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	Mild Rise

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

Macroeconomic Outlook

With a sustained inversion of the US Treasury yield curve and further actions expected from the Federal Reserve that will push up on interest rates, our projections have changed. We now anticipate more muted growth for the US economy and the industrial sector over the coming quarters and likely contraction for annual US Industrial Production starting in the last quarter of 2023. While the inverted yield curve has impacted our expectations for the timing, the recession itself is not unexpected. We had previously anticipated economic contraction in the middle of this decade; the Federal Reserve's actions are pulling it in.

Consumers are still spending, and their strength will help keep the economy rising into the latter half of 2023. Rising Real Personal Income (excluding current transfer receipts) and low credit card delinquencies are but two of a multitude of signs that consumer finances remain solid. Businesses are also in a strong position. Corporate profits are at record highs, and many companies are working through backlogs. We would suggest retaining some of those profits, as a rainy-day fund will benefit your company when activity slows.

What else can your business do to prepare for upcoming macroeconomic contraction? First, look to your own verticals. Some markets are more sensitive to interest rate changes than others, and some will have little correlation with the broader industrial sector. For instance, markets such as automotive and heavy truck, which had the greatest struggles with supply chain disruptions, are likely to have tempered reactions relative to markets such as home appliances and furniture, which enjoyed stimulus- or COVID-induced surges.

Whatever your verticals, labor should factor into your longer-term planning. We expect some easing in the tight labor market, but attracting and retaining quality talent will likely remain a challenge. While cutting staff is a typical move during a recession and may save your budget in the near term, we expect relative tightness and rising costs for the labor market in the coming years. Any workforce cuts should be weighed against the expense of rehiring and retraining during the subsequent economic recovery.

> *"Consumers are still spending, and their strength will help keep the economy rising into the latter half of 2023."*

Revisit your planned capital expenditures. Will these investments still make sense given expected industrial sector decline by year-end 2023? Despite higher interest rates, investments that save on labor costs may still be worthwhile.

Make Your Move

Later in 2023 and in 2024, essentials will fare better than discretionary goods and services; focus your strategies accordingly.

Investor Update

The S&P 500 Index ended November above 4,000. November was the fourth month in 2022 to post sharper-than-normal rise over the preceding month, yet the Index is down by double-digit rates year to date. Why? With six months of sharper-than-normal month-to-month decline, the sharp declines outweigh the rallies. Also notable is that only one month so far this year has fallen within normal parameters.

ITR Economics Long-Term View

2022	2023	2024
SLOWING GROWTH	SLOWING GROWTH	DECLINE

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 through at least the first 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.
- 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

- Annual US Total Retail Sales are above $8 trillion
- Retail Sales will grow at a slowing rate as US economic momentum wanes
- The strong labor market and low credit delinquencies signal that Retail Sales will remain relatively elevated even as economic momentum continues to wane

AUTO PRODUCTION

- Annual North America Light Vehicle Production is at 6.6% above the year-ago level
- Industry-specific utilization rates suggest cyclical rise will extend through the next two to three quarters for Production
- Consumer demand for light vehicles is high; however, interest rates could erode purchasing power, hindering rise

ROTARY RIG

- The US Rotary Rig Count rose to 779 units in November
- High US Oil and Gas Extraction Capacity Utilization signals capacity constraints, which could incentivize exploration activity
- However, slowing macroeconomic activity both in the US and abroad will dampen demand for oil and gas and, consequently, drilling activity

TOTAL NONRESIDENTIAL CONSTRUCTION

- At $860.3 billion, annual US Total Nonresidential Construction is less than 1% below the mid-2020 record high
- It is important to note, however, that the pricing environment is different today
- Adjusted for inflation, annual US Total Nonresidential Construction is below year-ago levels

WHOLESALE TRADE

- Annual US Total Wholesale Trade is at a record high, though growth rates are declining
- Declining and softening commodities prices will continue to put downside pressure on dollar-denominated Wholesale Trade
- Higher interest rates and an anticipated weaker economy in 2024 will hinder demand for goods, leading to further softening and, likely, contraction for Wholesale Trade in 2024

MANUFACTURING

- US Total Manufacturing Production is rising at a slowing pace
- The inverted yield curve signals that the US macroeconomy, as well as Manufacturing, will likely contend with some weakness in 2024
- Nearshoring efforts (as firms look to shorten their supply chains) and ongoing foreign direct investment into the US bode well for Manufacturing in the longer term

CAPITAL GOODS NEW ORDERS

- Adjusted for inflation, US Nondefense Capital Goods New Orders (excluding aircraft) have trended relatively flat since early 2022
- The pace of rise in capital equipment prices has started to slow
- Signals from the bond market suggest that New Orders will likely contract in 2024

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Single-Unit Housing Starts are below year-ago levels and declining
- Overall wage growth and low inventory levels suggest the housing market will avoid a Great Recession-like scenario this year
- In the near term, the multi-unit and remodeling markets may offer relatively greater opportunity than the single-unit market

A Closer Look: The US Economy

The Revised US Real GDP Forecast

BY: JACKIE GREENE

Our analysis suggests the Federal Reserve's actions have pulled a recession into 2024 that was previously forecast for 2026; the recession will be mild

We have been warning clients and readers that a sustained inversion in the 10-year to 3-month Treasury yield curve would trigger a revision to our macroeconomic outlook. That time has come. Here we will discuss the revised outlook for US Real GDP and, most importantly, what it means for you. It is important to note that an inverted yield curve does not mean immediate recession for the US economy. Instead, it is a signal that there is an 88% chance that a recession is coming, with most recessions beginning three to five quarters after the inversion appears. **Our analysis suggests that the Federal Reserve's aggressive rise in interest rates has largely resulted in pulling the recession that we had anticipated for 2026 into 2024.** Here are the details of the revised GDP forecast:

2022:

Our prior GDP forecast had been in place since January 2022, and results are likely to finish the year on target with that forecast (quarterly basis).

2023:

Our prior forecast had called for mild growth − with some brief flatness − in 2023. That aspect of our outlook has not changed. However, instead of mildly accelerating growth throughout the majority of 2023, we now anticipate GDP will be in a period of slowing growth throughout 2023 and trend relatively flat toward the end of the year.

2024:

We had previously projected 2024 as a year of accelerating growth, with anticipated rise of 3.2% relative to the 2023 level. In our revised forecast, however, 2024 is where we expect the bulk of the economic pain to reside. Our 2024 outlook has GDP falling during the first quarter, mildly rising in the second quarter, and then declining again in the third quarter before the economy gets back into a sustainable growth trend by year-end. However, GDP could just as easily fall during the first two quarters of 2024 and post mild rise in the third. At this point, if your business relates to US GDP, the key for you is to plan for a weakened economy during the first three quarters of 2024. The waffling in GDP during that time will be noise, and the quarterly fluctuations will not merit change to your strategy; plan for a mild recessionary environment. The key to that phrase is "mild": this is expected to be a mild contraction, similar to those of the early 1990s or early 2000s and <u>not</u> like the Great Recession.

2025:

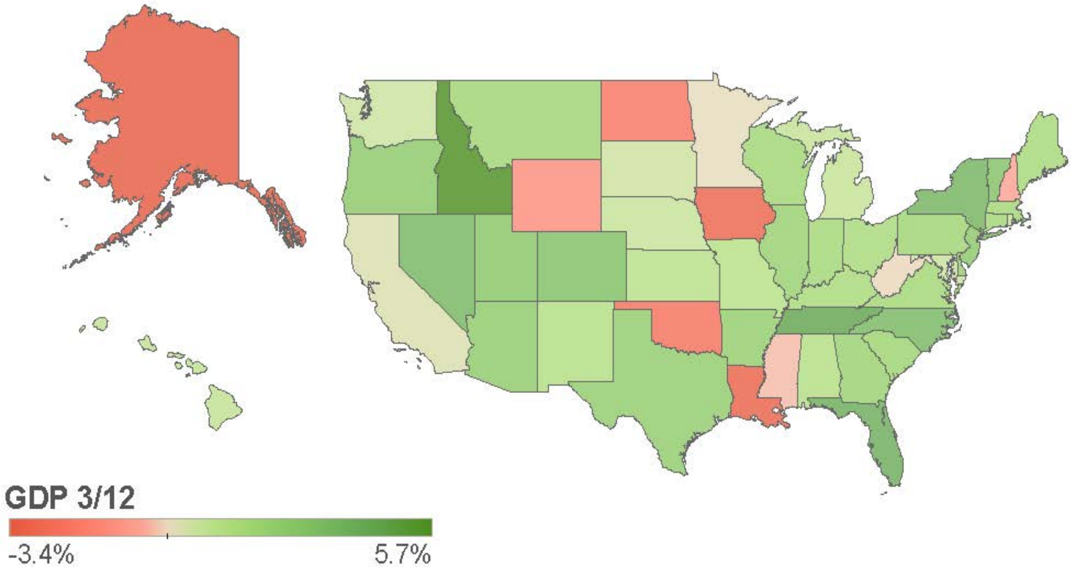
2025 will be a year of growth. While the prior outlook had 2025 as the last hurrah before the recession would take full force in 2026, the revised outlook has 2025 as the sunlight after the storm.

There are some key elements to keep in mind:

1. Ensure you know how you relate to GDP. If you are more closely aligned with US Industrial Production, the timing of the recession could be quite different for you. There are also some industries that are likely to be largely unaffected by the Fed's rate increases. Knowing the likely impact on your markets will shape your strategies.
2. This outlook is predicated on the assumption that the Fed will raise rates an additional 50 to 100 basis points between now and mid-2023 and that rates will start to ease during the second half of 2023. If that does not happen, we will likely need to revise this outlook.
3. While we are talking about a recession in 2024, it will be relatively mild, and that point should be stressed. US GDP is currently at a record high. At the projected low of the recession, GDP will come down close to today's level (quarterly basis). Put another way, we do not anticipate that GDP will fall below today's level during the upcoming recession.

While recessions can be painful and intimidating, they can also offer opportunity. Now that you know what is coming, you can plan for it and be better-positioned than your competitors. If you are unsure of how you fit into this picture or where your specific markets are going, let us know. We can help.

State-by-State: GDP



- US Real Gross Domestic Product (GDP) in the third quarter was up 1.9% from the third quarter of 2021. However, ongoing decline in the leading indicators, including the ITR Leading Indicator™, suggests that overall slowing growth will likely extend through the coming quarters.
- Most state economies are in Phase C, Slowing Growth. Given our long-term outlook for the US, this cooling is likely to persist during 2023.
- Though in Phase C, Slowing Growth, Idaho GDP posted the highest growth rate for the second quarter (latest data), coming in at 5.7%.
- GDP contracted for eight states in the second quarter. Alaska GDP, down 3.4% from the second quarter of 2021, posted the steepest decline; this state is significantly impacted by its aging population, lack of migration, and the oil sector.

Readers' Forum

What is an "inverted yield curve" and what does it mean for me?

Sara Aybar, Economist at ITR Economics™, answers:

An inverted yield curve is simply an occurrence in a plotted data relationship that shows that long-term interest rates are below short-term interest rates. While an inverted yield curve doesn't cause a recession, it is an excellent bellwether for the economy. Historically, recession in US Industrial Production has followed a sustained inversion of the yield curve 88% of the time.

While there is a high correlation between an inverted yield curve and a later recession, your business may have no demonstrable relationship with the yield curve inversion. Proper planning requires knowing how susceptible your company is to this situation. Once you have determined this relationship, reevaluate your late-2023 and 2024 business plans. Ensure you are tracking your specific verticals, as the severity of contraction will vary across markets.

Please send questions to: questions@itreconomics.com