THE PURCHASING ECONOMY SURVEY REPORT

FEBRUARY 2010

"A monthly survey of supply chain managers"

Welcome to our February report covering January survey results. According to Supply Managers the economy may be moving into a more sustained and positive recovery, but with rising inflationary pressures. Follow my daily comments at: www.twitter.com/erniegoss

INCREASING TAXES ON RICH IS NEITHER FAIR NOR SOUND

In the name of fairness, President Obama has endorsed increasing taxes on individuals making more than $200,000 by allowing the tax rate on each additional dollar of earnings to climb from 35 percent to 39.5 for these "rich" workers for 2011. Additionally, these individuals will see their taxes on dividends and capital gains advance to pre-2003 levels. This means that in states such as Oregon, successful business owners will pay more than $500 in income taxes for each $1,000 of additional in-come. Recently in a ballot initiative with less than 2.5 percent of the state's electorate participating, Oregon's voters approved raising the top tax rate on income to 11 percent. Oregon's experience is not unique. Across the nation, lower income individuals are shifting more and more taxes from themselves to the "rich" via the voting booth. In 2007, the top ten percent of income earners paid more than 70 percent of federal personal income taxes, while the bottom 50 percent paid less than three percent of federal income taxes paid (http://www.ntu.org/main/page.php?PageID=6). This disparity will increase significantly in 2011. There are three problems with this distribution of burdens. First, politically speaking a large number of low income individuals (the 90 percent) can vote to inflict even higher taxes on the supposed rich (the 10 percent). Second, this shifts the cost of government to a small proportion of the population, thus encouraging government overspending. Third, taxing higher wage earners more punitively reduces overall economic growth by discouraging work and entrepreneurship, thus reducing the size of the economic pie for all, including the poor. Fourth, raising taxes for either high or low wage earners in these times of economic fragility is unwise and potentially reckless. Ernie Goss.

LAST MONTH'S SURVEY RESULTS

REGIONAL ON EXPANSION PATH BUT
WITH ELEVATED INFLATIONARY PRESSURES

SURVEY RESULTS AT A GLANCE

- Leading economic indicator rises above growth neutral.
- The employment index indicates slight job additions for January.
- Inventories declined for the 16th straight month but pullbacks are slowing.
- Inflation gauge is more than double January 2009's level.

The January Business Conditions Index for the Mid-America region, a leading economic indicator from a survey of supply managers in a nine-state area, rose to a healthy level. The index expanded to 54.7 from December's 50.3 and November's 47.5. An index of 50.0 is considered growth neutral. Readings over the past several months indicate that the regional economic recovery is picking up steam, albeit at a subdued pace. While results from the January survey are encouraging, surveys over the past several months point to an economic recovery that is fragile. However, the likelihood of dipping back into recessionary territory has diminished significantly according to our surveys of supply managers. Supply managers are the 'canary in the coal mine' for the economy and they are indicating economic expansion in the months ahead. Economic conditions remain less healthy for rural areas of the nine-state region. The regional employment index rose above growth neutral for the month. The January reading of 51.7 was up from 47.6 in December, and 46.1 in November. For January, 13 percent of supply managers reported job losses and 17 percent indicated their firms increased employment. This month and in November 2009, we asked supply managers what their layoff expectations are for 2010. Between November and January the percentage of supply managers expecting layoffs in 2010 declined from 41 percent to 24 percent. Likewise the number expecting a pay increase in 2010 rose from 48 percent in November to 53 percent in January. While I would not call this a surge, it clearly reflects an improving job market.

MID-AMERICAN STATES

ARKANSAS

The Arkansas Business Conditions Index for January, based on a survey of supply managers, climbed to 46.7, a regional low, from December's 39.4 and November's very weak 33.1. Components of the overall index for January were new orders at 49.0, production or sales at 48.7, delivery lead time at 60.0, inventories at 29.3, and employment at 46.5. For January durable goods producers experienced stabilizing business while non-durable goods manufacturers detailed continuing pullbacks in economic activity.

IOWA

For the fourth time in the past six months, Iowa's Business Conditions Index rose above growth neutral. The index, a leading economic indicator from a survey of supply managers, climbed to 52.1 from December's 49.2. Components of the overall index for January were new orders at 52.1, production or sales at 57.1, delivery lead time at 56.4, employment at 49.1, and inventories at 45.8. Despite the upturn in overall business conditions, both durable and non-durable goods manufacturers in the state experienced losses of employment for the month. Truckers in the state have yet to benefit from an improving state economy.

KANSAS

The leading economic indicator for Kansas from a survey of supply managers in the state advanced for a third consecutive month. The January Business Conditions Index rose to a weak 47.4 from 44.8 in December from 42.1 in November. Kansas was one of two states to record a reading below growth neutral. Components of the overall index for January were new orders at 58.7, production, or sales, at 45.0, delivery lead time at 47.8, employment at 36.2, and inventories at 50.8. While improvements were recorded for non-durable goods producers, durable goods manufacturing continue to experience downturns in business activity. I do expect significant upturns in new orders for aircraft producers in 2010 as the global economy expands.

MINNESOTA

The state's leading economic indicator, based on a survey of supply managers, slipped for January. The Business Conditions Index sank to 51.4 from December's 53.5 and November's 57.1. This was the sixth straight month that the state's index has risen above growth neutral pointing to expanding economic conditions for the first half of 2010. Components of the overall index for January were new orders at 55.8, production, or sales, at 55.3, delivery lead time at 51.3, inventories at 43.3, and employment at 51.3. According to government data, Minnesota added almost 5,000 temporary jobs via employment agencies over the past 6 months of 2009. This compares to 3,000 temporary jobs lost for the same period of 2008. This and our monthly survey point to a state economy on the mend with permanent job gains for the first quarter of 2010. Even so, I expect the employment gains to be very modest.

MISSOURI
For a seventh consecutive month, Missouri's Business Conditions Index was above growth neutral. The index from a survey of supply managers in the state, climbed to 52.2 from December's 50.1 and November's 50.6. Components of the overall index from the January survey were new orders at 50.8, production, or sales, at 50.1, delivery lead time at 55.1, inventories at 54.6, and employment at 50.6. "We are seeing improving business conditions among manufacturers in the state, both durable and non-durable goods producers. January business activity was much healthier for food producers in the state.

NEBRASKA
For a fifth consecutive month Nebraska's Business Conditions Index, a leading economic indicator, expanded above growth neutral. The January reading, based on a survey of supply managers, climbed to 54.2 from 50.2 in December and 50.6 in November. Components of the overall index for January were new orders at 59.7, production, or sales, at 55.5, delivery lead time at 61.2, inventories at 38.8, and employment at 55.6. "Except for computer and electronic component manufacturers, durable and non-durable goods producers in the state experienced upturns in January business activity. Food producers are encountering improving economic conditions.

NORTH DAKOTA
After two months of moving below growth neutral, North Dakota's leading economic indicator expanded above 50.0. The January reading, based on a survey of supply managers in the state, climbed to 50.5 from December's 44.3 and November's 48.4. Components of the overall index for January were new orders at 40.4, production, or sales, at 57.5, delivery lead time at 51.5, employment at 46.9, and inventories at 56.8. The rest of the region is catching up economically speaking North Dakota. Durable goods producers experienced a much better January than non-durable goods manufacturers.

OKLAHOMA
For the first time since August of last year, Oklahoma's leading economic indicator from a monthly survey of supply managers climbed above growth neutral. The Business Conditions Index, advanced to 54.5 from December's 43.0 and November's 49.4. Components of January's overall reading were new orders at 49.7, production, or sales, at 49.4, delivery lead time at 76.4, inventories at 45.5, and employment at 51.5. Except for food producers in the state, non-durable goods manufacturers reported weak economic activity for January. On the other hand, durable goods producers are experiencing solid upturns in economic activity. Both sectors continue to add few jobs even as the economic outlook improves.

SOUTH DAKOTA
The state's leading economic indicator from a monthly survey of supply managers in the state rose to 54.4 from 46.0 in December and 50.2 in November. Components of the overall index for January were new orders at 63.0, production, or sales, at 62.1, delivery lead time at 55.1, inventories at 41.5, and employment at 50.3. Manufacturing in South Dakota has stabilized with January activity up slightly from December. I expect continuing growth for the state's computer and electronic component manufacturers for 2010.

THE BULLISH NEWS

- The Standard & Poor's/Case-Shiller home-price index of 20 major U.S. cities released last week rose 0.2% in November, the sixth straight monthly gain.
- The U.S. unemployment rate fell to 9.7 percent in January from 10% in December. The number of unemployed individuals fell to 14.8 million from 15.3 million.
- Including goods from food to clothing to gasoline -- but excluding cars -- U.S. retail sales rose 3.6% from January 2009. January 2010 sales were up by 0.3% from December 2009.
- The manufacturing sector added 11,000 jobs, a positive number after a downward trend, for January.
- Hopes that the economy can sustain its recovery drew support Wednesday from news that industrial output rose for a seventh straight month and home construction hit a six-month peak in January.
- The leading economic indicators from the Creighton and U.S. monthly survey of supply managers is improving and points to recovery but with excessive inflation.

THE BEARISH NEWS

- The U.S. trade deficit surged to a larger-than-expected $40.18 billion in December, the biggest imbalance in 12 months. The wider deficit reflected a rebounding economy that is pushing up demand for oil and other imports.
- The Mortgage Bankers Association's (MBA) index of mortgage applications, which in-cludes both purchase and refinance loans, decreased 1.2% for the week ended February 5.
- Discouraged workers, those not currently looking for work because they believe no jobs are available for them, rose to 1.1 million in January from 734,000 a year ago.
- Due to a frail economy, the average price of regular gasoline at U.S. filling stations declined to $2.67 a gallon as gasoline futures plunged and demand weakened.
- The euro fell below $1.37 on Wednesday, as uncertainty over whether Greece would be offered help to deal with its stressed sovereign debt spurred investors to seek the safety of the dollar and yen.
- The gold price fell slightly to $1,073 this week as uncertainty over a Greek bailout kept the price of gold under pressure.

WATCH OUT FOR

- Keep an eye of the value of the Euro. A continuing slump in the Euro's value (which I don't expect long term) will weigh on the U.S. economy as U.S. goods, including agricultural products, become more expensive in the 16 countries using the Euro.
- First time and continuing claims for unemployment insurance. Released every Thursday. First time claims above 460,000 will be bearish. (www.dol.gov).
- The best and most up-to-date economic indicator to watch is the yield on 10-year U.S. Treasury bonds. The yield incorporates the inflation outlook, financial risk assessments and buying/selling of Treasury bonds. I expect yields to increase by 0.4% in the next 3 months (http://finance.yahoo.com)

- For the first time in several years, we need to begin monitoring the release of the consumer price index (CPI) around mid-month. If the core annual growth begins to top 3.0% regularly, watch out for rate hikes on both the short and long end (www.bls.gov).

THE OUTLOOK: I expect

FROM GOSS:

- The U.S. unemployment rate to go above 10% again by mid-2010.
- The U.S. economy to show job gains for the first quarter of 2010 as the government hires Census workers.
- Annualized inflation will increase to 3.3% by the middle of 2010.
- Long term interest rates to increase by 0.4% in the next 3 months.

NATIONAL ASSOCIATION OF BUSINESS ECONOMICS FORECASTS:

- For the second straight quarter, price increases were more common than price cuts. Only 8% of respondents reported that their firms had cut prices last quarter, compared with 22% that had raised prices. Expectations for price increases in the coming quarter out-ran expected price cuts by 29 percentage points.
- Job losses continue to slowly abate, with the percentage of firms cutting payrolls falling to 28% from 31% in the October survey. The percentage of firms adding jobs edged higher to 13%. The share of respondents expecting their firms to add employees over the coming six months rose to 29% from 24%.

OTHER FORECASTS:

- Zillow Chief Economist Stan Humphries, "While we have seen strong stabilization in home values during 2009, there are clear signs that they will turn more negative in the near-term." What we saw in mid-2009 was a brief respite from a larger market correction that has not yet run its course."
- As the U.S. struggles to get out of its housing slump, its neighbor to the north faces a different challenge: Canada's housing recovery has been so rapid that some here are worrying about a bubble. http://online.wsj.com/article/SB20001424052748703808904575025100730017666.html
- The Chinese economy is expected to grow by 9.5% in 2010 with inflation running at 3% http://www.chinadaily.com.cn/bizchina/2010-02/10/content_9457796.htm.

SUPPLY MANAGERS READING ROOM

"IMPROVE YOUR ACQUISITION PROCESS WITH LEAN SIX SIGMA," Contract Management 49, no. 11 (Nov 2009): p. 68-73,75. "Lean Six Sigma" (LSS) is a methodology designed to reduce waste and improve quality in your processes. It combines the quality enhancement of "Six Sigma" and the improvement efficiency of "Lean." This article will examine what works and what does not in applying LSS for complex systems and services acquisitions. To successfully apply LSS to improve a complex systems and services acquisition program, the following approaches should be taken: 1. Make a long-term commitment to reaping the benefits of LSS to a major systems and services acquisition program. 2. Define your LSS project scope carefully with your project charter. 3. Do not attempt to take on more work scope with your project than you have time and resources for. You should start the application of LSS as early on in the complex systems and services acquisition program as possible. When appropriately applied, LSS is all about implementing effective, mission-focused processes that better use existing resources to meet program cost, schedule, scope, and performance objectives.

ASK ERNIE

If you have any questions about the survey or have any specific questions about the recent economic conditions, please write to Ernie at ernieg@creighton.edu.

PRICE DATA

ALL COMMODITIES/FARM PRODUCTS 2007-2009
FUELS & RELATED/METALS & METAL PRODUCTS