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news and economic outlook for the wire and cable industry
IEWC GLOBAL SOLUTIONS

IN THE SPOTLIGHT

The Impact of U.S. Tax Reform on Small Business

What you need to know: *We now have evidence confirming that 2018's U.S. tax code changes had a positive impact on the economy.*

Tax reform was a notable economic development in 2018, with changes to the codes for both corporate taxes and individual income taxes receiving substantial coverage in the mainstream press. We now have evidence confirming that these tax code changes did have a positive impact on the economy, extending the Phase B, Accelerating Growth, trend by approximately six months. We also have evidence that the boost from tax reform is waning; we will not likely see the same impact on the economy in 2019.

One important component of last year's tax reform received relatively little attention, even though it affected a great deal of small businesses and individuals in America. This critical piece focuses on qualified business income (QBI) deductions. A body of evidence, some of which is provided below, shows that while the QBI deduction component of 2018's tax reform package likely did stimulate small business optimism and investment, primarily in the latter part of last year, its effects are already fading and it is unlikely to yield similar levels of investment activity in 2019.

This aligns with expectations of a general macroeconomic slowdown over the course of this year, and the likelihood of a mild downturn in the US industrial economy in the first half of 2020. It underscores the need for small businesses to shift their mindsets and their actions to reflect the reality of being on the back side of the business cycle.

QBI is income derived from a pass-through entity, which is a business that "passes through" all or most of its income to the owner, who then claims it as income on his or her personal tax return. QBI includes business income after accounting for W-2 wages paid to employees, owner-guaranteed payments related to business activity, and other forms of business-related expenses incurred by the company owner.

Firms that qualify for the deduction include all pass-through businesses with incomes below $157,500 for those who file taxes as individuals, or $315,000 for those who file jointly. Many sole proprietorships, S corporations, and partnerships, as well as some trusts and estates, meet these criteria. Business owners are subject to restricted or lesser benefits from the deduction when their incomes exceed the $157,500/$315,000 threshold.

The QBI deduction is calculated as the lesser of:

1. 20% of a business' qualified business income, plus 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnerships (PTPs) income.
2. 20% of taxable income minus net capital gains (net capital gains are defined differently for the purposes of the QBI; it includes dividends and investment income).

These amounts are written off from the business income that must be reported by the owner/taxpayer before any other deductions. Although information that directly reflects the effects of the QBI deduction on small business investment is limited, data that measures overall planned small business investment and actual small business investment is readily available for analysis.

There are two primary datasets that illustrate small business investment intentions and actual activity: Small Business Capital Expenditure Plans and Small Business Actual Capital Expenditures. US Small Business Capital Expenditure Plans reached a cyclical peak in November of 2017, with a year-over-year growth rate of 10.9%. This highlights the optimism for the future exhibited by small businesses during that time. For the following nine months, the year-over-year comparison declined, reaching a low of 2.4% by August 2018 and mirroring waning small business optimism.

However, starting in September and lasting through the end of last year, capital expenditure plans by small businesses accelerated, partially reflecting the positive momentum associated with the boost from the QBI deduction. That momentum did not carry over into this year, with the year-over-year growth rate generally slowing through April of 2019, the latest month with available data. This indicates waning small business capital investment plans during the first four months of this year.

US Small Business Actual Capital Expenditures data, which measures the percentage of US small businesses making actual capital expenditures during the last six months, illustrates that the slowdown in investment intent has already translated to a decline in actual investment. The raw data for this series peaked at 61.0% in December 2018 and has since declined to 58.0% as of this April. When assessed on a rate-of-change basis, the April figure is 4.9% lower than the April 2018 figure, showing that fewer small businesses are pulling the trigger on capital investments so far this year.

Both the recent slowdown in Small Business Capital Expenditure Plans and the decline in the Actual Capital Expenditures data illustrate what some economists have been saying for quite some time: The downside pressure on the economy is real, it will likely persist into 2020, and companies large and small need to act accordingly.

READERS' FORUM

Tensions are rising again with China over trade. What's going on and what does this mean for my business?

Negotiations between the US and China over a possible trade deal appear to have suffered a setback in recent weeks. The US has since raised tariffs to 25% from 10% on about $300 billion worth of imports. China retaliated with tariffs of their own, and the US is now considering additional tariffs to retaliate for the retaliation. US businesses and consumers will see an inflationary effect from this trade war. However, this may be masked somewhat by the current slowing rise in inflation. US companies selling into China may find that their prices are less competitive than those of non-US firms. This could lead Chinese firms to switch from US goods to lower-cost alternatives. Fortunately, the two sides have not broken off communications, and further discussions are planned for June. A trade war harms both countries, incentivizing both governments to make a deal. In the event that no deal is reached, firms should plan for more expensive imports and less-competitive exports for at least the near term.

INDUSTRY SNAPSHOTS

Arrows indicate 12-month moving total/average direction

Retail Sales

- Up 4.2% during 12-months through March
- Retail sales will rise at a slowing pace into mid-2020
- Slowing inflation will likely pressure retail sales during the next quarters

Rotary Rig

- Count up 11.4% from one year ago
- Rig count has been relatively flat in recent months
- Oil rotary rig count unlikely to rise much more

Wholesale Trade

- Wholesale trade up 6.1% year-over-year
- Both durable goods (up 6.5%) and nondurable goods (up 5.7%) rising at slowing rates
- Durable goods will likely avoid recession during this cycle

Capital Goods

- Nondefense capital goods new orders up 5.2% from year-ago
- New orders likely to decline in latter half of 2019 into 2020
- Defense capital goods new orders up 19.5%
- Defense spending likely to be flat in second half of 2019

Auto Production

- N. America light vehicle production down 0.2% year-over-year
- Production likely to decline latter half of 2019 & into early 2020
- US heavy-duty truck production up 16.0%; unlikely to rise much further

Nonresidential Construction

- Nonresidential construction up 5.4% from year-ago level
- Nonresidential construction growing at an accelerating pace
- Warehouse and manufacturing construction is an area of opportunity in 2019

Manufacturing

- Total manufacturing production up 2.7% from a year ago
- Production transitioning to slowing growth
- Manufacturing sector likely to contract mildly in the latter half of this year and in early 2020

Residential construction

- Down 0.3% year over year
- Construction recently transitioned to recessionary trend
- Both single-unit housing starts and multi-unit housing starts currently declining, but single-unit expected to recover later in 2019

Aerospace & Defense Outlook

The defense sector has been an area of opportunity in recent months. US defense capital goods new orders during the 12-months through March were up 19.5% on a year-over-year basis. New orders tentatively transitioned to the back side of the business cycle and will likely be relatively flat during the latter half of this year. Exercise caution and budget for slower growth rates to persist throughout this year. However, it is not expected that this industry will enter a recession during this business cycle. Spending is expected to rise at a double-digit once again rate in 2020. Ensure that you are prepared to take advantage of the next rising trend.

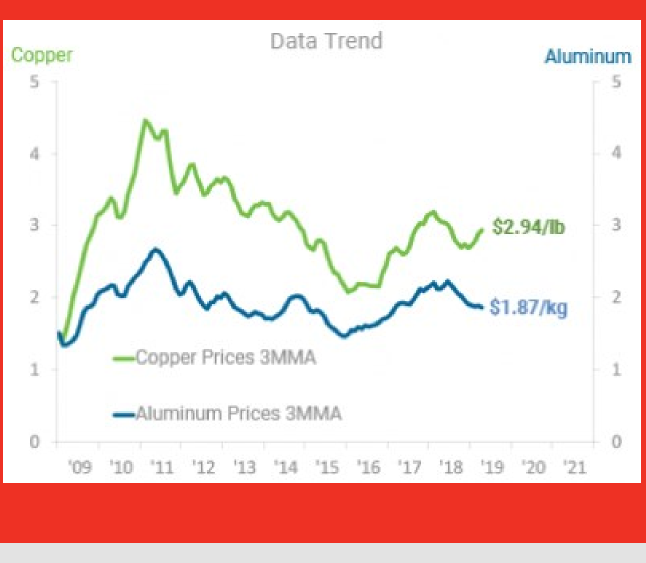
The defense sector has benefited over the last several quarters from rapid growth in the aircraft segment. US defense aircraft and parts new orders were up 34.9% from the year-ago level. However, it looks like this segment will transition to the back side of the business cycle imminently. Firms should plan for the pace of growth for new orders to slow through much of this year.

Meanwhile, the nondefense aircraft sector has dramatically underperformed the defense sector in recent months. US nondefense aircraft and parts new orders were down 9.4% from one year ago. The Boeing Corporation stock price, which typically leads new orders by about three quarters, slowed in its pace of rise through much of 2018 and in early 2019, an indication that nondefense aircraft and parts new orders will likely face further downward movement into at least late this year. The pace of rise for the Boeing stock price has ticked up in recent months; if this trend persists, it would bode well for new orders in 2020. However, escalating trade tensions between the US and China pose a risk to the aerospace industry at large, and recent safety concerns with the Boeing 737 Max will place further pressure on Boeing.

Copper & Aluminum Prices

US copper futures prices during the three months through April averaged $2.94 per pound, down 4.0% from the same period one year ago. Although prices are below the year-ago level, they have risen in recent months. However, prices will likely generally decline this year as slowing growth in the world economy limits demand for the metal. With further decline likely, avoid locking in costs at today's price.

US aluminum futures prices during the three months through April averaged $1.87 per kilogram, down 12.2% from a year ago. Prices have generally declined since the middle of last year. The US has reached an agreement with Canada and Mexico to lift metal tariffs, which may push down the cost of aluminum even further. Budget for prices to fall.

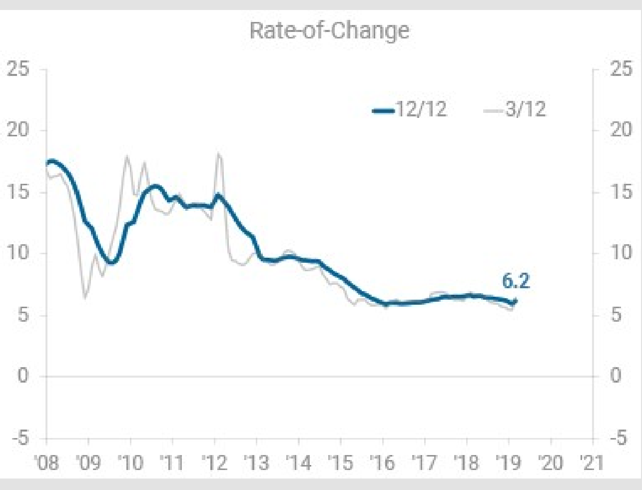


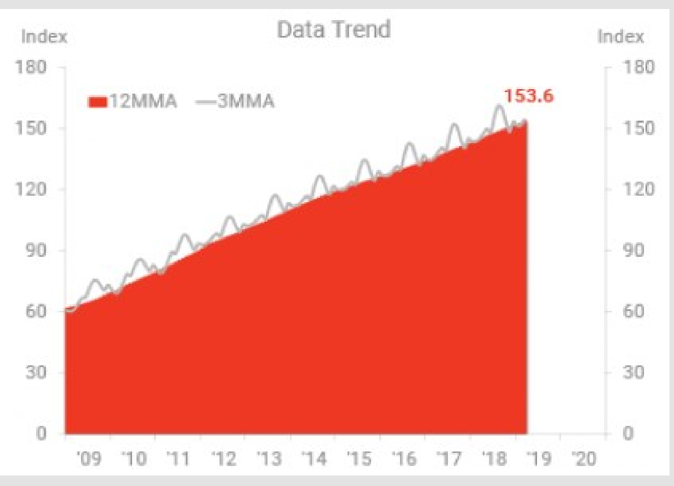
GLOBAL DEEP-DIVE

China Industrial Production

Chinese industrial production during the 12-months ending in February was up 6.2% from the same period one year ago. Production is rising at a slowing pace. The China Purchasing Managers Index for Manufacturing is signaling that the pace of growth for production will likely slow through at least the remainder of this year.

Trade tensions are escalating between the US and China at a time when the Chinese economy is already facing headwinds. President Trump recently raised tariffs on about $300 billion worth of imports from China and has threatened to implement additional tariffs in retaliation to China's implementing tariffs of their own. China exports have generally declined in recent months. A prolonged trade war would likely exacerbate this trend to the detriment of the economy. China industrial production, as depicted below, is unlikely to enter a recession during this business cycle; however, the pace of growth will likely feel quite slow compared to recent years, particularly if tariffs remain. The two countries may come to an agreement on conditions for a trade deal, but firms buying from China should be prepared to pay higher prices in at least the short term. Firms operating in China should be prepared for US demand for their goods to be impacted by tariffs.





Global Economic Outlook

	12-month Moving Avg	Chg. Over Prev. 12 Months	2019 YTD	2020 Projected	2021 Projected
Canada Industrial Production		2.1	0.5	0.2	2.8
Mexico Industrial Production Index		-0.1	-0.4	1.3	0.3
Brazil Manufacturing and Mining Industrial Production Index		-0.1	-1.4	1.9	1.1
Western Europe Industrial Production Index		0.4	-1.3	1.4	1.0
Eastern Europe Industrial Production Index		3.8	-1.3	4.3	3.2
India Industrial Production Index		4.1	3.3	5.5	4.5
China Industrial Production Index		6.2	5.2	6.1	5.9

Note: Forecast color represents market projection at end of year.
Accelerating growth Recovery Slowing growth Recession