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West Michigan Current Business Trends

November 6, 2023

GROWTH RATE DECLINES

Key Take-Aways from October 2023 Statistics:

- **Industrial Economy Continues to Slow**
- **National Industrial Economy Flattens**
- **UAW Strike Over With Minor Damage**

	Oct.	Sept.
NEW ORDERS Index (business improvement)	-13	- 9
PRODUCTION Index (aka "output")	- 4	- 5
EMPLOYMENT Index	-10	+ 0
LEAD TIMES Index	- 17	-13

Key Participant Comments for October:

"It feels as if the pent-up demand from COVID has been filled. Most companies are on coast mode. We're closely watching the global political situation to see if what effects to supply chain or business."

"New Orders have slowed significantly. As a result, inventories are up significantly."

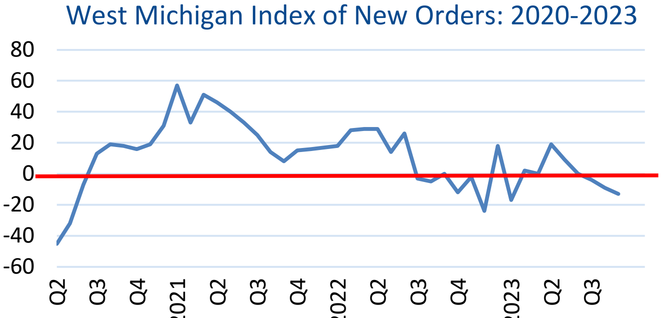
"Demand continues to outpace expectations. We remain cautious in our outlook, however, given the eventuality of higher interest rates negatively impacting final consumption."

"The UAW strike is drastically affecting our business. We're hoping for a resolution sooner rather than later."

"Higher interest rates and the UAW strike are affecting sales of capital equipment."

The Local Economy. The economy for West Michigan slowed considerably in October, although at least part of the decline can be attributed to the expanded nature of the UAW strike. Except for some local issues at a couple UAW plants, the strike is apparently over. However, the post-strike economy still shows signs of slowing but not collapsing into a recession. NEW ORDERS, our index of business improvement, fell to -13 from -9. The PRODUCTION Index, which some economists label as "output," stayed negative at -4 but was virtually unchanged from September's -5. At -17, the index of PURCHASES remains weak but modestly improved over -22 in September. Although comments from the survey participants have grown increasingly pessimistic, many firms appear to be preparing for more of a slowdown than a collapse. The Federal Reserve's higher interest rates are supposed to slow the economy, and several survey participants are noting that their firms are feeling the pinch of higher rates. If the economy continues to slow gradually, the Fed's hope for a soft landing can still be achieved. However, literally dozens of impediments can keep the Fed's dream from becoming a reality. In short, it is still not possible to rule out a 2024 recession.

West Michigan Index of New Orders: 2020-2023



The U.S. Economy. The October survey posted by the Institute for Supply Management reports further softening in the U.S. economy. ISM's NEW ORDERS Index came in at -11, down from September's -4. The ISM PRODUCTION Index (a.k.a., Output) softened to -3 from +3. ISM's closely watched ORDER BACKLOG Index remained unchanged at -15. The NEW EXPORT ORDERS Index modestly recovered to -1 from -5. After adding ISM's seasonal adjustments to the survey statistics, the composite index for October came in at 46.7, down considerably from 49.0 in September.

The October view of the U.S. economy from the British-based economic consulting firm S&P Global is considerably more optimistic. S&P's Composite PMI for October posted at the break-even point of 50.0, up slightly from September's 49.8, and considerably higher than August's 47.9. The S&P New Orders Index increased "... for the first time in six months and at the fastest pace since September 2022." The S&P Output Index also returned to a positive reading. However, many firms are now reporting more excess capacity and are adjusting their future plans downward in anticipation of a slower, but not collapsing, economy. Siân Jones, Principal Economist at S&P Global Market Intelligence, commented:

> "October PMI data signalled a stabilisation of U.S. manufacturing conditions amid a renewed rise in new order inflows and firmer output growth. Demand conditions reportedly showed signs of improvement as customer interest revived, but this was once again largely focused on the domestic market as new export orders fell at a quicker rate. Of concern were reports of dwindling backlogs of work, previously used to help support production, as firms also revised down their expectations for future output to the lowest in 2023 so far. At the same time, manufacturers cut employment for the first time in over three years as workloads were reportedly insufficient to warrant additional hiring or the replacement of voluntary leavers. On the price front, manufacturers saw sharper increases in costs and output charges, as inflation regained some momentum in the sector. Higher oil and oil-derived input prices again spurred hikes, as rates of inflation accelerated for the third month running."

The World Economy. After 21 months into the first major war in Europe since 1945, the J.P. Morgan Worldwide Manufacturing Index posted at 48.8, down modestly from 49.1 in September, but marginally below the break-even point of 50.0. JPM's New Orders Index edged higher to 48.6 from 48.4. However, the JPM Output Index softened to 48.9 from 49.8. For the sixth successive month, the PMI for Canada, our largest trading partner, remained stuck below the 50.0 break-even point and posted at 48.6. The October PMI for Mexico, our second largest trading partner, rebounded to 52.1 from 49.8. The PMI for beleaguered China, our third largest trading partner, again turned negative at 49.5, down from 50.6. Bennett Parrish, Global Economist at J.P. Morgan, further commented:

> "The global manufacturing sector remained downbeat in October. The output index from the PMI survey dipped by 0.9 pts to 48.9, its lowest level for three months. The downturn in new orders also extended to 16 months, a survey-record sequence of decline. This is leading to increased caution among manufacturers, with jobs, inventories and purchasing all cut back, while business optimism slumped to its weakest in almost a year. While Europe is still the main drag on world factory output, continued weakness in larger Asian manufacturers such as Japan and mainland China are also causes for concern."

Turning to the Eurozone economy, the Hamburg Commercial Bank reports that the October composite PMI posted at 43.1, up modestly from September's 43.5, but still signaling "…a sustained deterioration in manufacturing conditions." HCOB's New Orders index continued to decline at the fastest rate in the survey's 26-year history. At 40.8, the PMI for Germany, the largest economy in the group, continues to pull the averages down. The PMI For France, the second largest Eurozone economy, came in at a 41-month low of 42.8. "Destocking," a term for the gradual liquidation of excess inventories previously accumulated as a result of rising prices and shortages. continues to be a factor in the Eurozone PMI. Dr. Cyrus de la Rubia, Chief Economist at Hamburg Commercial Bank, further noted:

> "The Eurozone manufacturing sector's trend over the last two years or so looks like a bumpy sleigh ride down into the valley. Given that the headline PMI did barely move over the last few months, including October, we may be about to reach the bottom of the valley. Thus, the big question is when we will begin to make an ascent. The stagnating new orders index, which remains deep in negative territory, and the similar behaviour of the Quantity of Purchase Index does not suggest an immediate turnaround. Having said this, history tells us that in many cases the levelling out of these indices is the precondition for a start of the recovery. We expect this to happen in the first half of next year. Companies continue to decrease their stock of purchases. Hesitancy to lay off workers has meant that the jobs market is not taking as big of a hit as it did in past tough times. It looks like the eurozone countries are pulling each other down. With France, Italy, and Spain PMIs diving and Germany already signalling a deep manufacturing recession, it is pretty clear that the sector is headed for a contraction in all these countries this quarter."

Automotive. As the UAW strike unfolded over this past 40 days, the impact was finally felt by several of our local auto parts producers. However, assuming the contracts are ratified and that all of the local issue can be quickly resolved, the auto industry should now be able to return to filling the demand backlog that still exists for many current models. Although considerably higher interest rates are dampening the market, the October sales reported by *Automotive News* estimates that the October year-over-year SAAR (Seasonally Adjusted Annualized Rate) posted at 15.5 million, down slightly from 15.7 million units in September. After peaking four months ago at 16.2 million vehicles, the sales pace has cooled as we head toward the end of the year. Looking at October results for the firms that still report monthly, October year-over-year sales for Ford were up 8.3 percent, Hyundai-Kia, up 13.7 percent, Subaru, up 15.9 percent, Toyota, 2.2 percent, and Honda, gaining 33.2 percent. The average for all reporting firms was up a respectable 12.4 percent. GlobalData's David Oakley, manager of sales forecasting for the Americas at GlobalData automotive practice, further commented:

> "The restart of student loan repayments in October was a further headwind to add to the mix of high interest rates, sticky inflation and some lingering supply chain issues. Nevertheless, the market has shown resilience all year, and with the UAW strikes now resolved – pending ratification of the tentative agreements – there is still an opportunity for a robust final two months of 2023 if [automakers] can entice consumers with attractive offers."

West Michigan Unemployment. From Economic 101, we learned that unemployment is a laggard statistic. Hence, the unemployment situation for West Michigan continues to perform slightly better than historical averages. The September (latest month available) press release from the Michigan Department of Technology, Management & Budget (DTMB) reported that the seasonally adjusted year-over-year unemployment rate for Michigan edged up to 3.9. Our West Michigan EMPLOYMENT Index fell to -10 from +0, the lowest the index has been since the middle of the pandemic. For October, 21 percent of this month's survey respondents reported staff reductions, up from 16 percent in September and 6 percent as recently as July. Looking at the DTMB report for some of our West Michigan counties, the October unemployment rate (unadjusted) for Kalamazoo County posted at 3.8 percent, Kent County, 3.4 percent, and Calhoun County, 4.4 percent. At 3.2 percent, Ottawa County reported the lowest county unemployment rate for West Michigan. However, now that our West Michigan index of EMPLOYMENT has turned double-digit negative for the first time in many months, we should expect the unemployment rate for most counties to begin rising fairly soon.

Business and Consumer Confidence. According to the October 31 press release, the October Conference Board Consumer Confidence Index has fallen to 102.4 (1985=100), down from 104.3 in September. In a similar move, the October University of Michigan Index of Consumer Sentiment dropped to 63.8 from 67.9. A recession starting sometime over the next year is anticipated by 69 percent of all consumers. For our local survey, the SHORT-TERM BUSINESS OUTLOOK Index for October, which asks local firms about their business perceptions for the next three to six months, recovered to -4 from -15. For a pleasant surprise, the LONG-TERM BUSINESS OUTLOOK Index, which queries the perceptions for the next three to five years, shot up to +28 from +15.

Industrial Inflation. For West Michigan, only 4 percent of the October respondents reported their major commodities to be rising in price. Our index of PRICES posted at -14, down from -5. At the national level, the October ISM index of PRICES came in at -10, slightly improved from September's -12, but still double-digit negative. Just like last month, prices for most big-ticket commodities like aluminum, steel, corrugated packaging, copper, and plastic resins continue to fall. The S&P's Global Supply Shortage Index posted at 0.8, unchanged and still at its lowest level in 44 months. Commenting on the latest price trends, Tim Moore, Economic Indices Director at S&P Global Market Intelligence noted:

> "October data highlights that rebalanced demand and supply conditions across the global manufacturing sector have again translated into fewer incidences of short supply. The headline index remains the lowest since January 2020 and it reveals that total reports of supply shortages are around 20% lower than the long-run survey average. Increased supplier inventories have helped to soften commodity prices and put downward pressure on price negotiations with manufacturers so far in 2023. However, the 'All Items' commodity price index stabilized during October, with only metals and timber showing clear signs of remaining on a downward trend."

Consumer Inflation. The September (most recent month available) CPI posted unchanged at 3.7 percent, and core CPI, which excludes food and energy, came in at 4.1 percent, down from 4.3 percent. Although some retirement plans, including social security, are keyed to the CPI, the Federal Reserve continues to place more importance on their own index of Personal Consumptions Expenditures. The PCE, or the "deflator" as it is also known, is used by the Fed to adjust the Gross Domestic Product (GDP) for inflation. This index receives considerably less attention from the media than the CPI, but it is important for judging the interest rate policies of the Fed. According to the October 27 PCE press release, the September index reported prices rising at a rate of 3.4 percent, unchanged from August. The core PCE, which excludes food and energy, came in at 3.7 percent, down modestly from 3.8 percent. By reviewing the current data from both the CPI and the PCE, it is clear that the Federal Reserve's target inflation rate of 2.0 percent remains elusive. Assuming that a recession can be avoided, it will take many months before inflation can return to normal.

GDP. On October 26, the Bureau of Economic Analysis (BEA) posted a preliminary estimate of 4.9 percent for the third quarter growth rate for the U.S. economy. Although most third quarter estimates had been in the range of 2.1 to 2.4 percent, it was the Atlanta Fed's GDPNow model that accurately predicted the rate to be 4.9 percent. Even then, many analysts consider the 4.9 percent to be an outlier which may get revised downward. Looking forward to the 2023 fourth quarter, the GDPNow model is forecasting a rate of only 1.2 percent, which is in line with other forecasts. Fourth quarter average forecast for the Blue Chip GDP Realtime model has GDP flattening to 0.9 percent, and the Conference Board predicts a Q4 gain of only 1.0 percent. However, as of October, the Conference Board is still sticking with the prediction of a shallow recession covering the first two quarters of 2024. By contrast, S&P Global predicts a GDP growth of 1.4 percent for all of 2024, but remains hesitant to predict a 2024 recession.

Looking Forward. For Michigan, the UAW strike is over, automotive sales remain strong, and the recent GDP number came in very strong. That's the good news. We now have to deal with numerous economic headwinds, most of which are in the consumer market and have been well documented by the news outlets, such as the resumption of student loan payments, rising credit card interest rates, and increasing delinquency rates for most types of loans. With 40 percent of the CPI tied to housing or "shelter" as it is reported, we can easily call the cost of housing the most significant economic problem to watch. Although housing prices in some areas are beginning to fall, the absence of inventory for realtors to sell has kept housing prices in most market areas fairly high. The cost of financing a home or even the cost of moving from one home to another of equal value has skyrocketed. The current national average mortgage is $350,000, and the average monthly loan payment including interest and property taxes is about $2,800, according to the various web mortgage calculators. Three years ago, the payment on that same $350,000 mortgage was $1,900, or about $900 less per month. For renters, rising interest rates has caused some new construction projects to be scrapped, reducing the supply and causing existing rental rates to rise. Although not quite as severe, the same analysis can be applied to auto loans. At the Fed's most recent meeting, the decision was made to hold rates at the present level. If the aforementioned analysis is correct, the Fed would be well advised to keep rates steady. Overtightening COULD spin us into a Fed-induced recession.

It is worth repeating that many of our economic data collecting systems were set up in the 1930's, and then revised as we moved forward. Hence, we frequently hear the statement that two- thirds of the economy is driven by consumer spending, with government and business spending constituting the remining third. From an accounting standpoint, this is probably correct. In today's world, what this theory misses is that two-thirds of the VARIATION in the economy is in the industrial sector. For instance, just the respondents to this survey and their respective firms represent $15 billion in spending every year. If these firms were to cut purchases by, say, 10 percent, that would pull $1.5 billion out of the economy, sometimes overnight. That $1.5 billion spending drop would obviously be reflected in the economy. Add the other firms that are not respondents to our survey, and you can begin to see the impact of the industrial sector on the overall economy.

Last but not least, we cannot stick our head in the sand and ignore the increasingly unstable geopolitical environment. Thankfully, few U.S. personnel are physically involved in either of the two wars currently raging. We are, however, financially involved, and we are borrowing the money to support these military actions. On the other side of the world, another potential conflict is brewing between China and Taiwan. If any of these three situations get out of hand, it will upset the supply chains and economies of the world.

October 2023 Survey Statistics

	UP	SAME	DOWN	N/A	Oct. Index	Sept. Index	Aug. Index	25 Year Average
Sales (New Orders)	21%	45%	34%	0%	- 13	- 9	- 4	+14
Production (Gross Output)	17%	55%	21%	6%	- 4	- 5	+14	+14
Employment	11%	68%	21%	0%	-10	+ 0	+ 2	+ 8
Purchases	13%	57%	30%	0%	-17	-22	-17	+ 7
Prices Paid (major commodities)	4%	71%	17%	4%	-14	- 5	+ 0	+15
Lead Times (from suppliers)	2%	79%	19%	0%	-17	-13	- 14	+11
Purchased Materials Inv. (Raw materials & supplies)	17%	49%	23%	11%	- 6	- 6	- 5	- 4
Finished Goods Inventory	17%	64%	15%	4%	+ 2	- 17	- 4	- 8
Short Term Business Outlook (Next 3-6 months)	17%	62%	21%	0%	- 4	-15	+ 2	-
Long Term Business Outlook (Next 3-5 years)	34%	56%	6%	4%	+28	+15	+19	-

Items in short supply:

Powder coat, slides, domestic castings, domestic foundry/forge capacity, custom steel parts, casters, transformers, sprockets, panel components, equipment replacement parts.

Prices on the UP side:

Fuel, gelatin-based products, polypropylene, meat/dairy (grocery related), steel, aluminum, raw CBD, labor, hardware, plastics, interest rates, labor rates.

Prices on the DOWN side:

Aluminum*, steel*, scrap steel, oil related products, corrugated and packaging, copper, polypropylene*, produce and poultry (grocery related) ABS, PA6, soybeans.

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

Latest Unemployment Reports:

(Except as noted, data are NOT seasonally adjusted)

	Sept. 2023	Sept. 2022	Aug. 2009	20-Year Low
State of Michigan (Sept.)	3.9%	4.3%	14.6%	3.2%
State of Michigan (Unadj.)	3.9%	3.8%	14.1%	2.9%
Kent County	3.4%	3.4%	11.9%	2.1%
Kalamazoo County	3.8%	3.9%	11.1%	2.1%
Calhoun County	4.4%	4.6%	12.8%	2.7%
Ottawa County	3.2%	3.2%	13.3%	1.8%
Barry County	3.7%	4.0%	10.9%	2.2%
Kalamazoo City	4.8%	4.8%	15.2%	3.2%
Portage City	3.5%	3.5%	8.7%	1.3%
Grand Rapids City	4.5%	4.5%	16.1%	3.0%
Kentwood City	3.2%	3.2%	10.7%	1.4%
Plainfield Twp.	2.5%	2.5%	8.0%	1.4%
U.S. Official Rate (Sept.)	3.8%	3.5%	9.6%	3.5%
U.S. Rate (Unadjusted)	3.6%	3.3%	9.6%	3.4%
U.S. U-6 Rate (Oct.)**	7.2%	6.7%	22.9%	6.7%

***U-6 for Michigan = 7.1% for Q4 2022 thru Q3 2023*

OCTOBER COMMENTS FROM SURVEY PARTICIPANTS

"We're moving into our slow season, so it's not unexpected to see downward trends in sales, inventory, purchases. Sales are expected to be relatively flat next year.

"Furloughs and/or layoffs are happening across auto suppliers (Tier 1, Tier 2, etc.) in sync with the UAW targeted plant strikes."

"It's a very uncertain environment."

"Demand continues to outpace expectations. Suppliers across the board have ramped up production, bringing lead times back into historical averages. Last year at this time, nearly all customers were carrying more inventory than was needed. However, this year they seem to be more in balance with demand. We remain cautious in our outlook, however, given the eventuality of higher interest rates negatively impacting final consumption."

"We are entering our "slow" season but the drop-off in business is steeper than typical."

"The UAW strike is drastically affecting our business. We're hoping for a resolution sooner rather than later."

"We have steady incoming orders, but quote activity is down. We are continuing to cut back on purchases to bring down inventory."

"Current business conditions are somewhat unchanged from last month's survey. Optimism for the future remains."

"New Orders have slowed significantly. As a result, inventories are up significantly."

"The strike has officially hit us with the latest round of walk-offs at Ford. We are expecting this to continue on much longer than initially thought."

"We need to keep an eye on the situation in the Middle East."

"It feels as if the pent-up demand from COVID has been filled. Most companies are on coast mode. We're closely watching the global political situation to see if what effects to supply chain or business."

"We are very slow going into the 4th quarter."

"We are starting to be more impacted by the UAW strikes."

"Higher interest rates and the UAW strike are affecting sales of capital equipment. We are hearing that more customers want to hold off on purchases of machine tools."

"We are seeing pricing drop from our competition."

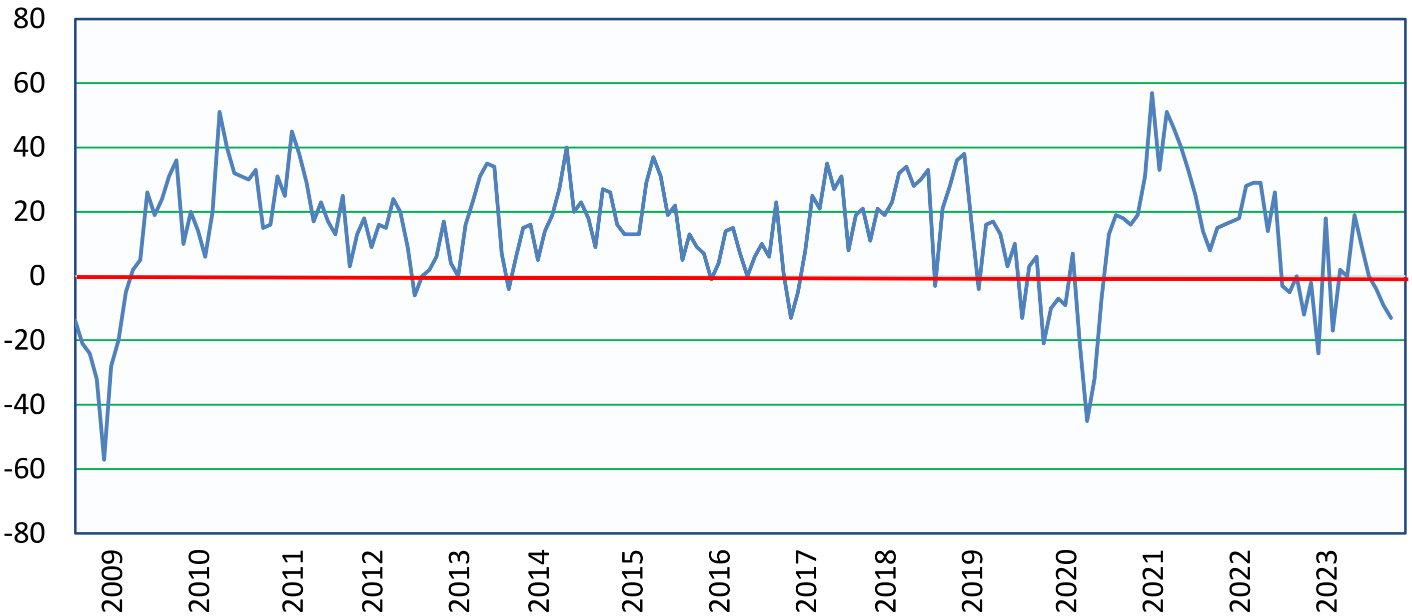
"With fuel prices slowly going down, we are seeing oil related products and services also decreasing in cost."

"Phosphate market has yet to fully rebound but has improved. Citric Acid continues to be a challenge. There are multiple force majeures impacting a variety of items."

"Steady."

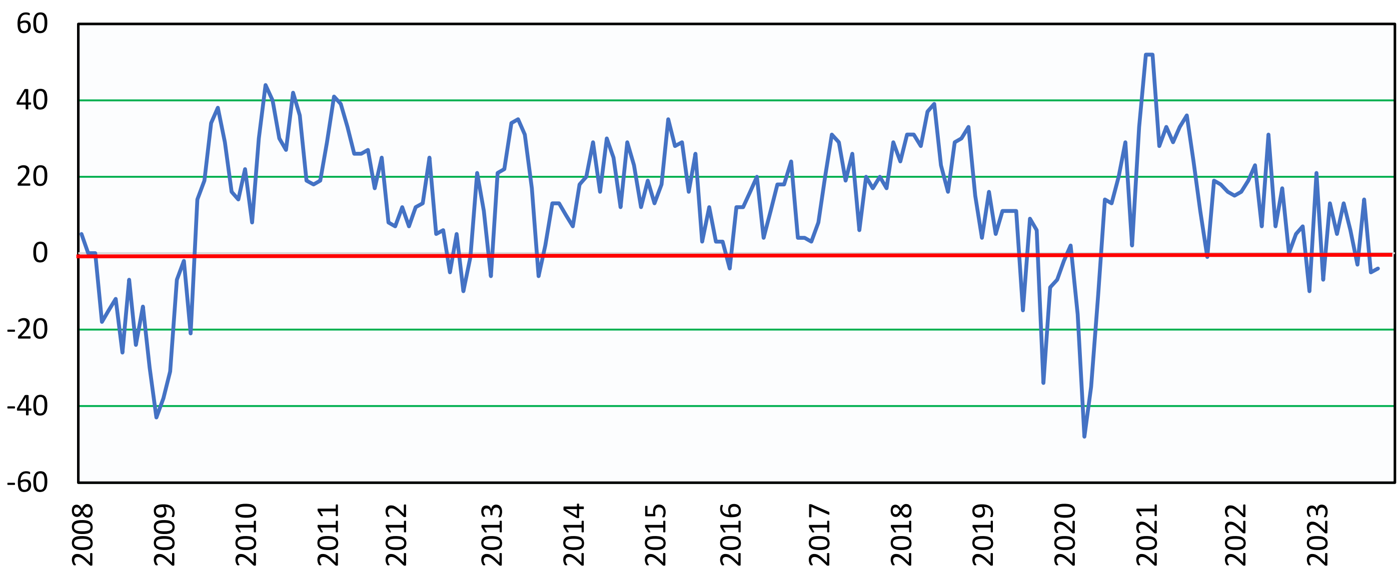
West Michigan Index of New Orders: 2008-2023

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.



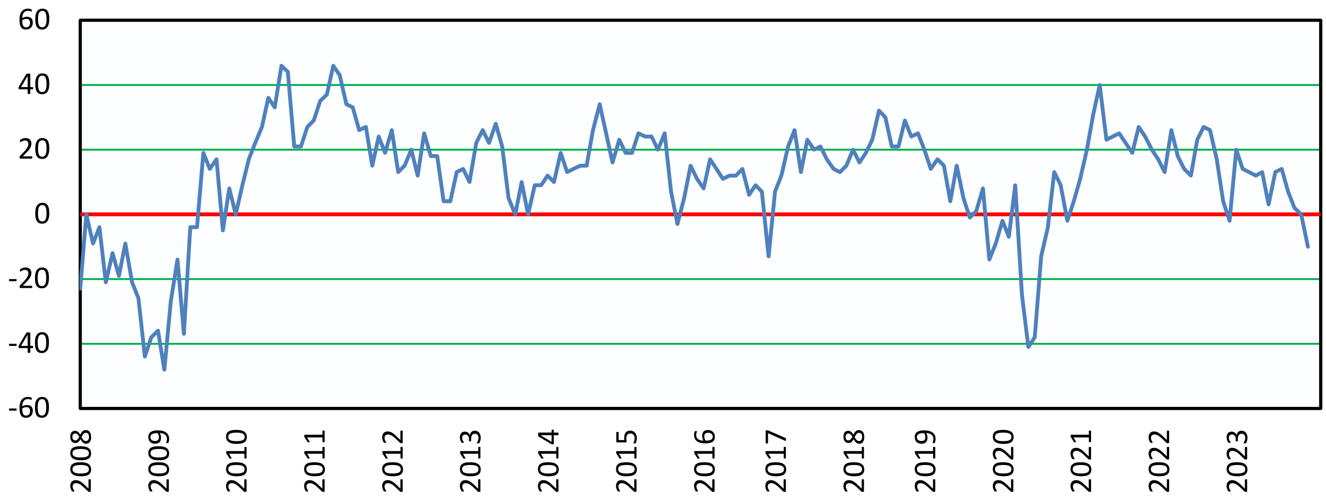
West Michigan Index of Production (Output): 2008-2023

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.