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Industry Snapshots

Arrow denotes 12-month moving total/average direction.

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

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

Macroeconomic Outlook

Although consumer and business financials generally weakened in 2023, the full impact of prior contractionary monetary policy – such as interest rate increases – has yet to fully manifest. Therefore, a number of segments of the economy will undergo decline during 2024 and potentially into 2025, though the severity will vary by market. Make sure you understand your own markets' place on the essential-to-discretionary spectrum. Pricing is also a factor; consumers may favor the cheaper versions of their essentials. Though you do not want to be competing on price alone, it would be prudent to evaluate your offerings and consider whether your mix needs lower-cost alternatives. Also, maintenance and repair services may fare better than sales of new equipment this year.

US Total Manufacturing Production is declining, and various factors, including elevated inventories, will apply further downward pressure. US Total Business Inventories are at record highs, and until some of this stock is unloaded, significant Production increases are unlikely. The inventory issue is especially pertinent on the durable goods side, where distributors' inventories are at almost double their sales numbers.

If your markets are declining or likely to decline in 2024, there are ways to mitigate the pain. Look to tighten accounts receivable timelines or cut back on discretionary spending. However, do not neglect to prepare your business for growth in 2025. Efficiency increases, including automation and bottleneck elimination, will be a help, especially with inflation projected to rise again starting in 2025.

"... prepare your business for growth in 2025."

Note that the residential and nonresidential construction sectors, which respectively lead and lag the manufacturing sector, are in different parts of the business cycle. The housing market, represented in the ITR Economics Trends Report™ by US Single-Unit Housing Starts, is showing post-recession green shoots. While still elevated, mortgage rates have declined mildly, and the Federal Reserve's hints at potential rate cuts in 2024 signal that they may have peaked. Low vacancy rates signal demand for housing, and we expect that the rise in Starts will persist through 2025. The ongoing rise in Starts, which lead the US economy, supports our outlook for industrial growth for much of 2025.

On the other hand, US Private Nonresidential Construction, a dollar-denominated dataset, is still getting a boost from both rising labor costs and a variety of federal spending bills (for infrastructure, semiconductor manufacturing, etc.) passed in 2021 and 2022. Rise in annual Construction will persist through 2024, though the pace of rise will slow throughout the year. Annual Construction will decline in 2025 as high interest rates and business hesitance in 2024 impact investment in new projects.

Interest rate changes, supply chain disruptions, and commodity price shocks are potential disruptors of this outlook. If any of these occur, we will keep you apprised of the impact.

Make Your Move

The upcoming downturn will be mild for many markets, and growth will return in 2025. Consider the level of expected rise for your markets or end markets in 2025 before making any large cuts to your capacity or workforce.

Investor Update

The S&P 500 posted a 24.2% gain for 2023 as a whole, led by gains in shares of the "Magnificent Seven" (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) as inflationary pressures eased and optimism increased for a "Goldilocks" soft landing for the economy coupled with low inflation. What happens in 2024? For the near term, we are concerned that the market is underestimating the potential for macroeconomic weakness.

ITR Economics Long-Term View

2024	2025	2026
RECESSION	GROWTH	SLOWING GROWTH

Leading Indicator Snapshot

	1Q2024	2Q2024	3Q2024
ITR Leading Indicator™	Green	Green	Gray
ITR Retail Sales Leading Indicator™	Red	Red	Red
US OECD Leading Indicator	Green	Green	Green
US ISM PMI (Purchasing Managers Index)	Red	Green	Green
US Total Industry Capacity Utilization Rate	Red	Red	Gray

Green: *Denotes that the indicator signals cyclical rise for the economy in the given quarter.*

Red: *Denotes that the indicator signals cyclical decline for the economy in the given quarter.*

Gray: *N/A*

KEY TAKEAWAYS

- The ITR Leading Indicator™ trended flat in December with a slight upward bias. Despite the prior rise in the indicator (indicated by the green dots in the table), the current stall in that rise alludes to weakness ahead. Waning macroeconomic fundamentals and still-elevated interest rates corroborate that weakness will persist.
- The US ISM PMI (Purchasing Managers Index) monthly rate-of-change moved higher in December. This indicator suggests an earlier cyclical low for the industrial sector than forecasted. Similarly, the US OECD Leading Indicator monthly rate-of-change moved higher in December and signals an imminent annual rate-of-change low for the US industrial sector. However, a broader survey of evidence, including the still-inverted yield curve and elevated interest rates, suggests that a low around the end of 2024 or early 2025 is most probable.
- The US Total Industry Capacity Utilization Rate monthly rate-of-change ticked up for a second consecutive month in December, but it is too early to determine if this is a sustainable rising trend. Prior decline in the monthly rate-of-change still suggests US Industrial Production business cycle decline into at least mid-2024, in line with our forecast.

Industry Analysis

RETAIL SALES

- US Total Retail Sales in 2023 grew 3.2% from the 2022 level
- Retail Sales will edge lower this year, as evidenced by weakening consumer financials and rising inventories
- Big-ticket items requiring financing are likely to face greater headwinds given the current high interest rate environment

WHOLESALE TRADE

- US Total Wholesale Trade in the 12 months through November came in 1.2% below the year-ago level
- Wholesale Trade is projected to decline further this year mild macroeconomic contraction reduces demand
- Price sensitivity is likely this cycle, given recent memories of high inflation and consumers' belt-tightening in response to macroeconomic weakness

AUTO PRODUCTION

- North America Light Vehicle Production is rising but is expected to begin declining in the near term
- The cumulative impact of tighter lending criteria and a weakening macroeconomy will contribute to the decline
- Vehicle inventories are rising but are below pre-pandemic levels; as carmakers shift logistics strategies, dealers may choose to carry lower inventories in the coming year

MANUFACTURING

- US Total Manufacturing Production in 2023 was 0.5% below the 2022 level; Production is generally declining
- We are monitoring shipping disruptions due to conflict in the Middle East; while shipments may be delayed due to longer journey times, the overall supply chain is in a better position to handle difficulty than in 2021 or 2022
- Production decline is likely to persist this year

ROTARY RIG

- The average US Rotary Rig Count in the fourth quarter declined to 622 rigs, 19.8% below the fourth quarter of 2022
- The Rig Count is likely to decline this year, as the combination of efficiency gains and slowing macroeconomic demand for oil requires fewer new wells
- Despite the declining Rig Count, US Oil and Gas Production is climbing to record highs

CAPITAL GOODS NEW ORDERS

- Annual US Nondefense Capital Goods New Orders (excluding aircraft) were 1.7% above the year-ago level in November
- Defense Capital Goods were 15.3% above the year-ago level over the same period
- Nondefense Capital Goods New Orders will likely decline in the near term, and that decline will extend through much of this year

TOTAL NONRESIDENTIAL CONSTRUCTION

- In November, annual US Total Nonresidential Construction was 18.8% above the year-ago level
- Both Public and Private Construction are in accelerating growth trends, the former driven in part by investment in semiconductor fabrication facilities and the latter pushed up by government infrastructure funding
- Annual Total Nonresidential Construction will likely rise into late this year

TOTAL RESIDENTIAL CONSTRUCTION

- US Total Residential Construction in the 12 months through November rose to $870.4 billion, though it remains 6.4% below the year-ago level
- Construction is tentatively in a recovery trend - trends in homebuilder sentiment and home sales suggest recovery and rise are likely sustainable
- Mortgage rates have trended below 7% since mid-December, a positive signal for easing affordability constraints

A Closer Look: The US Economy

Presidential Election Year

ALAN BEAULIEU

What you need to know: The common perception of election years as "good for the economy" is false

2023 FORECASTS IN REVIEW

We forecast using our economic theories, leading indicators, a 360-degree view of what is happening in the world, and our analytical tools. Each year we publish the same list of results so that you may have confidence in ITR Economics' forecasts for the coming year(s) and to hold ourselves accountable. The 2023 Preliminary Forecast Accuracy Results are shown below.

2023 Preliminary Forecast Results ITR ECONOMICS

	Duration	Accuracy
US GDP	15	98.0%
US Ind. Production	14	99.8%
Europe Ind. Production	14	99.5%
Canada Ind. Production	15	99.3%
China Ind. Production	13	99.6%
Retail Sales	12	99.9%
Housing - Single Family	14	92.0%
Employment-Private Sector	13	99.5%

ITR Economics provides the best economic intelligence to reduce risk and drive practical and profitable business decisions.

A COMMON PERCEPTION

Our tools and methods have worked for many decades. One of ITR Economics' cornerstones is that we are apolitical. Nevertheless, we are aware of concerns and perceptions pertaining to the economy in the political realm. One of those perceptions is that a presidential election year is "good for the economy." That perception is not valid for most areas of the economy when we measure "good" as an increased rate of growth from the previous year. We avoid the words "good" and "bad," as they are morally infused words, and their use can introduce forecaster's bias. Instead, we will use "slower growth and/or decline" and "faster rate of growth" to define our results.

FIVE SEGMENTS OF THE US ECONOMY

The methodology used is straightforward. The rate of growth in each presidential election year is compared to the rate of growth in the year prior. For example, the rate of growth for US Industrial Production in 2020 was -7.2%, which is below the 2019 growth rate of -0.7%. 2020 was the COVID year, but it did not produce any outlier results. Presidential election years stretching back to 1952 were used, resulting in 18 cases under examination. The exception to this is Single-Family Housing Starts, for which 15 cases were available for analysis.

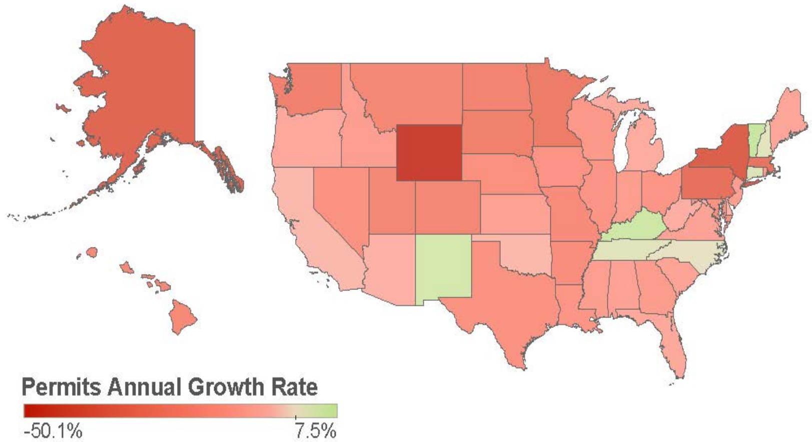
	Slower growth and/or decline	Faster rate of growth	No Change
US Industrial Production	55.50%	38.90%	5.60%
Retail Sales	44.40%	55.60%	
Single-Family Housing Starts	66.70%	33.30%	
Services (in real dollars)	50.00%	44.40%	5.60%
S&P 500	66.70%	33.30%	

Companies in the business-to-consumer space have the least downside potential stemming from a presidential election year. The service sector is ambivalent. The industrial side of the economy and the stock market are more likely to go down in a presidential election year.

THE FORECAST

ITR Economics' forecast for the industrial side of the economy is that the recession now in place will continue through at least late 2024. GDP will be essentially flat, with two quarters of mild decline. The key, as always, is to determine where your markets are heading and to adjust your expectations accordingly. The adage rings true: "You cannot change the wind, but you can adjust the sails."

State-by-State: Permits



- US Housing Permits in the 12 months through November came in at 1.5 million, 13.3% below the year-ago level.
- Permits were above year-ago levels in seven states: Vermont, Kentucky, New Mexico, Connecticut, Tennessee, New Hampshire, and North Carolina.
- Those states that had posted the greatest permitting growth in the wake of COVID-induced remote work and migration trends – including Wyoming, Alaska, and various Rocky Mountain and West region states – are now lagging behind much of the rest of the country as trends normalize.
- We anticipate general recovery and rise in the housing market this year as mortgage rates soften and affordability improves.

Readers' Forum

How will conflict in the Red Sea affect the US economic outlook?

Jenna Allen, Economist at ITR Economics™, answers:

Attacks on vessels in the Red Sea are causing a stir in global trade. Various industry sources report that the number of cargo ships going through the Red Sea is dropping significantly. To avoid the potential of damage or theft, ships are rerouting around the southern tip of Africa, a long detour that both incurs additional costs and delays delivery times.

As the situation currently stands, it is unlikely that the attacks in the Red Sea will change our outlook. Most of the attacks thus far have been relatively minor. Shipping companies, having adapted to disruptions in 2021, may have already moderated the impact of the current situation by pricing in the additional cost of avoiding the Red Sea.

We may see some supply chain tightness in the short term, including longer shipping times and an increase in demand for air freight. The situation may be a good reminder for businesses to re-up insurance policies and consider how they might diversify their supply chains or adopt near-sourcing. Ensure your risk management strategy is in place and, instead of reacting to media alarmism, focus on the leading indicators for your industry.

Please send questions to: questions@itreconomics.com

