Industry Snapshots

Arrow denotes 12-month moving total/average direction.

RETAIL SALES	Steep Rise
WHOLESALE TRADE	Steep Rise
AUTO PRODUCTION	Flat
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

US Industrial Production tentatively transitioned to a slowing growth trend in April, in line with our expectations. We expect slowing growth to characterize Industrial Production into the second half of next year as manufacturers work off hefty backlogs and the mining sector expands thanks to domestic and global needs for oil and gas.

Meanwhile, ominous news headlines are painting a picture of a US consumer beset by higher inflation and rising interest rates. The headwinds are real – and painful. However, the consumer's sound financial footing, while less enticing a headline, remains a key factor. Income is running well above the long-term trend, and job openings outnumber the unemployed. Further, consumers are enjoying a low debt-to-income ratio and have built-up savings to tap. In short, they can take the punch of high inflation and rising interest rates and continue to increase their spending. However, the headwinds will render economic growth decidedly less robust than what we saw in 2021.

Our forecast calls for US Real GDP to generally rise through at least 2024, but with flatness at the bottom of this cycle. Note that in this cycle, a forecast of 98.6% accuracy (our 2021 stat) would include wiggle room of a technical significance. One set of risk factors (Ukraine and Russia, supply chain woes, interest rate hikes) could tip GDP into the mildest of recessions; a different set could precipitate very slight growth at the bottom of the cycle.

> *"Focus on endeavors that will enable you to save on costs or give you the leverage to increase your prices."*

In any case, the media's recession-focused chatter obscures a more important reality: the propensity for margin compression this cycle. The stock market's year-to-date struggles – especially concentrated among growth stocks and sectors such as technology – are illustrative. High inflation, rising interest rates, and painfully high labor costs are cutting into companies' profits.

If business leaders fixate on the possibility of a mild recession this cycle, it may be to the detriment of improving efficiencies, sharpening competitive advantages, and meeting the demands of consumers and businesses with healthy balance sheets. "Profitless prosperity" – wherein top lines rise (thanks in no small part to inflation) but costs grow to compress margins and hurt profits – may be the fruit of such neglect.

Don't fall into that trap. Focus on endeavors that will enable you to save on costs or give you the leverage to increase your prices. This may require borrowing – while interest rates are up, borrowing at fixed rates is still cheap relative to historical norms. Be judicious with your spending but don't retrench completely. Look to make investments that help your profitability via cost savings, top-line expansion, or both.

Make Your Move

Retail spending and business-to-business spending are both rising. Focus on your margins, whether at the top line (via sharpening your competitive advantage to enable passing through costs) or the cost level (via fixed interest rates or efficiency improvements).

Investor Update

Stock market woes extended through April. The 8.8% decline in the S&P 500 was the sharpest March-to-April decline since 1970 and marks a cumulative decline of 13.3% over the first four months of the year – with additional decline occurring thus far in May. Despite any near-term pain, our analysis suggests longer-term gains are likely.

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

- US Industrial Production tentatively transitioned to a slowing growth trend, in line with leading indicator signals and our forecast.
- The majority of leading indicators – including the ITR Leading Indicator™, US OECD Leading Indicator, and US ISM PMI (Purchasing Managers Index) – suggest waning business cycle momentum will characterize the industrial sector through at least the end of this year.
- Leading indicators have yet to definitively signal the timing of the next business cycle low for the US industrial sector; ITR's proprietary business cycle theory suggests a low will occur in the second half of next year.

Industry Analysis

RETAIL SALES

- Annual US Total Retail Sales were at $7.7 trillion in April, up 15.7% from one year ago; growth is slowing
- Consumers have low debt relative to income, healthy savings, and healthy incomes, boding well for retail spending; however, high inflation and rising interest rates will bite into pocketbooks – expect slowing growth in dollar-denominated Retail Sales through at least 2022
- Consumers may be more price-conscious on the back side of the business cycle

AUTO PRODUCTION

- North America Light Vehicle Production during the 12 months through March totaled 12.8 million units, up 0.5% from one year ago
- While we expect Production to rise later this year as supply chain problems start to ease, the market will still face significant hurdles and trend well-below record highs in 2022
- Availability issues for both inputs and labor are downside risks for the auto industry this year

ROTARY RIG

- The US Rotary Rig Count in the three months through April averaged 662, up 60.0% from the same three months last year
- Triple-digit oil prices suggest ongoing rise in the Rig Count for at least the coming quarters
- In an effort to combat rising energy prices, the Department of the Interior is resuming leasing for oil and natural gas drilling on public lands; this could assist future rise in the Rig Count

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction rose to $816.6 billion in March, up 0.6% from one year ago, marking a transition to accelerating growth
- Annual Construction, a dollar-denominated series, is expected to generally rise into 2023, though some of that will be attributable to inflationary pressures
- The federal infrastructure package and general economic rise will contribute to growth as well

WHOLESALE TRADE

- Annual US Total Wholesale Trade during the 12 months through March totaled $7.5 trillion, up 25.8% from one year ago
- Annual Wholesale Trade will transition to a slowing growth trend imminently amid more modest growth in retail spending and industrial output
- Lower growth rates this year and next may allow your business some breathing room to implement improvements ahead of the next cyclical rising trend

MANUFACTURING

- US Total Manufacturing in the 12 months through April was up 6.6% from one year ago; growth is beginning to slow
- Despite slowing growth, consumer and business financial health remains relatively strong, and we expect ongoing Production rise through the coming quarters
- Utilize the upcoming period of slowing growth to make technological improvements and increase efficiencies

CAPITAL GOODS NEW ORDERS

- Annual US Nondefense Capital Goods New Orders in March totaled $840.5 billion, up 13.9% from one year ago
- The US Census Bureau issued its annual revision to New Orders data – annual New Orders are materially lower than previously reported, but growth rates are little-changed
- Inflation, automation-incentivizing labor challenges, and strong consumer trends suggest New Orders rise through at least 2022, though growth will slow this year

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction in the 12 months through March came in at $815.4 billion, up 22.4% from one year ago
- Mortgage rates trended above 5% in April and, given current Federal Reserve signals, are unlikely to fall; however, the still relatively tight housing market suggests ongoing, if more modest, Construction rise
- Decline in US New Homes Sold is a downside risk to the industry and our macroeconomic outlook

A Closer Look: The US Economy

Business-to-Business Spending Data Gets 10% Downgrade

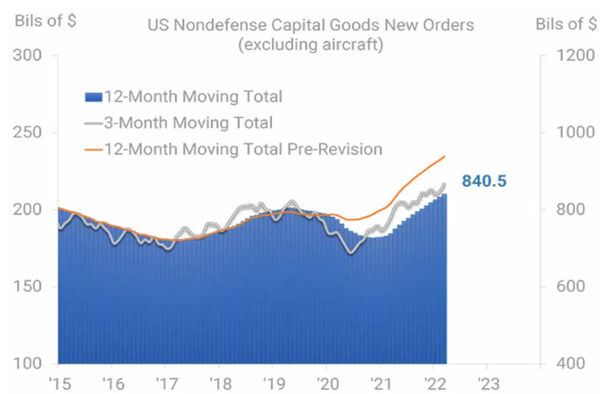
BY: JACKIE GREENE

What you need to know: Be cognizant of slowing growth but ready to leverage ongoing opportunities

US Nondefense Capital Goods New Orders (excluding aircraft) are a key measure of US business-to-business activity. The US Census Bureau issued its annual revision to New Orders data on May 13, and the revision brought about a noticeable change.

Prior to the revision, New Orders were running at a record high and had tipped into a tentative Phase C, Slowing Growth, trend.

The latest data shows that annual New Orders (the 12-month moving total) are still at a record high but roughly 10% lower than the pre-revision data had indicated. This is a significant downgrade for this dollar-denominated series. With the US Producer Price Index at a 47-year high, this downward revision to New Orders suggests less real growth was occurring in business-to-business activity than the data previously indicated. Adjusted for inflation, the New Orders annual growth rate is at 8.0%, rather than the 13.9% indicated by nominal New Orders.

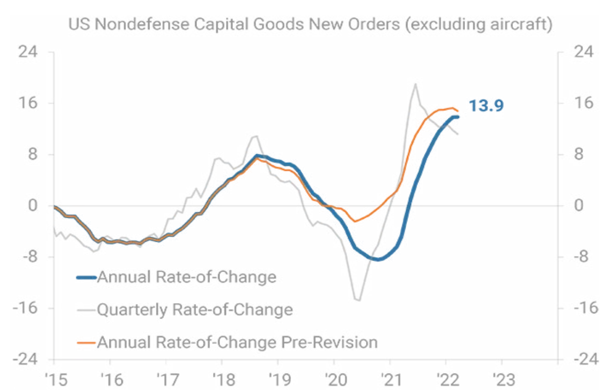


Many New Orders components were also revised lower:

- US Computers and Electronics New Orders: -8.8%
- US Construction Machinery New Orders: -10.3%
- US Machinery New Orders: -5.3%
- US Metalworking Machinery New Orders: -7.4%

However, there were some noticeable upward revisions:

- US Defense Capital Goods New Orders: +11.7%
- US Electrical Equipment New Orders: +6.0%



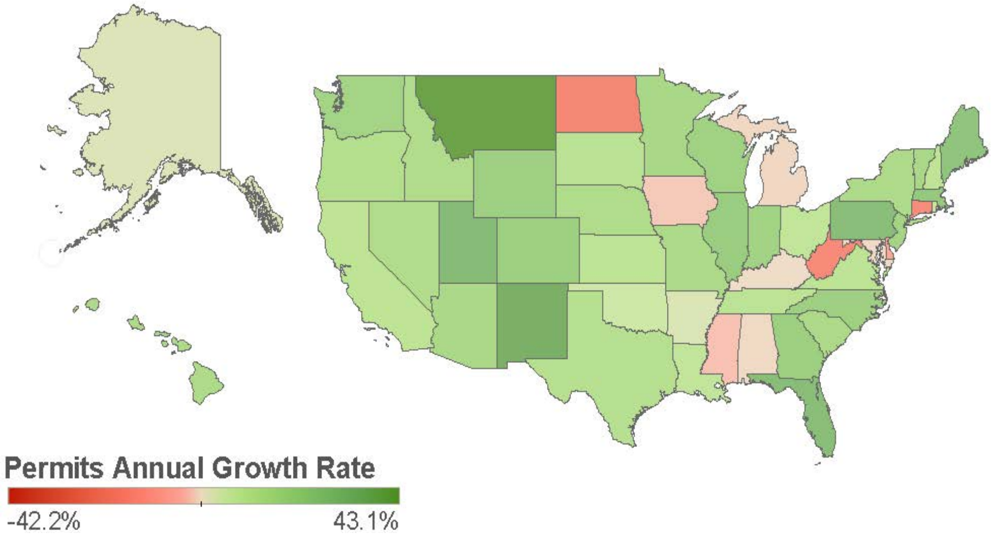
Following the revision to US Nondefense Capital Goods New Orders, our overall outlook still calls for rise. We will see New Orders rise 7.6% in 2022 and an additional 2.4% in 2023. Next year's anticipated lower rate of growth is on track with the majority of economic indicator signals for 2023. US manufacturing is performing well, as global supply chain issues led to a record amount of reshoring in 2021. However, we must also reinforce that New Orders are denominated in dollars, and expected elevated inflation during the next year would mitigate some of the decline we would otherwise potentially see in New Orders.

The business-to-business side of the economy is facing multiple hurdles during this business cycle, and they present risks to the forecast. However, not all of these risks to the forecast would necessarily mean bad news for your business.

- Employment shortages are leading companies to increase automation, but they are also hindering output for some. The ongoing labor shortage is a net downside risk to the forecast.
- Rising inflation could lead New Orders to outperform our expectations on a pricing (rather than volume) basis.
- If we see a weaker dollar than forecast in 2023, it could increase export activity beyond our expectations and result in New Orders outperforming this forecast.

Ensure that your business is prepared for slowing growth into the second half of 2023. However, take care to not go into 2023 with a 2008-2009-type recession in mind. Slowing growth will lead to recession in some, but not all, industries, and you need to be prepared to take advantage of the opportunities that exist in the market. Stay focused on your profitability and increasing your efficiencies so you are better situated for the next growth period.

State-by-State: Permits



- US Housing Unit Building Permits totaled 1.7 million in the 12 months through March, coming in 14.9% above the year-ago level. Growth in permitting activity is slowing following an August 2021 business cycle peak.
- Permits are posting year-over-year contraction in 10 states and the District of Columbia. The steepest pace of decline is occurring in DC, followed by North Dakota, West Virginia, and Connecticut.
- Permits are in slowing growth trends for about two-thirds of states. Most of the pockets of relatively higher growth are in the Mountain West or Southeast, areas with very high net migration. Certain Northeast states – specifically Pennsylvania, Maine, and Massachusetts – are also seeing robust rise.
- Rising mortgage rates may temper growth rates for permitting activity in many states; however, the national housing shortage is likely to spur demand for new homes despite the higher mortgage rates.

Reader's Forum

Does the GDP contraction in the first quarter change ITR's outlook for no recession in the economy?

John Olson, Economist at ITR Economics™, answers:

In short, no. The first-quarter GDP contraction is attributable to several factors; however, domestic spending and fixed investment actually increased. The contraction resulted from a decline in net exports, changes in inventory levels, and decreased government spending. The decline in net exports – i.e., the difference between imports and exports – is likely due in part to a strong US dollar. Government spending declined as fiscal stimulus programs continued to wrap up, and inventories declined in particular due to the motor vehicle supply chain quagmire.

Our outlook calls for several quarters of flat GDP at the bottom of the business cycle. If the downside risk factors dominate, we could see another tick-down in GDP in 2022–23; if the upside risk factors emerge, we could see growth, albeit relatively anemic, at the bottom of the cycle. Regardless, most businesses should be prudent but not draconian when it comes to their spending plans, focusing on efficiency and protecting margins in a high inflation environment with rising interest rates.

Do not allow alarmist headlines to press you into an overly conservative course of action. Businesses that take this tack will likely find themselves unable to control costs or assert the competitive advantages necessary to raise prices, and thus see their margins shrink and profitability erode.

Please send questions to: questions@itreconomics.com

