

June 2016

Valentyn Povroznyuk, Edilberto L. Segura

- **The Bureau of Economic Analysis revised its estimate for GDP growth in Q1 upwards again to 1.1% quarter-over-quarter.**
- **US industrial output reversed trend, posting a 0.4% mom decline in May.**
- **National construction saw mixed developments in May.**
- **US exports posted a minor decline of 0.2% mom after two consecutive months of growth.**
- **The Texas economy continued to expand in May despite contraction in manufacturing activity.**
- **The Texas rig count posted the ninth consecutive monthly decline in May.**
- **Labor market conditions of both the US in general and Texas improved, but due to different factors.**
- **The Federal Reserve left the policy rate unchanged at 0.25-0.5%.**
- **The housing market saw significant growth in both the US and Texas in May.**

Executive Summary

The US economy continued to moderately expand in May. The Bureau of Economic Analysis revised upward real GDP growth for Q1 from 0.8% qoq to 1.1% qoq in its third estimate. The general picture of growth remained virtually the same as in the second estimate; the uptick in growth was ensured by faster than previously estimated growth in national exports. The Texas economy also further expanded despite negative developments in the manufacturing sector.

US industrial production growth was back to negative territory in May. The main reason for this was the negative dynamics of both manufacturing and utilities. The first growth in mining over the last nine months (fueled by a coal mining rebound and growth in nonmetallic mineral mining) was not enough to offset the mentioned decreases. Manufacturing output declined thanks to a drop in production of durables, while output of utilities suffered from a decrease in electricity generation, which was partially compensated for by increased natural gas utilities output. The negative monthly developments accelerated the decrease in industrial output in year-over-year terms.

Consumer confidence strengthened at the national level in June after two months of softening. This was the result of improvements in perceptions of both the present situation and short-term outlook. Present situation perception improved on the back of more optimism regarding current business conditions. As for the short-term outlook, improvements were observed in both business conditions and labor market conditions.

National construction observed mixed developments in May. Construction put in place decreased again in monthly terms due to a further decline in the nonresidential segment. Most of the decrease was attributed to lower construction in the public sector, while private construction saw little change in the nonresidential segment and remained flat in the residential segment. Year-over-year growth further decelerated but remained positive. Private sector construction was the driver of the increase, as growth of public sector construction fell below zero. Construction permits posted increases in both the number and valuation in monthly terms in May.

US exports reversed trend in May. After several months of growth, they posted a tiny monthly decline. Both exports of goods and exports of services saw identical decreases in relative terms. Lower capital goods exports and exports of automotive vehicles, parts, and engines were the major factors of decline in exports of goods. At the same time, the decrease in exports of services was fueled by lower exports of travel services.

The Texas economy continued to expand in May despite negative developments in the manufacturing sector. The service sector also continued to expand, though at slower pace. The decline in manufacturing activity and deceleration in growth of the service sector softened consumer confidence, which, however, remained stronger than in the US in general. Texas construction reported positive developments in both residential and nonresidential segments. The Texas rig count further decreased despite some recovery in world oil prices.

The US labor market saw positive developments in May. Growth in employment was rather insignificant, while the number of unemployed posted a significant monthly drop, which led to a decline in the unemployment rate. In contrast, the Texas labor market saw little change in terms of unemployment and some small expansion of employment. In both the US in general and Texas, service providing industries stimulated growth in employment, while goods producing industries and mining reported negative developments in the number of employed. At the same time, government was among the leaders in job creation in Texas in May.

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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Valentyn Povroznyuk, Edilberto L. Segura

The Federal Reserve decided to leave the policy rate unchanged at 0.25-0.5% as the Federal Open Market Committee saw no economic developments significant enough to change it. CPI continued to grow in May but slower compared to its growth in April. Recovering fuel prices were the major driver of the increase. The food index was the only major index posting a decline because of the fifth consecutive monthly decrease in the food at home index. Despite a monthly increase, CPI growth remained almost unchanged in year-over-year terms at 1.0%. The US in general and Texas both reported similar positive developments in the housing market. They both saw monthly increases in existing-home sales and median prices. At the same time, unsold inventory remained unchanged in the US, while in Texas it saw a minor increase.

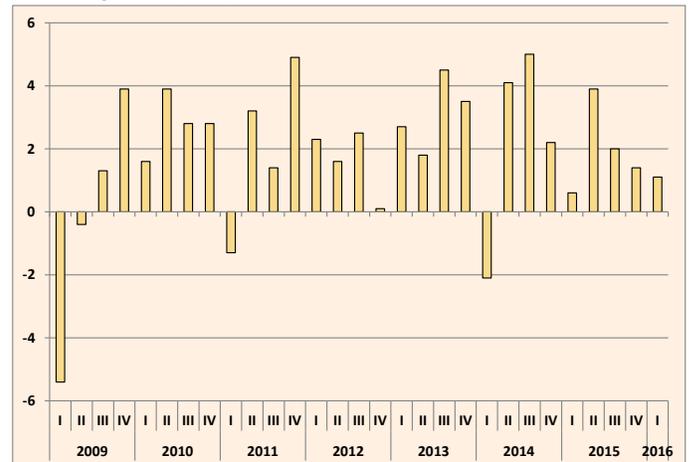
Economic Growth

The Bureau of Economic Analysis further upwardly revised GDP growth for Q1. According to the third estimate based on more complete source data, real GDP increased at an annual rate of 1.1% qoq in Q1. The latest estimate is 0.3 percentage points higher than that published in the second estimate earlier. The general picture remained almost the same as described in the second estimate, but the major difference was faster growth of exports (a 0.3% qoq increase instead of a 2.0% qoq decline).

After one month of growth in April, national industrial production returned to a decline. According to the Federal Reserve, the total industrial production index decreased by 0.4% mom in May compared to a downwardly revised 0.6% mom increase in the previous month. The major reason for the decline was the return of manufacturing and utilities to negative growth (0.4% mom and 1.0% mom, respectively). At the same time, mining posted the first growth over the last nine months at 0.2% mom. Dynamics of durables production was the major reason for the decline in manufacturing. A 0.7% mom decrease in output of durables was fueled by a 4.2% mom decline in motor vehicles and parts, while production of the rest of durables inched down by 0.1% mom. Other manufacturing (publishing and logging) posted a 0.6% mom decline, while production of non-durables remained almost flat. A drop in output of electric utilities was the major reasons for reduced output of total utilities but it was partially offset by a gain in natural gas utilities. Minor growth in mining output resulted from a rebound in coal mining and an increase in nonmetallic mineral mining. Oil and gas extraction saw almost no changes in May. The year-over-year decrease of industrial production accelerated again to 1.4% during the reporting month. The decrease was broad as all the major industry groups reported lower output. Manufacturing posted the slowest decline at 0.1% yoy, while mining once again saw the sharpest decrease at 11.5% yoy. Output of utilities fell by 0.8% yoy.

Despite the reported decrease in output, the manufacturing sector activity still expanded in May. As data from the Institute for Supply Management shows, the PMI index expanded by 0.5 percentage points to 51.3% in the reporting month. Except for employment, inventories, and backlog of orders, all the other indexes remained above a 50%. The new orders index remained virtually unchanged at 55.7%, while the production index declined by 1.6 percentage points to 52.6%. Two-thirds of eighteen manufacturing industries reported growth in May, while the remaining industries reported contraction. Those reporting decline were apparel, leather and allied products; petroleum and coal products; transportation equipment; nonmetallic mineral products; chemical products; and furniture and related products. Similarly to manufacturing activity, non-manufacturing activity also remained on the upward trend in May. At the same time, the pace of expansion slightly decelerated as the NMI index posted a 2.8 percentage point decline to 52.9%. Most of the NMI components continued to expand despite some

1. GDP growth, % qoq at annual rates



Source: The U.S. Bureau of Economic Analysis

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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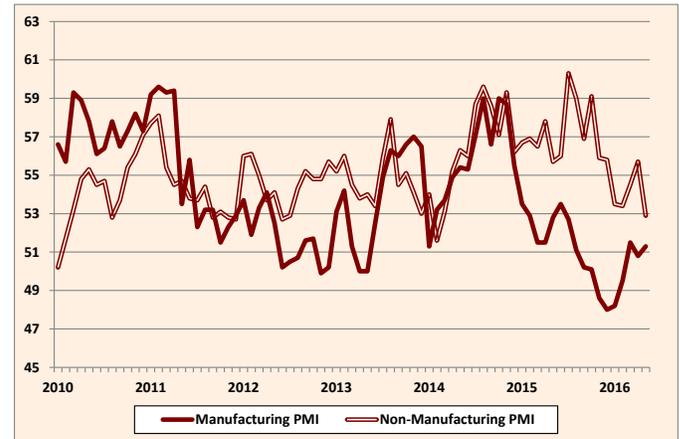
deceleration. However, employment and new export orders saw their indexes decrease below the 50% threshold to 49.7% and 49.0% respectively, marking the first month of decline. Fourteen non-manufacturing industries reported growth in May, while only four industries reported contraction. The largest growth was reported by health care and social assistance. Contraction in activities was observed in mining, other services, educational services, and in professional, scientific and technical services.

After two months of softening, consumer confidence strengthened in June. The Conference Board Consumer Confidence Index increased by 5.6 percentage points to 98.0. Improvements were observed in perception of both the present situation and short-term outlook. In particular, the present situation index rose from 113.2 to 118.3, while the expectations index increased by 6.0 percentage points to 84.5. Improvement in present situation appraisal was the result of more optimism regarding current business conditions, while perceptions of labor market conditions were rather mixed. In particular, the number of consumers claiming jobs are “plentiful” declined by 1.1 percentage points to 23.4%. At the same time, the number of those claiming jobs are “hard to get” also decreased almost identically to 23.3%. As for the short-term outlook, improvements were observed in relation to both business conditions and labor market. Furthermore, those improvements were almost identical. In particular, the number of those expecting better business conditions over the next six months increased by 1.8 percentage points to 16.8%, while the number of those expecting more jobs over the

period increased by 1.7 percentage points to 14.2%. At the same time, the number of consumers expecting worse business conditions and the number of those expecting fewer jobs declined by 0.3 percentage points each to 11.4% and 17.9% respectively.

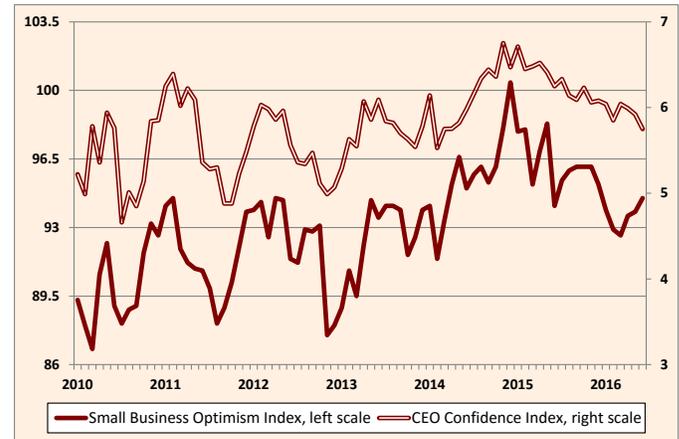
National construction reported mixed developments in May. The value of construction put in place further declined due to a decrease in the nonresidential segment. A 1.3% mom decrease in nonresidential construction transformed into a 0.8% mom decrease in total construction as residential construction remained flat in May. The public sector was responsible for most of the decrease in total construction as it observed declines in both residential and nonresidential segments. In particular, nonresidential public construction dropped 2.3% mom. Residential public

2. PMI, indexes



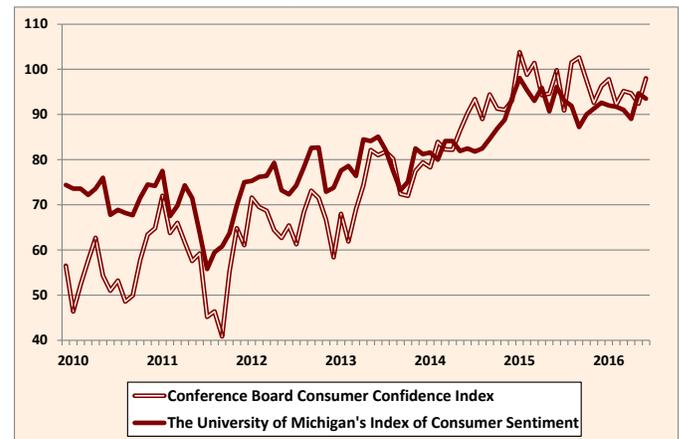
Source: Institute for Supply Management

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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construction fell by 0.7% mom, but its value is too small to have any significant impact on construction statistics. Therefore, total public construction posted a 2.3% mom decrease. At the same time, private construction inched down just by 0.3% mom and the decrease was fully attributed to the slowdown in the nonresidential segment. It decreased by 0.7% mom, while residential private construction saw no changes. The over-year growth of value of construction put in place remained positive but decelerated again to 3.5%. The private sector ensured this growth by its 5.4% yoy expansion, which was partially offset by a 2.3% yoy decline in public construction. The number of construction permits increased again in May. The growth accelerated to 8.0% mom from 2.0% mom observed in April. However, since most of the increase was observed in the number of permits for construction of multi-unit houses with lower unit cost compared to those for construction of single-unit houses, the valuation of permits posted much slower growth of 5.0% mom. At the same time, the number of construction permits further decreased in year-over-year terms in May, although the pace of the decrease decelerated from 5.9% yoy to 3.8% yoy. Furthermore, the mentioned decrease was ensured by a decline in the number of permits for construction of multi-unit houses, while the number of permits for construction of single-unit houses even increased. Thus, the increase in valuation of permits for construction of single-unit houses more than compensated for the corresponding decline in valuation of permits for construction of multi-unit houses thanks to higher unit cost of construction. Total valuation of building permits increased by 2.4% yoy in May.

National exports decreased in May after a couple of months of growth. Total exports inched down by 0.2% mom to USD 182.4 billion. Exports of goods and exports of services both reported identical declines of 0.2% mom. The former decreased to USD 119.8 billion, while the latter declined to USD 62.5 billion. The decline of USD 0.2 billion in exports of goods was the result of USD 0.4 billion decline on a census basis, which was halved because of an increase in the net balance of payments adjustments. The sharpest decrease in exports of goods was in capital goods of USD 0.8 billion followed by the decrease in exports of automotive vehicles, parts, and engines by USD 0.3 billion. At the same time, some categories of exports of goods posted increases. The highest increase was reported by foods, feeds, and beverages at USD 0.5 billion. As for exports of services, travel services reported a decrease of USD 0.2 billion, which was partially offset by an increase in exports of financial services by USD 0.1 billion.

Expansion of the Texas economy continued in May. Unfortunately, Texas factory activity did not stimulate growth as it did during previous months, but restrained it. According to the Texas Manufacturing Outlook Survey, the production index, a key measure of manufacturing conditions, fell from 5.8 to -13.1, its lowest reading this year. This means that the sector returned to decline. Actually, all the current manufacturing activity indexes saw significant negative developments and fell below zero. This also includes indexes reflecting perception of broader business conditions and employment. At the same time, expectations regarding future business conditions were mixed in May. The future general business activity index fell 2 points to -1.8. On the other hand, the future company outlook index remained positive at 4.4 despite some decline. Indexes for future manufacturing activity decreased but remained solidly positive.

Contrary to the manufacturing sector, Texas service sector activity further expanded in May despite some negative developments. The revenue index of the Texas Service Sector Outlook Survey remained positive but declined from 10.6 to 5.8, its lowest level in 2016. Labor market indicators saw mixed developments. The employment index moved down but remained positive at 4.5, while the hours worked index dropped by 4 points to -1.3, suggesting shorter workweeks. Perceptions of broader economic conditions clearly worsened in May as all the corresponding indexes moved into negative territory. Respondents were also less optimistic regarding future business conditions. All the indexes posted declines but remained positive.

Consumer confidence of Texas consumers moved opposite to that of the US consumers again in June. As the Conference Board Consumer Confidence Index data shows, Texas consumers were less optimistic about developments in the state economy. The Index fell from upwardly revised 120.2 to 103.4 although it remained higher than the national level index.

In contrast to the national level, Texas construction posted mostly positive developments in May. The value of nonresidential construction contracts expanded by 15.4% mom to USD 1.5 billion. The number of construction permits also increased during the reporting month. The total number of permits grew by 17.8% mom, which led to

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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an identical monthly increase in valuation of permits. In over-year terms, the number of construction permits rose by 18.5%, while growth of permits valuation was faster at 28.6%.

Texas exports returned to negative growth in April. After a 2.1% mom increase in March, exports posted a 3.4% mom decrease. As before, low oil prices, weak global demand, and a generally strong dollar were the major reasons for the decline.

The negative trend in the Texas rig count continued in May despite some rebound in world oil prices. The rig count dropped for the ninth month in a row, declining by 7.7% mom to 179. In over-year terms, the Texas rig count decreased by 52.3% in the reporting month.

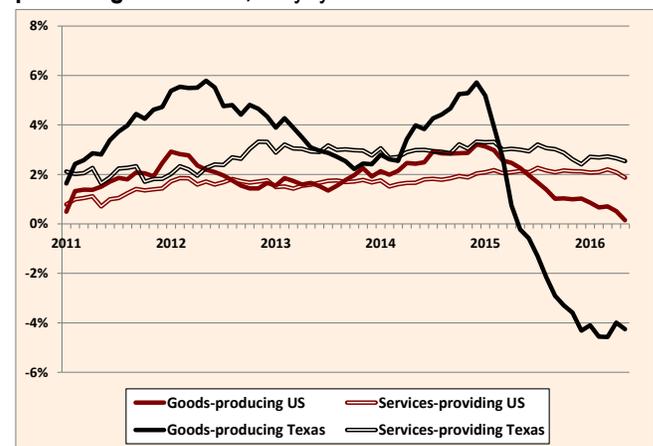
Employment

US labor market conditions further improved in May. Improvements in unemployment were more significant than those in employment. Employment was rather flat, increasing by just 11,000 positions compared to April. Notable employment increases were reported in health care (42,500 positions or 0.3% mom) and professional and business services (18,000 jobs or 0.1% mom). Decreases in employment were reported in information (39,000 positions or 1.4% mom), manufacturing (16,000 jobs or 0.1% mom), and mining (8,300 jobs or 1.3% mom). Other major industries reported insignificant or no changes in employment in May. These include construction, wholesale and retail trade, transportation, financial activities, leisure and hospitality, and government. In year-over-year terms, total nonfarm employment posted a 1.6% increase (2.3 million positions) to 144.6

million in May. The number of unemployed dropped by 6.1% mom or 484,000 to 7.4 million in May. This marked the largest change over the last nine months. Thanks to those changes, the unemployment rate declined by 0.3 percentage points to 4.7%.

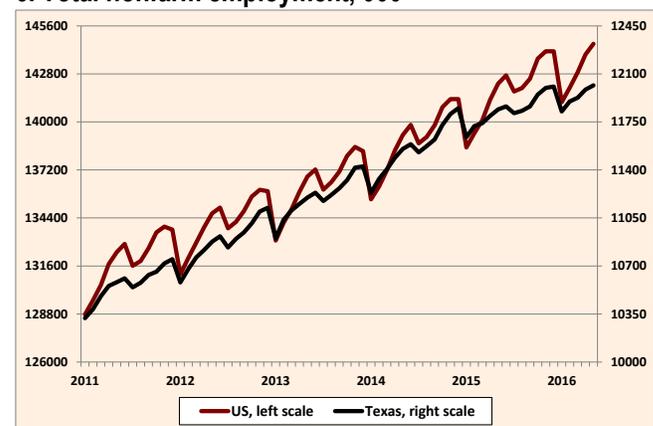
The Texas labor market saw positive changes in May. The state generated 6,600 new nonfarm jobs during the month (a 0.1% mom increase). The information industry was the first in terms of percentage growth in employment of 1.4% mom (2,700 positions). Education and health services and financial activities industry posted an identical increase in employment of 0.6% mom, which is equivalent to 10,100 and 4,200 new positions respectively. The government created 7,100 positions in May, which is the second largest in absolute terms but just third in terms of relative growth (0.4% mom). Some positive changes were also reported by trade (both wholesale and retail) and other services but they were rather insignificant. Other industries saw negative developments in employment. The largest decline in employment was observed in mining at 1.3% mom or 2,900 positions. In year-over-year terms, Texas added 175,800 jobs, which is a 1.5% increase. As for unemployment in Texas, the developments were rather insignificant. The number of unemployed increased by 0.5% mom or 2,954, which led to no changes in the

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

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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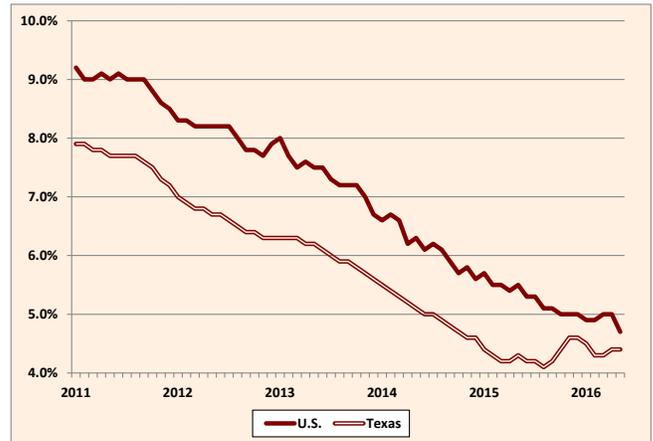
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unemployment rate. At the same time, the unemployment level in Texas still remained below the national one at 4.4%.

Texas metros observed some mixed developments in labor market conditions in May. There were little changes in terms of employment. The number of metros observing monthly decline in employment increased to eight but two of those metros observe just minor declines of 0.1% mom. At the same time, the number of metros observing zero growth in employment decreased from four to two, meaning that the number of metros observing growth in employment remained unchanged. Similar developments were observed in terms of year-over-year growth in employment among the Texas metros. Wichita Falls posted the highest growth in employment at 0.6% mom, which allowed its employment to recover to the level observed a year ago. More significant changes took place in terms of unemployment as most Texas metros experienced rather negative monthly developments in unemployment. The number of metros observing growth in the number of unemployed increased from one to seven and the number of metros observing zero developments in employment also increased from two to eight. At the same time, due to a favorable statistical base effect, the situation improved from the over-year perspective, as the number of metros observing growth in the number of unemployed halved to seven. Amarillo and Brownsville-Harlingen remained at their spots of metros with the lowest and highest unemployment rate respectively (2.8% and 6.6%).

7. Jobless rate, %



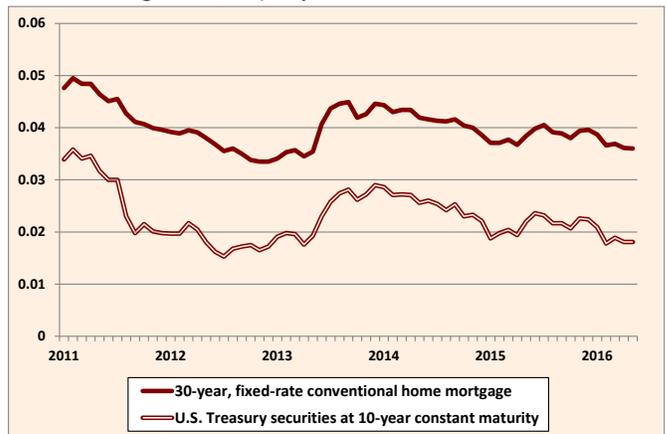
Source: Bureau of Labor Statistics

Monetary Policy and Asset Prices

The Federal Open Market Committee left the target range for the federal funds rate unchanged at 0.25-0.5% during its meeting on June 15th. After analysis of economic data, the Committee came to the conclusion that there were some significant developments in the US economy since its last meeting in April. Among those developments the Committee named a slow down in the pace of improvement in the labor market, economic activity picking up, improvement of the housing sector, and a lessened drag from net exports. At the same time, the Committee found those developments not that significant to change the policy rate. The stance of monetary policy remains accommodative.

The CPI increased again in May but at a decelerated pace compared to April. The all items index inched up by 0.2% mom, which is two times lower than a month ago. The energy index remained the driving force of consumer price growth with its 1.2% mom growth and was supported by growth in all items less food and energy index at 0.2% mom. The food index, on the contrary, decreased by 0.2% mom. Growth in the energy index was the result of higher prices for both commodities and services, but growth in prices of energy commodities was faster (2.4% mom compared to 0.2% mom). At the same time, growth in gasoline prices decelerated significantly (index grew by 2.3% mom

8. Borrowing rates, % per year



Source: Federal Reserve System

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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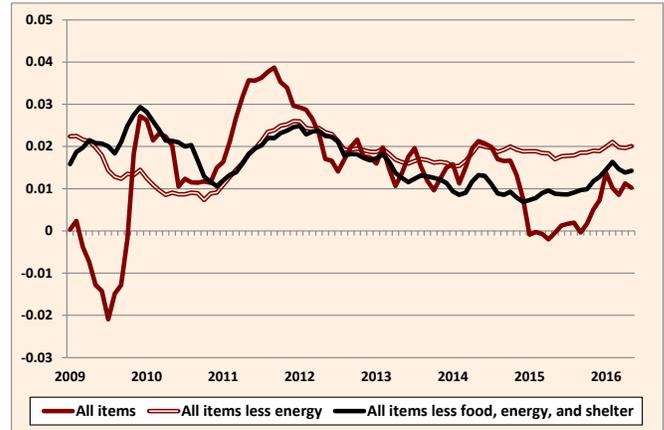
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compared to 8.1% mom in April), while growth of fuel oil prices accelerated (more than tripled to 6.2% mom). The increase in the all items less food and energy index was ensured by higher prices on services less energy services. Growth of the services price index of 0.3% mom more than offset the decline in index of commodities prices of 0.2% mom. The major reason for the decline in the food index was contraction in the food at home index of 0.5% mom, which was the fifth decrease over the last seven months. Price indexes fell for all the major grocery store food groups. The price index for fruits and vegetables posted one of the sharpest declines in May, which is seasonal. At the same time, a 2.8% mom decrease in index for eggs fueled a 0.6% mom decline in the index for meats, poultry, fish, and eggs. The year-over-year growth of all items index remained almost unchanged at 1.0%.

The all items less food and energy index saw little changes being equal to 2.2% yoy, while food index and energy index saw some negative developments. The former saw its pace of growth decelerated by 0.2 percentage points to 0.7% yoy. And the latter posted accelerated decline of 10.1% yoy (8.9% yoy in April).

The US housing market continued to expand in May being stimulated by increased supply and lower mortgage rates. At the same time, the Texas housing market expanded even faster. National existing-home sales reached their highest level over almost ten years of 5.53 million in seasonally adjusted annual rate terms thanks to a 1.8% mom increase. The major reason for continued growth of sales is increased supply as more homeowners realizing the equity they have accumulated in recent years and finally deciding to trade-up or downsize. Low mortgage rates, in turn, stimulate those wanting to buy a home. Most of the deals, however, were made by repeat buyers, while first-time buyers are still struggling to enter the market. In year-over-year terms, existing-home sales posted a 4.5% increase in May. The uptick in demand this spring led to continued growth in the median sales prices, which reached their all-time high of USD 239,700, which is 4.7% yoy growth. Total housing inventory also rose in May. It increased by 1.4% mom to 2.15 million existing homes available for sale, which was still 5.7% lower than a year ago. At the same time, the unsold inventory remained unchanged at a 4.7-month supply at the current sales pace. Texas also reported quite a jump in existing-home sales in May. Actual sales grew by 10.7% mom to 30,761 reaching the level 6.7% above than on the same months of previous year. Despite a 6.4% yoy increase to USD 215,000, the median sales price remained below the national level in Texas. The same is true for the unsold inventory, which inched up insignificantly to 3.7-month supply at the existing sales pace.

9. CPI, % yoy change



Source: Bureau of Labor Statistics

Headquarters
 123 N. Post Oak Ln., Suite 410
 Houston, TX 77024 USA
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