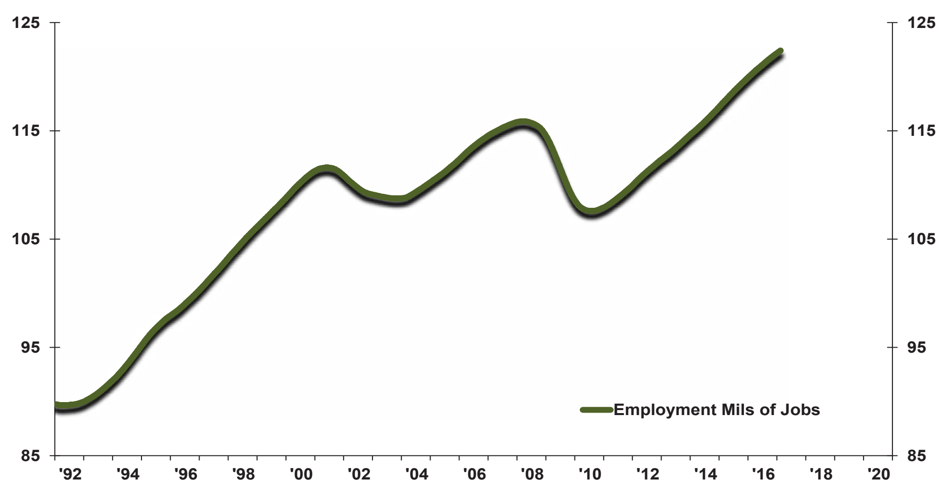
MACROECONOMIC OUTLOOK

US Industrial Production, our benchmark for the US economy, is rising. Industrial Production will grow through 2017 ending the year 2.7% above the 2016 level; leading indicator evidence supports this expectation. The economy will grow further in 2018; however, it will be a slower rate than in 2017. Rise in the near term will not be even across the board for the industrial sector of the US economy. Recovery in commodity-based components, such as Fabricated Metal Products, will alleviate some of the downward pressure. Conversely, there will be some downward pressure in the near term from cyclical decline in US Oil & Gas Extraction Production and US Chemical & Chemical Products Production. However, we expect these segments to transition to a recovery trend in the coming months.

Nondefense Capital Goods New Orders (excluding aircraft) serves as a barometer for business-to-business activity. New Orders are below the year-ago level but are recovering; we expect New Orders to expand through mid-2018. Increasing commodity prices and segments with ties to the consumer will support rise in the near term. Industrial segments will find their footing in the first half of 2017.



The consumer side of the US economy is doing well and remains an area of strength. This is supported by favorable job growth and rising wages. Be wary that the US Consumer Price Index rose in February and inflationary pressures will increase for the remainder of 2017 and into 2018. This indicates that the cost of living will rise during this period. Employers should be prepared for increasing wages or consider nonmonetary benefits to attract talent. However, decisions by the US consumer will not be negatively impacted by this until 2019. Rising commodity prices and rising global demand will add to increasing pricing pressure which will show in the rising US Producer Pricing Index through 2017 and 2018. It will be vital to communicate your competitive advantages during this time in order to justify price increases in order to make up for the rising input costs.

MAKE YOUR MOVE™

Lock in variable interest rates, wages, supplier contracts, and lease terms to avoid paying higher prices throughout 2017 and 2018 as inflationary pressures from both the industrial and consumer sides of the economy rise.

SNAP SHOT INDICATORS

Arrow Denotes Cyclical Movement

Retail Sales	Mild Decline
Manufacturing	Flat
Medical	Mild Decline
Auto Production	Flat
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	Mild Rise
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

INDUSTRY ANALYSIS

Retail Sales

US Total Retail Sales (deflated) are up 1.7% during the 12 months through February compared to one year ago. The rate of growth for Retail Sales is slowing. However, expect an imminent transition to accelerating growth. Retail Sales will expand throughout 2017 and 2018.

Interest Rates

The Federal Reserve increased interest rates for the second time this year. Short-term interest rates are likely to increase in reaction to the trend in long-term rates and increasing inflation, as measured by the Consumer Price Index and the Producer Price Index. The rising Price Index gives the Federal Reserve incentive to raise interest rates in 2017.

Medical

Average Medical Equipment and Supplies Production during the 12 months through January are up 4.9% compared to one year ago. Anticipate weakness in this industry during the second half of this year.

China Industrial Production

China Industrial Production for 2016 rose 6.0% compared to the 2015 level. Upward movement in the China Leading Indicator suggests that there will be rise in China's industrial sector this year. The expected positivity is also confirmed by momentum building in China Railway Freight Carried.

Wholesale Trade

US Total Wholesale Trade is up 1.3% over the last 12 months. The recent transition to a positive year-over-year growth rate is supported by the consumer, including the Housing market. Lumber & Other Construction Materials Wholesale Trade is up 6.3%. This segment will expand further into 2017.

Manufacturing

Average Manufacturing during the 12 months through January rose 0.4% compared to one year ago. Ascent in the Purchasing Managers Index, which leads by 12 months, indicates that there will be upward momentum for the manufacturing industry into early 2018.

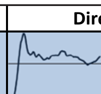
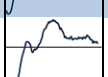
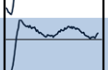
Capital Goods New Orders

Annual US Nondefense Capital Goods New Orders (excluding aircraft) is down 2.6% compared to the same 12 months one year ago. Recovering New Orders are supported by consumer-facing segments found in US Durable Goods New Orders, such as the overall expansion in US Computer & Electronics New Orders, while the industrial sector gains traction in the upcoming quarter.

US Industrial Machinery New Orders

US Industrial Machinery New Orders during the most recent 12 months is up 0.4% compared to one year ago. An expanding industrial economy, combined with a rising utilization rate will support increasing New Orders. New Orders will generally rise from mid-2017 into mid-2018.

SNAPSHOT INDICATORS

Indicator	Direction		What it means for the US economy
ITR Leading Indicator™ (Actual)		Rise	The ITR Leading Indicator rose in February, marking 13 months of general upward movement. Rise in the Indicator suggests rise for the US economy into at least late 2017.
Housing Starts (Most recent 12 months compared to same 12 months one year ago)		Decline	Expect Housing Starts to accelerate imminently, signaling rise in the US economy through 2017.
Consumer Expectations Index (Most recent 12 months compared to same 12 months one year ago)		Mild Rise	Consumer Expectations rose in March for the fourth consecutive month. This suggests consumers are confident which bodes well for Retail Sales into 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 slightly in February. The general rising trend suggests economic expansion in 2017.
US Leading Indicator (Most recent month compared to same month one year ago)		Rise	General rise in the Indicator since mid-2016 signals rise in the US economy through 2017.
Purchasing Managers Index (Most recent month compared to same month one year ago)		Rise	The Index has been generally rising since January 2016. This suggests general rise in the US economy through 2017.
S&P 500 Stock Prices (Raw Data)		Rise	The S&P 500 rose for the fourth consecutive month in February and suggests rise in the US economy through the first half of 2017.

LONG-TERM VIEW

2017:
Accelerating Growth

2018:
Slower Growth

2019:
Mild Recession

FOOD, FUEL, AND KEEPING UP WITH INFLATION

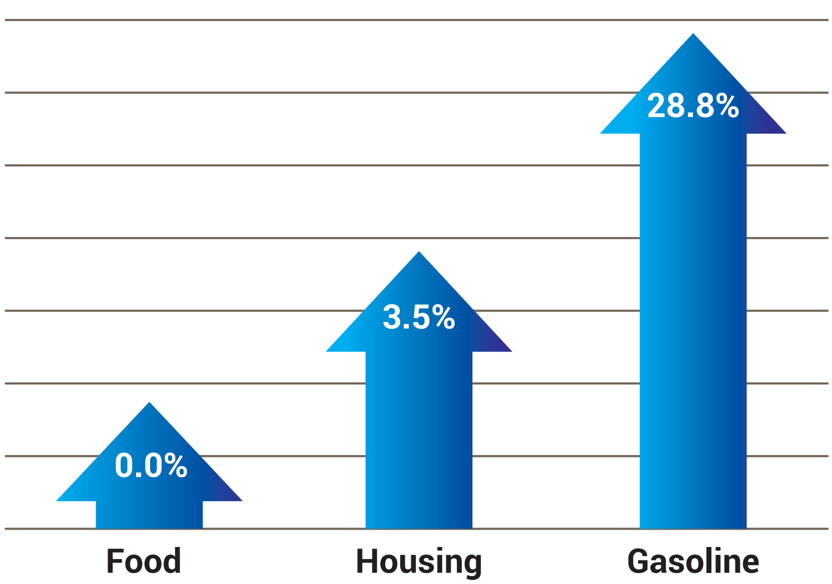
By: Alan Beaulieu

Consumers are facing more inflationary pressures than they have in a while. The monthly rate of inflation, using the Consumer Price Index for Urban Areas (CPIUA), stands at 2.7%, the highest level in 59 months. Inflationary pressures in the CPIUA and elsewhere are good news as it means the economy is heating up – more jobs, more spending, and more demand on producers and the entire supply chain. The issue is that consumers also work with us, and that is where things can get tricky. The inflationary pressure pain points are stemming from consumer-related segments, namely housing, fuel, and food costs. Food prices on a monthly basis rose 0.6% since the December 2016 low, which is a normal rate of rise. A typical length of rise would put a peak in food prices in August 2018; and a typical rate of rise would put prices 7.2% higher than the December low. We may not see a typical length of rise develop, but the ascent in wheat, corn, and soybean prices suggests further food price increases in 2017. It may not be long before you start hearing people talk about price increases at the grocery store as spending on food makes up 12.9% of personal consumption expenditures.

In conjunction with food prices, we can expect fuel prices to move higher in 2017. Gasoline is already 28.8% higher than this time last year. The fact that this is the highest monthly year-over-year comparison in over five years makes it noticeable at the pump and may begin to erode the discretionary spending of the average consumer. It would be normal for the rise in gasoline prices to last through the middle of 2018, which would be consistent with our forecast of higher oil prices through 2017. The good news is that gasoline only makes up 1.9% of our personal consumption expenditures; it is just that somehow it feels a lot more painful.

> *"The Consumer Price Index for Urban Areas stands at the highest level in 59 months."*

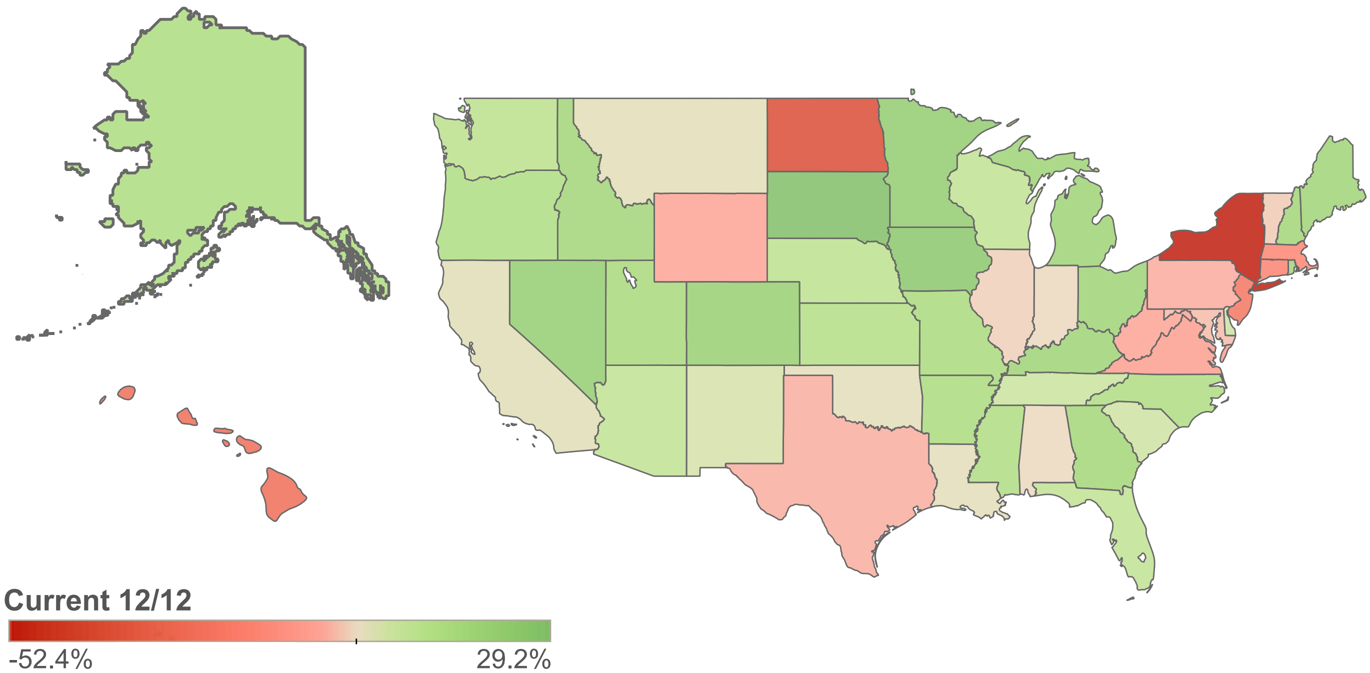
The Consumer Price Index for Housing, meanwhile, is up 3.2% on a year-over-year basis, making this the highest year-over-year increase in over eight years. Rents are up 6.4% nationally from the fourth quarter of 2015 to the fourth quarter of 2016. Upward pressure on housing costs are expected to continue in 2017. Housing consumes a significant 18.3% of a consumer's personal consumption expenditure.



There is some good news here in that wages are increasing at 2.9% year over year (monthly and quarterly comparison). That is consistent with the CPIUA of 2.7%, but below the increases in gasoline and housing. This means that your labor force is feeling some financial pain, although they may not be directly aware of where it is coming from. Employees in this situation are not likely to be content and, therefore, not as productive, as they feel that somehow they are not "keeping up" and that it is their employer's fault. Wage increases in excess of 6.0% would certainly help employees feel better, but wages are sticky and inflation is not. Price increases will ease in 2018 and/or 2019 while you are locked into higher wage costs, thereby permanently shifting production costs upward. We suggest you look at solid, attainable bonus plans that provide employees with the needed income, while keeping the cost at least somewhat variable.

It should be a good year for firms positively correlated to the economy. Plan for prosperity in 2017, but don't straight-line it through 2018 and 2019, as that would put you at a cost disadvantage in the later years.

STATE-BY-STATE: US Housing Unit Building Permits



- US Housing Unit Building Permits during the 12 months through January rose 0.9% above the year-ago level.
- Permits have tentatively transitioned to Phase B, Accelerating Growth, with growth stemming from the single family sector.
- US Single Family Unit Housing Permits are up 8.3%, outpacing Multi Unit Housing Permits, which are down 12.1% compared to last year.
- The Midwest region is generally outperforming the rest of the country, with the fastest pace of growth occurring in South Dakota, Iowa, Colorado, and Minnesota.

READER'S FORUM

Employment seems to be expanding more and more with every jobs report release; however, I am finding it more difficult to find and hire qualified workers. What should I do?

Ben Thompson, Economist at ITR Economics™, answers:

Yes, the US Private Sector Employment pace of job growth is likely to be higher in 2017 than 2016. While this is placing some upward pressure on your labor costs, due to rising wages, consumer strength is good for economic growth in 2017 and 2018. Expect US Retail Sales to grow with rising Employment and other consumer-facing segments of the economy. However, you are correct in your concerns about finding and affording the necessary qualified workers during the next two years. A two-pronged approach to meeting your labor needs is to ensure you have an aggressive and competitive plan in place to attract, train, and retain talent and to invest in capital efficiencies that can increase productivity without adding additional labor costs.

Please send questions to questions@itreconomics.com

