Industry Snapshots

Arrow denotes 12-month moving total/average direction.

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

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

Macroeconomic Outlook

The global and domestic economic landscapes have changed greatly over the past two years, from near total shutdowns in April of 2020 to current record levels of Real Gross Domestic Product (GDP), as well as record-high business-to-business and consumer spending. As such, the problems faced by businesses today are near polar opposites of those faced two years ago. Instead of total economic shutdown, companies are contending with more demand than they can accommodate. Instead of debating layoffs, companies are trying to find workers, as job openings are at over 10 million, near record highs. These are positive problems; they mean growth is likely ahead for your business.

Despite all the positive problems we are dealing with now, some companies are fretting about the potential for a recession in 2022 or 2023. The pace of growth for US Real GDP is slowing, as is the pace of rise for US Total Retail Sales. Meanwhile, inflation-adjusted annual Retail Sales declined in March. However, the slowing growth in the economy isn't a manifestation of broken economic fundamentals. Rather, the effects of stimulus are fading, and the economy is returning to more sustainable rates of growth after a very strong 2021. At ITR Economics, we anticipate soft landings for both US GDP and US Industrial Production, two key benchmarks for the US economy. In other words, we expect these benchmarks will avoid recession through at least 2023.

"While the broader economy and industrial sector will avoid recession through 2023, some markets may undergo mild contractionary periods."

Our expectation for a soft landing is in part underpinned by the current strength of the consumer. While high inflation is taking a bite out of consumers' spending power, built-up savings and an ability to borrow – apparent in currently low debt obligations – suggest consumers will be able to weather the storm of rising prices. We anticipate disinflation, or inflation at a slowing pace, by the second half of this year, which will offer some relief as well.

While the broader economy and industrial sector will avoid recession in 2022–2023, some markets may undergo mild contractionary periods. Ensure you are tracking growth rates for your own business so that you are not caught off guard when a period of slowing growth takes hold for you.

onDemand

Make Your Move

War between Russia and Ukraine is contributing to high inflation, but the financial health of consumers and businesses is strong, enabling the US economy to expand despite the headwinds. Approach the next three years with confidence in an expanding US macroeconomy.

Investor Update

The S&P 500 rose 3.6% in March. The Index clawed back the entirety of February's 3.1% drop, but the rise was not enough to keep the first quarter from closing in the red. March's gain obscures an important shift taking place in the market. Retail investors are allocating a high percentage of their portfolios to equities, but that percentage is declining as the percentage allocated to cash is moving higher. An analysis of peer cases shows the average forward-looking return of the S&P 500 in such instances is mildly negative. Add some flattening of portions of the yield curve into the mix, and clearly some sectors of the stock market are in a vulnerable – but not fundamentally compromised – position.

ITR Economics Long-Term View

2022	2023	2024
SLOWING GROWTH	SLOWING GROWTH	GROWTH

Leading Indicator Snapshot

	2Q2022	3Q2022	4Q2022
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

- Leading indicators point to imminent business cycle decline for the US industrial sector.
- The majority of leading indicators suggest that Phase C, Slowing Growth, will extend into at least late 2022.
- The plethora of indicators in our strong leading indicator system that point to Phase C should help you act with confidence.
- We will alert you to sustainable rising trends in these indicators when they develop; this will provide you with further confirmation of the timing of the next low in the business cycle.

Industry Analysis

RETAIL SALES

- Annual Retail Sales totaled $7.6 trillion in March, up 18.7% from one year ago; this marks a tentative transition to a slowing growth trend
- While still above the pre-pandemic level, US Disposable Personal Income is edging downward due to inflation and the phaseout of COVID-era stimulus, likely contributing to slowing growth for Retail Sales this year
- Put price increases through early this year to protect margins, as consumers are likely to get more price-conscious as 2022 progresses

AUTO PRODUCTION

- Annual Production is declining from a May 2021 peak but is 3.1% above the year-ago level
- The war in Ukraine could negatively impact the semiconductor industry and, consequently, further hinder vehicle manufacturing
- Shortages are impacting prices for new vehicles, which rose 12.6% from March 2021 to March 2022, the most robust such increase in nearly 43 years

WHOLESALE TRADE

- Annual US Total Wholesale Trade during the 12 months through February came in at $7.3 trillion, up 25.9% from one year ago
- As growth in consumer and business-to-business spending slows, so too will growth in Wholesale Trade
- Though slowing growth is imminent, we expect growth rates will remain in double-digit territory for at least the majority of this year

MANUFACTURING

- Annual US Total Manufacturing in March was up 8.1% from one year ago
- Trends in a multitude of leading indicators signal an imminent transition to a slowing growth trend
- Expect growth, but at a slower pace, for at least the remainder of this year

ROTARY RIG

- The US Rotary Rig Count in the 12 months through March averaged 535 rigs, up 58.4% from one year ago
- The Rig Count is in an accelerating growth trend
- Very high oil prices and the need for an increased supply both at home and abroad – as countries shift away from Russian sources – augur for more Rig Count growth ahead

CAPITAL GOODS NEW ORDERS

- Annual US Nondefense Capital Goods New Orders are rising at an accelerating pace
- Consumer strength is benefiting the macroeconomy, including the business-to-business sector; pressures and preferences favoring domestic sourcing are also contributing to New Orders accelerating growth
- Order cancellations will likely increase later this year and especially next; ensure you have protective policies in place

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction is rising, and a transition to accelerating growth is imminent
- Leading indicators point to further rise in Construction this year
- While growth in dollar-denominated Construction may be largely attributable to pricing, macroeconomic fundamentals suggest real rise in activity is ahead

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction was at $801.0 billion in February, up 22.2% from one year ago
- We expect rising Mortgage Rates and declining US Disposable Personal Income will contribute to slowing growth in Housing Starts this year
- However, the consumer's financial strength and very low inventories of existing homes relative to demand signal rising construction ahead, just at a slower pace

A Closer Look: The US Economy

Don't Let Your Business Planning Be Swayed by Misleading Economic Figures

BY: ERIC POST

What you need to know: Doom-and-gloom headlines lack context; expect economic growth through at least 2024

The following are all facts, and they represent the sentiments espoused in the business news of late. Read them and think about how they make you feel:

1. An inverted yield curve is often a precursor to recession. The 10 year-to-2 year yield curve recently inverted.
2. The US Retail On-Highway Gas Price reached a record-high $4.32 per gallon in March.
3. Inflation is at a 40-year high.
4. There is a recession coming.

My guess is you feel uncertain about the future, or perhaps downright fearful. The good news is that while all of the above statements are indeed true, they are also misleading. Specifically, they lack critical context, and we need that context to make the best business decisions with the information available today. Let's unpack the statements one by one.

YIELD CURVE

It's true the difference between 10-Year Government Bond Yields and 2-Year Government Bond Yields went negative in early April. The following are also true:

• The 10 year-to-2 year spread is a less reliable predictor of recession than the 10 year-to-3 month spread.

• The 10 year-to-3 month spread is positive (a good sign for additional economic growth ahead), steepening (another good sign), and above the average of the last five years, the last 10 years, and the last 20 years (yet another good sign).

GASOLINE PRICES

It's true that gas prices reached record highs in March. However, the following are far more salient economic facts when it comes to answering the important question: how painful are those higher gas prices for consumers?

• US Retail Sales at Gas Stations in March represented 9.44% of overall Retail Sales.

• US Retail Sales at Gas Stations in March represented about 3.61% of US Total Personal Income on an annualized basis.

• Both percentages are higher than about 75% of historical instances for which we have data and lower than about 25% of historical instances. In other words, while gas is starting to eat up a bit more of our spending and income than average, we aren't even close to unprecedented territory when it comes to how much we are spending on gas relative to our overall consumption or overall income.

INFLATION

Inflation is indeed at a 40-year high. However, the following facts make it likely that consumers can manage the inflation and still drive the economy to new heights (albeit at a slower pace) in 2022–23:

• Income is running well above the pre-pandemic long-run trend, and the labor market is exceptionally tight.

• Not all of the consumer's surplus savings gained during the initial period of the pandemic have been depleted, signaling that savings can still be tapped to fuel consumption.

• Debt-to-income ratios are very low, suggesting consumers can still borrow funds to fuel consumption.

• Leading indicators are declining, signaling that supply chain woes and inflationary pressures will likely ease as soon as the disruption of the war and attendant sanctions are behind us.

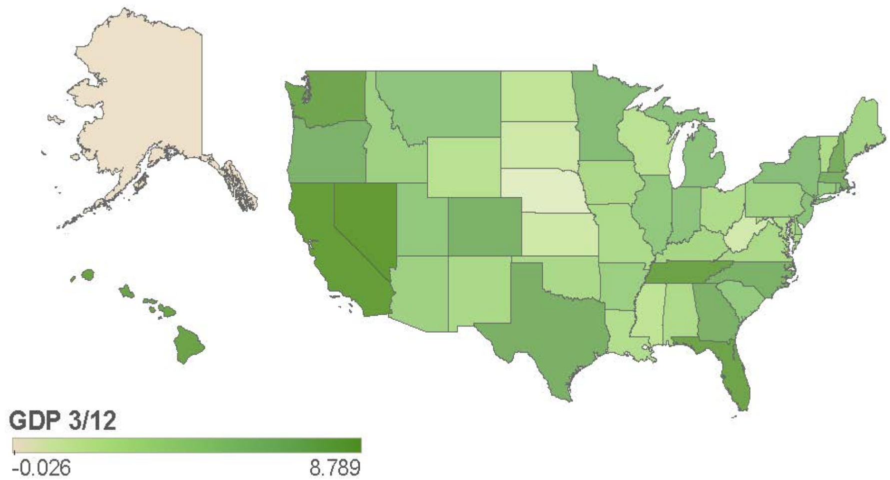
RISK OF RECESSION

There is always a recession coming. The question is when, and how big it will be. The very strong financial footing of both the US consumer and corporate America suggests the next recession isn't imminent. (See last month's topical article by ITR Economics Speaker Lauren Saidel-Baker for more on this point.) The leading indicators – which are easing but far from in freefall – confirm this probability. Rather, higher inflation and higher interest rates are precursors to the next recession that is still years away; we see the economic risks mounting substantially for 2025–26, but, until then, economic growth is the most likely outcome, and you should be planning for it.

BOTTOM LINE

Don't let misleading headlines in the public press keep you from preparing for more macroeconomic growth ahead.

State-by-State: GDP



- US Real Gross Domestic Product (GDP) grew in the fourth quarter of 2021, which came in 5.5% higher than the fourth quarter of 2020. While the GDP growth rate is easing from a June 2021 peak, we expect GDP will generally rise through the coming years.
- With the exception of Alaska, state GDPs are above year-ago levels across the board. Fourteen are rising at paces that exceed the national average. These include states in the Northeast, South, and West, suggesting that geographical location is not a key driver for GDP growth. GDP is rising fastest in California, Nevada, and Hawaii; relative to year-ago levels, GDP for these states is up 8.0%, 8.2%, and 8.8%, respectively. It is likely that the tourism industry is undergoing a bounce-back in these states as the COVID-19 shutdowns recede further into the past.
- On the opposite end of the spectrum, Alaska GDP for the fourth quarter of 2021 came in 0.03% below the fourth-quarter-of-2020 level. Several factors are contributing to GDP decline in this state, including a declining population and associated labor shortage, a struggling recovery for the tourism industry, and crude oil production at a 40-year low. It is possible that the recent spike in oil and gas prices will incentivize investors to increase crude oil production in Alaska, which could aid in GDP recovery this year.

Reader's Forum

How are sanctions against Russia going to impact the US economy?

Sara Aybar, Economist at ITR Economics™, answers:

Following the invasion of Ukraine and the implementation of early financial sanctions on Russia, US and European Union buyers became wary of purchasing from Russia. The EU, which is more dependent on Russia than the US, has since increased financial sanctions but has not banned the import of oil from Russia. Meanwhile, the US has banned the import of Russian oil.

The conflict in Ukraine has resulted in spiking energy prices in Europe and, to a lesser but still noticeable extent, the US. Consumers are facing elevated gasoline prices, but their ability to scale back their consumption of this resource is limited. Due to this inelasticity, higher gasoline prices could cut into consumers' discretionary spending – we are actively watching the situation.

Please note: At ITR Economics, we confine our analysis to the economic impact of events. That does not mean we assign primacy to the economics, and it does not diminish our personal anguish over the pain, suffering, and loss of life resulting from Russia's invasion of Ukraine.

Please send questions to:questions@itreconomics.com