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INDUSTRY SNAPSHOTS

Arrow denotes 12-month moving total/average direction

Retail Sales	Mild Rise
Wholesale Trade	Flat
Auto Production	Mild Decline
Manufacturing	Mild Decline
Rotary Rig	Steep Decline
Capital Goods	Mild Decline
Nonresidential Construction	Mild Rise
Residential Construction	Mild Decline

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

MACROECONOMIC OUTLOOK

Annual industrial activity in the US edged lower in October from a likely August 2019 peak. Plan for decline to persist into mid-2020. Activity will subsequently rise into at least late 2021.

Of the three segments of US Industrial Production, only Mining Production is growing. Annual Mining Production was up 9.1% year over year, but growth is slowing. Mining Production growth will slow further in the next couple quarters, but we expect the segment to avoid recession during this cycle. Activity is declining in US Manufacturing Production and US Electric and Gas Utilities Production, the other two segments of US Industrial Production.

With the holiday season upon us, we look to the Retail Sales figures to gauge the strength of the US consumer. The seasonal rise in Retail Sales is the strongest in over a decade. The decline in the industrial economy is not halting consumer spending. However, a deeper dive into the data reveals that health is not so robust as the top-line Retail Sales numbers would lead you to believe. At 2.1%, Consumer Price inflation is running above the five-year average and bolstering the Retail Sales figures. Adjusted for inflation, Retail Sales are up a lackluster 1.3% year over year, nearly a full percentage point below the five-year average of 2.2% growth for the deflated figures. We expect US Total Retail Sales and US Real GDP to avoid recession during this business cycle, but the inflation-adjusted Retail Sales numbers suggest that consumers are growing somewhat constrained in their ability to purchase goods.

> *"However, a deeper dive into the data reveals that health is not so robust as the top-line Retail Sales numbers would lead you to believe."*

Per our leading indicator-informed forecast, the US economy will return to upward business cycle momentum in the second half of 2020. For many businesses, the renewed business cycle momentum will necessitate increased capacity by 2021. Take a look at your equipment and labor needs and the individual outlooks for your markets. If your business moves in tandem with the economy and you faced capacity constraints at the height of the last economic cycle in 2018, ask yourself how you can arrive at the 2021 peak free of such constraints. As consistently scarce labor grows costlier, look for the efficiencies that will mitigate your need to hire. If you need equipment, consider funding your purchases via today's relatively low interest rates. Then, take advantage of the downtime afforded by a mild decline in US Industrial Production and get your new gear up and running ahead of the next business cycle upswing.

MAKE YOUR MOVE™

Evaluate your markets and consider investing in capital equipment during the coming quarters, if necessary. Consider borrowing at low rates to fund your purchases.

INVESTOR UPDATE

The S&P 500 set a record high in November. The S&P 500 trend, along with our system of leading indicators, should give you confidence regarding the direction of the US economy in the latter half of 2020.

ITR ECONOMICS' LONG-TERM VIEW

2019: Weaker Second Half **2020:** Strengthening Second Half **2021:** Mild Growth

INDUSTRY ANALYSIS

Retail Sales

- Annual Retail Sales were up 3.2% from a year ago
- Consumer Price Index inflation, at 2.1%, is above the five-year average of 1.5%, bolstering overall Retail Sales
- Retail Sales growth will generally slow into late 2020 before accelerating through much of 2021

Auto Production

- Annual North America Light Vehicle Production was down 2.9% from the same time last year
- Production will decline into early 2020
- Trends in Light Vehicle Month-End Inventory Days Supply suggest light vehicle inventories are tightening relative to demand, which bodes well for Production

Rotary Rig

- The Rotary Rig Count averaged 845 rigs during the three months through November, down 20.6% from the same three months one year ago
- Counts for both Natural Gas Rigs and Oil Rigs are declining on a quarterly basis
- Rise in annual Crude Oil Exports is slowing, while Imports are declining

Total Nonresidential Construction

- Growth is slowing for annual Nonresidential Construction, up 2.1% from the year-ago level
- Annual Public Nonresidential Construction is growing, up 5.6% from one year ago
- Annual Private Nonresidential Construction spending, down 0.2% year over year, has declined further

Wholesale Trade

- Annual Wholesale Trade spending will be relatively flat into mid-2020
- Wholesale Trade of Durable Goods will decline mildly into early 2020 before rising through the rest of that year
- Wholesale Trade of Nondurable Goods will be generally flat into mid-2020 before rising in the latter half of that year

Manufacturing

- Annual Total Manufacturing Production is declining but is 0.5% above the year-ago level
- Decline in Production is expected to persist through the coming quarters
- Our expectations for Machinery New Orders suggest that Production will reach a business cycle low around mid-2020

Capital Goods New Orders

- Annual Nondefense Capital Goods New Orders declined further in October
- New Orders spending will decline into mid-2020
- Annual Defense Capital Goods New Orders were up 10.7% year over year, but are in an overall slowing growth trend
- Growth in Defense New Orders will accelerate throughout 2020

Total Residential Construction

- Total Residential Construction in the 12 months through October was down 6.9% from one year ago
- Construction spending will decline into the first half of 2020
- Both Single-Unit and Multi-Unit Housing Starts are rising on an annual basis

LEADING INDICATOR SNAPSHOT

	4Q19	1Q20	2Q20
ITR Leading Indicator™	●	●	●
ITR Retail Sales Leading Indicator™	●	●	●
The Conference Board's US Leading Indicator	●	●	●
US ISM PMI (Purchasing Managers Index)	●	●	●
US Total Industry Capacity Utilization Rate	●	●	N/A

Green denotes that the indicator signals cyclical rise for the economy in the given quarter. Red denotes the opposite.

- Monthly rate-of-change decline in the US Total Industry Capacity Utilization Rate suggests further cyclical decline for the industrial sector in the coming quarters
- The US ISM PMI (Purchasing Managers Index) monthly rate-of-change is generally rising from a tentative September low, suggesting a cyclical low around mid-2020 for Industrial Production
- The ITR Leading Indicator™ rose in the last month from a tentative October low, suggesting upward momentum in the US Industrial Production annual growth rate in the latter half of 2020

Prepare for Rising Producer Prices

By: Lauren Saidel-Baker

What you need to know: *Producer Prices will generally rise during 2020. Marine shipping rates may contribute to higher costs in 2020 for some of our readers. The subdued Producer Price inflation trends of 2019 will not carry through 2020, particularly during the second half of the year.*

We expect US Producer Price inflation will generally rise into mid-2021. Now is the time to prepare for generally rising costs in the new year.

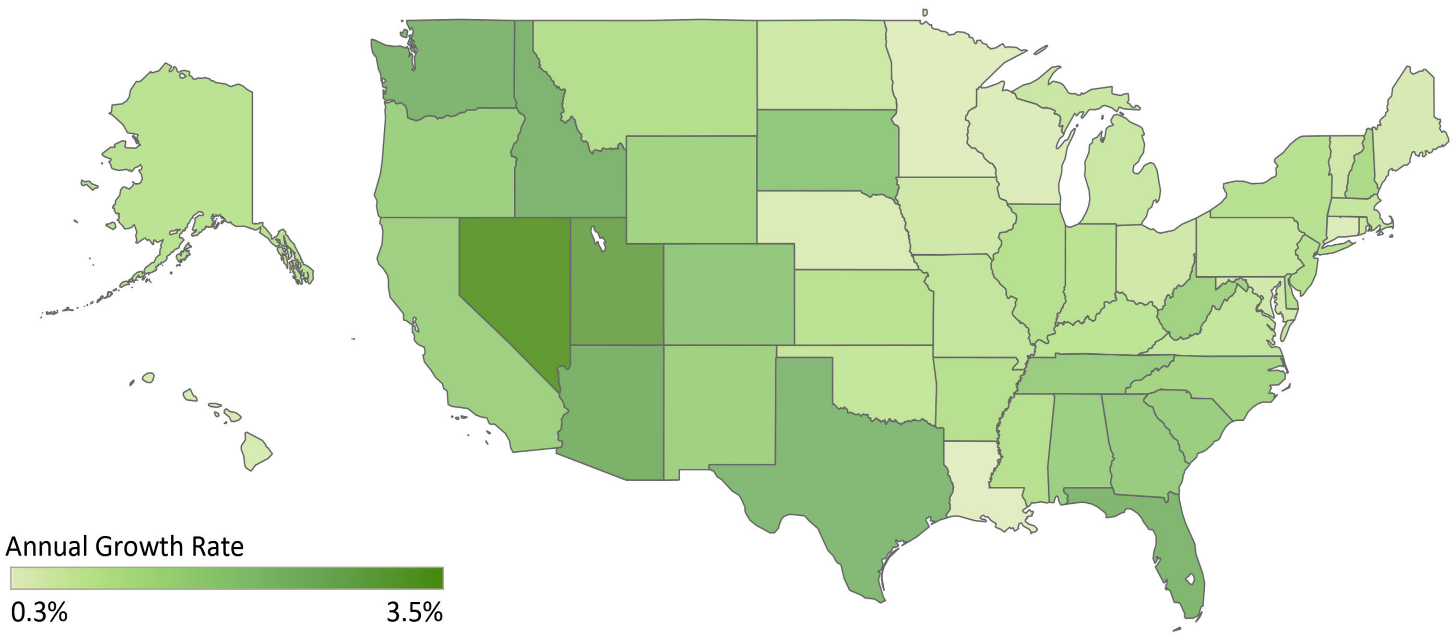
US Producer Price inflationary pressures eased throughout most of 2019, largely due to deflation in the prices of many raw materials. Slowing growth trends in the global economy and in China, the world's largest consumer of many commodities, contributed to less-robust global demand for such materials in 2019.

However, we expect prices for many commodities to bottom out between late 2019 and early 2020. Quarterly Oil Prices and quarterly Steel Scrap Prices, for example, will generally rise into at least the second half of 2020. Expect overall Producer Prices to more noticeably accelerate from the second half of 2020 into mid-2021.

Marine shipping costs will likely contribute to Producer Price inflation as well. On Jan. 1, new international regulations will take effect, potentially resulting in higher oceanic shipping rates. The regulations will lower the maximum acceptable sulfur content in ships' fuel from the current 3.5% to just 0.5%. Carriers will choose between installing exhaust-cleaning systems known as "scrubbers," which can cost several million dollars per ship, or purchasing costlier, cleaner fuel. Increased demand could strain the available supply of certain grades of fuel, driving costs higher. According to shipping industry executives, shipping fuel costs could rise by up to 40% as refineries and attendant infrastructure struggle to meet rising demand. Bottomline: The new regulations will likely translate to higher global shipping costs.

Most companies will need to budget for generally rising costs in 2020. If you are able to lock in raw materials prices or otherwise mitigate input costs, consider doing so in the near term. Many commodities will become more expensive in 2020. Your ability to pass through price increases to customers will be increasingly important that year and in 2021. Doing so will help you preserve your profit margins in a generally inflationary economic environment.

STATE-BY-STATE: Employment



- US Private Sector Employment growth will continue to slow into late 2020
- Employment is above the year-ago level in every state across the country
- Employment in the West, Southeast and Southwest regions is generally growing at higher rates, likely due in part to positive demographic trends
- Conversely, Employment growth is, for the most part, less robust in the Midwest than in the nation as a whole

READER'S FORUM

I've been hearing more about student loan debt in the news. Is it as big a problem for the economy as they make it sound? What's ITR's opinion?

Brian Beaulieu, CEO at ITR Economics™, answers:

We are concerned about student loans, but not for the reasons you would likely expect. Currently at 10.9%, the US Student Loan Delinquency Rate is below the 11.8% high seen in 2013 and edging downward. News of a $1.5 trillion liability is understandably worrisome, but, spread across the 43 million people with student loans, that comes to about $34,884 per person. Some owe more and some owe less, but on an overall basis, ITR does not believe this will permanently harm the economy. We are wary, however, of the idea of a national $1.5 trillion bailout. It may appeal to voters, but it would come at the cost of pushing the government further into debt.

Please send questions to questions@itreconomics.com