The Economic Outlook

February 2016

The U.S. Economy Hits Weak Patch at Turn of Year

Economic growth slowed at the end of the year, and will likely remain below average in the first quarter. Fourth quarter real GDP growth was hampered by a slowdown in overall consumer spending growth at year end, still tepid business equipment spending, weak exports to a challenged world economy, and an ongoing inventory correction. After slow real GDP growth of 0.7% in the fourth quarter, growth is expected to remain tepid at 1.7% in the first quarter. Much of the recent slowdown is the result of weakness in two areas of the economy that were strong during the early years of economic recovery – energy and exports. Suppressed by historically high supply and low demand, the price of crude oil declined from a monthly average peak of $105.79 in June 2014 to $37.21 in December 2015. The price of oil dipped further below $30 per barrel in January bringing fears of widespread stresses in the energy sector. The historic drop in energy prices contributed to recessions in such diverse areas as Canada, Brazil and Russia in 2015. Extremely low energy prices have also crimped demand for capital spending in the energy sector, as active rigs in the U.S. have plummeted in the last year. Weakness in the world economy was intensified by a 14.4% drop in China's imports in 2015, equivalent to a sizeable shock to world economic trade of around 1½%. Japan's economic recovery has also been disappointingly modest in 2015 as the economic giant continued to grapple with high government debt and rising taxes on consumers to fund it. As a result of the weakness in the world economy, U.S. exports of goods and services in pure dollar terms declined 5.7% annually in the fourth quarter for the largest annual drop in exports since the third quarter of 2009, the first quarter after the Great Recession ended. Reductions in the demand for goods have contributed to a slowdown in the manufacturing sector and to a generally high business inventory-to-sales ratio. An expected inventory correction will likely slow manufacturing, wholesale and retail activity in the first half of the year on average, although areas reliant on domestic consumers will likely complete their respective corrections more quickly than those areas tied to the international economy and energy.

Despite the considerable headwinds to the export, energy and some non-energy commodity areas of the economy, overall economic growth is expected to continue in 2016 at a modest overall pace of 1.8%, (2.1% on a Q4 2015 to Q4 2016 basis,) revised downwards from 2.4% in the December forecast. The average U.S. consumer is still fundamentally sound, and should drive domestic spending upwards in 2016. In the last quarter of 2015 consumers benefitted from one of the strongest quarters of net job growth during the recovery. With the further aide of lower energy prices, Inflation adjusted (real) disposable income rose 3.5% in 2015. The ratio of Household Financial Obligations to personal income remains at its lowest rate since the early 1980s. Consumers have begun to increase non-mortgage debt, but mortgage debt has continued to decline relative to personal income to its lowest level since data collection began in 1980. (Please see the following chart.) Mortgage debt service has remained low despite a solid year for housing in 2015. Existing home sales rose 6.3% in 2015 to the highest level of sales since 2006. Sales growth was highest in the Midwest where it was 8.3%. This compared to 7.2% in the Northeast, 6.4% in the West and 5.0% in the South. Housing inventories have tightened while price growth has been sustained. With mortgage rates likely to remain historically low, though gradually rising in 2016, and labor markets continuing to improve, 2016 is expected to be a strong year for housing markets. Tight inventories of existing homes and continued price increases should also raise demand for new builds and associated new home furnishings in 2016.

The automobile sector is coming off a banner year of a record 17.4 million vehicles sold in 2015. Sales are expected to decline somewhat in 2016, but remain at historically high levels.

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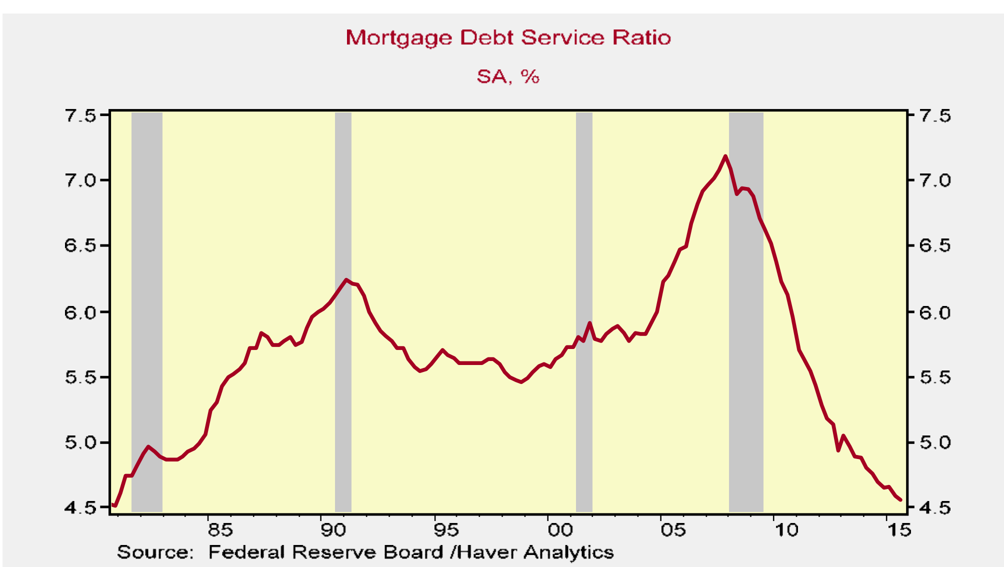
The U.S. Economy Hits Weak Patch at Turn of Year *(Continued)*

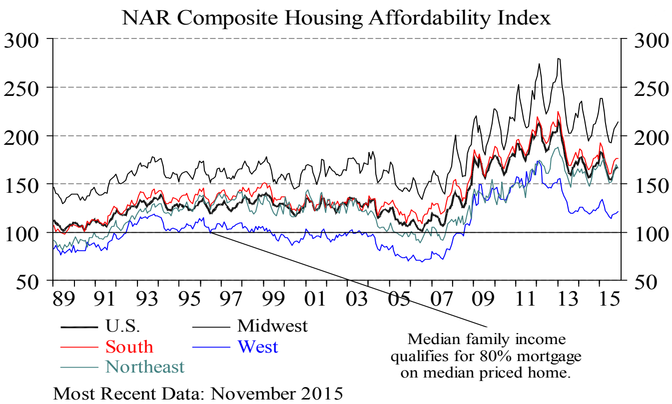
Demand for large vehicles is expected to remain especially strong as the likelihood of rising employment and incomes, low gas prices, an aging national vehicle fleet and rising demand for models featuring new technologies keep sales at high levels. Production schedules have been reduced recently to allow inventories to become better aligned with sales, (Source: Moody's Regional Economists.) This vehicle inventory correction is expected to be completed by spring. Therefore, as long as consumers maintain their strong pace of vehicle purchases and leases, the second half of 2016 will likely be a period of accelerating vehicle production.

The final major driver of economic growth is the expectation for continued steady expansion in the massive U.S. services sector. Although areas closely associated with international trade and commodities could undergo slowing, the overall services sector is primarily tied to the consumer. Therefore, consumer services, healthcare, housing and related technologies should experience a solid year of economic growth in 2016. (Please see the chart below.) The international economy represents the largest source of uncertainty, but not all areas of the international economy are weak or experiencing recession. Although struggling with their own internal geopolitical strains, the European Union is expected to continue a gradual economic recovery in 2016, fueled by the European Central Bank's commitment to maintain economic growth and inflation at moderate levels. While the extent of recovery in China this year is uncertain, continued economic growth in the United States would provide at least some offset to slower demand from China on world economic trade. The probable strength of the dollar will likely continue to challenge U.S. exporters, but it should also enable many of the world's emerging market economies to expand their own exports, including tourism, in 2016. Ultimately, stronger worldwide economic growth is the most important component of sustainable energy and non-energy commodity prices. Within the energy areas, supply cutbacks will likely remain the norm in the near term, but these cutbacks should support the ultimate rebound in energy and non-energy commodity prices. Even OPEC producers may find continued high production at extremely low prices is not necessarily in their economic interests if their fiscal situations are strained as a result. Hence, worldwide energy markets could remain in flux, perhaps to the upside by year end.

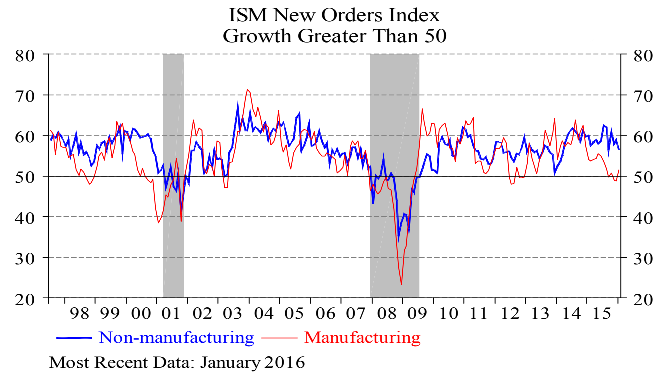
Mortgage Debt Service Lowest Since 1980



Housing Still Highly Affordable, Especially in the Midwest



Orders Growing for Services, Flat for Manufacturing



Inflation in 2016 will likely be restrained by a strong dollar, contained commodity prices and historically low energy prices. Inflation is expected to be the highest in services and rents where it has recently approached 3% annual growth. The CPI-U excluding energy and food is expected to stay close to 2.0%, as imports of goods outside of energy and food reduce prices to the consumer on many retail purchases. The overall inflation rate including energy and food should ultimately start to move towards the Federal Reserve core inflation target of 2% by year-end, but new downward pressures on economic growth, energy and commodities will likely raise concerns that deflation, and not inflation, is the biggest risk in 2016.

On December 16th, the Federal Reserve raised the Fed Funds rate target from the 0 to 0.25% range to the 0.25% to 0.50% range. In conjunction with slow near-term economic growth and no foreseen inflation in the first few months of 2016, the Federal Reserve is not forecasted to raise the Fed Funds rate target again until its June 2016 FOMC meeting. The Federal Reserve is likely to resume rate hikes of about one quarter percent at the end of each quarter thereafter as long as the forecasted pick-up of economic growth in the second half of the year occurs. However, despite fairly strong guidance for further interest rate increases from several Federal Reserve officials in recent weeks, the Federal Reserve will likely remain highly "data dependent" in the decision to raise rates further. Contagion effects from the international economy and weak commodity and energy sectors could remain high.

Long-term Treasury yields are not expected to make dramatic moves upward in the next year, as long-term yields have become increasingly suppressed by high world demand for bonds in a sluggish world economy. Long-term rates are forecasted to begin to rise gradually in the second quarter, and reach 2.3% by the fourth quarter. However, this projection is downwardly revised from 2.65% in the last forecast, and is dependent on a return to normal economic growth during this economic cycle in the second half of the year. Given the recent state of the international economy and financial markets, this upward movement in U.S. Treasury interest rates has large forecast risks.

The main baseline forecasts by quarter and annual average are in Table 1 for the GDP accounts and in Table 2 for the other major indicators forecasted.

Forecast Risks

As with all forecasts, the economic forecast for 2016 is subject to unknowable events and surprises.

Downside risks to the economy are significant, especially in the first half of 2016. If worldwide economic growth weakens as a result of some combination of China, Europe and Japan deterioration, it would likely suppress already weak worldwide demand for commodities and energy, bring additional countries into recession, and intensify downward pressures on already stressed financial markets in the materials and energy sectors. In such an event, U.S. economic growth, headline inflation, the Fed Funds rate target and long-term Treasury yields would likely be below the benchmark forecasts in Tables 1 and 2. Additionally, if consumer and business confidence falls sufficiently to reduce consumer spending and other discretionary spending significantly, then transmission to the U.S. economy of recent shocks would make a recession likely. Two consecutive quarters of real GDP declines, the classic textbook definition of a recession, is not necessary for an official recession to occur. According to the National Bureau of Economic Research (NBER), a sustained period of overall weakness in the economy may be sufficient for the “recession” label. This is dependent on expert agreement on what sufficient weakness represents in terms of employment, incomes, spending and other factors.

The biggest upside risk is the U.S. federal budget that recently was signed for fiscal year 2016. It incorporates increased spending on a broad range of public purchases from the private sector and a broad range of tax reductions including a permanent R&D tax credit, multi-year expansion of accelerated depreciation credits and several industry specific tax saving advantages. In its entirety, the newest fiscal legislation reduces a significant source of policy uncertainty for businesses, and will likely result in stronger business capital investment over the long-term, although the precise impact on 2016 is still difficult to estimate. Stronger economic growth than the forecast as a direct result of the fiscal package would likely support higher interest rates and possibly higher headline inflation than in the benchmark forecasts in Tables 1 and 2. Upside forecast risks to the economy are most significant in the second half of the year, but the downside risks to the economy are dominant at this time.

Table 1
Real GDP
Forecast as of January 29, 2016

	15-I	15-II	15-III	15-IV	16-I	16-II	16-III	16-IV	2014	2015	2016
Annualized Real Growth Rates (bln Chained 2009 Dollars)											
GROSS DOMESTIC PRODUCT (bln $)	17649.4	17913.1	18060.3	18082.5	18178.5	18313.7	18483.4	18676.2	17348.2	17926.3	18413.0
% change	0.8	6.1	3.3	0.5	2.1	3.0	3.8	4.2	4.1	3.3	2.7
IMPLICIT PRICE DEFLATOR	109.1	109.7	110.0	110.0	110.1	110.3	110.8	111.3	108.7	109.7	110.6
% change	0.1	2.1	1.3	-0.2	0.5	0.9	1.5	1.9	1.6	0.9	0.9
REAL GROSS DOMESTIC PRODUCT	16177.3	16333.6	16414.0	16442.3	16510.2	16596.8	16686.9	16780.5	15961.7	16341.8	16643.6
Real GDP Annualized Growth Rate	0.6	3.9	2.0	0.7	**1.7**	2.1	2.2	2.3	**2.4**	**2.4**	**1.8**
4-quarter % change	2.9	2.7	2.1	1.8	2.1	1.6	1.7	**2.1**			
CONSUMPTION	11081.2	11178.9	11262.4	11322.5	11377.7	11462.1	11535.5	11605.5	10875.7	11211.3	11495.2
% change	1.7	3.6	3.0	2.2	2.0	3.0	2.6	2.5	2.7	3.1	2.5
DURABLE GOODS	1430.4	1458.3	1481.7	1497.5	1496.5	1519.3	1539.8	1557.9	1384.1	1467.0	1528.4
% change	2.0	8.0	6.6	4.3	-0.3	6.3	5.5	4.8	5.9	6.0	4.2
NON-DURABLE GOODS	2397.8	2423.0	2447.9	2456.8	2472.4	2491.7	2505.2	2518.3	2367.8	2431.4	2496.9
% change	0.7	4.3	4.2	1.5	2.6	3.2	2.2	2.1	2.1	2.7	2.7
SERVICES	7277.4	7325.3	7363.4	7400.3	7441.9	7484.4	7524.0	7563.0	7144.6	7341.6	7503.3
% change	2.1	2.7	2.1	2.0	2.3	2.3	2.1	2.1	2.4	2.8	2.2
GROSS PRIV. DOM. INVESTMENT	2830.2	2864.8	2859.7	2842.0	2861.4	2873.4	2903.8	2937.6	2717.7	2849.2	2894.1
% change	8.6	5.0	-0.7	-2.5	2.8	1.7	4.3	4.7	5.4	4.8	1.6
FIXED INVESTMENT	2701.4	2735.5	2760.7	2762.2	2785.5	2804.6	2836.3	2879.1	2633.7	2740.0	2826.4
% change	3.3	5.1	3.7	0.2	3.4	2.8	4.6	6.2	5.3	4.0	3.2
NON-RESIDENTIAL*	2188.6	2210.6	2224.9	2214.7	2214.7	2219.1	2232.6	2257.6	2148.3	2209.7	2231.0
% change	1.6	4.1	2.6	-1.8	0.0	0.8	2.5	4.6	6.2	2.9	1.0
NON-RESIDENTIAL STRUCTURE	458.2	465.2	456.6	450.5	454.8	455.8	459.0	466.1	465.4	457.6	458.9
% change	-7.4	6.3	-7.2	-5.2	3.9	0.9	2.8	6.3	8.3	-1.7	0.3
EQUIPMENT	1046.0	1046.9	1072.0	1065.1	1060.7	1064.1	1074.5	1092.4	1026.2	1057.5	1072.9
% change	2.3	0.3	9.9	-2.5	-1.6	1.3	4.0	6.8	5.8	3.1	1.5
RESIDENTIAL	512.4	524.0	534.4	545.0	553.3	567.9	586.1	603.9	486.4	529.0	577.8
% change	10.1	9.4	8.2	8.2	6.2	11.0	13.4	12.7	1.8	8.7	9.2
CHANGE IN INVENTORIES	112.8	113.5	85.5	68.6	63.2	55.1	53.7	45.4	68.0	95.1	54.3
NET EXPORTS	-541.2	-534.6	-546.1	-566.5	-587.5	-610.5	-638.5	-663.2	-442.5	-547.1	-624.9
EXPORTS	2091.4	2117.5	2121.1	2107.8	2090.4	2091.3	2097.0	2107.9	2086.4	2109.5	2096.7
% change	-6.0	5.1	0.7	-2.5	-3.3	0.2	1.1	2.1	3.4	1.1	-0.6
IMPORTS	2632.5	2652.1	2667.2	2674.3	2678.0	2701.8	2735.6	2771.1	2528.9	2656.5	2721.6
% change	7.1	3.0	2.3	1.1	0.6	3.6	5.1	5.3	3.8	5.0	2.5
GOVERNMENT PURCHASES	2838.5	2856.9	2869.7	2874.5	2888.0	2900.9	2914.7	2928.6	2838.3	2859.9	2908.0
% change	-0.1	2.6	1.8	0.7	1.9	1.8	1.9	1.9	-0.6	0.8	1.7
FEDERAL	1111.3	1111.3	1112.0	1119.4	1123.6	1126.4	1129.2	1132.0	1116.3	1113.5	1127.8
% change	1.1	0.0	0.3	2.7	1.5	1.0	1.0	1.0	-2.4	-0.3	1.3
STATE & LOCAL	1725.9	1744.1	1756.2	1753.6	1764.5	1774.5	1785.5	1796.6	1720.8	1745.0	1780.3
% change	-0.8	4.3	2.8	-0.6	2.5	2.3	2.5	2.5	0.6	1.4	2.0

Table 2
Economic Indicators
Forecast as of January 29, 2016

KEY ECONOMIC INDICATORS	15-I	15-II	15-III	15-IV	16-I	16-II	16-III	16-IV	2014	2015	2016
Gross Domestic Product (bln $) *	0.8	6.1	3.3	0.5	2.1	3.0	3.8	4.2	4.1	3.3	2.7
Implicit GDP Price Deflator *	0.1	2.1	1.3	-0.2	0.5	0.9	1.5	1.9	1.6	0.9	0.9
Consumer Price Index -- CPI-U *	-3.1	3.0	1.6	0.2	-1.8	2.0	2.4	2.6	1.6	0.1	0.8
Producer Price Index *	-11.2	3.6	0.3	-5.7	-3.8	0.0	4.2	3.1	1.9	-3.3	-1.1
FEDERAL FUNDS RATE -- average	0.11	0.12	0.14	0.17	0.38	0.42	0.66	0.90	0.09	0.14	0.59
10-YEAR T-NOTE -- average	1.97	2.17	2.22	2.19	1.90	2.03	2.15	2.29	2.54	2.14	2.09
U.S. DOLLAR (FRB Index)	89.5	90.0	91.9	92.0	93.4	93.2	93.6	94.0	78.4	90.8	93.6
AVERAGE MONTHLY CHANGE (Th	195	231	174	284	169	152	223	208	260	221	188
UNEMPLOYMENT RATE (%)	5.6	5.4	5.2	5.0	5.0	5.0	4.9	4.8	6.2	5.3	4.9
Existing Home Sales (Thous SAAR)	4973.3	5296.7	5476.7	4949.6	5134.1	5315.4	5413.0	5481.5	4920.0	5174.1	5336.0
Housing Starts (Millions)	0.98	1.16	1.15	1.14	1.14	1.20	1.34	1.38	1.00	1.11	1.27
Motor Vehicle Sales (Millions SAAR)	16.7	17.1	17.8	17.8	16.8	17.1	17.1	17.0	16.4	17.3	17.0
Industrial Production Growth (SA) *	-0.4	-2.1	2.8	-3.6	-1.5	1.3	2.3	2.5	3.7	1.3	-0.2
Consumer Credit *	5.5	8.1	7.5	5.8	6.2	6.1	5.8	5.4	6.7	6.8	6.3
C & I *	13.8	12.2	8.4	11.0	7.4	5.5	6.5	6.6	10.5	11.6	7.9
CORPORATE PROFITS (Bil. of $)	2012.5	2083.0	2049.9	2016.2	2026.8	2045.0	2079.6	2120.5	2072.9	2040.4	2068.0
% change *	-21.1	14.8	-6.2	-6.4	2.1	3.6	6.9	8.1	1.7	-1.6	1.4
(Profits generated through U.S. GDP)											

* Annualized Growth Rates
Red -- First Period Forecasted
Brown -- Annual Averages

Historical Data Source: Haver Analytics, FACTSET, Recessions shown in grey in charts
Forecasts: Huntington Wealth and Investment Management