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News and Economic Outlook for the Wire and Cable Industry

SPOTLIGHT

Inflationary Pressures: Commodity Prices and US Wages

THE DECLINE IN COMMODITY PRICES was one of the main headwinds facing the global industrial sector over approximately the last year and a half. However, commodity prices of many types are showing increasing signs of rise. The latest US Purchasing Managers Index (PMI) report, put out by the Institute for Supply Management, noted 18 tracked commodities rose in price while only one *(corrugated boxes)* declined. As a result, the PMI Prices Index also increased for the third consecutive month.

Is the commodity price rise here to stay? First, let's consider why the commodity price decline occurred. Declining commodity prices resulted from weak demand and excess supply. Weak demand was due in large part to China's slowdown, as China is the world's largest consumer of many commodities. The annual growth rate in China Industrial Production fell from an August 2010 peak of 16.7% to 5.9% as of April 2016 *(latest data available)*. Although the top-line Industrial Production figures show ongoing growth, some industrial indicators within China show overt negativity. China Railroad Freight Carried went from a total of 2.9 trillion ton kilometers in 2013 to 2.4 trillion ton kilometers in 2015, an 18.6% decline.

Production of many commodities did not experience the same cutbacks. OPEC member nations, for example, have continued to pump large quantities of oil. The most recent 12 months of Saudi Arabia Oil Production, for example, is 7.2% higher than the year-ago level. Depreciated currencies also played a part in keeping commodity-dependent countries producing. For example, the Chilean peso dropped from 525 Pesos per US dollar at the end of 2013 to 709 pesos per US dollar at the end of 2015. Although Copper Prices fell 38.2% in dollar terms from December 2013 to December 2015 *($3.44 per lb. to $2.13 per lb.)*, the value of copper in pesos dropped a comparatively mild 16.6%. Taking into account additional cost savings *(given that mining involves significant commodity costs)*, it is unsurprising that Chile Copper Production remained relatively stable over the period of price decline, going from 5.8 billion tons produced by Chile in 2013 to an estimated 5.7 billion tons in 2015, a 1.3% drop.

Signs are pointing to cutbacks in production and improved demand, suggesting commodity price rise will extend throughout at least 2016 and likely 2017 as well. China Railway Freight Carried is in a recovery trend; its quarterly growth rate rose 11.8 percentage points from a November 2015 low of -17.9% to the current April quarterly growth rate of -6.1%. The China Leading Indicator rate-of-change *(nine-month lead time to China Industrial Production)* is rising. Outside of China, the global economy is showing signs of improvement. The Organization for Economic Cooperation and Development OECD Plus Six Non-Member Economies Leading Indicator rate-of-change has risen for three consecutive months. If this trend

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IEWC® GLOBAL SOLUTIONS

GLOBAL ECONOMIC OVERVIEW

NORTH AMERICA

US Real GDP is growing at a seasonally adjusted annual rate (SAAR) of 2.0%, but US Industrial Production is down 0.9% on a year-over-year basis. US Real GDP is being supported by a strong consumer enjoying rising wages *(growing at 3.4%, the highest rate in over seven years)*, low inflation *(1.1%)*, and low interest rates *(30-year mortgage rate at 3.6%)*. A weak May jobs report *(38,000 new jobs created)* made headlines and sent interest rates diving. However, a single bad month for jobs within a larger Employment rising trend is not without precedent. Expect US Real GDP to rise through at least 2018 supported by US consumer spending.

The US Purchasing Managers Index *(nine-month lead time to US Industrial Production)* is generally rising following a tentative December 2015 low and in recent months has remained above the 50 threshold that indicates US manufacturing is expanding. Plan for US Manufacturing Production *(up 0.6%, year-over-year)* to avoid recession this business cycle, although the rate of growth is slowing. Year-over-year contraction in US Mining Production *(down 7.6%)* and US Electric & Gas Utilities Production *(down 1.9%)* are putting US Industrial Production into a declining trend. Plan for the annual growth rate in US Industrial Production to reach a low in the third quarter of 2016 before rising through the end of 2017 supported by rising commodity prices and stronger global demand for US goods.

Macroeconomic conditions are generally weaker in Canada than in the US due to Canada's greater exposure to commodities. Canada Real GDP is growing at a SAAR of 1.1% while annual Canada Industrial Production is 1.2% below the year-ago level. Canada Retail Sales is in an accelerating growth trend. Canada Utilities Production *(down 3.7%, SAAR)* is dragging on Canada Industrial Production.

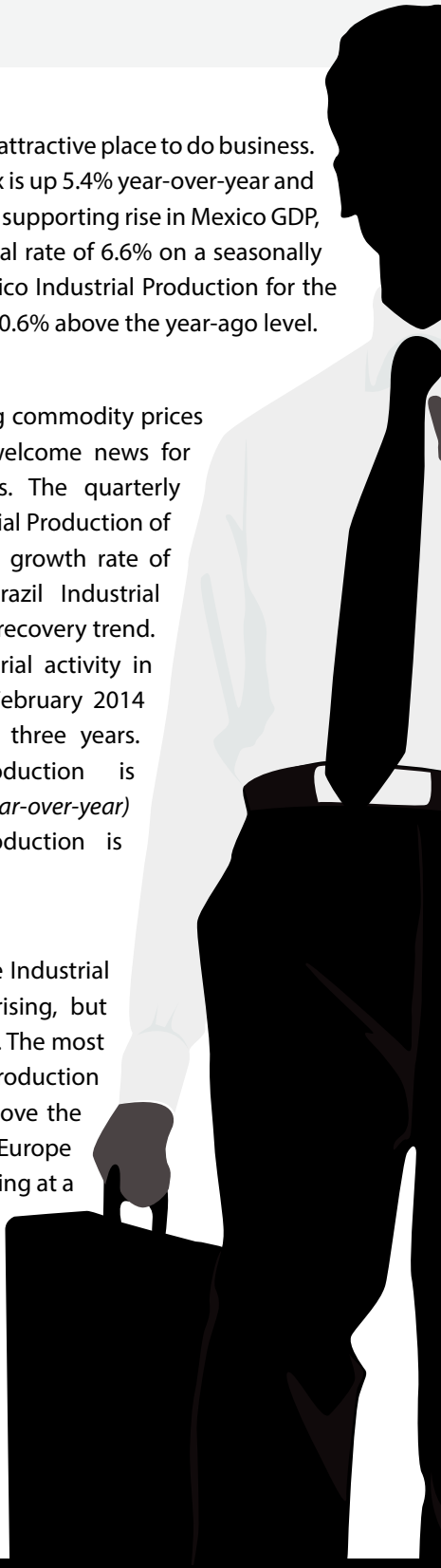
Mexico has a brighter economic situation than its neighbors to the North due to positive consumer trends, low wages, and close proximity to major consumer markets. These factors make Mexico an increasingly attractive place to do business. The Mexico Retail Trade Index is up 5.4% year-over-year and growth is accelerating. This is supporting rise in Mexico GDP, which is growing at an annual rate of 6.6% on a seasonally adjusted basis. Average Mexico Industrial Production for the 12 months through March is 0.6% above the year-ago level.

SOUTH AMERICA

Rising commodity prices are welcome news for South American economies. The quarterly growth rate for Brazil Industrial Production of -9.5% surpassed the annual growth rate of -9.6%. This signals that Brazil Industrial Production will soon be in a recovery trend. Plan for the level of industrial activity in Brazil to remain below its February 2014 peak for at least the next three years. Argentina Industrial Production is declining *(down 0.3% year-over-year)* while Chile Industrial Production is stagnating.

EUROPE

Western Europe Industrial Production is rising, but the rate of growth is slowing. The most recent 12 months of Production *(through March)* are 1.3% above the year-ago level. Eastern Europe Industrial Production is growing at a more robust annual rate of 2.4%. Average Europe Retail Trade in the 12 months through April is up 1.7% from one year ago. This is keeping Europe GDP rising at an annual rate of 1.9%, even as export demand



BY THE NUMBERS (US)

Conference Board Consumer Confidence Index	May (2016) Unemployment	Retail Sales (Apr to May change)	Mfg.'s New Orders for Durable Goods (Mar to Apr change)
92.6	4.7%	+0.4%	+3.4%

falters due to currency shifts and weak demand; the most recent three months of Europe Export Volume are 2.2% below the same three months one year ago. Europe Industrial Production is expected to slow through the third quarter of 2016, but is not expected to fall into recession.

ASIA China Industrial Production is growing at an annual rate of 5.9% as of April 2016. This represents a decline of 1.6% from one year earlier. However, there are several positive signals of future improvement in China's macroeconomy *(see spotlight article for further details)*. Annual Southeast Asia Industrial Production is even compared to its year-ago level. Declining Industrial Production in countries with particularly close ties to China, such as Hong Kong *(down 1.6%)* and Singapore *(down 4.4%)*, are being offset with growth in countries with weaker trade ties to China. Indonesia Industrial Production, for example, is up 4.5% on a year-over-year basis. Positivity is evident in the Southeast Asia GDP Index, up 3.6% on a year-over-year basis. Growth is being driven by Retail Sales in South Korea *(up 4.1%)* and Indonesia (up 11.5%). Japan Industrial Production *(down 1.5%)* is declining. Annual Industrial Production is stagnating in India, although it remains 2.4% above the year-ago level.

MIDDLE EAST / AFRICA Average Middle East & North Africa Industrial Production for the 12 months through March is 1.7% above the year-ago level. Egypt Industrial Production is dragging on the region, down 6.3% on a year-over-year basis. Rising oil prices are a positive sign for oil-dependent countries such as Saudi Arabia, where GDP is down 13.3% on a year-over-year basis.

*Source - IEWC contracts the services of a third party consultant to provide current insights on the economy.

CURRENCY TRENDS

	Current Value of $1USD	Change Since 6/1/2015	Change Since 1/1/2016
Brazilian Real	3.39	0.22	-0.57
Canadian Dollar	1.28	0.03	-0.11
Chinese RMB	6.57	0.37	0.06
Euro	0.88	-0.04	-0.04
Mexican Peso	18.67	3.20	1.47
Pound Sterling	0.68	0.02	0.00

Current values as of 6/20/2016

Mfg.'s Shipments of Durable Goods (Mar to Apr change)	Durable Goods Mfg.'s Inventories (Mar to Apr change)	CPI Inflation (over prev. 12 months)	US Industrial Production (over prev. 12 months)	Purchasing Managers Index (May)
+0.6%	-0.2%	+0.2%	-1.3%	51.3%

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persists, it would suggest an upturn in the annual growth rate for World Industrial Production by the end of 2016.

On the supply side, the decline in new drilling activity in the North American oil & gas sector is helping to curtail the oil supply glut. China Crude Steel Production is also declining, down 2.4% year-over-year. US Primary Smelting and Refining of Copper Production is still rising at a double-digit rate, suggesting that the upward price pressure on copper will take time to build momentum. However, commodity prices are generally moving higher rather than lower.

Another inflationary pressure many businesses will experience through at least the end of 2018 is rising US wages. US wages are rising at their fastest pace in over seven years (3.4%). Wage growth tends to lag the macroeconomy; US Overall Wage Growth lags the annual growth rate for US Private Sector Employment by around seven months. Although the May 2016 jobs report was weak, US Private Sector Employment is growing 2.2% on a year-over-year basis. This is 0.1 percentage point above the five-year average of 2.1% growth. The high level of Employment and low unemployment rate (4.7%) mean firms will need to offer higher wages to attract and retain increasingly scarce workers, especially among skilled professions.

Given these inflationary pressures, develop a price escalator plan to help maximize profits. Determine whether you want to grab market share or strengthen your margins. Focus on efficiency gains because productivity is the key to maintaining margins as your labor costs rise. Finally, consider taking advantage of low interest rates to fund capital expenditures of material handling equipment, for example, to offset higher labor costs.

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WIRE INDEX

The Wire Index fell by 6% since the beginning of May. It is still up 12.5% YTD but down 23% over the past 12 months. All five companies saw stock price decreases since the beginning of May with Houston Wire & Cable down 25.5% and General Cable down 14.5%. Visit **http://iewc.info/wireindex** for more information and historical data.

The Index tracks the weighted stock price of six publicly-traded wire and cable manufacturers and distributors based in the US and is benchmarked such that the average value during the second half of 2006 equals 100.

COPPER FUTURES

The spot price for Comex copper fell by 9.3% since the beginning of May. It now stands at $2.05 as of June 17th. Comex Copper is down 21.8% over the past 12 months and down 4.2% year-to-date.