ITR Advisor / Volume 139 / July 2024
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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	Flat
ROTARY RIG	Steep Decline
CAPITAL GOODS	Flat
NONRESIDENTIAL CONSTRUCTION	Mild Rise
RESIDENTIAL CONSTRUCTION	Mild Rise

Steep Rise · *Mild Rise* · *Flat* · *Mild Decline* · *Steep Decline*

Macroeconomic Outlook

US Industrial Production continues to trend slightly below year-ago levels on an annual basis as overall US Real GDP growth slows. Consumer price inflation is moving in a favorable direction for the Federal Reserve and consumers. This may motivate near-term rate cuts, boding well for business-to-business spending and its expected rise in 2025. Be aware that rate cuts will likely be mild as structural constraints, such as elevated government spending and a worker shortage, limit how much the Fed will likely cut rates.

Fed messaging prior to the release of June data for the Consumer Price Index (CPI) was somewhat dovish, citing a mildly softening job market as support for an interest rate cut; the US Unemployment Rate rose to a seasonally adjusted 4.1% in June, which is historically low but up 0.7 percentage points from its low point this business cycle. The June release of CPI data lends weight to this dovish sentiment, as year-over-year inflation fell to 3.0%, down from its May reading of 3.3% but still above the Fed target of 2.0%.

The shelter component of the CPI is a major contributor to persistent inflation. While high interest rates are inhibiting purchases of goods and services, their impact on the shelter component is less clear. Many homeowners with low fixed interest rates are deterred from listing their house for sale because of high rates, and the limited supply of homes is pushing up on shelter costs. Stripped of this component, inflation as of June was 1.8%, a rate the Fed would find more favorable for future rate-cutting.

Consumer spending has been relatively resilient, but not immune, to the effects of higher interest rates. Even in an unfavorable interest rate environment, US Total Retail Sales rise continues, even adjusted for inflation. Our analysis suggests middle-to-upper-income consumers are driving much of the rise in Retail Sales and the overall macroeconomy, while lower-income consumers have been hit harder by inflation and elevated interest rates. On net, we expect slowing growth for Retail Sales in the coming quarters.

> *"The shelter component of the CPI is a major contributor to persistent inflation."*

Business-to-business spending on an annual basis has trended relatively flat in recent months; we expect flat-to-mild near-term decline. Backlogs are diminishing, as indicated by US Nondefense Capital Goods Unfilled Orders (excluding aircraft), which are below year-ago levels. Producers are likely facing softer demand at this time in the business cycle, industry depending, though rise will resume in 2025.

Our system of leading indicators is generally rising, albeit weakly, supporting our forecast for a slightly stronger economy in 2025, particularly in the latter half. If you remain concerned about ongoing weakness in industrial markets, look to implement efficiencies in your business rather than cut your workforce, as we expect recovery soon amid a persistently tight labor market in the coming years.

onDemand

Make Your Move

Economic softness for the remainder of this year presents you with an opportunity to reevaluate your competitive advantages and hone your strategies for maximizing the business cycle upturn we are forecasting for 2025 and the first half of 2026. Identify your current bottlenecks so they are addressed prior to this macroeconomic upswing.

Investor Update

The S&P 500 posted a second consecutive month of better-than-normal gains in June. Historical peer cases indicate there is a 69% probability the market can hold onto its gains or build upon them during the second half of this year. We cannot rule out the possibility of some downside potential the deeper we get into the back half of the year or especially as we head into 2025, particularly if the Fed is slow to reduce rates.

ITR Economics Long-Term View

2024	2025	2026
RETAIL GROWTH; INDUSTRIAL FLAT	GROWTH	SLOWING GROWTH

Leading Indicator Snapshot

	3Q2024	4Q2024	1Q2025
ITR Leading Indicator™	Rise (green)	Rise (green)	N/A (gray)
ITR Retail Sales Leading Indicator™	Rise (green)	Rise (green)	Rise (green)
US OECD Leading Indicator	Rise (green)	Rise (green)	Rise (green)
US ISM PMI (Purchasing Managers Index)	Rise (green)	Rise (green)	Rise (green)
US Total Industry Capacity Utilization Rate	Decline (red)	Decline (red)	N/A (gray)

Denotes that the indicator signals cyclical rise for the economy in the given quarter. (green)
Denotes that the indicator signals cyclical decline for the economy in the given quarter. (red)
N/A (gray)

KEY TAKEAWAYS

- Many of our leading indicators are flashing green and signaling a stronger economy in 2025, though the strength of rise is weak and we still are seeing some signs of stress for the economy, which will likely persist through the end of this year.
- While Retail Sales are still rising, we anticipate that their rate of rise will be somewhat muted in the coming quarters. Retail Sales will not decline, but they are not likely to exhibit growth rates similar to those seen from 2020 to 2022, as we have moved into a different consumer environment, given lower savings rates and increased loan delinquency rates.
- We have yet to see well-defined rise in the US Total Industry Capacity Utilization Rate, unlike the performance of other leading indicators, highlighting the probability of a softening manufacturing sector in the near term.

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Industry Analysis

RETAIL SALES

- US Total Retail Sales in the 12 months through June were 3.1% above the year-ago level; growth is slowing
- Components of Retail Sales are trending differently due in part to varying pricing; growth rates are highest, though slowing, for restaurant and bar sales as well as non-store sales, while gas station sales are below year-ago levels
- Overall, growth will generally slow in the coming quarters

WHOLESALE TRADE

- US Total Wholesale Trade in the 12 months through May ticked up but was 0.3% below the year-ago level
- Prior rise in the US OECD Leading Indicator, which leads Wholesale Trade by about 10 months, supports continued recovery and rise in Wholesale Trade in the coming quarters
- Know your market; the sales-to-inventory ratio for durable goods is very low, while the ratio for nondurable goods is rising briskly

AUTO PRODUCTION

- Annual North America Light Vehicle Production in May was 6.5% above the year-ago level; growth is slowing
- Second quarter US Light Vehicles Retail Sales were 0.5% below the second quarter of last year, indicating weakened demand
- Rising auto loan delinquencies portend probable further weakness ahead

MANUFACTURING

- US Total Manufacturing Production in the 12 months through June was 0.4% below the year-ago level
- The US Manufacturing Capacity Utilization Rate is slightly below year-ago levels on a monthly basis, supporting an outlook for flat to mild decline in at least the near term
- Mild general rise in a number of key manufacturing leading indicators signals slightly higher manufacturing activity is likely in 2025

ROTARY RIG

- The average US Rotary Rig Count in the second quarter fell to 602 rigs, 16.6% below the year-ago level
- Rise in leading indicators for the global economy and, accordingly, oil demand signal drilling activity will likely be higher next year
- In the near term, however, economic weakness in countries such as China may place downside pressure on demand and, in turn, on the Rig Count

CAPITAL GOODS NEW ORDERS

- US Nondefense Capital Goods New Orders (excluding aircraft) in the 12 months through May were 0.9% above the year-ago level
- Given elevated financing costs, businesses are likely forgoing larger investments until rates are cut
- US Defense Capital Goods New Orders in the 12 months through May were 6.9% below the year-ago level

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction in May was 13.7% above the year-ago level
- Mild deflation in US New Nonresidential Construction Producer Prices, coupled with the lagged effects of more muted economic growth, will weigh on Construction spending in the coming quarters
- Sectors benefiting from infrastructure funding are growing robustly, but consider the unsustainability of this growth rate in planning

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction rose in May and was 1.2% above the year-ago level
- The single-family component is accelerating in its ascent and accounts for a larger share of the total than the multi-family construction component
- US Multi-Family Construction is in nascent decline, with further decline probable given that US Multi-Family Housing Starts are down 30.5% year over year

A Closer Look: The US Economy

A Look Into the Housing Market

JOHN OLSON

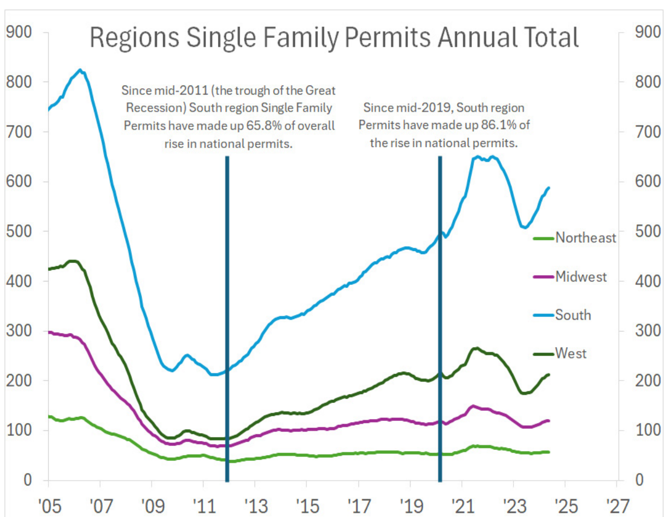
What you need to know: Single-Unit Housing is likely to move slightly lower late this year and into early 2025; the South dominates the national trend

THE NATIONAL PICTURE

Currently on the cusp of a slowing growth trend, US Single-Unit Housing Starts are expected to generally flatten and then move slightly lower into early 2025. With mortgage rates hovering around 7%, some would-be homebuyers remain stuck with "golden handcuffs" – their existing mortgage rates are often at or below 4%. Our analysis suggests the additional mortgage burden of purchasing a new home can be cost-prohibitive, with the average mortgage payment for a newly purchased home accounting for 47.2% of the median income in the US, more than ten percentage points above the 25-year average of 36.6%. Even if they can afford it, many homeowners are opting to wait for rates to decline before moving. While homebuyers and builders alike may see some respite from high rates in the form of a Federal Reserve interest rate cut later this year, significant decline is unlikely in the near term, meaning the low level of activity in the single-family resale market is likely to persist. This has led to a rise in housing prices as the relatively few homeowners who are selling look to make enough to cover anticipated higher costs.

REGIONAL DIFFERENCES

Our analysis suggests trends in the housing market vary significantly between regions. In fact, the national figure is dominated by just a handful of states. The chart below shows the annual US Single Unit Housing Permits totals for each of the four major regions since around the beginning of the Great Recession. In that time, building activity in the South has far outpaced that of other regions, making up roughly 60% of total permitting activity in the latest data. Drilling down further, just three states—Texas, Florida, and North Carolina—make up more than a third of national single-family permits.

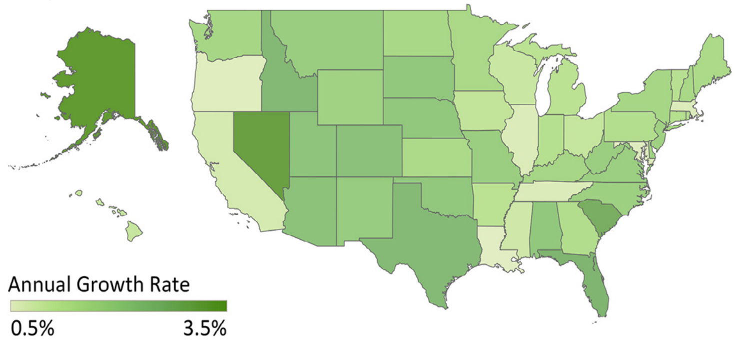


Meanwhile, permits in the Northeast region make up just 5.9% of the national total, suggesting significantly weaker overall activity in the region. These regional differences reflect similar trends in demographic shifts. For the most long-term growth potential, if feasible, consider expanding your business in locations with strong net migration trends. Those locations will not only attract new housing activity but also additional economic activity as the new residents stimulate the local economies. Cost of living, breadth and dynamism of local businesses, the regulatory environment, and desirable amenities are all considerations. Reach out to us if you need help identifying the most attractive areas.

TAKEAWAYS

The housing market is a leading sector of the economy, as trends in US Single-Unit Housing Starts generally precede trends in US Industrial Production by roughly three quarters. As a result, even if your business does not operate in the housing market, these trends are pertinent to your future planning. Although we do not expect the industrial sector to match trends in the housing market exactly during this business cycle, we expect an upturn in 2025 manufacturing activity. Additionally, in part because of the aforementioned golden handcuff effect, those who remain in their homes likely have additional spending money given their lower housing costs. This factor contributes to our expectations for a non-recessionary scenario for US Total Retail Sales and US Real Gross Domestic Product.

State-by-State: Employment



- US Private Sector Employment in the 12 months through June totaled 134.3 million workers, 1.7% higher than the year-ago level; growth is slowing.
- Employment gains continue to track well with demographic trends; six of the ten highest annual growth rate states—Arizona, Colorado, Florida, Idaho, South Carolina, and Texas—were in the top ten states of the 2023 U-Haul Growth Index, which measures migration trends.
- Similarly, five of the ten lowest annual growth rate states—California, Illinois, Louisiana, Maryland, and Massachusetts—were in the bottom ten of the U-Haul Growth Index.
- We expect national Employment growth will slow into the middle of next year as the labor market experiences the effects of monetary tightening in typically delayed fashion; however, the aging workforce will keep the labor market relatively tight.

Readers' Forum

I keep reading about how industrial sector activity is flat, but my business is contracting. Am I doing something wrong?

John Olson, Economist at ITR Economics™, answers:

The short answer: It depends! Not all markets are moving in the exact same direction. This business cycle, we are noticing some especially stark differences, given the push and pull of elevated government spending amid high interest rates, demographic shifts post-COVID, geopolitical conflicts, reshoring, and more. Overall, US Industrial Production is trending relatively flat, but we are seeing contraction in some segments and markets. Notable markets below year-ago levels include US Industrial Machinery New Orders (down 6.3% – this segment includes machinery for woodworking, plastics, rubber, paper, textiles, food, and more), US Metalworking Machinery New Orders (down 1.6%), and US Defense Capital Goods New Orders (down 6.9%). If your business operates in any of these markets, it would not be unusual for your sales to be below year-ago levels at this point. However, if your business is in consumer services and your sales are contracting, you may need to rethink your sales strategy, as that sector is up 6.8% year over year. In this quickly changing business cycle, it is especially important to equip yourself with market intelligence that will help you properly benchmark your business.

Please send questions to: questions@itreconomics.com

