The ITR Advisor

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Industry Snapshots

Arrow denotes 12-month moving total/average direction.

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

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

Macroeconomic Outlook

Inflation, supply chains, and labor are top concerns for businesses and, more recently, the US consumer. In October, consumer inflation surpassed 6% for the first time in 30 years while producer inflation broke above 12%, a rate of rise for pricing not seen in over 40 years. Material shortages, high transportation costs, port backlogs, and truck driver shortages are just some of the supply chain issues plaguing producers and putting upward pressure on prices. These constraints, coupled with a tightening labor market, have many wondering: How long will this last? And are we headed for an economic downturn? Our answer is economic growth will slow next year and inflation will moderate, particularly in the second half of 2022.

US Real Gross Domestic Product, which earlier this year notched a full recovery from the pandemic-induced shutdowns, has already transitioned to a slowing growth trend. This is the first realization of the softening growth our system of leading indicators has been alluding to. However, with both Domestic Corporate Cash Holdings and US Disposable Personal Income elevated relative to pre-pandemic levels, consumers and businesses have the financial health to drive further economic growth through 2022, albeit at a slower pace.

The softening of demand-side pressures will help moderate inflation through 2022, especially in the second half of that year. Remember, however, that inflation is the rate of rise in prices; price levels themselves, in many cases, will stay elevated relative to pre-pandemic norms. Deceleration in demand will also help mitigate supply chain issues somewhat as 2022 progresses, but do not expect such problems to disappear entirely.

> *"The softening of demand-side pressures will help moderate inflation through 2022"*

While the supply chain and inflation situations will improve during 2022, the labor shortage will be a consistent pain point. A record 5.2 million US nonfarm workers – or 3.6% of such workers nationwide – quit their jobs in August. This figure illustrates workers' confidence in the labor market and in their ability to get new jobs, and such confidence is well-founded. US Nonfarm Job Openings are surging, and average wages – up 4.9% over the last 12 months – are rising as firms compete for employees. The myriad of workforce-related issues mean the tight labor market will be a feature of the economy for at least the coming years.

To deal with the persistence of the labor shortage, strategize now on how to attract and retain workers. Conduct market research for your industry and geographic area to ensure your wages and benefits are competitive. Expand your hiring bandwidth. Finally, ensure your management team and company culture are not just good, but great. Woo even your existing workers – why is your company such a great place to work? Pricing and supply chains should still be on your mind, but your labor strategies will be key to success in 2022.

onDemand

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Make Your Move

Prepare your business for slowing growth by looking for ways to maintain and grow margins as demand softens next year. Avoid straight-line planning; ensure you are factoring a year of slowing macroeconomic growth into your budgets.

Investor Update

During October, the stock market recovered from September's decline and set record highs. Avoid getting emotionally caught up in the market's short-term volatility. Focus instead on the long-term probabilities, which suggest that now is a good time to be invested in sectors that tend to outperform during periods of slowing economic growth and elevated inflation.

ITR Economics Long-Term View

2021	2022	2023
RECOVERY AND RISE	GROWTH	GROWTH

Leading Indicator Snapshot

	4Q2021	1Q2022	2Q2022
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 consensus of the leading indicator movements suggests that US industrial sector activity will transition to a slowing growth trend, following a first-quarter-of-2022 business cycle peak, as forecasted.
- Trends in the US ISM PMI (Purchasing Managers Index) suggest that the post-peak business cycle decline will extend into at least late 2022.
- The ITR Leading Indicator™ strongly confirms the trajectory of our US Industrial Production forecast.

onDemand

Industry Analysis

RETAIL SALES

- US Total Retail Sales during the 12 months through October were up 16.6% from one year ago
- Low debt levels and high savings will likely keep Retail Sales elevated in the coming quarters
- Expect slowing growth in 2022; consumers may become more price sensitive on the back side of the business cycle

AUTO PRODUCTION

- Annual North America Light Vehicle Production is declining due to supply chain problems
- Input shortages will lead annual Production lower into early next year; expect subsequent recovery and rise through at least the remainder of 2022
- As you contend with supply issues, strategically fill orders as you are able according to profitability or the importance of the relationship

ROTARY RIG

- The US Rotary Rig Count averaged 516 thousand in the three months through October, up 96.6% from the same time period last year
- Hurricane Ida hindered US Oil and Gas Extraction Production in the fall; weekly output data shows a slow recovery and is well shy of pre-pandemic levels
- Expect a better year for oil exploration and production in 2022 as firms look to capitalize on elevated oil prices

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction in September was down 6.5% from one year ago
- The ITR Checking Points™ and leading indicators suggest further business cycle rise is probable
- Warehouse construction will be a winner this cycle due to demand for greater distribution throughput; be cautious with education given uncertainty around public school enrollment

WHOLESALE TRADE

- US Wholesale Trade during the 12 months through September was up 16.6% from last year
- The US ISM PMI (Purchasing Managers Index) signals slowing growth will characterize Wholesale Trade next year
- As businesses are placing orders with multiple distributors amid recent supply chain volatility, ensure your cancellation and return policies protect your bottom line

MANUFACTURING

- Annual US Total Manufacturing Production in October was up 5.5% from one year ago
- The ITR Checking Points™ signal a near-term transition to the back side of the business cycle
- Expect slowing growth as the prevailing trend for many manufacturing segments next year; sectors plagued by semiconductor chip shortages (heavy truck, automotive) will have a different shape to their cycles

CAPITAL GOODS NEW ORDERS

- US Nondefense Capital Goods New Orders (excluding aircraft) in the 12 months through September were up 14.0% from one year ago
- Expected easing in commodities prices will likely contribute to Phase C, Slowing Growth, in dollar-denominated New Orders next year
- Work to gain market share during the upcoming period of slowing growth; conduct market research to identify what your potential customers value most

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction was up 23.4% in September
- Low inventory, a relatively strong consumer, and low interest rates suggest that Residential Construction will generally rise in the near term
- Trends in US Single-Family Housing Permits (most recent three months down 4.9% from the same three months of 2020) signal downside business cycle momentum ahead

A Closer Look: The US Economy

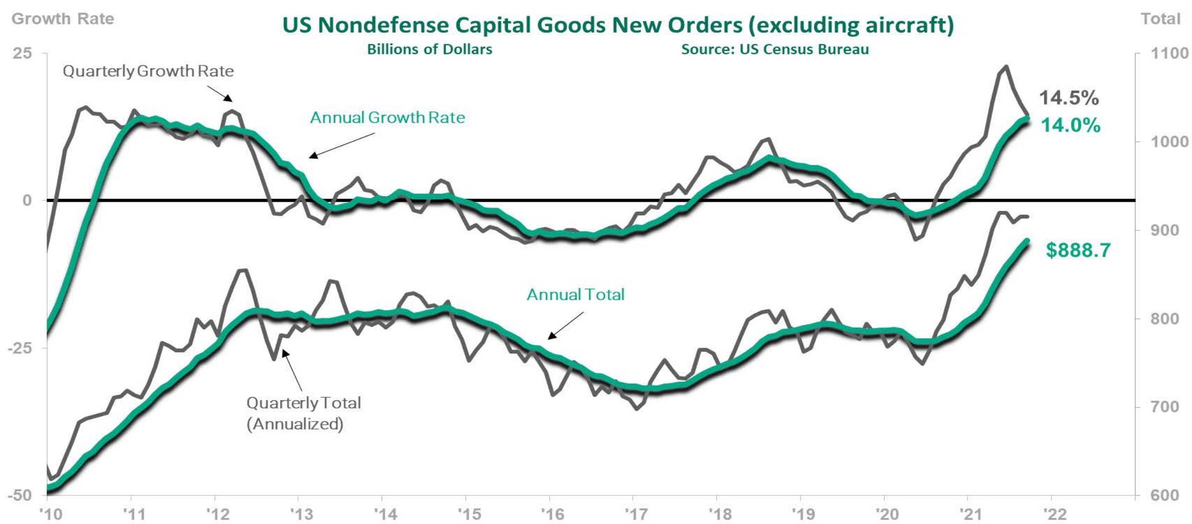
Sometimes the Answer Lies Within

BY: JACKIE GREENE

What you need to know: Companies are moving beyond the reactionary phase of bolstering their supply chains to look instead at longer-term, more strategic solutions

Chip shortages and supply chain constraints are frequently discussed pain points. How companies deal with these issues can vary.

Throughout the past recession, there was a lot of talk of companies seeking out new sources to bolster their supply chains. This was a natural reactionary move to ensure that operations could continue and product could get out the door. Reliability, accessibility, and expediency were prioritized over some of the cost-saving benefits of traditional outsourcing. These trends contributed to US Nondefense Capital Goods New Orders (excluding aircraft) totaling a record-high $888.7 billion during the past 12 months.



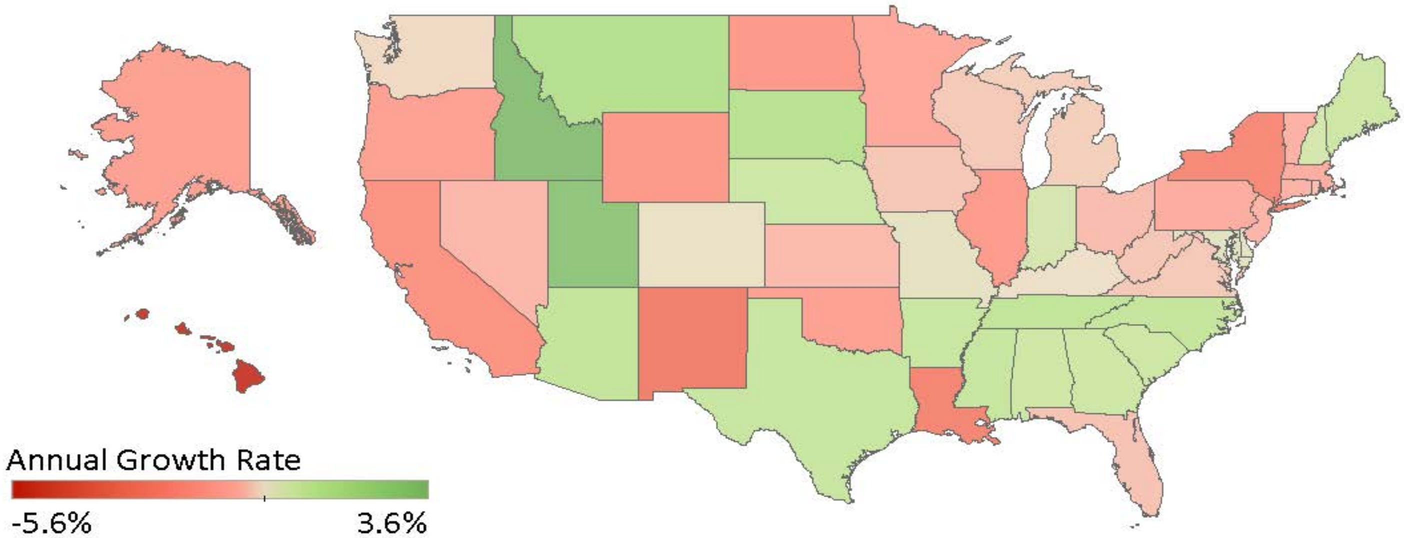
As companies are moving beyond the reactionary phase of bolstering their supply chains, they are looking for longer-term, more strategic solutions. This is leading some companies to look within.

Companies are evaluating their pain points and considering what parts of the supply chain they can own. This is not a new concept, and, after so many have felt the anxiety – not to mention the profit loss – of not being in control of their own production due to supply chains, taking matters into their own hands is a natural next step in the thought process. Amazon famously developed an in-house shipping network, and now Ford and General Motors (GM) are proposing alternative solutions to their semiconductor constraints. GM is creating partnerships in order to be better positioned to co-develop and potentially co-produce chips. Ford is partnering with a US manufacturer, a move that could eventually result in joint production on US soil, while also evaluating internalizing some chip development.

Vertical integration is not likely to solve all of a company's supply chain issues, but if you find that your sources are not prioritizing you or reacting to your needs quickly enough, this may be an avenue to explore.

Ensure you are going in with eyes wide open, as developing expertise in parts of the supply chain in which you were not previously involved is not without obstacles. For one, shortages of raw materials may still be outside your control. Also, bringing operations in-house will not solve the problem of skilled labor shortages. What is in your favor is the relatively low cost of money. Corporate bond yields are still below the one-year average, and short-term interest rates are only beginning to creep up from record lows. There is still time to act.

State-by-State: Employment



- US Total Nonfarm Employment in the 12 months through October averaged 145.1 million workers, 1.0% above the year-ago level. However, annual Employment is still down roughly 4% (6.25 million jobs) from the pre-pandemic level.
- Labor struggles are a supply rather than demand problem; annual US Total Nonfarm Job Openings are at a record high, as is the annual US Nonfarm Quit Rate, a measure of employees that voluntarily leave their jobs.
- State-level data through September (latest available) shows that annual Nonfarm Employment is above year-ago levels for about two-fifths of states; most of these are in the Southwest, Mountain West, and South regions, which tend to have very favorable demographic trends, business-friendly policies, and lower taxes.
- Annual Employment is below year-ago levels for much of the Midwest, Mid-Atlantic, Northeast, and Pacific regions; this may be a function of slower economic reopening following the shutdowns as well as worker movement away from areas with higher taxes and costs of living.

Reader's Forum

What effect does the passage of the Infrastructure Investment and Jobs Act have on ITR's outlook for 2022?

John Olson, Economist at ITR Economics™, answers:

The short answer: little to no impact for 2022. The process of bidding, selection, approval, and contracting is lengthy. Due to the long lead times, the signing of the infrastructure package will have a negligible effect in at least the near term for our put-in-place construction forecasts. Furthermore, the time horizon of the package, with spending extending into the second half of the decade, also suggests a limited near-term impact.

That is not to say that the package has no upside. The deal is a significant investment in domestic infrastructure. However, given long lead times for such projects, we anticipate that much of this spending will occur later in 2023 and beyond, as opposed to next year.

Please send questions to:questions@itreconomics.com