Industry Snapshots

Arrow denotes 12-month moving total/average direction.

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

Steep Rise | Mild Rise | Flat | Mild Decline | Steep Decline

Macroeconomic Outlook

Fourth-quarter US Real Gross Domestic Product (GDP) was up 0.72% from the third-quarter level, marking a second consecutive quarter of rise. Expansion was broad-based, with rise in consumer and government spending as well as inventory investment and nonresidential fixed investment. Residential fixed investment declined, as did net exports. Our analysis suggests GDP will likely post mild rise in the near term, then trend relatively flat for the remainder of this year.

Pricing trends are top of mind for many consumers and businesses. Both US Consumer Prices and US Producer Prices are in Phase C, Slowing Growth, signaling disinflation, i.e., a slower rate of rise for Prices. For Consumer Prices, the rate of rise will continue to ease as 2023 progresses, but rise will persist throughout the year. Producer Prices, by contrast, will edge downward late this year. 2023's easing pricing pressures are a result of easing supply chain issues, declining commodity prices, and cooling macroeconomic demand.

In an effort to subdue 2022's soaring inflation and the tight labor market, the Federal Reserve has raised interest rates at the fastest pace in decades. The magnitude of rate increases has declined recently – the Federal Reserve raised the federal funds rate 25 basis points (0.25%) in February, which, relative to previous rises of 50−75 basis points, could suggest the body is nearing the end of its upward push. However, we do not think the Federal Reserve is done just yet. Our macroeconomic forecasts anticipate roughly 50–100 basis points of additional rise between now and the end of the second quarter. If the Federal Reserve remains hawkish for longer than anticipated – resulting in a longer-lasting inversion of the yield curve – our expectation that next year's macroeconomic recession will be relatively mild would be at risk.

> *"Pricing trends are top of mind for many consumers and businesses."*

The higher interest rates have made borrowing less attractive for many businesses. Certain investments – some of which would have made sense when interest rates were at their lower, pre-pandemic levels or artificially low 2020−2021 levels – are likely infeasible. However, with labor costs expected to rise, our analysis suggests that investments that lower your dependence on labor or increase efficiencies will prove solid strategic decisions.

Make Your Move

Our analysis suggests the upcoming macroeconomic contraction will be mild relative to historical cycles. If you trend closely with the overall industrial sector, avoid cutting your capacity too much, as we expect the US industrial sector will regain record territory around the end of 2025.

Investor Update

The S&P 500 broke above 4,000 in January, rising an abnormally robust 6.2% from the December level. 2023 will not be a repeat of 2022. Opposing forces – easing inflation alongside deteriorating macroeconomic growth prospects and elevated interest rates – will likely lead to elevated volatility in at least the near term.

ITR Economics Long-Term View

2023	2024	2025
SLOWING GROWTH	RECESSION	GROWTH

Leading Indicator Snapshot

	1Q2023	2Q2023	3Q2023
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

- The general consensus among leading indicators is that the US industrial sector will remain on the back side of the business cycle into at least the second half of 2023.
- We have yet to see sustainable upward movement in the leading indicators in this dashboard; this contributed to our decision to revise our US Industrial Production outlook in December.
- Further decline in the ITR Retail Sales Leading Indicator™ signals that business cycle momentum will continue to wane for US Total Retail Sales in the coming quarters.

Industry Analysis

RETAIL SALES

- US Total Retail Sales for 2022 came in at a record $8.123 trillion, 9.2% higher than the 2021 total
- We expect Retail Sales growth to slow in 2023, culminating in a mild recession in 2024
- Solid consumer financials will contribute to the anticipated mildness of the declining trend

WHOLESALE TRADE

- Annual US Total Wholesale Trade was up 16.4% for 2022 relative to 2021
- Deflated data for US Durable Goods Personal Consumption Expenditures was flat in 2022, indicating that consumers have absorbed price increases for durable goods but are not increasing their volume of purchases
- This points to lower Total Wholesale Trade spending this year

AUTO PRODUCTION

- North America Light Vehicle Production for 2022 totaled 14.2 million units, up 9.6% from the 2021 level
- We expect Production to rise into late 2023 and then decline in 2024
- The US Total Light Vehicle Inventory is roughly 60% below the 10-year average, indicating the need for further Production to rebuild inventories to pre-pandemic levels

MANUFACTURING

- US Total Manufacturing Production is up 3.0% from last year
- Leading indicators suggest downward business cycle momentum will persist in 2023
- Decline is likely in 2024, but it will be relatively mild due to strong backlogs and reshoring trends

ROTARY RIG

- The US Rotary Rig Count averaged 735 in the 12 months through January, up 48.8% from one year ago
- Oil and gas firms continue to contend with supply chain disruptions, contributing to diminished investment in the sector
- The lack of investment will likely hinder activity in this sector moving forward

CAPITAL GOODS NEW ORDERS

- US Nondefense Capital Goods New Orders (excluding aircraft) were up 8.3% for 2022
- Activity is expected to rise into mid-2023 and then decline into 2024
- Higher interest rates are likely contributing to slowing growth for New Orders as some firms decide that borrowing costs are too high to justify investment in capital goods

TOTAL NONRESIDENTIAL CONSTRUCTION

- US Total Nonresidential Construction came in at $884.6 billion for 2022, up 7.4% from the 2021 level
- Nonresidential construction spending tends to lag the macroeconomy by roughly one year
- We expect the current slowing macroeconomic growth to manifest in Construction spending by the end of this year

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction was up 13.1% for 2022
- However, with US Single-Unit Housing Starts down 13.1%, we expect imminent contraction in Total Residential Construction will persist through the rest of 2023
- Mortgage rates are moving lower; further decline would point to recovery for this sector in late 2024

A Closer Look: The US Economy

Declining Residential Sector Foreshadows Trajectory of Nonresidential Sector

BY: LAUREN SAIDEL-BAKER

What you need to know: Nonresidential Construction Will Continue to Offer Opportunity for Adaptable Firms

The US construction sector is currently a tale of two markets. High home prices and rising interest rates are weighing on residential construction activity, largely due to strained affordability for the US consumer. However, the nonresidential construction sector is trending quite differently: it is still expanding even as the residential side is contracting.

The difference can be explained by typical lead times: nonresidential construction activity tends to lag the residential sector by roughly two years. While the descriptor "lagging" tends to carry a negative connotation, the nonresidential sector's lag time is a benefit in this case, as it allows for plenty of forward-looking visibility to coming trends for the sector.

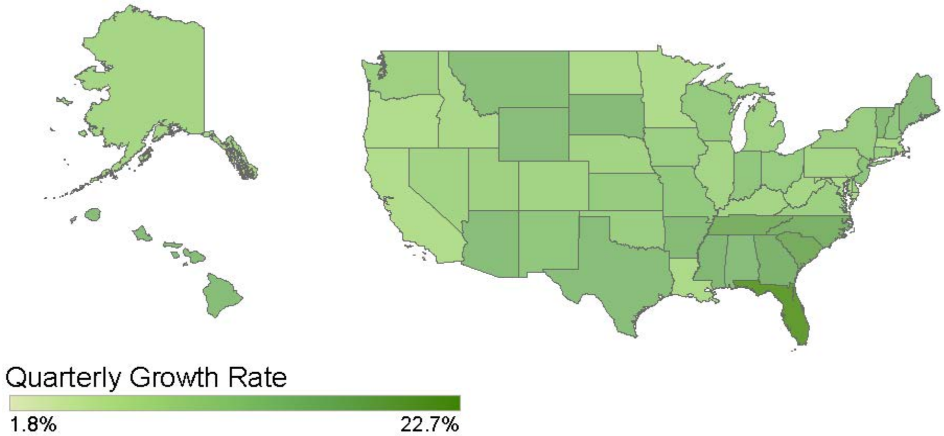
Currently, all of the major nonresidential construction markets we cover in the ITR Economics Trends Report™ are in or on the verge of Phase B, Accelerating Growth. However, all of these will transition to Phase C, Slowing Growth, by year-end, and many will contract in 2024.

This coming business cycle shift mirrors the housing market's recent transition to cyclical decline, and it will be driven by similar – though not identical – economic factors. Rising interest rates are deterring investment in both the residential and nonresidential spaces as borrowing costs rise from historically low levels. Furthermore, slowing growth in US corporate profits and mounting economic anxieties signal a coming pullback in firms' willingness and ability to invest in new construction.

However, there will still be opportunity in the nonresidential construction sector for those who are adaptable. As businesses shift away from new construction activity, there will be an increased need for renovation and repair of existing facilities, as is typical during periods of economic softness. Specific markets within the nonresidential sector will also offer relatively better prospects. Recent capacity constraints and supply chain limitations, coupled with reshoring and onshoring trends, are adding to the need for manufacturing facilities. As a result, annual US Private Manufacturing Construction is up 34.9% from the year-ago level. Warehouse construction will also offer opportunities this business cycle as supply chains shift to accommodate the post-pandemic "new normal" and as demand for ever-decreasing shipping times necessitates increasing numbers of distribution centers.

Furthermore, construction trends will vary widely by region. Many segments of commercial construction trail population movements; additional real estate resources are needed as populations increase. Across portions of the US – especially the Sun Belt and Mountain West – strong population growth trends will support further investment in commercial real estate. These population trends can highlight geographic areas of long-term opportunity.

State-by-State: Prices



- US Home Prices rose 15.1% in the 12 months through November.
- While all states' annual Home Prices were at record highs in September (latest available data), the pace of rise has differed significantly by region.
- Seven of the top 10 states in terms of year-over-year growth rates were in the Southeast region, while the majority of states in the West, Great Lakes, and Central regions were below the national average.
- Affordability constraints are weighing on consumers and contributing to decline in the number of new homes being built. Upward pressures on home prices are likely to ease, but that does not necessarily mean prices will contract. Location matters.

Readers' Forum

What is the future of the US labor market in the next few years?

Sara Aybar, Economist at ITR Economics™, answers:

Annual US Private Sector Employment was up 4.7% in January from the year-ago level, and we expect ongoing rise into mid-2024. At the peak, we expect Employment to be between 1.6 and 2.6 million workers above the current level. Demographic trends suggest that the relative tightness of the labor market will be a long-term issue. Therefore, many businesses would likely benefit from labor-saving improvements.

We expect that the upcoming recession will impact the various economic sectors differently; some will be more insulated and others more exposed. The US tech sector, for example, has prepared for the expected downturn by laying off more than 70,000 employees in the last year. Slowing consumer spending, which reduces investment in digital advertising, and inflation are highly impacting the tech sector. Meanwhile, US Total Construction Job Openings, up 16.9% year over year, are rising. The nonresidential construction sector lags the industrial sector, and projects are underway. Construction Job Openings are likely to continue rising into late 2023.

The economy is projected to grow again in 2025, and the labor market will still be relatively tight. ITR Economics can help you assess the likely trajectory of your industry before you adjust your hiring strategy.

Please send questions to: questions@itreconomics.com