IN THE SPOTLIGHT

Special Topic : Inflation

Heading toward the bottom of the macroeconomic business cycle, inflationary pressures are more pronounced than they were at the bottom of the prior cycle. Consumer Price inflation, at 2.3%, is 0.7 percentage points above the five-year average; Producer Price inflation, at 1.9%, is 1.3 percentage points higher than the five-year average. Longer-term, inflation will be generally more robust in 2021 than in 2020. The question is simple: What is causing this upward tick?

Inflationary pressures within the economy.

The forecast for US Crude Oil Prices upward trend is due in part to recent geopolitical tensions in the Middle East. OPEC oil supply restrictions are also keeping Prices higher during this cycle than during the 2015/2016 oil prices crash of the previous cycle. Many commodities prices are expected to end 2020 higher than 2019 as the US and global industrial sectors transition from business cycle decline to rise around mid-year. Consider tracking costs specific to the wire and cable industry; US Copper Futures Prices, for example, are expected to rise to just over $3 per pound by the fourth quarter of 2020. Consider locking in input prices if you have the ability to do so. Plan for rise in labor costs. US Overall Wage Growth, at 3.7%, is also running above the five-year average of 3.4% due to a tight labor market. Taking steps now, such as investing in efficiency enhancements at today's low interest rates, may pay dividends for your business in the form of minimized labor costs in the coming years.

A Closer Look: Foreign Policy

Making Sense of the Phase One Trade Deal

To better understand the impact of the Phase One Trade Deal the US signed with China Jan. 15, assess its various components. A fact sheet published by the Office of the US Trade Representative (USTR) states that the deal requires "structural reforms and other changes to China's economic and trade regime in the areas of intellectual property, technology transfer, agriculture, financial services, and foreign exchange [i.e. currency]." The trade deal also includes a commitment by China to "make substantial additional purchases of US goods and services in the coming years" and "establishes a dispute resolution system that ensures prompt and effective implementation and enforcement."

Key highlights of the deal:

- China committed to boost imports of US goods by $200 billion over two years, including increased purchases of manufacturing products and agricultural products.
- China agreed to stronger legal protections for intellectual property and to not force or pressure foreign companies to transfer proprietary technology in exchange for access to Chinese markets.
- In return, the Trump administration dropped plans to impose tariffs on $160 billion worth of Chinese goods and agreed to cut tariffs from 15% to 7.5% on another approximately $112 billion worth of Chinese goods.

The Phase One Trade Deal is largely a symbolic gesture that allows both sides to claim victory in the ongoing trade war. This is especially evident when we consider the existing tariffs that remain in place, both on the US side and in China.

Macroeconomic Outlook

Annual US Industrial Production declined further in November. Decline will persist into mid-2020. Subsequent rise will extend into mid-2022 before decline characterizes the remainder of 2022.

US Mining Production, one of the three segments of the US industrial sector, is growing. Annual average Mining Production was up 8.3% compared to the same time last year, but growth is slowing. Conversely, US Manufacturing Production and US Electric and Gas Utilities Production – the other two segments of the US industrial sector – are declining.

If you do business in the automotive sector or monitor it to gauge consumer health, you should be aware we recently downgraded our outlook for North America Light Vehicle Production. Expect decline in annual total Light Vehicle Production will persist into late 2020; annual Production will bottom out at about 15.9 million vehicles. Mild rise will then take hold and last through much of 2021. However, even at the height of that cycle, annual Production will come in at less than 1% above the current 16.3 million vehicles. Total Production will be approximately 7.9% lower during 2022 than 2021. If Light Vehicle Production is a market consideration, evaluate current capacity in light of our expectations and ensure your business is right-sized.

In contrast, optimistic signals abound in the US new housing market, another barometer of consumer well-being. The US Real Estate Sector ETF ended 2019 up 28.8% from the 2018 level, illustrating a robust rise in investor expectations for the sector. This is borne out in the new housing market leading indicators we track. The National Association of Home Builders Housing Market Index (most recent three months up 27.6% versus the same three months one year ago) and US Housing Permits (up 13.2%) are both growing at double-digit rates. The new housing market is generally a leading indicator to the US economy; take its bullish signals to mean that now is the time to prepare your firm for business cycle rise in the US economy during the second half of this year and into 2021.

INDUSTRY SNAPSHOTS

Arrows indicate 12-month moving total/average direction

Retail Sales

- Annual retail sales were up 3.1% compared to the same time last year
- Growth in retail sales will generally slow into late this year
- Expect retail sales to accelerate through much of 2021

Rotary Rig

- The rotary rig count averaged 821 rigs during the fourth quarter, down 23.5% from the fourth quarter of 2018
- Growth is slowing in both US natural gas production and US crude oil Production

Wholesale Trade

- Annual total wholesale trade will be relatively flat into mid-2020
- Wholesale trade of durable goods spending will rise starting in the near term and persisting into the first half of 2022
- Wholesale trade of non-durable goods spending will flatten into 2020

Capital Goods

- Annual non-defense capital goods new orders are declining
- Non-defense capital goods new orders spending will decline through mid-2020
- Defense capital goods new orders spending should rise during 2020

Auto Production

- Annual North America light vehicle production was down 3.3% from a year ago
- Production activity will decline into late 2020
- Activity will rise through 2021 before declining through at least 2022

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

- Annual total manufacturing production is declining and virtually even with the year-ago level
- Production will decline further into mid- 2020
- Indicators suggests upward momentum in the production annual rate-of-change in the latter part of 2020

Residential construction

- Annual total residential construction ticked up in recent months
- Construction spending should rise through early 2022
- The growth rate for single-unit housing starts will outpace that of multi-unit housing starts starting around mid-2020

Copper Prices

US copper futures prices through December 2019 averaged $2.70 per pound, down 2.0% since June. During the previous 18 months, pricing trended significantly downward but now look to stabilize in the next few months, perhaps even rising. Remember, if your input costs increase, adjust your pricing to remain profitable.

US aluminum futures prices through December 2019 averaged $1.76 per kilogram, slightly down from $1.78 per kilogram in June 2019. Overall, aluminum and copper prices are trending slightly upward.