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	Flat
RESIDENTIAL CONSTRUCTION	Steep Rise

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

Macroeconomic Outlook

High inflation is on everyone's mind. Consumer inflation reached 9.1% in June, the highest in 40.5 years. Producer inflation, at 18.6%, reached the highest level in 47 years.

On the producer side, prices are rising faster for intermediate demand goods and services as opposed to final demand goods and services. However, we are just beginning to see some easing of pricing pressures on commodities used for intermediate goods. Following early 2022 commodity price surges, US Crude Oil Prices have tentatively peaked and both US Copper Futures Prices and US Steel Scrap Producer Prices dropped dramatically from May to June. While we do not anticipate further decline for the majority of commodities, we expect these prices to remain generally flat through the next few quarters, which will still ease some pricing pressures on producers.

On the consumer side, the high levels of inflation increase are largely being driven by energy prices. In June, the energy-specific Consumer Price Index was up 41.6% from June 2021, and the gasoline Consumer Price Index was up 59.9% from June 2021. In recent weeks, however, gas price national averages have begun to decline mildly. Consumers may see some additional relief at the pumps in the near term.

> *"On the consumer side, the high levels of inflation increase are largely being driven by energy prices."*

While the current inflation numbers can be worrisome for both consumers and businesses alike, macroeconomic fundamentals signal that the rate of rise in prices will begin to slow by the end of this year and continue to slow into 2023. Despite the disinflation trend, be prepared for higher levels of inflation in the coming years relative to what was experienced in recent decades.

While elevated prices are eating into the purchasing power of consumers and businesses, both are still positioned well to drive future growth in the economy, just at a slower pace of rise. The labor market is on the side of the consumer, with about two job openings per unemployed person. Credit delinquencies remain low, and Real Personal Income (excluding transfer payments) is rising. Both Corporate Cash Holdings and Corporate Profits are elevated, and business bankruptcies are near record lows. As such we are anticipating no-recession scenarios for US Retail Sales and business-to-business spending.

Note that some of the projected growth in Retail Sales and business-to-business spending will be due to elevated pricing—volume will be a different story. While there is concern amongst many about whether GDP will go into recession or not, it is more important to focus on your business. How are your margins doing? It is important to watch your margins in this high inflationary environment–you do not want to be caught in a period of economic growth but declining profitability. Ensure you are consistently monitoring your margins.

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Make Your Move

Ongoing slowing growth in the economy is providing an opportunity for your business. Utilize the slower time to complete employee training, implement capital improvements, or perform maintenance on your equipment.

Investor Update

The S&P 500 dropped 7.6% in June. The last time we saw a more severe June drop was an 8.6% decline in 2008, which contributes to why people are concerned we are heading toward a recession. Underlying consumer and industrial strength are significant indications that this is not going to turn out to be a recession-ridden, elongated decline.

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 Industrial Production stayed in a slowing growth trend for a third consecutive month, and the majority of indicators on this dashboard signal this trend will persist at least into 2023.
- Further downward movement in the US OECD Leading Indicator now signals that US Industrial Production will remain in a business cycle declining trend through at least 1Q23, in line with signals from the US ISM PMI (Purchasing Managers Index).
- While there is not yet enough data for the leading indicators to signal a timing for the US Industrial Production low, our analysis suggests a soft landing will occur in the second half of 2023.

Industry Analysis

RETAIL SALES

- Annual US Total Retail Sales in May came in 14.1% above the year-ago level
- Retail Sales are in a slowing growth trend; leading indicators suggest that the pace of growth will slow further into at least early next year
- We anticipate a soft landing this cycle, aided by both stable consumer financials and elevated inflation

WHOLESALE TRADE

- Annual US Total Wholesale Trade in May came in at $7.721 trillion, 23.0% above the year-ago level
- Rise in Wholesale Trade reflects rise in both consumer and business-to-business spending; all of these are at record levels
- Growth rates this year and into the first half of 2023 will generally move lower as macroeconomic activity cools

AUTO PRODUCTION

- Annual North America Light Vehicle Production in May was 10.3% below the year-ago level
- Despite being down compared to one year ago, annual Production is rising
- As growth in the global economy slows, automakers will face less competition for inputs, allowing Production to ramp up to meet strong demand for light vehicles

MANUFACTURING

- US Total Manufacturing Production in the 12 months through June came in 4.6% above the year-ago level
- Leading indicators including the ITR Leading Indicator™, the US ISM PMI (Purchasing Managers Index), and Utilization Rates signal ongoing slowing growth in Manufacturing
- We expect a soft landing in overall manufacturing; however, markets that received a boost during COVID shutdowns have an increased risk of contraction this cycle

ROTARY RIG

- Second-quarter US Rotary Rig Count averaged 716, 58.7% above the second quarter of 2021
- Crude Oil Spot Prices averaged nearly $115 in June, the highest level since 2008; Prices have since retreated closer to $100
- Investor sentiment toward oil and gas, along with materials shortages, suggests the rig count will rise at a milder pace than demand would otherwise suggest

CAPITAL GOODS NEW ORDERS

- Annual US Nondefense Capital Goods New Orders (excluding aircraft) in May totaled $852.0 billion, 12.0% higher than the year-ago level
- Some rise in New Orders will be driven by rising prices, but we expect volume to grow as well in the coming quarters
- Annual Defense Capital Goods New Orders came in 1.4% below the year-ago level; however, ITR Checking Points™ signal accelerating growth ahead

TOTAL NONRESIDENTIAL CONSTRUCTION

- Following an annual revision to the data by the US Census Bureau, annual US Total Nonresidential Construction was at $826.8 billion, 1.2% below the year-ago level
- Despite robust growth in the macroeconomy in 2021, Construction rise has been sluggish, likely due to severe shortages in materials and labor
- Trends in corporate finances and prior growth in the economy suggest accelerating growth ahead for Construction

TOTAL RESIDENTIAL CONSTRUCTION

- US Total Residential Construction in the 12 months through May came in 23.0% above the year-ago level
- Leading indicators suggest there will be some contraction in homebuilding as incomes are unable to keep pace with housing affordability
- Dollar-denominated Construction is less likely to contract as inflationary pressures keep spending elevated

A Closer Look: The US Economy

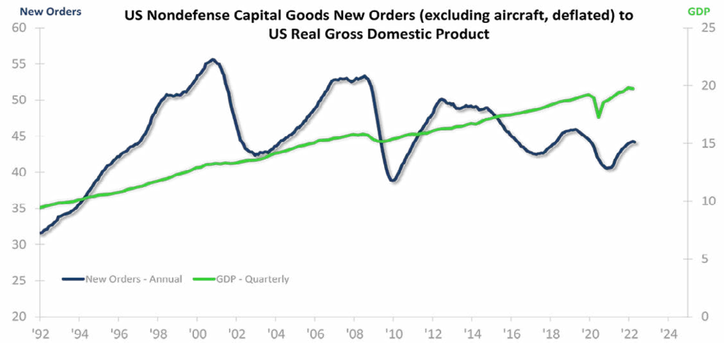
The Macro – The Market – Your Business

BY: ALAN BEAULIEU

What you need to know: Some markets will experience slowing growth; others, decline

THE MACRO

The rising trend in annual US Nondefense Capital Goods New Orders (excluding aircraft), on a deflated basis, has slowed noticeably. The annual growth rate stands at 5.1% and is in Phase C, Slowing Growth. Quarterly New Orders are a thin 0.3% above this time last year. The slowdown may lead some to believe there is a recession around the corner. The chart below shows that annual New Orders can in fact move lower without a corresponding decline in GDP. The essentially flat trend in annual New Orders does not mean there will be a recession. Our analysis suggests that annual New Orders will be essentially flat through the rest of 2022. On a positive note, quarterly New Orders is the highest it has been in just under three years.



Our analysis of inventories and unfilled orders suggests that we are not at a tipping point that would cause a macro recession. Some are concerned that there is a lot of 'water' in the new orders trends, that the macro slowdown will result in a quick evaporation in new orders, and that industry will need to work down inventory levels before resuming a normal order pattern. The levels of orders, unfilled orders, and inventories are likely to result in the deceleration we have been forecasting, but the data does not support a full-on macroeconomic recession, but a technical mild second-quarter decline in GDP. A technical decline in GDP is unlikely to be the result of business activity, declines in retail sales, or job losses. Rather, it would be a result of things that, most likely, do not impact your business, such as a decline in government spending or an increase in the trade deficit.

There are many markets that will experience only a slowing rate of growth in the second half of 2022 and into 2023. Others may be negatively impacted because there was a surge in inventory levels that is now followed by dramatic slowing, or even decline, in demand.

THE MARKET

Your company could find itself in the more comfortable, slower-growth environment where disinflation (a slowing in rate of inflation) is the norm. Your top line will likely move higher in unit and dollar terms under these conditions and, if you carry inventory, you will likely realize a slow reduction through time as you balance sales against inventory replenishment.

The situation is a bit different if you participate in a market where inventories are a concern and price deflation is likely. The inventory build-up could cause suppliers to see a dramatic reduction in orders whether it is justified or fear-driven. Market participants will be faced with price reductions to move inventory and maintain cash flow. This situation may see sales move lower in the latter half of the year as prices decline. Here are some things to keep in mind:

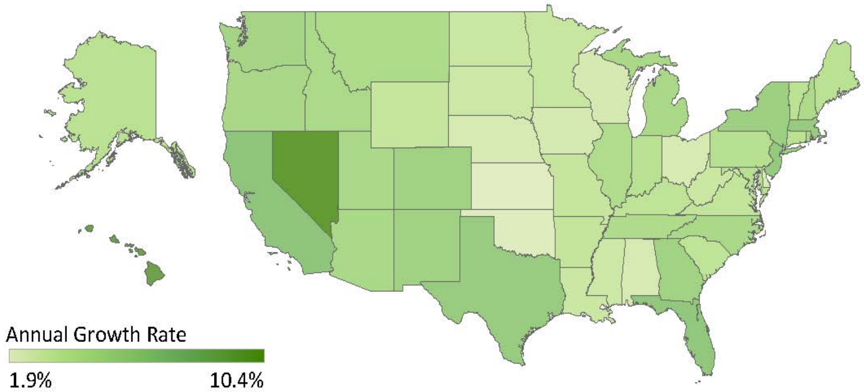
1. A decline in sales does not necessitate an equal decline in EBITDA. Sales dollars decline with deflation, but so do some of your input costs. Careful cost management and previously implemented efficiency gains should help.

2. Volume may not decline, even as dollars do. It is easy to make decisions based on a top line trend when we have been living in a no-inflation environment for years and, more recently, in an inflationary environment. Deflation causes a shift in focus to units or throughput where possible.

3. Cash becomes the greatest concern in a firm dealing with inflation-valued inventory and deflationary pricing pressures. Use of lines of credit or strategic reserves could become necessary.

4. Do not assume the deflationary trend will last. Straight-line forecasting is always dangerous. Stay abreast of anticipated price changes at least one year out.

State-by-State: Employment



- Annual US Private Sector Employment in June came in 5.0% above the year-ago level.
- US Employment reached a record high in June, surpassing pre-pandemic levels.
- Employment is in Phase C, Slowing Growth, in every state. Washington D.C. remains in Phase B, Accelerating Growth.
- States which rely more on services such as tourism for their economies have experienced higher growth rates in employment, while states which are more rural or have more agriculture have grown at a slower pace.

Reader's Forum

How do I know which of my end markets will perform better as the economy slows down?

Caroline Dunsby, Economist at ITR Economics™, answers:

You are right that some industries will continue to grow throughout this macroeconomic slowdown, while for others we are forecasting flattening levels of activity or even mild decline. There are a few things to keep in mind.

First, did any of your end markets largely benefit from the pandemic? While overall US Total Retail Sales is growing, we are starting to see corrections in certain segments that boomed during the earlier parts of the pandemic—furniture and appliance sales, for example. If your markets benefited from consumers being confined to their homes, do not be surprised if a correction begins or is already underway.

Second, is the market considered discretionary or a staple? While consumer financial health is stable, they are feeling their purchasing power diminish in this elevated inflationary environment. If the market is viewed as discretionary, you may begin to see activity dwindle or a substitution effect occur. If the market caters to businesses, keep in mind that while businesses are in a strong financial position, their demand for new goods is typically still rooted in consumer activity.

These are general rules of thumb. Please reach out to us if you need help identifying the trajectories of specific industries.

Please send questions to: questions@itreconomics.com

