

## “A monthly survey of supply chain managers”

Welcome to our June report covering May survey results. Follow my daily comments at: [www.twitter.com/erniegoss](http://www.twitter.com/erniegoss)

### Buy Or Rent That Home-Which Is A Better Deal?

Last September I recommended that if you expected to remain employed and in your new home for 3 to 5 years, it was a great time to buy a house. Since then, according to the Case-Shiller 20-city composite index, housing prices have plunged by another 6.2 percent. Do I still recommend buying a home? Yes, and let me provide the rationale. In 2007 at the height of the housing bubble, the average monthly payment on a U.S. home was \$1,166 assuming no down payment and a 30-year mortgage. At that same time, the average monthly rent for a U.S. apartment/house was \$665. Thus in 2007, the average monthly house payment was 75 percent higher than the average monthly apartment rent. By March 2011, housing prices had plummeted while apartment rents had expanded to the point where the two were equal--that is the monthly mortgage payment was the same as the monthly apartment rental. So where is the ratio going from here? Between 1988 and 2004, the monthly mortgage payment was approximately 31 percent higher than the average monthly apartment rent. If U.S. shelter prices return to this average ratio or relationship, one of three changes must occur, 1) apartment rentals must decline by 24 percent, 2) housing prices must rise by 30 percent, or 3) the 30 year mortgage rate must soar from its current level of 4.8 percent to 7.4 percent. Which will occur? First, I do not expect rental rates to decline. In fact, I expect robust growth in rental prices across the U.S. However, I do forecast a combination of advancing housing prices and expanding mortgage rates to bring the ratio back to its long run average. So much like last September, housing represents a true deal for the buyer who locks in current bargain prices and record low mortgage rates. However in my judgment, this option will only work for the person who remains in the home for more than three years and locks in a fixed mortgage rate close to today's ultra attractive rates. Ernie Goss.

## LAST MONTH'S SURVEY RESULTS

### Exports Push Mid-America Leading Indicator Higher: Wholesale Inflation Still a Problem

#### SURVEY RESULTS AT A GLANCE

- Leading economic indicator rises for first time since February.
- New export orders climbs sharply.
- Few companies reported expanding real estate space utilization.
- Even fewer companies expect to expand real estate space utilization with new construction and/or leasing over the next six months.

For the first time since February of this year, the Business Conditions Index, a leading economic indicator for the nine-state Mid-America region, increased. The index from a monthly survey of supply managers is pointing to positive growth for the next three to six months. As in prior months, the May survey indicated soaring inflationary pressures at the wholesale level. Overall index: The index, a leading economic indicator that ranges between 0 and 100, advanced to 60.2 from 57.7 in April. This is the 18th consecutive month that the index has been above growth neutral 50.0. The overall index, or Business Conditions Index, is a mathematical average of indices for new orders, production or sales, employment, inventories and delivery lead time. While higher commodity prices

have cooled regional growth a bit, our survey points to a healthy expansion in the months ahead with exports making a significant contribution to growth. Employment: For the 17th straight month, the regional employment index remained above growth neutral as the May job reading expanded to 58.1 from April's 54.0. This month 14.1 percent of firms reported reductions in employment. This compares to 16 percent of firms that indicated pullbacks in our April survey. Job growth was especially strong for firms more dependent on international sales and those with ties to agriculture.

Wholesale Prices: The prices-paid index, which tracks the cost of raw materials and supplies, slipped to a still inflationary 84.9 from April's record high 94.0. Companies continue to report transportation surcharges for their purchases with sellers resisting price negotiations. The higher commodity prices, especially for energy products, is cutting into the profit margins of businesses that we survey each month. Record high inflationary pressures at the wholesale level have begun to spill over into consumer prices. For example, since December of last year, the core consumer price index, which excludes energy and food, has exceeded 3 percent on an annualized basis, even though the Federal Reserve (Fed) indicated it would end its buying of long-term U.S. Treasury bonds, quantitative easing 2 (QE2), this summer. I expect the Fed's record-low short-term interest rates to continue to weaken the dollar and push inflation above the Fed's comfort zone.

This month survey participants were asked how their firms have changed their real estate utilization over the past six months and how their real estate utilization will change for the next six months. Approximately 17.8 percent indicated they had expanded real estate utilization while 3 percent reported reducing real estate utilization over the past six months. The remaining 79.2 percent indicated that their real estate utilization had not changed in the past six months. One supply manager reported, "We did not expand our company space. However, we greatly expanded our capacity through significant outsourcing, domestic and international." For the next six month period, approximately 13.1 percent indicated they expect their firm's real estate space utilization to expand while 9.0 percent anticipate a reduction. The remaining 77.9 percent indicated their real estate utilization would not change over the next six months.

Confidence: Looking ahead six months, economic optimism, as captured by the May business confidence index, grew to 60.4 from April's 57.5. Recent pullbacks in energy prices had a positive impact on supply manager's economic outlook. Even so, supply managers said they expect elevated commodity prices to limit future economic expansion. Inventories: For the 15th time in the past 16 months, supply managers in the nine-state region expanded inventory levels. The May reading expanded to 58.9 from April's 53.7. The upturn in inventory levels of raw materials and supplies for the month is another indication of the expansion in economic optimism among supply managers.

Trade: An expanding global economy continues to boost regional trade numbers. Aided by a cheap dollar making U.S. goods more competitively priced abroad, May's new export orders index advanced to 60.1 from 57.1 in April. The region's import reading dipped to 53.3 from April's 56.1. The cheap dollar and a global economic expansion combined to boost sales and new orders from abroad. Other components: Other components of the May Business Conditions Index were new orders at 59.6, up slightly from 59.5 in April; production or sales at 60.9, up from 59.5; and delivery lead time at 63.6, up from 62.0 in April.

## MID-AMERICA STATES

### ARKANSAS

For the first time since December of last year, Arkansas' leading economic indicator from Creighton's monthly survey of supply managers declined. Even so, the index stood at a healthy 64.0, down

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from April's regional high of 74.7. Components of the index for May were new orders at 59.9, production or sales at 68.5, delivery lead time at 67.8, inventories at 63.5, and employment at 60.2. Arkansas has added more than 12,000 jobs in 2011. Our survey indicates that the pace of job additions will climb in the months ahead. Despite very attractive interest rates and an expanding economy, Arkansas companies have been very reluctant to construct new facilities.

### IOWA

Iowa's Business Conditions Index remained above growth neutral for the 17th straight month. The index dipped to 65.6 from 69.7 in April. Components of the index for May were new orders at 68.3, production or sales at 64.5, delivery lead time at 70.2, employment at 68.3, and inventories at 56.6. Iowa's manufacturing sector continues to expand at a very healthy pace. The state's large durable goods industry is benefiting from the cheap dollar making U.S. goods more competitively priced abroad. Furthermore, very healthy farm income has bolstered sales of Iowa agriculture equipment manufacturers. I expect growth tied to agriculture to remain positive, but moderate significantly in the months ahead.

### KANSAS

The Business Conditions Index for Kansas rose to 59.2 from 58.4 in April. It is the ninth time in the past 10 months that the leading economic indicator for Kansas was above growth neutral. Components of the index for May were new orders at 59.0, production or sales at 68.5, delivery lead time at 67.8, employment at 60.2, and inventories at 63.5. Except for aircraft and aerospace parts producers, durable goods producers in Kansas are experiencing very healthy growth especially for firms with ties to international markets. Higher commodity prices continue to cut into profits and economic activity for Kansas food processors.

### MINNESOTA

Minnesota's leading economic indicator from the monthly survey of supply managers was above growth neutral for the 22nd straight month at 63.2, up from 60.9 in April. Components of the index for May were new orders at 65.2, production or sales at 67.6, delivery lead time at 66.7, inventories at 55.5, and employment at 60.8. Despite a construction industry that continues to restrain Minnesota economic growth, durable and nondurable goods producers report rapidly improving business activity. Higher commodity prices are negatively affecting Minnesota food processors.

### MISSOURI

The Missouri Business Conditions Index climbed above growth neutral to 57.4, up slightly from 57.2 in April. The index continues to point to growth in the months ahead. Components of the Business Conditions Index for May were new orders at 57.2, production or sales at 57.1, delivery lead time at 62.5, inventories at 56.8, and employment at 53.3. Except for food processors and vehicle manufacturers, manufacturers in Missouri reported healthy growth for the month. Higher commodity prices are negatively affecting food manufacturers while supply chain delays are having adverse impacts on Missouri vehicle manufacturers.

### NEBRASKA

Nebraska's Business Conditions Index moved above growth neutral 50.0 for the seventh straight month. The index from a survey of supply managers climbed to 57.7 from 54.4 in April. Components of the index for May were new orders at 61.3, production or sales at 60.9, delivery lead time at 54.5, inventories at 53.9, and employment at 58.1. An expanding manufacturing sector is spilling over into the rest of the state's economy. For example, rail transportation is growing rapidly even as higher fuel prices have restrained growth for trucking firms.

### NORTH DAKOTA

The leading economic indicator from Creighton's monthly survey of supply managers for North Dakota once again climbed above growth neutral. The Business Conditions Index rose to 58.0 from April's 56.1. Components of the index for May were new orders at 57.4, production or sales at 52.2, delivery lead time at 72.2, employment at 51.0, and inventories at 57.3. North Dakota's rapidly expanding energy sector is pushing overall state growth into an even healthier range. For durable goods producers, expanding sales abroad, supported by a cheap dollar, continue to support growth in the state.

### OKLAHOMA

For the 17th straight month, Oklahoma's leading economic indicator remained above growth neutral. The Business Conditions Index from a monthly survey of supply managers dipped to a still robust 68.2 from 68.8 in April. Components of the index for May were new orders at 74.6, production or sales at 73.1, delivery lead time at 63.4, inventories at 69.9, and employment at 59.8. The state's large energy sector is benefiting from higher energy commodity prices. However due to very strong productivity growth, this sector has grown sales much more briskly than employment. This growth along with rapid growth among the state's durable goods producers has pushed commercial and industrial construction higher and more than offset a weak Oklahoma residential housing sector.

### SOUTH DAKOTA

South Dakota's leading economic indicator once again rose above growth neutral. The Business Conditions Index from a monthly survey of supply managers, rose to 63.1 from April's healthy 61.2. Components of the index for May were new orders at 59.1, production or sales at 63.3, delivery lead time at 52.1, inventories at 69.7, and employment at 71.4. Manufacturers in the state report healthy economic activity for the month. As a result of the manufacturing expansion, durable and nondurable goods producers have increased employment at a steady pace but have also increased the hours worked by current employees dramatically over the past several months.



## THE BULLISH NEWS

- Investors were encouraged by when U.S. exports hit a record high in April, narrowing the U.S. trade deficit. U.S. companies sold more computers, heavy machinery and telecommunications equipment overseas while imports declined, largely because fewer autos were imported from Japan after factories were damaged by that country's earthquake and tsunami.
- The US municipal bond market is poised for its biggest week of new issuance this year as concerns of mass defaults have eased, sending borrowing costs lower. Some \$7 billion bond sales are expected this week, according to Ipreo, a market research group, up from an average weekly volume of about \$4 billion in 2010.
- U.S. retail and food services sales for April were \$389.4 billion, an increase of 0.5% from March and 7.6% from one year earlier. Not great but not bad.
- Oil prices have begun to retreat. However, this is just semi-good news since it is due primarily to the fallout from the Greek debt crisis.

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### THE BEARISH NEWS

- U.S. economic growth for the final quarter of 2010 was roughly double the current rate of expansion.
- Global food prices dropped 1% in May compared to the previous month, but remain 37% above May 2010, according to a price index released by the UN. It said lower cereal and sugar prices led to the decrease in the May index, offsetting increases in meat and dairy prices.
- For May, total nonfarm payrolls grew at a much lower-than-expected 54,000 (consensus expectations were for over 150,000). Additionally, the unemployment rate unexpectedly rose to 9.1%.
- From 2004 to 2007 the number of new households headed by foreign born citizens increased by 200,000 per year but since 2007 the number foreign-born non-citizen households have declined by the same amount.

### WHAT TO WATCH

- Retail sales: The U.S. Census Bureau releases retail sales for June on July 14. Non-fuel purchases will be a gauge of the U.S. consumer. Any weakness will be bullish for bond prices and tend to push interest rates down (stock prices down). Need to see monthly growth of more than 0.7%.
- Jobs: On Friday July 8, the U.S. BLS will release the employment report for June. Another positive increase in the unemployment rate and less than 120,000 jobs created will be bullish for bond prices and negative for stocks pushing interest rates lower.
- First time claims for unemployment insurance: Released every Thursday by the U.S. Department of Labor, this report will be closely watched for new claims of more than 420,000.
- PMI: On July 1, Creighton and the ISM release June survey results of supply managers. Watch for signs of a contracting economy (PMI < 50.0). These are very, very important numbers.

### THE OUTLOOK

#### FROM GOSS:

- I expect the nation's unemployment rate to continue to rise, albeit slowly, for the next couple of months, before it begins to move lower
- Mortgage rates should begin to rise slightly in July as the Fed's QE2 program ends
- The trade deal with South Korea to be put on the “back burner” until the Fall as politics interferes with economic decision making.

#### OTHER FORECASTS:

- US President Barack Obama Tuesday dismissed fears of a plunge into a “double-dip” recession and warned against “panic” over dismal economic data. In a news conference

with German Chancellor Angela Merkel, Obama responded to signs the recovery may be slowing and sought to assure “skittish and nervous” investors and voters that better times lay ahead

- Fed Chairman Bernanke said Tuesday that recent signs of economic weakness had not altered his basic view that the economy is mending slowly and that the pace of recovery “seems likely” to increase during the rest of the year. He also said that he continues to see no evidence of broad and enduring inflation despite recent increases in the prices of oil and other commodities.

### Goss Eggs (Recent Dumb Economic Moves)

- U.S. House Members, Senators and the Administration continue to put politics ahead of economics as they stumble and delay trade deals with South Korea, Columbia and Panama. According to analyses by Iowa State University economists, the three agreements will boost U.S. port, beef and poultry exports alone by \$2.3 billion creating 30,000 new jobs. While the U.S. is fiddling, Europe is dealing. And you wonder why the U.S. recovery is so lethargic?

### SUPPLY MANAGER READING ROOM

“Insure Against Disruptions,” Inside Supply Management, May 2011. Businesses will feel the impact of the tragic earthquake and tsunami in Japan for months to come. The direct physical losses to companies located in Japan are substantial, as is the impact on companies that depend on the country's suppliers to provide products and materials. For instance, the earthquake and tsunami devastated a plant in Japan responsible for approximately 20 percent of the world's production of certain silicon wafers used in microchips. Without immediate alternative sources, the supply chain disruption for high-tech and other industries has the potential to cause enormous losses for companies around the world. Companies that have suffered an interruption in their business often overlook potential CBI and extra expense claims. Companies suspecting they might have suffered an interruption-related loss should give notice and implement good record-keeping, careful tracking of expenses and controls over internal communications that may be detrimental to the company's claim. Remember to maintain open communication with the injured supplier, as proving damage to that supplier is vital to companies' recovery. <http://www.ism.ws/pubs/ISMMag/ismarticle.cfm?ItemNumber=21599>

### ASK ERNIE

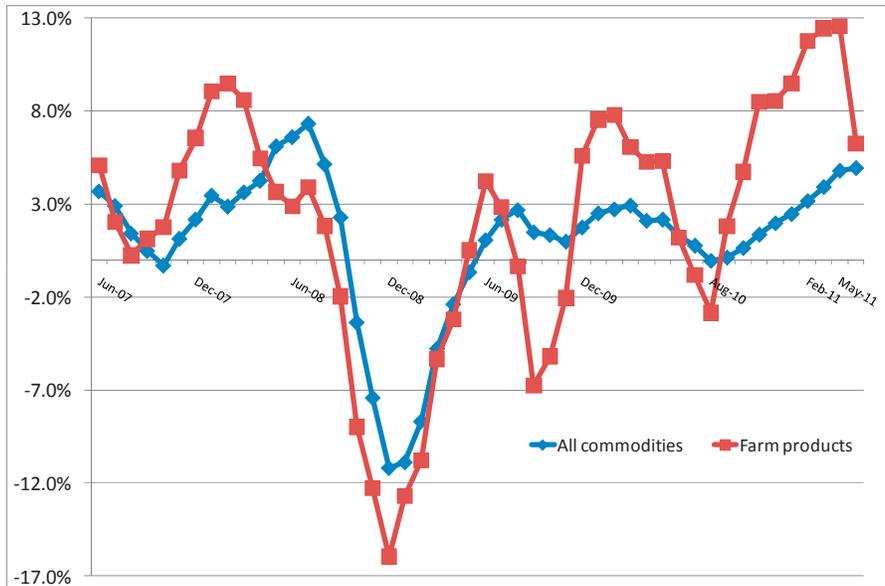
If you have any questions about the survey or have any specific questions about the recent economic conditions, please write to Ernie at [ernieg@creighton.edu](mailto:ernieg@creighton.edu).

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## PRICE DATA

ALL COMMODITIES/FARM PRODUCTS 2007-2011  
 FUELS & RELATED/METALS & METAL PRODUCTS

Price changes, 3 month moving average, 2007-2011



Price changes, 3 month moving average, 2007-2011

