"A monthly survey of supply chain managers"

Welcome to our October report covering September survey results. Follow my daily comments at: www.twitter.com/erniegoss

The Federal Reserve Actions Are Hurting, Not Helping

Next month, the Federal Reserve (Fed) interest rate setting committee, the FOMC, meets to consider changes in rates. Unfortunately for the U.S. economy, they have telegraphed that they intend to exercise more quantitative easing (QE). What this means is that they have exhausted traditional weapons to combat the economic malaise and they intend to engage in the unconventional policy of buying long term U.S. Trea-sury bonds. This policy has the impact of reducing long term interest rates and pumping more dollars into the economy. There are two problems with this policy. First, long term interest rates and mortgage rates are already at historic lows. Lower rates will not stimulate greater consumer spending or home buying. In fact by telling families that rates will remain low for the foreseeable future, potential home buyers are encouraged to delay the purchase in hopes of a lower home price combined with even lower mortgage rates down the road. Second, pumping more dollars into the system will result in excessive inflation as early as the second half of 2011, even more asset price bubbles (e.g. gold) and a fragile U.S. dollar. This will generate another round of economic unwinding in the near term. So what should the Fed do? They should indicate that they will soon begin raising interest rates. This will encourage some home buyers that are currently on the fence to buy that new home. It would also shore up the confidence of investors and business owners who gauge QE as an extreme measure conveying Fed panic. As the old saying goes, "when you've dug yourself into a hole, quit digging." Ernie Goss.

LAST MONTH'S SURVEY RESULTS

Mid-America Leading Economic Advances for First Time Since May: No Double-Dip as Outlook Improves

SURVEY RESULTS AT A GLANCE

- Leading economic indicator increases for first time since May.
- Business confidence continues to slump.
- Approximately one out of five firms expect this year's holiday sales to be up from last year by more than 5 percent.
- Approximately one out of 10 firms anticipate this year's holiday sales to be down from last year by more than 5 percent.
- Inflationary pressures on the rise again.

The September Business Conditions Index for the Mid-America region climbed for the first time since May of this year. According to the September survey of supply managers in the nine-state region, the region will experience improving economic conditions in the months ahead with little likelihood of a double dip recession. Overall index: The index, a leading economic indicator which ranges between 0 and 100, rose to 56.3 from 55.8 for August and 60.8 for July. An index of 50.0 is considered growth neutral. This was the 10th straight month that the regional index has risen above growth neutral. Over the past year, the Mid-America index has normally exceeded the national reading (www.ism.ws) Results from our survey over the past year are similar to that expected from exiting a recession. However, coming out of the 2001 recession U.S. workers experienced cuts in federal tax rates. Unless Congress and the administration move quickly, U.S. workers are facing a mammoth tax increase on Jan. 1, 2011. This increase will restrain economic growth in the U.S. and the region. Employment: For a ninth straight month, the regional employment index remained above growth neutral. However, the September job reading dipped again to a less than stellar 53.2 from 55.2 in August and 58.8 in July. For September, 22.3 percent of firms reported increases in employment while 16.0 detailed pullbacks in company employment levels. "During the official national recession, the region lost almost 465,000 jobs. Since the recession officially ended in June 2009, the region has added less than 24,000 jobs. In terms of jobs, I do not expect the region to be back to pre-recession levels until the first quarter of 2012. Wholesale Prices: The prices-paid index, which tracks the cost of raw materials and supplies, advanced to 71.1, its highest level since May, and well above 64.6 in August.

MID-AMERICAN STATES

ARKANSAS
The state's leading economic indicator based on a survey of supply managers inched higher for the month. The Arkansas Business Conditions Index for September increased for the first time since March to 52.6 from August's 50.2. Components of the overall index for September were new orders at 38.8, production or sales at 60.2, delivery lead time at 62.6, inventories at 45.3, and employment at 56.1. During the official national recession, Arkansas lost more than 45,000 jobs. Since the recession officially ended in June 2009, the state's employment level has been virtually flat. In terms of jobs, I do not expect the state to be back to pre-recession levels until the middle of 2012.

IOWA
For the ninth straight month, Iowa's Business Conditions Index climbed above growth neutral. However, the index, a leading economic indicator from a survey of supply managers, slipped to 61.3 from 66.9 in August and 68.2 in July. Components of the overall index for September were new orders at 64.7, production or sales at 64.2, delivery lead time at 61.7, employment at 62.1, and inventories at 54.1. During the official national recession, Iowa lost more than 53,000 jobs. Since the recession officially ended in June 2009, the state lost another 1,000 jobs. In terms of jobs, I do not expect the state to be back to pre-recession levels until the end of 2011, or the first quarter of 2012.

KANSAS
The leading economic indicator for Kansas from a survey of supply managers increased for a second straight month. The September Business Conditions Index climbed to 55.5 from 53.4 in August and 49.3 in July. Components of the overall index for September were new orders at 59.5, production or sales at 55.8, delivery lead time at 54.5, employment at 51.6, and inventories at 45.7. During the official national recession, Kansas lost more than 48,000 jobs. Since the recession officially ended in June 2009, the state has lost another 2,900 jobs. In terms of jobs, I do not expect the region to be back to pre-recession levels until the first quarter of 2012.

MINNESOTA
For a third consecutive month Minnesota's leading economic indicator, based on a survey of supply managers, declined thus pointing to somewhat slower but still positive growth in the months ahead. The state's Business Conditions Index slumped to a still healthy 58.9 from 63.7 in August and 64.4 in July. September represented the 14th straight month that Minnesota's index was above growth neutral. Components of the overall index

for September were new orders at 56.2 production, or sales at 61.5, delivery lead time at 54.0, inventories at 65.1, and employment at 57.6. During the official national recession, Minnesota lost almost 130,000 jobs. Since the recession officially ended in June 2009, the state has recovered almost 20,000 of the lost jobs. In terms of jobs, I expect the state to return to pre-recession levels of employment by the end of 2011.

MISSOURI

For the 15th straight month, Missouri's Business Conditions Index climbed above growth neutral. The index based on a survey of supply managers rose to 52.9 from 51.6 in August. Components of the overall index from the September survey were new orders at 52.0 production, or sales at 53.0, delivery lead time at 58.3, inventories at 54.7, and employment at 46.7. During the official national recession, Missouri lost approximately 120,000 jobs. Since the recession officially ended in June 2009, the state has lost an additional 11,500 jobs. In terms of jobs, I do not expect the state to be back to pre-recession levels until the second half of 2012.

NEBRASKA

For the 13th consecutive month, Nebraska's Business Conditions Index, a leading economic indicator, moved above growth neutral. The September reading based on a survey of supply managers dipped slightly to 57.3 from 57.5 in August. Components of the overall index for September were new orders at 57.3, production or sales at 59.8, delivery lead time at 59.4, inventories at 51.3, and employment at 59.0. During the official national recession, Nebraska lost more than 21,000 jobs. Since the recession officially ended in June 2009, the state has recovered more than 4,000 of the departed jobs. In terms of jobs, I expect the state to return to pre-recession levels in the second half of 2011.

NORTH DAKOTA

North Dakota's leading economic indicator remained above growth neutral. The index, based on a survey of supply managers in the state, inched higher to 52.7 from August's 50.4. Components of the overall index for September were new orders at 49.4, production or sales at 44.6, delivery lead time at 68.7, employment at 62.0, and inventories at 38.9. During the official national recession, the state actually gained almost 6,000 jobs. Since the recession officially ended in June 2009, the state has added another 4,500 jobs. As a result, there are now more workers employed in North Dakota than ever before. However based on our study, job growth for the next six months will be much less than the last six months.

OKLAHOMA

For a ninth straight month, Oklahoma's leading economic indicator from a monthly survey of supply managers remained above growth neutral. The Business Conditions Index slipped to a still healthy 60.4 from 64.1 in August. Components of September's overall reading were new orders at 70.0, production or sales at 62.2, delivery lead time at 76.3, inventories at 51.2, and employment at 42.3. During the official national recession, Oklahoma lost almost 47,000 jobs. Since the recession officially ended in June 2009, the state has recovered almost 10,000 of the departed jobs. In terms of jobs, I expect Oklahoma to be back to pre-recession levels by the end of 2011.

SOUTH DAKOTA

South Dakota's leading economic indicator continues to point to a healthy economic expansion. The overall index, based on a survey of supply mangers in the state, expanded to a regional high of 70.2 from 67.5 in August. Components of the overall index for September were new orders at 69.4, production or sales at 74.1, delivery lead time at 61.2, inventories at 74.6, and employment at 71.9. During the official national recession, South Dakota lost more than 5,000 jobs. Since the recession officially ended in June 2009, the state has recovered approximately 2,600 of the lost jobs. In terms of jobs, I expect the state to be back to pre-recession levels by the middle of 2011.

THE BULLISH NEWS

- While the overall economy lost 95,000 jobs in September, the private sector added 64,000 jobs. I assess it as a "not bad" report.
- A gauge of corporate credit risk in the U.S. fell to a five-month low as a bigger-than-estimated de-cline in the nation's payrolls last month bolstered bets the Federal Reserve will increase asset purchases to support the economy.
- The U.S. Labor Department reports the number of initial jobless claims fell by 11,000 last week to 445,000. That's the lowest it has been in three months.
- The ISM manufacturing index came just a bit better than expected, at 54.4, versus the 54 con-sensus.

THE BEARISH NEWS

- According to the Mortgage Bankers Association, 9.5% of loans were delinquent by 90 days or more in the first quarter of 2010.
- The Conference Board Measure of CEO Confidence™, which was unchanged in the second quarter of 2010, declined in the third quarter. The Measure now reads 50, down from 62 last quarter (a reading of more than 50 points reflects more positive than negative responses).
- The Conference Board Consumer Confidence Index®, which had improved in August, retreated in September. The Index now stands at 48.5 (1985=100), down from 53.2 in August. The Present Situation Index decreased to 23.1 from 24.9. The Expectations Index declined to 65.4 from 72.0 last month.
- During the first 8 months of this year, construction spending amounted to $539.4 billion, 11.2% below the $607.5 billion for the same period in 2009.

WHAT TO WATCH

- On Oct. 15, the BLS releases the consumer price index for September. While I don't expect it, an increase in the core inflation gauge for the month greater than 0.2% would be bearish and put the Fed between a "rock and a hard place."

- On Oct. 29, the Bureau of Economic Analysis (BEA) releases its advance GDP number for the 3rd quarter. Annualized growth of less than 1.0% will be very bearish.

- On Nov. 10, the BEA releases trade numbers for September. A large deficit increase with China (above $25.0 billion) will encourage the protectionists in Congress to raise trade barriers which will slow the recovery.

- On Nov. 5th , the U.S. BLS will release the employment report for October. A decrease in the unemployment rate (which I expect) and positive job growth will be bullish.

THE OUTLOOK: I expect

FROM GOSS:

- The moratorium on foreclosures will hurt the economy. The longer it takes for the housing market to bottom out, the longer it will take our economy to recover. A moratorium on foreclosures will slow the housing recovery, because it puts off the pain for a later date.

- A continuing U.S. economic expansion (GDP growth above 2.5%) assuming Congress and the President agree on extending the Bush tax cuts before the end of 2010.

- November's job report to show an upturn in hiring though still weak with unemployment declining to a lousy 9.4%.

CONFERENCE BOARD:

- GDP growth for QI, 2011 to be 1.4% (annualized and seasonally adjusted

- Housing starts for QI, 2011 to rise to 680,000.

NATIONAL ASSOCIATION FOR BUSINESS ECONOMICS (NABE) AUGUST SURVEY:

- Nearly 60% percent feel that monetary policy posture is appropriate at the present time and that the greater risks facing the U.S. economy are deflation in the near term and inflation in the longer term

- The majority of the respondents also do not believe another stimulus package is necessary but think the various tax cuts should be extended beyond their scheduled expiration at year-end

- 39% feel that the current posture of fiscal policy is appropriate, down from 44 percent in March. Over 75% oppose another stimulus package but rank promoting economic growth a higher priority than deficit reduction.

REUTERS SURVERY:

- 16 primary dealers expect the U.S. central bank to lower long term rates with 14 of 15 respondents calling for an announcement at the end of the Federal Open Market Committee's next policy meeting on November 3. The remaining one of the 15 respondents said the program would be announced in November or December.

Goss Eggs
(Recent Dumb Economic Moves)

- Before exiting for their fall break, the U.S. House, by a wide bipartisan margin of 348-79, passed a bill giving the executive branch authority to impose tariffs on a wide range of Chinese exports. U.S. manufacturers and farmers will be the big loser as China retaliates.

SUPPLY MANAGER READING ROOM

"A Negotiation-Credit-Auction mechanism for procuring customized products," International Journal of Pro-duction Economics 127, no. 1 (Sep 2010): p. 203. Customization promises higher value creation by matching cus-tomers' individual specific needs with manufacturers' capabilities. However, difficulties in terms of information asymmetry, information stickiness, and conflicting incentives prevent customers from effectively tapping into the value of customization in procurement. This research conceptualizes procurement of customized products as a transaction problem with an embedded design problem. A Negotiation-Credit-Auction mechanism is developed to separate design and transaction into two stages and employ negotiation and auction, respectively. Bidding credits are introduced in an intermediate stage as an instrument for incentive adjustment. This hybrid mechanism proves to be socially efficient and provides necessary flexibility as well as incentives for innovation in customization.

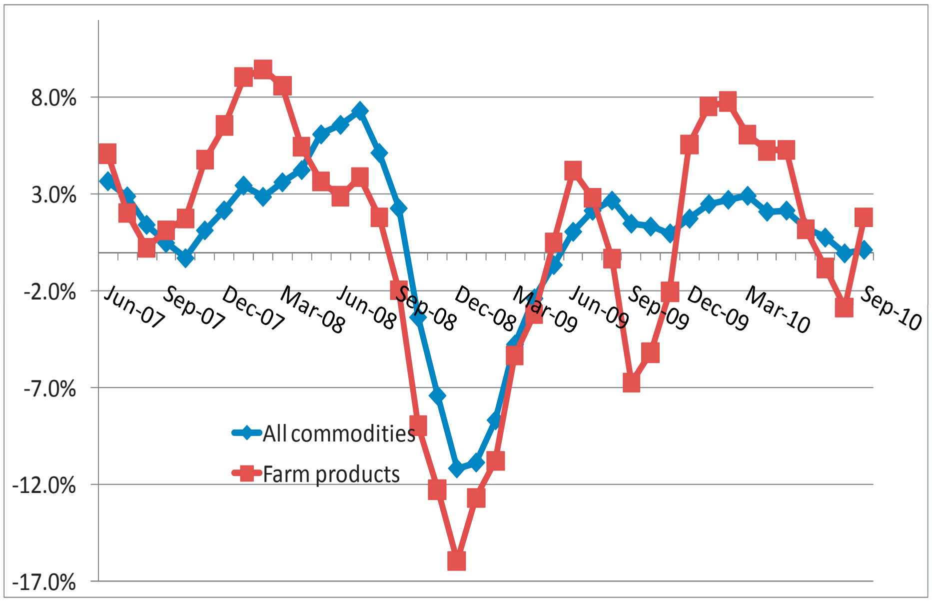
ASK ERNIE

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 2007-2010
FUELS & RELATED/METALS & METAL PRODUCTS

Price changes, 3 month moving average, 2007-2010



Price changes, 3 month moving average, 2007-2010