September 9, 2019, 10:00 AM GMT+2

Recession Already Grips Corners of U.S., Menacing Trump's 2020 Bid

The president's trade wars are creating a scenario similar to 2016.

▲ The shop floor at Kuhn North America in Brodhead, Wis. PHOTOGRAPHER: LYNDON FRENCH FOR BLOOMBERG BUSINESSWEEK

By Shawn Donnan

The moment usually comes during Greg Petras's commute through the rolling hills and cornfields of southern Wisconsin. Somewhere between his home near Madison and the factory he runs on the edge of the small town of Brodhead, the news will turn to the trade wars and Donald Trump will again claim that China is bearing the cost of his tariffs. That's when Petras loses it.

"It's just an outright lie, and he knows it," says Petras, president of Kuhn North America, which employs some 600 people at its farm-equipment factory in Wisconsin. For Kuhn, Trump's trade war has produced a toxic mix of rising costs and falling revenues. “You’re slamming your fist on the steering wheel and saying ‘Why would you tell people this?’”

About 250 Kuhn employees spent the Labor Day holiday caught in a two-week furlough, and they’re facing another in early October. A shrinking order book means Kuhn is cutting costs and slashing production as Petras and his managers peer out at a U.S. economy that looks far bleaker from the swing-state heartland than it does in either the White House or on Wall Street.

The company’s circus-themed summer picnic survived but weekend shifts are gone. A plant that just four years ago was humming along to a record $400 million in sales together with a sister plant in Kansas is running at 50% capacity. The five-year-old, $11 million paint shop that coats the company’s manure spreaders and livestock feeders in a distinctive “Kuhn Red” is at 39% capacity. Plans for a new $4 million research and development building are on hold. “We’ll do it someday,” Petras says. “We just need things to be going in a better direction.”

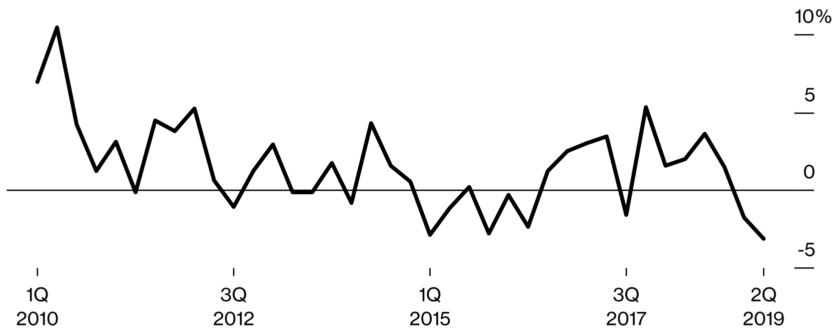
And there’s the rub. For all the debate on whether the U.S. is headed for a recession there’s plenty of evidence that corners of the economy—such as the one Petras and his employees inhabit—may already have tumbled into one.

After two boom years the picture has changed for America’s factories. Battered by rising uncertainty and the damper it has put on capital expenditures, slowing export markets, a stronger dollar, and higher input costs due to tariffs, U.S. manufacturers are making less than they did a year ago.

A widely watched index of manufacturing activity compiled by the Institute for Supply Management showed a contraction in August—the first since 2016. The Sept. 3 data release sent U.S. stock prices and bond yields tumbling as it confirmed a worrying trend that became visible over the summer, when Federal Reserve data showed factory output falling for a second consecutive quarter.

U.S. Manufacturing Activity

Seasonally adjusted*



Data: Federal Reserve

*Quarterly percentage changes are at annual rates

The surge in industrial jobs seen in the first two years of the Trump presidency has also gone into reverse in some parts of the country. Nationally, the U.S. has added 44,000 manufacturing jobs so far this year, according to data released on Friday. But that’s way down from the 170,000 added in the same period last year.

In 22 states—including electorally important ones like Wisconsin and Pennsylvania—the number of people working in factories actually fell in the first seven months of this year, according to figures compiled by the Economic Innovation Group, a think tank.

This isn’t what Trump promised. From his trade policy to tax cuts and deregulation, his grand economic vow was to bring factories home. By unraveling trade deals such as Nafta, taking on

China, and deploying tariffs like economic cruise missiles, Trump's "America First" agenda was supposed to boost growth in an iconic sector of the economy.

The attack on trade and globalization that Trump launched in 2016 always had a political calculus, and this helped him win a narrow victory in industrial swing states like Wisconsin. But as Trump bids for a second term there are signs he may have shot his own manufacturing recovery in the foot and undermined his own best argument—a strong economy—for reelection.

Trump bristles at the idea, portraying his trade war against China as a necessary fight against a rising economic rival. "To me, this is much more important than the economy," Trump told reporters on Sept. 4. "Somebody had to do this."

▲ Kuhn's plants are running at 50% capacity. PHOTOGRAPHER: LYNDON FRENCH FOR BLOOMBERG BUSINESSWEEK

The president has lashed out at businesses that blame tariffs for their woes, calling them "badly run and weak," and threatened to force American companies to abandon China. His advisers argue that the blame for any slowdown rests with a Federal Reserve that last year hiked interest rates too quickly and a strong dollar that makes U.S. exports less competitive. Trump and his allies also point to gains in manufacturing employment during his presidency. By the end of August of this year the U.S. had added 485,000 factory jobs since Trump took office, according to Bureau of Labor Statistics data.

The inescapable irony is that Trump's trade wars have helped create a scenario similar to one that helped get him elected in 2016. As a candidate, Trump benefited from the grinding and uneven recovery from the last recession. He also got a boost from a manufacturing slowdown that struck the Rust Belt just as he hit the stump promising a new era of protectionism.

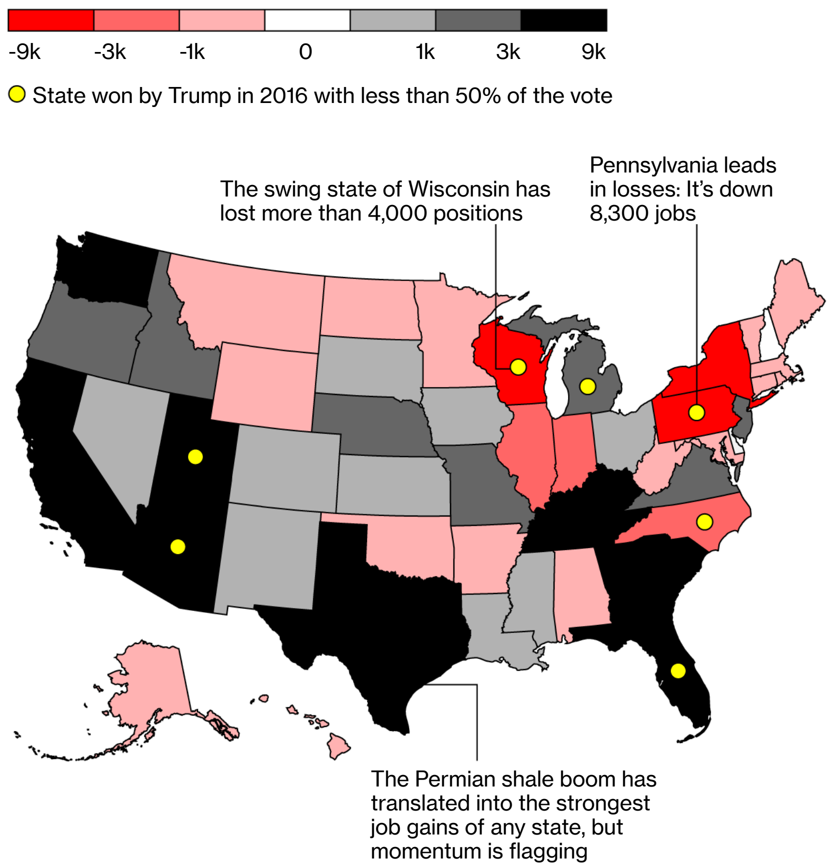
The last time the U.S. logged two consecutive contractions in quarterly industrial production before this year was the first half of 2016. The country lost almost 30,000 manufacturing jobs that year as a collapse in oil prices hit the energy sector and filtered through manufacturing. Industrial regions such as western Pennsylvania saw a slowdown in shale oil projects and in sectors supplying them, such as steel. Yet none of those 2016 quarters saw as large a slump as the 3.1% fall in output recorded in the second quarter of this year.

Nationally, the U.S. has not yet seen a collapse in factory jobs. But in politics, timing and geography matter. Almost all of the gains in manufacturing employment came in the first two years of Trump's presidency, and things have gone into reverse in swing states like Pennsylvania, which lost more than 8,000 manufacturing jobs in the first seven months of this year.

Trump is also more exposed politically to a manufacturing downturn than any Democratic rival. Nationally, manufacturing accounted for almost 12% of the jobs in counties that voted for Trump in 2016 vs. less than 7% in those that supported Hillary Clinton, says Mark Muro, a senior fellow at the Brookings Institution. In battleground states the divergence is starker, with factory jobs accounting for more than 21% of employment in Trump counties. "This is the one thing he was going to deliver. And Democrats are not vulnerable at all because if things go south they are not responsible at all," Muro says.

Manufacturing Jobs

Change in manufacturing jobs, January 2019 to July 2019



Data: Bureau of Labor Statistics, Federal Election Commission

The trade wars have helped flip one vote. Petras, a 56-year-old lifelong Republican, says he had reservations but voted for Trump in 2016. "I defaulted to the Republican ticket thinking pro-business," he says. But he won't in 2020. Trump has turned him into an independent, he says, and he's now expecting to vote for a Democrat.

Ask purchasing manager Jim Paum how the economy looks from his office inside Kuhn's factory and you get a bleak reply. In recent months he has fielded a growing number of cold calls from fabricators offering their services, a sign that many factories have spare capacity and are chasing work. It's his own leading indicator. "You can tell the health of the economy from these phone calls," Paum says. "For the most part it's not as healthy as Wall Street thinks."

Steel prices, which surged last year after Trump imposed a 25% tariff on all imports, have come down as demand has fallen and the administration has exempted imports from Canada and Mexico. But Kuhn is still digesting the impact. In the 12 months through July, it paid $2.5 million more for steel than the year before, according to Petras, or 1% of the $250 million in sales he expects this year. The company will also pay more than $1 million in tariffs this year on about 100 different parts that it buys from outside suppliers. The bill on one type of ball bearing from China alone was $138,000, he says.

As costs rise Kuhn is also being squeezed by falling demand from an agricultural sector battered by the loss of China as an export market. The hit to commodity prices from the sudden collapse of Chinese buying came as markets were already absorbing a glut in supply of everything from corn to soybeans that grew out of the vigorous planting encouraged by high prices in the years before.

The Trump administration has offered aid to farmers. But a summer of escalation in the China trade wars has only made things worse, Petras says. "There's more uncertainty, not less uncertainty," he says. "It's not a good economy at all."

Kuhn isn't alone in feeling the effects of an agricultural downturn. John Deere, its far bigger competitor, said in May that it would reduce production in response to sagging sales. But the impact of the trade wars on industrial America goes far beyond companies catering to farmers.

At Cummins, the Indiana-based diesel engine maker, executives are responding to downturns in the U.S. and Chinese truck markets, the world's two largest. "We know that 12 months from now our sales will be significantly lower than they are now in a couple of our really important key markets," says Tom Linebarger, Cummins' chairman and chief executive officer.

That hasn't yet translated into layoffs. But Cummins is already dialing back production and looking at other ways to trim spending, in part to offset higher costs resulting from Trump's tariffs. The company expects to spend more than $150 million on tariffs this year, or more than twice the $70 million it expects to save as a result of a cut in the corporate tax rate passed by a Republican-controlled Congress in 2017, according to Linebarger.

Tariffs aimed at China have become a "gigantic tax over the U.S. economy," he says. While Cummins is looking at sourcing parts from other countries to reduce the bill, Linebarger dismisses the idea pushed by Trump that it could simply pull out of China, where it both makes and sells 40% of its engines.

Cummins began selling engines in China in the 1980s and has spent decades building up its presence there as part of a strategy of international expansion that Linebarger says has made the company more resilient. In 2001, the year China joined the World Trade Organization, Cummins had $5.7 billion in sales and operated at a loss. In 2018 it recorded $24 billion in sales and a healthy profit, thanks in no small part to China.

If China is often viewed as the bogeyman that stole America's factories, the current reality is that many U.S.-based manufacturers' fortunes are more linked to China, whether as a market or as a supplier, than Trump or his hawks are prepared to admit.

▲ Follow the Trump Administration's Every Move.

At Gradall, an Ohio company that makes excavators used by municipal governments and heavy industry, business has been good this year, says CEO Mike Haberman. But he worries about what Chinese retaliatory tariffs will do to his exports to China, which now make up 6% of the company's sales.

Add 25% to the $400,000 to $500,000 price tag on an excavator and it means losing business to a German competitor not subject to the same duties, which is one reason he's not adding to the ranks of his 330 employees. "If we lose $5 million of business it hurts," Haberman says.

Allan Klinge spent his summer driving back and forth from his York, Pa., factory to Washington to lobby against new tariffs on Chinese-made shipping containers, which his family-owned company customizes to create explosion-proof, temperature-controlled, and other specialized transports that sell for up to $150,000. He got a victory when the Trump administration in August struck shipping containers off a list of products subject to new tariffs, but that doesn't mean Klinge's challenges have gone away.

Klinge Corp. is paying tariffs on other imported parts and has seen the price of aluminum go up over the past year as a result of Trump's duties. Klinge, who came to York from Denmark as a six-year-old when his father and grandfather bought the business in the 1980s, is also concerned about the faltering global economy given that exports account for 80% of revenue.

"It's really hard to think in anything beyond 90-day increments," Klinge complained recently as he walked a visitor through his factory and aired his frustration at all the expansion plans he had on hold. "The biggest thing for us is the uncertainty."

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