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

Consumers are spending more than ever. Annual US Total Retail Sales and annual US Total Personal Consumption Expenditures (which include spending on services as well as goods) are at record highs. However, both are rising at slowing rates.

The ongoing spending rise is largely due to the financial stability of the consumer. Although consumers are now saving a smaller portion of their incomes than earlier in the pandemic, their debts remain manageable – delinquency rates are low relative to recent years. Additionally, labor market conditions favor the consumer; throughout 2022, there have been roughly two job openings for every person seeking a job. Wages and real personal income (excluding transfer payments) are rising, as well. Consumer inflation has declined for three straight months from a tentative June peak, indicating preliminary signs of a disinflation trend. We anticipate 2023 will be characterized by disinflation, which will help ease some of the pricing burden on consumers.

Consumers' financial health will drive further rise in spending – we anticipate growth for Retail Sales on both a dollars basis and an inflation-adjusted basis through at least 2023. However, the pace of rise for consumer spending will likely slow for the majority of this time.

Businesses are also in good financial standing. Annual US Nondefense Capital Goods (excluding aircraft) – a measure of business-to-business spending – are also at record highs, though the pace of rise is slowing as demand cools amid a softening US economy. However, businesses have ample backlogs to work through, which will help support New Orders spending.

> *"The ongoing spending rise is largely due to the financial stability of the consumer."*

US Domestic Corporate Profits are at record highs, signaling that many businesses have the means to invest in new capital. As with Consumer Prices, we anticipate disinflation in Producer Prices in 2023, which will help ease pressure on businesses' margins. Overall, we anticipate slowing growth will characterize business-to-business spending in 2023.

The Federal Reserve poses a major risk to our longer-term outlooks for consumer and business spending. The Fed has taken an aggressive approach to trying to rein in inflation and the labor market this year – since March, the Fed has raised the federal funds rate by 300 basis points. The body has signaled that further rate increases are to come, and it began reducing its balance sheet (quantitative tightening) during the second quarter. There is the potential that the Fed will over-tighten, which has occurred in the past, potentially resulting in a more severe cyclical downturn for the US economy. We are monitoring the situation closely.

Make Your Move

While inflation is beginning to ease, overall pricing will still be elevated in 2023 relative to recent years . If your business is consumer-facing, make sure you have options to cater to a more price-conscious consumer.

Investor Update

September bolstered its reputation for market pain this year. The S&P 500 closed the month down 9.3% from August, marking the sixth-sharpest month-to-month drop of the last 30 years. Be on the lookout for shifting trends within sectors as inflation begins to ease.

ITR Economics Long-Term View

2022	2023	2024
SLOWING GROWTH	SLOWING GROWTH	GROWTH

Leading Indicator Snapshot

	4Q2022	1Q2023	2Q2023
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 ITR Leading Indicator™ moved lower in September, signaling ongoing business cycle decline for the US industrial sector into the second quarter of 2023.
- General decline in the US OECD Leading Indicator's growth rate signals decline for the US Industrial Production growth rate into at least the first half of next year, in line with our outlook.
- Downward movement in the ITR Retail Sales Leading Indicator™ corroborates our expectation for further growth-rate decline in US Total Retail Sales.

Industry Analysis

RETAIL SALES

- US Total Retail Sales in the 12 months through September were at $7.99 trillion, 11.7% above the same period one year ago
- Rising wages and a tight labor market oriented to the consumer's advantage bode well for future Retail Sales spending
- Annual Retail Sales will rise through at least 2023, though at a slowing pace

WHOLESALE TRADE

- Annual US Total Wholesale Trade was at $7.9 trillion in July, 21.5% above the year-ago level
- Both business-to-business and consumer spending are at record highs, contributing to rise in Wholesale Trade
- Wholesale Trade will generally rise through 2023, but the pace of rise is likely to slow throughout that time

AUTO PRODUCTION

- Annual North America Light Vehicle Production is rising
- Annual Production will rise through at least 2023, surpassing year-ago levels by the end of 2022
- Though easing, supply chain constraints are still a pain point and annual Production will remain below pre-pandemic levels through 2023

MANUFACTURING

- Annual US Total Manufacturing Production was 4.2% above the year-ago level in September
- Rising interest rates could impact demand for Production in numerous sectors; however, this economic impact will likely manifest over years rather than immediately
- Annual Production will expand at a slowing pace through 2023

ROTARY RIG

- The US Rotary Rig Count averaged 761 units in the three months through September
- The quarterly Rig Count has risen to just 3.0% below the pre-pandemic level
- Slowing macroeconomic growth in the US and abroad will soften demand for drilling activity

CAPITAL GOODS NEW ORDERS

- US Nondefense Capital Goods New Orders in the 12 months through August were 10.5% above the same period one year ago
- The labor shortage and the consequent increased need for automation will contribute to some rise in New Orders
- Easing pricing pressures will contribute to continued slowing growth in New Orders

TOTAL NONRESIDENTIAL CONSTRUCTION

- US Total Nonresidential Construction in the 12 months through August came in 1.2% above the year-ago level
- However, inflation-adjusted Total Nonresidential Construction is below year-ago levels
- Construction is likely to rise in the coming quarters given its typical lag time to the US economy

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction was 19.5% above the year-ago level in August
- Mortgage rates have so far doubled in 2022, breaking above 7% as of mid-October
- Input costs have bolstered the dollar-denominated Construction data, but Single-Family Housing Starts, which are measured in units, are contracting

A Closer Look: The US Economy

Housing Affordability Headwinds and the Scarcity Cushion

BY: ERIC POST

What you need to know: Home prices are likely to come down somewhat, but generally more so in higher-price areas

In the second quarter of 2022, the US median sales price of a new home sold was $440K, a 35% increase relative to the pre-pandemic price. Meanwhile, the US 30-Year Conventional Mortgage Rate for the week of Oct. 13 was at 6.92%, the highest in more than 20 years and up 3.81 percentage points from the start of 2022. Consequently, average household incomes are running below what is needed to afford average-priced homes in 37 of the 50 states.

The problem extends beyond affordabilility. With buyers warier to commit to large-dollar sums, the number of US New Homes Sold over the most recent 12 months is down 16.1% from the year-ago level. In addition, the US Personal Savings Balance Index (deflated) is declining, signaling that buyers may have a harder time making down payments going forward.

HIGH-PRICE AREAS AT GREATER RISK FOR DECLINING PRICES

Areas of particular concern include the West Coast, the Mountain West, and the Northeast as far down as New York and New Jersey. In Florida, too, incomes have lagged significantly behind average home prices. In most of these areas, average household income is running $40–60K below what is needed to afford the average home; home prices are generally likely to come down harder here than elsewhere in the country.

By contrast, incomes are above home prices in 13 states clustered in the middle of the country: Nebraska, Kansas, Iowa, Missouri, Indiana, Ohio, Kentucky, West Virginia, Oklahoma, Arkansas, Louisiana, Mississippi, and Alabama. If you operate in these states, know that you will have a relatively stable housing market this cycle.

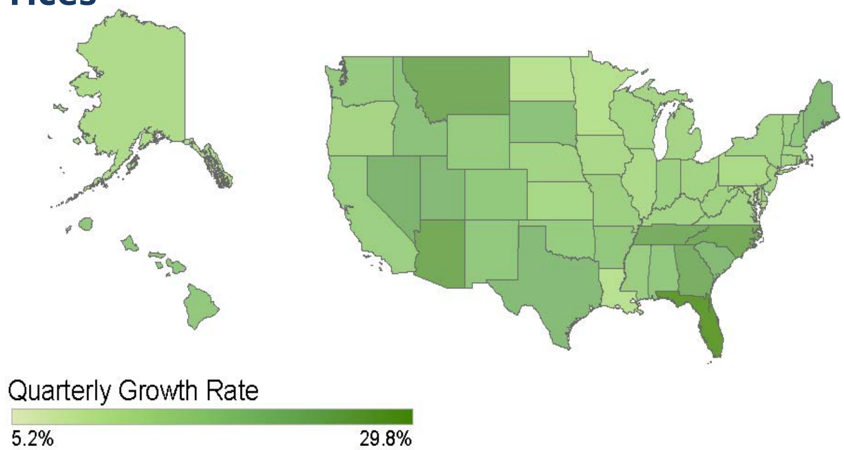
WHY THIS WON'T BE THE GREAT RECESSION 2.0 FOR HOUSING

In a word, inventory. Prior to the Great Recession (July 2007), there were as many 4.0 million existing homes for sale nationwide; in August 2022, that figure was just 1.3 million. We have not built nearly as many homes following the Great Recession as we did leading up to it. The resulting supply-demand dynamic will overcome some of the affordability headwinds and keep the housing market from undergoing what would otherwise be a more painful price correction.

WHAT TO DO

Consider your business's regional exposures. Are you heavily tied to markets that have seen an incredible surge in home prices this cycle (Boise, Austin, Tampa, etc.)? If so, you should be more conservative in your planning than those who operate in the low-home-price areas of the country (Indiana, West Virginia, Alabama, etc.).

State-by-State: Prices



- In July, monthly seasonally adjusted US Home Prices declined for the first time since May 2020. However, despite the month of decline, Prices were still above year-ago levels by double-digit percentages.
- State Home Prices for the second quarter (latest available data) were up from year-ago levels by double-digit percentages – Washington, DC, with Prices at 5.2% above the year-ago level, was the outlier.
- Home price gains have been strongest in states with favorable demographic trends, such as those in the Southeast, Southwest, and Mountain regions.
- Builders face some danger of overextension in these strong markets. When making plans for next year, ensure that local wage growth is sufficient to support ongoing buyer activity.

Reader's Forum

What is the state of the global financial system?

Sara Aybar, Economist at ITR Economics™, answers:

In brief, the global financial system is tightening.

Many central banks around the world have raised interest rates in response to rising inflation. This comes amid rising uncertainty regarding the Russian war in Ukraine and skyrocketing energy costs in Europe. Markets have responded to economic changes with volatility; the S&P 500 posted its sixth-worst month-to-month drop in 30 years in September, and the British sterling has fluctuated several times in reaction to former Prime Minister Liz Truss's economic policies. Evidence suggests that the factors driving tight financial conditions will not be going away any time soon.

Trends in the World Uncertainty Index and the US National Financial Conditions Index suggest that financial conditions will create further headwinds for the global industrial sector in the next 8–12 months.

That said, we encourage readers to avoid excessive pessimism. The back side of the business cycle can be stressful; channel your fears into your preparations for the future and ask yourself what opportunities the low point of this cycle could bring.

Please send questions to: questions@itreconomics.com

