2012

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West Michigan Supply Management: A Year in Review

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Since April of 2009, Grand Rapids has been in a state of recovery from one of the worst recessions in recent history. Although there have been a few months that were less robust than others, the recovery has continued unabated. Unfortunately, the pace of the recovery is still very slow by historical standards, and the 2007–2009 economic downturn will always be referred to as the “Great Recession.”

During 2011, office furniture, our region’s largest industry, continued to lead the recovery, albeit at a slower pace than expected. Since commercial construction continues to be at historical lows, almost none of the uptick can be attributed to furnishing new office space. The strong cash positions of customers resulted in some firms investing in long promised new replacement office furniture. Analysts also attribute the industry’s continued diversification into the medical furniture business as a major component of the industry’s success in 2011.

Automotive parts, our second largest industry, continued on the recovery path in lockstep with slow but steady increases in the sales for new motor vehicles in North America. In recent months, the standards for auto financing have loosened, and the interest rates are near record lows. Whereas auto sales are still far below the levels of five years ago, the number of miles that Americans are driving has only fallen about 2½%. Although the prices for new cars remain very high, consumers are being forced to buy new cars or drive less. Furthermore, with rising prices for quality used cars, some buyers have found it to be more economical to buy new cars than old cars. Hopefully, this trend will continue well into 2012.

As we approached the end of 2011, some of the economic indicators began to show signs of stress. Fear and rumors again surfaced that the 2½ year old recovery may have run its course and a second economic dip might be on its way. With incoming orders starting to flatten, the office furniture industry has begun to show signs of topping out. Other local firms experienced slower sales, partially due to sluggish business conditions throughout the country. Whereas this hesitation is not necessarily a major cause for concern, it reminds us that there is still a long way to go before the economy returns to the lofty levels of 2004–2005. It also suggests that the first half of 2012 may be less robust.

Probably the biggest economic news for 2011 was the passage of Michigan’s new budget for FY 2012. In setting a pattern for future years, the new budget incorporates some of the biggest changes in taxation since the Hedley Amendment many years ago. With the goal of closing a huge budget gap, the new budget incorporates some controversial cuts in education as well as benefit cuts for state workers. Most important, the complicated Michigan Business Tax has been replaced with a simplistic 6% flat rate tax on profits. Will this new tax structure attract new business to the state as the proponents have claimed? Yes, of course. But it may take years before the major impact is felt. Indeed, the most immediate benefit to Michigan will be the retention of jobs that would otherwise move out of the state. This means that the total cost of business will now be reduced just enough to keep some firms solvent and discourage others from seeking more favorable tax environments elsewhere. The simplicity of the new tax for planning purposes is also a plus. Hence, we should see some moderate improvement in unemployment rate over the next couple of years. However, this should not be regarded as a total fix. Michigan must still continue to diversify its economy by balancing our automotive concentration with new industries over the long term.

About the Survey

The monthly survey of business condition, published under the title of “Current Business Trends,” first debuted in Kalamazoo in February of 1979, and was expanded to Grand Rapids in 1988. At present, the survey encompasses 53 purchasing managers from ISM-Greater Grand Rapids and 25 from N.A.P.M. Southwestern Michigan. For both surveys, the respondents are purchasing managers from the region’s major industrial manufacturers, distributors, and industrial service organizations.

Patterned after the nationwide survey conducted by the Institute for Supply Management, the strength of the survey is its simplicity. Each month, the respondents are asked to rate eight factors as “SAME” or stable, “UP” or improving/rising, OR “Down” as in declining/falling.

New Orders

This index measures new business coming into the firms 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. This results in billions of dollars being added to the local economy. Conversely, billions of dollars are pulled from the economy when the index turns negative. Depending on the firm, a significant portion of this money ends up being spent in the local community.

We entered 2011 on a firm footing and a New Order index of +25 for January. The index jumped to +45 in February, but eased slightly to +38 in March. Then tragedy struck Japan with a devastating tsunami, and the next few months resulted in parts shortages that slowed automobile
production around the world. The impact of the tsunami was certainly not enough to put us into recession, but any disruption to the automobile industry generally has an impact on Michigan. Despite the recovery from the parts shortages, the pace for New Orders continued to slow for the rest of the year. We expect the index to be positive as we enter 2012.

The caution remains that the world economy continues to slow, and many countries may soon slide into a technical recession, i.e., two continuous quarters of negative economic growth. For us, the big question remains about how much we will be drawn in if the economy for most of the rest of the world turns slightly negative. In the case of the Eurozone, the most recent GDP numbers are just barely positive, and many forecasts for the fourth quarter expect the numbers to turn negative. The main problem continues to be the heightened caution over the European debt situation, which has caused businesses and consumers alike to hunker down.

Production

For 2011, the production schedules varied widely between different types of manufacturing firms. At least some of the production slowdown in the middle of the year can be attributed to the annual “model changeover,” although this trend continues to become less pronounced with each passing year. Despite the slowing of production by some firms later in the year, the strength in the automotive sector kept the index positive. Unlike previous years, several auto parts producers expect the schedules to remain higher than usual in the season surrounding Thanksgiving and Christmas. Other holidays, bad weather, and material shortages may also constitute uncontrollable influences for the production index.

When the production index remains positive for several months, it almost always result in an increase in the employment index. Conversely, a decline in production for several months in a row will almost always results in layoffs. Hence, the fact that the production index in late 2011 has slowed will probably result in the Employment Index slowing as well in early 2012.

Industrial Inflation

For many industrial buyers, 2011 will be remembered as a year with a wave of severe industrial inflation. As noted in Figure 3, the year began with our index of prices at the highest level we had seen in three years. For the next three months, the index escalated to its highest level in the 22-year history of the survey. To make matters worse, the inflation centered on big ticket commodities like steel, aluminum, magnesium, corrugated, plastic resins, and all oil related products. Industrial buyers scramble to find better pricing for these commodities, but most were unable to hold back the tide.

Where did this inflation come from? Unfortunately, much of it came from speculation. With interest rates for all the major currencies still historically low, professional money managers and hedge fund operators have been forced to look for creative ways to increase investment returns. With the stock market already fairly high, some otherwise conservative investors decided to dabble in commodity speculation.

Another cause for the escalation of prices was the problem of shortages. Some of these shortages were the result of various pockets of bad weather all over the world. Other shortages resulted from the tsunami that devastated Japan.

By mid-year 2011, the speculative bubble burst, and prices began to fall. As a result of the falling prices, speculators began liquidating inventories, driving prices even lower. By the end of the year, the index of Prices turned negative for the first time since July, 2009.

Employment

As we approach another election year, the cry for more “jobs” permeates almost every candidate’s rhetoric regardless of party affiliation. For 2011, the unemployment rate in the Greater
Grand Rapids area remained excessively high, despite the continued local industrial sector recovery.

On the other hand, our survey’s index of Employment was very positive for the entire year. The automotive parts producers were among the firms to call back many laid off workers and hire many new people as well. In April, the Employment Index rose to a twenty-year high of +46. For several months in the middle of the year, over half of the firms in our survey reported adding personnel. We did not always hear about it in the news because some firms were very quiet about it lest they end up with a line at the door.

Unfortunately, our survey covers only the industrial sector, and the consumer sector has not shown as much promise. Again, retailers and other service-related firms are uncertain about the future and prefer not to expand. Smaller firms are also far more reluctant to hire and view the future with much more caution.

In 2011, another problem surfaced, namely the shortage of qualified personnel. The fact is that ALMOST all of the new hires require some kind of skill, such as computer analysis, CNC operators, electronics repair, lab techs, medical skills, etc. Hence, the shortage of personnel has inhibited growth. Several firms in our survey have complained that the inability to hire qualified personnel has forced them to turn away work and halted plans to expand production.

Looking Ahead to 2012
In summary, softness in the world economy is spilling over into our domestic economy, and we are not completely immune. Our local economy is still holding positive, but we are not an island. The statistics for 2012 may dance back and forth from incrementally positive to negative. Unemployment, which has improved little since the 2007–2009 recession, may drift higher. The business tax cuts, which do not take effect until January of 2012, will take time to show results. As we are all aware, the national surveys show that most people feel that the 2007–2009 recession never ended.

Business confidence and consumer confidence will continue to be negative. The segments of this negativity include (1) the disheartening “debt ceiling” battle in August, (2) the high unemployment rates, and no sign of significant improvement, (3) concerns over the European debt situation, (4) concerns over our own sovereign debt situation and the impact that it will have on the future, (5) the uneasy feeling that the tax and regulatory environment will remain unclear until after the national election in November of 2012. In other words, 2012 could be a year of legislative gridlock at the national level.

The ongoing housing crisis will continue to weigh on the economy. Locally, there is evidence that home prices are starting to stabilize, although the continued high level of foreclosures will inhibit prices from rising for years to come. Hence, homeowners now feel like homes are not the investment that they once were. In short, 2012 will not be the year that the housing market returns to normal.

Overall, barring an immediate collapse of the Euro, we still expect to see the current pattern of slow growth to continue in West Michigan for 2012. If we do slide into another recession, chances are that this time we can blame it on the Europeans. As long as automobile sales remain positive, we should continue to stay modestly positive in Michigan for at least the first half of 2012. However, the fact remains that the ENTIRE western world has awakened to the fact that politicians have vastly overpromised pensions as well as benefits to the baby boomers that are unfunded and unsustainable. Greece, the first country to run out of money, was simply the proverbial canary in the coal mine. Fortunately, the problem is still fixable, and the sooner we start, the better.

Last but not least, we need to be vigilant of surprises or catastrophes that may be out of our immediate control. The tsunami in Japan was unexpected, but it impacted most of the industrialized world. Many terrorist acts have been subverted since 9/11, but a major terrorist act that could slip through the cracks would shake our confidence and force us back into a recession.