

## SMMA Quarterly Economic Report March 2008

Prepared by the Institute for Trend Research

### **The Macroeconomic Overview:**

Our general outlook for 2008, as measured by the US Industrial Production Index, is still positive, despite all the media consternation to the contrary. Based on leading indicator input through 2007, we expect mildly higher activity to occur in the second and third quarters of 2008. Look for the acceleration process in 2008 to be sufficient to sustain economic growth this year but not sufficient to resolve the accumulative impact of issues in the financial sector, the housing market and the resultant diminished consumer “wealth effect”. We have not altered our projection that 2009 and 2010 will be characterized as recession years.

The recent cuts in interest rates and fiscal stimuli will likely provide an additional boost for the economy in late 2008 and perhaps into early 2009. We are not as confident that the deeper systemic issues rolling through the housing and financial markets will be resolved quickly and easily by pouring money into the system. The housing market is not expected to generate a sustainable recovery until late 2009. The “credit crunch” and the full magnitude of the housing collapse on financial markets are still not known, but it is having a ripple effect that is being felt worldwide. Credit has become harder to obtain and more expensive in the US, Europe and Japan.

Inflationary pressures are hovering around 4.0%. Oil is now running over \$100 a barrel, which means that we likely see increasing prices in what is made and what is transported. Tighter credit restrictions going forward, for both consumers and businesses will slow economic growth. Retail Sales have slowed significantly in the last three months, a reflection of the higher cost of fuel, food and a shrinking consumer confidence due to declining housing values. Disposable Personal Income will diminish as inflation takes a larger chunk out of the cost of living.

Inflationary pressures, due to rising energy, food and wages, are increasing in most developed and emerging economies. Europe has exceeded 3.0%. China’s inflation is close to 7.0%, with much of the rise coming in late 2007. As various countries (including the US) lower interest rates to stave off slowing growth (or recession), we are likely to see inflationary pressures gather strength, largely due to rising commodity prices worldwide. A global slowdown that will encompass Asia is still expected to begin post mid 2009.

The *Fabricated Metals Production Utilization* rate is 80.8%, down from a November 2007 peak but 1.6 percentage points above the year-earlier level. The *Iron & Steel Products Utilization* rate is 89.3%, 5.9 percentage points above one year ago. Look for these to stay within acceptable levels through at least mid 2008. A sudden and steep drop in these utilization rates would potentially signal an earlier-than-anticipated onset of recession in the US.

*It is worth mentioning with all the negative news that there are sectors of the economy still expanding. There are opportunities going forward.* Nonresidential construction (power and manufacturing, airline terminals and resorts) is running at record highs. The energy sector (wind, solar, biofuels, and geothermal) is benefiting from an influx of investment and the added incentive from rising oil prices. Building the infrastructure to transmit our oil and gas is well worth pursuing. Food Production, for people and pets, is a growing business. Aviation (civilian and commercial) is set for several years to come and Airbus is going to set up shop(s) in Mississippi. Precision Manufacturing, the high-end, high-tech, high-touch sector that is not competing with China, is generally growing and profitable. Environmental concerns and accompanying technology present business opportunities as well. Medical equipment and products is likely to weather the projected recessionary trend well.

*“The pessimist complains about the wind; the optimist expects it will change. The realist adjusts his sails.”*  
William Ward.

## US Industrial Production

**Trend:**        **Positive**

**Outlook:** 12MMA rise through 2008

### **Estimated Annual Growth Rates:**

2008: 2.3%

2009: -2.0%

Our outlook for the US economy, as measured by the US Industrial Production Index, has the current slowdown in the economy transitioning into a *slightly* milder pace of growth as we move into the second quarter of 2008. The projected increase in activity will be mild and short-lived.

Evidence that positive cyclical momentum is underway can be found in the fact that both the US Industrial Production 1/12 and 3/12 rates-of-change have notched higher and are tracking above the 12/12. US Industrial Production will soon shift into a mild Phase B (faster growth). The upward movement will be brief. We expect the 12/12 to transition to the back side of the business cycle around December 2008.

The January 2008 12MMA (lower blue line) recorded its 41<sup>st</sup> consecutive record high, which makes for a strange “recession.” Pundits purporting that we are currently in a macroeconomic recession are clearly wrong or looking at faulty data. The stimulus package will probably assure that 2008 as a whole will avoid an official recession and end the year 2.0% to 2.3% above 2007. A decidedly negative macroeconomic trend is expected to begin by early 2009 and extend into 2010.

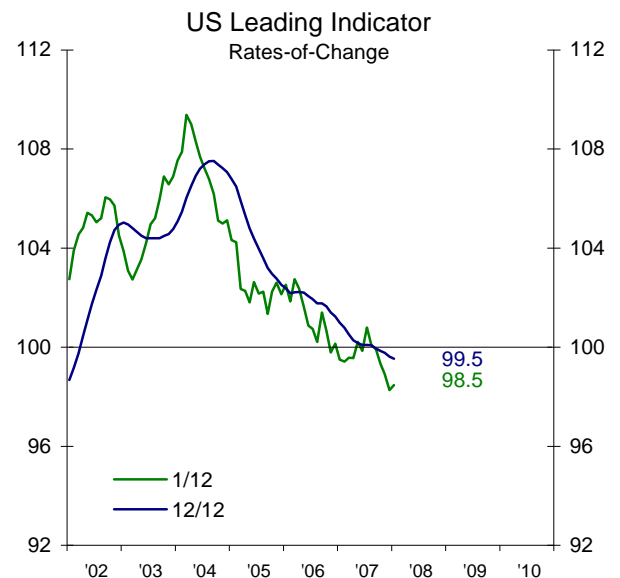
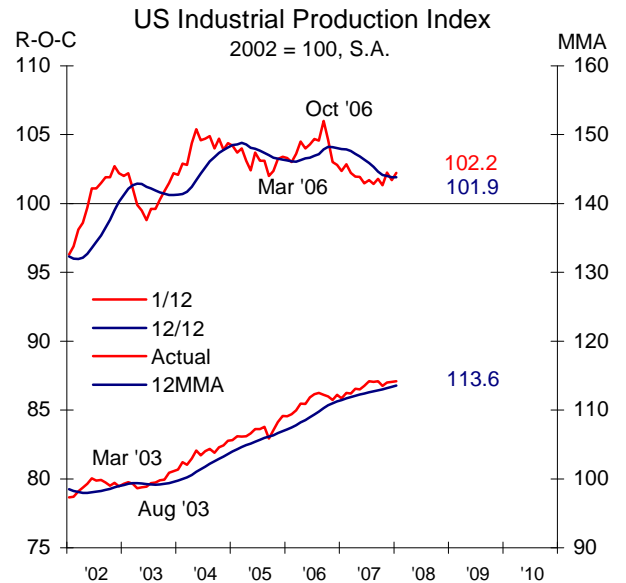
*US Manufacturing Capacity Utilization w/o High Tech* declined in January to 80.1%, down from a July high of 81.4%, even with January 2007. The *Machinery Manufacturing Capacity Utilization* is at 78.1, down from the December 2006 apex of 82.9. Both reflect a slowing in the overall economy that is sufficient to be busy, without being inflationary.

**Key input for planning:** Plan on the same level of activity this year as last. Watch your balance sheets.

## US Leading Indicator

The implications from the US Leading Indicator January rate-of-change trends you see on the chart are clearly not a good sign for 2008. The general trend of malaise that began in the third quarter of 2007 continued with the January index slipping lower to 135.8. The 1/12 (green line) held relatively stable at 98.5 but it is running below the 12/12, which slipped a little lower to 99.5.

As a leading indicator to the overall economy, this index is not offering any substantive upside signal that the current softness in the economy will disappear anytime soon - as in 2008. It also makes us more sensitive to the declining input coming from the Retail Sales data over the last three months and may be a prelude to waning consumer demand by the end of this year.



## North America Light Vehicle Production

**Trend:** **Flat**

**Outlook:** Essentially flat through 2008

### **Estimated Annual Growth Rates:**

2008: 0.3%  
2009: -10.0 %

The North America Light Vehicle Production 12MMT slipped below 15 million units and slightly below the forecast range. Although production in January was impressive, we have elected to leave the forecast unchanged.

Production jumped 23.5% in January from December, making the January increase both steeper than normal and better than each of the last four years. Average performance in February and March will keep the 12MMT below 15 million units through the near term, which seems like a good bet. It is hard to imagine production will dramatically improve going forward, given prevailing economic conditions and repossession rates.

Given the status of the rates-of-change and the stuttering consumer trends, look for production through 2008 to remain about even with 2007 levels. Production of new domestic passenger cars and trucks is 4.2% higher than this time last year on a 12MMT basis, but expect slower activity in the near term.

**Key input for planning:** Stash cash. Continue cost reductions wherever possible. Prepare for 2009.

## Industrial Machinery Production:

**Trend:** **Positive, for now**

**Outlook:** Decelerating rise

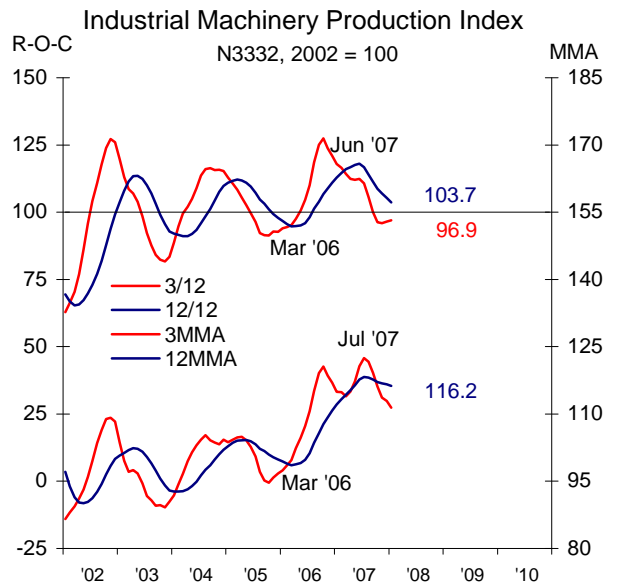
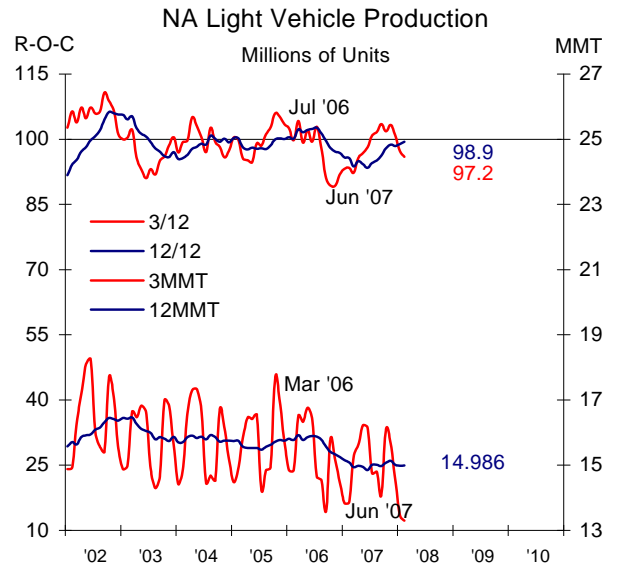
### **Estimated Annual Growth Rates:**

2008: -1.8%  
2009: -6.6%

We have revised the forecast. The annual average index is a positive 3.7% above the year-earlier level but diminishing growth is projected to move this index into a negative cycle by mid 2008. Neither the data trends, nor the rate-of-change trends are giving any evidence of a trend reversal.

A glimmer of optimism for this Index is based on the fact that January rates-of-change for *Industrial Machinery New Orders* posted impressive gains and are clearly pointing towards 12MMT rise going forward. The weakness in the US dollar is likely contributing to this. If you have opportunities in export markets this year and next make the most of it.

**Key Input for Planning:** The best of this cycle is behind us. A challenging couple of years are ahead. Watch your balance sheets. Emphasize the maintenance contracts as the economy slows down.



## Metalworking Machinery New Orders

**Trend:** Positive

**Outlook:** Rise in 2008

### Estimated Annual Growth Rates:

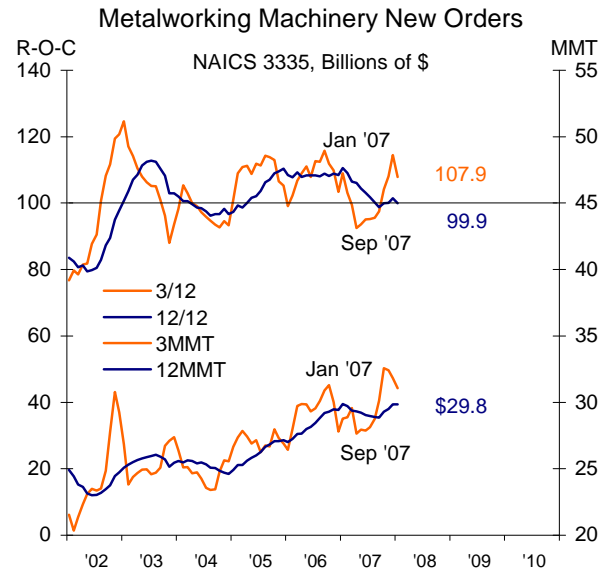
2008: 9.5%

2009: -11.5%

Metalworking Machinery New Orders ended 2007 on target. A better than expected fourth quarter resulted in an adjustment to the forecast going forward. Plan on seeing steady but moderate growth in this New Orders series in 2008.

The 12MMT data trend slipped to 0.1% below the year-ago level in January, which is not of particular concern. The index is expected to benefit from a slightly stronger US economy in 2008. The 3MMT seasonal decline in January is normal and 7.9% ahead of the same quarter last year. Quarterly production figures are projected to track above comparable year-ago levels through March 2009.

**Key Input for Planning:** A challenging couple of years lie beyond 2008. Emphasize the maintenance contracts as the economy slows down.



## Mining Production (w/o Oil & Gas)

**Trend:** Essentially Flat

**Outlook:** Mild recovery second half 2008

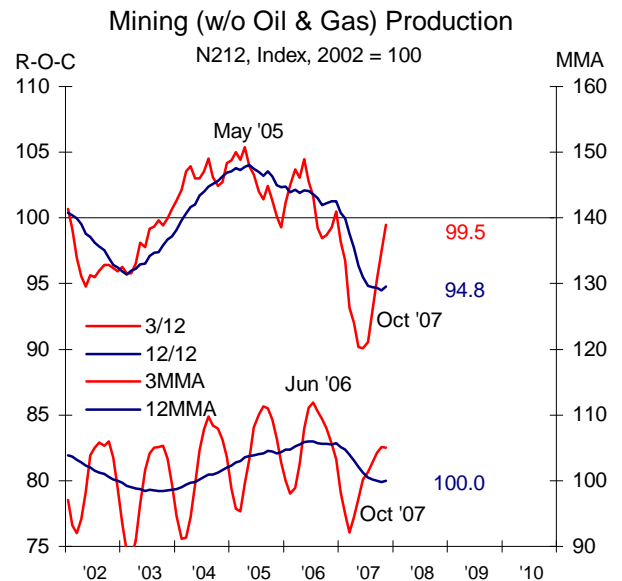
### Estimated Annual Growth Rates:

2008: -0.2%

2009: -1.0%

The 12MMA (lower blue line) for Mining Production (w/o oil and gas) moved lower in January, but the 12/12 inched higher, leaving December as the probable low for this cycle. The encouraging news is that the 3MMA seasonal decline is milder than the past two years.

The rates-of-change are moving in the right direction – up. Look for a long Phase A recovery trend extending into 2009.



*Coal Production* is a large portion of this market (44%). Disruption in supply in China and Australia have decreased world stocks causing a steep increase in world prices and will likely push this segment of the market higher in 2008, but the rise in coal as a component of overall Mining will be largely offset by the deterioration in Aggregates, which is down 15.8% from last year and not likely to show much improvement through the year.

**Key Input for Planning:** Increasing demand for electricity production and rising prices should mean that Coal will provide the best opportunities in the coming year.

## Ship Production

**Trend:** **Positive**

**Outlook:** Relatively steady growth

### **Estimated Annual Growth Rates:**

2008: 2.8%

2009: 5.0%

The 12MMA slipped off its record high in January (+2.5%) and we expect the 12MMA to move horizontally through the first half of this year. The second half of 2008 should see a slightly mild rising trend.

Production in the last three months saw its mildest rise in the last three years and ended a hair below the same quarter a year earlier (-0.1%). The rate-of-change trends (upper portion) are telling us to expect milder 12MMA rise in the near term.

Global growth should keep production positive through 2009 and into early 2010.

**Key Input for Planning:** Keep personnel and resources sufficient to meet a moderate increase in demand.

## Canada:

**Trend:** **Improving**

**Outlook:** Rise in 2008

### **Estimated Annual Growth Rates:**

2008: 2.3%

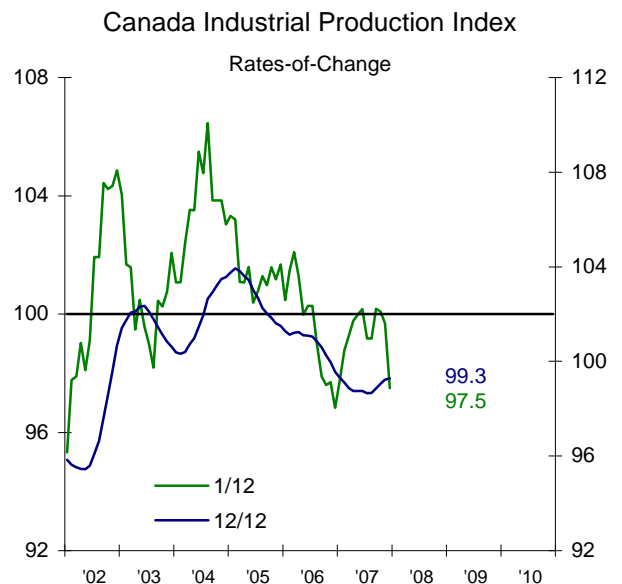
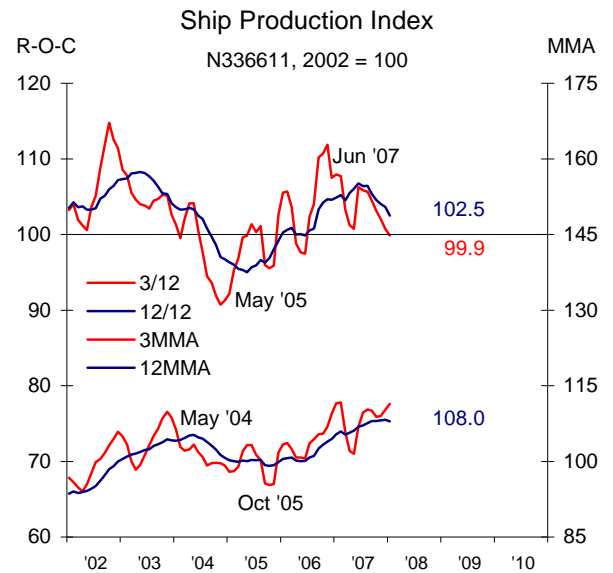
2009: 0.9%

Canada Industrial Production ended 2007 0.7% below 2006. A recent data revision turned an already negative trend slightly more negative. There will likely be more near-term deterioration based on the status of the rate-of-change trends you see on the chart.

The Canadian dollar is up 20% over the past 12 months which has resulted in Canada seeing its first Current Account Deficit since late 1999. Rising prices for Canada's commodities did not offset slower US demand for factory goods. The economy slowed in the fourth quarter in spite of the fact that domestic spending increased to an annualized rate of 7.4% (up from 4.5% the previous quarter). Business spending for US equipment will serve to increase Canada's competitive position.

We are still forecasting a mild rising trend in 2008, similar to the bounce anticipated in the US economy.

**Key Input for Planning:** Construction trends and commodity industries are healthy. The weak dollar makes US purchases particularly attractive. We do not see much change in exchange rates this year. Fortunately Canada is not faced with the housing and financial crisis we are seeing in the US.



## The Global Economy:

**Europe:** The January 12MMA for the EU 25 set a new record high. Mild deceleration is entering the picture, but it will hardly be noticeable in 2008. 2009 will see growth diminish as the US enters recession.

Growth in the Industrial Production Indexes in the major European countries moved generally lower last month as did Consumer Confidence. Rising food and energy prices pushed inflation to its highest level in 12 years (+3.2%) and above the ECB's comfort level of 2.0%. The financial markets are still in turmoil.

**Southeast Asia:** The major Southeast Asia economies, South Korea, Thailand, Indonesia, and Taiwan, are operating at record levels and are strong enough to push the entire region 5.9% higher than the year earlier, despite the subpar growth in the Philippines and Hong Kong.

Inflation (oil and food based) is rising throughout the region and reaching new highs. Taiwan, Thailand, Malaysia and Singapore are expected to allow their currencies to appreciate to help cool the inflationary threat. A stronger currency makes exports more expensive, causing fears of a loss of competitive advantage, which could mean fewer exports and net slower growth.

**Japan:** The Japanese Industrial Production 12MMA moved to a new high in January and there is a chance that the rate of growth could move slightly higher in the near term, but our analysis suggests mild deceleration is more likely. The rates-of-change contain a mildly negative bias.

The upward trend in wages (+0.6%) and household spending (+3.6%) is good news for this economy. Domestic activity will be needed to fill the gap left from slower exports to the US. Fifty percent of Japan's exports go to the US.

**South America:** South America set record levels of production through 2007 (12MMA) and more rise is expected in 2008 and into 2009. Demand from emerging world economies for raw materials and agricultural products is the basis for their growth.

A slowdown in the US will have an effect on this region but possibly not as great as in past economic downturns. Increasing exports to Asia and India (China has become a major trading partner for Brazil) and record high commodity prices have increased reserves in the major economies, strengthened their currencies, lowered inflation and allowed them to pay down some of their debt. If Southeast Asia is too far to travel, go south.

**Mexico:** The 12MMA for Mexico Industrial Production is at a record high and the signs are in place for growth in 2008 to be better than 2007.

The government hopes to compensate for slower US exports with increasing consumer demand, acceptable inflation limits and lower interest rates later in 2008. This may be difficult as *remittances from workers abroad* have stagnated (lowering disposable income) and December retail sales were a mild 1.1% better than a year ago. Inflation, at 3.7%, is below government expectations.

