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SNAP SHOT INDICATORS

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Steep Rise
Mild Rise
Steep Decline
Flat
Mild Decline

MACROECONOMIC OUTLOOK

Weaker economic conditions abroad, especially in China, have depressed demand for commodities and increased demand for US currency. The resulting low commodity prices and strong US dollar have contributed to recession in US Total Exports (last three months down 9.0% from the same three months one year ago) and US Nondefense Capital Goods New Orders (down 2.4% on a year-over-year basis). These headwinds are weighing on the manufacturing side of the US economy.

We have revised our US Industrial Production forecast as the leading indicators are signaling that the 2016 cyclical low in the annual growth rate will occur during the second quarter, one quarter later than previously forecasted. We are still projecting that 2016 will be a better year than 2015, with 2016 growing 2.5% versus the projected 1.6% growth rate for this year. The revised forecast calls for 2017 to come in 2.9% higher than 2016. The 2017 year-over-year growth rate is unchanged from our previous forecast.

We revised our US Nondefense Capital Goods New Orders forecast downward due to persistent decline in the rate-of-change in the Purchasing Managers Index and ongoing weakness in the oil patch. Our revised forecast calls for the current recession to deepen through the first half of the year before recovery and accelerating growth take hold in the second half of 2016. Plan for 2.1% growth in 2016 and 6.5% growth in 2017.

The good news for the US economy is seen on the consumer side, which accounts for approximately two thirds of US GDP. Annual growth in Retail Sales Excluding Gas Stations, adjusted for inflation, is currently 4.7%, the eighth consecutive month of growth above 4.0%. Strength in Retail Sales Excluding Gas Stations is a function of declining unemployment (currently 5.0%), rising wages (2.3% wage growth over the year), and a high level of consumer confidence. The Federal Reserve increased the Fed Funds Rate by 25 basis points, commenting on the "considerable improvement in labor market conditions this year." Consumer spending is having positive effects on consumer-focused industries including automotive and housing.

In 2016 focus marketing efforts on consumer-oriented products. Be cautious about extending credit to customers exposed to commodities and/or exports. If you use commodities as key inputs, consider locking in prices in the first half of the year before they rise along with the US and global economies in the second half of 2016. Also, be aware that the labor market will be tightening, particularly among skilled workers, and that interest rates are likely to rise. Consider hiring and training skilled employees and/or undertaking capital expenditures at today's low interest rates if you are able to afford it in advance of the 2016 upswing.

MAKE YOUR MOVE™

Consumers are driving the economy. Focus efforts on your consumer-related endeavors through the first half of 2016

INDUSTRY ANALYSIS

Retail Sales

Retail Sales (deflated) for the 12 months through October are 2.2% above one year ago. Internal trends suggest further slowing in the growth rate through at least early 2016. The 19.4% year-over-year decline in Retail Sales at Gas Stations is the largest drag on total Retail Sales.

Wholesale Trade

Wholesale Trade is down 2.8% from one year ago. Internal trends suggest that recession will deepen through at least early 2016. Consumer-driven segments such as Furniture and Home Furnishings (up 8.0%) are stronger than areas such as Metals and Minerals (down 9.3%).

Manufacturing

Average annual Production is up 2.5% from one year ago. However, general decline in the ITR Leading Indicator, and the rates-of-change for the US Leading Indicator and US Purchasing Managers Index suggest that the current trend of slower growth will extend through the first half of 2016.

Interest Rates

The Federal Reserve increased the Fed Funds Rate 25 basis points in December. The median projected Fed Funds Rate according to the Federal Open Market Committee is 1.375% by the end of 2016. We expect Government Long-Term Bond Yields of 2.49% by 3Q16.

Medical

US Medial Equipment and Supplies Production is up 2.5% on a year-over-year basis, but the pace of growth is slowing. Hospitals Revenue is also in a slower growth trend (annual growth rate of 6.8%). However, Production and Revenue are at or near all time record high levels.

Capital Goods New Orders

New Orders for the 12 months through October are down 2.4% from their year-ago level. The 6.7% year-over-year drop in Machinery New Orders, which accounts for nearly half of overall New Orders, is tied to low commodity prices and a strong dollar.

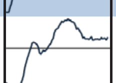
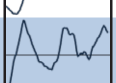
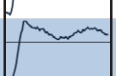
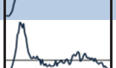
Canada

The 12 month moving average of Canada Industrial Production in September is down 0.4% from one year ago. Low oil prices are having a negative impact on the Canadian economy. Plan for recession to extend through the first half of 2016, with a stronger second half of the year.

Industrial Machinery New Orders

New Orders for the recent 12 months are down 10.3% from one year ago. The most recent three months of New Orders are up 7.4% from one year ago. New Orders are helped by accelerating growth in Food Production, which is up 3.6% for the quarter.

SNAPSHOT INDICATORS

Indicator	Direction		What it means for the US economy
ITR Leading Indicator™ (Actual)		Mild decline	Fell to lowest level since August 2009 signaling potential slowdown in the second half of 2016
Housing Starts (Most recent 12 months compared to same 12 months one year ago)		Mild rise	Increasing Housing Starts signals US economic growth in 2016
Consumer Expectations Index (Most recent 12 months compared to same 12 months one year ago)		Tentative decline	The consumer will support the economy through the first half of 2016
Chicago Fed National Activity Index (Six-month average)		Tentative rise	Tentative June low suggests increasing economic activity beginning in the first half of 2016
US Leading Indicator (Most recent month compared to same month one year ago)		Mild decline	General downward trend in 1/12 suggests slowing into at least the second quarter of 2016
Purchasing Managers Index (Most recent month compared to same month one year ago)		Decline	Reading below 50, but not necessarily indicative of recession
S&P 500 Stock Prices (Raw Data)		Tentative rise	Ongoing ascent would help offset weakness evident in the industrial leading indicators
LONGER-TERM View: 2015: Slower Growth	2016: Stronger Growth		2017: Ongoing Strength

LONG-TERM VIEW

2015:
Slower Growth

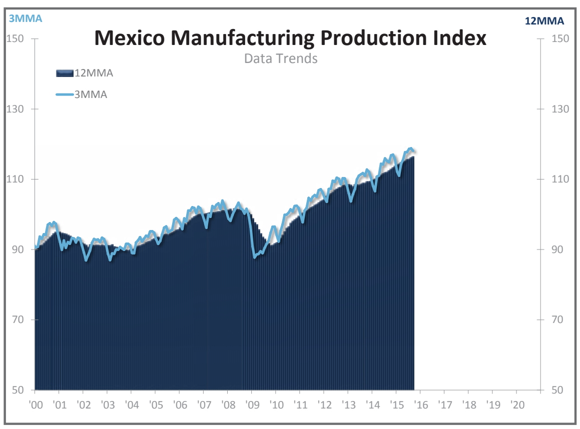
2016:
Stronger Growth

2017:
Ongoing Strength

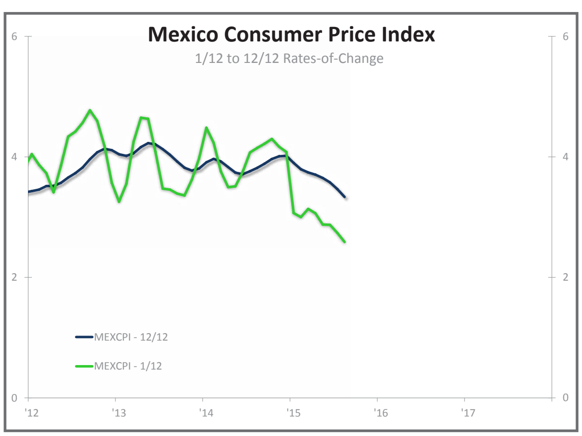
A NEARBY OPPORTUNITY

By: Brian Beaulieu

Mexico has a varied reputation and is hurting in some industrial segments from low oil prices just as the US is hurting in some segments. Look beyond the immediacy of those issues to see the potential opportunities you may have by finding customers in Mexico or doing some manufacturing in Mexico. Others clearly have already done so. The first chart below shows the annual average Manufacturing Index for Mexico from January 2000 to date. The annual average Index is 14.6% higher than the pre-Great Recession high. It is also up 3.5% over the last 12 months and the latest monthly Index is up 3.3% from one year ago. More growth lies ahead. Retail sales during the past three months are cruising at 5.9% higher than last year. Residential Construction for the recent quarter is slowing in its rate of growth but is still 8.1% higher than one year ago. Nonresidential Construction is exhibiting softness, but that is to be expected with the weakness in oil and natural gas pricing. Average Oil and Gas Mining for the past 12 months is down 6.1% year over year. Nonresidential Construction will pick up again, but will likely lag the 2016 improvement in oil pricing that we are forecasting.

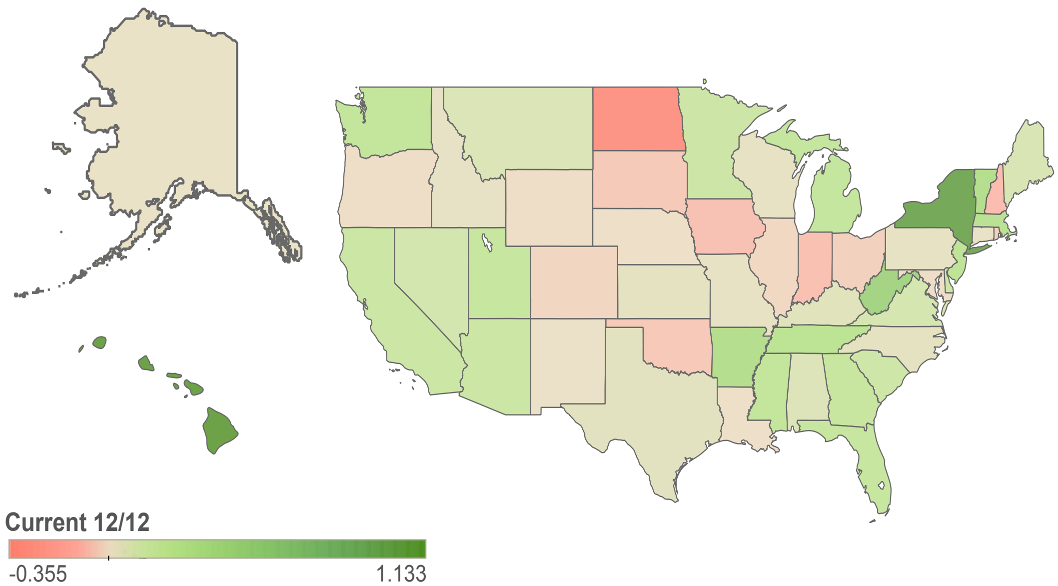


Regarding the relatively near term, Mexico's PMI is running at 53.0 (October and November 2015). Additionally, Inflation is quiet at 2.6% (1/12 rate-of-change) which means there is room for stimulating the economy despite the current growth data.



These factors are consistent with better days being ahead in conjunction with the US outlook. Don't look for the immediate gains to really hit their stride until the global economy improves in the second half of 2016. Mexico's exports to Europe, China, and South America are running below year-earlier levels. Indeed, like US Industrial Production, we are projecting growth for manufacturing in Mexico for 2016, 2017, and 2018.

STATE-BY-STATE: Housing Permits



Average Housing Permits for the year are mostly above year-ago levels with some exceptions. Housing Permits are growing in the Pacific and Southeast region. By this metric, these regions offer the best opportunities for growth as a region. The high rate of Permits increase in New York is due to a one-time tax code change over the summer which brought future projects into the current period. Housing Permits are in general decline throughout the north central region of the country. Decline is most prominent through the upper Great Plains States and the Ohio River Valley. Depressed commodity prices are weighing on Housing Permits in these regions due to a decline in extraction and production activity.

READER'S FORUM

A few years ago, ITR put a strong warning about the 2019 time frame, specifically late 2019 and the start of 2020. My take at that time was that was a great depression-sort of period. Yesterday I heard something very different, that 2019 would be a mild recession and that 2029 would be the bigger, financial event timeframe. Alan also mentioned some books that would dive into this in more detail. Maybe I can order copies of those to further educate myself.

Answer:

You are correct. We did previously forecast the recession in 2019 to be more severe than the current outlook but nothing as deep as the anticipated great depression. In terms of historical recessions, think of 2019 ranking in between the downturns the economy experienced in 1990 and 2001. One of the major reasons for the upgrade to our outlook is the fracking boom that occurred in the US. This provided a lift to the economy in terms of job creation and increased demand for many goods, including machinery. The 2019 recession is expected to be consumer driven and led by inflationary pressures, but the economy will likely bounce back quickly.

Alan and Brian Beaulieu wrote the book Prosperity in the Age of Decline. This book points out the drivers that will lead to the next Great Depression (around 2030) in greater detail and what you can do to safeguard yourself from it.

Please send questions to questions@itreconomics.com