IN THE SPOTLIGHT

Slowing Trade Dragging on US and Global Economies

What you need to know: *While exports are not a dominant part of the US economy, the US is still the world's second-largest exporter, and the slowdown in US and global trade is likely to cause pain in the second half of 2019.*

When it comes to US trade, the general perception is that imports are all that matter. "The US doesn't make anything anymore," is a common refrain, or "We buy everything from China." These common maxims are likely derived from the fact that the US runs a perpetual trade deficit.

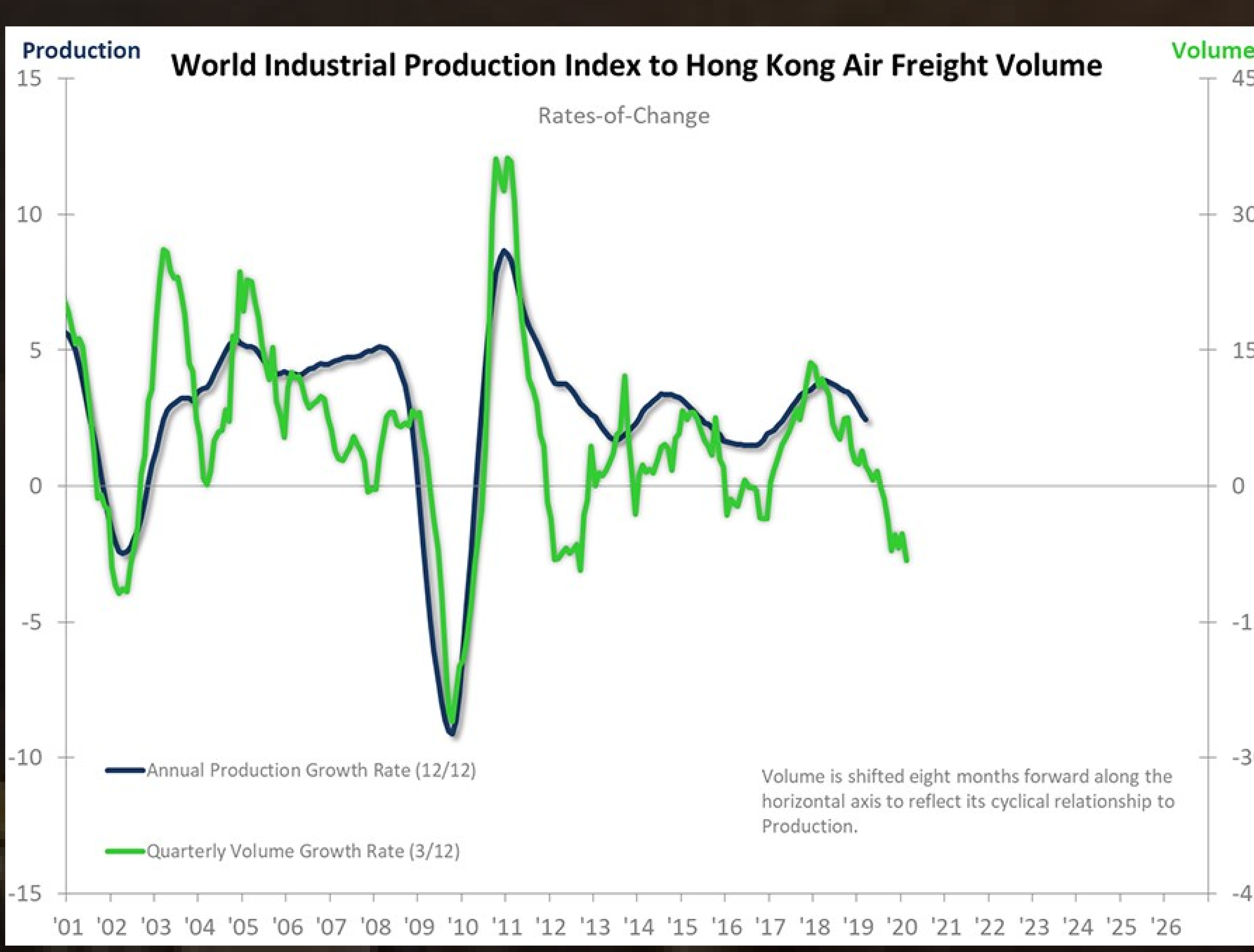
However, this line of thinking is incorrect. US manufacturing is quite robust. Not only does the US create a tremendous number of products in-country, it also sell a tremendous number of those products overseas. For this reason, trade wars can cut both ways, potentially harming US exporters as much as they harm the targets of tariffs and trade barriers. While it is impossible to assign exact percentages, the global wave of protectionism headlined by the US-China trade conflict appears to be taking a toll, with global economic activity on the back side of the business cycle and key global and US export trends moving in a negative direction.

Total US exports to the world amount to roughly 8.8% of the overall US economy as measured by US gross domestic product. It may be a small slice of the pie, but to cast it as irrelevant would be a mistake. On a dollar basis, the US exported $1.67 trillion in goods during the most recent 12 months, making it the world's second-largest goods exporter, behind only China. While it may import more than it exports, the chart below shows that the export side of the equation is relevant to the US economy:

US exports are trending negatively. US total goods exported during the most recent three months totaled $414 billion, down 0.5% from the same period a year ago. This is the first time quarterly exports have contracted year-over-year since late 2016. The exports quarterly growth rate typically leads production through the business cycle by four months and is clearly indicating ongoing downward pressure on the growth rate for the US economy. In fact, since 2000, every time the US exports trend has moved into negative territory, US industrial production has followed suit.

The struggling US exports trend is likely due to a combination of the strengthening US dollar, the simmering US trade conflict with China, and weaker global demand stemming from anemic growth amongst most other advanced economies.

The trend lines look worse outside the US. World industrial production was up 2.4% during the most recent 12 months and decelerating. The current growth rate for US industrial production is 3.3%. A look to Hong Kong air freight, a bellwether for global trade volumes, points to a rather unsettling trajectory for the global economy through the rest of this year:



Hong Kong air freight volume during the second quarter came in 8.2% below the second quarter of 2018. This portends further deceleration in the world industrial production trend into at least early 2020.

As US exports activity goes, the broader US trend lines tend to follow, and slowing or contracting trade activity across much of the globe points to a difficult second half of the year ahead. Living in a globalized economy for quite some time, we often take for granted the importance and value of trade. It allows countries to specialize, creates jobs while raising standards of living, facilitates economic development, and encourages the international competition that ultimately delivers the consumer the highest quality goods and services at the lowest prices. It is important for the US and the rest of the world that the current downswing in trade prove only a symptom of the current business cycle rather than the beginning of a long-term shift away from the global trade system.

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READERS' FORUM

Why did the stock market fall after the latest jobs report? The jobs-added number was supposedly better than expected. The market later rebounded, but I don't understand why the jobs report was bad news.

Generally speaking, the June jobs report was good news for the economy. The higher-than-anticipated number of jobs added suggests that companies are still looking to expand and that there are still workers to hire. However, this jobs report created a strange situation wherein good news for the economy was actually bad news for investors. Investors were expecting the Federal Reserve to cut interest rates in response to recent slowing economic growth, but the stronger-than-anticipated job growth weakened the case for cuts. The stock market has since rebounded, assisted by hints from Chairman Jerome Powell that the Federal Reserve could cut interest rates this month despite the job growth number. However, if job growth continues to exceed expectations going forward, the chances of a second cut later this year will fall. Businesses should not view this jobs report as bad news, but they should be mindful that a second cut is not a given.

INDUSTRY SNAPSHOTS

Arrows indicate 12-month moving total/average direction

Retail Sales

- Retail sales up 4.0% from same period a year ago
- Pace of growth will slow into mid-2020
- E-Commerce retail sales were up 13.3% with slowing growth

Rotary Rig

- Count up 7.4% from one year ago
- Rig count has moved down in recent months
- Oil prices will pressure rotary rig count downward for at least the next two quarters

Wholesale Trade

- Wholesale trade was up 4.4% from one year ago
- Durable goods up 4.8% and wholesale trade of nondurable goods up 4.1%; growth in both is slowing
- Durable segment likely to outperform bondurable segment this cycle

Capital Goods

- Nondefense capital goods new orders up 4.2% from year-ago level
- New orders likely to peak imminently before declining in early 2020
- Defense capital goods new orders were up 16.7%
- Spending on defense capital goods will likely plateau in late 2019

Auto Production

- N. America light vehicle production down 0.5% from year-ago level
- Production will generally decline into next year
- N. America light truck production up 2.6% while passenger car production down 7.2%

Nonresidential Construction

- Nonresidential construction up 5.8% from one year ago
- Construction is currently in accelerating growth trend
- The manufacturing and warehouse segments, expected to grow at double-digit rates in 2019, will be areas of opportunity

Manufacturing

- Total Manufacturing Production up 2.1% from one year ago
- Production likely to decline during majority of second half of 2019
- US Metalworking Machinery and US Construction Machinery are expected to be particularly weak

Residential construction

- Residential construction down 3.5% from a year ago
- Residential construction is declining at an increasing rate
- Recent decline in mortgage rates suggests that construction may transition to a recovery trend by early next year

Agricultural Machinery Outlook

US farm machinery and equipment production, up 7.5% on a year-over-year basis, is rising at a generally slowing pace. This includes agricultural and farm machinery and equipment and other turf and ground care equipment, including planting, harvesting, and mowing equipment. Activity will likely peak imminently before declining through the remainder of 2019 and into mid-2020.

Stagnating US food production is likely limiting demand for farming equipment. Food production will be relatively flat during at least the next few quarters, which will drive down farm machinery and equipment production into mid-2020.

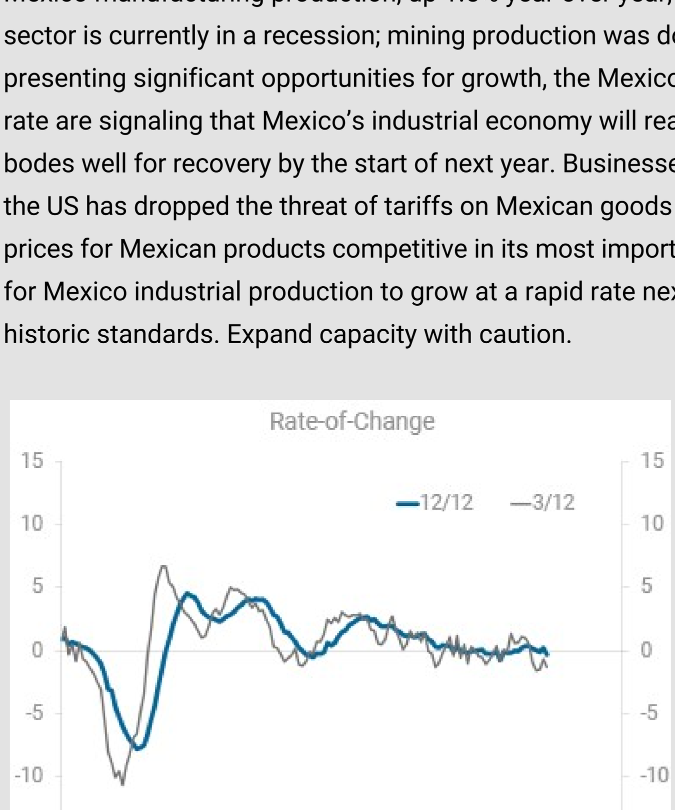
Foreign markets are not presenting significant growth opportunities in this sector. US exports of farm machinery and equipment were up 2.3% year over year, and the pace of growth is generally slowing. Exports will likely be limited by slowing in the global economy and the increasing strength of the US dollar.

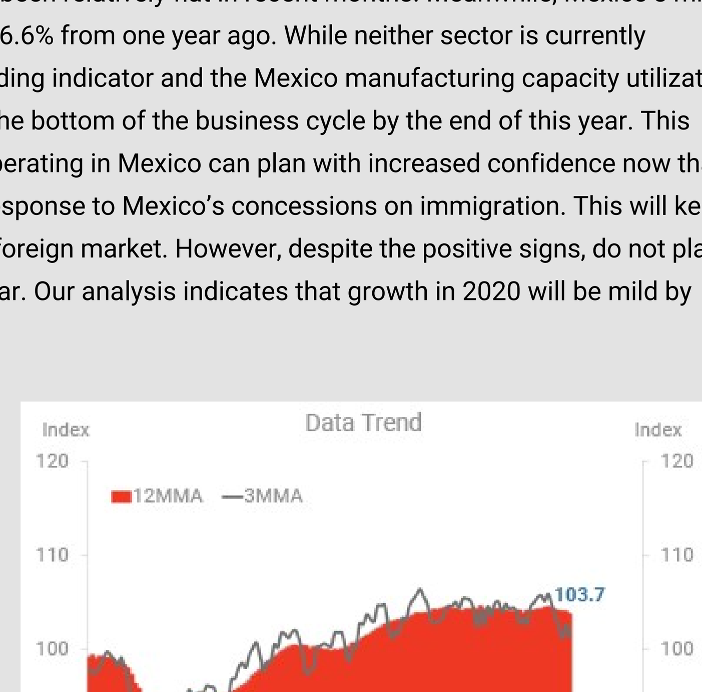
Farming equipment production is also likely suffering from the effects of protectionist trade policies. Although the US agreed to remove tariffs on Canadian and Mexican metals, tariffs remain in place for the rest of the world, driving up costs for equipment. This may be discouraging farmers from purchasing new machinery. Retaliatory tariffs implemented by US trade partners, most notably China, are lifting prices and limiting demand for American food products abroad. Until the US and China can come to an agreement on tariffs, farmers will likely have less money to spend on new equipment than they would otherwise.

Copper Prices

US copper futures prices during the three months through June averaged $2.76 per pound, down 8.7% from the same period one year ago. Prices have generally fallen in recent months. Slowing growth in the global industrial economy could keep prices trending downward through the remainder of this year. If your input costs fall, ensure that you are adjusting your prices to remain competitive in your market.

US aluminum futures prices during the three months through June averaged $1.78 per kilogram, down 20.2% from the second quarter of 2018. Prices have generally declined since mid-2020. As with copper prices, aluminum prices are unlikely to rise much this year as the global economy slows in its pace of growth.



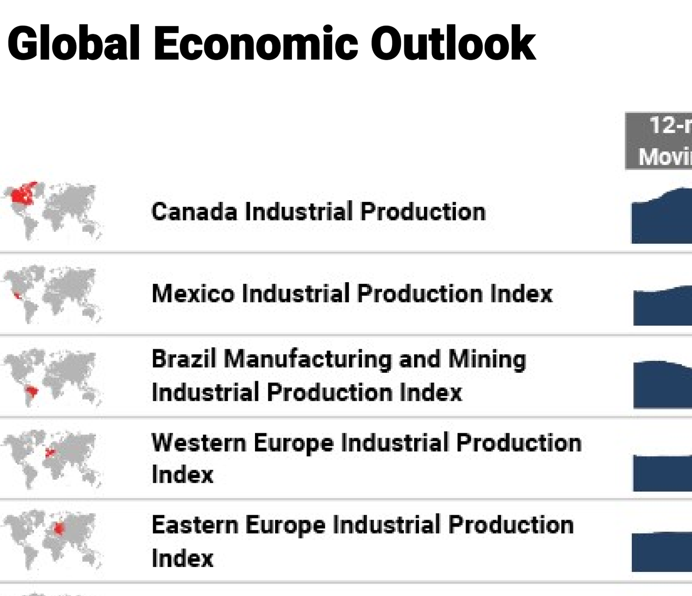


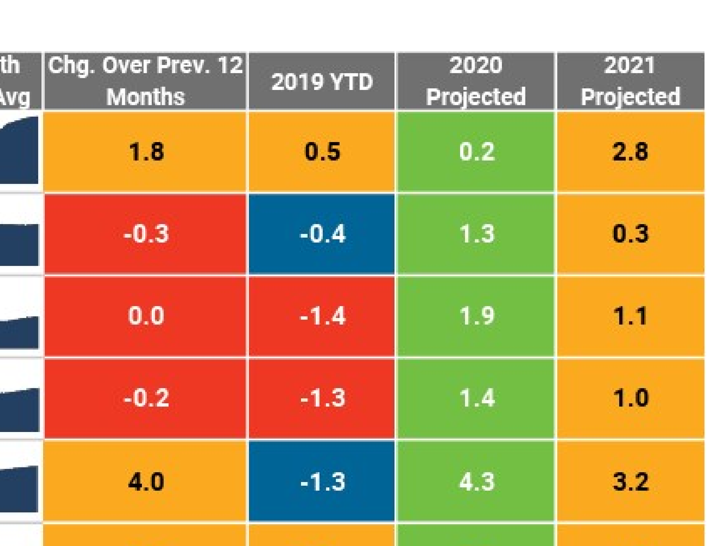
GLOBAL DEEP-DIVE

Mexico Industrial Production

Mexico industrial production during the 12-month period ending in May was down 0.3% from the same period one year ago. Mexico's industrial sector recently entered a recessionary trend.

Mexico manufacturing production, up 1.5% year over year, has been relatively flat in recent months. Meanwhile, Mexico's mining sector is currently in a recession; mining production was down 6.6% from one year ago. While neither sector is currently presenting significant opportunities for growth, the Mexico leading indicator and the Mexico manufacturing capacity utilization rate are signaling that Mexico's industrial economy will reach the bottom of the business cycle by the end of this year. This bodes well for recovery by the start of next year. Businesses operating in Mexico can plan with increased confidence now that the US has dropped the threat of tariffs on Mexican goods in response to Mexico's concessions on immigration. This will keep prices for Mexican products competitive in its most important foreign market. However, despite the positive signs, do not plan for Mexico industrial production to grow at a rapid rate next year. Our analysis indicates that growth in 2020 will be mild by historic standards. Expand capacity with caution.





Global Economic Outlook

	12-month Moving Avg	Chg. Over Prev. 12 Months	2019 YTD	2020 Projected	2021 Projected
Canada Industrial Production		1.8	0.5	0.2	2.8
Mexico Industrial Production Index		-0.3	-0.4	1.3	0.3
Brazil Manufacturing and Mining Industrial Production Index		0.0	-1.4	1.9	1.1
Western Europe Industrial Production Index		-0.2	-1.3	1.4	1.0
Eastern Europe Industrial Production Index		4.0	-1.3	4.3	3.2
India Industrial Production Index		3.5	0.9	5.5	4.3
China Industrial Production Index		5.9	5.2	6.1	5.9

Note: Forecast color represents market projection at end of year.
Accelerating growth Recovery Slowing growth Recession

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