Industry Snapshots

Arrow denotes 12-month moving total/average direction.

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

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

Macroeconomic Outlook

US Real Gross Domestic Product (Real GDP) in the second quarter of 2022 contracted 0.2% relative to the first quarter. This was the second consecutive instance of quarter-to-quarter contraction, fulfilling the criteria for a technical recession. Taking a step back, Real GDP is still above year-ago levels – the second quarter of 2022 was 1.6% above the second quarter of 2021. While the word "recession" is intimidating, do not be scared. The economy as a whole, with rising consumer spending and a tight labor market, is still strong, and you do not want to miss out on potential growth opportunities.

The second quarter's mild contraction was caused by many of the same factors that precipitated the first-quarter contraction, including decline in government expenditures and fixed investments, imports outpacing exports, and changes in private inventory investments. However, inflation-adjusted consumer spending, which accounts for roughly two-thirds of Real GDP, increased over this period. More granularly, inflation-adjusted consumer spending on services, such as health care, increased, while spending on goods decreased.

While consumers are cutting back on some discretionary spending amid the current inflationary environment, they are spending more than ever: US Total Retail Sales continue to reach record highs. Consumers' financial standing remains stable, with rising Real Personal Income (excluding transfer payments) and US Average Annual Wages. Additionally, the labor market is tight and poised to remain so, which will put upward pressure on wages to help support future consumer spending. We are also anticipating a period of general disinflation (slowing rise) for Consumer Prices in late 2022 and into 2023, which will help bolster consumer purchasing power.

> *"Do not let the technical GDP recession distract you from improving your business."*

We are seeing positive trends in the supply chain. The Global Supply Chain Pressure Index, while still elevated, has generally declined for the past seven months, indicating that pressure is easing. However, supply chains vary by region and market, so it is likely that some industries are getting more relief than others. If you have yet to see it in your own company, know that the general trends are moving in the right direction, and relief is coming.

Lastly, the US industrial sector is growing, albeit at a slowing pace, and backlogs are likely to keep companies busy. While not all markets will perform the same on the back side of the business cycle – those subject to pandemic-induced demand increases are beginning to normalize – various markets will offer growth opportunities.

Do not let the technical GDP recession distract you from improving your business. Do your market research and look to invest if and where possible. Make sure to use the back side of the business cycle as an opportunity for planned maintenance, employee training, and investing in new automation and process efficiencies.

onDemand

Make Your Move

Consider updating your inventory mix given the environment of elevated inflation and slowing macroeconomic growth.

Investor Update

The S&P 500 gain in July nearly offset June's losses. July's strong rally was led by sectors punished particularly hard in the first half of 2022, such as technology and consumer discretionary; these rose in July but are still down double digits year-to-date. Our analysis shows that the market is not out of the woods just yet when it comes to future pain potential in risky sectors, but the market environment is nonetheless shifting.

ITR Economics Long-Term View

2022	2023	2024
SLOWING GROWTH	SLOWING GROWTH	GROWTH

Leading Indicator Snapshot

	3Q2022	4Q2022	1Q2023
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 GDP has met the technical criteria for recession, but there is no concurrent recession in the industrial sector. We are forecasting ongoing slowing growth for US Industrial Production into late next year, culminating in a soft landing.
- The US Total Industry Capacity Utilization Rate 1/12 declined in June. General decline in the Rate 1/12 signals waning business cycle momentum for US Industrial Production into at least early next year. The Rate 1/12 does not signal contraction for Production at this time, supporting our forecast for a soft landing next year.
- The US ISM PMI (Purchasing Managers Index) 1/12 ticked up in July. A tentative June low would suggest a June 2023 business cycle low for US Industrial Production. However, we will need to see sustained PMI 1/12 rise before we can identify the low point, especially given this cycle's increased economic volatility.

Industry Analysis

RETAIL SALES

- US Total Retail Sales in the 12 months through June came in 13.3% above the year-ago level
- Inflation-adjusted Retail Sales have faltered in recent months but remain near record highs
- Leading indicators including the ITR Retail Sales Leading Indicator™ signal likely ongoing slowing growth for Retail Sales in at least the near term

WHOLESALE TRADE

- US Total Wholesale Trade in the 12 months through June came in 22.4% above the year-ago level
- Inflationary pressures are contributing to Wholesale Trade rise
- However, as the rate of growth slows for consumer and business-to-business spending, a similar trend for Wholesale Trade growth will likely follow

AUTO PRODUCTION

- North America Light Vehicle Production in the 12 months through June came in 9.2% below the year-ago level; quarterly Production was double-digits above year-ago levels
- Annual Production is rising; rise is expected to persist through at least 2023
- Supply chains will likely continue to improve, a good sign for annual Production

MANUFACTURING

- Annual US Total Manufacturing Production in July came in 4.2% above the year-ago level
- Expect overall growth for Manufacturing Production in the coming quarters as producers catch up on extended backlogs
- Reshoring efforts and favorable demographic trends bode well for long-term growth in Manufacturing Production

ROTARY RIG

- The US Rotary Rig Count for the three months through July averaged 738, 58.0% above the year-ago level but still well below the pre-pandemic peak
- US Oil and Gas Extraction Capacity Utilization is at 97.5%, suggesting Oil and Gas Production gains will be moderate until more capacity is available
- Producers are hesitant to invest in new wells, keeping capacity constrained

CAPITAL GOODS NEW ORDERS

- US Nondefense Capital Goods New Orders (excluding aircraft) in the 12 months through June came in 11.4% above the year-ago level
- Labor shortages and rising costs will likely support new investment in capital goods, signaling future growth for New Orders
- Ensure you are tracking volume as well as revenue to ensure rising prices are not hiding any activity-level changes

TOTAL NONRESIDENTIAL CONSTRUCTION

- US Total Nonresidential Construction in the 12 months through June came in 0.6% below the year-ago level
- While Construction, a dollar-denominated series, is rising mildly, inflation-adjusted Construction figures show decline, suggesting that rising prices are driving the current rise
- Expect upcoming real growth as labor and material shortages ease

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction in June was at $880.3 billion, up 21.7% from the year-ago level
- Amid a tight rental market and rising mortgage rates, some would-be buyers are opting to rent, boding well for multi-unit housing starts
- We expect mild contraction, primarily in single-unit housing starts, in the coming quarters, as signaled by existing home sales and housing permit trends

A Closer Look: The US Economy

A Brief Overview of the Inflation Reduction Act

BY: CAROLINE DUNSBY

What you need to know: The legislation's impact will vary across markets and likely take some time to manifest

In mid-August, President Biden signed the Inflation Reduction Act into law. Given the period of heightened inflation we are in – Consumer Prices came in at 8.5% above the year-ago level in July – the name of the legislation was of interest to many, including us here at ITR Economics. While we are not politically aligned, we will outline the primary focuses of this legislation and potential future impacts. Below are three major focuses of the act:

TAX REFORM

This section creates a new minimum tax – 15% – for corporations with more than $1 billion in income. Taxes on individuals and households will not be affected. However, with profitability being the goal for most, many corporations will likely leverage legal, financial, and accounting resources to minimize their tax liabilities. It will take time to see how this provision affects tax revenue. Additionally, beginning in 2023, there will be a 1% excise tax on stock buybacks. This is likely to incentivize a boost in stock buybacks for the remainder of this year.

CLIMATE CHANGE

The act allocates $300 billion for energy and climate reform. The goal is to benefit the environment in a variety of ways, including by making renewable energy more affordable. Some of this funding – $60 billion – will be focused on promoting renewable energy use in the manufacturing sector. Another portion will go toward incentivizing electric car purchases. However, many vehicle manufacturers are already increasing their electric vehicle offerings, and some even have waiting lists. As such, the act is unlikely to lower inflation given it is addressing just the demand side of the equation and not the supply side.

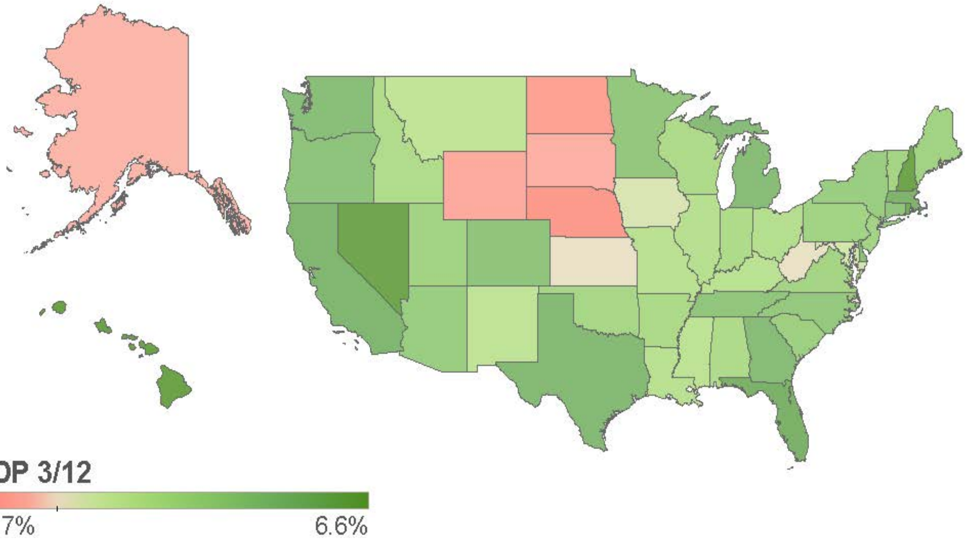
PRESCRIPTIONS

Part of the legislation aims to keep healthcare prices from spiking. One way it will attempt to do so is by authorizing the federal health secretary to negotiate prices on drugs for Medicare, essentially making prescription drugs more affordable. However, the timeline is long – currently, the secretary is allowed to negotiate prices for 10 Medicare-covered drugs, with the pricing going into effect in 2025. In 2029, this provision will expand to 20 drugs. Given that timeline, we are unlikely to see major reduction in inflation in the healthcare sector in the near term.

THE TAKEAWAY

As time passes, we will be able to observe this legislation's impact and better asses what it means for the US economy as a whole. We can say that the impact will certainly vary across individuals, companies, and industries, and you are unlikely to see an immediate effect on your business. Please reach out to us if you would like to talk more about the legislation's potential impacts to your specific circumstances.

State-by-State: GDP



- Second-quarter US Real Gross Domestic Product (GDP) was down relative to the first quarter but up 1.6% relative to the year-ago level.
- While many headlines emphasize GDP's quarter-to-quarter movements, the map above depicts changes relative to year-ago levels, which is why it may look different from other sources.
- First-quarter GDP came in below the year-ago level for five states: Alaska, South Dakota, Wyoming, North Dakota, and Nebraska (second-quarter state data is not yet available).
- Despite the national-level contraction over the same time period, first-quarter GDP came in above fourth-quarter-2021 GDP for four states: New Hampshire, Vermont, Massachusetts, and Michigan.

Reader's Forum

I think my industry is headed toward a recession. What can I do to mitigate the impact of the downturn?

Sara Aybar, Economist at ITR Economics™, answers:

Recession fears can become self-fulfilling when you make them the basis for business decisions. Instead, look at the hard data and utilize our forecasts. Some markets will contract this cycle, but we do not expect broad-based decline in industrial markets. If recession is indeed ahead for your sector, there are some key steps you can take:

1. As interest rates rise, approach potential capital investments with prudence. Now is a good time to borrow at fixed rates if the ROI on the project is sufficient. Target projects that will combat labor scarcity and expenses, help you save on costs, or otherwise add resilience to your business.

2. Closely monitor your margins, which are likely to be pressured as customers become more price-sensitive. Look for efficiency gains and consider adjusting your product lineup toward lower-cost options. If you deal exclusively in higher-end products, ensure your customers understand your competitive advantage. This may help you fill your backlog ahead of any decline.

3. The downtime attendant to any market decline may allow your business room to schedule improvements and maintenance, or to explore ways to gain market share. Take advantage of this opportunity ahead of accelerating macroeconomic growth expected for 2024.

Please send questions to: questions@itreconomics.com

