North American Building Material Distribution Association

Trends ▪ Education ▪ Leadership ▪ Networking

Published Quarterly by ITR Economics™ for NBMDA and NAFCD Members

ITR Advisor / Volume 5 / March 2021

Industry Snapshots

Arrow denotes 12-month moving total/average direction.

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

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

Macroeconomic Outlook

Business ingenuity and the impacts of the government stimulus packages are aiding the US industrial sector's recovery. Manufacturers are diversifying their supply chains, increasing automation, and producing the goods for which demand has increased during the pandemic. The service industry has adapted the way it operates, and small businesses have expanded their online presence. In addition to these adaptations, the CARES Act, according to some sources, may have mitigated the impact of the shutdowns by approximately 20%, thanks in large part to the direct payments and enhanced unemployment insurance for individuals and Paycheck Protection Program loans for small businesses.

Due to the resulting stronger-than-anticipated economic recovery, we raised our outlook for US Industrial Production by 2.3%, 2.9%, and 1.5% for 2021, 2022, and 2023, respectively. We expect annual Production will begin rising imminently, in line with trends in the US Total Industry Capacity Utilization Rate and the US ISM PMI (Purchasing Managers Index). Rise will extend through at least year-end 2023, though at a comparatively slower pace for much of 2022 and 2023.

"US Industrial Production will begin rising imminently"

On the consumer side, we just saw the strongest December-to-January percentage change in the history of the US Total Retail Sales data, which goes back to 1947. Many earners shifted seamlessly to remote work in 2020, enabling their households to save more even as large segments of the economy were shut down. Coupled with the stimulus checks, this led to an increase in annual US Disposable Income, up 6.8% in January, and contributed to strengthened spending ability in recent months. We lifted our Retail Sales outlook by 3.4%, 3.0%, and 2.0% for 2021, 2022, and 2023, respectively. The consumer will keep Retail Sales rising through 2023, but the rate of growth will be noticeably slower in 2022 and 2023. We are watching the situation closely as, in these unprecedented times, this sector could outperform our expectations.

At the current rate, and with a two-dose system, it will take five months for the US population to be 75% vaccinated. The introduction of the Johnson and Johnson vaccine is speeding up the timeline. The stimulus provided via the $1.9 trillion American Rescue Plan, which passed Congress in March, is expected to further accelerate recovery in the consumer sector. We are closely monitoring the impacts of the vaccine development and the new stimulus spending on consumer trends.

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Make Your Move

Identify unprofitable business segments and clients and begin preparations to drop them during the industrial sector rising trend so you can repair or grow your margins.

Investor Update

The S&P 500 set a record high in February despite some late-in-the-month decline ostensibly stemming from long-term interest rates moving higher. Positive ITR Checking Points™ are in place, indicating that additional rise is likely. This continues to look like a momentum market held up by the Fed's monetary policies.

ITR Economics Long-Term View

2021	2022	2023
RECOVERY AND RISE	**GROWTH**	**GROWTH**

Leading Indicator Snapshot

	2Q2021	3Q2021	4Q2021
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	🟢	🟢	⚪

🟢 *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

- Rise in all of the represented indicators supports our expectation for imminent recovery and rise in US Industrial Production.
- The US ISM PMI (Purchasing Managers Index) and the US Total Industry Capacity Utilization Rate faltered in February. We are monitoring these indicators closely, but, given the weather-related disturbances in February, some short-term decline is neither surprising nor concerning at this point.
- The $1.9 trillion stimulus package passed by Congress in March could result in prolonged business cycle rise for the industrial sector during 2022.

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Industry Analysis

RETAIL SALES

- Annual US Total Retail Sales were up 0.4% in February compared to one year ago. Annual Retail Sales will generally rise throughout 2021
- Expanding vaccine distribution is expected to contribute to a bounce-back in hard-hit consumer sectors, such as Retail Sales at Restaurants and Bars
- The $1.9 trillion American Rescue Plan, which includes direct payments and unemployment insurance, will likely contribute to further upside momentum in Retail Sales this year

AUTO PRODUCTION

- Annual North America Light Vehicle Production fell to 12.7 million units in January, down 21.2% from the year-ago level
- It is likely that the distribution of the COVID-19 vaccine will result in increased business and leisure travel. This bodes well for Production this year
- Trends in the industry utilization rate further indicate that a recovery will begin in the near term

ROTARY RIG

- The annual average US Rotary Rig Count fell to 368 in February, down 59.1% from the year-ago level
- A deep freeze in the South did permanent damage to a number of rigs and took others off line
- Rising US Crude Oil Spot Prices will likely incentivize investment in bringing rigs back on line in the coming quarters

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction totaled $809.9 billion in January, down 1.1% from the same period one year ago
- Construction typically lags the US industrial economy by approximately one year. 2020's cash-flow disruptions and reduced corporate profitability will impact Construction in 2021, driving decline in this sector throughout the year
- A transition to remote workforces is diminishing demand for new office construction

WHOLESALE TRADE

- Annual US Total Wholesale Trade was down 4.3% in January compared to one year ago
- Rising monthly commodities prices will drive up costs for producers, who will in turn pass them on to distributors, contributing to the rise in Wholesale Trade this year
- Not all of the rise will be price-driven. Trends in US Real Gross Domestic Product (GDP) also signal higher levels of activity for Wholesale Trade during 2021

MANUFACTURING

- Annual US Total Manufacturing Production was down 6.9% in February compared to one year ago
- Rise in the Manufacturing Capacity Utilization Rate signals an imminent transition to recovery
- Trends in global leading indicators and rising US Exports to the World suggest that global demand is slowly returning. This will further support the recovery in annual Production this year

CAPITAL GOODS NEW ORDERS

- Annual US Nondefense Capital Goods New Orders (excluding aircraft) were up 2.4% in January compared to one year ago
- Mounting inflationary pressures will contribute to further rise in New Orders
- Rising Corporate Profits suggest companies will be more likely to spend in 2021, boosting New Orders activity this year

TOTAL RESIDENTIAL CONSTRUCTION

- Annual US Total Residential Construction was up 12.6% in January compared to one year ago
- Low mortgage rates and low home inventories are driving rise in the single-family component of Residential Construction
- Extended eviction moratoriums are fueling investors' hesitance toward the multi-family housing market

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A Closer Look: The US Economy

The Impact of the Gulf Deep Freeze, by the Numbers

BY: CONNOR LOKAR

What you need to know: While significant, industry-level setbacks do not dampen our 2021 outlook for rise

During mid to late February, an anomalous and crippling deep freeze gripped the central and southern US. While Texas garnered the lion's share of headlines due to its power grid struggles, it was a region-wide event. Upstream and downstream petroleum activity was knocked off line, and, simultaneously, energy demand spiked, power grids failed, supply chains were disrupted, and consumer activity and construction projects were interrupted. Now, a month later, we are getting the data points to quantify the disruption.

To start, I will clarify that this was a short-term event, and we will not be lowering our 2021 macroeconomic expectations for the US as a result. We anticipate that much of the economic ground that was lost in February will be recouped during the spring months. With that laid out, let's take a look at the numbers:

Retail Sales: US Total Retail Sales softened from January to February. It should be noted that it is normal for retail activity to fall in February, as a seasonal lull typically characterizes the start of a new year following the fourth-quarter holiday season. However, this February's data point came in a bit worse. An average decline would amount to 2.2%, but Retail Sales this February declined 5.4% from the January level. This marks the most severe such decline for nominal Retail Sales since the 1980s. Normally, this would be more concerning; however, with even more stimulus support on the way from the Biden administration's American Rescue Plan Act, the loss will likely be recouped in short order this spring.

Petroleum: US Oil and Gas Extraction Production faced significant decline as well, as freezing conditions inhibited production out of the southwest, most notably in Texas. US Production in February fell 5.5% compared to the January level, the worst outcome for a February output level since the 1960s. Downstream, things fared poorly as well, with US Petroleum Refineries Production dropping 4.9% from the January level. This supply-side disruption has manifested in the higher prices at the pump that Americans have experienced for the last few weeks. US Crude Oil Spot Prices (WTI) rose to $59.04, a 13.5% jump from January, marking the second-strongest such increase on record. This started to flow through to gas prices, which rose to average $2.59 per gallon in February and have since risen higher in March. We had anticipated that oil and fuel prices would rise in 2021 as demand-side fundamentals improved and the COVID-19 vaccination effort enabled increasing air and ground travel, but the compounding supply-side impacts have driven pricing above our expectations. We lifted our oil pricing expectations as a result.

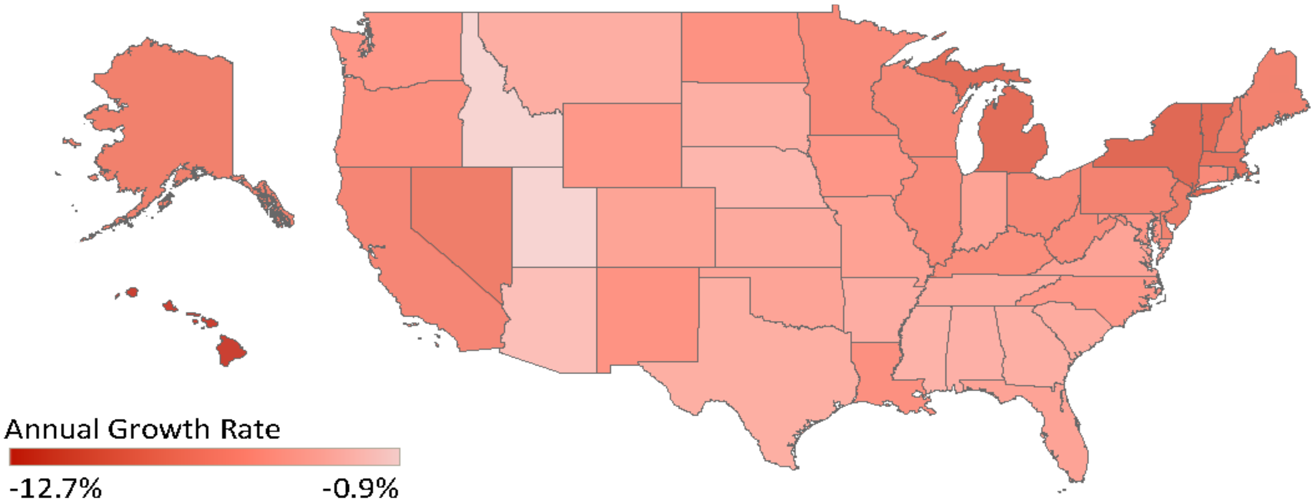
Petroleum-derived products outside of fuels took a beating as well. US Plastics Material and Resin Production collapsed 26.1% from the January level. This poses a supply chain risk to anyone reliant on plastic or resin products sourced from the Gulf Coast area, as much of that infrastructure is still damaged and under repair.

Construction: February nonresidential construction data is not yet available, but February residential data retells the now-familiar story. US Single-Unit Housing Starts stumbled last month, slipping 6.4% from the January level. This is uncharacteristic of the single-family housing market, as Starts tend to begin their seasonal ascent in February. With robust demand in 2021, this atypical pause will be short-lived.

Utilities: US Electric and Gas Utilities Production fared better, despite Texas's power grid woes. Production in February declined only a mild 2.4% from the January level. A February decline may appear bizarre, but it is typical as the early-spring conditions generally reduce heating demand. In fact, monthly Production has not increased from January to February since 1972; the average January-to-February decline is 6.5%. Natural Gas Prices jolted upward initially, surpassing $3.00 per million BTUs from Feb. 16 to Feb. 19, but have already moderated back toward January levels and were near $2.56 at the time of this writing.

Despite all the February setbacks cited above, overall US Industrial Production came in only slightly below our expectations for the month, and our forecast for ongoing recovery moving forward remains viable. Higher fuel prices augment an already inflationary environment but do not preclude ongoing gains in the US economy and consumer spending. Continued gains in the labor market and the stimulus support should bolster disposable income levels more than enough to offset marginally higher fuel prices. Construction activity in the deep-freeze-impacted regions will likely rise to make up for lost time. The most noticeable hurt, for some, may be supply chain issues around non-fuel petroleum products. Countless industries rely on such products, and this wrinkle adds to the preexisting supply chain woes related to COVID.
Overall, the narrative remains largely unchanged: In 2021, businesses will more likely struggle to meet demand than suffer from a lack thereof, and most will continue to contend with the challenges inherent to a rising price environment. Scrupulously examine your supply chains and ensure price increases are part of your strategy to capitalize on the rising economic tide this year.

State-by-State: Employment



- Quarterly US Total Nonfarm Employment is generally rising from a June 2020 low but was still down 6.0% from the year-ago level as of February.
- Annual Hawaii Nonfarm Employment was down 12.7% in 2020 relative to 2019; of the 50 states, Hawaii was the furthest, proportionally speaking, below year-ago levels. The state's tourism industry was hit hard in the last year but is slowly picking back up. Hawaiian Airlines recently extended its flight pre-clearance program to visitors from Japan and South Korea, and March's spring-break vacationers helped the state notch its biggest three-day tourism streak since the start of the pandemic.
- Though both are below year-ago levels, Utah and Idaho are the country's top performers for Nonfarm Employment; the respective states were down 0.9% and 1.0% from 2019. Utah's performance may be attributed to a strong health technology sector, a focus of much demand during the pandemic. Utah also functions as a popular distribution center for the US, and the pandemic-related increase in e-commerce may have boosted demand for distribution center workers this year. In Idaho, increased demand for construction, transportation, and utilities workers is bolstering the Employment trend.

Reader's Forum

Can you give some insight into the likely impacts of President Biden's cancelation of the Keystone Pipeline and his decision to stop issuing new drilling permits for federal land?

Lauren Stockli, Economist at ITR Economics™, answers:

The cancelation of the Keystone Pipeline is unlikely to hold back activity. Canada has the capacity on hand to increase its exports to the US from the current 3.8 million barrels per day (BPD) to about 4.2-4.4 million, according to the Canada Energy Regulator, the agency charged with regulating oil and other utilities for Canada. This covers a large portion of the 830,000 BPD that the Keystone Pipeline would have added. Beyond that, Canada is also expanding the government-owned Trans Mountain Pipeline's capacity by 590,000 BPD for a total of 890,000 BPD. Tankers could presumably carry barrels to the US from the Trans Mountain's termination point at the Port of Vancouver.

Regarding drilling permits, President Biden took the first of what may be several steps toward curtailing oil and gas development on federal lands; this follows record-setting permit approval under the Trump administration. The process will likely take time, given the legal disputes that are likely to arise. We also expect it will be largely offset, at least in the near term, by the large drillers that have already obtained permits as well as by oil and gas supply coming from private lands and from overseas.

What is unknown is how OPEC and North American producers, including US producers that drill on private land or hold existing permits for federal land, will respond to the policy shift. At present, OPEC's current course of action – curtailing production – will likely have a larger near-term impact on prices than Biden's permitting restrictions, given our assumption that demand will continue to increase in the coming quarters as the US and global economies recover and rise.

Please send questions to: questions@itreconomics.com