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MANUFACTURING

Growth continues — but it's sluggish

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Economists and others watching the manufacturing industry predict growth will continue in the second half of 2019, but they expect that growth to be sluggish.

Manufacturers are facing a tough trade environment and a tight labor market, though consumer demand is still expected to be strong.

Expectations for manufacturing for the second half of 2019 are “uninspiring,” said Sarah House, a senior economist at Wells Fargo Securities. Global trade tensions are a big factor, which House doesn't expect to see resolved or escalated any time soon. Overall uncertainty, weak foreign demand and the strong dollar are also contributing to slower rates of growth for manufacturers.

In addition, manufacturers will have to watch import prices, which have been down this year, in part because of the stronger dollar, said Kurt Rankin, an economist for PNC Financial Services Group. Tariffs could make imports more expensive for consumers, but the stronger dollar can offset those gains for domestic manufacturers.

Ultimately, financial conditions and business owner or CEO confidence has been slowing, said Tom Jalics, director of asset allocation for Fifth Third Private Bank.

“Certainly, we believe the trade-war rhetoric has put global manufacturing, global business owners on alert,” Jalics said.

Instead of investing in their businesses, decision-makers are taking a “wait-and-see approach” to the U.S.-China trade disputes, Jalics said. He expects growth in the second half of 2019, but on a slower scale.

The uncertainty caused by tariffs and oth-

er geopolitical factors are creating caution among companies, said T.J. Monico, managing director for KeyBanc Capital Markets' industrial investment banking. But KeyBanc's manufacturing clients are optimistic about demand for the second half of 2019. The biggest challenge they still face is access to talent and labor.

“That's really been the biggest bottleneck in terms of further expansion in manufacturing activity,” Monico said.

Monico added he's expecting “mid-single-digits” in terms of organic growth in the second half of the year. House anticipates industrial production growth below 2%, while she expects GDP to be about 2.25% on an annualized basis for the second half of the year.

Monico said he's seen more companies turn to mergers and acquisitions to enhance their growth in recent years. A lot of KeyBanc's clients have been looking to expand into new, higher-growth markets, such as medical. He's also seeing growth among companies that work in replacement parts instead of original equipment.

“Part of that is trying to position a business to be more resilient during a future recession,” Monico said.

Recessionary activity in some end markets, like in heavy-duty truck manufacturing, could begin as early as next year, he added.

A recent report from professional services firm Sikich LLP found that 63% of respondents were taking steps to prepare for a possible recession, increasing efficiency in production and business operations and increasing their ability to swiftly scale operations up or down.

The report reflects “hesitation in the market,” said Tracy Burkhart, a partner in Sikich's Akron office. In addition to recent trade issues, companies realize the econo-

my is in its longest expansion on record and that a recession will occur at some point, even if it's not for 12 to 18 months.

Burkhart said companies are looking to reduce nonproduction expenses and protect cash flow.

Just 27% of respondents in Sikich's report thought it was “extremely or very likely” that the U.S. would enter a recession in the next 12 months. That percentage increases to 49% when looking at respondents with more than \$500 million in annual revenue.

Burkhart said the disparity in responses between larger companies and smaller ones could be due to bigger companies having more “visibility into the demand for their product” and more international exposure. Also, smaller companies may have more niche products, which could be more recession-proof, she said.

Matthew Nipper, senior vice president and KeyBank's commercial team lead for Northeast Ohio, said locally, clients aren't necessarily preparing for a future recession, but they are looking for ways to raise revenue and grow. He does see clients who hesitate to invest in M&A and over-leverage their existing company.

Despite the headwinds, there are factors that support manufacturing in the months to come. Fifth Third has been “bullish” on U.S. manufacturing in 2018 and 2019, Jalics said. The industry has been adding jobs and the country's share of global manufacturing has grown in recent years. Long term, he said, the segment looks strong.

Currently, House said, the consumer sector is still strong and there are expectations that the Federal Reserve will cut rates.

“It's not all doom and gloom, but it's tough to get too excited about things right now,” House said.