August
2024

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Economic Outlook

The decision of the Federal Open Market Committee to hold interest rates stable in July was no surprise as Fed officials have been hell-bent on waiting for inflation data to improve. Now, Federal Reserve Chairman Jerome Powell has mentioned that inflation doesn't have to return to the 2% long-term target for interest rate cuts to happen.

The market has effectively priced in a 25-basis-point cut to the target range of the federal funds rate at the September FOMC meeting. Many economists are now weighing whether a larger cut – 50 or even 75 bps – should be in the cards. Some of the largest banks in the country believe that the economy could withstand a 100-bp cut to the fed funds rate.

Why the thoughts around the potential for larger cuts?

The labor market is clearly slowing while there is progress being made on the inflation front. Many economists and analysts believe that the Fed has been slow to react and could have started cutting interest rates earlier this year.

The evidence of a slowing labor market was present in July as the employment report was severely underwhelming. Nonfarm payrolls in July increased by 114,000, falling short of June's downwardly revised figure of 179,000 and well short of analysts' expectations for 185,000 added during the month. Additionally the unemployment rate increased to 4.3%, the highest level since October 2021.

The increase in the unemployment rate triggered the Sahm Rule, named after former Fed Economist Claudia Sahm. The Sahm Rule is when the three-month moving average in the unemployment rate moves 50 basis points above the 12-month low unemployment rate. This rule has been used as a recession indicator in past economic cycles. Sahm herself stated that just because the rule was triggered, the U.S. economy was not necessarily entering a recession, but she voiced concern that if the Fed were slow to cut rates, it would lead to even greater odds of the U.S. entering a recession.

Why the uptick in the unemployment rate, especially in the latest report where it jumped 20 bps?

There has been an influx in the number of individuals in the labor force. The labor force increased by 420,000 people during July while the number of unemployed increased by 352,000. The increase can in part be attributed to the increase in foreign-born workers in the labor force. Over the past year, the foreign-born labor force has increased by 1.65 million, while the native-born labor force has decreased by 279,000. Even more eye-opening is that the number of foreign-born workers increased by 1.273 million, while the number of native-born workers has decreased by 1.217 million.

Additionally, the trend in the number of part-time workers, specifically for economic reasons, continued. The total number of part-time workers for economic reasons in nonagricultural industries increased by 353,000 (or 8.5%) month over month. That number is 576,000 higher than it was in July 2023, up 14.7%.

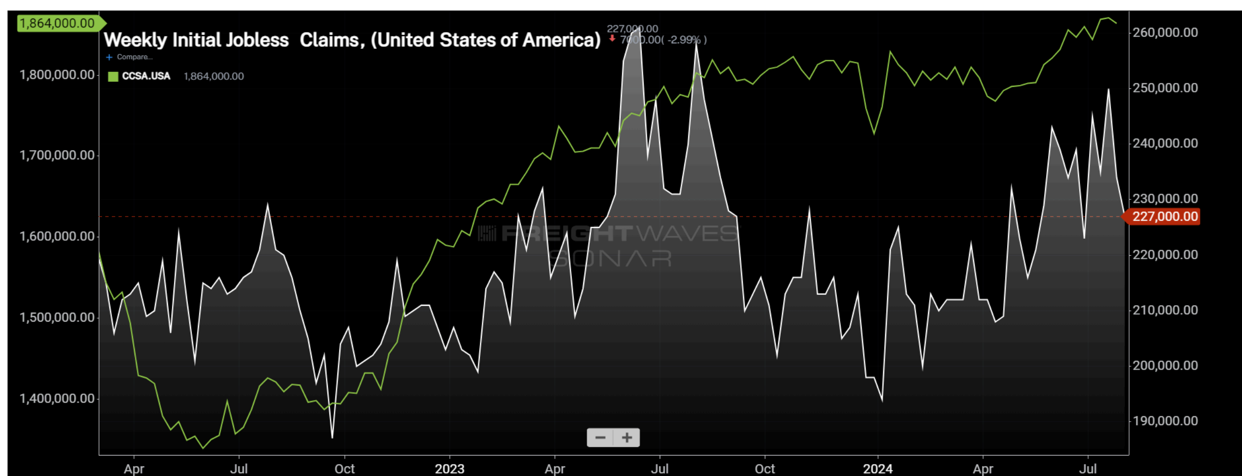
While jobs growth was underwhelming, it continued to stem from just a handful of industries.

Health care sustained its growth, adding 55,000 to payrolls during the month. Both leisure and hospitality and government also experienced increases of 23,000 and 17,000 in the month, respectively.

Retail trade didn't see a significant change, but there was growth in general merchandise retailers, which added 7,100 jobs during July. But 6,300 of those came at supercenters, warehouse clubs and other various general merchandise stores as opposed to department stores.

Construction hiring was a bright spot in July, adding 25,000 to payrolls during the month. Most of the growth stemmed from specialty contractors, which added 18,700 jobs.

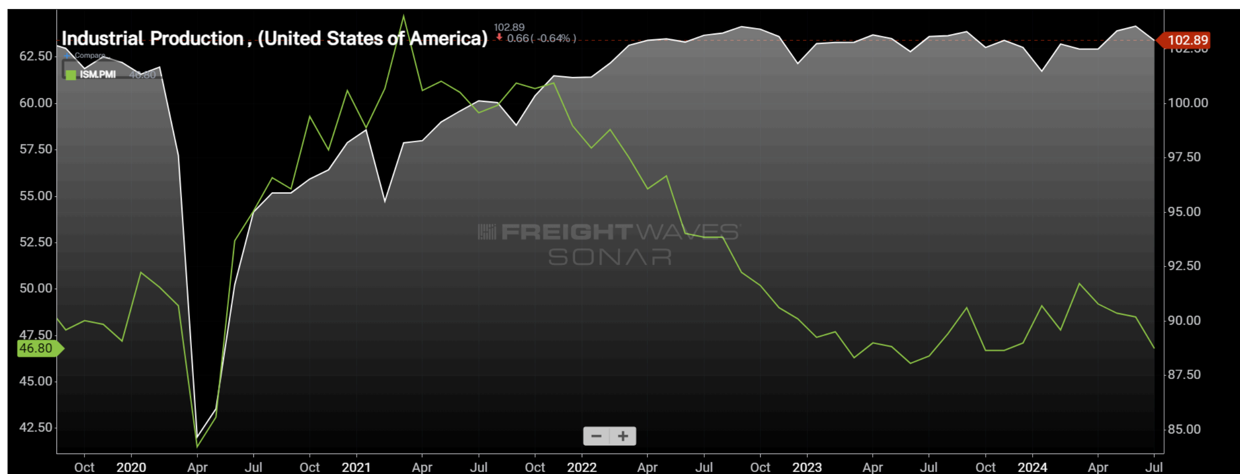
While the jobs report was underwhelming, the past two initial jobless claims reports have been better than expected.



Initial jobless claims for the week ending Aug. 10, the most recent week for which data is available, fell by 7,000 week over week to 227,000. The four-week moving average fell by 4,500 from the prior week to 236,500. Analysts were expecting jobless claims to come in at 235,000. Initial jobless claims were 8.5% lower than they were in the same week last year.

Continuing jobless claims, for which the overarching trend is higher, did fall in the most recent week. For the week ending Aug. 3, continuing claims totaled 1,864,000, down 7,000 from the prior week but up 61,000 compared to the same week last year.

Manufacturing



July presented challenges to the industrial side of the economy as Hurricane Beryl added disruption to a sector of the economy that was already contracting. The Institute for Supply Management's Manufacturing Purchasing Managers Index was in contraction once again. The Manufacturing PMI came in at 46.8 in July, down 1.7 points from June. For 20 of the past 21 months, the Manufacturing PMI has been in contraction, marking the longest period of contraction since the onset of the index, surpassing the contraction period during the great financial crisis, though it was far deeper.

New orders contracted for the fourth consecutive month, falling faster than they did in June. The New Orders component of the index fell by 1.9 points m/m during July, to 47.4. The decline in new orders is concerning amid hope for a recovery in the manufacturing sector. There will have to be a shift in the trend, as new orders have been in contraction for 20 of the past 22 months.

Backlogs contracted for the 22nd consecutive month. The Backlog of Orders component of the PMI remained stable m/m at 41.7.

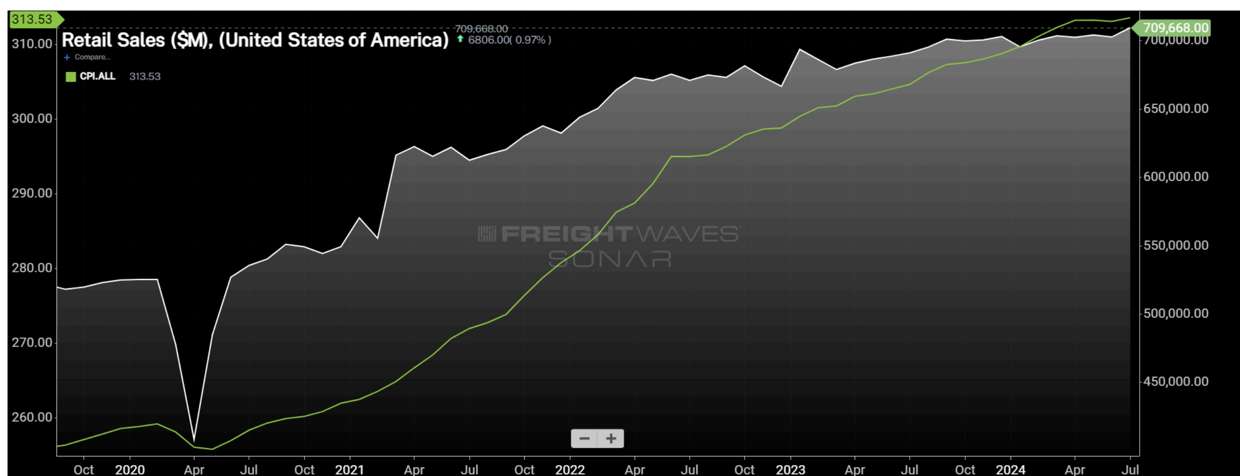
The Customers' Inventories component remained well below 50 for the eighth consecutive month, indicating inventories are "too low." The component fell by 1.6 points m/m in July to 45.8. Twenty-two percent of respondents stated that inventories were too low, the highest percentage in the past four months, up from 18.9% in June.

The Manufacturing PMI wasn't the only data point that suggested that the manufacturing sector of the economy is in contraction. Industrial production declined by 0.6 points m/m in July, the first monthly decline since March. The release from the Federal Reserve highlighted that Hurricane Beryl attributed to a 0.3% decline in production during the month. Overall industrial production declined by 0.2% y/y.

Consumer goods experienced the largest decline in production in July among the major market groups. Consumer goods production fell by 1% m/m in July but was flat y/y.

Consumer Conditions and Retail

The trend of positive inflation data continued in July, though prices were in aggregate slightly higher than in June. The increase in prices in July still brought the headline inflation number below 3%, while the core CPI remains slightly above that level. Forecasts are for the core Personal Consumption Expenditures Price Index, the Fed's preferred metric for inflation, to show continued progress toward the long-term goal of 2% inflation.



The Consumer Price Index rose 0.2% m/m in July, marking the first monthly increase since April, after prices fell in June and were unchanged in May. The headline figure matched analysts' expectations, a positive sign that inflation as a whole is moving in the right direction. The 12-month running total for the CPI came in at 2.9%, the lowest total since March 2021.

Core inflation, which is the CPI excluding the more volatile food and energy prices, matched the headline number, increasing by 0.2% m/m. The 12-month running total for core CPI is 3.2%.

For the first time this year, energy prices, which had been living up to their volatile reputation, were stable in July. The overall energy price index was unchanged in July but was 1.1% higher

than it was during the same period last year. Gasoline prices were also unchanged in the month after two consecutive 3% m/m declines. Gasoline prices remain 2.2% lower than they were in July 2023.

Food prices increased at the same rate as the headline CPI, rising 0.2% m/m, but are up just 2.2% y/y. Food-at-home price increases continue to be fairly small, if there are any increases at all. Food-at-home prices matched June's increase, rising 0.1% m/m, and are up just 1.1% y/y. Food-away-from-home continues to rise, but the increase in July was the smallest monthly increase since February. Food-away-from-home prices increased by 0.2% m/m but are still 4.1% higher than they were this time last year.

The primary driver of core inflation has been the significant increase in shelter prices. Overall, shelter prices increased by 0.4% m/m, up from the 0.2% m/m increase in June, matching the increases from February through May. Shelter prices are 5.1% higher than they were this time last year.

Besides inflation data, another positive sign for the consumer side of the economy is that consumers are continuing to spend. Headline retail sales bested expectations, but in recent months the advanced retail sales release has been revised lower in subsequent releases.

Headline retail sales grew by 1% m/m in July, well ahead of expectations of a 0.3% increase in retail sales during the month. Total retail sales were 2.7% higher y/y in July, falling just short of the CPI reading, so there is still some pressure on real retail sales. When you remove autos (both motor vehicle and gasoline station sales), the increase is less robust, rising just 0.4% m/m but up 3.4% y/y.

July was a positive month for motor vehicle and parts sales as they increased by 3.6% m/m and 0.8% y/y. This has been a sector that was under pressure, especially in a higher interest rate environment.

General merchandise stores increased sales by 0.5% m/m in July and were 2.7% higher y/y. This increase in consumer spending could explain why this sector of the economy has been hiring. Walmart, the country's largest retailer, reported that second-quarter U.S. comparable sales excluding fuel were up 4.2% in the quarter. The company cited a flight to value for the consumer for the strong sales metrics.

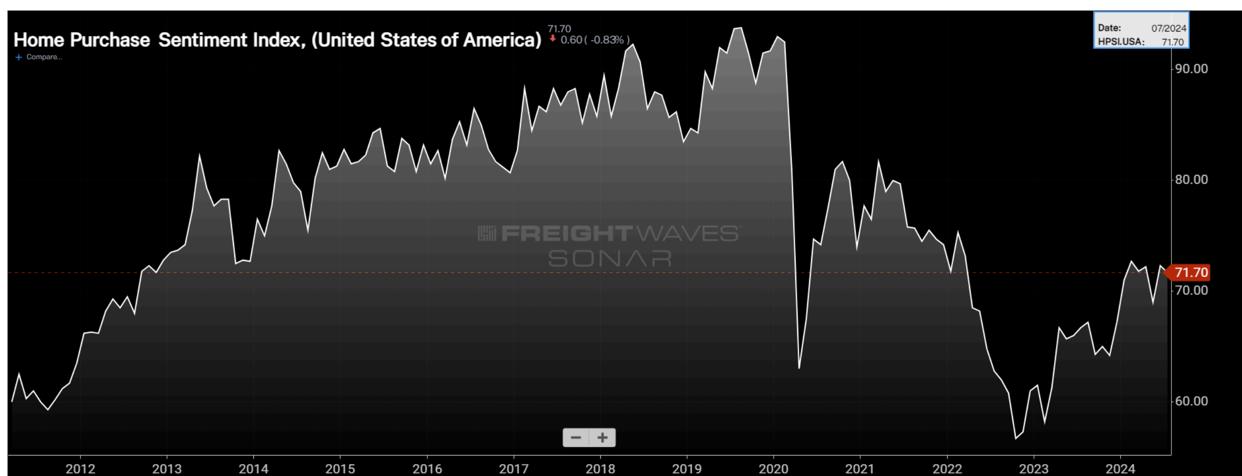
Other retailers aren't faring quite so well. The Home Depot reported that U.S. comparable sales fell by 3.6% in the second quarter, which aligns with the slowdown in home improvement spending as signaled in Bank of America's card spending reports. Retail sales data for building materials and garden equipment and supplies dealers did increase by 0.9% m/m in July but is only 0.4% higher y/y.

Housing and Construction

Continued positive inflation data along with the belief that interest rates will be lower in the coming months has created more positivity around the housing market. According to the Mortgage Bankers Association's Weekly Mortgage Application Survey for the week ending Aug. 14, mortgage applications increased by 16.8% w/w. Joel Kan, the Mortgage Bankers Association's vice president and deputy chief economist, stated in the release that "Rates on both 30- and 15-year fixed rate mortgages decreased for the second consecutive week, and combined with the previous week's rate moves, spurred another strong week for application activity as borrowers with higher rates took the opportunity to refinance." The Refinance Index from the survey increased by 35% w/w.

After the underwhelming jobs report allowed for the overwhelming assumption that lower interest rates were on the way soon, mortgage rates quickly declined. According to Freddie Mac, the average 30-year fixed rate mortgage was 6.49% for the week ending Aug. 15. It was just 2 basis points higher than it was the week prior. But even with the slight increase, the 30-year mortgage rate is at the lowest level since May 2023.

Mortgage rate declines throughout July were not enough to boost sentiment around home purchases. The Fannie Mae Home Purchase Sentiment Index (HPSI) fell 1.1 points m/m to 71.5. Even with the decline in July, the HPSI was 4.4 points higher than it was last year.



Doug Duncan, Fannie Mae senior vice president and chief economist, said in the Aug. 7 release: "While we're seeing signs that affordability may be improving in certain parts of the country as supply slowly comes online, household incomes remain stretched relative to would-be mortgage or rent payments, and our latest survey once again reflects real consumer frustration with the housing market."

In the HPSI survey, 82% of respondents believe that it is a bad time to purchase a home, which is 1% more than in June's survey. Conversely, 65% of respondents believe that it is a good time to sell their home, down 1% m/m.

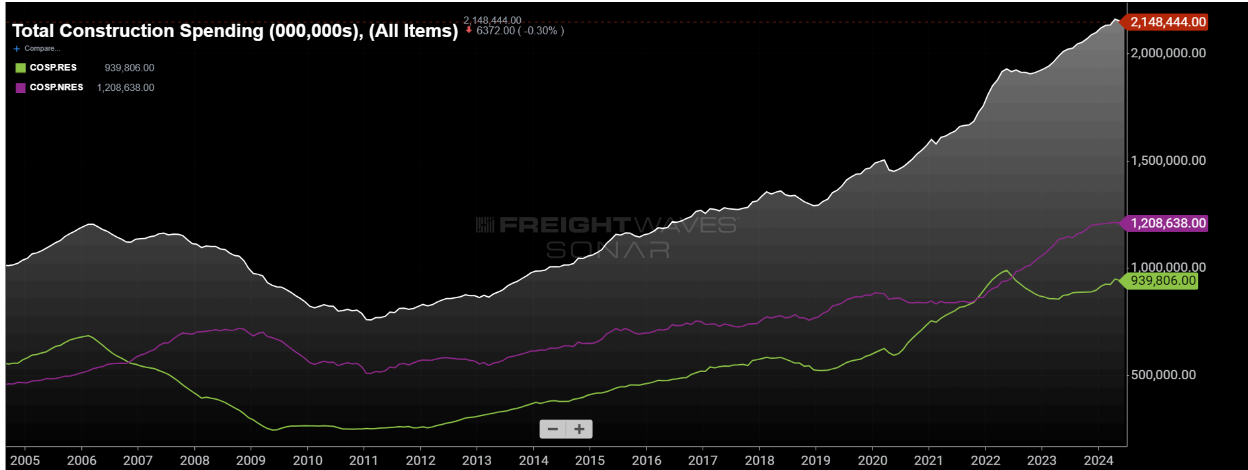
Sentiment around mortgage rates moved more to equilibrium as there was an increase in the number of respondents who expect lower interest rates over the next year. Twenty-nine percent of respondents expect that mortgage rates will go down over the next year, up 5 percentage points from June. At the same time, sentiment around housing prices turned slightly sour. Forty-one percent of respondents expect that housing prices will increase over the next year, down 4 percentage points from June. Twenty-one percent of respondents expect housing prices to decline over the next year. This is interesting, given that typically declining interest rates put upward pressure on housing prices as well as the supply constraints that continue to hamper the market.

Existing home sales dominate the housing market, but they have been challenged in recent months. Existing home sales dropped 5.4% m/m in June, according to the National Association of Realtors, after two fairly sizable drops in April and May. Compared to this time last year, existing home sales were down 5.4% as well. Inventory of existing homes for sale increased by 3.1% m/m as total supply sits at 4.1 months, up from 3.7 months in May.

Sales dipped across the four regions in June, but on a year-over-year basis only the West saw existing home sales remain stable.

Existing home prices reached another all-time high in June, rising to $426,900, up 4.1% y/y.

June's construction spending report was underwhelming, especially during the period when construction spending tends to gain momentum. Total construction spending fell by 0.3% m/m, accelerating from the 0.1% m/m decline in May. The seasonally adjusted annual rate (SAAR) for total construction spending totaled $2.148 trillion. Even with the slowdown in June, total construction spending was 6.2% higher y/y.



Residential construction spending fell again in June, by 0.4% m/m. The SAAR for residential construction spending came in at $939.8 billion in June. Residential construction spending remains well above last year, 7.3% higher y/y in June.

Nonresidential construction spending fell, but the decline was smaller than the overall drop in construction spending and residential construction spending. Nonresidential construction spending fell by 0.2% m/m to a SAAR of $1.209 trillion. Nonresidential construction spending was 5.3% higher than it was in June 2023. Manufacturing construction spending continued to rise, up 0.1% m/m and 19.1% y/y, to a SAAR of $235.5 billion.

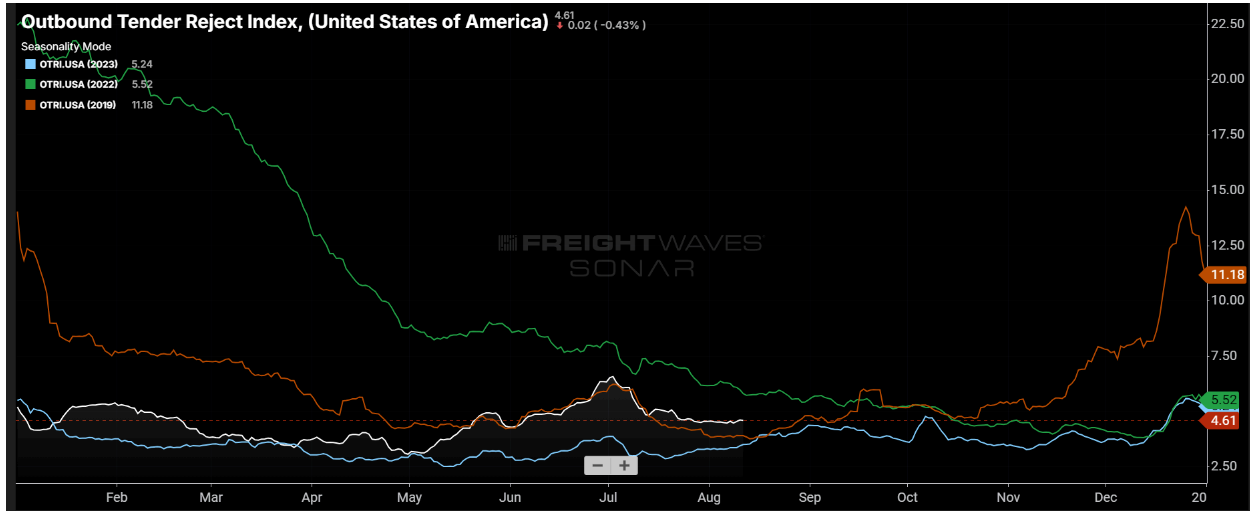
Freight Market Overview

National Summary

July proved to be a relatively quiet month as it traditionally is for the domestic freight market. Tender rejections and spot rates fell off summer peaks, but they did not fall all the way back to first-half lows heading into mid-August. Most data and anecdotal evidence point to a slow directional push toward a tighter or potentially more balanced truckload environment. The market remains in a state of measurable transition as capacity bleeds out, due to there being insufficient demand to keep carriers in business. The Red Sea conflict continued to plague the maritime space, keeping rates elevated. Imports flooded the West Coast, keeping the ports of Los Angeles and Long Beach busy. The subsequent outflow of imported goods is also pushing intermodal and trucking networks out of balance.

Trucking

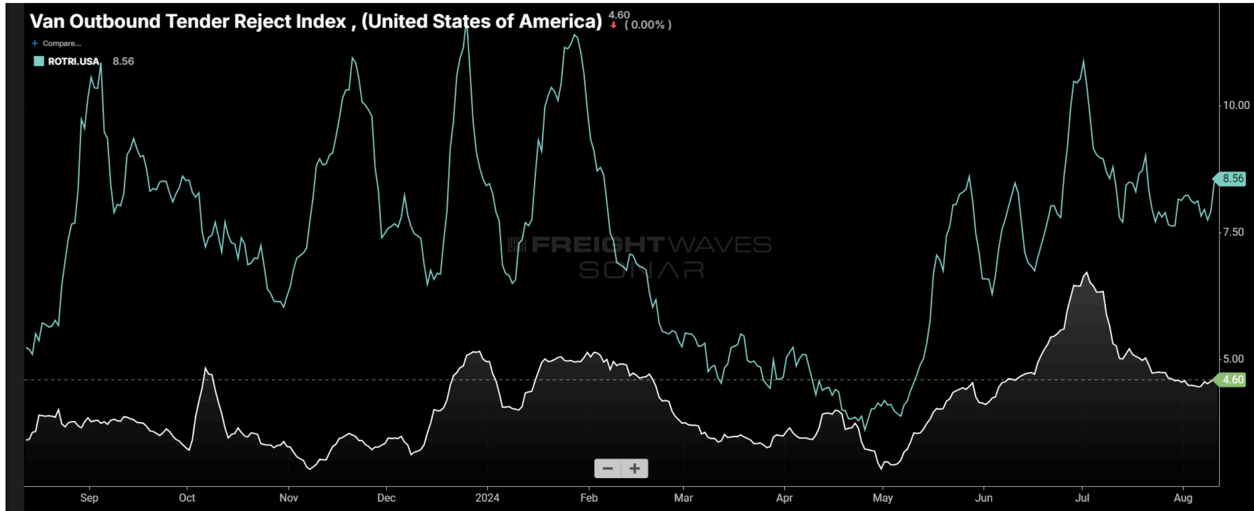
The story of the truckload market has become more about direction than a definitive state of being. Capacity has been more than ample for the past two years, pushing rates well below operating costs of carriers on the spot market, and has led to thousands of operators exiting the space. But not until the past few months has the exodus of carriers become measurably evident in terms of market data.



National tender rejection rates fell back after the Fourth of July and held steady at 4.5% from late July into the middle of August. While these rates are historically low and suggest there is plenty of carrier availability, the fact they are sustaining at levels over 100 basis points above the previous year since the middle of May supports the theory that capacity has meaningfully left the market.

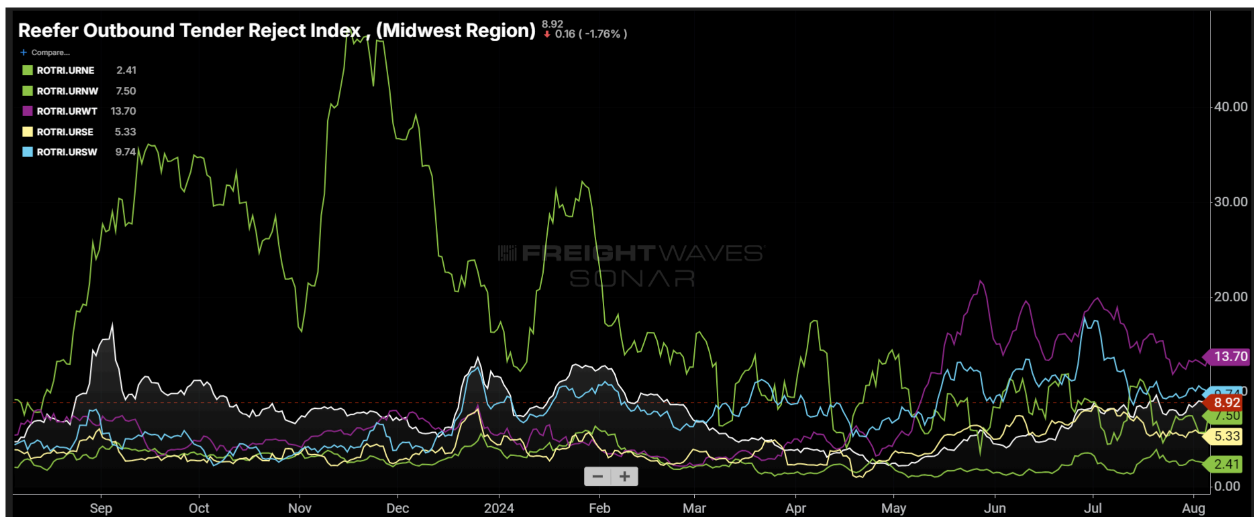
While beating 2023 rejection rate levels sustainably is telling, perhaps the fact that the current year's OTRI trend line has separated from the 2019 one may be more telling. Rejection rates averaged roughly 50 basis points higher from mid-July to mid-August than the same period in 2019, breaking the trend of near-perfect alignment that began in May. This could be a tell that the market is more vulnerable than it was in 2019 — a year when rejection rates spiked above 14% during the holidays.

Refrigerated breaks out



Breaking reflection rates down into van and refrigerated (reefer), the reefer market has broken out earlier this year than it did in 2023. Reefer rejection rates have been averaging above 6% since May, a feat not achieved until late last August.

Reefer rejection rates fell rapidly in February after a sustained period of elevation from September through January. This was followed by a very freight recession-like period from that lasted into May, when rejection rates hovered around and below 5%. The fact that the van market had not shifted may have insulated the refrigerated sector from a more sustained tightening as the drivers and freight are somewhat fungible with one another. That appears to be ending as van rejections are moving higher y/y.



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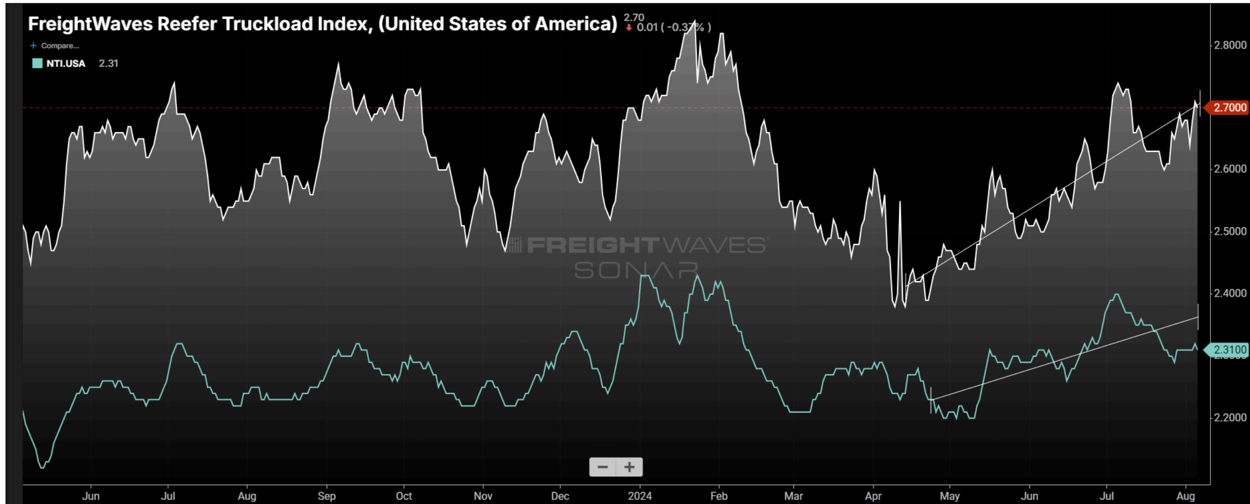
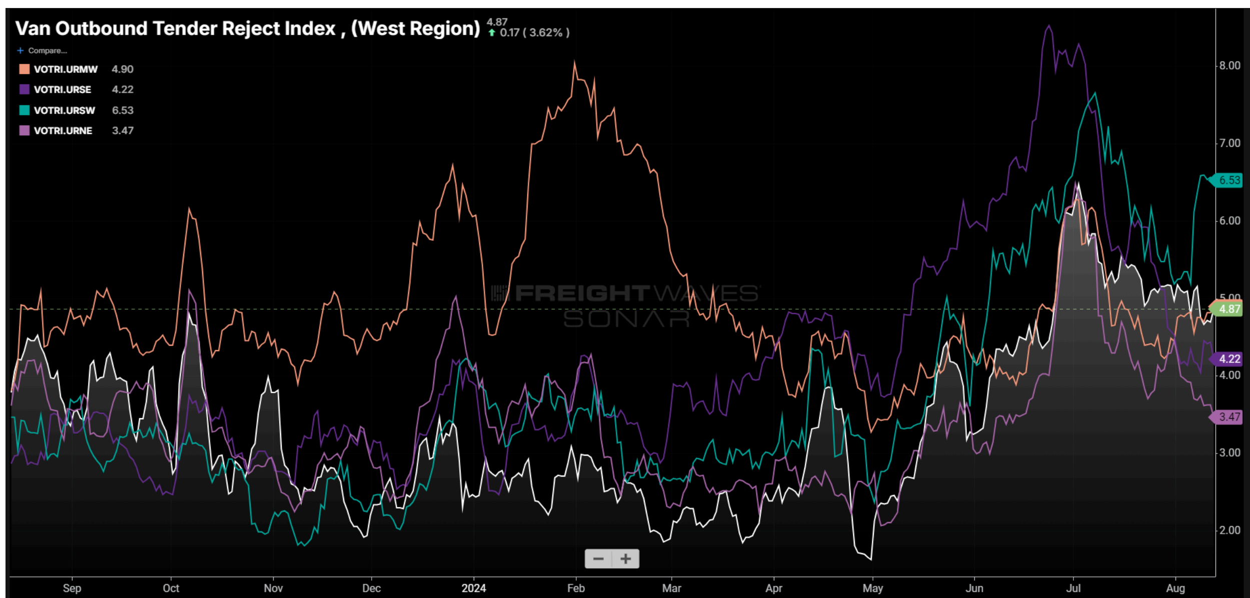
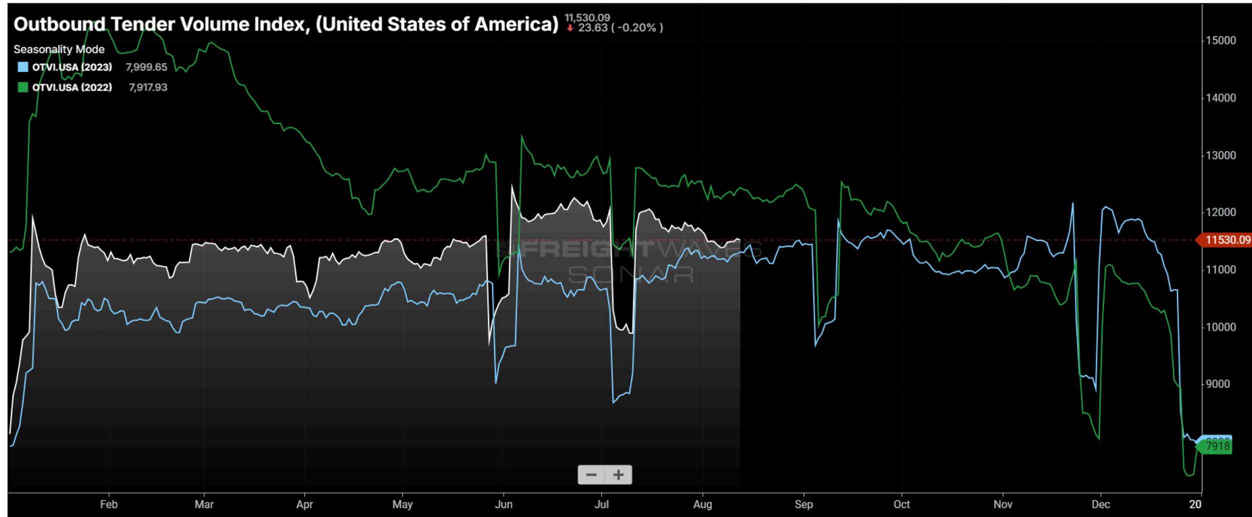
The West Coast region — mainly California — continued to have the highest rates of rejection throughout July and into August for refrigerated loads. The Southwest, which includes Texas, stabilized in second place. The Northeastern region continued to be the best supplied in terms of temperature-controlled capacity.



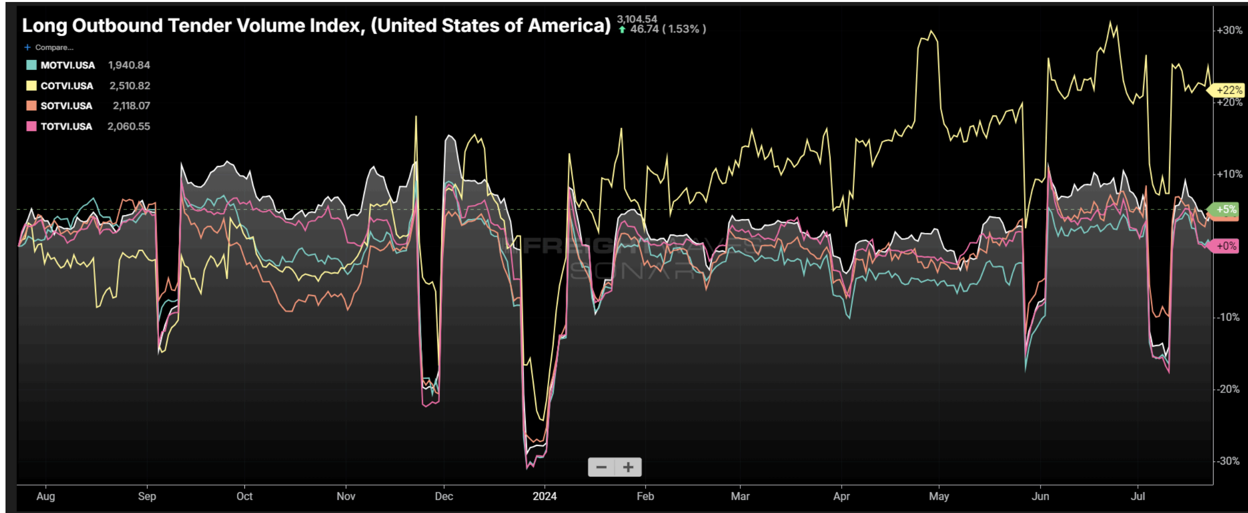
Spot rates for refrigerated loads are up roughly 12% since April, according to the Reefer Truckload Index (RTI). The NTI, which measures dry van spot rates, is up roughly 4% over the same period. The reefer market is more sensitive to disruptive forces, but the fact that van rates are also moving slowly higher gives the temperature-controlled sector's movements more meaning from a sustainability standpoint.



On the van side, the Southwest and West Coast are leading the way. The Dallas and Houston markets both have averaged rejection rates above 5% through the summer months. The Los Angeles market bounced between 5% and 7% from May to mid-August, fed by an active maritime import sector.



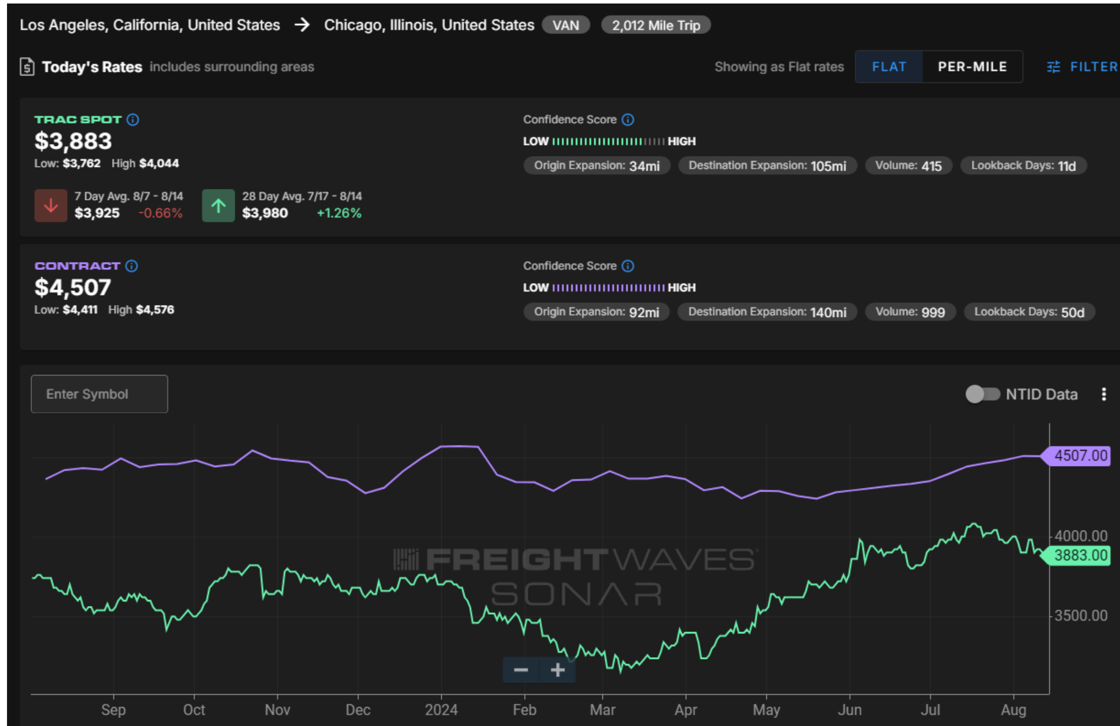
From a demand perspective, tender volumes gradually fell from their summer peak levels before showing signs of stabilizing. By mid-August, tender volumes were hovering at levels roughly 2.5% higher than the previous year. The annual comps got tougher in July as the OTVI took an unseasonal step up at this point in 2023. The shape of this year's tender volume index looks much more consistent with historical pre-pandemic norms. The main takeaway potentially is that the goods economy has held up despite growing signs of consumer weakness.



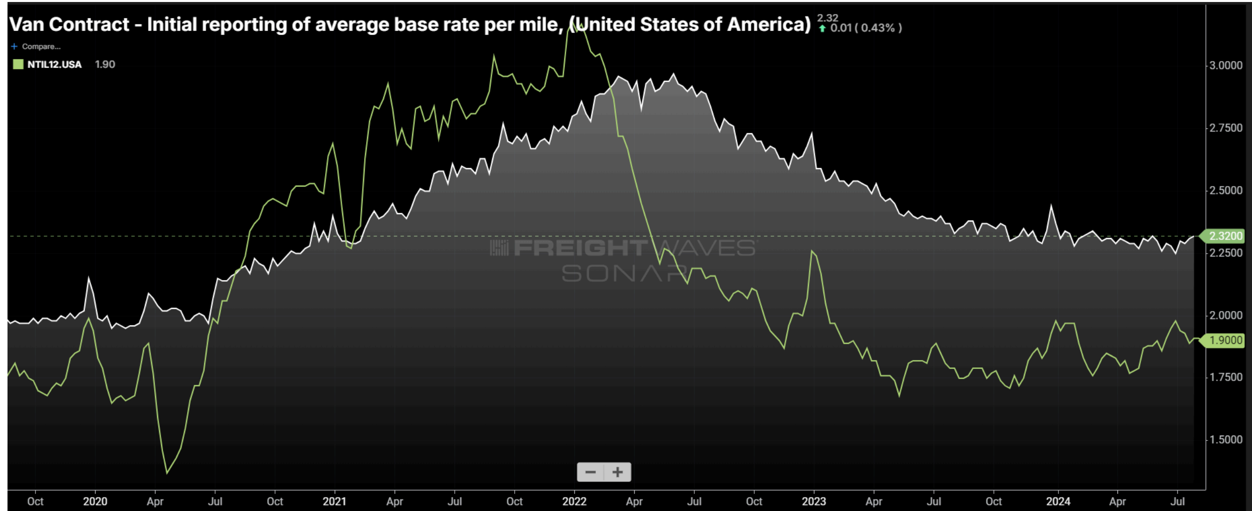
Disproportionate growth in freight moving less than 100 miles (COTVI) is an important nuance to call out when looking at demand. The COTVI had grown about 22% y/y as of mid-August with all other lengths of haul showing 0%-5% annualized growth.

The implication is that there has been significant upstream demand, which includes moves from the port cities to upstream warehouses as well as some level of upstream manufacturing activity. The COTVI for the Los Angeles markets continued to grow, averaging around 15% y/y growth from mid-July to mid-August.

Demand for loads moving more than 800 miles has also grown out of the nation's long-haul capital markets of Los Angeles and Ontario, California, but not as significantly. Long-haul demand has a far greater impact on national capacity than shorter-haul freight, taking more than eight times the amount of time to cover than local freight. This demand growth has put more of a strain on carrier networks in general, but some destinations like Chicago and Harrisburg, Pennsylvania, have been on the receiving end of many of these shipments — keeping capacity more abundant in these markets.

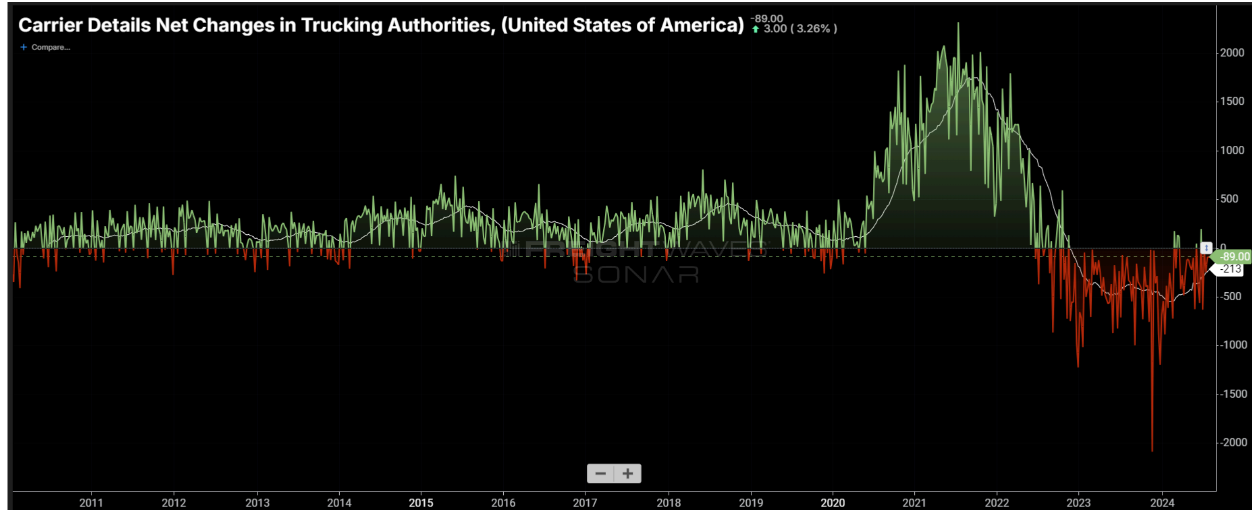


The growing imbalance of demand has shown up in rates, with spot rates from Los Angeles to Chicago increasing about 5% over the previous year's levels in mid-August. Rates for the reverse trip from Chicago to Los Angeles have conversely dropped approximately 9% y/y.



Looking at aggregate contract (VCRPM1) and spot (NTIL12) rates, we can see that spot prices have been trending higher since May of last year, while contract rates are still leveling off. Contract rates were down just under 2% y/y at the end of July, whereas spot rate averages were up about 9%. The takeaways here are that the market floor is on the rise as capacity leaves, and most of the juice has been squeezed out of the contract rates.

The closer these two values get to each other, the greater the likelihood of a violent market swing. The gap between these values remains historically wide, but it is shrinking quickly.



Net changes in active motor carrier of property operating authorities remain negative but less so than they were earlier in the year. The diminishing level of exits does not necessarily mean the market has improved enough to sustain this level of operators, but more that a lot of the newer operators who bought their equipment at elevated rates during the pandemic

era have flushed out. Since Sept. 1 over 61% of the exits have come from operators with less than three years of experience. The main takeaway is that capacity is still leaving the market and therefore remains in a state of transition to a tighter state.

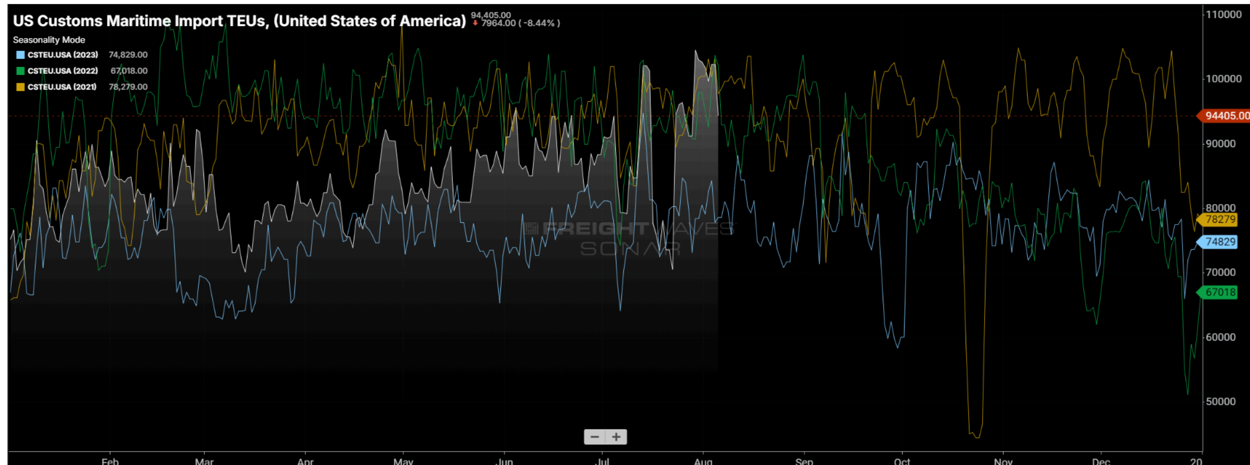
Maritime

Ocean spot rates have peaked, according to Maersk on its second-quarter analyst call. The reasons for an expected decline in spot rates from here include an easing in port congestion, expected seasonal declines in freight demand as the end of the year approaches, and increases in ocean capacity, which is rising 2%-3% per quarter. That said, ocean spot rates are still expected to remain historically high since there is no evidence of a resolution of the Red Sea disruption in sight. Maersk expects to avoid the Red Sea through at least the end of this year. The impact of the Red Sea attacks has assuaged carriers' concerns of a near-term overcapacity situation.

Meanwhile ocean contract rates are expected to rise in the third quarter from second-quarter levels – contract rates generally follow spot rates, which rose sharply in the second quarter, as shown in the SONAR chart below. Therefore, ocean carriers' profits should rise sequentially in Q3 despite higher costs associated with running vessels at higher speeds and chartering more vessels. If ocean volume were to significantly decline, carriers would likely manage capacity downward by running vessels slower and letting charters expire.

The volume of containers passing through U.S. customs remains at a very high level, particularly at the West Coast ports – the Port of Long Beach, California, set a monthly record in June. The main question going forward is about the sustainability of that demand. Many industry observers have suggested that the industry has seen a pull-forward of fall demand from the third and fourth quarters to the second. Motivation for shippers moving demand forward is risk mitigation against disruptions from labor unrest (a potential International Longshoremen's Association strike in Q4), port congestion and oceangoing container availability. In addition, growth in Amazon Prime Day sales, as well as competing sales, has

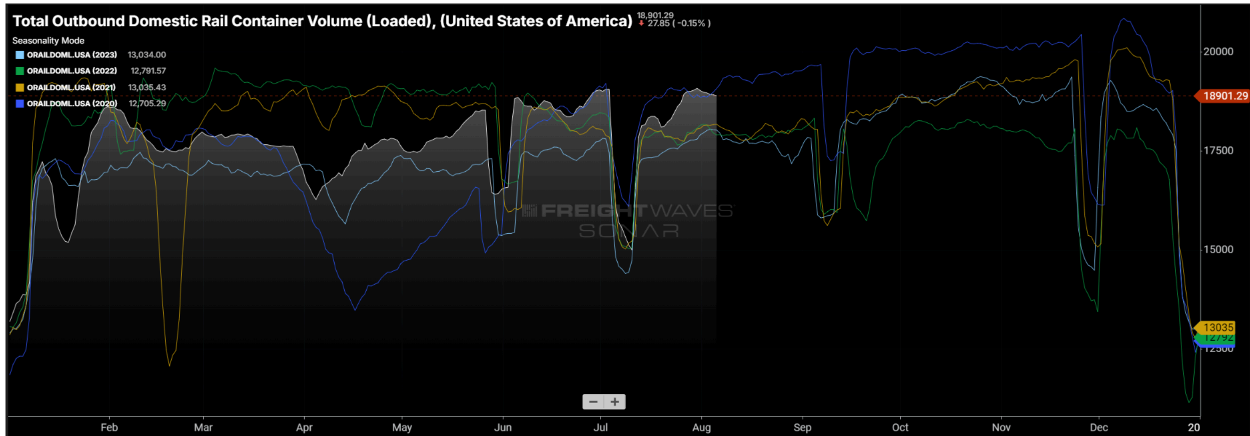
altered seasonal retail patterns – July is now a busy month instead of a slow one. The U.S. West Coast ports are also seeing a volume boost from vessel diversions away from the western Canadian ports, particularly the Port of Prince Rupert, as shippers avoid potential labor disruptions. On its most recent analyst call, Canadian National Railway's management said it expects the Canadian labor issues (both the Canadian rail workers and the Canadian port workers) to be resolved by the end of August.



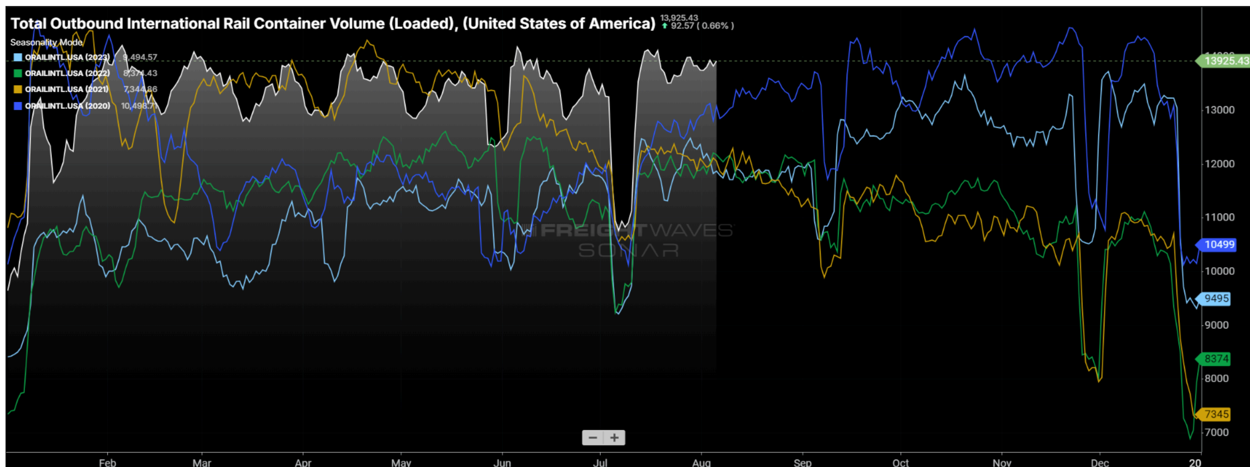
The recent strong import demand may also be attributed to inventory replenishment, which could prove temporary. Interestingly, J.B. Hunt, the largest domestic intermodal carrier, said it has not seen the import volume translate commensurately to inland movements, suggesting that much of the import cargo is being warehoused in Southern California. The current retail inventory-to-sales ratio of 1.31 is below the typical pre-pandemic range of 1.45-1.5, suggesting room for growth in retail inventory levels remains.

Intermodal/Rail

Domestic intermodal volume started strengthening in June, and that strength has persisted through early August. In the period since the Fourth of July, domestic intermodal volume has been up 5.5% year over year and is roughly in line with 2020 levels, which, of course, were being supported by the tight truckload market at that time. Intermodal volume strength is being driven by several factors, including robust import volume, share gain among the U.S. West Coast ports and an increase in the share of the transloading of imports from international containers to domestic containers. Those factors are more than offsetting the impact of a still-loose truckload market.

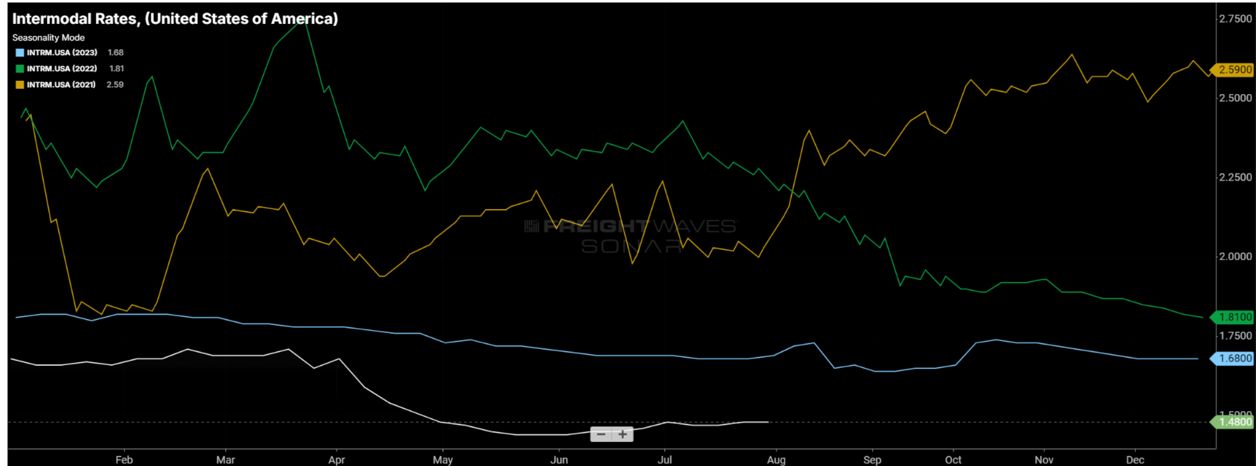


In light of the higher transloading activity, one might expect international intermodal volume to be declining, but SONAR data shows continued robustness in that segment as well. That is consistent with a statement made by Union Pacific's management team on its second-quarter earnings call. International intermodal volume is being supported both by share gains at the west coast ports at the expense of both the U.S. East Coast ports and the Canadian ports, particularly the Port of Prince Rupert. Prince Rupert is particularly vulnerable to shippers hedging against the risk of labor disruptions, because most of its freight is bound for U.S. consumption centers, such as Chicago.

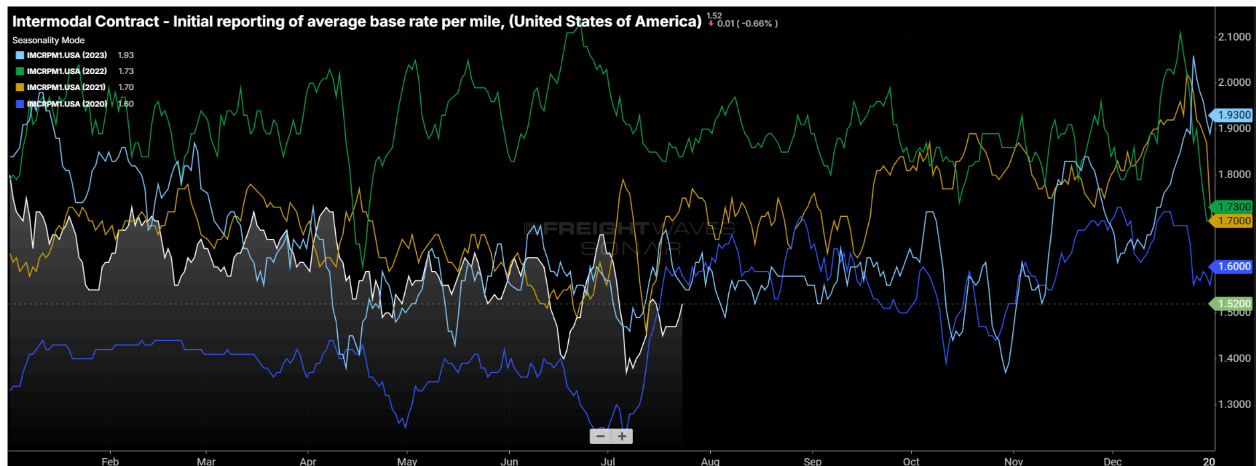


Despite the strong domestic intermodal volume, domestic intermodal spot rates to move 53-foot containers door to door (INTRM tickers) remain depressed. Not much intermodal volume moves on the spot market, but spot rates can be used to assess whether carriers are concerned about protecting capacity for contractual shippers. Carriers do not appear concerned currently – the average spot rate across 100 lanes is at a depressed $1.48 per mile, including fuel. Shippers should watch intermodal spot rates in the key headhaul lanes (e.g.,

LA-Chicago and LA-Dallas) for any signs of tightness as the traditional fall peak season approaches.



Intermodal contract rates are currently below year-ago levels after the most recent bid season resulted in declines. J.B. Hunt's gross revenue per load declined 4% in its second quarter, excluding fuel surcharges, while Hub Group's revenue per load declined 17%, though that figure was negatively impacted by a mix shift toward a shorter average length of haul. Two consecutive years of declining contract rates, combined with a fluid railway network, have improved the value proposition of rail intermodal to shippers. The spread between domestic intermodal contract rates and domestic truckload contract rates in SONAR appears to be 15%-20% in the routes with length of haul exceeding 1,200 miles. On its second-quarter analyst call, Hub Group estimated the spread it is seeing in transcontinental lanes to be 30%.



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Air Cargo

Industry consensus is that the air cargo market's remarkably strong first half will build momentum during the final months of the year, when international shipping normally peaks to meet holiday shopping demand, leading to pressure on capacity and higher rates.

Although many U.S. and European businesses pre-ordered inventory to avoid being impacted by supply chain constraints, such as vessel rerouting around the Red Sea conflict zone, the expectation is that underlying demand will translate into more transport activity. Still, a scenario in which fall orders were simply moved up by several months, effectively frontloading at the expense of upcoming volumes, can't be ruled out. And mixed macroeconomic signals still have economists questioning the endurance of consumer spending.

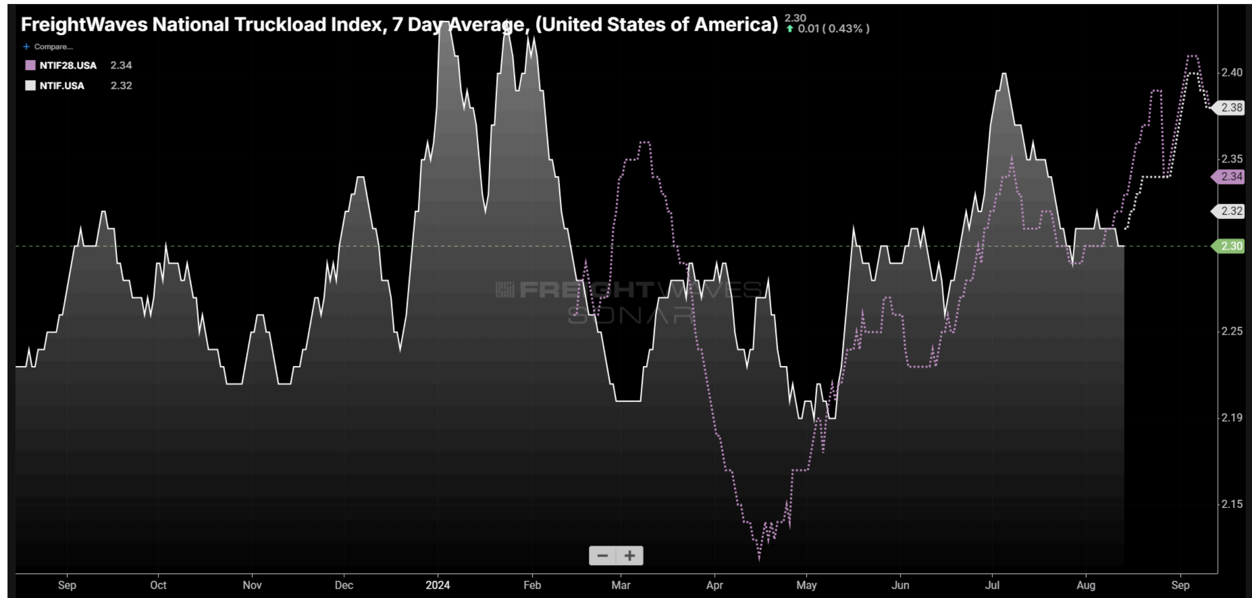
Airfreight demand increased 13% year over year in July behind the persistent e-commerce volumes from China and ocean substitution, during what is typically a slow season for air cargo. Volumes have increased by double digits for eight consecutive months. The market's performance is partly influenced by the fact that July 2023 volumes were relatively weak. Meanwhile, the supply of cargo space grew at a slower 2% rate, leading to tight capacity on certain trade lanes. The load factor, a measure of capacity utilization, increased 5 points to 59% as demand growth exceeded that of supply.

Global average spot rates reached $2.64 per kilogram earlier this month, close to the high for the year and roughly on par with the same time last year. Since then, rates have declined about 5%. Rates on routes out of the Asia-Pacific girded the global average. Shipping rates from Shanghai to North America, for example, rose more than 25% compared to the same month last year, while rates to Europe increased by 44%.

Shippers and freight forwarders in the Northeast Asia to Europe market are feeling the price squeeze with aircraft nearly 90% full each flight, according to Xeneta. Load factors on the backhaul are only 43%, down 18 points from 2019 levels – which explains why fronthaul rates are three times higher than the return leg. Forwarders are passing on high rates to customers signing long-term contracts, with base rates up 30% year over year to $4.42 per kilogram. But when logistics companies commit to space on terms valid for less than a month, they are paying 40% more than a year ago.

Airfreight volumes and rates have tapered off in recent weeks, potentially reflecting reduced demand as ocean congestion eases and volumes shift from air back to ocean.

Outlook



The National Truckload Index Forecast models all agree that spot rates should be on the rise heading into Labor Day, possibly exceeding Fourth of July levels. While this is not a deviation from historical patterns, the level of increase is worth noting. Labor Day is not traditionally as tight an environment as the midsummer holiday, outside of the pandemic era when imports flooded the western ports. This market has some characteristics similar to that era as imports are again a major factor influencing domestic surface transportation. Cross-country long-haul demand peaks in September. While lower demand is the main difference between the pandemic era and this one, intermodal capacity appears to be more capable of handling current levels of demand and may keep the truckload market from experiencing significant tightening. A caveat: The bulk of hurricane season lands this time of year.