March 2016

Valentyn Povroznyuk, Edilberto L. Segura

- **The Bureau of Economic Analysis improved its estimate of real GDP growth for Q4 2015 to 1.4% quarter-over-quarter.**
- **National industrial production saw a 1.3 percentage point drop in growth to a 0.5% mom decrease in February.**
- **In February, national exports expanded for the first time in months, posting a 1.0% mom increase.**
- **The Texas economy moderated a bit due to reduction of manufacturing activity, a decrease in exports, and the negative impact of low world oil prices.**
- **Labor market conditions improved at both the national and Texas levels.**
- **Consumer prices inched down again due to lower energy prices in February.**

Executive Summary

Moderate growth of the US economy continued in February. Based on the most complete source data, the Bureau of Economic Analysis revised real GDP growth upwards to 1.4% qoq in Q4 2015, which is still significantly below growth observed in the previous quarter. The Texas economy, in turn, moderated a bit, suffering from slowdowns in manufacturing, exports, and oil extraction.

Growth of national industrial production returned to negative territory again in February. Manufacturing posted a minor increase, which was more than offset by decreases in mining and utilities. Performance of utilities was affected by unfavorable weather conditions, while mining suffered from low world oil prices. Negative monthly developments significantly impacted over-year dynamics of industrial production. Total industrial production growth turned negative at 1.0% because of almost double-digit declines in both mining and utilities, which overwhelmed the small growth in manufacturing.

After one month of softening, consumer confidence strengthened in February. Confidence improved on the back of the short-term outlook of both business and labor market conditions, while appraisal of the current situation continued to worsen. There was less optimism in evaluation of current business conditions, and current labor conditions received rather mixed reviews.

National construction observed mixed developments in February. Monthly dynamics were negative in all construction segments except private residential construction. Growth of the latter, however, was more than offset by the decrease in private nonresidential construction. But the resulting total private construction was insignificant. Sluggish monthly performance of construction led to further deceleration of the year-over-year growth. On the other hand, year-over-year construction growth still remained in double-digits. Building permits, in turn, observed only positive developments in terms of both their number and valuation.

Increased exports of goods generated the first positive growth of US exports in months in February. Consumer goods and other goods categories generated additional export inflows fueling growth of total exports during the month. At the same time, exports of services reported little change in February.

The Texas economy slightly moderated in February. Sluggish performance was the result of a decline in manufacturing activity, lower nonresidential construction, continued decline in exports, and low world oil prices, which hurt the mining sector. These negative developments were to a large extent compensated by further expansion of service sector activity and increased activity in the residential segment of construction. However, this did not prevent consumer confidence from further softening, as the Conference Board Index dropped almost 10 points.

Both national and Texas labor market conditions improved in February. Employment grew a bit faster in Texas but the difference was insignificant. At both the national and Texas levels, the service sector was the driving force of employment growth, which was partially offset by a decline in employment in goods-producing industries. Mining remained the leader in contraction of the number of employed in February. Development patterns of unemployment differed in the US in general from those in Texas. The number of unemployed did not change much at the national level in February, leaving the unemployment rate also unchanged. Meanwhile, Texas saw a decrease in the unemployment rate. Improvements in labor conditions in Texas were caused by positive developments in most Texas metros.

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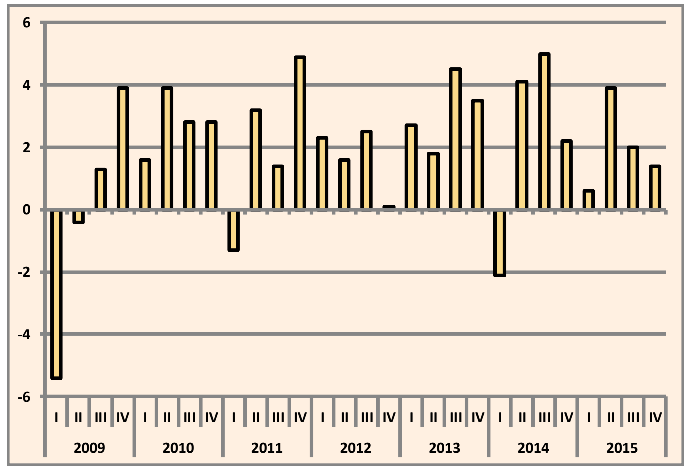
The Federal Reserve decided to leave the policy rate unchanged within the 0.25-0.5% range, finding recent changes in economic development trends insufficient for any changes. In particular, consumer prices decreased again on the back of a decline in energy prices, which more than offset minor growth in prices of foods and in prices of all items less food and energy. The US housing market reported significant contraction after reaching its six-month high in January. Supply issues and affordability problem were the major reasons for this. In contrast, the Texas housing market saw further expansion of existing home sales despite faster growth in prices compared to the national level.

Economic Growth

1. GDP growth, % qoq at annual rates



Source: The U.S. Bureau of Economic Analysis

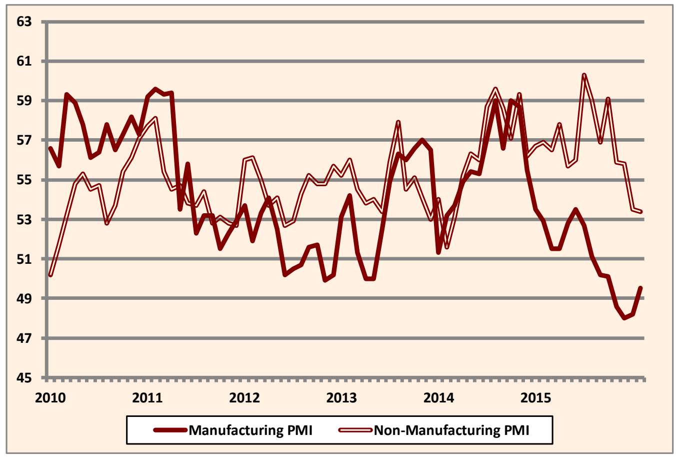
In its third estimate, the Bureau of Economic Analysis upwardly revised the GDP growth rate for Q4 2015. According to the most complete source data, GDP grew by 1.4% qoq at an annual rate during the quarter, which is 0.4 percentage points higher than in the second estimate published earlier. At the same time, despite quite a significant revision, the general picture of economic growth remains largely the same. The upward revision in real GDP growth was mainly the result of upward revisions to personal consumption expenditures (to 2.4% qoq) and to exports (to -2.0% qoq), which were partially offset by a downward revision to private inventory investment, which affected gross private domestic investment (the decline accelerated to 1.0% qoq). Growth rates of imports and government consumption expenditures and gross investment remained unchanged compared to the second estimate (-0.7% qoq and 0.1% qoq respectively). Despite the above-mentioned revisions in GDP growth for Q4, real GDP growth for the year 2015 as a whole remained intact at 2.4% yoy in the third estimate.

After one-month growth in January, national industrial production posted a decline in February. The total industrial production index decreased by 0.5% mom, a significant deceleration compared to a downwardly revised 0.8% mom growth in January. Significant declines in mining and utilities outweighed the tiny growth in manufacturing. In particular, unseasonably warm weather decreased demand for heating, which led to a 4.0% mom drop in utilities. At the same time, low world oil prices continue imposing pressure on the extraction industry as crude oil extraction, coal mining, and oil and gas well drilling and servicing decreased again in February. As a result, mining in general posted a 1.4% mom decline. Over the last six months, mining has decreased by nearly 1.3% mom, while oil and gas well drilling and servicing index has fallen by more than 60% since late 2014. A 0.2% mom increase in manufacturing output was the result of a 0.4% mom expansion in production of durables, which more than offset a 0.1% decrease in production of nondurables. The output of other manufacturing (publishing and logging) was flat in February. Growth of machinery, primary metals, and miscellaneous manufacturing of around 1% mom each ensured the mentioned growth of durables as other major durable goods industries reported little change and wood products saw a 1.2% mom decrease. As for nondurables, several important industries such as food, beverage, and tobacco products, textile and product mills, and chemicals reported decreases, which just slightly offset quite high growth for apparel and leather manufacturing and for petroleum and coal products, accompanied by smaller increases for some other industries. Significant over-year decreases in mining (by 9.9%) and utilities (by 9.3%) outweighed moderate growth in manufacturing (by 1.8%), leading to the overall 1.0% yoy decline in total industrial production in February.

The manufacturing sector observed further contraction of economic activity in February, but at a slower pace compared to January. The PMI index, constructed by the Institute for Supply Management, posted a 1.3 percentage point increase but remained below the 50% threshold at 49.5%. Positive dynamics of the index was the result of favorable changes in most of its components. In particular, decreases were observed for indexes of supplier deliveries, exports, and customers' inventories. The decrease in the imports index had a positive influence on the PMI index, same as growth in all the other PMI components except for the new orders index, which remained unchanged. On the negative side, only production and new orders indexes are above the 50% threshold, which indicates growth. Half of the 18 manufacturing industries reported growth in February, while seven other industries reported declines. Strong domestic demand was named as a factor stimulating growth, while low oil prices and soft international demand were named as major reasons for the decline. Economic activity in the non-manufacturing sector remained virtually unchanged in February. The NMI index was equal to 53.4%, which is almost the same as a month ago. Since the index is well above 50%, the sector continued to expand. Growth of new orders decelerated as the correspondent index posted a 1.0 percentage point decrease to 55.5%. At the same time, growth in production further accelerated as the production index grew by 3.9 percentage points to 57.8%. Foreign trade of the sector further improved as both new export orders and imports indexes posted significant growth (by 8.0 and 9.5 percentage points, respectively). 14 non-manufacturing industries reported growth and only three reported declines. Overall, we think that the sector will further grow next month as all the NMI components except for employment and prices index were above the 50% threshold in February.

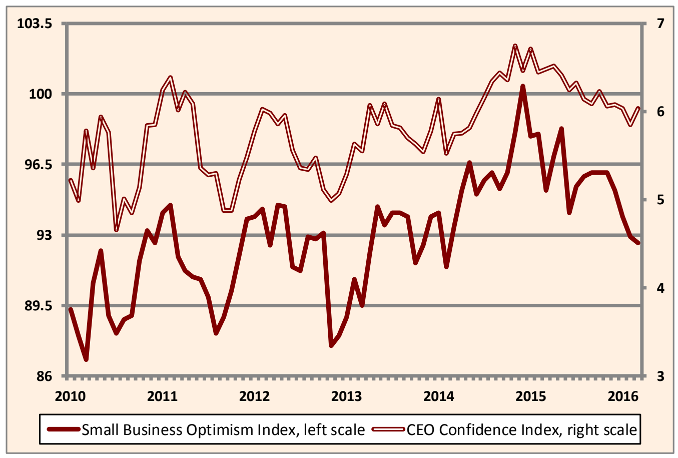
After one month of softening, consumer confidence strengthened again in March. According to the Conference Board, the Consumer Confidence Index increased by 2.2 basis points to 96.2 in the reporting month. The index improved on the back of the short-term expectations of consumers, while their assessment of the present situation slightly softened again. In particular, the Present Situation Index moderately declined from 115.0 to 113.5 and the Expectations Index grew from 79.9 to 84.7.

2. PMI, indexes



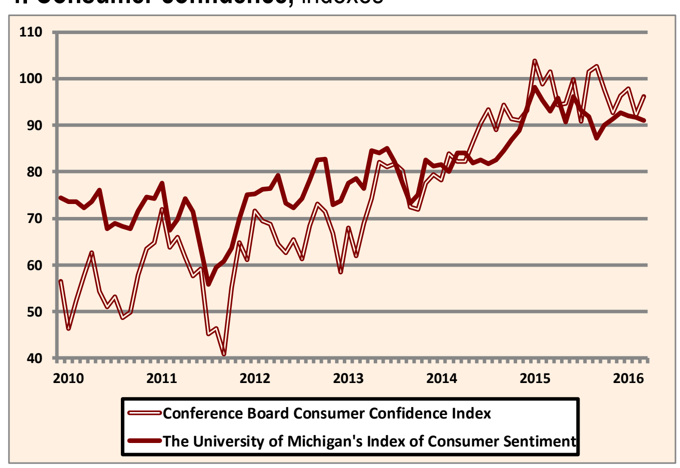
Source: Institute for Supply Management

3. Business confidence, indexes



Source: Chief Executive, National Federation of Independent Business

4. Consumer confidence, indexes



Source: Conference Board, The University of Michigan

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

Consumers' appraisal of the current situation worsened on less optimistic assessment of business conditions. The share of people claiming that business conditions were good decreased, while the share of those claiming business conditions were bad remained virtually unchanged. At the same time, consumers' appraisal of current labor market conditions was mixed. On the other hand, consumers' outlook of both business conditions and labor market were more optimistic than in February.

National construction saw both positive and negative developments in February. Public construction put in place reported a 1.7% mom decline, while private construction was almost flat. As a result, the total construction posted a 0.5% mom decrease. A 0.9% mom growth in private residential construction almost fully covered the decrease in private nonresidential construction of 1.3% mom. At the same time, both residential and nonresidential segments posted declines in the public construction sector. In year-over-year terms, growth in construction remained positive and even accelerated a bit. Total construction expanded by 11.4% yoy thanks to 12.1% yoy growth in private construction supported by a 9.1% yoy increase in public construction. Building permits saw only positive developments in February. Their number grew by almost 13% mom. At the same time, statistical base effects led to further deceleration of over-year growth in the number of building permits to 7.5% yoy. As for building permits valuation, it grew faster than the number of permits in both monthly and over-year terms because the number of permits increased on the back of those permits issued for construction of houses with higher unit costs (single and double unit houses). In particular, monthly growth of valuation was equal to 15.2%, while the over-year one was at 16.2%.

US exports reversed the trend in February. Total exports increased for the first time in the last couple of months advancing by 1.0% mom to USD 178.1 billion. All of the mentioned increase was attributed to growth in exports of goods, while exports of services remained virtually unchanged. Exports of goods amounted to USD 118.6 billion in February, which was USD 1.8 billion more than a month ago. Most of the USD 1.9 billion growth of exports of goods on a census basis came from exports of consumer goods (USD 1.1 billion) and other goods (USD 0.6 billion) export categories. In particular, gem diamonds ensured additional USD 0.6 billion and pharmaceutical preparations ensured additional USD 0.3 billion to consumer goods exports. Net balance of payments adjustments posted a minor decrease of USD 0.1 billion. Exports of services amounted to USD 59.5 billion in February. Growth in travel of USD 0.2 billion was offset by decreases in transport and financial services.

In February, the Texas economy moderated. One of the major reasons for that was the second consecutive month of contraction in Texas factory activity. As the data collected within the Texas Manufacturing Outlook Survey shows, the production index remained negative but slightly improved from -10.2 to -8.5 meaning that the decline in output decelerated a bit. Most other manufacturing activity indexes also indicated further decline. In particular, the new orders index dropped by 8 points to -17.6, the lowest level since May 2009, and the shipments index stayed at -1.1 despite a 10-point increase. Broader business conditions perception was still strongly negative in February. Both the general business activity index and the company outlook index remained strongly negative at -31.8 and -17.4, respectively. Furthermore, the former has been negative for more than a year, while the latter posted a third consecutive negative reading. Finally, the employment index hit its lowest reading since November 2009 at -11.1.

In contrast, service sector activity further expanded in February. The revenue index, calculated within the Texas Service Sector Outlook Survey, remained unchanged at 9.7 points meaning increase in activity at the same pace as in January. At the same time, perceptions of broader economic conditions were more pessimistic in February compared to the previous month. The general business activity index dropped 8.8 points to -19.2, while company outlook index remained unchanged at -6.3. Labor market indicators reflected stable employment but slightly longer workweeks.

Contrary to the national level, consumer confidence further softened in Texas in February. The Conference Board Index dropped almost ten points from 106 to 96.1.

Texas construction saw mixed developments again in February. Nonresidential building construction decreased again after one month of growth. The value of contracts dropped from USD 2.1 billion observed in January to USD 1.2 billion. The number of building permits expanded by 6.0% mom which is a bit slower than in January.

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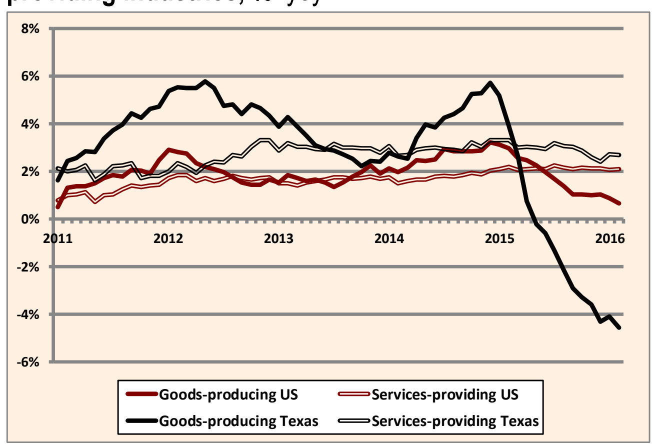
Slowing of the monthly growth led to further acceleration in the over-year decrease of the number of permits to 10.5%. Valuation of building permits grew faster at 8.1% mom in February because the increase in number of permits was ensured by faster growth in permits for construction of the single unit houses, which have higher unit cost of construction. Similarly, the year-over-year decrease in building permits valuation was also significantly lower than that for the number of permits at just 0.7%.

Texas exports returned to a downward trend. The latest available data shows that exports saw a 1.4% mom decline in January after a 1.7% mom increase in December. Lower oil prices, weaker global demand, and strong dollar were still the major factor of the decline. In year-over-year terms, the decline in exports decelerated to 5.9%.

Lower oil price led to further contraction in the Texas rig count in February. The sixth consecutive rig count decline was at 18.9% mom to 244. The statistical base effect, however, softened the decline in over-year terms as it decelerated to 59.3%.

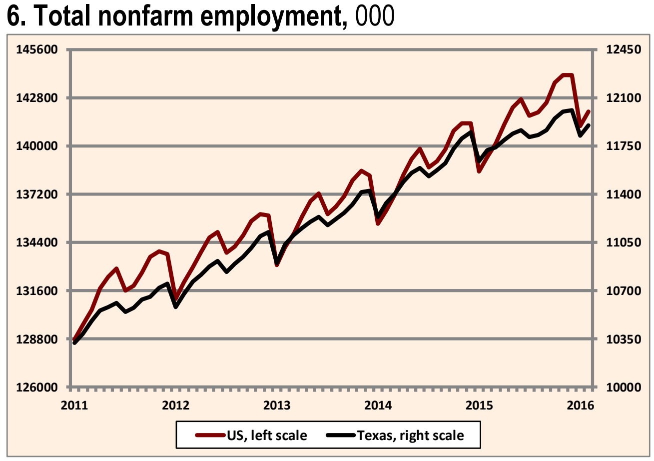
Employment

5. Jobs growth in private goods-producing and service providing industries, % yoy



Source: Bureau of Labor Statistics

6. Total nonfarm employment, 000

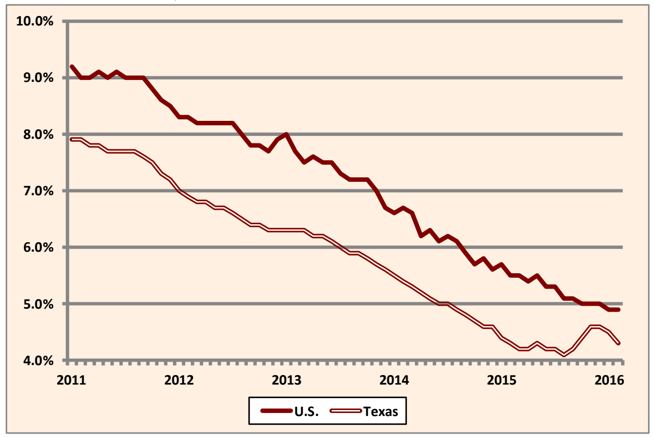


Source: Bureau of Labor Statistics

National labor market conditions continued to gradually improve in February. Total nonfarm payroll employment expanded, while the unemployment rate remained unchanged. According to the Bureau of Labor Statistics, total nonfarm payroll employment increased by 233,000 or 0.2% mom. This growth was fully attributed to expansion of employment in service-providing industries (253,000 new jobs, 0.2% mom), as goods-producing sector reported decrease in the number of employed again (20,000 jobs or 0.1% mom). The major contribution to employment growth was on the side of health care and social assistance (56,700 new jobs, 0.3% mom growth), retail trade (52,000 new jobs, 0.3% mom growth), and food services and drinking places (25,300 new jobs, 0.2% mom growth). Quite notable employment growth was also reported by private educational services and construction. Mining was once again the only sector reporting significant decrease in employment (17,600 or 2.5% mom). Other industries, including manufacturing, wholesale trade, and transportation, showed little change over the reporting month. In year-over-year terms, total nonfarm payroll employment expanded by 1.9% or 2.6 million new jobs in February. The number of unemployed edged up by 0.3% mom or 24,000 in February. Such increase was not enough to have any significant impact on the unemployment rate, which remained at 4.9%. Over year, the number of unemployed decreased by 876,000 lowering the unemployment level by 0.6 percentage points.

Texas labor market conditions further improved in February. Both employment and unemployment saw positive changes in the reporting month. Texas observed employment growth in seven out of eleven major industries. All but one service providing industries posted increases generating the total growth of employment in service sector at 0.3% mom or 29,000. Most of the mentioned gains, however, were offset by a decrease in goods-producing employment by 20,300 positions or 1.1% mom. Therefore, total nonfarm employment expanded by just 8,700 positions or 0.7% mom in February. Education and health services remained the leader in employment gains with 9,400 new jobs. Trade, transportation and utilities saw the second best expansion of 5,500 jobs. All the goods-producing industries reported declines in employment with the smallest one observed in manufacturing (5,900 jobs or 0.7% mom) and the largest in mining and logging (8,100 jobs or 3.2% mom). Construction employment dropped 0.9% mom or 6,300 jobs. The number of unemployed posted a 3.3% mom decrease to 574,855 leading to a 0.2 percentage point decline of seasonally adjusted unemployment rate to 4.3%.

7. Jobless rate, %



Source: Bureau of Labor Statistics

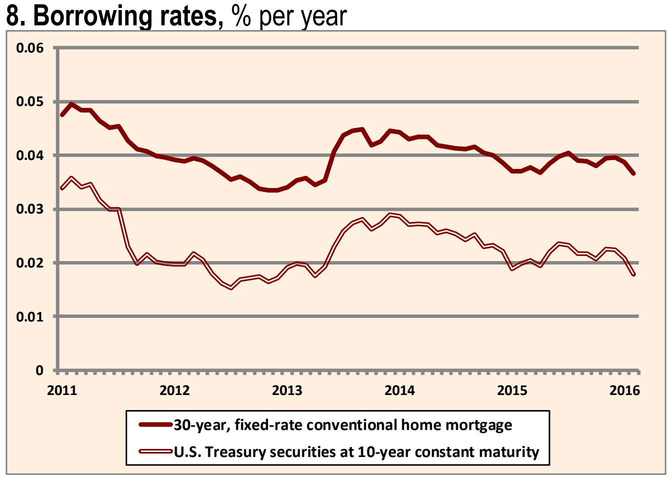
At the Texas metros level, labor market conditions saw mostly positive developments in February. According to the unadjusted data, all the metros posted monthly employment growth ranging from 0.1% in Midland to 1.26% in Longview. Thanks to this only five metros observed their annual employment growth being still at the negative territory, including the named Longview and Midland. The decline decelerated to 1.6% yoy in Longview, while it stayed almost unchanged at 4.5% yoy in Midland. Other three metros with annual employment decrease were Odessa (5.9% yoy), Wichita Falls (0.3% yoy), and Victoria (0.2% yoy). Significant progress was observed also in the unemployment dynamics in February. Just three metros reported monthly growth of the number of unemployed (Odessa at 4.8%, San Angelo at 4.4%, and Midland at 2.9%). Five other metros saw the number of unemployed remain flat, while the rest of the metros reported declines in unemployment. At the same time, the negative effect from growth in unemployment over a couple of months in 2015 was still present in the over-year dynamics of unemployment of Texas metros. As a result, one-third of metros reported year-over-year growth in unemployment ranging from 5.9% in Laredo to 41.9% in Odessa. Overall, situation with unemployment was still worse in metros, which heavily depend on oil and gas extraction. Amarillo remained as the metro with the lowest unemployment at 2.9%.

Monetary Policy and Asset Prices

According to the Federal Reserve Open Market Committee, the data on economic activity did not show any significant changes in trends the Committee takes into account to make its decisions. In particular, economic activity in general continued expanding at a moderate pace, labor market further strengthened thanks to strong job gains, and inflation continued to run below the 2% long-run target. Therefore, the Committee decided to maintain the target range for the federal funds rate at 0.25% to 0.5%.

Consumer prices remained on the downward trend in February. The all items index for all urban consumers inched down by 0.2% mom due to continued decline of

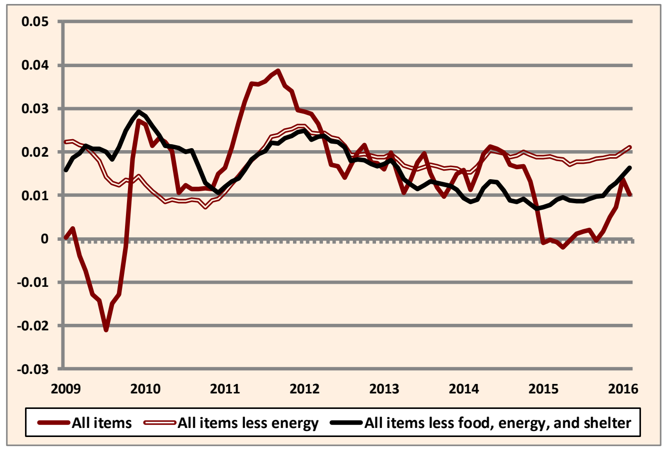
8. Borrowing rates, % per year



Source: Federal Reserve System

the energy prices. A 13.0% mom decline in gasoline prices was the major reason of a 6.0% mom energy index decrease which more than offset minor increases in prices of foods and of all items less food and energy. The first increase in the food at home index since September 2015 of 0.2% mom was fueled the identical increase in the overall food index. A 0.3% mom expansion in the all items less food and energy index was the result of increase in all its major components with the largest increase reported for the apparel index. Year-over-year growth in consumer prices further decelerated in February. Its reading of 1.0% yoy for the month is 0.4 percentage points lower than the one observed in January. Growth of the food index at 0.9% yoy and of all items less food and energy at 2.3 together overwhelmed a 12.5% yoy decline in the energy index. Growth in the energy index on its own almost doubled from that observed in January on the back of almost three-fold increase in the gasoline index (to 20.7% yoy).

9. CPI, % yoy change



Source: Bureau of Labor Statistics

The US experienced a serious housing market tumble in February after quite good performance in January. Total existing-home sales shrank significantly in February after increasing to the highest annual rate in six months in January. They saw a 7.1% mom decline to a seasonally adjusted annual rate of 5.08 million. The major reasons for the decline were insufficient supply and affordability problem. The decrease in sales was observed in most of the country but especially in Northeast and Midwest. Demand for housing remained solid but home prices and rents outpaced wages, which was the main reason why a segment of would-be buyers was held back in February. In particular, the median existing-home price increased by 4.4% yoy to USD 210,800 during the month marking the 48th consecutive year-over-year gains. Total housing inventory expanded by 3.3% mom to 1.88 million existing homes by the end of February which was still 1.1% lower than inventory a year ago. On the other hand, unsold inventory edged up to 4.4-month supply at the current sales pace from 4.0-month supply reported in January. Texas performed significantly better in terms of housing sales compared to the national level. Actual existing-home sales expanded by almost one-fifth in February compared to January. This was one of the largest monthly increases over the last 12 months. Furthermore, in year-over-year terms the increase was also large at 9.8%. Sales grew even faster in Texas regardless of a 1.0 percentage point larger increase in the median existing-home price than the national level. The unsold inventory expanded insignificantly for the second month in a row, reaching 3.5-month supply at the current sales pace.

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

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