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Current Business Trends

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Meekly Positive

Flat, but meekly positive. That's the latest word on the West Michigan economy according to the data and comments collected in the last two weeks of January 2016. Our index of business improvement, which we call NEW ORDERS, edged back to +4, up from -1. The PRODUCTION index recovered more ground, rising to +12 from -4. Activity in the purchasing offices, our index of PURCHASES, remained negative at -1, but improved from December's -4. In last month's report, we noted that December is often a month of slower sales and reduced production and predicted that January would probably see a return of the same slow growth we have reported for dozens of months. We had hoped for a stronger bounce, and some firms are not as optimistic about 2016. But the West Michigan economy continues to outpace the national economy as well as the overall Michigan economy, so many local firms are still very optimistic.

Given the slower pace of the West Michigan economy, it is not surprising to see that the momentum for most of our industrial groups has turned widely mixed. This is clearly the case with our industrial distributors, the office furniture manufacturers, capital equipment firms, and aerospace contractors. The exception may be our automotive parts producers, who are still basking in the light of record auto sales that are optimistically projected to go even higher in 2016. However, the January auto sales report came in flat, and the retail auto market remains oversaturated and bolstered by lower credit requirements, massive incentives, and low gasoline prices. These incentives cannot go on indefinitely.

Our national parent organization, the Institute for Supply Management, reports that the U.S. industrial economy continues to flatten. Typical of most post-holiday reports, ISM's index of NEW ORDERS came back considerably from December's low of -9 to +1 for January. The ISM PRODUCTION index remained negative at -5, but improved modestly over December's -8. Winter storms were blamed for part of the problem. The EMPLOYMENT index decline accelerated to -11 from -7. According to ISM's index of INVENTORIES, many firms are continuing to liquidate stocks of basic materials in anticipation of lower prices. New EXPORT ORDERS edged back to negative at -6, down from December's +2. At 48.2, ISM's overall index for January remains below the 50.0 break-even point for the fourth consecutive month. Since the end of the Korean War, a recession has always followed.

A contrasting view comes from the survey conducted by Markit.com, the international economics consulting firm. For January 2016, Markit's PMI rose modestly to 52.4, up from December's 51.2. Upturns in both PRODUCTION and NEW ORDERS were cited as factors accounting for the rise. However, the survey author is not as positive:

"The manufacturing sector continues to struggle against the headwinds of weak global demand, the strong dollar, slumping investment in the energy sector and rising financial market uncertainty, all of which mean the goods-producing sector looks set to act as a drag on the wider economy again in the first quarter of 2016. Despite picking up slightly, the January PMI reading is one of the worst seen over the past two years, highlighting the ongoing plight of the manufacturing sector."

According to the J.P. Morgan Global Manufacturing report released on February 1, the growth in world manufacturing remains "subdued" at the start of 2016. Brazil, Russia, Canada, South Korea, Indonesia, Malaysia, and China are mired in contraction. Improvements were seen in Poland, the Czech Republic, Taiwan, Turkey, and Vietnam. Because of quantitative easing by Europe's central bank, most of the major Eurozone countries have returned to modest growth. Even the PMIs for France and Greece are now at the break-even point of 50.0. Surprisingly, it is now Spain, Italy, and Ireland that are posting the strongest growth numbers. According to the J.P. Morgan Chief economist:

"The January PMI data signals that the upturn in global manufacturing remained lacklustre at the start of 2016. A mild improvement in new order growth and higher employment are steps in the right direction, but with export trade flows still close to stagnation the trend in output has yet to break free of its ongoing inertia."

Industrial deflation continues to be an unrecognized threat to the U.S. economy. Basic commodities like oil, copper, steel, and aluminum are down 30-40% from 2011, resulting in mine closures, mill closures, and significant layoffs in these industries all over the world. Many farm commodities have fallen far enough in price to cause a recession in the seed, fertilizer, and farm equipment industries. ISM's January index of PRICES came in at -33, a level that has only been seen during periods of severe recessions. As a result, at least a trillion dollars of worldwide wealth has been obliterated. The news media is still primarily giving attention to the oil industry, but the rest of the commodities in the supply chain are equally important. In the West Michigan economy, we don't see the consequences, because our industrial base has not been impacted. However, that doesn't mean we are immune from the fallout.

Good news. The employment picture remains very positive for West Michigan. The December unemployment rate for Kent County eased to a fifteen-year low of 2.7%, down from 3.6% one year ago and a fraction of the 12.6% rate reported in July of 2009 at the peak of the Great Recession. In Kalamazoo County, the December unemployment rate fell to 3.2%, down a

full percentage point over the past calendar year and the same rate the Michigan Department of Technology, Management and Budget reported in June of 1999. Although our local index of EMPLOYMENT came in only modestly positive at +8, the projection indicates that many of our local unemployment rates should continue to fall for the next couple of months. However, with the ISM national EMPLOYMENT index now falling at a double digit rate, it will be difficult for West Michigan to avoid being dragged down.

The impact of expanding or contracting employment in the industrial sector cannot be overemphasized. One new job for a manufacturing firm can generate as many as ten additional jobs in the supply chain. The respondents to our survey represent about \$15 billion in spending every year, so any form of expansion or contraction will ultimately be reflected in the employment picture. Hence, as long as our EMPLOYMENT index remains positive, unemployment in West Michigan will probably continue to fall. To their discredit, it should be noted that Keynesian economists generally ignore the industrial market and concentrate their analysis only on end consumers.

Finally, it is essential to remember a lesson from Economics 101. As an economic indicator, employment is a LAGGARD. Hence, the early stages of any economic downturn usually show no sign of trouble in the labor market. Firms continue to hire, sometimes because of the disbelief that a slump is imminent, but often because managers believe that their firm or their industry may be exempt from the downturn. Coming out of a recession, the reverse is true. Employers rehire staff very slowly, and only begin expansion when the recovery is well underway and confidence has improved.

Another recession? That's the big question everyone is asking. According to many indicators, that

possibility remains a serious threat. Many pundits correctly point out that a few negative indicators do not always predict the future, and that many other current indicators are still very positive. The preliminary estimate of GDP for the fourth quarter of 2015 came in at an anemic 0.7%.

Although deflation in the supply chain is important, our greatest threat still comes from the possibility of the Chinese economy imploding, drawing the rest of the world into a global recession. The Chinese have now experienced 40 years of unparalleled growth without experiencing a significant recession. In fact, China's reported a 9.2% GDP growth rate back in 2009 when the economies of the rest of the industrialized world were collapsing. By combining entrepreneurship and capitalism with a dictatorial government, they believe that they have identified a better model for long-term growth. They further believe that they can pinpoint the "right" way to allocate resources and regulations better than Western governments which must rely on legislative bodies to argue rather than act. It is possible that they might be right, but a more likely scenario involves some kind of a free market solution. In other words, so far they have gotten lucky.

Some current predictions are that the 2016 U.S. economy expand at a rate as high as 2.5%, while others are predicting a slide of approximately equal proportions. However, a third possibility exists in the form of growth that simply flattens to somewhere near zero. We have now seen six years of slow growth, and the possibility remains that the growth could get even slower without dipping into a formal recession. According to the textbooks, the term "growth recession" can be attributed to a period of GDP growth which hovers above 0% but stays below 1%. Again, it is just a possibility.

JANUARY 2016 COMMENTS FROM SURVEY PARTICIPANTS

"Gasoline costs are down, but this is affecting our machine sales in the gas industries."

"Metal and commodity prices continue to decline, but not at the pace of Q1 & Q2 of 2015."

"Prices are not falling commensurate with commodity declines. Firms are holding excess profits for their stock holders Durable goods orders ex-autos are definitely slowing. A manufacturing recession has started. The Fed has hurt global markets by raising rates and "Fed-speak" has wiped out trillions globally. Yay Fed! You just hurt the 1% and every American with a 401k and tax revenue."

"I don't care what the news media is saying about China. I am still selling equipment to companies that have or are starting manufacturing plants in China."

"We are heading toward our typical Q1 slow period, especially in the office furniture industry."

"What the heck happened???? There is an eerie stillness of late. Activity has dropped. December finished with a whimper. January so far has been very slow."

"Business is steady. 2015 was down from 2014, but 2014 was a great year. So 2015 was good, and 16 is planned up."

"Should be a solid year if the 2016 forecast in the automotive world materialize."

"We're taking advantage of the lower prices of road asphalt products and lower winter costs by doing more maintenance and construction projects in 2016."

"We are surprisingly steady this month, and next month looks about the same. Hopefully the trend continues."

"Business is strong, and we continue to forecast a strong year. But we're a little concerned that there may be a slowdown."

"Business is very strong, and quoting is also very high for this time of year."

"We came out of December stronger than expected, and held strong for the first week or so in January. But the orders for end of month are dropping off."

"In my opinion a slow fourth quarter was not an anomaly. I believe we shall see a 10 - 15% dip in year-over-year sales."

"Business seems to be currently strong, with the exception of China. Volumes in that market are softening, which could impact everyone."

"Were working a large opportunity."

"Business was extremely busy at the end of the year, but it seems to be slowing down now. We still anticipate 2016 to be a good year."

"It feels like things are softening some. We are still in fine shape, though."

"2016 is looking to be another great year!! We have the 1st, 2nd & 3rd quarters of 2016 almost filled!"

"We are on a small down-cycle of new business, which should turn around shortly."

"M&A activity in pharma is adding uncertainty to an industry that was historically stable."

"We've been investing in new business initiatives since 2009 in an effort to diversify, and will finally be starting to realize the paybacks from these investments starting this year."

"It's a smooth start to the New Year."

"We're still slower than forecasted, but we hope to see a pickup in the larger projects in next 6 months."

"Will the wealth effect on US economy cause a slowdown here?"

"January is busy, however, February and March are usually soft for us."

"This typically a slower time for office furniture. However, this year we will be very busy."

January 2016 Survey Statistics

	UP	SAME	DOWN	N/A	Jan. Index	Dec. Index	Nov. Index	25 Year Average
Sales (New Orders)	31%	41%	27%	1%	+ 4	- 1	+ 7	+14
Production	27%	52%	15%	6%	+12	- 4	+ 3	+14
Employment	15%	78%	7%		+ 8	+12	+15	+ 8
Purchases	21%	57%	22%		- 1	- 4	+ 5	+ 7
Prices Paid (major commod.)	6%	70%	24%		-18	- 6	-13	+15
Lead Times (from suppliers)	8%	79%	13%		- 5	- 2	+ 4	+11
Purchased Materials Inv. (Raw materials & supplies)	18%	60%	16%	6%	+ 2	- 6	+ 3	- 4
Finished Goods Inventory	12%	64%	17%	7%	- 5	-12	- 6	- 8
Short Term Business Outlook (Next 3-6 months)	42%	40%	18%		+24	+26	+10	-
Long Term Business Outlook (Next 3-5 years)	54%	37%	6%	3%	+48	+49	+39	-

Items in short supply: HPDE (high density polyethylene), HMW (high molecular weight) polyethylene, gears, stainless steel (due to ATI lockout), hourly employees, electric components, labor, good plating suppliers, electrical components suppliers.

Prices on the UP side: Fasteners, heavy construction equipment, scrap steel, polypropylene, cold rolled steel (slightly), modest first-of-the-year stuff, PVC resin, laminate, wages.

Prices on the DOWN side: Steel and steel products, carbon steel, stainless steel*, petroleum based products, lubricants, scrap steel, alloys, natural gas, fuel, raw materials, HDPE grades except HMW, brass, aluminum, zinc, plastic resin, polypropylene*, transportation, aluminum, copper, metal based chemicals, plasticizer, paraffinic oil, SEBS resin, metal surcharges, powder paint.

Latest Unemployment Reports

(Except as noted, data are **NOT** seasonally adjusted)

	Dec. 2015	Dec. 2014	Aug. 2009	20 Year Low
State of Michigan (Adj.)	5.1%	6.4%	14.6%	3.2%
State of Michigan (Unadj.)	4.5%	5.6%	14.1%	2.9%
Kent County	2.7%	3.6%	11.9%	2.1%
Kalamazoo County	3.2%	4.2%	11.1%	2.1%
Calhoun County	3.9%	4.8%	12.8%	2.7%
Ottawa County	2.6%	3.5%	13.3%	1.8%
Barry County	3.3%	4.2%	10.9%	2.2%
Kalamazoo City	3.9%	5.2%	15.2%	3.2%
Portage City	2.9%	3.8%	8.7%	1.3%
Grand Rapids City	3.6%	4.8%	16.1%	3.0%
Kentwood City	2.5%	3.4%	10.7%	1.4%
Plainfield Twp.	2.0%	2.7%	8.0%	1.4%
U.S. Official Rate (Nov.)	5.0%	5.6%	9.6%	3.8%
U.S. Rate Unadjusted	4.8%	5.4%	9.6%	3.6%
U.S. U-6 Rate**	9.9%	11.2%	16.7%	8.0%

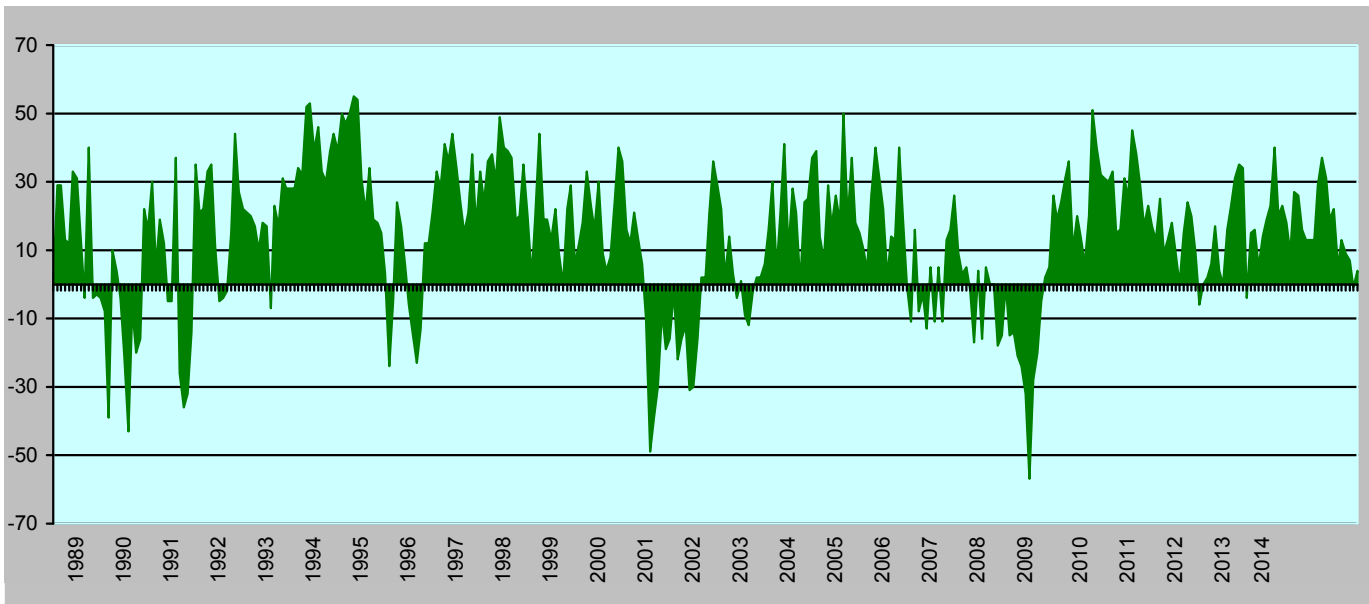
**U-6 for Michigan = 12.0% for Oct. 2014 to Sept. 2015

Index of New Orders: West Michigan

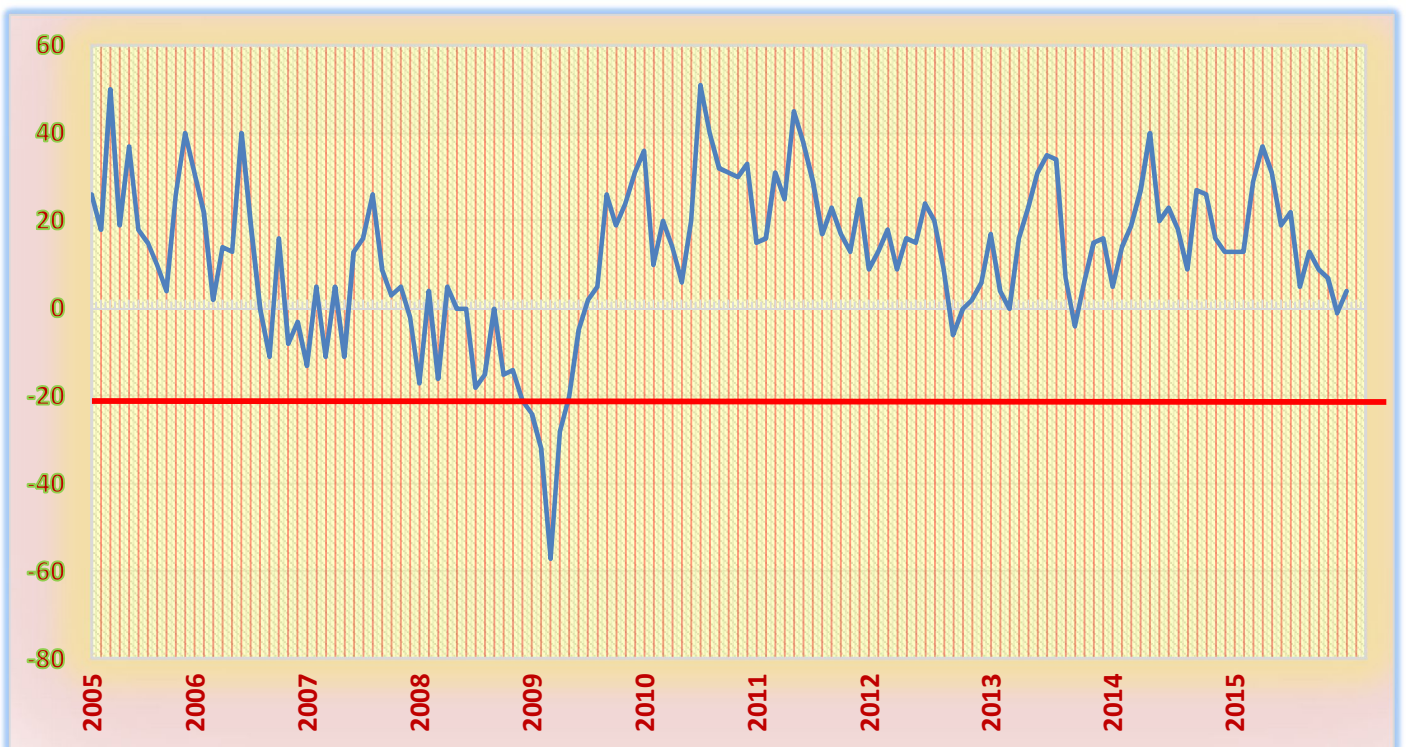
As the name implies, this index measures new business coming into the firm, and signifies business improvement or business decline. When this index is positive for an extended period of time, it implies that the firm or organization will soon need to purchase more raw materials and services, hire more 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.

Latest Report	+4 for the month of January, 2016
Previous Month	-1 for the month of December, 2015
One Year Ago	+13 for the month of January, 2015
Record Low	- 57 for the month of December, 2008
Record High	+ 55 for the month of September, 1994
First Recovery	+ 3 in April of 2009 and forward

ISM-West Michigan Index of New Orders 1988 - 2015

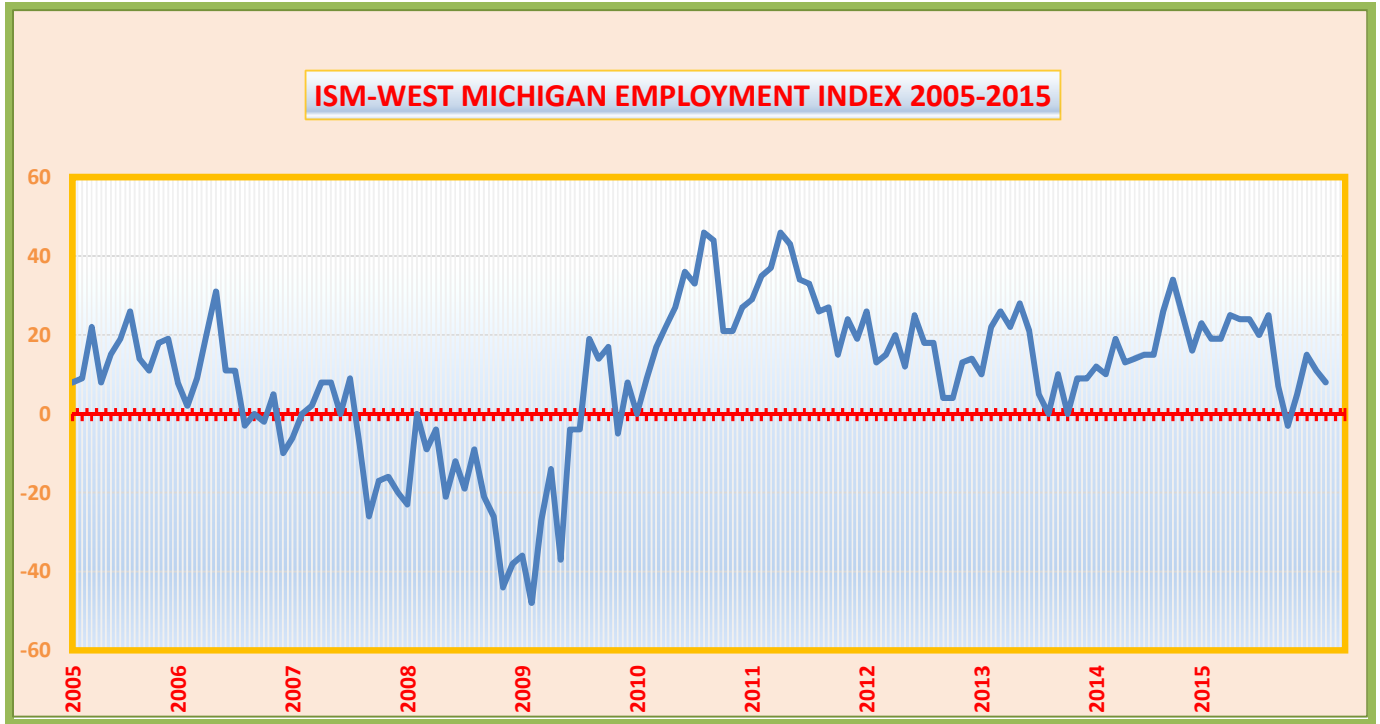


ISM-West Michigan Index of New Orders: 2005-2015 Only



ISM-West Michigan Index of Employment

The index of EMPLOYMENT measures the firm's increases and decreases in staffing, including permanent workers and temps. After economic downturns, it measure 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.



ISM-West Michigan Future Business Outlook

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.

