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Great Recession of 2009 will Leave Lasting Impact on US Manufacturing Strategy and Capacity

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The economic turmoil that gripped the US and the world from the last quarter of 2008 through 2009 will leave a lasting impact on the strategies and footprint of US manufacturing – and not necessarily for the better. Trends seen before the recession appear to be accelerating.

The basic message – "heavy industry" continues to shed US capacity and go offshore, while some life – maybe even growth – will be seen by higher tech industries.

The chemicals industry offers one interesting example. Long the largest single manufacturing sector in terms of both output and exports, the chemicals industry is moving away in the US from production of basic chemicals to more specialty chemical manufacturing, which involves higher levels of both "value-added" and customization – and higher margins.

In its Q4 earnings call last week, for example, Dow Chemical said Tuesday it is aiming to shed some $2 billion worth of basic chemical factories and related assets this year as it transitions into more profitable specialty chemicals.

Part of that story though is that industries such as chemicals that were slow to offshore are now starting to make moves, as the recession and resulting drop in demand serve as a catalyst for companies to totally rethink their supply chain networks.

"Chemical makers are relocating labor-intensive operations to countries where workers are cheaper," the Wall Street Journal recently noted, as chemical companies follow the trend of electronics, apparel and other US industries before them.

"The chemical industry is leaving the United States, and it won't be back," says Peter Huntsman, CEO of Texas-based chemical giant Huntsman Corp. "When demand picks back up, they'll build new capacity overseas—in the Middle East, Singapore and China."

Huntsman itself is expanding its capacity in the Mideast and China, and now has about a third of its capacity in the US - down from more than four-fifths a decade ago.

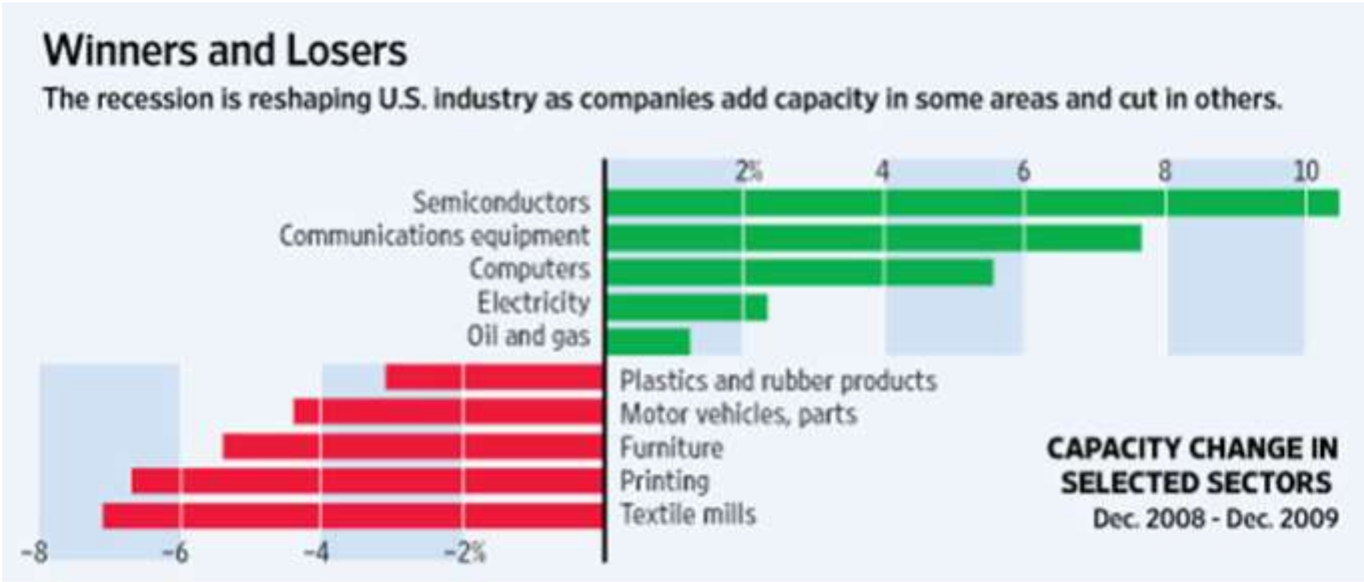
Hangover from the Bubble

Other industries, such as building materials, appliances, and automotive production, need to adjust to a "new normal" in which it will take years to once again reach unit volumes that were artificially inflated in the 2000s by loose credit that took demand to levels that were simply not sustainable.

Appliance manufacturer Whirlpool, for example, took out 5 million units of capacity in 2009, and plans to idle more capacity this year. That includes having shuttering an entire factory in Indiana last year.

After last year's dismal automotive sales, experts are saying there will be about 12 million cars sold in the US in 2010; while up from 2009, that is still way below the peak of 17 million units in 2005 – a drop of about 30%.

The US' auto production capacity dropped 4.4% in 2009, and likely



Source: Federal Reserve and the Wall Street Journal

would have been larger had US OEMs had less union contract issues to deal with.

Chemical factory capacity shrunk 1.7%. Both of these numbers represent the largest such drops since at least 1949, according to the Federal Reserve.

The unfortunate result is that many suppliers to these industries get taken out as a result of the final producer shuttering factories.

The Wall Street Journal quotes Diane Swonk, chief economist at Mesirow Financial in Chicago, as saying that "The earthquake that we felt was so big, and the aftershocks so strong, that we could easily destroy perfectly good manufacturers that are crucial in the supply chain," such as auto-parts makers that supply the entire industry. That's the great danger, and it's still a risk."

Some Bright Spots

Some sectors of high tech, such as semiconductors and computers, as well as energy production, are relative bright spots, each adding capacity in 2009 (see graphic above).

"Many companies still prefer to produce in the US, particularly if their manufacturing entails little human labor or is highly complex," the Wall Street Journal adds. As long as US brands still lead in the world, being close to the U.S.-based design centers of major chip users like computer maker Dell Inc. and consumer-electronics maker Apple Inc. also can be an advantage.

Market and supply chain dynamics, especially continuous replenishment, also mean most consumer packaged goods, food and beverage production for the US market remains here, though clearly some is moving to Mexico.

Still, the overall trend seems to be that more and more production will go offshore for products with lower value add – and that no one seems to really discuss whether this is good or bad.

How dramatically do you think the recession will reshape US production capacity? Is this smart – or right? Do you see any bright spots? Let us know your thoughts at the Feedback button below.

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