

IAR'S INLAND EMPIRE REPORT ON BUSINESS

Prepared by: The Institute of Applied Research

***Housed in CSUSB's
Jack H. Brown College of Business and Public
Administration***

Report for July 2020

***Sponsors: San Bernardino County Economic Development Agency
Riverside County Economic Development Agency***

NO SURPRISE – PMI DROPPED BELOW 50 AGAIN

CONTEXT FOR THIS REPORT: As of the writing of this report, the U.S. COVID-19 case count is 4,790,889 (up from 2,723,262 when the June *Report on Business* was released). There have been 158,188 deaths in the U.S. (up from 130,067 at the end of June), with the state of New York still being the hardest hit (32,780), followed by New Jersey (15,913). California has the third highest U.S. death count (9,265) but the highest case count in the nation (509,291, up from 230,140 last month). Those sobering statistics look a bit better when we look at cases and deaths relative to population size: California has now reached 12,889 cases per 1 million population – a far cry from Louisiana's 25,756 cases per 1 million population. And California has 237 deaths per 1 million population, way less than New Jersey's 1,792 deaths per 1 million population. But regardless of California's "relative ranking," it is objectively clear that the public health crisis is severe and growing.

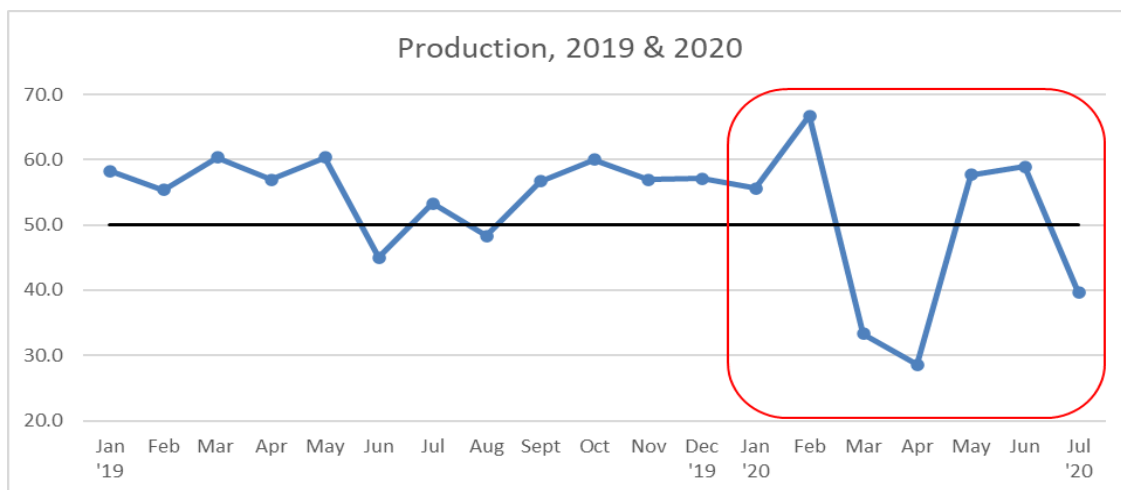
Drilling down to the county level: Riverside County has 37,612 confirmed cases (up from 17,683 last month) and 695 deaths, and San Bernardino County has 32,696 confirmed cases (up from 12,550 last month) and 417 deaths. And the numbers continue to rise. (<https://www.worldometers.info/coronavirus/country/us/>)

The economy took an unprecedented blow back in March when Governor Newsom announced a mandatory stay-at-home order throughout California. Essential businesses remained open, but others were forced to close their doors – some temporarily, some permanently. By early May the Governor announced that California was ready to move into Stage 2 of reopening businesses, and June saw the reopening of restaurants, bars, gyms, and personal care establishments (hair and nail salons). People flocked to the beaches and began to resume their lives until California saw a huge spike in cases and ICUs which were dangerously near capacity. On July 13 when the Governor moved to close all indoor operations statewide for restaurants, movie theaters, and other non-essential businesses.

It is in this context that we write this report based on the data from our monthly survey of manufacturing firms in the Inland Empire.

According to Dr. Barbara Sirotnik (Director, Institute of Applied Research) and Lori Aldana (Project Coordinator, Institute of Applied Research), “This month’s Inland Empire Purchasing Managers’ Index (PMI) registered 42.9, a significant drop from last month’s 55.7. We remind the reader that the March and April PMI figures were similarly low (43.3 and 41.8, respectively) before returning to two months of above-50 figures which normally would be an indication that the manufacturing sector is expanding. But as we predicted last month, those two months above 50 were most likely a “bounce back” from the incredibly low numbers registered when the economy first shut down, and *not* a return to a trend of growth. In other words, March and April were SO extremely low that the PMI indices (Production, New Orders, Employment, Inventory, and Supplier Deliveries) recovered slightly in May and June. But with the Governor’s “dimmer switch” slowing (and in some cases reversing) the reopening process, this month’s PMI has once again provided an indication of contraction in the Inland Empire manufacturing sector and overall economy. It will take two more months of below-50 figures to definitively determine the direction the economy is going in the Inland Empire.”

“Two of the most critical components of the index (Production and New Orders) showed substantial drops from last month. As noted in the graph below, Production dropped to 39.6 from 58.9 the previous month, returning to near March/April levels. New Orders showed a similar pattern, decreasing to 35.4 from last month’s 58.9.”



“Inventory of *raw materials* also dropped to 41.7, showing a diminishing level of raw, MRO (Maintenance, Repair, Operating), intermediates, etc. compared with the previous month. It is possible that companies have purposely reduced inventory in anticipation of

decreased production over the next few months. It is interesting that 66.7% of companies indicated that the level of *finished goods* is unchanged from last month (meaning that their production of finished goods is “staying even” with sales). About a quarter of companies (25%) said their inventory of finished goods has actually declined.”

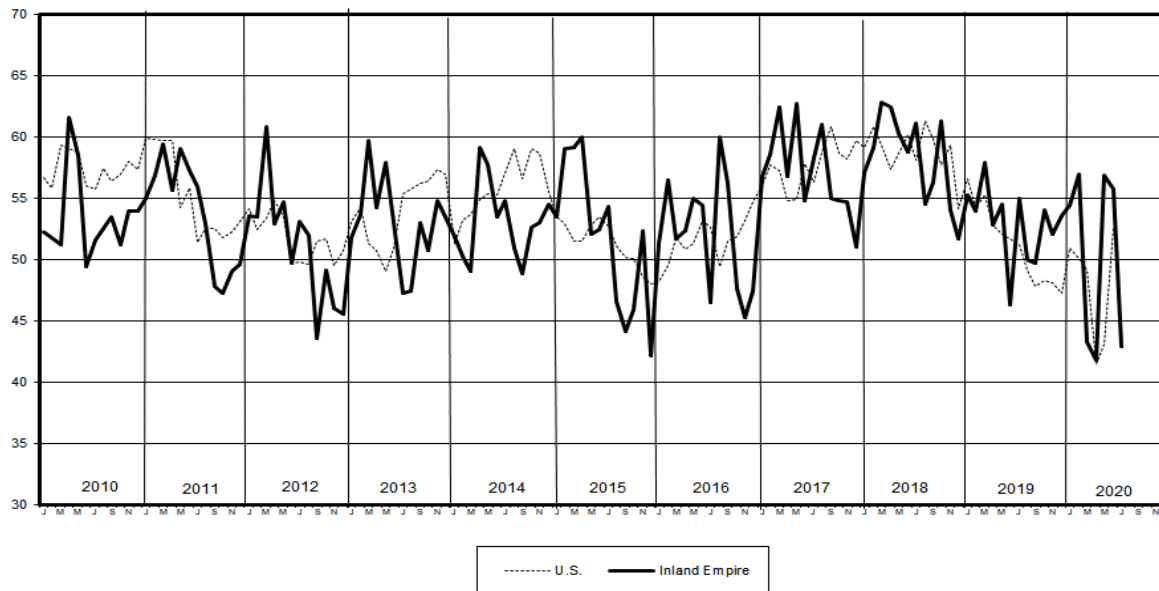
“The Employment Index dropped to 41.7 from 51.8 last month. The Supplier Deliveries Index (56.3) still showed slowing of deliveries, however at a slightly reduced rate from last month when the index was 57.1. And the Commodity Prices Index increased from 57.1 last month to 62.5 this month, indicating that cost pressures continue to be an issue for companies in the Inland Empire.”

“Consistent with the above findings, Purchasing Managers were relatively pessimistic about the state of the local economy for the coming quarter. Over a third (38%) believe that the economy will become even weaker in the coming quarter (up from 24% last month). Only 29% (down from last month’s 36%) think the economy will be stronger over the next few months, and the remaining 33% think the economy will remain about the same (where the “same” reflects a struggling economy). Clearly our respondents do not agree with the relatively few economists who believe that a “V” shaped recovery is likely.”

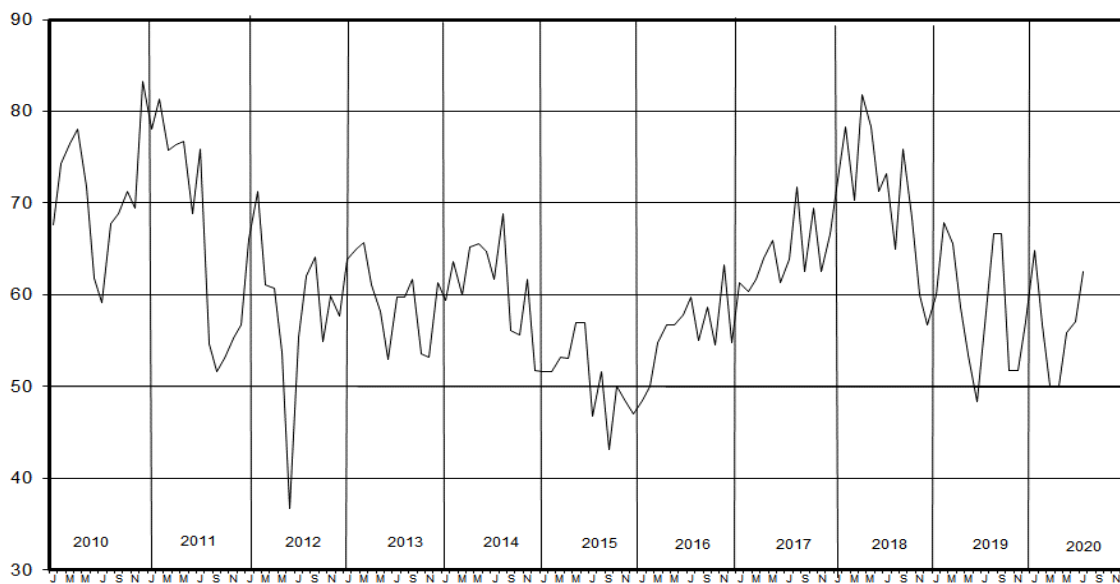
Following is a summary of highlights from this month’s report:

July 2020 Business Survey at a Glance					
	Series Index		Direction from 50	Rate of Change from Last Index	Trend Months
	Last Month	This Month			
Local PMI	55.7	42.9	Contracting	From Growing	1
Commodity Prices	57.1	62.5	Increasing	Faster	13
Production	58.9	39.6	Contracting	From Growing	1
New Orders	58.9	35.4	Contracting	From Growing	1
Inventory	51.8	41.7	Decreasing	From Increasing	1
Employment	51.8	41.7	Contracting	From Growing	1
Supplier Deliveries	57.1	56.3	Slowing	Slower	10
Purchasing Managers' Confidence in the State of the Local Economy					
% Stronger	36%	29%			
% Same	40%	33%			
% Weaker	24%	38%			

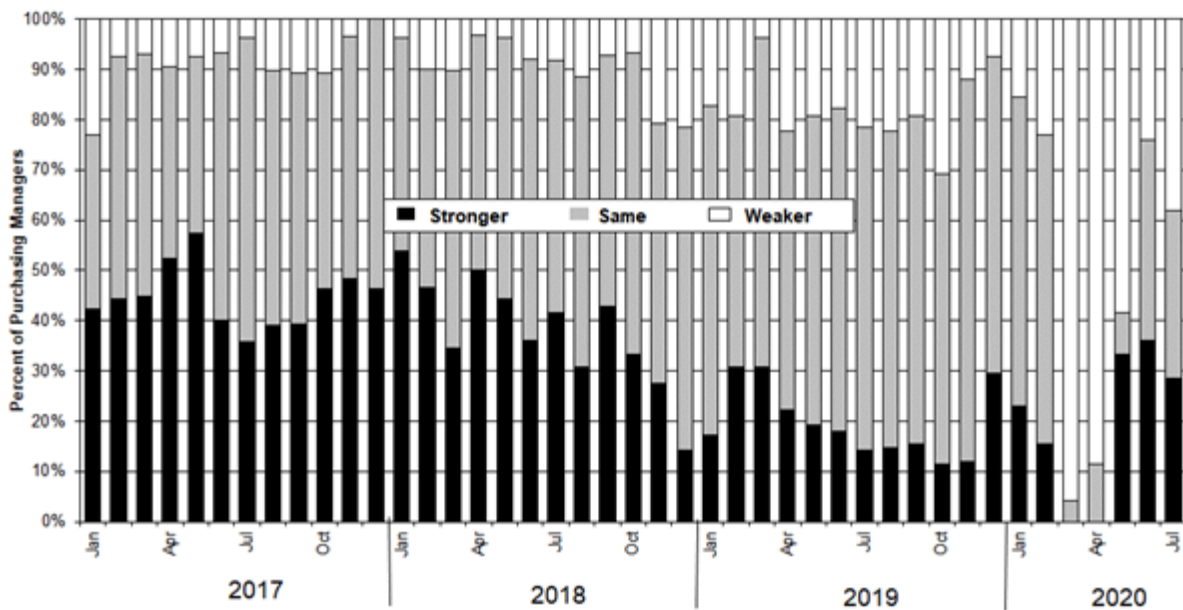
Purchasing Managers' Index



Commodity Prices



State of the Local Economy



STATE OF THE ECONOMY: DATA FROM 7/2019 THROUGH 7/2020

	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Weaker	18	22	22	19	31	12	7	15	23	96	89	58	24	38
Same	64	64	63	65	58	76	63	62	62	4	11	9	40	33
Stronger	18	14	15	16	11	12	30	23	15	0	0	33	36	29

What Respondents are saying:

This month, relatively few respondents made comments (either positive or negative) regarding the business outlook for their company or industry. Positive comments included:

- "As of now, we really have not experienced anything significant that would affect the manufacturing of our products. However, this could change due to the fact that "children" are not going back to school. We will have to wait and see if this changes the volume of construction being conducted."
- "Business continues to be very steady."
- "July was more of the same as May and June. However, we have seen a bit more activity in the second half of July. It is remained to be seen if this carries into August. however, I am more upbeat about the economy than I was 30 days ago."

- "In March we increased temp workers by 400 to help make PPE faster. Orders have slowed for this month, so we reduced labor by 100 temp workers. That said, we are having our best year ever."
- Just trying to maintain current order levels in this ever-changing environment.

Negative and/or mixed/cautionary comments included:

- "The economic hope we started to see in June has quickly turned into more despair."
- "Business is slow! We closed from July 3rd to the 13th. This week we are operating with all employees on reduced hours."
- "Slow."
- "The lack of a comprehensive direction from government at all levels creates risk rather than security relative to plans for the future of our business. Issues include tax policy, unemployment policy, health related policies, school policies, etc. The only thing known is that there are many unknowns."
- "Hard to bring the customer to a decision. Uncertainty abounds."
- "Had to import more since we needed raw materials not available in this country."

Special Questions: This month we continued to add a few special questions regarding the challenges of the Inland Empire business community during this crisis. Following is a summary of responses to those questions:

- 1) **About a week ago the governor did a "U turn" and rolled back plans for reopening certain sectors of the economy. Obviously that means more layoffs, more economic pain, and potentially less willingness on the part of consumers to purchase non-essential items. What effect do you think this new closure will have on your firm's business in the *short term*?**

Eight of the 21 individuals who chose to answer this question indicated that they do not see any short-term effects from the governor's roll back of certain sectors. Three more indicated that their business has been classified as "essential," so the pandemic (including the recent closure) does not affect them:

- "The lack of comprehensive and consistent policies leads us and many businesses to try to avoid risks but still be in control of our own destiny, so we continue to support our staff and at the same time approach the markets that we address as an essential business to the transportation and aerospace industries."
- "The future is unknown. We have been able to maintain our business during the pandemic with our sales growing slightly each month since this started back in March. The new closures could have a reverse effect on our sales depending on the type of businesses that might close in relation to our customers. However, our business (printing) has been classified as "essential."
- "We are an essential business producing automotive parts and parts for DOD and Government - we have seen large increases and this closure really does not affect us."

On the other hand, some of the respondents are among the many business owners struggling to stay afloat during the pandemic. Comments indicating a concern about their future business in the short term included:

- “It will slow the business if this goes on for longer than a couple of weeks.”
- “Keeping/ lower employment.”
- “Our customers are demanding price reductions as common goods continue to rise in cost. This is shrinking profitability to very little, if any.”
- “Our customers will order less, and we might let some employees go.”
- “Sales will drop. Just as companies were beginning to come back and order, they stopped. Starting to hear businesses giving up and shutting down for good.”
- “Some negative impact.”
- “We have seen a steady decline of sales since March, though there's been an increase in requests for quotes over the last month. We are still seeing very few new orders. I suspect this U turn will only further impede future sales.”
- “We sell to companies that sell to restaurants, so things have slowed down. Fine dining restaurants are closed.”

2) What does the *long-term* future look like for you and your business?

For some people, their “crystal ball” was clouded – they seemed uncertain as to their long-term future:

- “Looks like we have a lot of growth, but the long-term situation will depend on the election results. If the administration changes, then it may affect our business in a negative way by pushing jobs back out of the US and to low-cost countries.”
- “Optimistic that we will be able to return to normal operations in the final quarter of this year or early next year, but this is impossible to tell based on changing current events.”
- “There is a lot of uncertainty right now. We do not know how long it is going to take before we get back to some kind of normal. It is too soon to answer.”
- “Yet to be seen.”

Others showed optimism (either based on actual industry trends or just a general sense of “hope”):

- “At this time, it is looking like the long-term future is looking good. There are bonds that are coming up on the election to fund the addition of two-story buildings in order to make additional school classrooms so that there are less students in each classroom. That will ensure more work for us.”
- “Business is slowly picking up.”
- “Hopefully better???????”
- “I hope once things start to open, our business will get busy.”
- “Seems a little brighter.”
- “Still looking forward to a strong year end.”
- “Strong”
- “We should be stable for the long term.”

For some, the long-term future is more bleak:

- “Challenging times are ahead.”
- “Hard to see, but too many companies are impacted in the aerospace industry and it is going to have a negative impact on business overall.”
- “It’s looking very slow and worrisome at this point.”
- “Not good!”
- “Risky”
- “Slow sales until more companies reopen.”
- “Slower than last year, but we should recover next year, 2021.”

3) Over the past month have you experienced any supply chain disruptions? If so, please explain, indicating the product/component and also the geographic source of the issue (e.g. China).

Last month we noted that about half of the respondents indicated that there have NOT been supply chain disruptions, either in terms of lead times, cost, or unavailability of needed product. This month, only 6 of the 19 people making comments indicated that supply chain disruptions were not an issue for them.

The people that cited disruptions commented:

- “A few items have had extremely **long lead times**, a few vendors are offering slower service due to employees missing work from illness.”
- “**Deliveries have slowed** from our suppliers mainly due to employees at those companies taking COVID time off. Everyone seems short or understaffed at this point.”
- “Deliveries of **sulfuric acid** were delayed due to a vessel delay leaving Japan caused by COVID-19. Supply has now resumed with no down time due to the delay.”
- “**Epoxy** - comes from Texas - they can't seem to be able to hire enough employees in order to have a second shift.”
- “Just the normal **cleaning supplies and office supplies** seem the hardest hit.”
- “No disruptions with supplies, but we have experienced **delays in LTL** (less than truckload freight) shipping, both pick-ups and deliveries. We have been told that the company laid off many workers and has not been able to get them back.”
- “No one wants to bring stock in from **China**, making orders be “just in time” which is 30 days minimum.”
- “The only disruption has been **UPS delivery time**. Often, the deliveries are delayed one or two days due to UPS crazy schedule.”
- “One **aerospace** supplier is shutting its doors in (SoCal) area, as well as facilities that support that company in (SoCal).”
- “**Wide Format Materials** (Floor Decal Material, Poster Board Material, Acrylic Material - United States).”
- “Yes -- **slow deliveries** and lots of accounting issues.”
- “Yes, **freights** are slower than normal.”

4) How long do you think it will take to get the Inland Empire economy back to what we had before the pandemic hit? Please explain.

Most of the respondents believe that the Inland Empire economy will recover in six months to a year. A few noted that it could take a few years for the economy to rebound due to the very real possibility that a second (or third or fourth) wave of the pandemic will hit before an effective vaccine is produced. And one said: “It will take a couple of years to recover from the pandemic. Businesses have suffered and some have or will have to reorganize or close due to the pandemic. Returning to pre-pandemic economic strength will take time.” One person summarized the feelings of several people by saying: “Unknown, with significant potential pitfalls ahead.”

In summary, the authors of this report tend to see the world through an “optimistic lens,” however that perspective is difficult to maintain these days. The PMI is back down below 50 and based on the data we expect it to continue meandering above and below 50 through the remainder of 2020. In other words, we don’t see a return to growth mode until at least early 2021. Of course, we are not alone in that evaluation: Fed Chair Jerome Powell has recently acknowledged that the coronavirus pandemic “will weigh heavily on economic activity, employment and inflation.” The Consumer Confidence index is at a 7-year low, and consumer spending is down a whopping 34.6% nationwide. There is clearly cause for concern about the economic recovery in the short term. Obviously, that applies to the Inland Empire as well as to the nation as a whole. Only when the health crisis is under control through effective treatments and a readily available vaccine will life return to “normal.”

IAR will continue to provide the most up-to-date data on business conditions that we can during this uncertain time.

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