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Industry Snapshots

Arrow denotes 12-month moving total/average direction.

RETAIL SALES	Mild Rise
WHOLESALE TRADE	Flat
AUTO PRODUCTION	Mild Rise
MANUFACTURING	Mild Decline
ROTARY RIG	Steep Decline
CAPITAL GOODS	Flat
NONRESIDENTIAL CONSTRUCTION	Steep Rise
RESIDENTIAL CONSTRUCTION	Mild Rise

Steep Rise | Mild Rise | Flat | Mild Decline | Steep Decline

Macroeconomic Outlook

A resilient consumer, the distribution of government spending, and onshoring efforts have eased much of the burden of high interest rates and restrictive monetary policy. However, given recent inflation results, the Fed seems unlikely to lower interest rates in the near term. Our analysis suggests that the US macroeconomy is unlikely to escape the full weight of interest rate and monetary policy pressures unscathed. We continue to expect one quarter of US Real Gross Domestic Product (GDP) decline this year. Note that a single quarter of GDP decline within a broader rising trend is not unprecedented and happened most recently in 2014.

The industrial and business-to-business sectors on the whole have proven somewhat more resilient than we anticipated this year. However, performances vary widely across segments of the industrial economy. It will be important in the coming quarters to monitor your vertical markets as well as the broader economy to capture a full picture of where your business is headed. This month's "A Closer Look" article includes more details about divergence between markets.

Many nonresidential construction markets are beginning to make the transition to Phase C, Slowing Growth. US Total Nonresidential Construction, which typically lags the industrial sector by roughly one year, has been buoyed greatly, in large part by government investment through subsidies and grant funding. However, leading indicator signals suggest that annual growth rates for construction markets will decline in the coming quarters. The current pace of growth in construction markets is likely unsustainable over the longer term as government investment subsidies and funding run out. Keep this in mind when considering your long-term plans in the construction sector.

Just as nonresidential construction lags the industrial sector by roughly a year, residential construction leads by roughly a year. The housing market, despite some recent bumps from a rainy March and stubbornly high mortgage rates, continues to signal annual growth rate rise for the industrial sector and macroeconomy as we move into 2025. These trends, along with other leading indicator signals, bode well for recovery and rise in many markets next year.

> *"We continue to expect one quarter of US Real Gross Domestic Product (GDP) decline this year."*

Many businesses will need to prepare for rise next year. While your preparations will vary based on the market in which you operate, it will serve all business leaders well to lead with confidence. Economic uncertainty is high, as the University of Michigan's US Index of Consumer Expectations and other indicators of consumer sentiment remain weak relative to pre-pandemic levels. As a result, reassuring your workforce through transparency and expectation-setting will likely settle nerves. Continue to build and maintain a cash buffer, as investing in your business will likely be more attractive if you can avoid contending with the currently high interest rates.

Make Your Move

Make the most of any downtime this year. Determine where your bottlenecks are likely to be when business demands increase and consider investing in technology to increase efficiencies. In the manufacturing sector, it is also a good idea to schedule maintenance ahead of the anticipated rise in economic activity in 2025 and 2026.

Investor Update

The S&P 500 rose 10.2% in the first quarter of the year. Our analysis of peer cases suggests that the S&P 500 could transition to slowing growth in the next couple of months. Leading indicators and a no-recession outlook for Real GDP suggest that there are still gains to be had this year, albeit at a muted pace compared to the first quarter.

ITR Economics Long-Term View

2024	2025	2026
RECESSION	GROWTH	SLOWING GROWTH

Leading Indicator Snapshot

	2Q2024	3Q2024	4Q2024
ITR Leading Indicator™	🟢	🟢	⚪
ITR Retail Sales Leading Indicator™	🔴	🟢	🟢
US OECD Leading Indicator	🟢	🟢	🟢
US ISM PMI (Purchasing Managers Index)	🟢	🟢	🟢
US Total Industry Capacity Utilization Rate	🔴	🔴	⚪

🟢 *Denotes that the indicator signals cyclical rise for the economy in the given quarter.*

🔴 *Denotes that the indicator signals cyclical decline for the economy in the given quarter.*

⚪ *N/A*

KEY TAKEAWAYS

- The ITR Leading Indicator™ rose in March. Despite recent rise in the Indicator, elevated interest rates coupled with recent weakness seen across a collection of consumer indicators suggest there will be mild decline in US Industrial Production this year.
- The US Total Industry Capacity Utilization Rate is signaling that relatively less capacity is being used and suggests downward momentum for Industrial Production into the second half of this year.
- The ITR Retail Sales Leading Indicator™ rose in March to its highest level since 2022. Strength among middle-to-upper-income consumers has bolstered US Retail Sales despite unfavorable financing conditions; however, growth in US Retail Sales is slowing as some consumers show signs of distress, evidenced in rising credit card delinquency rates.

Industry Analysis

RETAIL SALES

- US Total Retail Sales in the 12 months through March were 2.8% above the year-ago level
- Despite high borrowing costs, Retail Sales will trend relatively flat this year, bolstered by middle-to-upper-income consumers and a still-tight labor market
- Retail Sales, a dollar-denominated series, will also benefit less from inflation in the coming quarters, as we anticipate easing pricing pressures

AUTO PRODUCTION

- Annual North America Light Vehicle Production in February was 9.2% above the year-ago level; the rate of growth is slowing
- Historically low inventories are rising at an accelerating pace, and replenishing these inventories has contributed to the rise in Production
- General plateau in the near term is being driven by high financing costs competing with pent-up demand from prior supply chain pressures

ROTARY RIG

- The average US Rotary Rig Count for the three months ending in March was 622, 18.2% below the year-ago level; the Rig Count is in a tentative recovery phase
- Strength in US Oil and Gas Production, which is in an established rising trend, may be attributed, in part, to ongoing geopolitical conflict
- However, decline in the US industrial sector typically dampens oil demand

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction in February was 20.0% above the year-ago level; the rate of growth is tentatively slowing
- Recent Fed messaging signals that rates may remain higher for longer than previously indicated by the Fed, a downside pressure on Construction
- Be mindful that government infrastructure funds are likely to be disbursed at a slower rate moving forward

WHOLESALE TRADE

- US Total Wholesale Trade in the 12 months through February was 1.7% below the year-ago level; Wholesale Trade is tentatively in recovery
- Slowing growth in the retail sector is signaling slowing demand in Wholesale Trade as consumers tighten purse strings
- Be mindful that there is a large degree of variability across the segments of Wholesale Trade; ensure you are benchmarking to your specific markets

MANUFACTURING

- US Total Manufacturing Production in the 12 months through March was 0.4% below the year-ago level
- Mild decline in the near term is likely given the previous contraction in the housing market, which leads Manufacturing by roughly three quarters
- The effects of nearshoring are mitigating some of the expected decline in the near term

CAPITAL GOODS NEW ORDERS

- US Nondefense Capital Goods New Orders (excluding aircraft) in the 12 months through February were 1.2% above the year-ago level
- Annual US Defense Capital Goods New Orders declined in February but were 5.9% above the year-ago level
- Escalating tensions abroad present further upside potential for Defense Capital Goods

TOTAL RESIDENTIAL CONSTRUCTION

- US Total Residential Construction in the 12 months through February rose to $880.1 billion, 4.2% below the year-ago level
- The Fed's recent messaging on potentially keeping rates higher for longer could place downside pressure on Construction
- However, low housing inventory and high demand suggests further upside pressure on Construction

A Closer Look: The US Economy

Winners and Losers in 2024

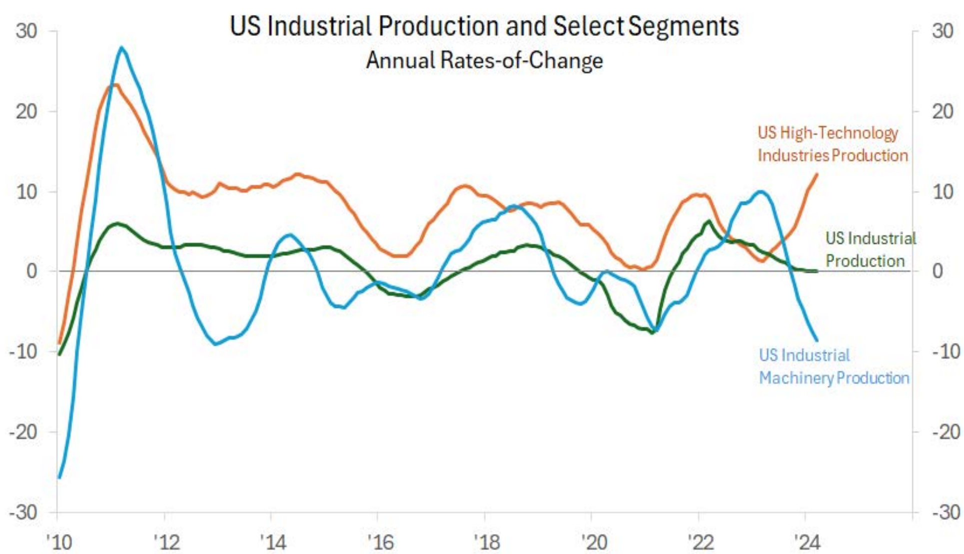
CONNOR LOKAR

What you need to know: With such a large divergence between various market segments this year, knowing which bucket your customers fall into will be crucial

It is different right now. In my 10 years with ITR, consulting with companies directly and delivering keynote presentations around the world, I have never, to my recollection, received such disparate responses when asking people how they are feeling about the economy. Usually, you will get a critical mass of folks saying the economy is generally good or generally poor, and those sentiments will typically align with the current phase of the economic cycle. However, as we break into the second quarter of 2024, it is clear that there may be a wider divergence between the winners and losers in this particular cycle than businesses are accustomed to seeing.

As things currently stand, US Industrial Production (a measure of the general state of the economy) has been slowing since a business cycle peak in early 2022 and is now clocking in at an annualized growth rate of 0.0%, quite literally on the line between growth and contraction. Meanwhile, those living in the GDP economy, particularly those in the service sector, are experiencing much higher growth. Services are accelerating. In our February Advisor™ article, we detailed the divergence between the US GDP and US Industrial Production trends. To a certain extent, divergence is common between the two; the physical goods economy tends to endure more dramatic ebbs and flows relative to the more holistic GDP. This may explain some of the perception gaps, but even within the narrowed scope of Industrial Production, we are seeing winners and losers.

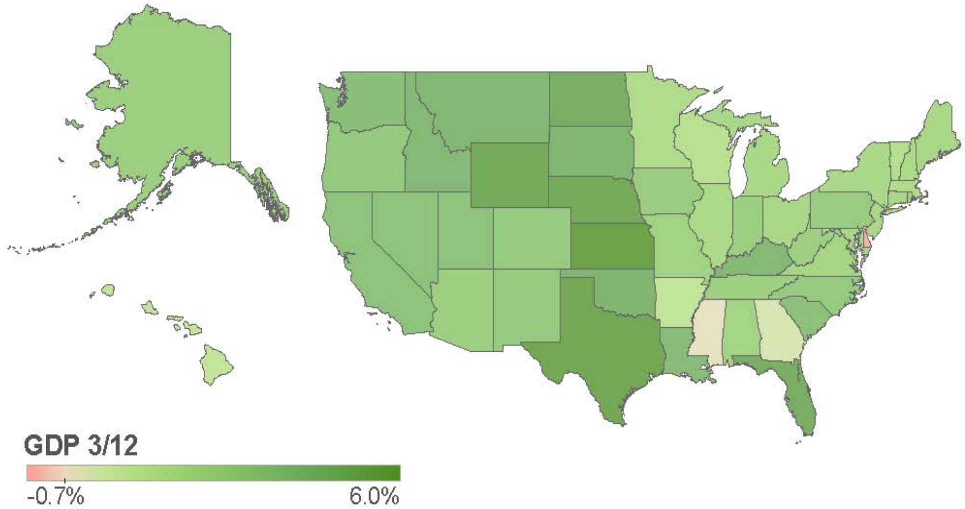
There are more instances of this than can be covered in this article, but we can look at a couple examples:



The chart shows overall US Industrial Production against two of its components. US High-Technology Industries Production is a smaller segment that encompasses only the production of computers, communications equipment, and semiconductors. US Industrial Machinery Production includes a broad array of machinery with industrial applications. High-Technology is showing prolific growth; Industrial Machinery is exhibiting a weakening recessionary trend. A market participant in the former, currently bolstered by a wave of targeted government spending such as the CHIPS and Science Act, would feel that we are in a very hot economy. Someone in the latter – with more traditional exposure to capex cycles, higher interest rates, and potentially swollen inventories – would say things are cold and getting colder.

When 2024 is in the rearview mirror, businesses that were acutely exposed to areas of the economy supported by stimulus, infrastructure spending, or other positive market factors will appropriately grade it as a hot year. Those with more traditionally cyclical markets will grade it as cold. Those in the middle, with a healthfully diversified mixture, will likely feel that the year was just right, with mild and manageable growth. What is important is that you are managing your business and pulling the appropriate levers according to what the reality is for you.

State-by-State: GDP



- US Real Gross Domestic Product (GDP) in the fourth quarter came in 3.1% above the year-ago level.
- Of all 50 states and Washington, D.C., only Delaware had year-over-year GDP decline.
- Regional differences were noticeable in the fourth quarter; the Central and Southwest regions grew at a faster pace than the Northeast and Mid-Atlantic regions.
- We expect GDP will generally grow at a slowing pace in 2024, aside from one quarter of decline later this year.

Readers' Forum

I read that inflation came in strong this past month. What does this mean for my business?

Jenna Allen, Economist at ITR Economics™, answers:

The inflation reading that is typically reported in the news is the Consumer Price Index (CPI), which did come in stronger than the market was anticipating in March. At 3.5% above the year-ago level, CPI was slightly above our forecast as well. Expect disinflation to persist through at least the remainder of this year.

We can expect that customers will be increasingly price-sensitive this year, so it may be best to find ways to preserve your margins other than raising prices. If you do need to raise prices, ensure that you are communicating your competitive advantages.

Recent statements from Fed Chairman Jerome Powell suggest that the stronger-than-anticipated inflation reading could be cause for the Fed to delay anticipated rate cuts. Companies can expect borrowing costs to remain elevated for most of the year. If you are looking to make capital investments, weigh the benefit of waiting for lower prices and lower interest rates against timing purchases to best align with end-market demand.

Please send questions to: questions@itreconomics.com