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Research Briefing | US

Supply chain stress is poised to intensify

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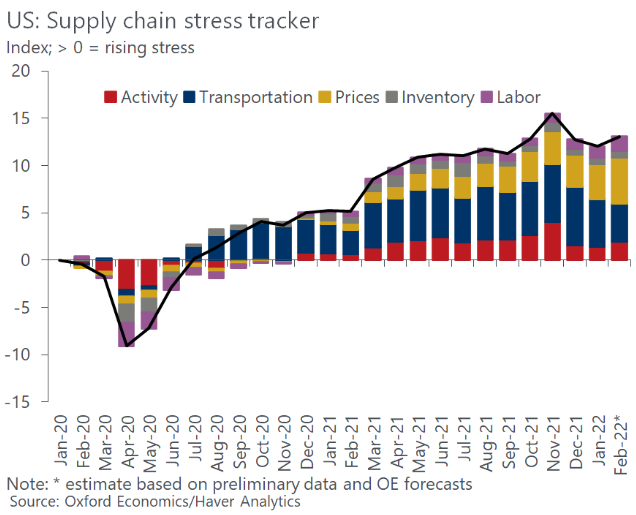
- **Our US supply chain stress tracker brought bad news in February. Inflation took up the baton from transportation and now represents the most stressed aspect of supply chains as input costs rose and firms exercised pricing power. Good news from the transportation front, however, was diminished by greater activity and labor pressures, while inventory tensions subsided slightly.**
- **While backlogs at the Los Angeles and Long Beach ports fell during the month, elevated shipping costs and air freight demand – alongside the absence of positive news from the trucking front – has meant a continuation of logistics stress. And, with some key shipping routes affected by the war in Ukraine, shipping will be even more expensive, meaning logistics stress will rise.**
- **Wholesale services inflation and durable and nondurable goods manufacturing costs remained extremely high. Inflationary pressures are certain to grow given the impact of the Ukraine war on oil, natural gas, metals, and grain prices.**
- **With Omicron fading, activity in February accelerated once again. And with unfilled goods orders at historic highs and in-person services spending rising, the US economy's productive capacity will continue to be tested.**
- **Labor market pressures increased overall as overtime hours jumped and wage pressures stayed firm, but job opening rates likely ebbed. Better health conditions will push Americans back to work, gradually loosening constrictions around a very tight labor market.**
- **Inventories displayed more encouraging dynamics, though considerable imbalances relative to sales remain. The war in Ukraine is likely to reinforce US businesses' plans to reduce their reliance on intricate global supply chains, a pre-existing trend that the pandemic only reinforced.**

Figure 1: Supply chain pressures increased in February



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Supply chain stress is poised to intensify

Logistics stress poised to rise again

Transportation stresses eased in February, according to our tracker – an encouraging sign for what once was the most strained component of the supply chain (**Figure 1**). Backlogs in the LA/Long Beach ports subsided compared to January (**Figure 2**). But transportation challenges remain, as costly shipping rates persisted, trucking dynamics were unchanged, and air cargo load factors stayed high.

The war in Ukraine is making it harder and more costly for goods (and people) to move freely across the globe. Key shipping routes are blocked, and others are feeling ripple effects from the conflict. At the same time, oil prices have risen above $100/barrel, and we expect them to remain elevated through at least mid-2022 – which will keep fuel expensive. Furthermore, shipping costs are set to rise for reasons unrelated to Ukraine. The authority of the Suez Canal – a key chokepoint through which nearly 15% of global trade flows – is about to charge higher prices.

Disparate developments on the other fronts

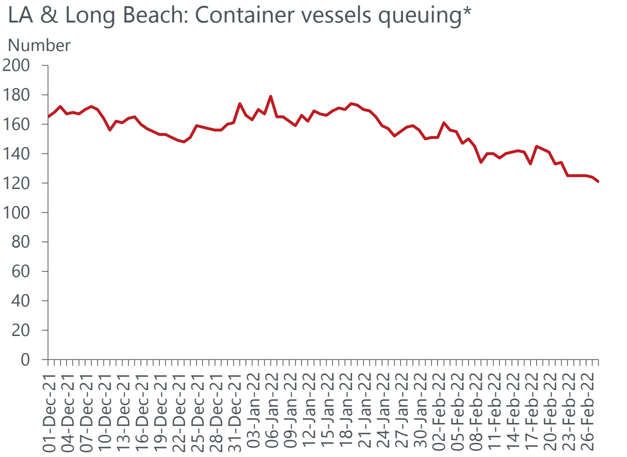
Pressures are now highest on the inflation front, according to our tracker. Wholesale services inflation likely remained very high. Meanwhile, the cost to produce durable and nondurable manufactured goods increased again last month. Regional Fed surveys showed a slight uptick in input price pressures, and businesses commanded more pricing power (**Figure 3**). Production costs will likely rise further since the war in Ukraine has significantly raised the cost of energy and some key non-energy commodities.

As we expected, activity was more stressed last month with the fading of Omicron. Lower Covid infection rates and looser public health restrictions will keep activity on a solid footing, but capacity limits and ongoing supply-side snarls will cap the economy's growth.

Stress on the labor front rose last month. Looking past February's strong jobs gain, overtime hours jumped, wage growth remained firm, but job openings rates moderated.

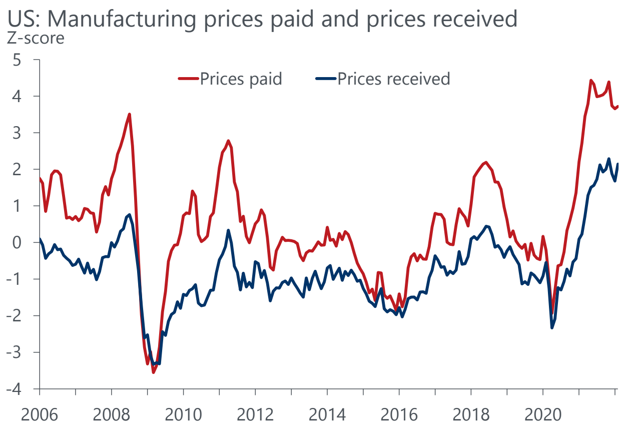
Inventory measures do not signal a major shift in dynamics. While there are some encouraging inventory signs, stockpiles remain lean relative to sales. Indeed, customers of manufactured firms still regard their inventories as too low (**Figure 4**).

Figure 2: Improvements in backlogs at the LA and Long Beach ports in February



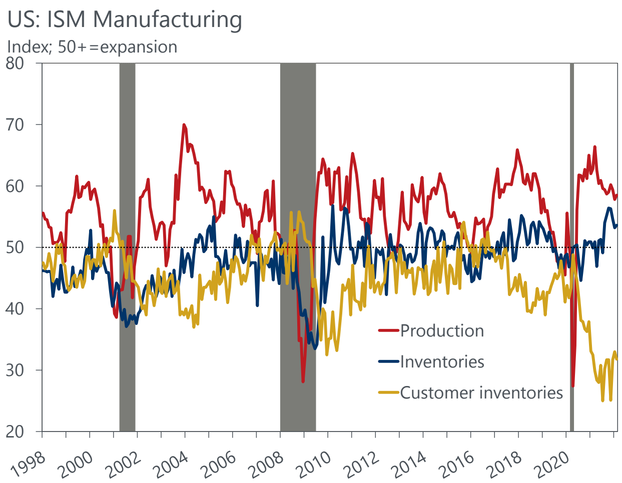
Note: Vessels in port and those that filed a CTA but are drifting 40+ nautical miles offshore
Source: Oxford Economics/Haver Analytics

Figure 3: Price pressures show no sign of relenting



Note: The average z-scores of the Texas, Kansas City, Empire State, Philadelphia and Richmond Fed manufacturing surveys.
Source: Oxford Economics/Haver Analytics

Figure 4: Inventory dynamics are slightly more encouraging most recently



Source: Oxford Economics/Haver Analytics