THE VISION COUNCIL

ITR ECONOMICS

SEPTEMBER 2015 VOLUME 13

SNAP SHOT INDICATORS

Published by ITR Economics

Indicator	Trend
Retail Sales	Mild Rise
Manufacturing	Flat
Medical	Mild Rise
Auto Production	Mild Rise
Wholesale Trade	Mild Decline
Interest Rates	Mild Rise
Capital Goods	Mild Decline
Electronics	Mild Rise
ITR Leading Indicator	Mild Rise
Housing Starts	Mild Rise
Consumer Expectations	Steep Rise
Chicago Fed National Activity	Mild Rise
US Leading Indicator	Mild Rise
Purchasing Managers Index	Mild Decline
S&P 500 Stock Prices	Flat

Steep Rise
Mild Rise
Steep Decline
Flat
Mild Decline

MACROECONOMIC OUTLOOK

The United States is the top global economic power. However, most people in this country do not realize that. According to a Gallup poll conducted as recently as 2013, a staggering 52% of Americans named China, not the US, as the leading economic power in the world. Only 32% of those polled believed the US held the top position, while others thought it was the likes of Japan, Germany, India or even Russia in the top spot. The majority of the people that took part in the Gallup poll were wrong for several reasons.

First, the US definitively has the largest economy. In 2014, the US economy was nearly 70% bigger in terms of GDP than that of China, the runner up. Second, the US dollar is the leading reserve currency of the world, a position that is unlikely to change in the foreseeable future. The Chinese yuan, on the other hand, is a currency controlled by the communist government in Beijing and not allowed to float freely in the open market. In fact, the recent 3% devaluation of the yuan proved that it is light years away from challenging the dollar for the title of leading global reserve currency.

The nature of the US and Chinese economies is also vastly different. The US economy is driven largely by domestic consumption, services and innovation. China, on the other hand, is heavily reliant on low-cost manufacturing and exports to fuel its growth. The latest data from the UN shows that exports comprised more than 26% of Chinese GDP in 2013, a value which was nearly double that of US exports at 13.5% of GDP. Chinese exports to the US account for approximately 5% of the country's economic output, while China receives less than 1% of all US exports. Therefore, China's economic performance is much more dependent on the US than the other way around.

For this reason, fears of the ongoing slowdown in the Chinese economy resulting in a recession in the US are largely overblown. Economic growth, as measured by Industrial Production, is slowing in both countries. Annual US Industrial Production growth slowed to 2.9% in August, and ITR's forecast calls for growth to cool further to 2.1% by the end of this year. Although this rate of expansion is nothing to celebrate, it is also a far cry from a recession.

Chinese growth on the other hand, which slowed to 6.8% on an annual basis in July, was the slowest pace of expansion in more than sixteen years. The government reported data is indicative of significant headwinds facing the Chinese economy. Our forecast for Chinese Industrial Production calls for growth to slow to 6.5% by year-end, which would pose a major problem for Beijing. It would bring with it rising risks of higher unemployment and civil unrest, factors which provide further evidence that the US is the leading economic power in the world, and not China.

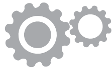
MAKE YOUR MOVE™

Mixed signals from the leading indictors are creating increased downside risk. Take advantage of low interest rates now to shore up your cash position given near-term uncertainty.

INDUSTRY ANALYSIS

Retail Sales

Annual Total Retail Sales (deflated) are ascending; with the pace of growth flattening at 2.5% in July. Monthly Retail Sales in July were strong at $191.0 billion. This was a 1.8% increase from June when on average Retail Sales decline 1.2% June-to-July. Expect Retail Sales growth to cool in the second half of 2015



Manufacturing

11 of the 14 major manufacturing industries are either in slowdown or recession. Ongoing strength in the US dollar and jitters in global financial markets are casting a shadow over domestic manufacturing. However, consumer-oriented manufacturing is likely to remain more robust through the first half of 2016.

Medical

Medical Equipment and Supplies Production is up 3.7% over the past year and is slowing. Pharmaceutical and Medicine Production gained 4.5% in the 12 month period in August. Medical Equipment Production will experience a soft spot late this year before growth is renewed in early 2016.

Crude Oil

Oil of late has been fluctuating in the mid $40s. Consistent with our assessment of more deceleration in the US and last month's downgraded outlook for China, we have revised our near-term and our 2016 outlook for oil prices. We expect prices to rise to no higher than the low 60s by the end of 2016.

Wholesale Trade

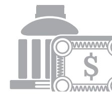
Wholesale Trade slipped into recession in July as falling oil and commodity prices have reduced wholesale and distributor revenues. Retail and construction-oriented Trade is strong. Much of the decline in overall Trade is from petroleum and raw materials, which reflects price decline, not necessarily volume.

Interest Rates

Long-Term Bond Yields rose slightly in August, finishing the month at 2.21%. If sustained in the coming months, as we expect, this will mark a long term shift in the interest rate environment that will extend into the years ahead. The forecast calls for ongoing rise in Yields of around 40 basis points over the next year.

Capital Goods New Orders

Capital Goods New Orders are actively contracting and a transition into recession is imminent. Machinery New Orders accounts for approximately 47% of Capital Goods New Orders; Machinery New Orders are down 2.9% over the past year. New Orders will weaken into early 2016.



US Dollar

The rising trend in the US dollar will reverse for 2016. The pending 2016 recovery in Europe's economy and the second-half-2016 improvement in China's economy will provide an environment where other currencies start to look undervalued and the need for safety via the US dollar will dissipate.

SNAPSHOT INDICATORS

Indicator	Direction	What it means for the US economy
ITR Leading Indicator™ (Actual)	Mild Rise	Accelerating growth in 2016
Housing Starts (Most recent 12 months compared to same 12 months one year ago)	Rise	US economy will enter Phase B in early 2016.
Consumer Expectations Index (Most recent 12 months compared to same 12 months one year ago)	Rise	Consumers are positive and spending money
Chicago Fed National Activity Index (Three-month average)	Tentative rise	US economy will expand into mid 2016
US Leading Indicator (Most recent month compared to same month one year ago)	Decline	US Industrial Production could slow into mid 2016
Purchasing Managers Index (Most recent month compared to same month one year ago)	Decline	US economy could remain in Phase C into mid 2016
S&P 500 Stock Prices (Raw Data)	Flat	Market correction not unusual and healthy

LONG-TERM VIEW

2015:
Slower Growth

2016:
Robust Economic Activity

2017:
Ongoing strength

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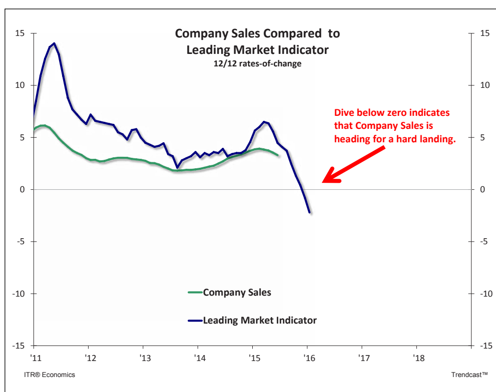
By: Grace Schatz

Budget planning time comes at a particularly difficult time in the current business cycle. Signals from the leading indicators are more varied than usual. At the same time, business-to-business activity and the consumer economy have diverged. Now is the time to analyze your market and determine whether this cycle will be recessionary for your business. Understanding where your market is headed is essential for planning but reading the economic signals can be difficult.

Some leading indicators, including the Purchasing Managers Index and the ITR Leading Indicator, suggest an extended slowdown. Others, such as the Chicago Fed's National Activity Index and Housing Starts, are consistent with an early 2016 rise in the annual growth rate for US Industrial Production. On the positive side the US consumer is in a strong position. The US is a major driver of economic activity globally. Fundamentals are strong in the consumer economy: wages are rising, Employment is healthy, Retail Sales remain strong, and Housing Starts are expanding. If your business is closely tied to US consumer activity, your business is well positioned for growth over the next year.

Your business is at heightened risk for contraction over the next year if demand for your product is heavily reliant on capital expenditures, demand from outside the US, or commodity producers. Business-to-business activity will soon fall into recession, global economies outside the US are generally weak, and commodity prices have fallen dramatically.

While these generalizations are useful as a benchmark, this should not be the end of the analysis for your business. You need to figure out how your business fits into the overall economy. What are the main drivers of demand for your product? The answer to this question will help you to identify economic indicators of interest. Research these markets of interest to determine whether they are contracting or are expected to contract in the coming quarters. If activity in your markets is poised to decline, your business is also at risk to decline.



How to do this? By analyzing the year-over-year rates-of-change of your sales and revenue in comparison to external data that reflect down stream demand for your product you can identify cyclical leading indicators specific to your company's market. The timing and steepness of downturns in these indicators can provide invaluable insight into the future for your sales.

Once you are confident that you know where your business is heading, your internal strategy should change to reflect your expectation. If this business cycle will be recessionary, cross train key people and prepare to have to cut back on labor costs. Consider offering alternative products at a lower price point in an effort to capture market share while your competitors also struggle. If your business will not fall into contraction this cycle, now is a good time to analyze your current offerings and eliminate the ones that are not profitable. Do not lose sight of expanding your capacity or you will fall behind the competition next year.

Regardless of whether the current cycle will be recessionary for your business or not, there are certain actions that you should take now. We are currently at or near the bottom of the price cycle for most goods and commodities. Take advantage of this now and lock in as many input costs at current prices as possible. Interest Rates are also lower than they will be in the foreseeable future. Borrow now in anticipation of economic expansion that will extend through at least 2017. Build capacity now to capitalize on cyclical upswing that will take hold next year. If you are able to lock in those low prices and rates now, you will have a significant advantage relative to your competitors when demand picks up.

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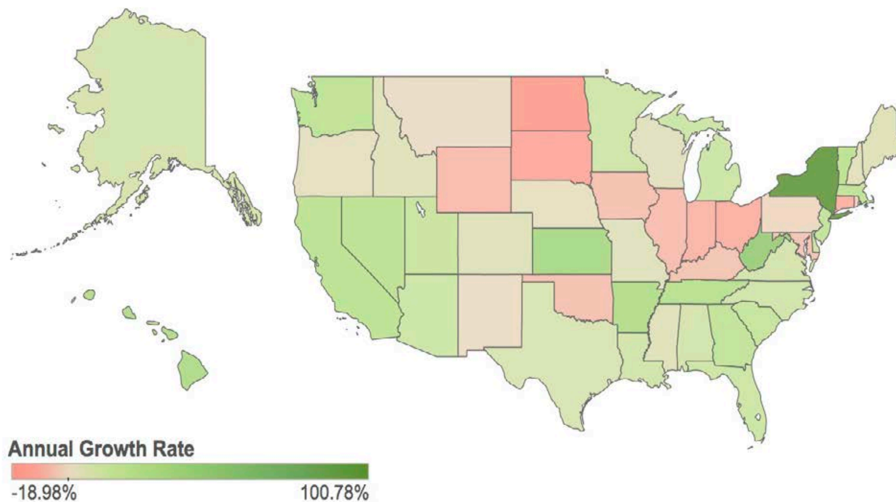
STATE-BY-STATE: HOUSING PERMITS



Housing Permits show significant negative activity through the Ohio River Valley and upper Great Plains states, merging into a single cluster of declining permits across the north central region of the country since last quarter. The Southeast and Pacific regions show the most significant, solid growth in Housing Permits. Note that New York state shows an anomalously high rate of increase in Permits due to a one-time change in the tax code that was scheduled for this past summer, which pulled a large proportion of future projects into the current period.

READER'S FORUM

How does the mass migration flowing into Europe from Syria and Iraq change ITR's long-term economic view of Europe? (Is this enough of a demographic shift for Europe or specific countries within Europe to improve its long-term economic outlook?)

Jim Chappelow, an economist at ITR Economics answered:

The current trend of migration into Europe from the Middle East and North Africa does not change our outlook at this time. Given the small volume of migrants involved relative to Europe's population, potential for social instability, and uncertain political reaction to the trend, the direct economic impact of any resulting demographic changes in terms of age cohorts is likely to be small. We do not expect this to alleviate the long term problem of low birth rates and aging population that many European economies face in the decades ahead.

Please send questions to questions@itreconomics.com