vacancies, and the improvement in supply chains helped reduce input cost inflation. However, rising wage pressures and efforts to raise margins meant average prices for goods leaving the factory gate rose sharply once again, the rate of inflation accelerating for a second straight month to hint at stubbornly high price pressures.”

The World Economy. The March 1 press release for the J.P. Morgan Worldwide Manufacturing Index reported that the February PMI upticked from 49.1 to the all-important break-even point of 50.0. JPM’s New Orders Index rose to 49.3 from 47.8, but the February Output Index bounced back to positive at 50.8, up from 48.9. The February PMI from Canada, our largest trading partner, posted at 52.4, up nicely from January’s 51.0. In a similar move, the PMI for Mexico, our second largest trading partner, returned to a positive reading of 51.0, up from 48.9. In China, our third largest trading partner, the government is reopening the economy. The February PMI posted at 51.0, up from 49.2, but still not exactly as robust as might be expected from the news report. Bennett Parrish, Global Economist at J.P.Morgan, further commented:

> “The February manufacturing PMIs point to a welcome return to growth for global industry, amid supply chains improvements and China's reopening. A bounce in new orders reinforces the signal from the output PMIs and should help to sustain the recovery in the coming months. While the supply chain disruptions of the past year continue to fade, the output price PMI has been stuck at an elevated level this year and somewhat raises the risk of goods inflation becoming entrenched.”

Reflecting the numerous problems resulting from the Ukrainian war, the February PMI for the Eurozone remained negative, and posted at 48.5, slightly below January’s reading of 48.8. Four of the major countries in the survey, namely Italy (52.0), Greece (51.7), Ireland (51.3), and Spain (50.7) have now posted positive PMIs for February. On a positive note, respondents cited the easing supplier bottlenecks, improved raw material availability, and shorter lead times all resulting in improvements in the PMI Output Index. Chris Williamson further commented:

> “A marginal expansion of output reported by Eurozone manufacturers in February is welcome news in representing the first increase since last May and a further improvement in the underlying trend from the low seen back in October. The brighter production picture first and foremost reflects a broad-based improvement in supply chains, with deliveries of inputs into factories quickening on average to a degree not seen since 2009. Fewer supply shortages and delays have facilitated higher output, allowing companies to deal with backlogs of work accumulated during the pandemic. Unfortunately, inflows of new orders continued to fall at a marked rate, reflecting persistent weak demand as customer spending remained subdued. Inventory reduction policies also led to falling demand for manufactured inputs. Demand will therefore need to rise further in the coming months if production growth is to be sustained, breaking the reliance on backlogs of work.”

Automotive. Although the automotive chip shortage may be improving, there are still plenty of kinks in the automotive supply chains—at both ends. According to a preliminary tally from LMC Automotive, U.S. light-vehicle sales rose 9.5 percent in February. Many of the manufacturers appear to be giving additional preference to the fleet customers such as the rental car companies, many of which are still scrambling to replenish their airport fleets. Even though dealer inventories are still historically low, they are about 47 percent higher than they were a year ago. The SAAR (Seasonally Adjusted Annualized Rate) for February came in at 14.6 million, down considerably from January’s unexpected 16.2 million units. Of the firms that are still reporting monthly, sales at Ford rose 22 percent, primarily because of sales for both the Ford Branco and Ford Explorer doubling in a year. Other gainers included Hyundai-Kia, up 15.5 percent, Volvo, 26.4 percent, and Subaru gaining a paltry 2.1 percent. Losers included Toyota, falling 2.4 percent, and Honda, losing 1.4 percent. Regarding the auto market going forward, Charlie Chesbrough, senior economist at Cox Automotive, commented:

> “While pent-up demand remains strong in the wake of chronic inventory shortages, higher interest rates, rising new-vehicle prices and falling used-vehicle prices are weighing on retail volume. We have diverging markets today. New inventory is slowly stabilizing while used supply is falling. With many affordability-seeking vehicle buyers leaving the new market for the used, dealers may find they have too little used inventory, and price declines may reverse. And [automakers] may find they have too much new-vehicle inventory and be forced to be more aggressive with incentives to boost sales."

Industrial Inflation. For West Michigan, industrial inflation continues to moderate. Our February Index of PRICES came in at +2, up from January’s +0 and December’s -2. Several key commodities such a steel, aluminum, corrugated, plastic resins, and freight have been reportedly falling in price. However, the February

ISM national index of PRICES bounced back to +3 from -11. According to Usamah Bhatti at S&P Global Market Intelligence:

> "Manufacturing supply chains showed sustained evidence of normalising during February, albeit on a backdrop of depressed output and demand. Latest data pointed to the least acute commodity shortages for 29 months. Overall, all but four of the monitored commodities signalled fewer or the same number of shortfall reports as in January, including semiconductors and electrical items - the latter saw the lowest reports of shortages since January 2021. At the same time, manufacturers reported that the degree of commodity price rises was unchanged from January and among the lowest seen in two-and-a-half years. Panellists signalled price decreases for six commodities (out of 26), including a fourth successive reduction in oil prices. Indeed, reports of oil price reductions were at their greatest since May 2020."

West Michigan Unemployment. One bright spot in our February report is the index of EMPLOYMENT, which remained double-digit positive at +12. Just as last month, only 5 percent of the February survey respondents reported layoffs, compared with 17 percent who are still backfilling job openings. If business conditions continue to soften, this situation may change. However, the labor market remains historically tight, and many firms worked had to build their current workforces. Layoffs will come only when absolutely necessary. Even if the economy does slide into a shallow recession, the West Michigan unemployment will probably rise very slowly.

Business and Consumer Confidence. If there is a recession coming, it is not reflected in either business or consumer confidence. The February 28 report from the Conference Board Consumer Confidence Index posted another minor drop to 102.9 (1985=100), down from an adjusted reading of 106.0 from the previous month. From a historical perspective, the University of Michigan's index of Consumer Sentiment remains fairly low, but the February report upticked to 66.3 from 64.9. However, the author also noted that two-thirds of survey respondents expecting an economic downturn over the next twelve months. Turning to local industrial market, the West Michigan survey of the SHORT-TERM BUSINESS OUTLOOK Index for February, which asks local firms about their business perceptions for the next three to six months, fell to -8 from +6. A sharper drop came from LONG-TERM BUSINESS OUTLOOK Index, which queries the perceptions for the next three to five years, fell sharply to -19 from +10. All measures of future confidence are driven by the news cycle, as well as current markets. This month's pessimism may be related to February's significant drop in NEW ORDERS.

GDP. On February 23, the Bureau of Economic Analysis posted a revised estimate of the fourth quarter 2022 GDP. The minor downward revision from 2.9 to 2.7 percent was attributed to a decrease in "housing investment" on the part of the American public. As always, the attention is now turning to the forecasts for the first quarter of 2023. In the Atlanta Federal Reserve's March 1 report, the GDPNow model forecasts the first quarter of 2023 to grow at a rate of 2.3 percent, up sharply from last month's projection of only 0.7. At 0.5, the February 23 Blue Chip estimate has risen from near zero last month. By sharp contrast, the Conference Board is currently forecasting a first quarter growth rate of -0.6 percent, followed by another drop of -2.0 percent in the second quarter. In blunt terms, the Conference Board is calling for a shallow recession for the first part of 2023, which suggests that we are already in a recession which probably began in January. The first quarter is not yet over, and all of the estimates will be revised when the data for the entire quarter are posted. However, the wide range of opinions shows how highly-educated economists with access to the same data can come to markedly different conclusions.

Summary. A lot of significant date are coming our way in a few days. On March 14, the Bureau of Labor Statistics will release the latest Consumer Price Index for the month of February. We expect only modest improvement. On March 15-16, the Federal Reserve's open market committee (FOMC) will meet again to raise Fed Funds interest rates, probably by another quarter point. The February 24 report on the BEA's Personal Consumption Expenditures Price Index came in at 5.4 percent up from 5.3 percent. Hence, the are some well-founded rumors that some FOMC members are considering a half point increase at the March meeting. The Fed is well aware of the mistakes made back in the 1970's by being too conservative on raising rates and does not want to repeat the mistake. At the same time, they are still hoping for the illusive "soft landing," whereby inflation subsides but the economy does not slide into a recession. Worldwide, many industrial firms are now raising their prices, and it is only a matter of time before these industrial price increases spill over to the consumer market. The Fed has a limited time to act before inflation psychology takes hold among consumers and business alike, which with result in interest rates having to be raised even higher. For the next few months, we may be in for a rough ride.

FEBRUARY 2023 Survey Statistics

	UP	SAME	DOWN	N/A	Feb. Index	Jan. Index	Dec. Index	25 Year Average
Sales (New Orders)	19%	45%	36%	0%	-17	+18	-24	+14
Production (Gross Output)	19%	45%	26%	10%	- 7	+21	-10	+14
Employment	17%	76%	5%	2%	+12	+13	+14	+ 8
Purchases	17%	64%	19%	0%	- 2	+11	- 19	+ 7
Prices Paid (major commodities)	19%	64%	17%	0%	+ 2	+ 0	- 2	+15
Lead Times (from suppliers)	5%	71%	24%	0%	-19	-16	-14	+11
Purchased Materials Inv. (Raw materials & supplies)	17%	47%	26%	10%	- 9	- 9	-10	- 4
Finished Goods Inventory	17%	47%	26%	10%	- 9	- 5	-12	- 8
Short Term Business Outlook (Next 3-6 months)	21%	50%	29%	0%	- 8	+ 6	-12	-
Long Term Business Outlook (Next 3-5 years)	36%	48%	14%	2%	+22	+10	+31	-

Items in short supply:

Copper and copper products, steel, steel fabricated components, electrical components, motors, sprockets, reducers, electronics, stainless steel, garments, various janitorial supplies, aluminum, some protein commodities, foundry capacity, cables and wiring harnesses, control boards, good people.

Prices on the UP side:

Steel, overseas steel, HR and CR steel, steel clamps, scrap steel, stainless steel, fasteners, powder coat, brass, copper, eggs, fresh food, machine tools, copper, freight, paper products, toilet paper, paper towel, wipers, all metals, some electronic components, nylon, aluminum, polypropylene, acetal, benzene.

Prices on the DOWN side:

Steel *, stainless steel*, aluminum*, nylon 6, ABS, natural gas, some chemicals, freight* and ocean freight, corrugated.

**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*

FEBRUARY COMMENTS FROM SURVEY PARTICIPANTS

"Some automotive customers are beginning to push out and reduce demand, leaving us with excess stock and/or raw material and components. Q2 Q3 at this time look a bit more promising, but we're still cautiously optimistic."

"Sales are down across the board. We are working to backfill sales with takeover & new/supplemental sales."

"We're starting to slow down."

"Our government needs to get on a budget and learn how to not spend what we don't have and give it away. This is causing more inflation and problems for everyone."

"Our business is pretty stable right now, which is a good thing!"

"Lead times are still unpredictable, and in most cases, suppliers are extending their lead times instead of ordering higher quantities or using safety stock to better manage the fluctuations in their raw material lead times."

"We are seeing a very gradual increase in business., but we're still well below the peak of last summer."

"The chemical market is beginning to soften. We are starting to see slight price reductions on various chemicals."

"Our business is showing signs of slowing. We continue to keep employees, and are working ahead on some production."

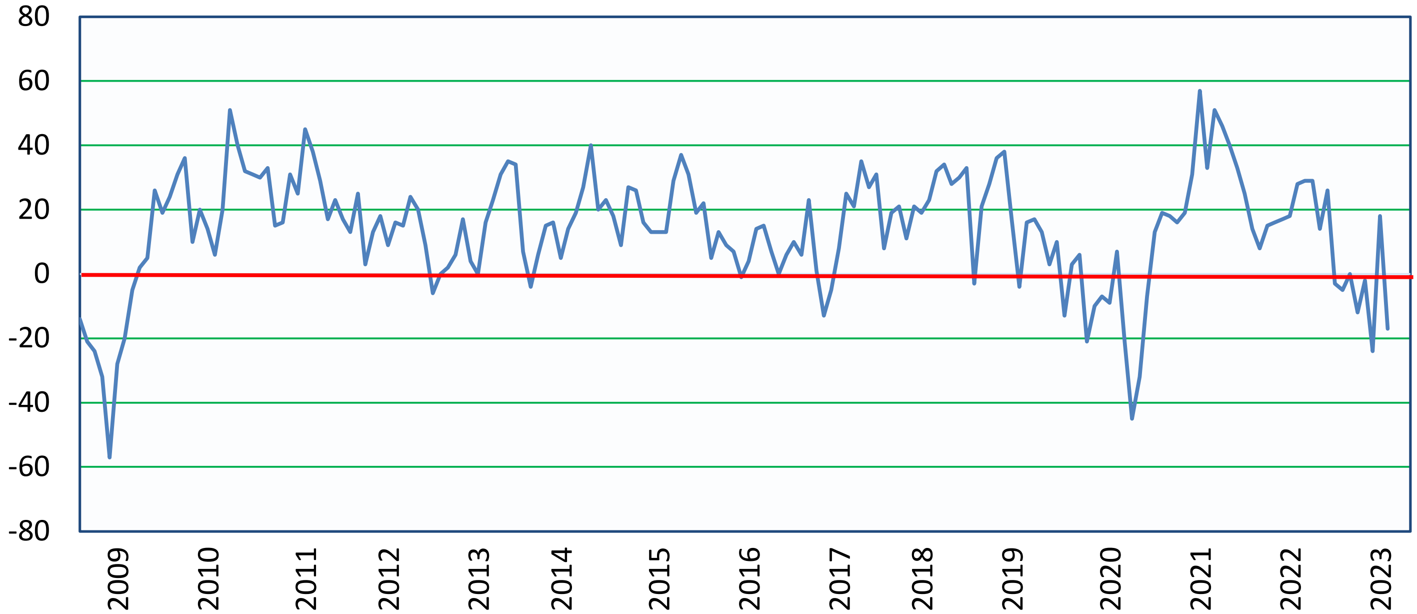
"Sales are softer with no indication of a change."

"We're still steady, but our record dollar sales are being driven by price increases. The actual unit volume is flat."

"We are watching the office furniture industry closely. Some market indicators suggest a softening in the coming months as backlogs are reduced or eliminated."

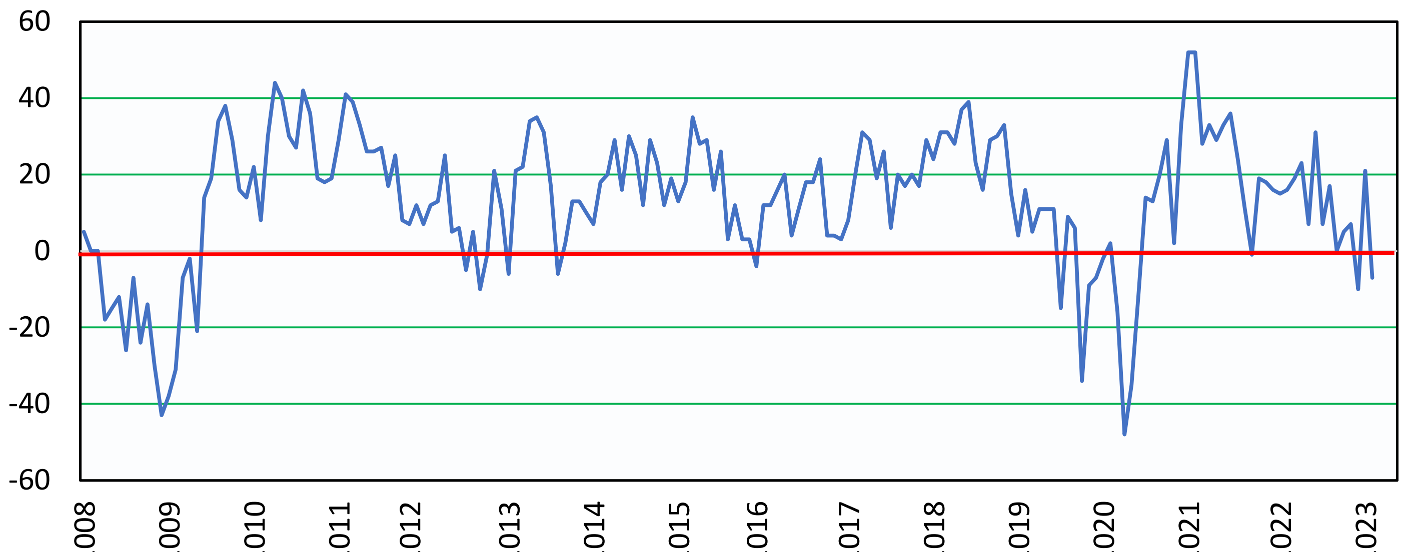
West Michigan Index of New Orders: 2008-2023

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.



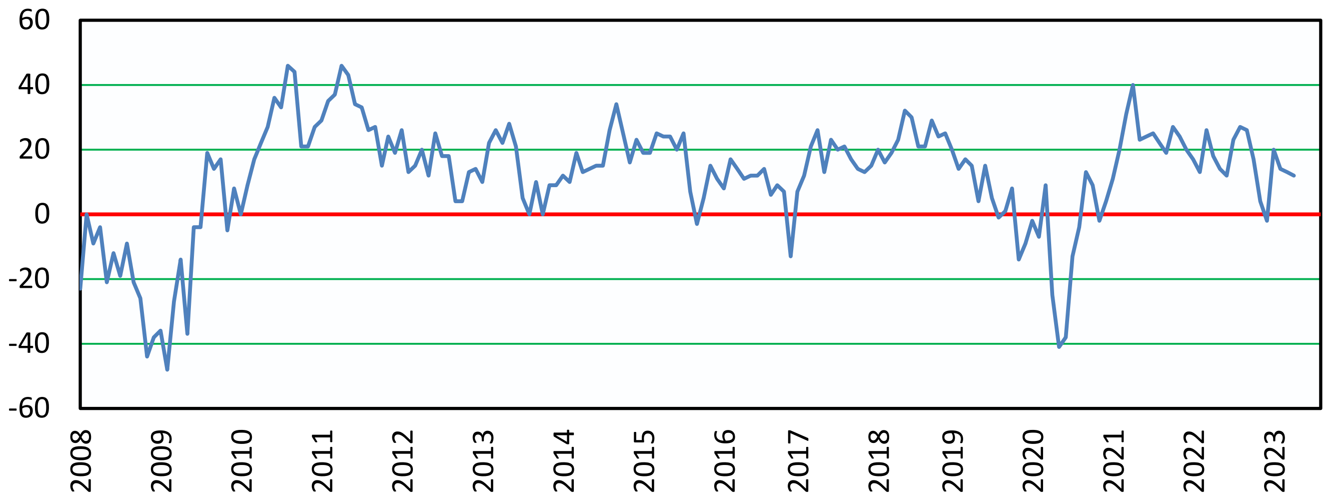
West Michigan Index of Production (Output): 2008-2023

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: 2008-2023

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.