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VOLUME 3

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INDUSTRY SNAPSHOTS

Arrow denotes 12-month moving total/average direction

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

Steep Rise
Mild Rise
Steep Decline
Flat
Mild Decline

MACROECONOMIC OUTLOOK

US Industrial Production during the 12 months through June was up 2.9% on a year-over-year basis. Each of the three main components of the industrial economy is expanding at an accelerating pace. US Mining Production is growing at the fastest rate, up 10.3% from one year ago. Meanwhile, US Electric and Gas Utilities Production was up 2.6%, and US Total Manufacturing Production was up 2.0%. Growth in the industrial economy will persist through the remainder of this year. Activity will decline mildly in 2019.

A data revision by the Bureau of Economic Analysis led us to revise our US Real Gross Domestic Product (GDP) forecast. Our growth-rate projections were on target, with GDP in the second quarter of 2018 up 2.8% from the same quarter in 2017, just below the 2.9% projected. However, we revised the forecast due to the bureau's change in the data history. Activity will rise through the remainder of 2018, but the pace of growth will slow through the rest of this year. GDP will be relatively flat in 2019.

Retail Sales will transition to a slowing growth trend late this year, which will contribute to hindering the pace of growth for the macroeconomy by the end of this year.

Growth in the retail sector is supporting rise in GDP. US Total Retail Sales are in an accelerating growth trend, up 5.0%, rising as a result of increased consumer strength and inflation. Retail Sales will transition to a slowing growth trend late this year, which will contribute to hindering the pace of growth for the macroeconomy by the end of this year. We expect Retail Sales to expand in 2019, but not at a fast-enough rate to keep overall US Industrial Production from entering a mild recession. Use the current period of growth to build up your reserves of cash to better weather the upcoming recession in 2019.

MAKE YOUR MOVE™

Build up your reserves of cash this year, before Industrial Production declines next year. This will position your company to outbid competitors for resources in 2019 to prepare for growth in 2020.

INVESTOR UPDATE

Rising corporate profits and investor confidence due to a growing economy suggest further room to run for the current bull market. However, the market's rate of rise will be slowing. Our analysis of the S&P 500 and fundamentals suggests the macroeconomy is likely to transition to a slowing growth trend by the end of this year.

ITR ECONOMICS' LONG-TERM VIEW

2018: Slowing Growth **2019:** Mild Recession **2020:** Growth

INDUSTRY ANALYSIS

Retail Sales
- Retail Sales during the 12 months through June were up 5.0% compared to one year ago
- Consumers are feeling more confident about spending, and the US Savings Rate is declining as a result
- Focus on competitive advantages other than pricing to promote your brand

Wholesale Trade
- Wholesale Trade during the 12 months through June was up 7.8% from the same time last year
- The first-to-second-quarter gain was 10.0%, the second-best gain on record for this period
- However, plan for a slowing growth trend to form by the end of this year

Auto Production
- Auto Production was down 5.1% on a year-over-year basis
- Plan for a mild rise in activity through the remainder of this year
- North America Light Truck Production hold the highest potential for opportunities this year and next, compared to North America Passenger Car Production

Manufacturing
- Total Manufacturing Production during the 12 months through June was up 2.0% year-over-year
- The defense industry may present growth potential; New Orders were up 16.5% in this sector
- We revised our outlook upward for this market to account for increased defense spending passed by Congress

Rotary Rig
- The Rotary Rig Count is increasing, albeit at a slowing pace of rise
- Both oil and natural gas demand are fueling the rise in Production, keeping the pressure on the number of rigs needed
- However, firms should budget for the slowing growth trend to continue into 2019, in line with our expectations for Prices and Production

Capital Goods New Orders
- New Orders during the 12 months through June were up 7.7% compared to the previous year
- The Small Business Optimism Index is on the back side of the business cycle, suggesting investment in capital goods will decline by late 2018
- Build a backlog to keep your team flowing through the upcoming declining trend

Total Nonresidential Construction
- Nonresidential Construction is virtually even with the year-ago level
- Expect Construction to grow at an accelerating rate into the third quarter of 2019
- Ensure quality control keeps pace with growing volume to avoid reworks and protect your brand

Total Residential Construction
- Residential Construction during the 12 months through June was up 9.9% compared to one year ago
- However, plan for slowing growth to persist through most of 2019
- Rising Mortgage Rates will make housing relatively less affordable, likely reducing Construction activity in 2019

LEADING INDICATOR SNAPSHOT

	3Q18	4Q18	1Q19
ITR Leading Indicator™	Green	Red	Red
ITR Consumer Activity Leading Indicator™	Red	Red	Red
US Leading Indicator	Green	Green	Red
Purchasing Managers Index	Green	Red	Red
US Total Capacity Utilization Rate	Green	Red	N/A

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

- Plan for the US industrial economy to transition to a slowing growth trend by the fourth quarter of 2018
- The ITR Consumer Activity Leading Indicator was revised due to a data revision, resulting in a milder decline in the overall Indicator; however, the direction is unchanged
- Leading Indicators suggest business-cycle decline for the macro economy through at least early 2019, in line with our outlook

The Tariff Threat to Exports Across the Country

By: Lauren Saidel-Baker

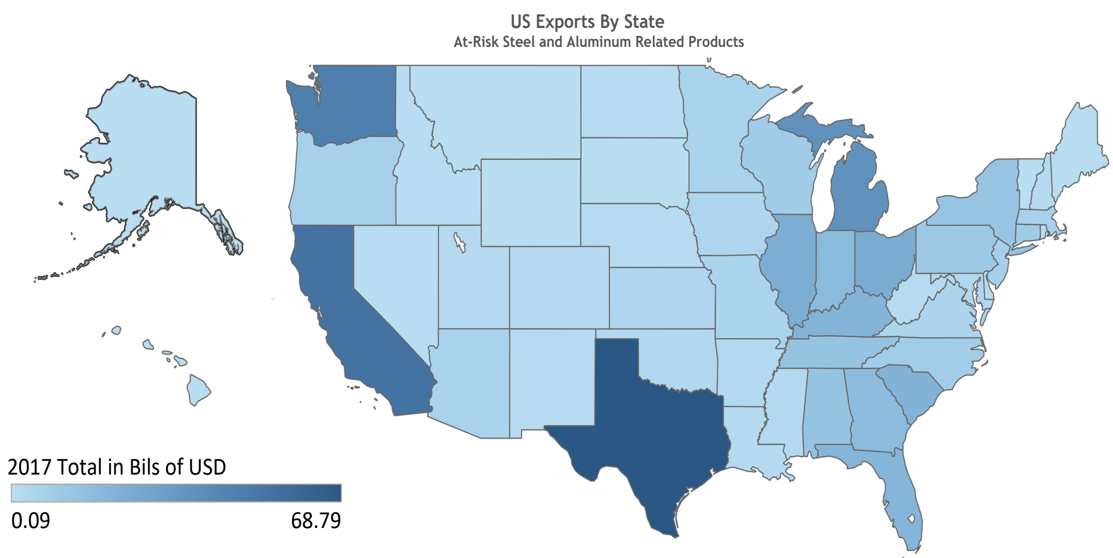
What you need to know: *Texas and California are most vulnerable to loss of export competitiveness due to tariffs.*

In our analysis of tariffs, unintended consequences remain the overarching theme. Tariffs are inflationary by nature, as they aim to protect often higher-cost domestic production by raising the price of imported goods. The Trump administration's 25% tariff on steel and 10% tariff on aluminum are likely contributing to rising prices of these materials, with Steel Prices in July up 25.2% from July 2017 and Aluminum Prices up 8.2% for the same time period. Elevated input costs are contributing to rise in Producer Prices, which were up 4.2% in July from the prior year. We expect Producer Prices to rise through 2020, albeit at a slower pace in 2019 and into mid-2020; ongoing trade issues threaten to lift Prices further.

For domestic companies that use steel and aluminum, higher input costs threaten margins. Furthermore, such companies comprise a greater share of US industry than those companies that produce these metals and therefore enjoy the protective aspects of the tariffs. While there are nearly 30,000 companies (employing 900,000 workers) that use steel as an input in the US, there are just 916 companies (employing 80,000) producing steel.

This pressure on margins comes at a precarious time for many US companies, as Corporate Profits for Domestic Nonfinancial Industries are already contracting. Firms will likely be unwilling or unable to absorb these higher costs and will instead pass them along to consumers. In recent weeks, several major brands, including Coca-Cola, General Motors, Toyota, and Whirlpool, have announced price hikes in response to the tariffs.

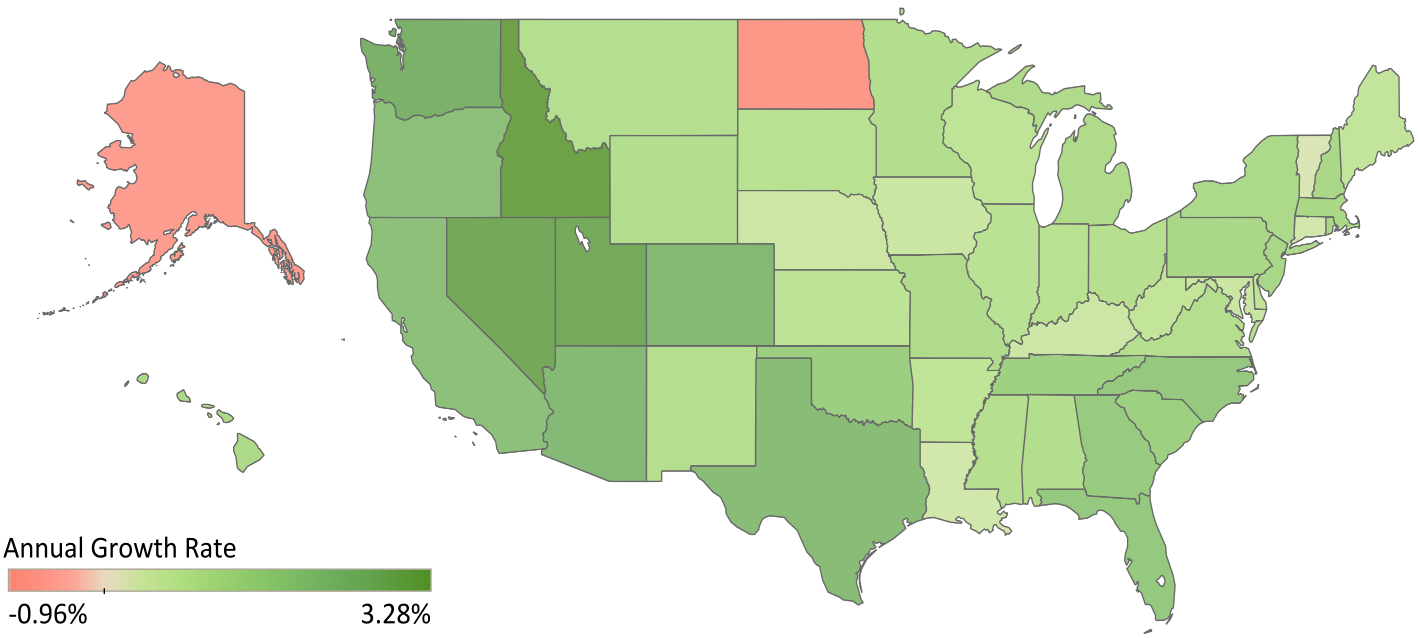
The net domestic result will be higher prices for US consumers. However, international importers of US goods will not necessarily feel equivalent effects, as they can choose to substitute away from now-higher-cost US products. US exports of items with high steel or aluminum content will likely be less competitive on the global market. We can examine these exports on a state-by-state basis to find vulnerabilities. The map below showcases export values for at-risk products.



Exports of US-made vehicles face a high threat, as vehicles contain a high quantity of these raw materials and are already high-priced items. Toyota, for example, recently estimated that higher input costs alone would raise the price of a new Camry by $1,800. Michigan leads the country in vehicle exports, with $24.8 billion in value exported in 2017, and is therefore the most vulnerable to reduced export competitiveness. California, South Carolina, and Texas, with vehicle-export values of $11.4 billion, $10.6 billion, and $9.8 billion, respectively, are also vulnerable. Machinery is another high-metal product which will cost more due to tariffs. Texas leads the nation in machinery exports, valued at $41.7 billion, while California machinery exports are valued at $26.6 billion.

Across a wide range of steel- and aluminum-intensive production, Texas and California stand out as the two states with the highest related export value. Producers around the country should be aware of the implications of losing export competitiveness and possibly consider focusing on the domestic market, where price increases will be more uniform. As in any rising price environment, aim to protect your profit margins through pricing while delivering the added value to maintain customer loyalty.

STATE-BY-STATE: Employment



- US Private Sector Employment during the 12 months through July averaged 125.6 million employees, up 1.8% from one year ago
- Every state in the nation saw positive employment change compared to last year, with the exceptions of Alaska (down 0.8%) and North Dakota (down 1.0%)
- Do not plan for Employment to contract; ensure wages and benefits are competitive to help retain your employees

READER'S FORUM

How does the media-reported "surge in retail sales" affect the macroeconomic outlook?

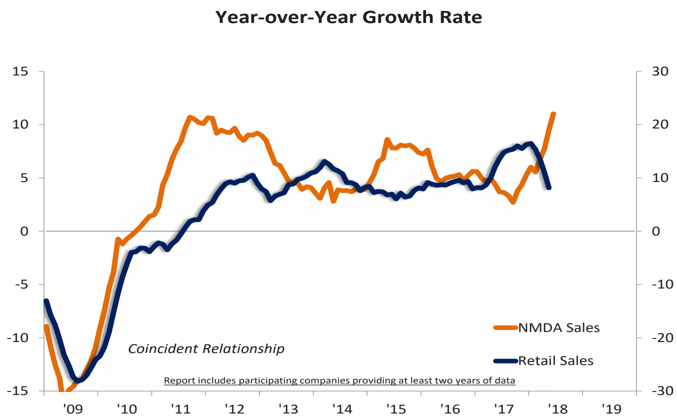
Alan Beaulieu, President at ITR Economics™, answers:

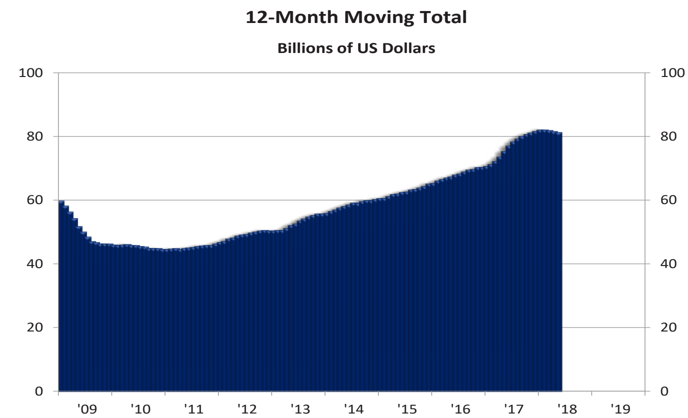
Retail Sales look great on the surface; a 5.3% growth rate would be impressive if it wasn't inflated by price increases. The deflated growth rate is a more subdued 2.8%. The deflated numbers suggest more economic growth as we head to the end of 2018, but they do not signal a year-over-year surge. May posted a steeper-than-normal monthly rise, followed by a steeper-than-normal monthly decline in June. July posted a drop of 0.66%; the average June-to-July change after 2009 is a rise of 0.3%. None of these numbers, deflated or not, suggest a surge occurred during the last two months.

Headlines and media pronouncements grab our attention, but the context of the numbers, the cyclical trends, and the leading indicators should form the basis for 2019's strategic plans. If you relate to the general economic environment, you should budget for slowing in the rate of rise in some markets in 2019, with overt decline occurring in others. Please let us know if we can help.

Please send questions to questions@itreconomics.com

US Motorcycles, Boats, and Other Motor Vehicle Dealers Retail Sales

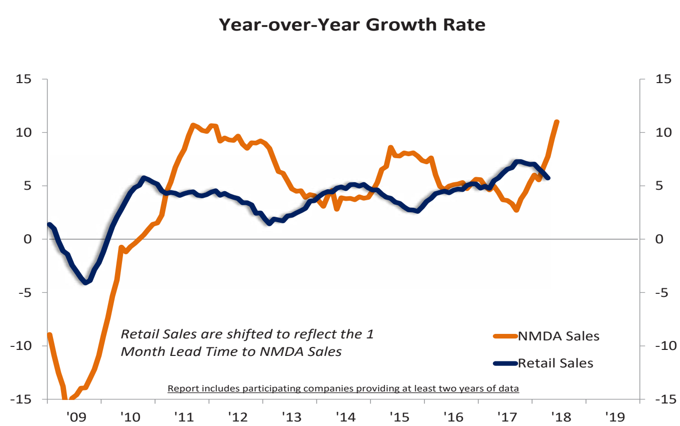


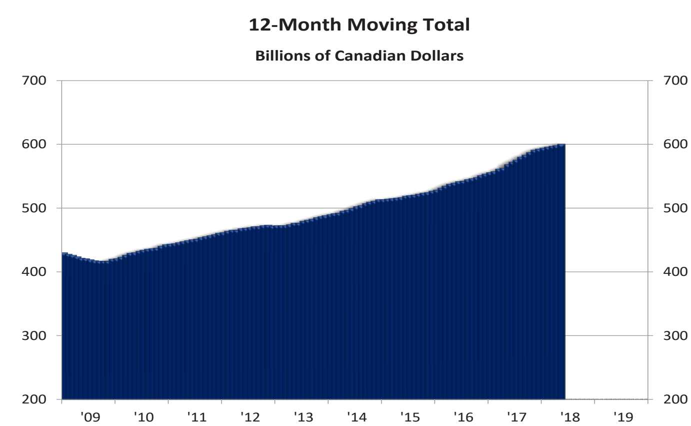


US Motorcycles, Boats, and Other Motor Vehicle Dealers Retail Sales during the 12 months ending in May were up 8.1% from one year ago. Although the year-over-year growth rate for this segment is higher than that of overall Retail Sales, which were up 5.0%, take caution not to budget linearly. Retail Sales in this segment have declined in recent months. We expect this trend to persist into at least the middle of next year.

The pace of growth for Personal Savings has increased in recent months, which typically bodes poorly for Motorcycles, Boats, and Other Motor Vehicles Retail Sales. This shift toward saving may suggest that consumers will be more price-conscious. However, you should conduct market research to determine which price points are most attractive to customers and cater your offerings accordingly. Evaluate the demand for your newer-to-market products, as they are more likely to outperform business cycle trends. Ensure that your marketing strategies reflect your research findings.

Canada Total Retail Sales





Canada Total Retail Sales during the 12 months through May were up 5.7% from the same period one year ago. Retail Sales are growing at a slowing pace. We expect activity to rise into at least the middle of next year, but the pace of growth will slow further during this time.

Canada Consumer Prices are rising at an accelerating pace, up 1.9% from the year-ago level. Our analysis indicates that this trend will persist into at least the middle of next year. Inflation may provide businesses with opportunities to raise their prices. However, firms should do so with caution. Be sure that your price increases are gradual to avoid scaring off customers. Ensure that your prices are still competitive with others in your sector to avoid losing market share.

* Report includes two participating companies providing less than two years of data. This addition may skew near-term performance of NMDA Sales.

