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 Rise

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

Macroeconomic Outlook

In December, we revised our US macroeconomic outlook due to the sustained yield curve inversion. We are now anticipating a recession for 2024; we had originally expected that the downturn would occur later in the decade. Here is what this means for the different segments of the US economy:

Retail Sales: We are likely to see softer consumer spending ahead, given elevated and still rising interest rates, stock market volatility, and declining inflation-adjusted savings. However, the labor market still favors consumers, inflationary pressures are easing, and credit delinquencies remain low. Altogether, these factors will result in relatively mild rise in annual US Total Retail Sales spending this year and relatively mild decline in 2024.

Industrial Production: The US industrial sector will decline in 2024 as demand from consumers and businesses slows and high interest rates curtail some investments. However, decline will be relatively mild due to nearshoring trends. After the sourcing challenges and delays of 2020–22, US companies are looking to keep more of their supply chains closer to North American consumers, which will benefit the US manufacturing sector.

Residential Construction: Given affordability constraints and macroeconomic concerns, annual US Single-Unit Housing Starts are declining. This trend will extend into late 2023, troughing below 2020 levels. To date, Multi-Unit Housing Starts have fared better than Single-Unit Starts, as many would-be homebuyers have instead opted to continue renting. However, Multi-Unit Starts are weakening; a mild declining trend will extend from the first half of this year into early 2024. Given low vacancy rates and housing inventories, we do not anticipate a Great Recession-like scenario this cycle. Rise across the residential construction market will characterize the rest of 2024.

Nonresidential Construction: Nonresidential construction lags the US macroeconomy by about a year, as funding, planning, and starting such projects is a lengthy process. We expect to see some decline in the nonresidential sector materialize in 2024 as early impacts of high interest rates manifest. Weakness will likely extend past 2024, given this sector's lag time to the macroeconomy.

> *"In December, we revised our US macroeconomic outlook due to the sustained yield curve inversion."*

For your business purposes, keep in mind that the above overviews apply to very large sectors, and trends within your specific vertical markets will vary in sensitivity to the economic downturn. Furthermore, there are still risks to the above outlooks. These forecasts are predicated on the assumption that the yield curve inversion will not last past 2023. If it does persist further, it would indicate the likelihood of a deeper and longer-lasting recession than forecasted.

Make Your Move

The upcoming macroeconomic downturn will be relatively mild. Make the most of any downtime by scheduling maintenance and improvements to your business ahead of the accelerating rise expected for 2025.

Investor Update

The S&P 500 Index declined 19% (18% adjusted for dividends) over the course of 2022. In the post-WWII era, only 1974, 2002, and 2008 posted worse results. The bond market offered no relief in 2022; interest rate hikes resulted in historic bond market losses. As a result, a 60/40 portfolio of stocks and bonds ended the year down 17%.

ITR Economics Long-Term View

2023	2024	2025
SLOWING GROWTH	RECESSION	RECOVERY

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 leading indicators are overwhelmingly signaling ongoing downside pressure for the US industrial sector into at least the second half of 2023.
- The US ISM PMI (Purchasing Managers Index) 1/12 ticked up in December, but this is more likely normal volatility than the start of a rising trend.
- Given our overall macroeconomic expectations, we are likely to see further decline in the leading indicators through much of 2023.
- The ITR Retail Sales Leading Indicator™ points to lower growth rates for the US consumer sector through much of 2023.

Industry Analysis

RETAIL SALES

- Annual US Total Retail Sales are up 10.1% from last year
- Several factors portend softer consumer spending ahead, including decline in inflation-adjusted savings levels, stock market volatility, and elevated interest rates
- However, a strong jobs market and low credit delinquency rates suggest consumers will be able to continue spending through most of this year

WHOLESALE TRADE

- Annual US Total Wholesale Trade was up 17.9% in November
- We expect slowing growth to persist in the coming quarters
- Slowing industrial activity and waning Retail Sales momentum will hinder demand for goods later this year

AUTO PRODUCTION

- Annual North America Light Vehicle Production totaled 14.1 million units in November, up 7.9% from the year-ago level
- A number of leading indicators suggest that Phase B, Accelerating Growth, will persist during the first half of this year
- However, a bearish stock market and elevated interest rates may hinder demand for vehicles

MANUFACTURING

- US Total Manufacturing Production is up 3.6% from one year ago
- Producer backlogs and our Retail Sales expectations suggest that further Manufacturing rise is likely during at least the first half of 2023
- Manufacturing will likely contract in 2024, in line with expected trends in overall industrial activity

ROTARY RIG

- The US Rotary Rig Count averaged 721 in 2022, up 51.9% from the 2021 level
- Oil and natural gas exports are at or near record highs, and extraction capacity is constrained, indicating a need for more wells
- This bodes well for further rise in the Rig Count this year

CAPITAL GOODS NEW ORDERS

- US Nondefense Capital Goods New Orders (excluding aircraft) were up 9.1% in November
- Higher interest rates will contribute to slowing growth in the business-to-business sector this year
- However, nearshoring trends and extended backlogs will likely cushion downside pressures

TOTAL NONRESIDENTIAL CONSTRUCTION

- US Total Nonresidential Construction during the 12 months through November came in at $872.8 billion, up 5.9% year-over-year
- Construction backlogs suggest builders will remain busy through at least the first half of this year
- Elevated interest rates and waning industrial sector momentum could put some projects on hold

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Single-Unit Housing Starts in November were down 9.2% from last year
- Elevated mortgage rates are expected to hinder consumer demand this year
- However, low inventories will buoy Starts and prevent a Great Recession-like scenario this cycle

A Closer Look: The US Economy

Shifting Sands in Financial Markets

BY: ERIC POST

What you need to know: 2023 will be fundamentally different than 2022; the rearview mirror will not be helpful

When they first come to ITR Economics, many of our clients have fallen prey to a common pitfall: using the rearview mirror to make forward-looking decisions. It is human nature, but it is not the best business practice or investment approach. With that in mind, we will dive into four hot-button financial topics: inflation, commodity prices, interest rates, and the stock market.

INFLATION

Inflation averaged 4.7% in 2021 and 8.0% in 2022. It would be easy to think inflation will stay elevated in 2023, but our analysis shows significant easing in inflationary pressures is probable. We are forecasting inflation to average 3.6% for 2023, dipping back into the 2%s in the second half of the year. The bottom line is that by the second half of this year, we will be in a very different inflation environment than that of 2021–22.

COMMODITIES

Prices of most commodities will move lower in 2023, with the specific supply-demand dynamics determining the extent of the pullback. Oil prices averaged $95 per barrel in 2022, a 39% increase from the 2021 average. We expect relief at the pump in 2023, with oil forecasted to average $76 this year, 20% below the 2022 average. Prices will bounce around the low $70s in the second half of 2023. Steel scrap prices will come down 28% this year from their 2022 average. Copper will come down a comparatively scant 8% as the end of China's zero-COVID policy blunts the downward momentum in the global economy.

INTEREST RATES

Our analysis suggests that US short-term interest rates, as set by the Federal Reserve, will cease their rise around March–May as the above-described easing in inflationary pressures enables the Fed to take its foot off the interest rate gas pedal. Long-term interest rates are likely to move generally lower in 2023, with more pronounced decline in the second half of the year as the economy heads into a 2024 recession.

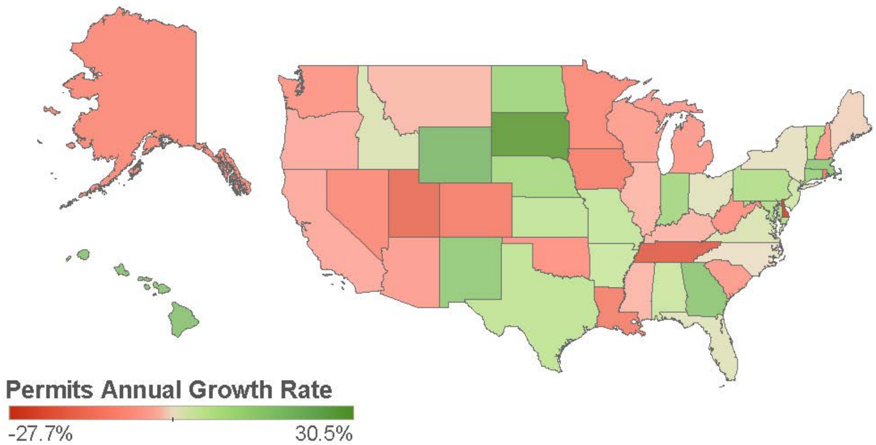
STOCK MARKET

We do not forecast the stock market, and for good reason! However, we do study the market closely as part of our ITR Optimizer™ process. That process enabled the Optimizer portfolio to avoid most of the 2022 market decline by favoring defensive-oriented or inflation-resistant sectors; the Optimizer portfolio – managed by Bellwether Wealth – was down 3% for 2022 versus the S&P 500's 18% decline. At some point this year, the market will likely come to terms with the 2024 recession that we are forecasting and shift its focus toward the subsequent recovery. Do not get caught flat-footed; 2022's market pessimism should not color your long-term thinking.

SUGGESTED TAKEAWAYS

1. Look to put through your price increases sooner rather than later.
2. If possible, delay transportation contracts, raw commodities purchases, and getting locked into interest rates.
3. Consider the stock market on a sector-by-sector basis and account for the disparate impact of inflation and interest rate pressures; reach out to Bellwether Wealth or your financial advisor if you need help.

State-by-State: Permits



- US Housing Unit Building Permits in the 12 months through November totaled 1.675 million, down 1.0% from the year-ago level.
- The US states are evenly split between Permits rise and contraction relative to the year-ago level; however, nearly all are characterized by declining rates-of-change.
- Given our outlook for the housing market, Permits are likely to decline in the coming months and quarters as consumers contend with high prices and high interest rates.
- States with favorable demographic and migration trends will likely fare better, as housing will be needed to accommodate population increases.

Readers' Forum

What will be the primary drivers of economic trends in 2023, and how can I prepare my business accordingly?

Sara Aybar, Economist at ITR Economics™, answers:

We expect the majority of the US macroeconomy to grow in the first half of 2023 before winding down in the latter half of the year. We expect near-term growth will be driven by the combination of a relatively strong consumer, expanded producer backlogs, and nearshoring trends; these factors will also keep the subsequent recession relatively mild. High interest rates will take a higher toll moving into the second half of 2023; the elevated cost of borrowing will impact businesses and consumers' willingness to spend. Furthermore, high interest rates have resulted in high mortgage rates, reducing demand for new homes and sending US Single-Unit Housing Starts into recession.

The bottom line is that if your business correlates well with the industrial sector, you will likely need to reevaluate your business plans for late 2023 and 2024. Over the next few quarters, make an effort to grow your backlogs where possible to mitigate softening demand on the back side of the business cycle. However, keep in mind the relative mildness of the anticipated recession; do not scale down too drastically. This is particularly important as it relates to your future labor needs, as we expect growth to return in 2025.

Though high interest rates will likely negatively impact many this year and moving into 2024, they will likely achieve the intended result of reducing inflationary pressures. We expect the upcoming year and a half to be characterized by disinflation, or slowing rise in prices. You will need to manage your business differently in the disinflationary environment of 2023−24 than you did during the inflationary period of 2021−22. Pricing pressures will be less of a contributor to your nominal sales numbers; make sure your financial plans account for that.

Please send questions to: questions@itreconomics.com