

# The ITR Advisor

MAY 2019
























**Insider**

ITR Economics

## Industry Snapshots

Arrow denotes 12-month moving total/average direction.

	RETAIL SALES	
	WHOLESALE TRADE	
	AUTO PRODUCTION	
	MANUFACTURING	
	ROTARY RIG	
	CAPITAL GOODS	
	NONRESIDENTIAL CONSTRUCTION	
	RESIDENTIAL CONSTRUCTION	

 Steep Rise
  Mild Rise
  Flat
  Mild Decline
  Steep Decline

## Macroeconomic Outlook

US Total Industrial Production during the 12 months through March was up 3.8% from the year-ago level. All three major segments of the industrial economy are rising at a slowing pace. US Mining Production, up 12.9%, is growing at the fastest rate, followed by US Electric and Gas Utilities Production, up 2.9%, and US Total Manufacturing Production, up 2.6%. Total Industrial Production activity will peak around the middle of this year before declining into early 2020.

Producer Prices are rising at a slowing rate, along with the industrial economy. This trend will likely persist into mid-2020. Although we are not expecting Producer Prices as a whole to decline during this time, prices for certain commodities, including steel and oil, will likely fall from their current levels. Ensure that you are not raising your own prices too rapidly during the next few quarters, as this could make your products less competitive. If your costs are falling, consider passing some of your savings on to your customers.

*“Ensure that you are not raising your own prices too rapidly during the next few quarters, as this could make your products less competitive.”*

The OECD's US Business Confidence Index is suggesting that companies' opinions regarding their current situation and immediate future are growing less optimistic. This indicator, which typically leads Industrial Production by about two to three quarters, is signaling that business cycle decline in the industrial economy will persist through at least much of this year. As confidence in the economy wanes, it will become increasingly important to communicate the value of your products and services. Consumers will be increasingly interested in lower-cost options. Ensure that your clients understand the unique benefits that your company provides, so that they will be less inclined to seek substitutes as the business cycle declines.

## Make Your Move

Market your products with a lower cost basis to appeal to increasingly price-conscious consumers as the business cycle moves downward this year and in early 2020.

## Investor Update

The stock market is showing positive signs despite cyclical decline in the industrial economy. However, it is too early to determine whether stock market conditions will improve further during this cycle.

## ITR Economics Long-Term View

# 2019

WEAKER SECOND HALF

# 2020

MILD GROWTH

# 2021

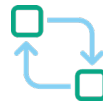
GROWTH

## Industry Analysis



### RETAIL SALES

- Retail Sales during the 12 months through March were up 4.2% on a year-over-year basis
- Retail Sales will grow at a slowing rate into the middle of next year
- Slowing inflation will place downward pressure on Retail Sales during the next few quarters



### WHOLESALE TRADE

- Wholesale Trade was up 6.1% from a year ago
- Wholesale Trade of Durable Goods, up 6.5%, and Wholesale Trade of Nondurable Goods, up 5.7%, are both in slowing growth trends
- The Durable Goods segment will likely avoid recession during this cycle



### AUTO PRODUCTION

- North America Light Vehicle Production was down 0.2% from the year-ago level
- Production will decline in the latter half of this year and into early 2020
- US Heavy-Duty Truck Production was up 16.0% but is unlikely to rise much further during this cycle



### MANUFACTURING

- Total Manufacturing Production was up 2.7% from one year ago
- Production tentatively transitioned to a slowing growth trend
- The manufacturing sector will contract mildly in the latter half of this year and in early 2020



### ROTARY RIG

- The Rotary Rig Count was up 11.4% from a year ago
- The Rig Count has been relatively flat in recent months
- Oil Prices are unlikely to rise much above their current level, which will likely keep the Rig Count from rising much above its current level



### CAPITAL GOODS NEW ORDERS

- Nondefense Capital Goods New Orders were up 5.2% year over year
- New Orders will decline in the latter half of this year and in early 2020
- Defense Capital Goods New Orders were up 19.5%
- Defense spending will be relatively flat in the second half of the year



### TOTAL NONRESIDENTIAL CONSTRUCTION
















- Nonresidential Construction was up 5.4% from a year ago
- Nonresidential Construction is growing at an accelerating pace
- The Warehouse and Manufacturing buildings segments will be areas of opportunity in 2019




### TOTAL RESIDENTIAL CONSTRUCTION

- Residential Construction was down 0.3% from the year-ago level
- Construction recently transitioned to a recessionary trend
- Both Single-Unit Housing Starts and Multi-Unit Housing Starts are declining, but the Single-Unit segment will recover later this year

## Leading Indicator Snapshot

	1Q2019	2Q2019	3Q2019
ITR Leading Indicator			
ITR Retail Sales Leading Indicator™			
US Leading Indicator			
US ISM PMI (Purchasing Managers Index)			
US Total 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 these leading indicators are signaling that US Industrial Production will trend along the back side of the business cycle through at least the end of this year
- The new ITR Retail Sales Leading Indicator™ is showing that cyclical decline will persist throughout this year, but rise could take hold around mid-2020
- The US ISM PMI has shown some positivity in recent months, which would bode well for cyclical rise in early 2020, but more data is needed to confirm this trend

## A Closer Look: Tax Reform

### The Impact of Tax Reform on Small Business

BY: ALEX CHAUSOVSKY

*What you need to know: We now have evidence confirming that 2018's tax code changes did have a positive impact on the economy.*

Tax reform was a notable economic development in 2018, with changes to the codes for both corporate taxes and individual income taxes receiving substantial coverage in the mainstream press as well as by ITR Economics. We now have evidence confirming that these tax code changes did have a positive impact on the economy, extending the Phase B, Accelerating Growth, trend by approximately six months. We also have evidence that the boost from tax reform is waning; we will not see the same impact on the economy in 2019.

One important component of last year's tax reform received relatively little attention, even though it affected a great deal of small businesses, and individuals, in America. This critical piece focuses on Qualified Business Income (QBI) deductions.

A body of evidence, some of which is provided below, shows that while the QBI deduction component of 2018's tax reform package likely did stimulate small business optimism and investment, primarily in the latter part of last year, its effects are already fading and it is unlikely to yield similar levels of investment activity in 2019.

This aligns with ITR Economics' expectations of a general macroeconomic slowdown over the course of this year, and the likelihood of a mild downturn in the US industrial economy in the first half of 2020. It underscores the need for small businesses to shift their mindsets and their actions to reflect the reality of being on the back side of the business cycle.

QBI is income derived from a pass-through entity, which is a business that "passes through" all or most of its income to the owner, who then claims it as income on his or her personal tax return. QBI includes business income after accounting for W-2 wages paid to employees, owner-guaranteed payments related to business activity, and other forms of business-related expenses incurred by the company owner. Firms that qualify for the deduction include all pass-through businesses with incomes below \$157,500 for those who file taxes as individuals, or \$315,000 for those who file jointly. Many sole proprietorships, S corporations, and partnerships, as well as some trusts and estates, meet these criteria. Business owners are subject to restricted or lesser benefits from the deduction when their incomes exceed the \$157,500/\$315,000 threshold.

The QBI deduction is calculated as the lesser of:

1. 20% of a business' qualified business income, plus 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnerships (PTPs) income.
2. 20% of taxable income minus net capital gains (net capital gains are defined differently for the purposes of the QBI; it includes dividends and investment income).

These amounts are written off from the business income that must be reported by the owner/taxpayer before any other deductions.

Although information that directly reflects the effects of the QBI deduction on small business investment is limited, data that measures overall planned small business investment and actual small business investment is readily available for analysis.

There are two primary datasets that illustrate small business investment intentions and actual activity: Small Business Capital Expenditure Plans and Small Business Actual Capital Expenditures.

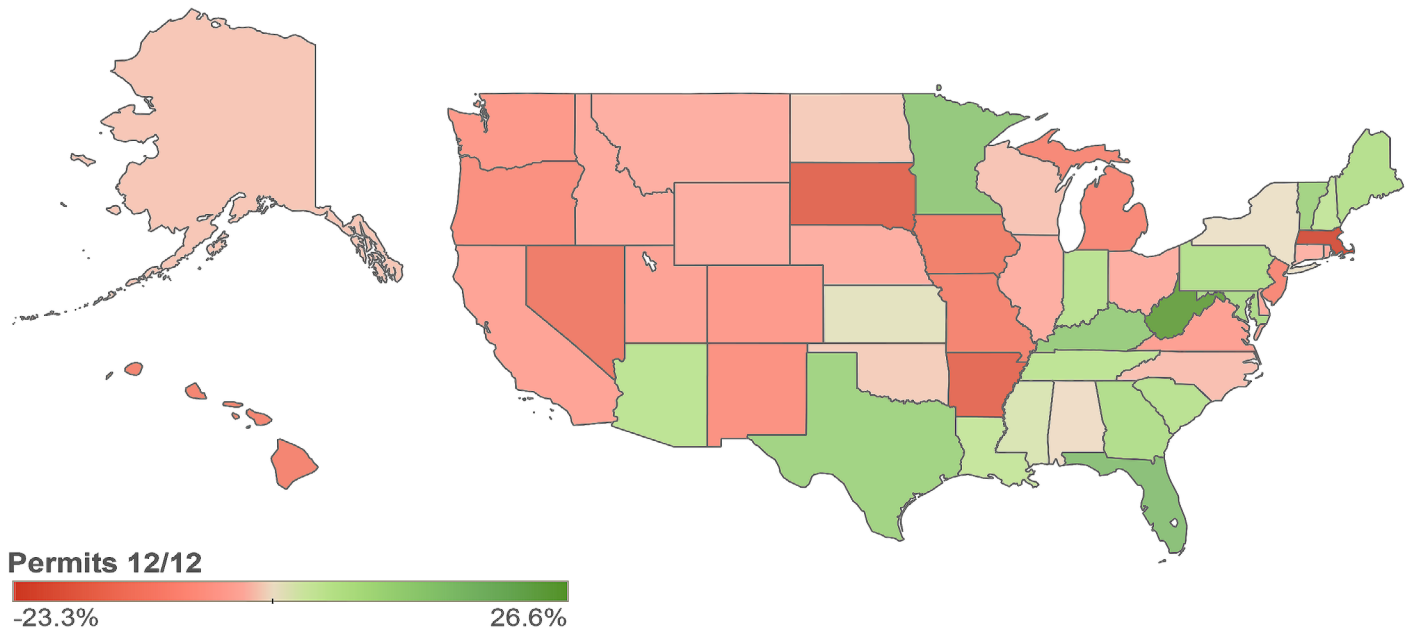
US Small Business Capital Expenditure Plans reached a cyclical peak in November of 2017, with a year-over-year growth rate of 10.9%. This highlights the optimism for the future exhibited by small businesses during that time. For the following nine months, the year-over-year comparison declined, reaching a low of 2.4% by August 2018 and mirroring waning small business optimism.

However, starting in September and lasting through the end of last year, capital expenditure plans by small businesses accelerated, partially reflecting the positive momentum associated with the boost from the QBI deduction. That momentum did not carry over into this year, with the year-over-year growth rate generally slowing through April of 2019, the latest month with available data. This indicates waning small business capital investment plans during the first four months of this year.

US Small Business Actual Capital Expenditures data, which measures the percentage of US small businesses making actual capital expenditures during the last six months, illustrates that the slowdown in investment intent has already translated to a decline in actual investment. The raw data for this series peaked at 61.0% in December 2018 and has since declined to 58.0% as of this April. When assessed on a rate-of-change basis, the April figure is 4.9% lower than the April 2018 figure, showing that fewer small businesses are pulling the trigger on capital investments so far this year.

Both the recent slowdown in Small Business Capital Expenditure Plans and the decline in the Actual Capital Expenditures data illustrate what ITR Economics has been saying for quite some time: The downside pressure on the economy is real, it will likely persist into 2020, and companies large and small need to act accordingly.

## State-by-State: Permits



- US Housing Unit Building Permits during the 12 months through March were up 1.5% from the same period one year ago
- The volume of Permits likely peaked late last year and will decline for at least the next few months
- Permits are above the year-ago level in the Southwest region, up 8.4%, and the Southeast region, up 7.3%
- Permits were down 6.4% on a year-over-year basis in the Pacific region



## Reader's Forum

**In the news, it appears that tensions are rising again with China over trade. What's going on, and what does this mean for my business?**

**James Giles, Economist at ITR Economics™, answers:**

Negotiations between the US and China over a possible trade deal appear to have suffered a setback in recent weeks. The US has since raised tariffs to 25% from 10% on about \$300 billion worth of imports. China retaliated with tariffs of their own, and the US is now considering additional tariffs to retaliate for the retaliation. US businesses and consumers will see an inflationary effect from this trade war. However, this may be masked somewhat by the current slowing rise in inflation. US companies selling into China may find that their prices are less competitive than those of non-US firms. This could lead Chinese firms to switch from US goods to lower-cost alternatives. Fortunately, the two sides have not broken off communications, and further discussions are planned for June. A trade war harms both countries, incentivizing both governments to make a deal. In the event that no deal is reached, firms should plan for more expensive imports and less-competitive exports for at least the near term.

Please send questions to: [questions@itreconomics.com](mailto:questions@itreconomics.com)



### Concerned about the slowing economy?

*Our personalized programs will show you how this will impact your business directly! Contact us today to learn more about our services.*

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