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West Michigan Current Business Trends

September 11, 2023

GROWTH RATE RATE REMAINS FLAT

Key Take-Aways from August 2023 Statistics:

- **West Michigan Industrial Economy Remains Flat**
- **National Industrial Economy Remains Soft, But Not Collapsing**
- **Prolonged Auto Strike Could Dampen West Michigan's Economy**

	Aug.	July
NEW ORDERS Index (business improvement)	- 4	+ 0
PRODUCTION Index (aka "output")	+14	- 3
EMPLOYMENT Index	+ 2	+ 7
LEAD TIMES Index	- 14	-21

Key Participant Comments for August:

"Our business is steady in office furniture. Not great, but steady."

"We had a good month, and prospects are strong for at least through year end."

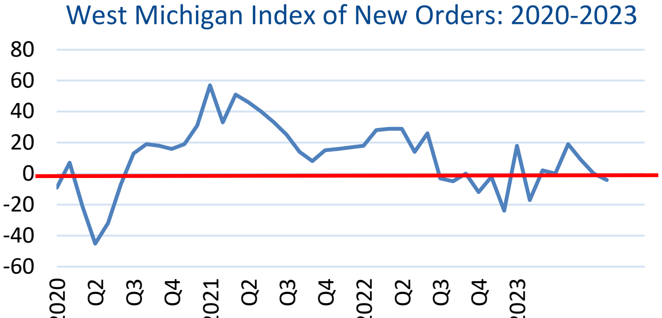
"Our sales demand has dropped by 20% over the last two months."

"We've had a busy month. We are watching to see if there will be a labor strike at GM. If there is a strike at GM, that will have a large impact on our business."

"Supply bottlenecks are returning, and lead times are extended on better-than-expected demand."

The Local Economy. Although many economists and businesspeople agree that that the economy is slowing, the August comments from our survey panelists continue to be widely mixed. Looking at the past few months, our survey of business conditions in West Michigan for April was flat, May and June came in modestly positive, and July again turned flat. For August, our survey remained flat, but some statistics bucked the trend. NEW ORDERS, our index of business improvement, turned slightly

West Michigan Index of New Orders: 2020-2023



negative at -4, down from July's +0. However, the August PRODUCTION Index, which some economists label as "output," bounced from -3 to +14. The index of PURCHASES, which measures activity in purchasing offices, dropped to -14 from -5. Just as last month, we rated the office furniture industry as flat overall but still showing no signs of collapsing into a recession. Throughout the past few months, we have seen some of the major labor contracts come up for renewal and have been pleasantly surprised to see both sides avert what could have been several disruptive strikes. However, unless it is just rhetoric, the UAW appears to be edging toward what could be a prolonged work stoppage. Although business conditions for our local automotive parts producers are currently positive, a major strike could be devastating to some (but not all) of our local auto parts suppliers.

The U.S. Economy. The August survey from the Institute for Supply Management came in slightly less pessimistic. ISM's NEW ORDERS Index posted at -6, marginally better than July's -8 reading. However, the PRODUCTION Index (a.k.a., Output) for ISM turned back to positive at +1, up from -3. For the third month, ISM's ORDER BACKLOG Index modestly recovered to -12, up from July's -14. Although a double-digit negative reading for ORDER BACKLOG is obviously not great news, at least the index is not collapsing like it has previously at the onset of a recession. ISM's NEW EXPORT ORDERS Index remained unchanged at -7, which also depicts an economy that is slowing but not collapsing. After seasonal adjustments, ISM's Composite Manufacturing PMI for August came in at 47.6, up considerably from July's 46.4 and also better than June's 46.0.

Unlike the past, we now have two prominent surveys of U.S. purchasing managers to provide guidance for the U.S. industrial economy. Unfortunately, the August survey from S&P Global, the British-based international consulting firm, has turned much more pessimistic. Although S&P's Composite PMI for July had recovered to 49.0, slightly below the all-important break-even point of 50.0, the August PMI reversed course and fell to 47.9, down 1.1 points. Although S&P's Employment Index remains positive, the decline in New Orders accelerated to register "the second-steepest reduction seen over the past six months." Chris Williamson, Chief Business Economist at S&P Global Market Intelligence, further commented:

"U.S. manufacturers reported another tough month of trading in August. Output has fallen back into decline after a brief respite in July amid an increasingly steep deterioration in order books. Orders are in fact falling faster than factories are cutting output, suggesting firms will need to continue scaling back their production volumes into the near future. An increasing sense of gloom about the near-term outlook has meanwhile hit hiring and led to a further major pull-back in purchasing activity. The survey meanwhile adds to evidence that the deflationary impact of improving supply chains has peaked, with prices starting to rise at an increased rate again in August. However, falling demand is clearly continuing to dampen pricing power and is keeping overall inflationary pressures in the manufacturing sector very subdued. Policy initiatives such as the CHIPS and Science Act and IRA should start to help buoy production in the medium term as capacity in U.S. manufacturing is expanded. A shifting of the inventory cycle toward restocking should also be evident by the end of the year, given improvements in some survey metrics such as the orders-inventory ratio. However, such rays of hope remain currently overshadowed by business confidence turning lower, which indicates that producers anticipate some further near-term headwinds to any manufacturing revival."

The World Economy. For August, the J.P. Morgan Worldwide Manufacturing Index posted at 49.0, up slightly from 48.6, but still below the neutral point of 50.0. JPM's New Orders Index edged higher to 48.1 from 47.6, and Output recovered to 49.4 from 48.9. The PMI for Canada, our largest trading partner, edged lower to 48.0 from July's 49.6. The PMI for Mexico, our second biggest trading partner, remained positive but slipped to 51.2 from 53.2. The China Caixin PMI returned to a positive reading of 51.0, up from 49.2 in July. However, there is still no sign that the long-awaited bounce in the Chinese economy is at hand. Bennett Parrish, Global Economist at J.P. Morgan, further commented:

"The August PMIs signaled a slight easing in the rate of contraction of the global manufacturing sector, with the output and new orders indexes advancing 0.5-point but remaining below the 50-mark. The improvement on the month owes almost entirely to a large 2.4-point jump in the China output index. Excluding China, the global output PMI declined nearly one point in August and is stuck at a level that does not point to much if any momentum lift in the manufacturing sector. There are other signs of tough times ahead, including a 1.2-point dip in the future output index and the new orders-to-inventory ratio remaining at a level consistent with output declines."

According to the monthly report from the Hamburg Commercial Bank, the beleaguered Eurozone August PMI posted at 43.5, a modest improvement over the July reading of 42.7. Lower production volumes, new orders, employment, and purchasing activity all contributed to the negative August PMI. The index is also skewed by the 39.1 PMI for Germany, the largest economy in the group. However, the survey author cites evidence that the worst may be over. The PMI for Greece remains positive, largely because of new leadership which has recently guided the recovery from the devastating 2009 Greek financial crisis. The August PMI for Ireland posted a significant jump from 47.0 to 50.6. However, the PMIs for all of the other major European countries remain negative. Dr. Cyrus de la Rubia, Chief Economist at Hamburg Commercial Bank, further noted:

"These numbers aren't as terrible as they might look at first glance. Obviously, the overall PMI manufacturing index, sitting at 43.5, suggests pretty noticeable weakness in this sector. However, all of the twelve subindices have moved upwards or remained practically unchanged, showing that the downward trend from the past few months is starting to lose steam across the board. Businesses are still holding back from making big staff cuts, even with a substantial drop in output over five months. This does not bode well for productivity or output per head, but provides some stability for the economy as a whole as people do not lose their income. Looking at the PMI price indices, companies were able to keep part of the reductions of input costs for themselves since spring of this year, thereby increasing their profit margins. However, the experience of 2020 and 2021 shows, that on the way up this development tends to reverse and margins suffer. The driver of the downturn has been the destocking cycle. There are tentative signs, however, that this process is nearing its end as companies took their foot off the gas when it came to reducing the stock of purchases in August. Germany remains a negative outlier among the big euro countries. This will fuel the discussion about Germany being the sick man of Europe, even though the nation continues to be among the most diversified economies."

Automotive. At least for now, the continued strong demand for cars and light trucks has resulted in most of our West Michigan auto parts suppliers continuing to prosper. For the month ended August 31, *Automotive News* estimates that year-over-year U.S. sales rose by 14.6 percent. The estimated August SAAR (Seasonally Adjusted Annualized Rate) posted at 15.4 million, down slightly from July's 15.9 million but far above the August 2022 SAAR of 13.4 million. Unfortunately, some of the manufacturers, especially GM and Stellates, no longer report monthly sales. For the major firms that do report monthly, August year-over-year sales for Ford were up 2.0 percent, Hyundai-Kia, up 8.0 percent, Subaru, up 12.5 percent, Toyota, 14.8 percent, and Honda, gaining a whopping 56.7 percent. Jeff Schuster, group head and executive vice president for automotive with GlobalData, commented:

"We're still seeing demand that has existed, and that pent-up demand is still there. But we could be getting to the end of that. The UAW negotiations could throw a wild card into the remainder of the year. If we go the route of not a lot of disruption, I would expect this pattern to continue through the end of the year."

West Michigan Unemployment. The West Michigan EMPLOYMENT Index for August flattened to +2, down from July's +7, but still marginally positive. For August, 13 percent of this month's survey respondents reported staff reductions, up from 6 percent in July. At the state level, the Michigan Department of Technology, Management & Budget (DTMB) reported that the July (latest month available) seasonally adjusted year-over-year unemployment rate for Michigan remained stable at 3.6 percent. For West Michigan, the July unemployment rate (unadjusted) for Kalamazoo County posted at 4.3 percent, Kent County, 3.8 percent, and Calhoun County 5.1 percent. At 3.6 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 3.2 percent, respectively. A prolonged UAW strike could change all of that.

Business and Consumer Confidence. Confidence at both the consumer and industrial levels is partially driven by the news cycle. Hence, confidence appears to be softening at both levels. According to the most recent press release, the August Conference Board Consumer Confidence Index has fallen to 106.1 (1985=100), down significantly from 117.0 in July. In a less extreme move, the August University of Michigan Index of Consumer Sentiment backtracked to 69.5 from 71.6. Worries over higher interest rates, inflation, and "employment conditions" were cited as reasons for the weaker numbers. For our local survey, the SHORT-TERM BUSINESS OUTLOOK Index for August, which asks local firms about their business perceptions for the next three to six months, eased modestly to -2 from July's +0. The LONG-TERM BUSINESS OUTLOOK Index, which queries the perceptions for the next three to five years, slipped to +19, down from July's +23.

Industrial Inflation. In our August survey, the West Michigan index of PRICES posted at the break-even point of +0, up from July's -7. At the national level, the August ISM index of PRICES came in at -4, up from -15. Despite the indices of most industrial prices falling, the supply situation for a few key commodities like copper and some electronic components remains tight. At 1.0, the S&P's Global Supply Shortage Index has returned to normal after about three years of turmoil. Commenting on the latest results, Usamah Bhatti at S&P Global Market Intelligence, noted:

> "August data signalled a sustained alleviation in price and supply pressures faced by manufacturing firms across the world, amid further weakness in the global manufacturing economy. Reports of price decreases continued for a fourth straight month, with companies signalling that more than half of the monitored commodities fell in price in the latest survey period. News remained positive on the energy front, where overall prices dropped for the sixth month running. The muted demand picture for manufacturing supported a continued normalisation of supply chains, as signalled by the Supply Shortages Index which remained at its long-run average for the second month running. There was evidence in the JPMorgan Global Manufacturing PMI that supply shortages were in part alleviated thanks to manufacturers drawing down safety stocks built up throughout much of the past three years amid the softer outlook for the global manufacturing economy."

Consumer Inflation. Several note-worthy economists have pointed to the orderly reduction in the CPI as evidence that a so-called soft-landing still possible. Yes, but it is worth repeating that the "shelter" component of the CPI appears to be stalled at the current level, which could result in further interest rate hikes by the Fed. An old adage implies that if the only tool you have is a hammer, then you probably see every problem as a nail. In the case of the Federal Reserve, raising interest rates is virtually the only major tool they have for fighting inflation, even though several officials from the Fed have correctly termed the interest rate "tool" as a "blunt instrument." According to Bankrate, the current interest rate for a 30-year mortgage has now risen to 7.51 percent, about a half percent higher than last month. Higher mortgage rates have put a damper on the housing market as well as the rates which banks are charging for all types of loans. Hence, all interest rate sensitive businesses are beginning to slow, which the Fed hopes will be enough to eventually tap down inflation. But there is a Catch-22. About 40 percent of the Consumer Price Index calculation is the cost of "shelter," which means the aggregate cost of rent or rent equivalent, as well as the cost of utilities, insurance, and other items associated with the total cost of maintaining a home. The catch relates to the fact that higher interest rates, which are supposed to help control inflation, simultaneously raise the cost of housing. Hence, although the CPI had appeared to be falling, the decline has now stalled and even started to edge higher. As of the most recent reading, the CPI stands at 3.2 percent, up from 3.0 percent in the previous month, and core CPI posted at 4.7 percent, up from 4.5 percent in July and 4.3 percent in June. Although the Fed continues to say that more attention is placed on the index of Personal Consumptions Expenditures than the CPI, the August 31 PCE inflation rate rose to 3.3, up from 3.0 percent. When stripping out energy and food prices, the core PCE index showed prices increasing at a rate of 4.2 percent, up from 4.1 percent. Although the inflation numbers may resume declining when reported in September, it now appears possible that inflation could be stuck at or near 3 to 4 percent for at least the next year or more. If the Federal Reserve continues to plan to tighten interest rates until reaching the long-term goal of a 2.0 percent annual growth rate so, higher rates may be coming.

GDP. According to an August 30 press release from the Bureau of Economic Analysis (BEA), the second estimate of year-over-year growth for the 2023 second quarter came in at 2.1, up modestly from 2.0 percent in the first quarter. For the third quarter, we have our usual wide mix of forecasts, beginning with the September report from the Atlanta Federal Reserve's GDPNow model that forecasts a growth rate of a staggering 5.6 percent. The average for the Blue Chip GDP realtime model, which has been edging up for the past six months, now estimates a third quarter growth rate of 2.3 percent. J.P. Morgan recently posted a Q3 forecast of 2.5 percent. On the negative side, the Conference Board continues to estimate the third quarter GDP growth rate of only 1.3 percent but continues to forecast a shallow recession to begin in the 2023 fourth quarter and ending after the first quarter of 2024. Tying all of these diverse opinions together, the consensus for third quarter growth appears to be in the range of 2.1 to 2.4 percent.

Looking Forward. For Michigan, some news outlets claim that a strike by the UAW is almost a foregone conclusion. The union is printing a massive number of picket signs, setting up picket stations, and calculating strike fund stipends for all workers who show up for picket duty. Assuming that the management teams of the Detroit Three auto firms do not suddenly capitulate to the rather outlandish demands of the UAW, there will be a strike. That said, the key question becomes how long the strike will last. A week? A month? Several months? Also, to what degree does Washington get involved? If all of the Detroit Three are strike at once, a few of local auto parts producers will be shut down completely. However, many firms have wisely diversified their customer base to include Japanese and Korean non-union auto firms, as well as at least some businesses outside of automotive altogether. However, it is obvious that a prolonged strike will have a dampening effect on the West Michigan economy.

Higher interest rates will obviously continue to impact the housing market, but the interest rates for auto loans are also rising. Because of the scare generated by the demise of several regional banks, there is considerable evidence that some institutions have raised their loaning standards by, for instance, demanding higher credit scores and larger downpayments.

For the overall economy, the softening of the August S&P Global PMI report was not good news. In addition, the accompanying analysis was also more pessimistic than previous months. If the report continues to be negative for about three months, past precedents indicate that a recession may be at hand.

August 2023 Survey Statistics

	UP	SAME	DOWN	N/A	Aug. Index	July Index	June Index	25 Year Average
Sales (New Orders)	26%	44%	30%	0%	- 4	+ 0	+ 9	+14
Production (Gross Output)	31%	48%	17%	4%	+14	- 3	+ 6	+14
Employment	15%	70%	13%	2%	+ 2	+ 7	+ 14	+ 8
Purchases	13%	55%	30%	2%	-17	- 5	- 4	+ 7
Prices Paid (major commodities)	11%	76%	11%	2%	+ 0	- 7	- 17	+15
Lead Times (from suppliers)	7%	71%	22%	0%	-14	- 21	- 17	+11
Purchased Materials Inv. (Raw materials & supplies)	15%	63%	20%	2%	- 5	- 7	- 6	- 4
Finished Goods Inventory	11%	67%	15%	7%	- 4	-26	- 24	- 8
Short Term Business Outlook (Next 3-6 months)	24%	50%	26%	0%	- 2	+ 0	- 4	-
Long Term Business Outlook (Next 3-5 years)	30%	57%	11%	2%	+19	+23	+27	-

Items in short supply:

Some steel, some steel alloys, some aluminum, copper, brass, specialty water fittings, casters, slides, trucking, domestic casting capacity, glass, professional and skilled technicians, chips, custom machined parts, electrical controls, construction supplies, garment material, anything with copper content.

Prices on the UP side:

Brass, steel, hemp clothing, transportation, aluminum, copper, polypropylene, fuel, forgings, food, disposables, china and glassware, computer services, employees, steady new business.

Prices on the DOWN side:

Calcium Silanes, polyols, cardboard, metal products, steel*, steel components*, carbon steel, stainless steel, steel pipe, aluminum*, seasonal food items, plastics (PP, PC, ABS, PA6, Styrene), ammonia, benzene.

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

Latest Unemployment Reports:

(Except as noted, data are NOT seasonally adjusted)

	July 2023	July 2022	Aug. 2009	20-Year Low
State of Michigan (July)	3.6%	4.1%	14.6%	3.2%
State of Michigan (Unadj.)	4.3%	4.5%	14.1%	2.9%
Kent County	3.8%	4.1%	11.9%	2.1%
Kalamazoo County	4.3%	4.6%	11.1%	2.1%
Calhoun County	5.1%	5.6%	12.8%	2.7%
Ottawa County	3.6%	3.8%	13.3%	1.8%
Barry County	3.9%	4.2%	10.9%	2.2%
Kalamazoo City	5.4%	5.7%	15.2%	3.2%
Portage City	4.0%	4.2%	8.7%	1.3%
Grand Rapids City	5.0%	5.4%	16.1%	3.0%
Kentwood City	3.6%	3.8%	10.7%	1.4%
Plainfield Twp.	2.9%	3.1%	8.0%	1.4%
U.S. Official Rate (Aug.)	3.8%	3.6%	9.6%	3.5%
U.S. Rate (Unadjusted)	3.8%	3.8%	9.6%	3.4%
U.S. U-6 Rate (July)**	7.1%	7.0%	22.9%	6.7%

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

AUGUST COMMENTS FROM SURVEY PARTICIPANTS

"Delivery performance still varies from one day to another. Raw materials continue to be longer lead times contributing to shortages on various parts. Chips are still being allocated to the electronics manufacturers."

"We are still seeing pressure from our suppliers for increases due to their increased material and labor costs. The limited talent pool of skilled workers continues to drive wages up in an effort to compete for those workers."

"Most of our prices have stabilized from the large increases we saw over the last three years."

"Things seem to be slowing down now. We have a trade show coming soon and are hearing that some customers are not attending due to bad business and not needing equipment. Also, we continue to hear that companies can't find people to work."

"Our sales demand has dropped by 20% over the last two months."

"Our business is steady in office furniture. Not great, but steady."

"We've had a busy month. We are watching to see if there will be a labor strike at GM. If there is a strike at GM, that will have a large impact on our business."

"Production levels remain high as we work to reduce our backlog. However, incoming orders remain softer than forecasted. We expect a production slowdown in the next 3-6 months if incoming orders remain at current levels."

"In general, companies are watching their pennies going into the 4th quarter, and saving where they can."

"We had a good month, and prospects are strong for at least through year end."

"Our suppliers are doing the best with lead times and completing orders than they have in 3 years. We are coming to the end of paving season, so we are in a big crunch to get projects completed before the snow hits."

"This month looks steady compared to last month, with a good start to the new fiscal year. We have too much inventory, and will reduce purchases for a while to reduce our dollars on hand."

"Same comment as every month. If our government just keep spending in printing money, inflation is not going to stop and interest rates are going to rise. It's simple 101 economics, but our government doesn't understand that."

"Supply bottlenecks are returning, and lead times are extended on better-than-expected demand."

"The steady progress on supply chain pressure are easing. There appears to be an upturn in applicants looking for work in the hospitality sector, and not nearly as few as last year."

"We have a steady and robust business climate."

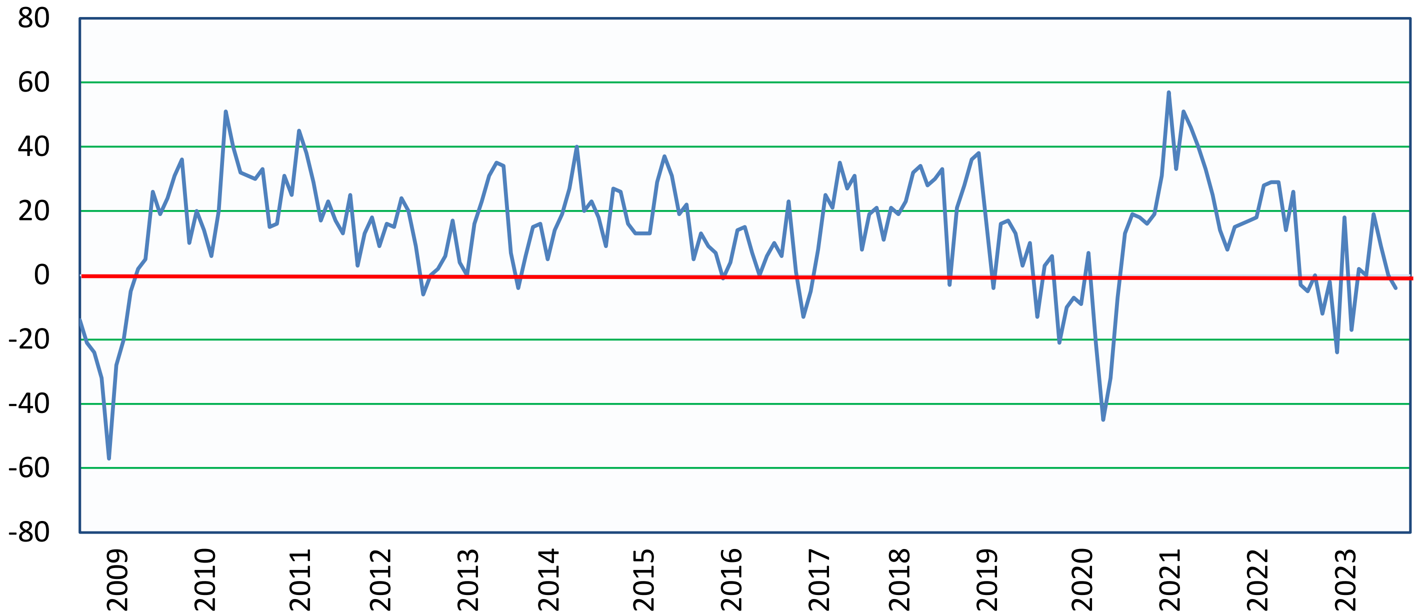
"We see some strength in the forecasts to end the year but are cautious as the UAW contracts loom in the future for all of the big three."

"We are still dealing with some effects from the microchip shortage."

"Quiet month."

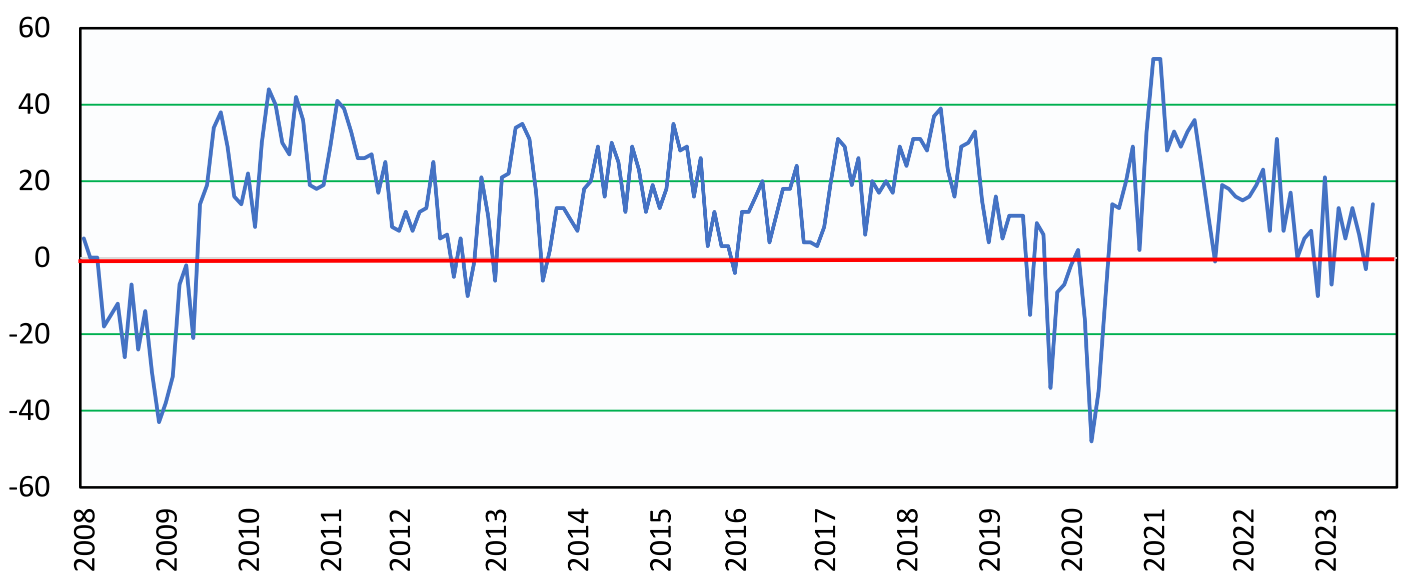
West Michigan Index of New Orders: 2008-2023

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.



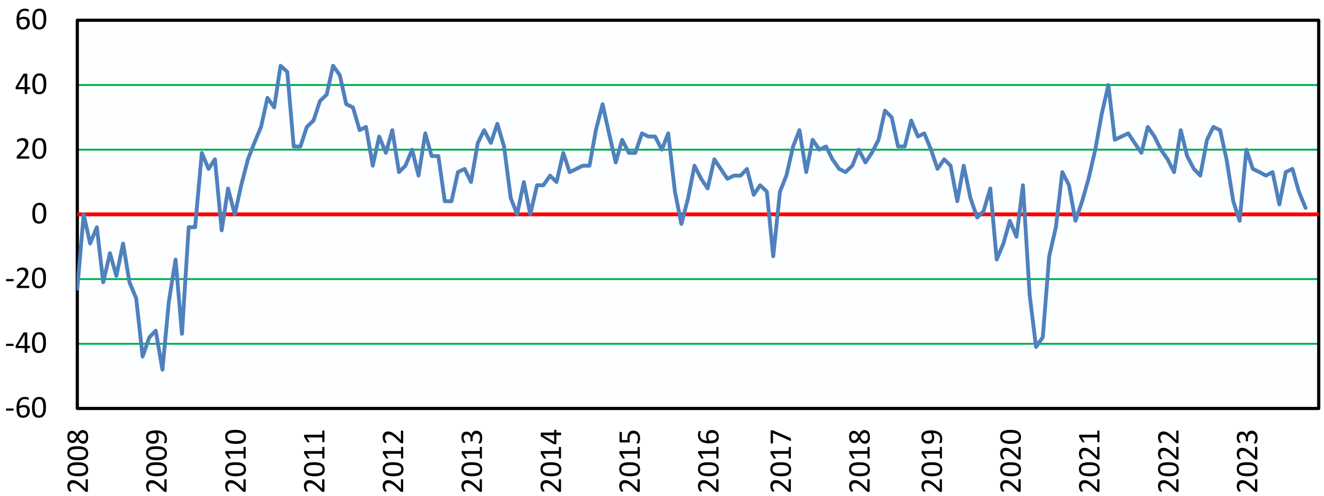
West Michigan Index of Production (Output): 2008-2023

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.