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West Michigan Current Business Trends

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GROWTH RATE FLATTENS

Key Take-Aways from July 2023 Statistics:

- **Pace of the West Michigan Industrial Economy Flattens**
- **National Industrial Economy Remains Soft, but Stable**
- **Current Data Bolster the Case for a Soft Landing**

	July	June
NEW ORDERS Index (business improvement)	+ 0	+ 9
PRODUCTION Index (aka "output")	- 3	+ 6
EMPLOYMENT Index	+ 7	+14
LEAD TIMES Index	- 7	-17

Key Participant Comments for July:

"July sales are much slower than the previous 3-4 months. Office furniture continues to be soft. We'll have to see if this is a trend or an anomaly."

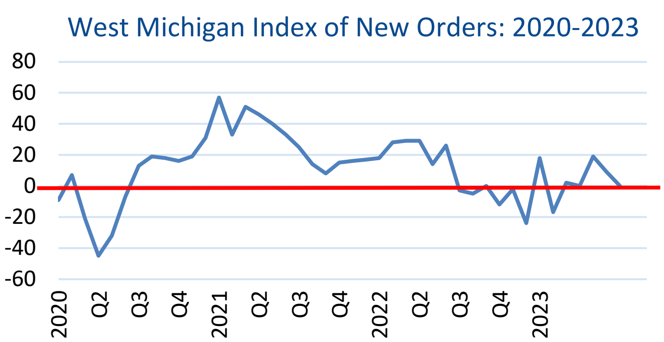
"Many of our suppliers are hesitant to re-activate shuttered capacity because of demand uncertainty.

"Market demand is stabilizing…"

"Business continues to slow down."

"We continue to struggle with getting employees to fill positions."

The Local Economy. In times of uncertainty, statistics tend to bounce around. For our survey of business conditions in West Michigan, April was flat, but May and June came in modestly positive. For July, our survey again flattened to the same level as April. NEW ORDERS, our



index of business improvement, posted at +0, down from June's reading of +9. In a similar move, the July PRODUCTION Index, which some economists label as "output," eased to -3 from +6. The Index of PURCHASES, which measures activity in purchasing offices, came in virtually unchanged at -5, down from -4. Although the office furniture business continues to soften, business conditions for our local automotive parts producers are generally positive. Most economists agree that the economy is slowing, but the July comments from our survey panelists continue to be widely mixed. Although some West Michigan firms are still producing at record levels, several firms posted negative reports, and others expressed concern about the future direction of the economy. So far, there have been no major layoffs in West Michigan. The job market remains fairly tight, and a few firms continue to report problems filling open positions.

The U.S. Economy. The July 3 press release from the Institute for Supply Management continues to depict the industrial economy as modestly (single digit) contracting. ISM's July NEW ORDERS Index came in at -8, marginally lower than June's -7. In a similar move, the PRODUCTION Index (a.k.a., Output) for ISM eased to -3 from -2. For the second month, ISM's ORDER BACKLOG Index continued to recover, posting at -14, up from June's reading of -23, and significantly improved from May's fifteen-year low of -27. July's NEW EXPORT ORDERS Index edged slightly lower to -7 from -5. After statistical adjustments, ISM's Composite Manufacturing PMI posted at 46.4, slightly better than June's 46.0.

S&P Global, the British-based international consulting firm that conducts a monthly survey of purchasing managers similar to ISM, posted a slightly more optimistic report on July 3. Last month, the S&P Composite PMI recorded a significant drop to 46.3 from May's 48.4. For July, the index recovered to 49.0, only a slight margin below the all-important break-even point of 50.0. The positive factors noted for July included a slight uptick in business optimism as well as continued growth in employment. However, declining new orders and a sharp reduction in order backlogs were cited as negative factors. Chris Williamson, Chief Business Economist at S&P Global Market Intelligence, further commented:

> "Manufacturing continues to act as a drag on the U.S. economy, the recent spell of malaise persisting at the start of the third quarter. However, producers are clearly shrugging off recession fears and planning for better times ahead. The sector continued to suffer from lower demand, as a post-pandemic shift in spending from goods to services, and an ongoing trend of cost-focused inventory reduction, led to a further drop in orders. The overall rate of order book decline nevertheless moderated during the month, helped by a slower decline in exports, to help stabilize production. There were several other encouraging bright spots in the survey, most notably including a marked improvement in business expectations for output in the year ahead. Firms are therefore anticipating the current soft patch to soon pass, and importantly are hiring more staff as a result. There was also good news on the inflation front. The combination of weak demand and improved supply led to a further "buyers' market" for many goods. Prices charged for goods consequently barely rose for a third straight month, which should help subdue consumer price inflation in the near term."

The World Economy. The J.P. Morgan Worldwide Manufacturing Index for July remained unchanged at 48.7, marginally below the break-even point of 50.0. JPM's New Orders Index edged lower to 47.7 from June's 48.0. The PMI for Canada, our largest trading partner, edged up to 49.6 from June's 48.8. The PMI for Mexico, our second biggest trading partner, rose nicely to 53.2 from 50.7. The China Caixin PMI posted at 49.2, down from 50.5. The long-awaited recovery of the Chinese economy remains elusive, and some analysts are beginning to suggest that China's current level of output may become the new norm. Bennett Parrish, Global Economist at J.P. Morgan, further commented:

> "The July PMIs signal continued momentum loss in global manufacturing. Output and new orders moved lower again last month, dragged down by acute weakness in the Euro area and signs of a slowdown in China. Near-term forward-looking indicators also headed lower, most notably the finished goods orders-to-inventory ratio, which fell further below 1.0 from an already contractionary reading. The weak environment is softening inflationary pressures, however, with input and output prices remaining below the 50 mark."

For the Eurozone economy, there is still no good news. According to the monthly report from the Hamburg Commercial Bank, the July PMI for the Eurozone edged slightly lower to 42.7 from 43.4. Production volumes, new orders, employment and purchasing activity all declined at faster rates than in June. The PMI for Germany, the largest economy in the group, sank to 38.8. Skyrocketing costs for energy have made some German firms non-competitive with a few European competitors as well as the rest of the world. At 53.5, the Greek PMI remains the only positive industrial economy in Europe. The new president was recently reelected, and the economic environment has significantly improved in the last few years. The PMIs for all of the other major European countries remain negative, with some countries reaching 39-month lows. Commenting on the July data, Dr. Cyrus de la Rubia, Chief Economist at Hamburg Commercial Bank, further noted:

> "It looks like the manufacturing recession is here to stay in the Eurozone. Stronger declines in output, new orders and purchase volumes at the start of the third quarter back up our view that the economy as a whole is in for a bumpy ride in the second half of the year. The manufacturing sector's rough patch is the result of a classic inventory cycle, where companies have purchased too many goods. As companies adapt to the new reality of reduced demand and faster deliveries, there will be some over-the-top reactions in terms of destocking. As a result, renewed stock-building can be expected in 2024, taking the sector out of the slump. Until then, there are some lean times ahead. The further and sharper deterioration in backlogs of work has seen manufacturers reduce employment further, though still at a modest pace. Manufacturers suffer from a global drop in this sector, especially in top eurozone export destinations like the U.S. and China. As such, new export orders, which include also intra eurozone trade, have gone downhill fast. The European Central Bank will be pleased to see that deflation of output prices has picked up speed again, falling at then of output prices has picked up speed again, falling at the most rapid pace in almost 14 years. However, the worries about services inflation remain high on the agenda."

Automotive. Because of the continued strong demand for cars and light trucks, most of our West Michigan auto parts suppliers continue to prosper. For the month ended July 31, Automotive News estimates that year-over-year U.S. sales rose by 15 to 18 percent. The estimated July SAAR (Seasonally Adjusted Annualized Rate) posted at 15.9 to 16.1 million units, up considerably from the July 2022 reading of 13.1 million units. Among the firms reporting monthly results, Ford sales were up 10.2 percent, Hyundai-Kia, up 16.0 percent, Subaru, up 16.1 percent, Honda, up 28.7 percent, and Toyota, a scant 0.6 percent. Chris Hopson, principal analyst at S&P Global Mobility, further commented:

> "The first half of 2023 has proven once again that one shouldn't doubt the spending capacity of U.S. consumers. The market, which rose 13 percent in the first six months of the year, continues to be supported by healthy pent-up retail and fleet demand that is offsetting higher interest rates, tighter credit standards and near-record vehicle prices."

Industrial Inflation. As the industrial economy continues to slow, so does industrial inflation. In our July survey, the West Michigan Index of PRICES posted at -7, higher than June's -17, but still below the break-even point of +0. At the national level, the July ISM index of PRICES posted at -15, close to the reading of -17 reported for June. Although prices may be falling overall, prices are still rising for copper and any copper-based products, some machined parts, some electronic components, and some food categories. After 42 months of pandemic disruptions, the S&P's Global Supply Shortage Index finally returned to normal in July. Commenting on the latest results, Andrew Harker at S&P Global Market Intelligence further noted:

> "Global manufacturing supply chains were back to normal in July, finally bringing to an end the period of elevated disruption that was seen following the outbreak of the COVID-19 pandemic in early-2020. There remains some hangover from the pandemic, with items such as electrical products and transport still in short supply, but the issue for a range of commodities now is one of insufficient demand. Weak demand conditions globally have caused widespread price falls for commodities, with reports of declines

the most pronounced in more than seven-and-a-half years. Chemicals and energy are bearing the brunt of the declines, according to respondents to the PMI surveys, while metals prices are also heading down."

Consumer Inflation. For almost forty years, inflation, along with all of its ill effects, has not been a serious problem for almost everyone in our country. However, with interest rates now rapidly rising to dampen the newfound spike in inflation, assessing where inflation stands has become a more current concern for our economy. In general, we watch two basic measures of inflation, primarily the widely-publicized CPI, or Consume Price Index, and the PCE (Personal Consumption Expenditures), a less-publicized measure of inflation used by the Federal Reserve as a price deflator when calculation GDP. To confuse us further, both of these measures have a "core" rate of inflation, which excludes the more-volatile food and energy components. As of the most recent reading, the CPI stands at 3.0 percent, and the core CPI at 4.8 percent. For the Fed's PCE, the July 28 inflation rate also posted at 3.0 percent. When stripping out energy and food prices, the core PCE index showed prices increasing at a rate of 4.1%. To combat inflation, the Federal Reserve's benchmark Fed Funds Rate has been escalated to 5.5 percent. The Fed plans to tighten interest rates until reaching the long-term goal of a 2.0 percent annual growth rate. However, if the current inflation numbers continue to fall, further rate increases appear unnecessary.

West Michigan Unemployment. The West Michigan EMPLOYMENT Index for July posted at +7, not as strong as June's +14, but still well above the +0 break-even point. Only 6 percent of this month's survey respondents reported staff reductions. At the state level, the Michigan Department of Technology, Management & Budget (DTMB) reported that the June (latest month available) seasonally adjusted year-over-year unemployment rate for Michigan edged lower to 3.6 percent. For West Michigan, the June unemployment rate (unadjusted) for Kalamazoo County posted at 4.3 percent, Kent County, 3.7 percent, and Calhoun County 4.9 percent. At 3.5 percent, Ottawa County reported the lowest county unemployment rate for West Michigan. However, two other Michigan counties, namely Livingston and Oakland, are taking advantage of the booming auto industry and boast unemployment rates of 2.8 percent and 3.1 percent, respectively.

Business and Consumer Confidence. If a recession is coming soon, it is certainly not because of a collapse in consumer confidence. The Conference Board Consumer Confidence Index, revised on July 25, increased to 117.0 (1985=100), up from 110.1 in June. In a similar move, the July University of Michigan Index of Consumer Sentiment rose sharply to 71.6 from last month's reading of 64.4. Overall, the rise in sentiment was largely attributable to the continued slowdown in inflation along with stability in labor markets. For our local survey, the SHORT-TERM BUSINESS OUTLOOK Index for July, which asks local firms about their business perceptions for the next three to six months, improved modestly to +0 from June's -4. The LONG-TERM BUSINESS OUTLOOK Index, which queries the perceptions for the next three to five years, came in at +23, down slightly from +27.

GDP. According to July 28 press release from the Bureau of Economic Analysis (BEA), the first "advance" estimate of year-over-year growth for the 2023 second quarter came in at 2.4 percent, up from 2.0 percent in the first quarter. Looking ahead to the third quarter, we have our usual wide mix of forecasts. The August 1 report from the Atlanta Federal Reserve's GDPNow model forecasts a growth rate of a significant 3.7 percent. Wolters Kluwer N.V.'s Blue Chip GDP realtime model for the third quarter has risen to only 0.9 percent. Confirming the Blue Chip model is a recent report from S&P Global, which pegs the third quarter GDP at 1.0 percent. The Conference Board has revised the third quarter GDP growth estimate to 1.3 percent but now expects a shallow recession to begin in the fourth quarter, ending after the first quarter of 2024. Although some of these forecasts continue to cite numerous reasons why the economy should start to slow in late 2023, the recent GDPNow forecasts have tended to be more accurate (or luckier) despite the contrasting opinions of many economists at other reputable institutions.

Looking Forward. Among the most important statistics to watch going forward are the PMIs from both S&P Global and ISM. With the current S&P Global PMI at 49.0, we are a long way from declaring a recession anytime soon. However, if either or both of these surveys were to take a sharp turn downward, we would have to reevaluate the situation. Unless there is a catalyst, such as a collapse among the regional banks or a new war somewhere that impacts the world supply chains, a new recession seems unlikely.

As a result of higher interest rates, the banks, especially the regional banks, find themselves in a bind. They have loaned out vast amounts of their portfolio at 3-4 percent interest, and the current rate for a 30-year fixed rate mortgages now average 7.09 percent, according to Bankrate. Most banks are still offering very low rates for CDs, but attracting new money by offering 0.1percent APY is virtually impossible.

Economists in today's world seldom agree, but they do concur on two simple facts. Interest rates are rising, and the economy is slowing. In the U.S., they don't agree about whether we are headed for a soft landing or a mild recession. The difference between a soft landing and a recession for most industrial firms is simply a question of where they are in the economy. Obviously, interest rate sensitive firms are more likely to suffer, while others like automotive may see no downturn at all because of the well-publicized pent-up demand. However, the recent pandemic recession left us with a lot of pent-up demand in many sectors of the economy, especially in automotive, and to some extent, affordable housing. Even though residential housing prices have come down, they are not collapsing like they did in the Great Recession. Part of the resiliency can be attributed to pent-up demand, part to consumer liquidity, and part to the fact that banks have not flooded the market with a bunch of sub-prime, defaulted homes.

July 2023 Survey Statistics

	UP	SAME	DOWN	N/A	July Index	June Index	May Index	25 Year Average
Sales (New Orders)	19%	62%	19%	0%	+ 0	+ 9	+19	+14
Production (Gross Output)	19%	60%	16%	5%	- 3	+ 6	+13	+14
Employment	14%	79%	7%	0%	+ 7	+14	+13	+ 8
Purchases	9%	77%	14%	0%	- 5	- 4	+13	+ 7
Prices Paid (major commodities)	12%	64%	19%	5%	- 7	- 17	- 2	+15
Lead Times (from suppliers)	7%	65%	28%	0%	-21	- 17	- 2	+11
Purchased Materials Inv. (Raw materials & supplies)	19%	51%	26%	4%	- 7	- 6	- 3	- 4
Finished Goods Inventory	7%	60%	33%	9%	-26	-24	- 23	- 8
Short Term Business Outlook (Next 3-6 months)	19%	62%	19%	0%	+ 0	- 4	+ 7	-
Long Term Business Outlook (Next 3-5 years)	37%	47%	14%	2%	+23	+27	+16	-

Items in short supply:

Some aluminum, electronics, chips, plastic resins, laminated glass, domestic sand castings, certain metals, certain electronic items, specialty steel products, good people.

Prices on the UP side:

Machined parts, brass forgings, steel braided hose, petroleum-based products, copper-based products, electronics, everything with copper in it, some services, some equipment support, SAS, isocyanate.

Prices on the DOWN side:

Calcium carbonates, polyoils, soybean oil, steel, aluminum, eggs, polypropylene, carbon steel, stainless steel, corrugated packaging, steel, iron-based products, resins, plastics (PP, PA6, PC, ABS), natural gas, polystyrene, benzene.

Latest Unemployment Reports:

(Except as noted, data are NOT seasonally adjusted)

	June 2023	June 2022	Aug. 2009	20-Year Low
State of Michigan (June)	3.6%	4.0%	14.6%	3.2%
State of Michigan (Unadj.)	4.1%	4.4%	14.1%	2.9%
Kent County	3.7%	4.0%	11.9%	2.1%
Kalamazoo County	4.3%	4.4%	11.1%	2.1%
Calhoun County	4.9%	5.3%	12.8%	2.7%
Ottawa County	3.5%	3.8%	13.3%	1.8%
Barry County	3.9%	4.2%	10.9%	2.2%
Kalamazoo City	5.3%	5.9%	15.2%	3.2%
Portage City	3.9%	4.1%	8.7%	1.3%
Grand Rapids City	4.9%	5.3%	16.1%	3.0%
Kentwood City	3.5%	3.7%	10.7%	1.4%
Plainfield Twp.	2.9%	3.0%	8.0%	1.4%
U.S. Official Rate (June)	3.6%	3.6%	9.6%	3.5%
U.S. Rate (Unadjusted)	3.8%	3.6%	9.6%	3.4%
U.S. U-6 Rate (June.)**	6.9%	6.7%	22.9%	6.7%

***U-6 for Michigan = 6.9% for 2022 and Q1 2023*

JULY COMMENTS FROM SURVEY PARTICIPANTS

"Capacity constraints remain on key pharmaceutical raw materials. These raw materials are the major components for everyday medications consumed by the market (sorry, I can't be more specific... think of what people take when they have a headache or feel sore...).

"Certain metals and electronic items have very long lead times and are being allocated."

"Data and market suggest pricing is trending downward; however; not to levels previously established; if you recall there have been multiple ways of increases levied; recovery to original levels not yet attained; however price reductions have been occurring, especially with international suppliers. Change from a domestic perspective not in line with international supply base."

"We are starting to see machinery specials and promotions due to building inventories of finished machines."

"July sales are much slower than the previous 3-4 months. Office furniture continues to be soft. We'll have to see if this is a trend or an anomaly."

"Steel prices are trending down. There is still some pricing pressure on high labor services. We continue to struggle with getting employees to fill positions."

"July was a slow month with projects being put off."

"I've been talking with many people, People believe we are start of a recession, it's only a matter how bad it gets, and it all depends on the feds with the interest rates. Housing and the construction market is slowing down, but projects with the government are not slowing down… only speeding up because we only keep printing more money.

"Our supplier lead times have been close to pre-pandemic levels for the last 6 months or so, but strong demand is pushing them out. Many of our suppliers are hesitant to re-activate shuttered capacity because of demand uncertainty. It's propping up prices, and extending lead times. Labor is still very tight, and higher wages are required to attract and retain employees."

"Market demand is stabilizing, and we're seeing some deflation."

"We just wrapped up a record fiscal year, though mostly due to price increases. We need to reduce our inventory now that the supply chain has stabilized."

"Business is similar to last month, but perhaps softening slightly."

"H2 for 23 will be a big push to align to strategies to support overall business. Our primary focus will be pricing (reduction), inventory levels, and service level attainment; also major pushes for product launch(es) to secure market share in emerging categories."

"We are seeing a stronger back-half of the year starting to materialize."

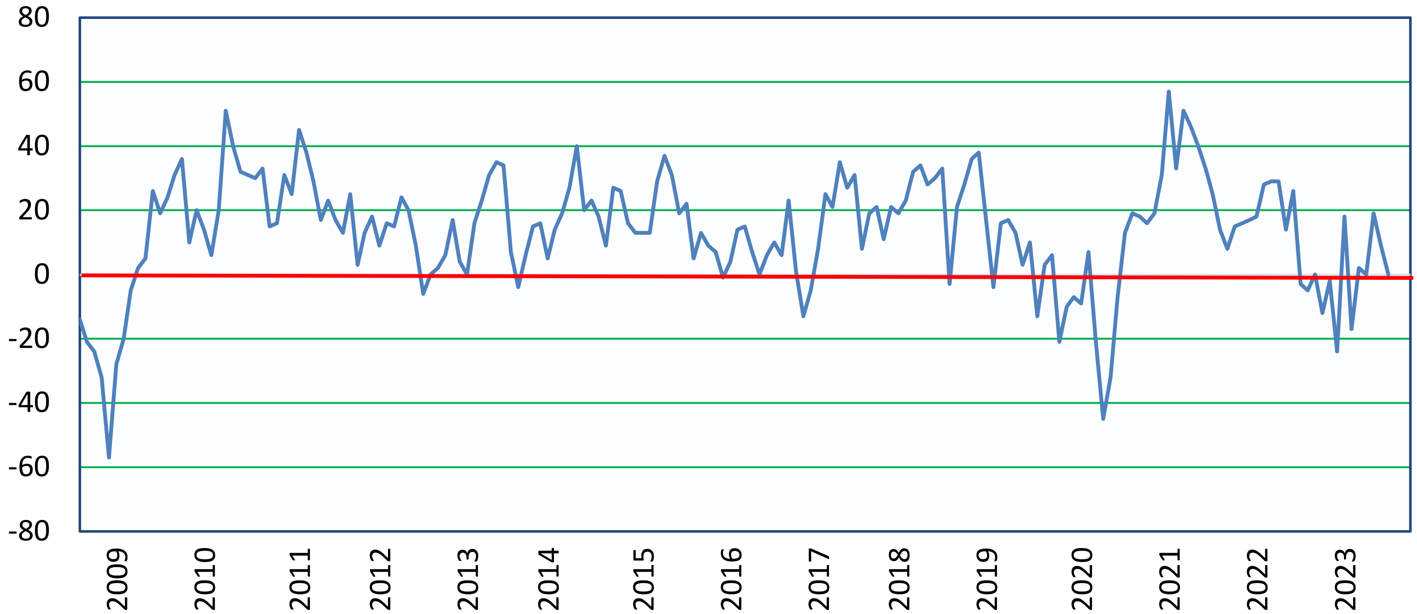
"Lead times for our products remain a moving target due to ongoing material and labor constraints throughout the supply chains."

"Business is slower but steady."

"Business continues to slow down."

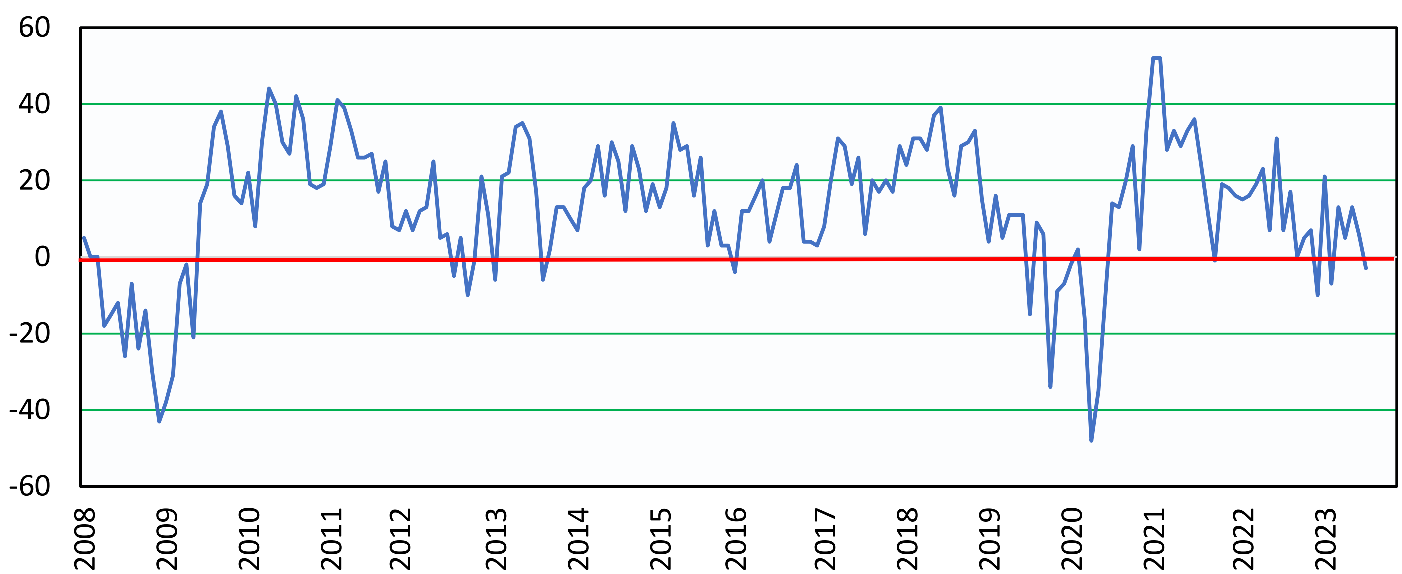
West Michigan Index of New Orders: 2008-2023

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.



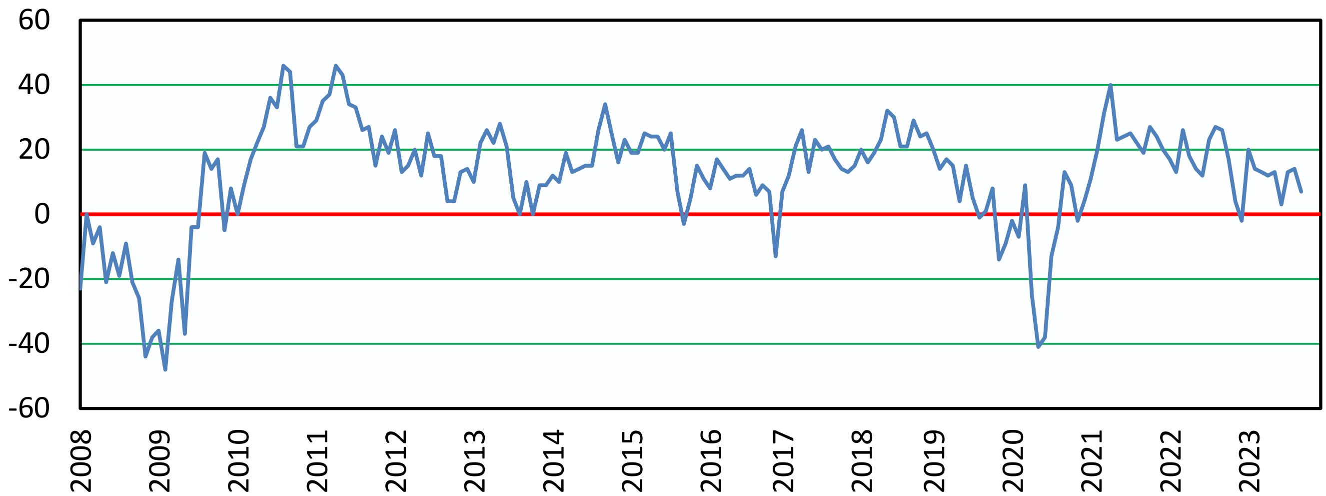
West Michigan Index of Production (Output): 2008-2023

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.