Louisiana Corporate Credit Union

ECONOMIC & FINANCIAL DIGEST

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Manufacturing Shrinkage: It's Not All Due To Trade

As summer approaches, the dreary months of winter are becoming a fading memory. It's still unclear how much of a growth lift is unfolding over the spring season. But early indications are that the period got off to a decent start. Consumers unzipped their wallets and purses in April, sending retail sales to their biggest gain in over a year, led by a resurgence of auto and e-commerce sales. While the nascent rebound in overall growth is encouraging, it should not come as a surprise. As discussed more thoroughly last month, growth slumps in the first quarter have been a recurring pattern in recent years only to give way to more vigorous activity in subsequent quarters. This repetitive pattern may reflect measurement problems that obscure actual swings in economic activity.

That said, things would be worse if the winter slump were followed by a spring swoon. Keep in mind that in a chronically slow-growing economy, any bump in the road is regarded as a recession threat. Indeed, recession fears surfaced earlier this year when the slowdown was amplified by turmoil in the financial markets, weak commodity prices and mounting concerns over global growth, both in advanced and developing economies.

But not only are conditions seeming to perk up in the spring, the growth-dampening headwinds of the winter are fading. Commodity prices stopped tumbling and have actually increased in recent months, paced by oil, gold, silver and agricultural prices, which has eased deflation concerns. China and several other emerging markets are still struggling, punctuated by a deepening recession in Brazil; as well, the prospect of the U.K. exiting the European Union (a.k.a. Brexit) is clouding the outlook there. But the Eurozone delivered a surprisingly strong performance in the first quarter, posting a 2 percent growth rate that was more than double that in the U.S. At its April policy meeting, the Fed expressed less apprehension about global headwinds than it did before. Still, it wanted to see more evidence of sustained growth in the U.S. before pulling the rate-hiking trigger again. Simply put, policy is now fully geared to incoming data rather than on a calendar schedule. That's a better strategy if only because it reduces a source of instability in the financial markets when the data conflict with the Fed's timetable.

Making More Stuff

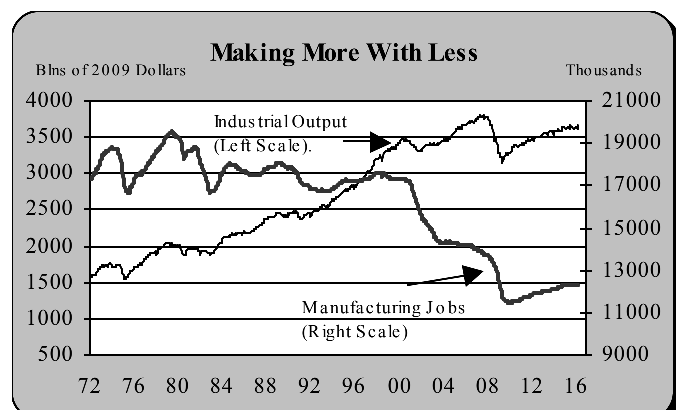
In this contentious and unpredictable election season, a number of controversial – and often unsupported – assertions have been made about a range of issues. One prominent claim is that the U.S., once a powerhouse manufacturing hub, has suffered an irreparable loss of its industrial might. For the most part, politicians are pointing the finger of blame on overseas conspirators. The accusation that China and Mexico are eating our lunch, trade agreements unfairly penalize U.S. producers, and other countries are engaging in currency manipulation designed to undercut American price competitiveness dominate the headline-grabbing anger expressed by candidates of both parties.

In good part, the ire is meant to highlight a vexing issue that has afflicted the U.S. economy for decades: the loss of good-paying factory jobs that underscores the income stagnation of middle-class Americans. But like most controversial issues, this one has elements of both truth and fiction. The truth is that factory jobs have been shrinking for some time. Early in the postwar years, factories employed one out of every three American workers. That share now stands at under 9 percent. The decline has been particularly sharp in recent decades. Since 2000, five million workers have been cut from manufacturing payrolls, more than a third of the factory workforce.

The fiction, however, is just as startling. The U.S. has not stopped making stuff, as the finger-pointers would have us believe. Indeed, the real value of manufactured output has increased steadily throughout the postwar years, peaking out at just under $3.8 trillion in September 2007. The plunge in global demand caused by the Great Recession dealt a severe blow to production over the following two years, sending it down by a whopping 17 percent. But output has since recovered nicely and now stands at $3.66 trillion, slightly more than 3 percent off its peak. In other words, factories are still turning out an ever-growing volume of products; they are just doing it with fewer workers.

The Blame Game

That's not to say U.S. producers have been winners in the global market place. For sure, Many of the jobs lost have been



taken by lower-wage factory workers in emerging market countries, where the goods are being produced more cheaply. This dynamic has almost entirely vaporized some industries, such as textiles, furniture and apparel. Those firms and jobs are probably lost for good. Indeed, the globalization process, once universally accepted as a positive force for the U.S. and global economy is now recognized as having negative as well as positive consequences. This newfound awareness is understandably fueling debate over the fairness and efficacy of trade pacts made by the U.S., and is commanding much attention in the political discourse.

But it would be a mistake to put the entire blame for the loss of factory jobs on globalization. Advances in technology have been a major disruptive force for over a century, thanks to new and more efficient capital equipment and management techniques that have facilitated productivity growth, the seed corn of rising living standards. And as the U.S. economy grew wealthier, services took an ever-larger share of consumption, a natural evolution in advanced nations. Hence, just as workers moved from farms to factories early in the 20th century, they transitioned from factories to the service-providing sectors over time. Services now account for 46 percent of total GDP, up from 28 percent in 1960.

Needless to say, there's a natural synergy between the mix of jobs and the changing composition of economic output. While the vast majority of factory workers found jobs in the services sectors, the transition has not been seamless. Many have wound up on the unemployment lines because they lacked the skills and/or knowledge needed for a successful transfer. Indeed, some believe the growing dominance of jobs in services has been at least partly responsible for the increase in income inequality. That's because there's a more unequal distribution of incomes among service-providing workers – where levels of education, knowledge and skills are more widely dispersed, ranging from hamburger flippers to software managers – than in factories, where unions have traditionally had a stronger toehold and was the great equalizer in determining worker pay.

Tide Is Turning

Interestingly, as the U.S. becomes ever more of a service-based economy, logic holds that it should become less vulnerable to the job-hemorrhaging impact of trade. After all, restaurant meals and haircuts cannot be imported like autos, appliances and other factory-produced goods. But unless the political climate leads to protectionist trade measures, trade will continue to be an important aspect of the American economy. The world is becoming increasingly interconnected and it's unlikely that anything – short of war — will retard this process.

The challenge is to minimize the losers and maximize the winners. Changes in regulations and tax laws that discourage companies from moving operations overseas would be one step. Making sure that trade pacts are forged in a way that levels the playing field between countries – in terms of environmental and labor practices – and protect against currency manipulation is another. Providing a stronger safety net for workers displaced by trade, including improved access to retraining and educational resources, might also be considered.

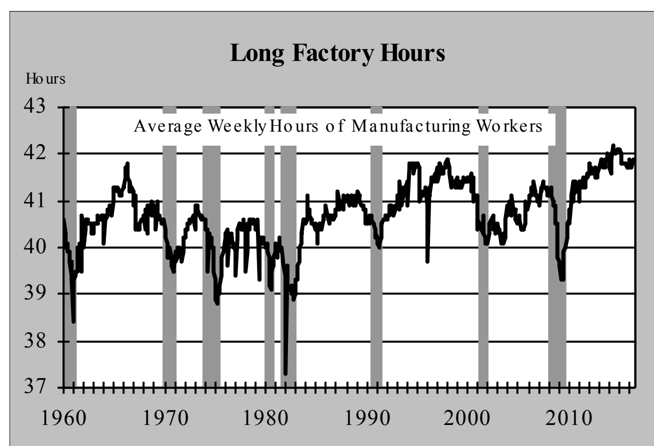
But trends already underway are mitigating the job losses attributed to trade. The increased prosperity of emerging market nations – itself a byproduct of expanding trade – is narrowing the cost-advantage to U.S. companies of outsourcing operations. In China, for example, average hourly wages of manufacturing workers have increased by an average of 12 percent a year since 2001, closing the gap with American workers, where wage increases have been much more restrained. More companies are also disenchanted with having to rely on suppliers in distant locations, which heightens the risk of supply disruptions from natural causes, such as the Fukushima earthquake in Japan, or adverse geopolitical shocks. Indeed, according to one recent study, manufacturers have "reshored" 248 thousand jobs that left the country since 2010.

Promising Signs

It's been a rough slog for the entire U.S. economy since the Great Recession. But manufacturers have faced some particularly strong headwinds that have reinforced the long-term decline in this sector's relative importance in the American economy. While international trade has contributed to the loss of well-paying factory jobs as well as to the overall woes of industrial companies, the primary culprit in recent years has been insufficient global and domestic demand for American goods. The strong dollar has made things worse, undercutting exports and damaging sales of domestic companies by increasing the price of American goods relative to imported products.

In 2015, the widening trade deficit subtracted .64 percentage points or about one-quarter of the economy's 2.4 percent growth rate. In the first quarter, the relative hit was even larger, as the deficit in net exports sliced 0.34 percent, or nearly 70 percent of the preliminary growth estimate of 0.5 percent. Not surprisingly, industrial output took a big hit from weakening exports, falling by 0.3 percent in 2015 and slipping further in the first quarter. Yet about 300 thousand manufacturing jobs have been recovered over the past two years and the factory workweek is hovering near record highs.

Looking ahead, manufacturers still face strong headwinds, most notably the strong dollar and weak foreign demand. But the long decline in factory jobs is ebbing and the steady tightening of the broad labor market should open up more opportunities for laid-off factory workers. Even more encouraging, industrial production in April staged the strongest increase since November 2014; with the workweek already stretched to the limit, manufacturers will need to beef up payrolls to meet demand. If the April production bounce is a portent of a stronger growth in the U.S. economy, the anti-trade rhetoric should lose some momentum.



KEY ECONOMIC AND FINANCIAL INDICATORS

*FINANCIAL INDICATORS**

	April	March	February	January	December	November	October	12-Month Range High	12-Month Range Low
Prime Rate	3.50	3.50	3.50	3.50	3.37	3.25	3.25	3.50	3.25
3-Month Treasury Bill Rate	0.23	0.29	0.31	0.26	0.23	0.12	0.02	0.31	0.02
5-Year Treasury Note Rate	1.26	1.38	1.22	1.52	1.70	1.67	1.39	1.70	1.22
10-Year Treasury Note Rate	1.81	1.89	1.78	2.09	2.24	2.26	2.07	2.36	1.78
30-Year Treasury Bond Rate	2.62	2.68	2.62	2.86	2.97	3.03	2.89	3.11	2.59
Tax-Exempt Bond Yield	3.30	3.38	3.30	3.41	3.57	3.68	3.67	3.82	3.30
Corporate Bond Yield (AAA)	3.62	3.82	3.96	4.00	3.97	4.06	3.95	4.19	3.52
Conventional 30-Year Mortgage Rate	3.61	3.69	3.66	3.87	3.96	3.94	3.80	4.05	3.61
Dow Jones Industrial average	17844	17302	16300	16305	17543	17724	17182	18125	16300
S&P 500 Index	2076	2022	1918	1918	2054	2081	2025	2112	1918
Dividend Yield (S&P)	2.18	2.17	2.31	2.28	2.30	2.12	2.12	2.31	2.04
P/E Ratio (S&P)	19.2	19.1	17.6	17.7	18.6	18.8	18.8	19.2	17.4
Dollar Exchange Rate (vs. Major Currencies)	89.4	91.5	93.2	95.3	94.1	94.0	91.2	95.3	89.2

** Monthly Averages*

ECONOMIC INDICATORS

	April	March	February	January	December	November	October	12-Month Range High	12-Month Range Low
Housing Starts (In Thousands)	1172	1099	1213	1128	1160	1171	1073	1213	1063
New Home Sales (Thousands of Units)		511	519	521	537	511	480	537	457
New Home Prices (Thousands of Dollars)		288	297	283	299	317	298	317	283
Retail Sales (% Change Year Ago)	2.9	1.7	3.6	2.8	2.8	1.6	1.6	3.6	1.6
Industrial Production (% Change Year Ago)	-1.1	-1.9	-1.4	-1.3	-2.3	-2.0	-0.5	1.0	-2.3
Operating Rate (% of Capacity)	75.4	74.9	75.6	75.7	75.4	75.7	76.3	76.9	74.9
Inventory Sales Ratio (Months)		1.41	1.41	1.41	1.40	1.39	1.38	1.41	1.37
Real Gross Domestic Product (Annual % Change)		0.5			1.4			3.9	0.5
Unemployment Rate (Percent)	5.0	5.0	4.9	4.9	5.0	5.0	5.0	5.5	4.9
Payroll Employment (Change in Thousands)	160	208	233	168	271	280	295	295	149
Hourly Earnings (% Change Year Ago)	2.5	2.3	2.4	2.5	2.6	2.4	2.6	2.6	2.0
Personal Income (% Change Year Ago)		4.2	3.8	4.1	3.9	4.0	4.3	4.7	3.8
Savings Rate (Percent of Disposable Income)		5.4	5.1	5.2	5.0	4.9	5.1	5.4	4.8
Consumer Credit (Change in Mil. Of Dollars)		29674	14145	13054	6297	16098	16413	29674	6297
Consumer Prices (% Change Year Ago)	1.1	0.9	1.0	1.4	0.7	0.5	0.2	1.4	-0.2
CPI Less Food & Energy (% Change Year Ago)	2.1	2.2	2.3	2.2	2.1	2.0	1.9	2.3	1.7
Wholesale Prices (% Change Year Ago)	0.0	-0.1	0.0	-0.2	-1.0	-1.1	-1.6	0.0	-1.6

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