THE VISION COUNCIL
ITR ECONOMICS
December 2016 VOLUME 17

MACROECONOMIC OUTLOOK

SNAP SHOT INDICATORS

Arrow Denotes Cyclical Movement

Retail Sales	Mild Rise
Manufacturing	Flat
Medical	Mild Rise
Auto Production	Mild Decline
Wholesale Trade	Mild Rise
Interest Rates	Mild Rise
Capital Goods	Mild Rise
Electronics	Mild Decline
ITR Leading Indicator	Mild Rise
Housing Starts	Mild Decline
Consumer Expectations	Flat
Total Industry Capacity Utilization Rate	Mild Rise
US Leading Indicator	Mild Rise
Purchasing Managers Index	Mild Rise
S&P 500 Stock Prices	Mild Rise

Steep Rise
Mild Rise
Steep Decline
Flat
Mild Decline

US Industrial Production, our benchmark for the US industrial economy, transitioned to a tentative recovery trend in November. Production, which comprises Mining, Manufacturing, and Utilities, has been declining since August 2015 in the face of weak demand for electricity and ongoing price shocks related to the Mining sector. Early signs of recovery are a long-awaited signal of health in the overall US economy and support our expectation of 2017 being a growth year.

The US Mining component of Industrial Production reached a tentative business cycle low in October and transitioned to a recovery trend. Oversupply in the oil market will keep the rise in Crude Oil prices relatively mild and we expect mining activity to be below the year-ago level through mid-2017. The North American Rotary Rig Count is recovering, averaging 663 Rigs in the 12 months through November. A record oil discovery in the Permian Basin suggests the US oil industry will be somewhat shielded from global dependence, but places further pressure on high inventory levels. Despite this, rising economic activity, both domestically and in major emerging markets, will help drive rising Prices and encourage renewed investment in this segment of the economy.

The US Electric and Gas Utilities component of Production tentatively transitioned to a recovery trend in October. However, the last three months of activity faltered, contracting from the year-ago level. The Utilities Capacity Utilization Rate, which tends to lead US Electric and Gas Utilities Production by five months, is generally rising from a March 2016 low. Rising Utilization Rates suggest that previously-idle machinery is coming back on line, and combined with rising seasonal demand for heating, bodes well for Production in 2017.

The Manufacturing component of Production (up 0.3%) is nearing a period of accelerating growth. Rise in both the ITR Leading Indicator™ and the Purchasing Managers Index (PMI) over the final quarter of 2016 support our expectation of faster Manufacturing growth in 2017 and rising commodity prices will help diminish the downward pressure on profit margins, which characterized 2016. The Federal Reserve raised interest rates in December and further increases seem likely moving into 2017. However, rates are still historically low; consider making large capital purchases sooner rather than later in order to take advantage of the current low borrowing costs.

Despite ongoing industrial weakness, the consumer side of the economy is still firing on all cylinders. Private Sector Employment is up 2.0% year-over-year and Wages are up 2.4%. Wage growth is outpacing the current mild inflationary environment, leading to increased Disposable Personal Income. The US consumer is enjoying rising purchasing power, and it shows. US Total Retail Sales tentatively transitioned to an accelerating growth trend, rising 3.5% in November against the same month last year. Overall, strong consumer trends are contributing to growth in the US economy as Real Gross Domestic Product (GDP) rose 1.6% above the same period last year. Look for ways to tap into the spending habits of consumers in 2017 as activity rises to record-high levels. However, be aware of the impact rising labor costs have on your bottom line as inflationary pressures mount.

MAKE YOUR MOVE™

Evaluate capacity as many markets will be growing in 2017. If possible, upgrade technology to increase capacity and efficiencies without increasing employees, as labor costs will continue to rise in the next three years.

INDUSTRY ANALYSIS

Retail Sales

US Total Retail Sales (deflated) during the 12 months through November totaled $2.287 trillion, up 2.0% from the year-ago level. Retail Sales tentatively transitioned to an accelerating growth trend. Growth in Private Sector Employment and rising levels of US Disposable Personal Income will help support growing Retail Sales in 2017.

Interest Rates

US Short-Term Interest Rates fell 15 basis points from October to November. However, the Federal Reserve Board voted to raise interest rates at their December meeting, which will likely push Short-Term Interest Rates higher. US Government Ten-Year Bond Yields closed November up 53 basis points from October. Prepare for higher borrowing costs moving into 2017.

Medical

Average US Medical Equipment and Supplies Production during the past 12 months through November is up 6.0%. Annual Electromedical and Electrotherapeutic Apparatus Production is growing at a slowing pace. This will put downward pressure on overall US Medical Equipment and Supplies Production growth in 2017.

Industrial Machinery New Orders

Annual Industrial Machinery New Orders through October are at an 11-month low. Accelerating growth in US Food Production indicates consumer demand is rising and suggests the food component of Industrial Machinery could be an area of opportunity. Rising business-to-business activity will also help support annual New Orders growth in the latter half of 2017.

Wholesale Trade

US Total Wholesale Trade was down 1.6% from the year-ago level during the 12 months through October. US Wholesale Trade of Furniture and Home Furnishings and US Wholesale Trade of Drugs and Druggists' Sundries are two areas that are up year-over-year and may offer opportunity, while US Wholesale Trade of Computer and Computer Peripheral Equipment and Software is in a recessionary trend.

Manufacturing

Average Manufacturing Production during the 12 months through November rose 0.3% from the year-ago level. An expanding industrial economy, as well as recovery trends in US Wholesale Trade of Durable Goods and US Exports, will help lift Manufacturing Production in 2017.

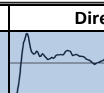
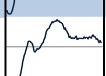
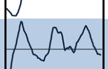
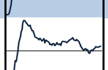
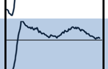
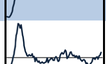
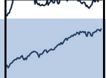
Capital Goods New Orders

Annual US Nondefense Capital Goods New Orders (excluding aircraft) through October are down 3.8% from the year-ago level. Machinery Manufacturing Capacity Utilization, a five-month leading indicator, indicates that the recovery trend in annual New Orders will persist into at least mid-2017. Rise in the US Purchasing Managers Index (PMI) suggests cyclical rise in New Orders will persist throughout 2017.

Average US Mining Production

Average US Mining (excluding Oil and Gas) Production during the 12 months through November is down 9.7% from the year-ago level, but is in a recovery trend. A rising trend in the IMF Metals Price Index quarterly growth rate, an eight-month leading indicator, is signaling that the recovery in Mining Production growth will persist into at least mid-2017.

SNAPSHOT INDICATORS

Indicator	Direction		What it means for the US economy
ITR Leading Indicator™ (Actual)		Rise	The Indicator rose for the 10th month, substantiating the tentative low in Industrial Production and signaling rise in the US economy into at least the second half of 2017.
Housing Starts (Most recent 12 months compared to same 12 months one year ago)		Mild Decline	Housing Starts are generally declining through November, in line with our expectation of decline into the first half of 2017.
Consumer Expectations Index (Most recent 12 months compared to same 12 months one year ago)		Mild Decline	Internal trends suggest upward momentum will take hold imminently. Rise bodes well for Retail Sales in the second half of 2017.
US Total Industry Capacity Utilization Rate (Most recent month compared to same month one year ago)		Rise	The Utilization Rate rose for the third consecutive month, which indicates upward movement for the US economy in 2017.
US Leading Indicator (Most recent month compared to same month one year ago)		Mild Rise	Despite a tick down in October, the Indicator remains above the previous low and indicates expansion for the US economy in 2017.
Purchasing Managers Index (Most recent month compared to same month one year ago)		Rise	General rise in the Index since November 2015 supports the tentative low in Industrial Production and signals cyclical rise into at least late 2017.
S&P 500 Stock Prices (Raw Data)		Rise	The S&P 500 rose in the month of November. Further upward movement is likely going in at least 2017.

LONG-TERM VIEW

2016:
Recovery in Second Half

2017:
Accelerating Growth

2018:
Slower Growth

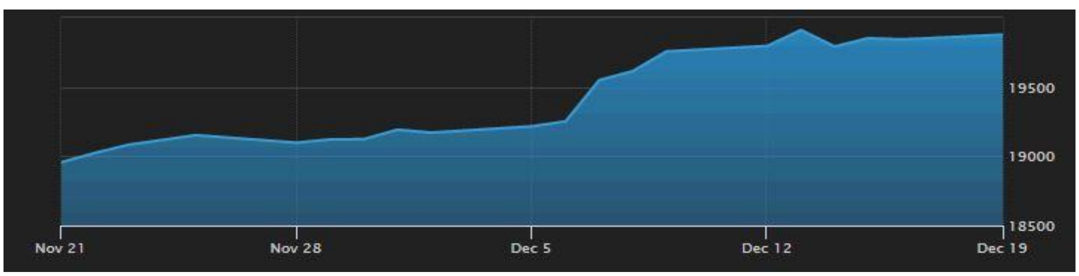
THE POST-ELECTION REACTION

By: Brian Beaulieu

We are rounding the bend on 2016 and heading into a 2017 that is likely to be filled with changes, given the views of President Elect Trump and a Republican Congress. We are not changing our outlook for 2017 or 2018, even with the probable political changes ahead or after seeing what the financial markets have done since the election. Indications are that the economy will be rising in 2017. GDP will rise at a faster pace than what we experienced in 2016 and US Total Industrial Production will continue the recovery trend begun in 2016 and accelerate in its ascent in 2017. 2018 continues to look like a year of growth, but at a slower pace than that we will see in 2017.

Stocks:

The financial markets since the election have been the proverbial tale of two cities. The bond markets responded with ongoing higher interest rates, especially on the long-end of maturity. The S&P 500 (the shorter-term view) is upbeat and expecting improving corporate profits in the future. It has been a good run over the last 30 days, with the DJIA up about 5.0%. There is talk about stocks being overvalued, but there usually is after a good run. Our take is that profits are shifting into cyclical rise and GDP is set to experience business cycle ascent through 2017, so there is no fundamental reason from a cyclical perspective why we will not see more rise in the year ahead. This makes the stock market a positive leading indicator signal and an opportunity.

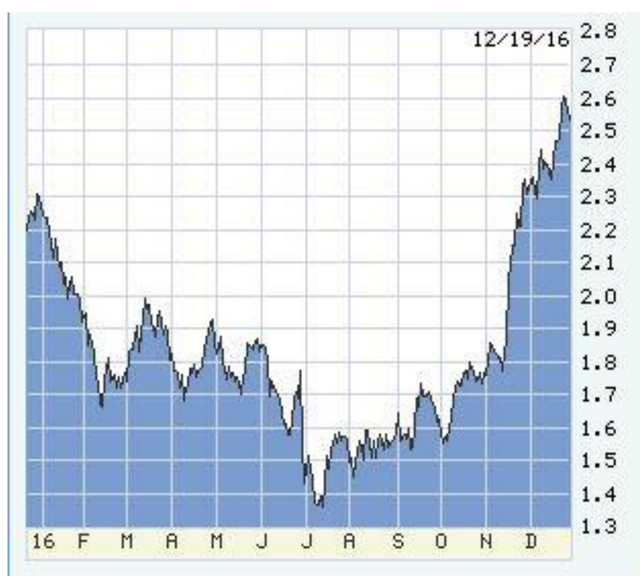


DJIA 30-day run through December 19, 2016. Graph from the Wall Street Journal.

Bonds:

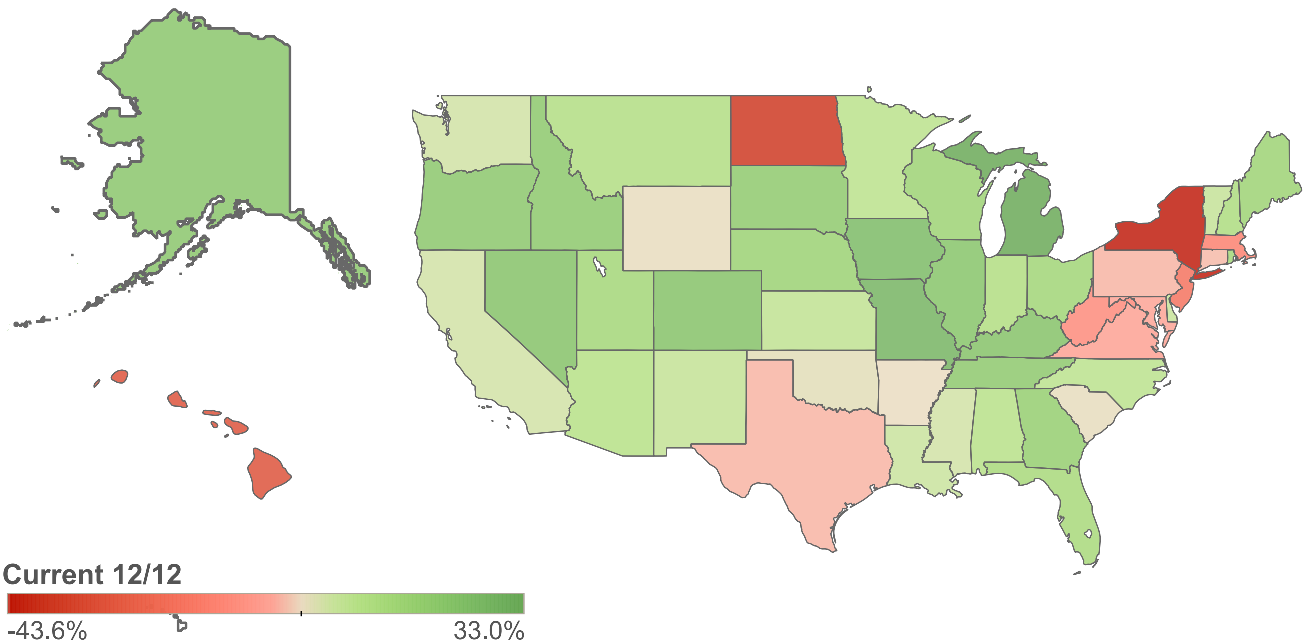
The bond market is espousing a different view. The ascending trend in the US Government 10-Year Bond Yield is steeper than normal, reminiscent of when Ronald Reagan was elected in 1980. We think the bond market is looking further out than the stock market. We also think the bond market is saying that we should expect higher inflation and/or government debt levels in the future. We agree with both assessments.

We trust you have already locked in a long-term fixed rate loan. It's not too late if you haven't. There is more interest rate rise to come in the years ahead.



US Government 10-Year Bond Yield. Source: Wall Street Journal December 19, 2016

STATE-BY-STATE: US Housing Unit Building Permits



- US Housing Unit Building Permits during the 12 months through October are up 3.5% from the year-ago level, but the pace of growth is slowing.
- US Single Family Unit Housing Permits are up 7.5% on annual basis through October, outpacing Multi Unit Housing Permits, which are down 5.8% year-over-year.
- The Midwest and West Regions are leading annual Permits growth, up 15.8% and 8.9%, respectively, and growth in these regions is accelerating. The Northeast is an area of weakness, as Permits are down 24.6% on a year-over-year basis.
- Rising Private Sector Employment, up 2.0% year-over-year, and rising levels US Disposable Personal Income indicate that consumers have the financial stability to invest in large purchases.

READER'S FORUM

How would limitations on free trade affect the recovery in both North America and elsewhere (e.g. China.)?

Brian Beaulieu, CEO at ITR Economics™, answers:

Limitations on free trade would likely boost domestic activity in the US for perhaps six months before the effects began to show up. The ill-effects for China would be almost immediate. I tend to doubt that Mr. Trump and the next Congress will follow through in any meaningful way on that part of his campaign.

Please send questions to questions@itreconomics.com

