Research Briefing | US

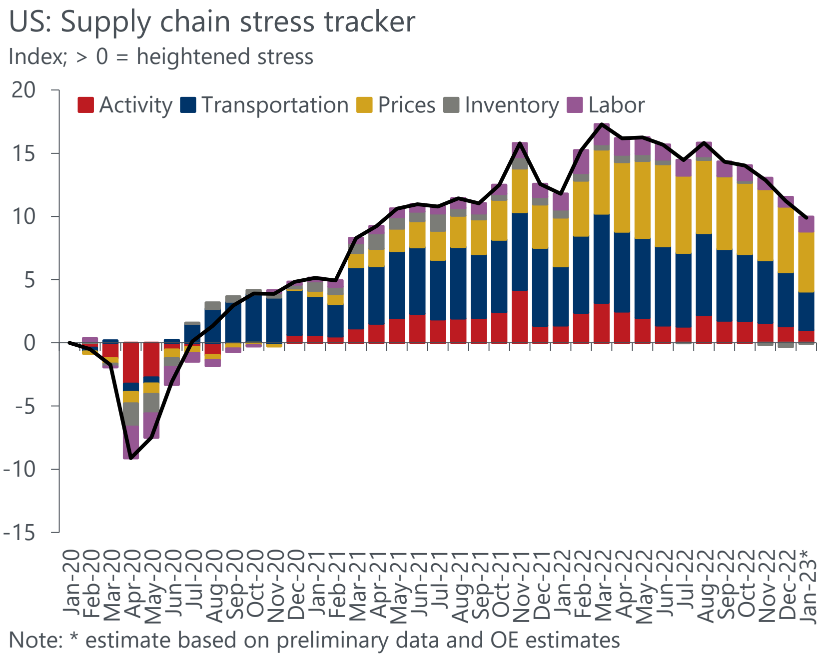
Supply chain stresses fade as recession nears

- **Supply chain stress fell at the beginning of the year and further easing is likely due to weaker domestic and global demand. As the US economy enters a mild recession, softening consumer demand and cooling business activity will continue to unwind supply chain strains.**
- **Our supply chain stress indicator fell to its lowest level in nearly two years and is 16% below the January 2022 level. Easing in transportation was the main impetus for the improvement, with a pullback in consumer demand opening capacity in ocean and air freight routes. The activity component recorded a more modest decline.**
- **The labor component registered a modest increase in pressures in January, confirming that the market remains exceptionally tight. We expect further Fed policy tightening as the central bank works to cool the labor market. Meanwhile, inflation pressures eased and inventory growth weakened as businesses became more wary of holding stockpiles amid recession worries.**

Transportation stress eases. The environment for shippers has improved from a supply chain perspective. Spot shipping rates are down 80% y/y across major ocean trade routes and there is potential for further declines as more capacity comes online. Major logistics companies have announced layoffs, warning about a "bumpy year" ahead. We anticipate that cooler demand will be a key driver of reducing stress in the logistics sector.

Price pressures cool. The ISM Manufacturing survey offered encouraging news on inflation while ISM Services prices rose modestly. A relatively steep decline in the PPI, though driven partially by volatile energy prices, corroborates the ISM surveys. Goods prices will remain under pressure this year – which will likely keep inflation falling for goods most exposed to supply chains – though the drag won't be large enough to completely offset stubborn services inflation (**Chart 2**).

Chart 1: Positive supply chain news continues to flow



Source: Oxford Economics/Haver Analytics

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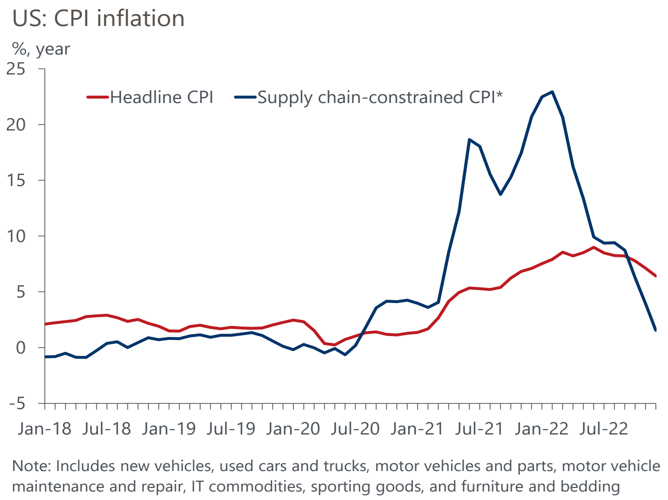
Chart 2: Inflation for goods impacted by supply chain snarls is now retreating quickly



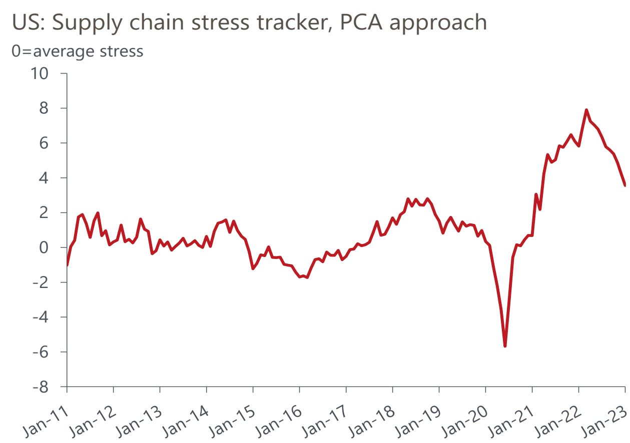
Source: Oxford Economics/Haver Analytics

Labor market defies expectations. The economy added a resounding 517k jobs last month, but the surge overstates the labor market's strength as employment growth frequently surprises to the upside in January. Meanwhile, growth in average hourly earnings slowed to 4.4% y/y from 4.8% y/y in December. The Fed has welcomed signs of easing inflation, but wage growth remained too strong for policymakers' comfort. The good news for supply chains is that average hourly earnings for transportation workers rose more slowly than other US industries in January – a sign that labor supply constraints are less restrictive.

Replenished inventory. Inventory growth moderated and a drawdown is likely as we head towards a recession. A more typical mild downturn should lead to less pullback from businesses, while the pandemic has forced firms to rethink their inventory management strategies, leaning less on just-in-time practices and building larger safety buffers.

Our alternative US supply chain indicator (which includes more than 30 real and survey datapoints in a principal component approach and provides more historical data for comparison) showed continued improvement through year-end (**Chart 3**).

Chart 3: Our alternative supply chain tracker is trending in a positive direction



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