MACRO PULSE™

July 2016 A Delphi Advisors Publication Volume 7, No. 7

## Catching Up

A variety of factors conspired to keep us from publishing this newsletter since February, so we thought a review of what has occurred in the sectors of the economy that are relevant to the U.S. forest products sector during the intervening time might be appropriate for this issue.

***Gross domestic product***: Overall activity as measured by GDP is exhibiting a pattern consistent with the late phase of a business cycle. Down from the most recent peak of 3.9% in 2Q2015, the growth rate in 1Q2016 was a seasonally adjusted and annualized rate of just 1.1%. Reaction from the analysts at Consumer Metrics Institute seems prescient: “Although the [final 1Q2016 GDP] report did break the 1% growth threshold, it still does not [reflect] a robustly growing economy,” they wrote. “From a larger perspective the past three quarters continue to show a slow-motion slide towards economic stagnation." At 85 months, this expansion is nearly 50% longer than the average (and the third-longest) since WWII. What could be contributing to the slowdown? Separating correlation from causation among intertwined economic relationships is almost impossible, so the following is a mix of both.

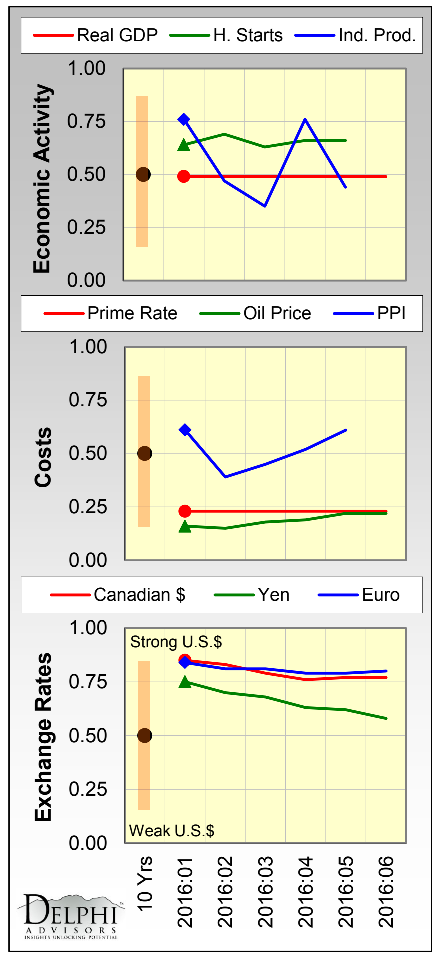
***Exchange rates***: Although the U.S. dollar was 3.2% weaker (when compared to a trade-weighted basket of 26 currencies) in June than its recent peak in January, that decline has only started reversing the 32.3% appreciation that occurred between July 2011 and January 2016. Despite the Federal Reserve backtracking on interest rate hikes, with the recent Brexit vote we would anticipate this recent weakening trend of the U.S. dollar to reverse course near-term.

***International trade***: A strong currency discourages consumption of products manufactured in the strong-currency country since equivalents made elsewhere appear less expensive. Trade in softwood lumber readily illustrates this relationship: Since July 2011, exports of U.S. softwood lumber have been relatively constant at 137 MMBF but the volume of imports into the United States has doubled (from 0.8 to 1.6 BBF). With U.S./Canada Softwood Lumber Agreement talks at an impasse, the prospect of imports declining seems slim. Meanwhile, growth in the volume of general global trade has stalled since the end of 2014.

***Manufacturing***: Total industrial production (IP) decreased year-over-year (YoY) for a ninth month in May, the longest streak of IP weakness in modern U.S. history outside a confirmed recession. Wood Products output was up 1.5% YTD relative to the same months in 2015; Paper: -3.0%. New orders excluding aircraft declined YoY for the 19th consecutive month – something that has never happened outside of a recession. Also, domestic business spending has contracted on a YoY basis during all but two months since December 2014.

***Residential construction***: Momentum has essentially evaporated since total housing starts first hit the post-bust peak of 1.213 million units in June 2015 (and again in February 2016) Incidentally, starts are levitating above 0.5 in the top dashboard chart only because the last 10 years include the housing crash and its aftermath. Rising home prices, which are in the neighborhood of pre-Great Recession peaks – coupled with stagnant wages in the key 25-34 age cohort and the U-6 unemployment rate near 10% – offer little prospect of significant near-term improvement in the housing sector. As housing frequently leads the economic cycle, we find this a foreboding signal for the broader economy over the next 24 months. ■

*This report is typically a compilation of articles posted on our website; those articles relate in greater detail recent economic developments to the U.S. forest products sector.*




**Previous six months’ behavior of macroeconomic variables indexed relative to their historical 10-year min, max and average (lower and upper ends of the orange bars, and black dots, respectively)**