

January 2016

Valentyn Povrozhnyuk, Edilberto L. Segura

- **Real GDP grew by 0.7% quarter-over-quarter (qoq) in Q4 compared to 2.0% qoq in Q3.**
- **National industrial production declined again in December 2015.**
- **US construction posted tiny growth of 0.1% mom after one month of decline in November 2015.**
- **Factory activity expanded in Texas for the third consecutive month but showed signs of a possible slowdown in the near future.**
- **A continued decline in world oil prices further pushed the Texas rig count and exports down.**
- **Professional and business services were the driver of growth in employment of both Texas and the US in general in December 2015.**
- **The Texas unemployment rate inched up again to 4.7%, getting closer to the national 5.0% level.**
- **In December 2015, existing-home sales posted double-digit growth in the US and in Texas thanks to delayed closings from November and some increase in demand.**

Executive Summary

The US economy continued to expand in December. However, real GDP growth decelerated in Q4 because of lower monthly growth at the end of the year. As advanced estimates showed, GDP edged up by 0.7% qoq in Q4, which is three times lower than growth in Q3. The Texas economy further expanded at a modest pace.

The downward trend in national industrial production continued in December. The declines were observed in all major components of industrial production, although the decline in manufacturing was insignificant. Performance of utilities was negatively affected by weather conditions, while the drop in coal mining output led to a further decline in mining production. The year-over-year decline in industrial output was at 1.8% for both December and 2015 as a whole.

Consumer confidence further improved in January. The improvement was attributed solely to a more optimistic assessment of the short-term outlook, as perceptions of the current conditions remained unchanged. Consumers expect positive changes in both business conditions and labor market over the next six months.

National construction reversed the trend again in December 2015. After one month of decline, construction put in place returned to growth, although the growth itself was insignificant. Public and private construction moved in opposite directions during the reporting month. Growth in residential construction was too weak to compensate for faster decline in the nonresidential component of private construction. And vice versa, strong growth of the nonresidential component ensured good growth of public construction in general. The mentioned monthly developments did not affect the year-over-year dynamics of national construction put in place much. Good monthly growth of both the number and valuation of issued building permits supported their double digit growth in year-over-year terms.

The downward trend in US exports continued in December 2015. The decline decelerated compared to that observed in the previous month. It was fully attributed to the decrease in exports of goods, which was partially offset by positive developments in exports of services, which returned to growth after one month of decline.

The Texas economy expanded further at a moderate rate in December 2015. Manufacturing activity expanded for the third consecutive month after a long decline. At the same time, some indicators showed that it may slow down in the nearest future again. The services sector continued to expand at a good pace. Consumer confidence strengthened after a couple of months of softening and significantly stronger than at the national level. The construction sector posted mixed performance in December. The further decline in world oil prices led to a continued softening of the Texas rig count and exports. The latter also suffered from weak international demand and a strong dollar.

In December 2015, employment continued to expand at both the national and Texas level. Service-providing industries and in particular, the professional and business services industry, were the drivers of growth. Goods-producing industries did not perform well in terms of job creation, especially in Texas. Texas manufacturing employment posted a decline, which was even sharper than that in mining. The number of unemployed and, correspondingly, the unemployment rate, remained unchanged at the national level. At the same time, the unemployment continued to expand in Texas. However, the Texas unemployment rate remained below the national level despite increases over the last couple of months.

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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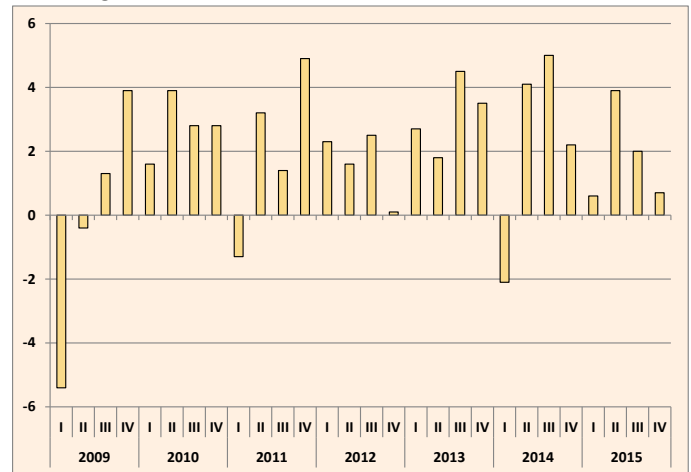
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According to the Federal Reserve, recent economic developments provided no grounds for further changes in the policy rate. Therefore, it was left unchanged within the 0.25-0.5% range. Another reason for the decision was the dynamics of prices. Consumer prices did not change much in December 2015. Small declines in prices of foods and energy were almost fully compensated in prices of all items less food and energy. The housing market returned to growth after two months of cooling down. Existing-home sales jumped in both Texas and US in general driven by higher demand and by delayed closings from November. Fast growth, however, led to further decline in housing inventory moving them close to historical lows, especially in Texas.

Economic Growth

Real GDP growth significantly decelerated in Q4 2015. According to the advanced estimate published by the Bureau of Economic Analysis GDP expanded by 0.7% qoq at an annual rate compared to 2.0% qoq in the previous quarter. Deceleration in overall growth was the result of negative developments in dynamics of all the major GDP components. In particular, growth of personal consumption expenditures decelerated from 3.0% qoq to 2.2% qoq. Similarly, growth of government consumption expenditures and gross investments decelerated by 1.1 percentage points to 0.7% qoq. Growth of exports turned negative at 2.5% qoq, which was slightly offset by lower growth in imports (growth halved to 1.1% qoq). The decline in gross private domestic investment accelerated to 2.5% qoq. First estimates showed that real GDP grew by 2.4% yoy in 2015 which is exactly the same as in 2014. Although the growth rate was the same, there were offsetting movements in the components. In particular, there were observed decelerations in nonresidential fixed investment and in exports, which were accompanied by faster growth of imports. At the same time, those negative developments were offset by accelerations in personal consumption expenditures and in residential fixed investments, smaller decrease in federal government spending, and by faster growth in private inventory investment and in state and local government spending.

1. GDP growth, % qoq at annual rates



Source: The U.S. Bureau of Economic Analysis

US industrial production further declined in December 2015. On the positive side was that the decline more than halved from the downwardly revised 0.9% mom in November to 0.4% mom. This decline was the result of monthly contraction in all its major components. The smallest decline was observed in manufacturing at 0.1% mom driven by lower nondurables production. In particular, petroleum and coal production dropped 1.2% mom and paper production saw a 0.8% decline. These declines were partially offset by increases in output of plastics and rubber products and of textile and product mills leading to the overall nondurables decline of 0.2% mom. Output of durables remained almost flat. The sharpest decline was reported by utilities at 2.0% mom due to much lower demand for heating because of warmer-than-usual temperatures. Mining production was in between dropping 0.8% mom. This fourth consecutive monthly decline was caused by a large drop in coal mining. In year-over-year terms, total industrial output posted a 1.8% decline in December. This decline was fueled by accelerated declines in mining and utilities of 11.2% yoy and 6.9% yoy respectively which more than offset growth of manufacturing at 0.8% yoy. In 2015 as a whole, industrial production posted a 1.8% yoy decline.

Economic activity in the manufacturing sector contracted for the second month in a row in December 2015. According to the Institute for Supply Management, the PMI index inched down by 0.4 percentage points to 48.2%. Despite some improvements both the new orders and production indexes remained below 50% meaning that new orders and production continued to decline. Furthermore, employment dynamics of the sector also entered the negative territory as the employment index observed a 3.2 percentage point decline to 48.1% compared to November reading. On the

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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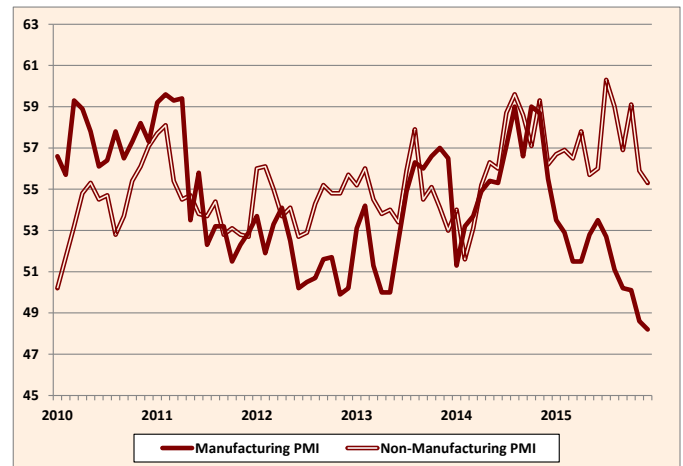
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positive side were return of sector's exports to growth (the corresponding index grew by 3.5 percentage points to 51.0%) and contraction of imports at faster pace compared to November (the imports index saw a 3.5 percentage point drop to 45.5%). Just one-third of 18 manufacturing industries reported growth which includes printing and related support activities, textile mills, paper products, miscellaneous manufacturing, chemical products, and food, beverage, and tobacco products. Ten industries reported declines, among which were such important ones as machinery, primary metals, transportation equipment, and electrical equipment, appliances and components. Several industries saw decreasing oil prices as one of the major factors of decline. In contrast to manufacturing sector, the non-manufacturing sector continued to expand in

December. The NMI index remained well above 50% (at 55.3%) despite a 0.6 percentage point contraction during the month. Other major indexes of the sector also indicated further growth. The only index that observed a significant contraction to the level indicating decline was the supplier deliveries index (dropped 4.5 percentage points to 48.5%). Among the most notable positive developments were improvements in foreign trade of the sector. In particular, the new export orders index expanded by 4.0 percentage points to 53.5% meaning that export orders returned to growth. At the same time imports posted a decline as import index slipped 2.0 percentage points to 49.0%. Eleven non-manufacturing industries reported growth, while just five observed contraction in December 2015.

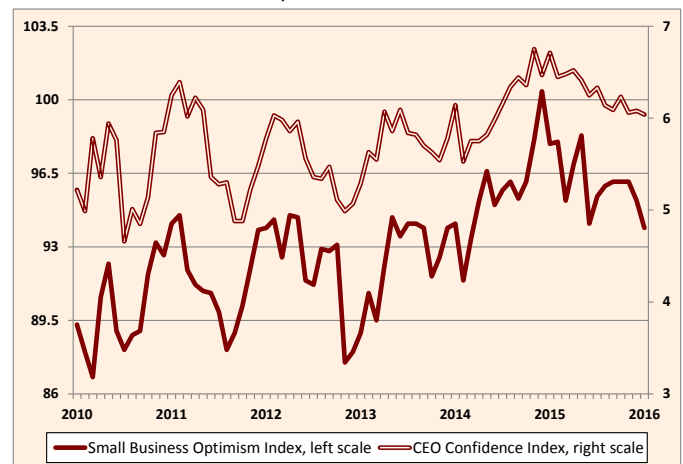
According to the Conference Board, consumer confidence further strengthened in January but at a slower pace compared to the previous month. The Consumer Confidence Index moderately improved from the upwardly revised 96.3 to 98.1. Actually, consumers' assessment of current conditions remained relatively flat. Therefore, improvement of the Index was attributed to moderately improved expectations for the next six-month period. In particular, the were almost no changes in assessments of present business conditions, while negative changes in the number of respondents claiming jobs are "plentiful" and in the number of respondents claiming jobs are "hard to get" almost fully offset one another. As for the short-term outlook, consumers were more optimistic in terms of

2. PMI, indexes



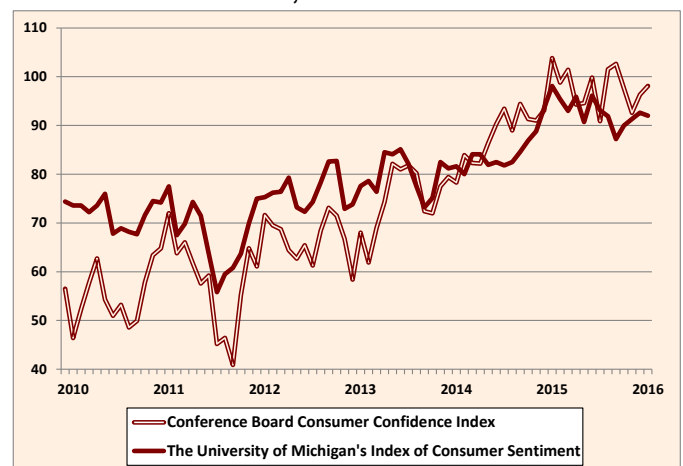
Source: Institute for Supply Management

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

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both business conditions and labor market as the number of respondents expecting improvements increased and the number of those expecting deterioration decreased.

National construction returned to growth in December 2015. A 1.9% mom expansion of public construction put in place fully offset a 0.6% mom decline in private construction put in place and ensured 0.1% mom total growth. Sluggish performance of private construction was attributed to a decline in its nonresidential component of 2.1% mom, which overwhelmed a 0.9% mom expansion of residential construction. The situation was the opposite in public construction. Nonresidential component posted a 2.2% mom growth, which was only slightly offset by an 11.7% mom decline in residential construction (the share of residential component in public construction remains below 2%). Total year-over-year growth of construction saw little change being equal to 10.5%. Private construction still grew much faster than public construction (12.3% yoy against 5.6% yoy). The number of building permits posted a 7.4% mom increase in December. However, since most of the increase was attributed to growth of building permits for multi-unit houses with lower unit cost of construction, growth of building permits valuation was significantly lower at 3.3% mom. As for year-over-year dynamics, the number of building permits grew by 13.9%, while building permits valuation posted a 16.7% growth in December.

US exports posted another minor decline in December. Total exports inched down by 0.3% mom to USD 181.5 billion, which was fully attributed to a decline in exports of goods. Exports of goods observed a 0.7% mom or USD 0.8 billion decline to USD 121.2 billion during the reporting month. The most significant declines in monetary terms were observed in automotive vehicles, parts, and engines (USD 0.6 billion), industrial supplies and materials (USD 0.4 billion), and foods, feeds, and beverages (USD 0.4 billion). A 0.5% mom increase in exports of goods to USD 60.3 billion slightly offset the decline in exports of goods. The increase was ensured by financial services (by USD 0.2 billion) and other business services (by USD 0.1 billion). In 2015 as a whole, total exports posted a 4.8% yoy decline to USD 2,230.3 billion. Exports of goods was again the driver of decline observing a 7.3% yoy decline to USD 1,513.9 billion mainly due to weaker exports of industrial supplies and materials (declined by USD 76.9 billion) and foods, feeds, and beverages (declined by USD 16.0 billion). In contrast, exports of services increased in 2015. Total exports of services grew by USD 5.9 billion or 0.8% yoy to USD 716.4 billion. Not all the services posted growth, but the best performers were other business services (expanded by USD 9.3 billion) and transport (gained USD 5.4 billion).

The Texas economy expanded in December. This growth was supported by further expansion of economic activity in both the manufacturing and services sectors. In particular, the Texas Manufacturing Outlook Survey showed growth of the production index for the third consecutive month. The index expanded by 8.2 bps to 13.4 indicating stronger growth in output. Several other indexes of current activity also reflect further growth but survey's demand measures continued to raise concerns. The new orders index continued to decline and the pace of decline accelerated. The index reading was at -8.9 in December. Similarly, the growth rate of orders index posted a 7 bps decline to -14.3. Together with weakened perceptions of broader business conditions (general business activity index at -20.1 and 10 bps decline of the company outlook index to -9.7) may indicate deceleration in growth or even decline in factory activity in January.

The service sector saw positive developments in perception of current conditions in December, while respondents' expectations regarding future business conditions were less optimistic. The revenue index moved up from 10.3 to 15.2. The labor market indicators reflected faster growth during the reporting month. Perceptions of broader economic conditions were still reflecting optimism, as all the corresponding indexes remained positive and almost unchanged compared to the previous month. At the same time, indexes related to future business conditions posted declines of around 3.0 bps and more.

Consumer confidence strengthened in Texas in January following the trend observed at the national level. At the same time, improvements in consumers' assessment of business conditions and labor market were more significant in Texas. The Conference Board Index posted a 16.8 bps increase from upwardly revised 101.1 to 117.9.

Texas construction saw both positive and negative developments in December 2015. As the date on the nonresidential building construction contracts shows, the nonresidential construction further declined. The value of contracts dropped USD 0.5 billion to USD 1.5 billion. The number of building permits grew by 9.6% mom almost

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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fully recovering from the decline in November. At the same time, growth in valuation of building permits was much lower at 4.3% mom. The year-over-year dynamics of the number of building permits reversed the trend in Texas in December 2015. The number of permits dropped 6.2% yoy. However, since most of the decline was attributed to permits for multi-unit houses, the valuation of issued permits saw a decline of 2.9% yoy.

The latest available data on Texas exports showed that the downward trend continued in November 2015. The rate of decline decelerated from 4.0% observed in October to 3.2%. At the same time, the year-over-year decline accelerated by 1.8 percentage points to 8.4%. The factors conditioning exports decline remained the same as in previous months; namely, lower oil prices, weaker global demand, and strong dollar.

The Texas rig count further declined marking the fourth consecutive month of the trend in December. The monthly decline accelerated from 2.9% to 4.4% but the over-year decline remained almost unchanged at 62.8% because of statistical base effect.

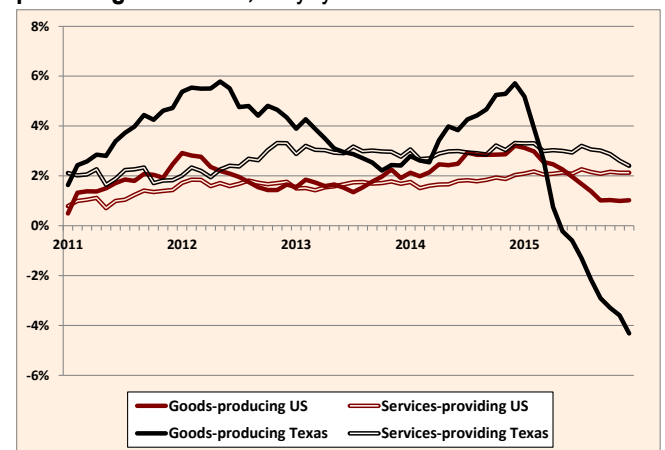
Employment

The labor market conditions continued to improve at the national level in December. Total nonfarm employment continued to expand and the pace of growth accelerated. At the same time, the situation with unemployment remained essentially unchanged. The number of new nonfarm jobs increased by 262,000 or 0.2% during the reporting month. Most of the increase was driven by services industries, but construction also made a significant contribution to the growth. Acceleration of growth during the last couple of months allowed improving the dynamics of total nonfarm payroll employment in 2015 compared to 2014. But the gain in employment remained lower by around 250,000. Professional and business services reported the highest gain in employment at 60,000 or 0.3% mom. It was followed by construction (48,000 or 0.7% mom), food services and drinking places (36,600 or 0.3% mom), and health care (35,300 or 0.2% mom).

Transportation and warehousing and information saw significantly lower gains, while mining remained the only sector observing further decline in employment (7,000 or 1.0% mom). Other sectors observed either little or no change in employment in monthly terms in December. Most of the sectors posted decelerated growth in employment in 2015 compared to 2014. The number of unemployed saw almost no changes for the third consecutive month in December. Therefore, the unemployment rate also remained unchanged at 5.0%. Compared to 2014, the unemployment rate was down by 0.6 percentage points in 2015 thanks to a decline in the number of unemployed by 800,000.

Texas also observed some improvements in the labor market conditions in December, which however were not as significant as those at the national level. The state finished 2015 strong in terms of employment adding 169,000 new jobs but the unemployment rate further expanded to 4.7%. In December alone, Texas employment expanded by 14,400 positions which is one of the lowest monthly gains in 2015. This growth was fully attributed to service-providing industries as employment in goods-producing industries even declined in December 2015. Similarly to the national level, professional and business services industry was the most successful in generating new jobs gaining 12,500 positions during the reporting month. Education and health services industry was the second best with 7,400 new jobs, which marked the 21 consecutive month of employment growth within the industry. Despite continued decline in oil prices, employment in mining remained almost flat in December. At the same time, manufacturing reported a 0.6% mom (4,800 jobs) drop in employment. The year-over-year growth of total

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



Source: Bureau of Labor Statistics

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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nonfarm Texas employment remained almost unchanged at 1.4%. Unemployment also continued to expand in Texas in December 2015. The number of unemployed grew by 2% mom to 610,253 pushing the unemployment rate upwards to 4.7%. Although the Texas unemployment rate increased again in December, it still remained below the national level.

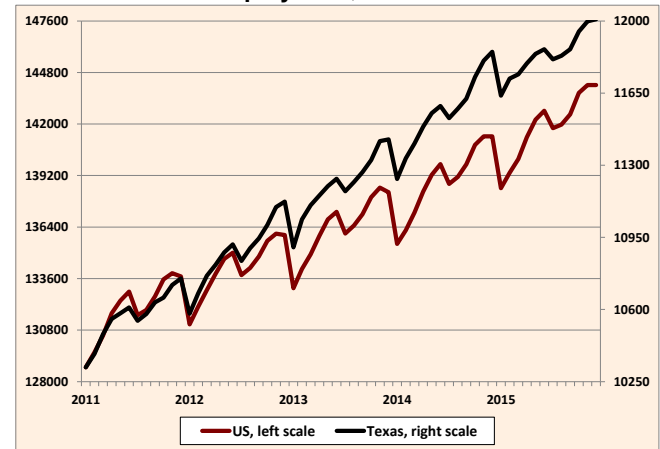
The labor market conditions saw mixed developments in Texas metros in December 2015. Situation with employment deteriorated, while the one with unemployment improved. Seven Texas metros reported decline in employment. The sharpest decline was in the College Station-Bryan metro. Laredo, Odessa, and Wichita Falls saw no changes in the number of employed, while the rest of the Texas metros observed employment growth. The highest increase in employment was reported by San Angelo. In year-over-year terms, employment situation slightly improved as most of the metros observing employment losses reported marginal deceleration in pace of decline, while those observing growth reported slight uplift in pace. In terms of unemployment, the situation improved in monthly terms in all the metros in December. This, however, did not lead to improvement in the over-year dynamics of the number of unemployed. Actually, a half of Texas metros observed either acceleration in growth in the number of unemployed or deceleration in its decline. Amarillo still remained as the metro with the lowest unemployment rate (2.9%) and McAllen-Edinburg-Mission still had the highest unemployment rate at 7.8%.

Monetary Policy and Asset Prices

The Federal Reserve Open Market Committee held its meeting on January 27th. After analysis of the latest available economic data, the Committee decided to leave the policy rate unchanged within a 0.25-0.5% band.

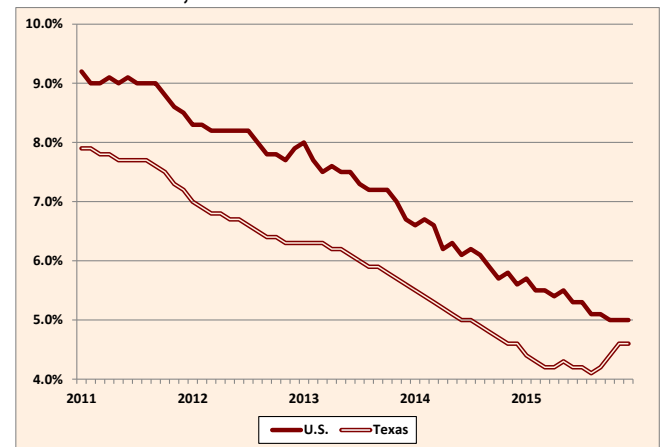
Consumer prices mostly saw just minor changes in December 2015. The all items index remained almost flat in monthly terms. The minor decline of 0.1% mom was the result of declines in the food and energy price indexes, which could not be offset by a minor increase in all items less food and energy price index. The food at home and food away from home indexes moved in different directions but a 0.5% mom decline in the

6. Total nonfarm employment, 000



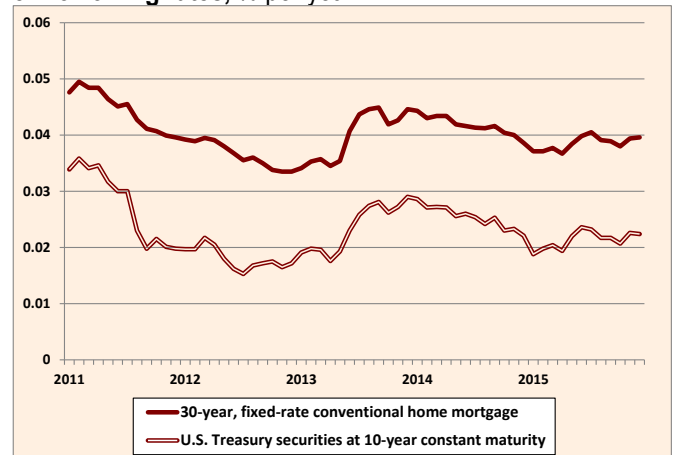
Source: Bureau of Labor Statistics

7. Jobless rate, %



Source: Bureau of Labor Statistics

8. Borrowing rates, % per year



Source: Federal Reserve System

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 123 N. Post Oak Ln., Suite 410
 Houston, TX 77024 USA
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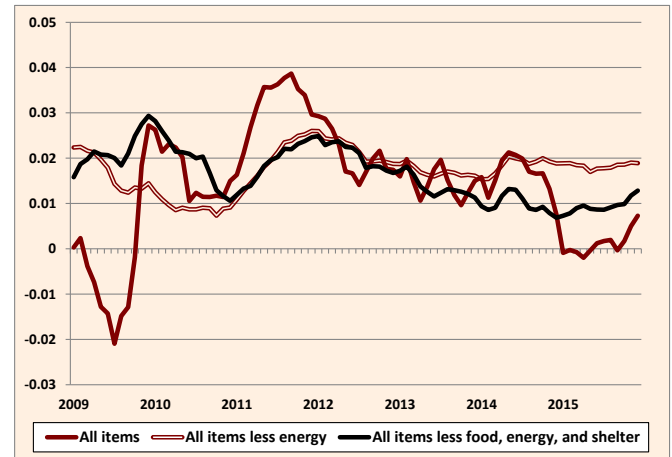
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former (the largest decline since March 2015) had a decisive impact on dynamics of the food index compared to a 0.1% mom growth in the later. Therefore, the food index posted a 0.2% mom decline. As world oil prices declined again in December, the energy index posted a 2.4% mom decline thanks to declines in prices of both energy commodities and energy services. The sharpest decline in prices was reported for fuel oil at 7.8% mom. The all items less food and energy index inched up by 0.1% mom on the back of prices of services less energy services, which prolonged their moderate upward trend with 0.2% mom increase in December. Despite the minor decline in the all items index in monthly terms, the year-over-year data showed a minor acceleration of the index to 0.7%. Similarly to the previous month, the acceleration was the result of slower decline in energy prices, which more than offset the deceleration in growth of food prices. In particular, the food index grew by 0.8% yoy in December, which is 0.6 percentage points less than in November. The energy index posted a 12.6% yoy decline compared to 14.7% yoy a month ago. The all items less food and energy remained virtually unchanged at 2.1% yoy.

9. CPI, % yoy change



Source: Bureau of Labor Statistics

The US in general and Texas both saw recovery of the housing market after a two-month cooling period in December. Total US existing-home sales jumped by 14.7% mom to a seasonally adjusted annual rate of 5.46 million. This jump was attributed to both more buyers in the market and delayed closings resulted from the rollout of the Know Before You Owe initiative. The mentioned initiative pushed a portion of November's would-be transactions into December's figure. Thanks to such high monthly growth, the existing-home sales saw also a reversal of the over-year trend back to growth of 7.7%. As housing supply remained limited, the market reacted to higher demand with increase in prices. The median existing-home price grew by 7.6% yoy to USD 224,100 in December, which is 1.3 percentage points higher than in November. That was the 46th consecutive months of year-over-year growth in the median price. Total housing inventory dropped 12.3% mom to 1.79 million existing homes available for sale. At the same time, unsold inventory decreased to 3.9-month supply at the current pace of sales, which is the lowest level since January 2005. Actual existing-home sales increased by almost one-third to 24,519 in December compared to previous month because of the same reasons described for the US housing market. However, despite the fact that Texas is even more limited in housing supply compared to the national level, the median existing-home price continued to growth at a level significantly lower than that of the national median existing-home price (5.2% yoy). The unsold inventory declined again in December but at the pace much slower than that observed at the national level. At the same time, the level of 3.1-month supply at the current sales pace is significantly below the national level and the lowest for Texas in history of observations.

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