Industry Snapshots

Arrow denotes 12-month moving total/average direction.

RETAIL SALES	Steep Rise
WHOLESALE TRADE	Steep Rise
AUTO PRODUCTION	Mild 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

With the close of the third quarter of 2021, the media messaging on the state of the US economy is mixed. Concerns over the longevity of inflation, September's stock market wobbles, and persistent supply chain shortages have caused jitters regarding the strength of the recovery. In recent weeks, energy prices have skyrocketed worldwide, with oil topping $80 per barrel and natural gas at Henry Hub breaking above $6 per million BTUs. Domestic oil and gas producers have been slow to invest in new production capabilities, and international players have been more measured in increasing supply than many had hoped.

So how do businesses cope with these issues, the mixed messaging, and the uncertainly wrought by the combination? Our independent, data-driven analysis suggests your business should prepare for the following scenario in 2022:

- The US economy is poised for growth through at least 2022, supported by a consumer base with low credit card debt, elevated savings rates, and abundant job opportunities.
- Declines in our system of indicators signal that growth will occur at a less robust pace next year than this year.
- The leading indicator declines put the stock market at elevated risk for a correction beginning at some point in the coming quarters.
- The combination of less-robust demand next year – as foreshadowed by the leading indicators – and firms' ramping up supply will allow supply chains to untangle somewhat as 2022 progresses, but issues will not likely disappear altogether.
- Given the shifting balance of supply and demand, inflation in 2022 will be lower than in 2021.

> *"Declines in our system of indicators signal that growth will occur at a less robust pace next year than this year"*

Producers will have a chance to catch their breath to some extent in 2022. Activity will still be on the rise next year, but the pace of rise will be slower. Ensure your business is prepared with adequate, but not excess, capacity for growth. For many businesses, labor constraints will likely pose the largest problem. We expect a tight labor market in the coming years, so businesses must be creative with their benefits and seize opportunities to attract and retain talent. Firms must also take extra care to monitor their finances on the back side of the business cycle. Consumers have thus far been willing to accept higher prices, but they may become more price sensitive next year. Keep your price increases on track within your industry to preserve your margins. At the same time, hone your competitive advantages and advertise them to existing and potential customers to avoid competing on price alone.

ITR Advisor / Volume 16 / October 2021
Published Quarterly by ITR Economics™

Make Your Move

Record-high quit levels illustrate the tightening labor market. Take this time to ensure your wages and benefits are competitive – while also ensuring your managers, company culture, and other nonmonetary offerings are top notch – to attract and retain employees.

Investor Update

The stock market declined in September, as measured by the S&P 500. This is not likely the onset of a bear market, given that we are not forecasting a recession in the macroeconomy. Be cognizant of what sectors you are investing in.

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 majority of key leading indicators signal a likely early-2022 peak for US industrial sector activity.
- The US ISM PMI (Purchasing Managers Index) suggests upcoming business cycle decline in the industrial sector will persist into at least the second half of 2022.
- The timing relationship between the US economy and the ITR Retail Sales Leading Indicator™ has been altered this cycle due to consumer stimulus and the COVID-19 pandemic; accelerating growth in 2022 is improbable for the economy and retail spending.

Industry Analysis

RETAIL SALES

- Annual US Total Retail Sales, up 15.9% in September, are growing at a record pace
- Savings rates (as a percentage of disposable income) have dipped closer to pre-pandemic levels, signaling less excess to draw upon for spending
- Although growth will slow in 2022, consumers are still poised to drive Retail Sales to further record highs

WHOLESALE TRADE

- Annual US Total Wholesale Trade totaled $6.6 trillion in August, up 14.8% from the year-ago level
- Leading indicators signal Wholesale Trade will grow at a slowing pace beginning in the first half of 2022
- Avoid over-purchasing materials, as inflation and economic growth rates will be lower next year

AUTO PRODUCTION

- Annual North America Light Vehicle Production moved lower in August but was up 8.9% from one year ago
- Supply chain difficulties are continuing to impede Production, resulting in temporary shutdowns of manufacturing facilities
- The strength of demand is illustrated by consumers' willingness to pay high prices

MANUFACTURING

- Annual US Total Manufacturing Production was 4.9% above the year-ago level in August
- Our analysis indicates slowing growth will take hold by the second quarter of 2022
- Steps are being taken to alleviate supply chain constraints; we expect progress will be made on supply chain entanglement in 2022, but the issues will not vanish entirely

ROTARY RIG

- The quarterly average US Rotary Rig Count rose to 498 in September, nearly double the year-ago level
- Quarterly US Oil and Gas Extraction Production – 10.3% below the record high – has been slow to recover, contributing to higher oil prices
- Crude Oil Prices (WTI) averaged $71.65 per barrel in September and surpassed $80 in mid-October

CAPITAL GOODS NEW ORDERS

- Annual US Nondefense Capital Goods New Orders (excluding aircraft) were up 13.4% in August
- Leading indicators point to an early-2022 transition to slowing growth
- Be aware of the potential for canceled orders next year; we are hearing that firms are placing duplicate orders due to long lead times

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction tentatively transitioned to a cyclical rising trend in August but was still 7.1% below one year ago
- Adjusted for inflation, the year-over-year decline in Construction spending comes in at a more severe 16.4%
- 2022 Nonresidential Construction spending will benefit from the strong 2021 economy, given typical lead times

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction was up 23.6% in August
- Consumers' strong financial position and a shortage of overall housing inventory will keep residential construction demand high
- However, a number of leading indicators to the single-family market are signaling probable 2022 deceleration in that sector

A Closer Look: The US Economy

Where Have All the Workers Gone?

BY: ERIC POST

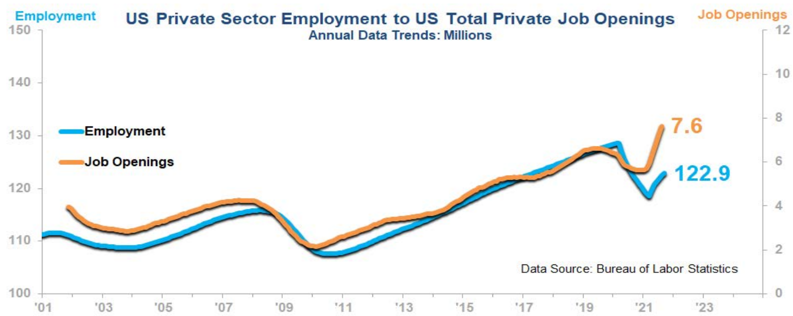
What you need to know: Take action to prepare for a tight labor market in the coming years.

It's well established that there have been myriad "positive problems" – raw material shortages, price spikes, transportation delays, labor shortages, etc. – in this business cycle. Some of these problems will be somewhat ameliorated next year by the combination of softening demand (foreshadowed by numerous declining macroeconomic indicators) and increasing supply (illustrated by rising utilization rates, capital equipment purchases, and construction starts), though the difficulties will not vanish entirely. Is there a positive problem you should be prepared to combat well into the future? According to our analysis, there is. It's the labor shortage.

Your long-term business planning must address ways to work around the scarcity of workers for at least the next three years. To understand why, consider the list of factors contributing to the current worker shortage:

1. Health and safety concerns related to the pandemic
2. Scarce and expensive childcare
3. A mismatch between the skills workers possess and the skills employers need
4. Demographics

The net result of these factors? US Private Sector Employment is running well below the pre-pandemic level, while job openings surge to record highs, driving wages higher.



While the end of extended unemployment benefits could lead to some relief for employers, such benefits are clearly not the only issue impacting labor scarcity, nor are they – in our view – the main issue. The massive baby boomer generation includes those between 57 and 75 years old. As more baby boomers retire, we will need younger workers to replace them, especially in the sectors our clients tend to operate in, which are already short on workers:

- Manufacturing: 892,000 openings in August, more than twice the August 2019 number
- Wholesale Trade: 263,000 openings in August, up nearly 50% from August 2019
- Construction: 365,000 openings in August, up about 5% from August 2019

Unfortunately, the baton pass is not occurring. Labor force participation among younger workers is severely depressed, and enrollment at two-year colleges – which tend to teach vocational skills that employers in the above sectors are seeking – is down almost 10% from one year ago.

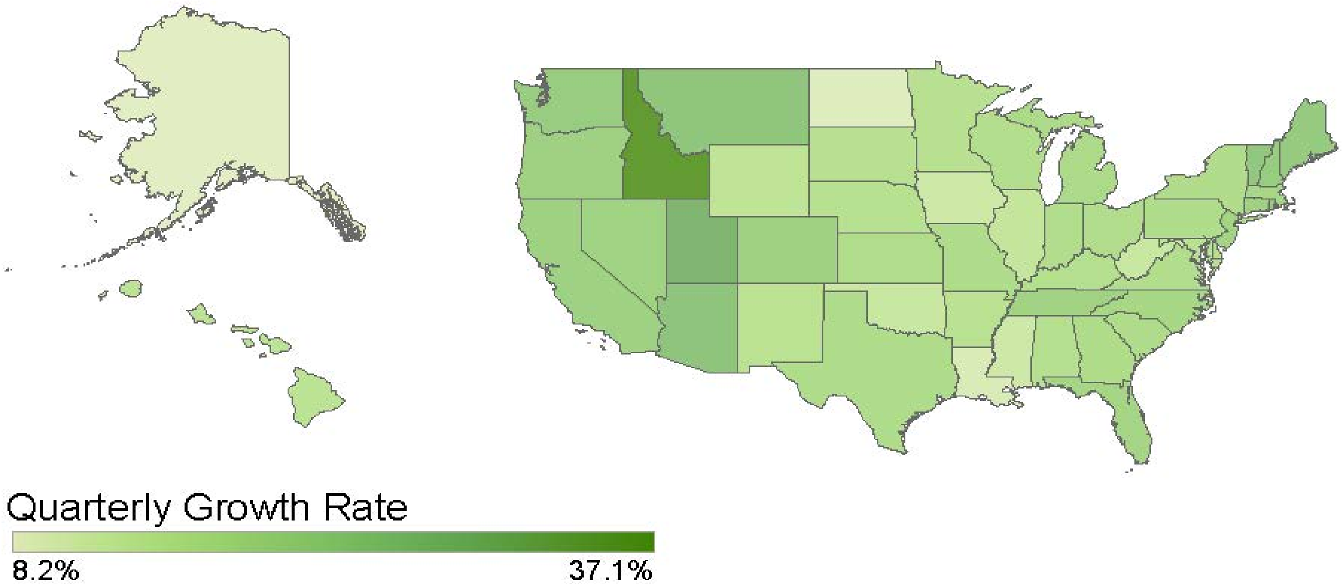
What can you do to overcome these challenges? Offering higher wages, automating labor, and raising your prices to pay for these things can help.

And if you've already done these things, or you can't afford to do more? We hear this all the time. There are many strategies which don't involve financial outlays:

- Establish a pipeline of new talent by partnering with those local institutions that have historically produced your great workers.
- Create job postings that stand out from the crowd.
- Focus on bettering your management staff.
- Support younger employees' career advancement.
- Ensure your workplace is dynamic, fun, and safe.
- Ask your employees for anonymous feedback and be transparent about working to fix any issues.

By considering the above, along with other ideas from your management team, you can ensure you are maximizing your business's odds of success in what the data shows is likely to be a persistently tight labor market in the coming years.

State-by-State: Home Prices



- Seasonally adjusted US Home Prices in the three months through July were 18.8% above the same three months of 2020; much of 2022 will be characterized by flatness or decelerating rise in Prices, with the possibility for mild decline in certain areas.
- In the second quarter (latest available data), Home Prices for all but three states (North Dakota, Louisiana, and Alaska) posted double-digit quarterly growth rates.
- The West and Northeast regions had the strongest appreciation in home values, with average quarterly growth rates of 21.7% and 20.9%, respectively, for Prices.
- The West has benefited from significant migration, while the Northeast is contending with a shortage of available homes in the suburban and rural areas sought by workers moving from cities such as New York and Boston.

Reader's Forum

My business is struggling to fulfill orders because we can't get materials from suppliers. It's hurting our bottom line as well as our reputation. When will these supply chain problems end?

John Olson, Economist at ITR Economics™, answers:

The untangling of the supply chain is and will continue to be a slow and arduous process; there is no overnight fix. Shipping container throughput is already at record highs, and yet problems persist, due in no small part to the strength of demand. Businesses are continuing to take drastic steps to address supply chain problems. Major goods carriers including UPS, FedEx, and Walmart, along with the largest ports on the West Coast, have moved to 24/7 business models to address shipping logjams and port backlogs. As we move into 2022, and demand softens as the leading indicators suggest it will, we will see a gradual easing of supply chain disruptions. We do not foresee a complete resolution by late next year, however. To implement reshoring and other alternate supply chain strategies takes time – measured in years, not months.

Please send questions to: questions@itreconomics.com

onDemand

