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IN THE SPOTLIGHT

Reshoring in Turbulent Times: Should I Stay or Should I Go Now?

Mentions of reshoring in the media have skyrocketed during the decade following the Great Recession as periods of high unemployment lend themselves to increasing the profitability, and probability, of reshoring. While the unemployment rate has dropped significantly as of late — most recently to 3.9%, the lowest rate since 2000 — reshoring remains a hot topic.

In 2017 approximately 171,000 manufacturing jobs were reshored to the US, up 2,800 percent from the low recorded in 2010. The cut to the US corporate tax rate signed into law at the end of 2017 provides additional incentive for companies to bring production stateside. As political discourse regarding the North American Free Trade Agreement (NAFTA) renegotiation and a potential trade war heats up, reshoring might become more attractive to certain businesses. However reshoring is a major decision for companies that requires serious examination of all related economic, political and business factors. So let's take a look why companies might consider reshoring, what benefits and risks exist, as well as the potential effects of NAFTA renegotiations and trade disputes between the US and the rest of the world on that decision-making process.

What is Reshoring, Near-shoring and Back-shoring?

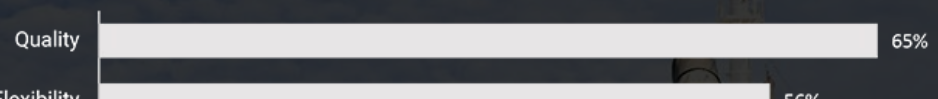
Reshoring typically moves production of products or services from developing countries to more developed countries, though not necessarily back to the same country as a company's headquarters. Near-shoring occurs when a company moves production closer to home, such as a US-based company moving production from China to Canada. More frequently we hear about back-shoring, wherein a US-based company moves production directly back to the US.

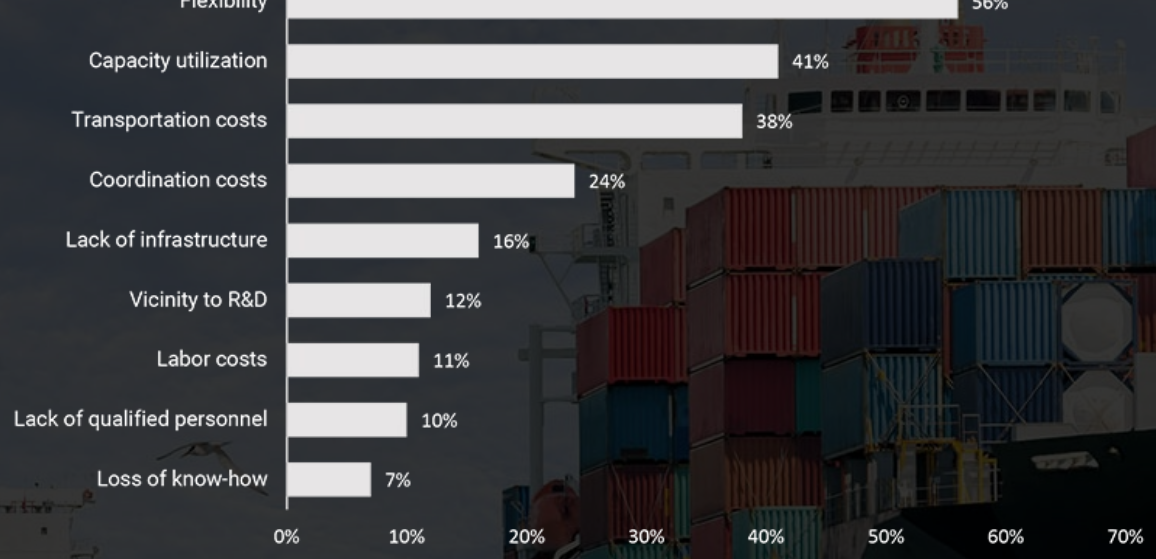
Another way to break down reshoring is to look at what kinds of production are being moved. Reshoring of manufacturing production is most common, but reshoring services are also gaining momentum. For example, growing demand for customer service representatives located in-country has increased the number of service jobs reshored to the US and Canada. While reshoring manufacturing production typically moves jobs out of China, reshoring service production tends to move jobs out of India.

Why Is It Increasing?

Like the growing consumer preferences surrounding customer service representatives, there are several reasons a company might consider reshoring all or some segments of production (see Figure 1). One commonly discussed reason is the changing cost of production in developing countries. Rising energy costs and wages in developing countries are increasing the cost of offshoring. Average hourly wages in China increased by 10% during 2017, roughly triple the pace of US overall wage growth during the same time period. Consistently rising costs are beginning to decrease the benefits of offshoring to China. Meanwhile, according to a 2014 study by the Boston Consulting Group, the cost of manufacturing in Mexico was estimated to be 4 percent cheaper than the cost of production in China.

Figure 1. Reasons for Reshoring, *Source: European Manufacturing Survey 2012, Fraunhofer ISI*





Cost structures are not only changing abroad, digitalization and improving technology can lower labor costs for companies producing domestically. Automation, 3D printing and improved processes, though a potentially costly investment at the start, can greatly reduce the cost of production in developed nations.

Another growing concern for companies with offshore production are the hidden costs of doing business over a great distance. Coordination between headquarters, shipping and transportation costs, and quality control all fall under this category. These hidden costs, once realized, can make offshoring unprofitable in some cases. Additionally, production in developed nations can facilitate easier research and development (R&D) and help protect intellectual property (IP). Innovation can slow when production is distanced from R&D as new ideas and procedures become more difficult to implement. Manufacturing closer to a company's market can also shorten time to market. In the case of IP protection, domestic production can reduce the risk of foreign suppliers becoming competitors by learning about the production process as they supply a manufacturer. US companies operating in other countries may also have a harder time protecting intellectual property in a foreign legal system than stateside. Furthermore, the recent US corporate tax rate cut could have the desired effect of making US-based production more attractive for companies who were previously drawn by low corporate tax rates abroad.

What Are the Risks?

However, there are certainly risks to reshoring as well. Companies considering reshoring should examine the cost of extracting operations (loss of or cost of transporting equipment, buying out contracts, etc.). Companies should also consider whether the necessary skills are available in the country to which they plan to re- or near-shore. Currently the US is experiencing a labor shortage, which could make reshoring production difficult. A third consideration is whether your company is ready to invest in automation to reduce labor costs. Wages are rising in the US, increasing the cost of labor. If the cost of labor is too great, companies that reshore need to consider the likely heavy near-term cost of investment. For this reason, companies might consider reshoring select segments of production, particularly segments that require greater quality control, IP protection, or specialized skill sets.

Should Your Company Consider Reshoring/Near-shoring/Back-shoring?

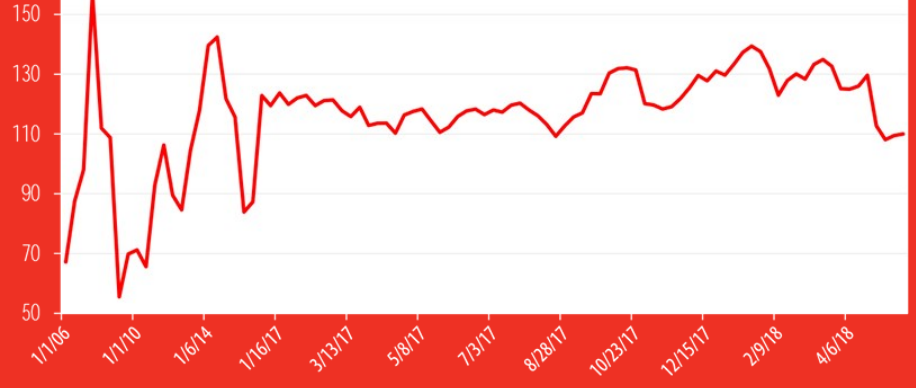
In today's unpredictable, whipsaw-like political landscape there is little clarity regarding possible tariffs and trade agreement negotiations. While corporate tax code changes and economic indicators offer some stability on which to base decisions, ultimate relocation determinations will likely rely on the outcome of NAFTA renegotiations and tariff resolutions. A wait-and-see approach, paired with preparation that allows companies to move quickly when the situation becomes clear, might make reshoring an attractive solution to companies looking to maximize profits, minimize cost, and minimize business disruption.

WIRE INDEX

The Wire Index has decreased by 17.5%

since the beginning of the year and decreased by 12% since the beginning of April. It is now down 3.8% over the past 12 months. Anixter (-17.9%), Belden (-14.1) and Encore Wire (-13.4%) all had double digit decreases since the beginning of April.

The Index tracks the weighted stock price of five 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. The Wire Index has five publicly traded wire and cable manufacturers and distributors.



COPPER FUTURES

Comex copper prices increased by 0.3% since the beginning of April and sits at $3.05/pound as of 5/18/18. Year-to-date, copper is down 6.3% but is up 20.8% over the last 12 months.

BY THE NUMBERS

128.7%
Conference Board Consumer Confidence Index

3.9%
April (2018) Unemployment

0.4%
Retail Sales (March to April)

2.6%
Mfr's New Orders for Durable Goods (February to March)

0.3%
Mfr's Shipments of Durable Goods (February to March)

0.1%
Durable Goods Mfr's Inventories (February to March)

0.2%
CPI Inflation (over prev. 12 months)

3.5%
US Industrial Production Index (over prev. 12 months)

57.3%
Purchasing Managers Index (April)

GLOBAL ECONOMIC OVERVIEW

NORTH AMERICA

US Real Gross Domestic Product (GDP) accelerated upward during the first quarter of 2018. GDP grew at an annualized rate of 2.9%, 0.7 percentage points faster than the five-year average of 2.2%. Expect GDP to rise through 2018 before generally flattening during 2019. Both the industrial and consumer segments of the US economy are expanding. Average US industrial production during the 12 months through March was up 2.5% year over year. Leading indicators, such as the stock market and the ISM US Purchasing Managers Index® (PMI), suggest that industrial production will peak in the third quarter of 2018 before decelerating at the end of the year, with eventual recession potentially forming in 2019. Experts anticipate any such 2019 recession would be brief and mild.

Each component of the industrial economy is growing at an accelerating pace. US mining production was up 8.8%, US total manufacturing production was up 1.9%, and US electric and gas utilities production was up 1.5%. On the consumer side, annual total US retail sales were up 4.4% compared to

one year ago. Annual total retail sales are expected to grow at a slowing pace in late 2018 and throughout 2019.

Rising costs for labor and materials contributed to the tick down in fourth quarter US corporate profits. This trend does not bode well for investment. Expect US Nondefense Capital Goods New Orders, a measure of business-to-business activity, to transition to a slowing growth trend in the third quarter of this year before declining in 2019. Falling demand for capital goods during 2019 will hinder industrial activity. However, if you position your company to have a cash reserve while your competition does not, you may be able to take advantage of pessimism in the economy during this time and invest in your future at a reduced price.

Canada industrial production is expanding at an accelerating pace, up 5.1% year over year. General decline in the Canada Purchasing Managers Index monthly rate-of-change suggests that Canada industrial production will grow at a slowing pace during the second half of 2018. Canada electrical equipment manufacturing transitioned to an accelerating growth trend in February, up 1.1% year over year. In contrast to US industrial production and Canada industrial production, Mexico industrial production is below the year-ago level. Average Mexico industrial production during the 12 months through February was down 0.3% from one year ago. Rise in the Mexico leading indicator rate-of-change suggests industrial production will grow at an accelerating pace during the second half of 2018 into early 2019.

SOUTH AMERICA

Average South America industrial production during the 12 months through February was up 2.2% from last year. Within the region, Argentina and Brazil industrial production are accelerating (up 3.1% and 2.9% year over year, respectively). Growth in these countries is mitigating year-over-year decline in industrial production indicators for Colombia and Peru. However, leading indicator evidence suggests slowing growth is on the horizon for both Argentina and Brazil industrial production. A general decline in the Argentina industrial production quarterly rate of growth suggests slowing growth is imminent. Annual average Brazil industrial production is expected to decline mildly during the second half of 2018 and into late 2019, as suggested by the tentative declines in the monthly growth rates of the Brazil Purchasing Managers Index and the Brazil manufacturing capacity utilization rate.

EUROPE

The European industrial economy is expanding at an accelerating pace. Average Europe industrial production during the 12 months through February was up 3.5% compared to last year. Expect industrial production to rise through 2018 before declining mildly during the majority of 2019. Trends in both the Europe Leading Indicator and Europe Economic Sentiment Index suggest that slowing growth is likely to characterize the European economy during the second half of 2018. On the consumer side of the economy, Europe retail sales were up 3.8% compared to last year (year-over-year basis). Prepare for increasing activity in the overall European economy this year but beware of linear budgeting, as the pace of growth is likely to moderate during the second half of the year.

ASIA

Average China industrial production during the 12 months through March was up 6.4% from last year. Slowing growth in several China-specific indicators, including power generation, automobile production, and railway freight carried, suggests that China industrial production will grow at a slowing pace through at least the near term. Plan for production to grow at a slowing pace throughout 2018 into late 2019. While Japan industrial production growth began slowing in December, production during the most recent 12 months was up 4.1% from one year ago. Expect production to begin declining in 2019. India industrial production was up 4.3% compared to last year. Expect accelerating growth to extend into the fourth quarter of 2018.

MIDDLE EAST/AFRICA

Average Middle East and North Africa industrial production during the 12 months through February was up 1.6% compared to last year. The pace of growth is slowing. The recent rise in month-end crude oil futures prices, which averaged $65.05 during the three months through April, bodes well for further growth in the region in the near term.

CURRENCY TRENDS

	Current Value of $1USD	Change Year-to-Date	Change Last 12 Months
Brazilian Real	3.72	0.41	0.47
Canadian Dollar	1.28	0.02	-0.07
Chinese RMB	6.38	-0.13	-0.50
Euro	0.85	0.02	-0.04
Mexican Peso	19.91	0.25	1.20
Pound Sterling	0.75	0.01	-0.02