

December 2012

- **Texas factory activity grew slower in November.**
- **The Texas jobless rate fell to 6.6% in October.**
- **The Federal Reserve promised to keep interest rates exceptionally low as long as the national unemployment rate stays above 6.5%.**

### Executive summary

The national economic outlook remains weak as the main components of domestic demand, namely personal consumption and business investments, struggle to regain firmer footing. In fact, recent revisions to third quarter GDP growth showed that consumer spending, or over 70% of the U.S. economic output, grew by only 1.4%, while business investments fell by 2.2%. Spending on equipment and software (or over 71% of all business capital outlays) dropped for the first time since the start of the recovery in the second quarter of 2009. On the bright side, residential investments continued to add to economic expansion for the sixth straight quarter.

Above all, it appears that weaker sales may be forcing business to stockpile unsold merchandize. In particular, in October the inventories to sales ratio for all businesses increased to 1.29 in October, compared to 1.26 during the first months of 2012 and a year ago. More importantly, this involuntary uptick in inventory accumulation may foretell future economic weakness as businesses lower production to adjust to reduced demand. In fact, national factory activity resumed its downtrend in November after two consecutive months of moderate gains and is now at its weakest point since mid-2009.

Meanwhile, personal expenditure on durable goods, including cars, which has been propping up retail sales, appears to be cooling. First, a modest recovery of the national labor market as well as the slow growth of personal incomes is depressing households' buying power. Second, consumer confidence, which has recently recovered back to its post-crisis highs, is starting to weaken on growing pessimism about future economic conditions. After all, fears of impending tax hikes are becoming a formidable obstacle to the sustained growth of consumer spending.

More importantly, policy uncertainties are a serious drag on business confidence nationwide. Indeed, November readings on business sentiment indicate that business owners are becoming increasingly concerned with the hostility of government policies and regulations, which are perceived as a potent deterrent to private investments.

Texas, which faces broadly similar economic headwinds, saw slower growth of business activity in November as well. In addition, weaker activity in the mining industry is exerting a toll on the states' largest metro – in November, manufacturing activity in Houston registered its lowest

reading in two years, although it still remained in expansionary mode for the 39th consecutive month.

On top of that, fading foreign demand is creating some headwinds for the Texas economy. Indeed, in January-October, the state's exports grew at the slowest pace compared to the same ten months of the previous two years. In particular, local exporters have to deal with a tougher external environment due to slowing economic growth in Latin America and China.

Still, faster recovery of the regional jobs market is helping to sustain growth momentum in the largest Texas metros. And a strong rebound in the residential construction industry is an important factor that helps offset a less favorable external environment both in the U.S. and worldwide. In fact, in October, the Texas construction industry saw a record monthly jobs gain. As a result, it is now the biggest source of new private jobs accounting for over a fifth of all new private sector jobs created this year in Texas. Meanwhile, construction jobs are still disappearing nationwide.

December 2012

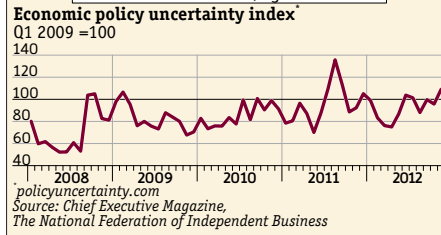
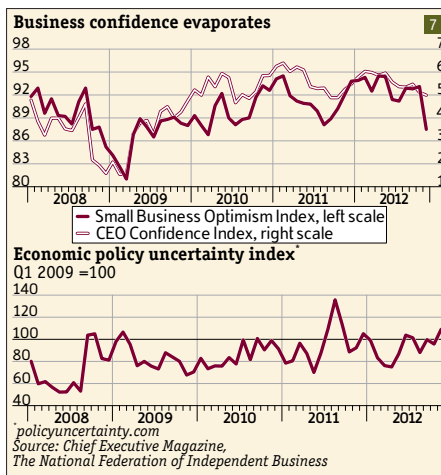
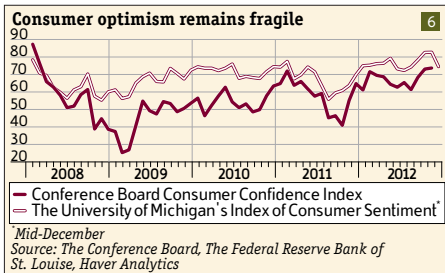
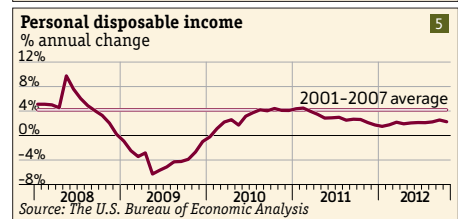
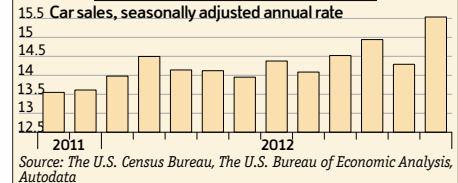
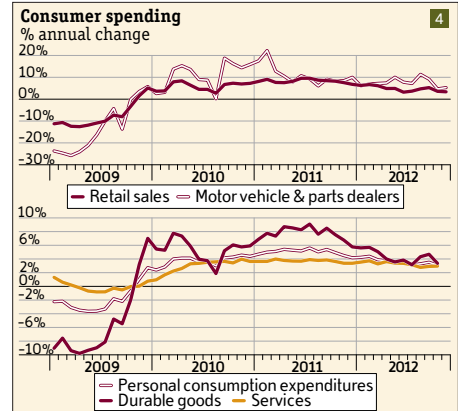
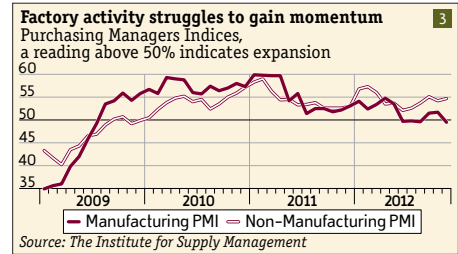
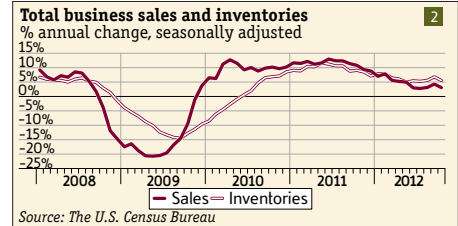
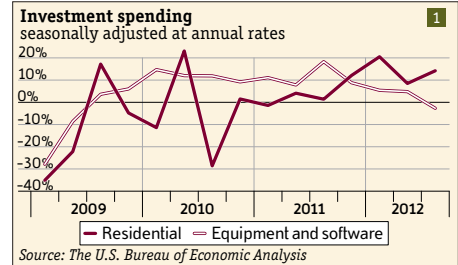
**Economic output**

The national economy appears to be stuck in low gear. Indeed, despite an upward revision of third quarter GDP growth to 2.7%, personal consumption, which accounts for over 70% of U.S. economic output, posted a rather modest gain of only 1.4% - the slowest pace since the second quarter a year ago. More importantly, business investments fell by 2.2% - the first quarterly decline since the first quarter of 2011. Business spending on equipment and software (or over 71% of all business capital outlays) fell for the first time since the start of the recovery in the second quarter of 2009 (see chart 1). On the upside, spurred by low borrowing costs and a gradual improvement in the jobs market, the residential construction sector continued to add to economic expansion for the sixth straight quarter.

Residential investments aside, slower growth of domestic demand seems to be the reason for the quicker pace of inventory accumulation in July-September. In particular, nonfarm inventories added 1.2 percentage points to GDP growth in the third quarter as weaker sales may be forcing businesses to stockpile unsold merchandise. For instance, according to the U.S. Census Bureau, the inventories to sales ratio for all businesses increased to 1.29 in October, compared to 1.26 during the first months of 2012 and a year ago. After all, business sales have been recently growing slower than inventories (see chart 2). And this involuntary pickup in inventory accumulation may foretell future economic weakness as businesses lower production to adjust to reduced demand. In fact, according to the Institute of Supply Management, in November, national factory activity resumed its downtrend following two consecutive months of moderate gains (see chart 3). Manufacturing PMI is now at its weakest point since the middle of 2009.

In October, inventories of cars and parts saw the fastest annual gain of over 21% as improving vehicle sales prompted dealers to increase stock to meet demand. Indeed, car sales grew to another post-recession record in November following a dip in sales the month before. However, consumer spending on durable goods, including cars, which has been propping up retail sales, appears to be cooling (see chart 4). Due to a rather modest recovery of the national labor market, personal income is growing twice as slow as in precrisis years (see chart 5). Meanwhile, consumer confidence, which recently recovered back to its post-crisis highs, may be starting to weaken. In particular, according to the University of Michigan, consumer sentiment dropped sharply in early December (see chart 6) as expectations of future economic conditions significantly worsened. After all, political deadlock over fiscal policy negotiations adds to the fears about impending tax hikes. And this uncertainty over future income is becoming a formidable obstacle to the sustained growth of consumer spending.

More importantly, intensified policy uncertainty is a serious drag on business confidence nationwide (see chart 7). In November, the Small Business Confidence Index slid to its weakest reading in nearly three years, while the CEO



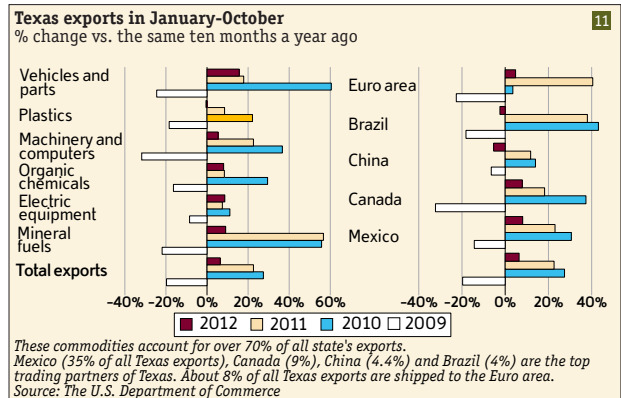
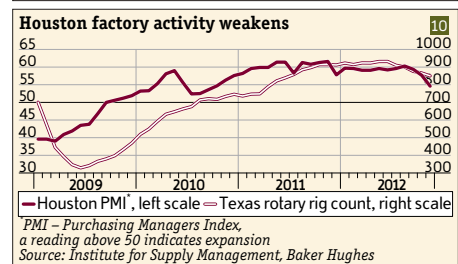
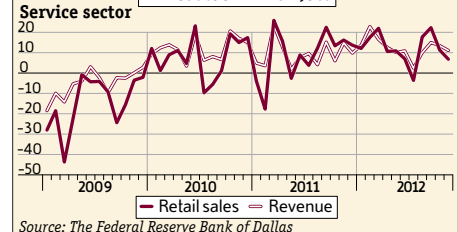
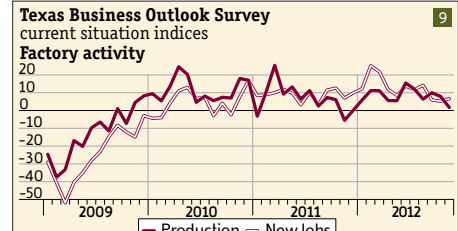
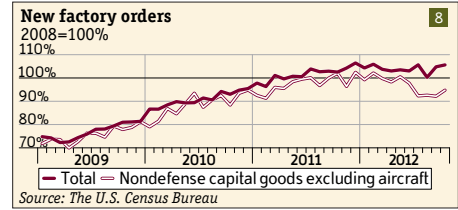
December 2012

Confidence Index dropped to the lowest level in over a year. This may partly reflect the negative impact of hurricane Sandy, but according to the National Federation of Independent Business, small business owners appear to be equally pessimistic regardless of whether or not they reside in the affected states. In particular, business owners are becoming more and more concerned with the increasing hostility of government policies and regulations. Above all, owners point to the threat of higher tax rates and costly new regulations (for example, healthcare reform) as a potent deterrent to private investments – less than a fifth of the surveyed small businesses plan to have capital outlays in the near future. Likewise, CEO Magazine finds that worries over future regulations and the impact of fiscal cliff tax hikes are the main reason for the poor business outlook and reduced capital outlays. The fact that factory orders of capital goods still remain below last year's level (see chart 8) testifies to businesses' reluctance to step up investment spending.

Turning to Texas, local factory activity as well as the service providing part of the regional economy weakened in November (see chart 9). Texas is facing similar headwinds as the nation as a whole. Meanwhile, a slower expansion of the mining industry (partly due to lower natural gas prices as shale gas production continues to boom) is exerting a toll on the states' largest metro – in November, manufacturing activity in Houston posted its lowest reading in two years, although it still remained in expansionary mode for the 39<sup>th</sup> consecutive month (see chart 10).

Weaker foreign demand is creating headwinds for the Texas economy as well – in January-October, the state's exports grew at the slowest pace compared to the same ten months of the previous two years (see chart 11). Commodity exports aside, which were hit by lower energy and metal prices, exports of chemical products barely grew this year. And this may partly explain the decelerating pace of growth of the Houston economy – the state's biggest metro and the leading global petrochemical hub. Meanwhile, the geographical breakdown of foreign trade flows points to the negative impact of the slowing economic growth in Latin America and China on Texas exporters. Economic troubles in the Euro zone are not helping either. Lastly, Texas is second only to California in the number of jobs in the semiconductor industry – the state employs nearly 30 thousand workers in that sector. Yet, shrinking global factory activity (according to the JPMorgan Global Manufacturing PMI, global manufacturing output has been contracting since June) depresses demand for a wide range of computer chips supplied to the car industry as well as the producers of consumer and industrial electronics and equipment. Demand for semiconductors in Europe and Japan is particularly weak (see chart 12) as both regions are entering another recession. As a result, this may exert a toll on economic activity in Texas metros that are home to clusters of semiconductor firms (for example, Austin and Dallas).

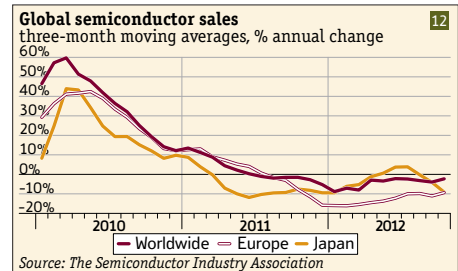
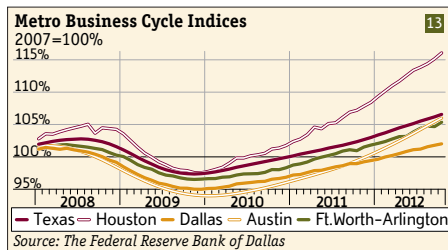
However, thanks to a faster recovery in the local jobs market, the growth momentum appears to be on more sustainable footing in the largest Texas metros (see chart 13). And a strong rebound in the residential construction industry (see chart 14) is an important factor that helps partly offset the less favorable external environment both in the U.S. and worldwide.



**Building permits**  
% annual change

	Single family	Multi-family
Texas	40%	42%
Austin	77%	661%
Dallas	73%	13%
Houston	40%	13%
Fort Worth	37%	600%

Source: The U.S. Census Bureau



December 2012

## Employment

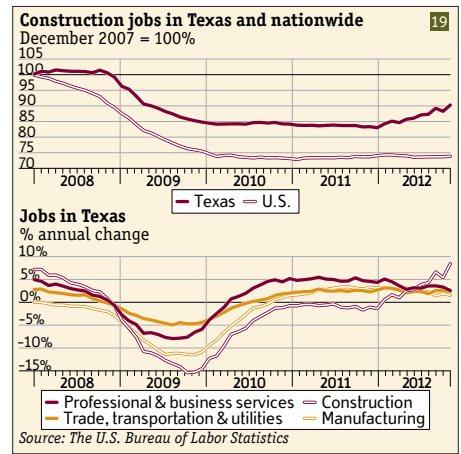
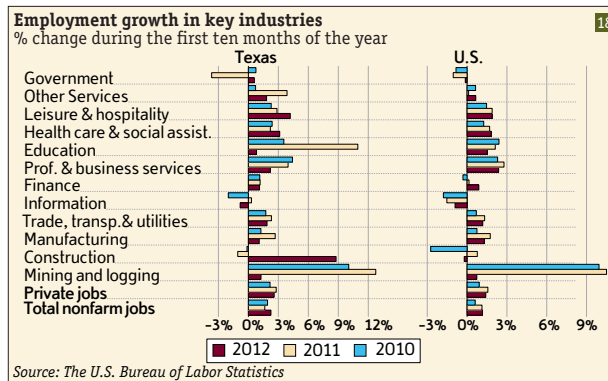
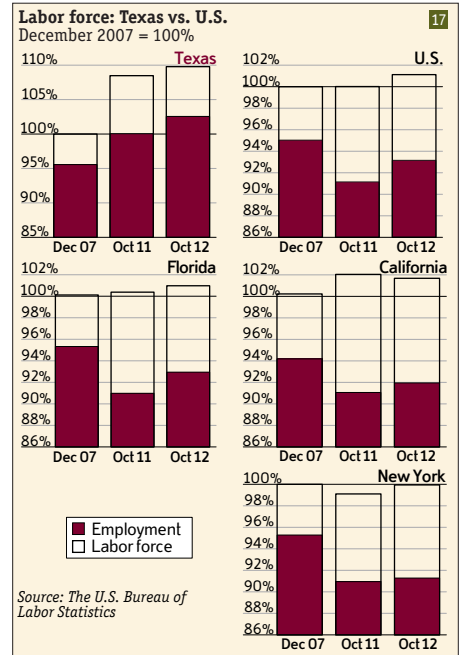
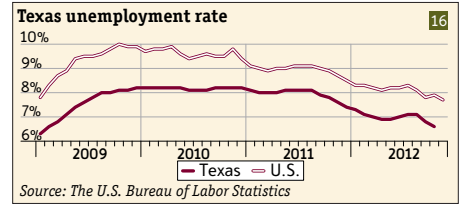
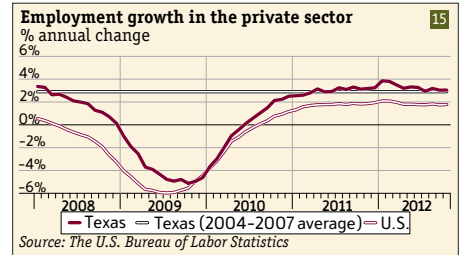
A strong rebound in private sector hiring in Texas, which saw jobs growing at a faster rate than the nation as a whole and somewhat quicker than the state's precrisis trend (see chart 15), testifies to the strength of the regional economy. As a result, in October, the jobless rate in Texas fell to 6.6% - its lowest level since February 2009 (see chart 16). Importantly, unlike the nation overall and some other big states, this labor market improvement was achieved on the back of a steadily growing labor force. Thus, employment growth in Texas was fast enough both to recover jobs lost during the recession as well as to provide employment to the fresh entrants into the labor market. Meanwhile, employment in such states as New York, California and Florida is still struggling to bounce back to its pre-recession levels (see chart 17).

That being said, job growth in the Texas private sector appears to be slowing down to its long-term trend of about 2%. Indeed, the service providing industries (and, in particular, business and professional services) as well as the mining sector were instrumental to the Texas labor market recovery during its initial phase (see chart 18). Job growth in those industries has recently eased on slower expansion of the mining industry (which may have depressed job growth in mining-related services) as well as diminished global demand for engineering and architectural services, which account for a big chunk of the Texas professional services industry. On the upside, job growth in the financial sector and trade transportation and utilities – sectors providing over 30% of all private jobs in the state, remains relatively stable (at about 1% and 2%, respectively), while hiring in leisure and hospitality and healthcare industries appears to be accelerating. Better still – this year the construction industry may become the biggest source of new private jobs in Texas. After all, 21% of all new private sector jobs (about 230 thousand) created in Texas during the first ten months of this year were in construction; meanwhile, construction jobs are still disappearing nationwide. As a result, the national construction industry has yet to regain more than a quarter of its pre-crisis employment compared to a much more advanced recovery in Texas (see chart 19).

In fact, in October, the Texas construction industry saw a record monthly gain of 13,600 jobs, which puts the annual pace of job creation in this industry at over 8% – the fastest growth rate of all the sectors of the economy. Meanwhile, the biggest monthly jobs losses were registered in professional and business services (down by about 12 thousand); manufacturing and trade, transportation and utilities shed jobs as well (1,800 each). Lastly, the number of government jobs increased by 12,100 in October, which helped offset losses in the previous months and delivered a modest annual gain of about 0.5%. Government employment did not fare as well nationwide – in October it was 0.3% lower than a year ago.

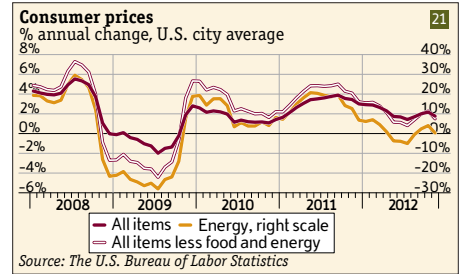
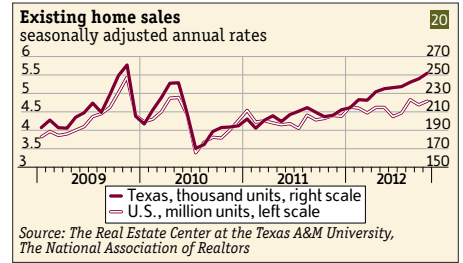
## Monetary Policy and Asset Prices

Low borrowing costs continue to support business activity in construction as growing employment and more affordable homes are encouraging the return of demand for housing (see chart 20). The decision by the Federal Reserve to keep the federal funds rate within the 0% to 0.25% range as long as the jobless rate exceeds 6.5% may help sustain recent

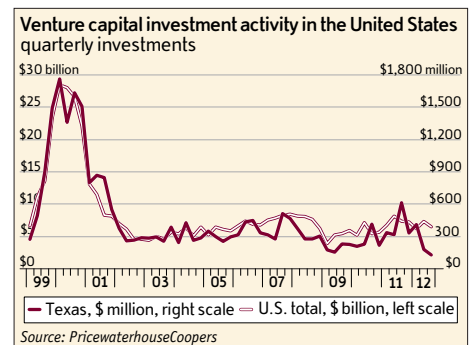
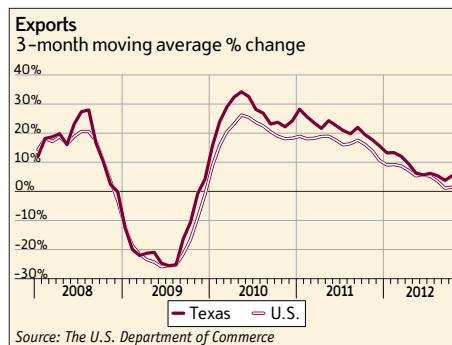
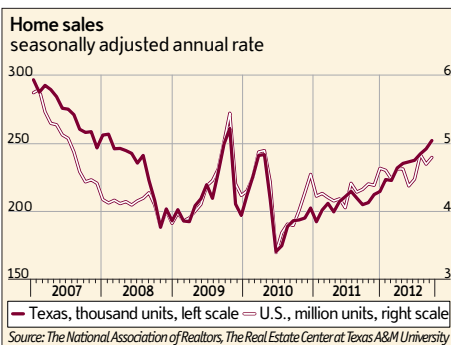
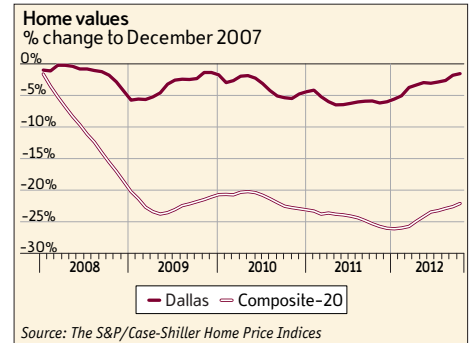
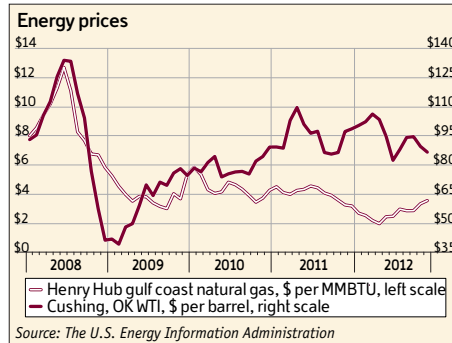
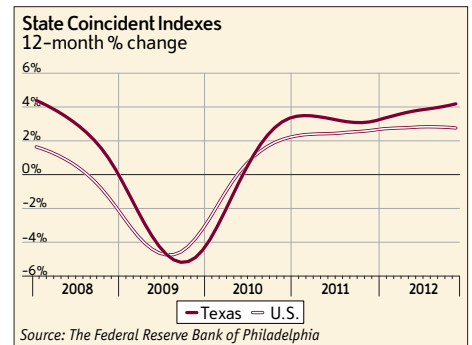
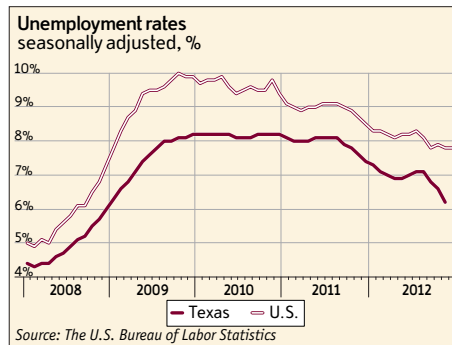
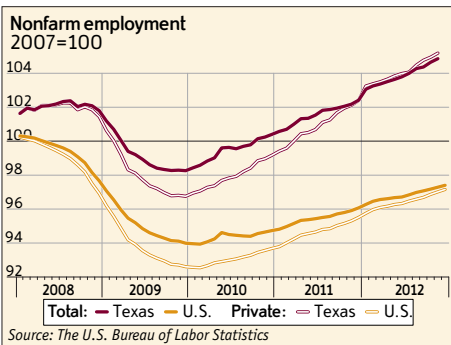
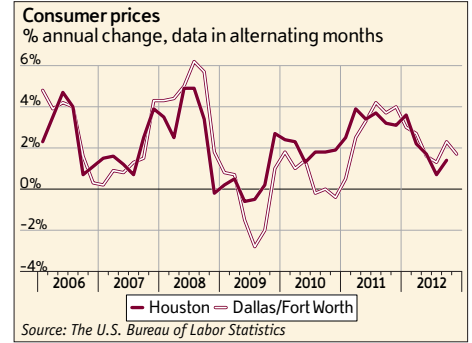
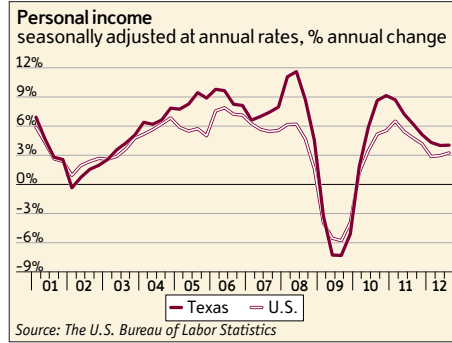
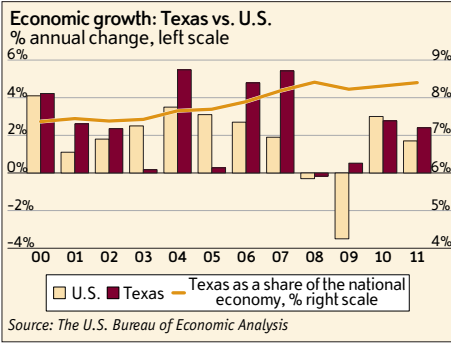


December 2012

improvements in the jobs and residential housing markets. The Fed will continue to buy agency mortgage-backed securities at a pace of \$40 billion per month and will extend its program (dubbed "Operation Twist", this program was initially set to expire at the end of 2012) to lengthen the average maturity of the holdings of Treasury securities at a monthly pace of \$45 billion. November's reading on consumer prices points to subdued inflationary pressures as the growth of consumer prices remains comfortably within the Fed's preferred bounds – the annual growth of consumer prices, stripped of the impact of more volatile prices of energy and foods, dropped to just 1.5% (see chart 21).



December 2012



**Headquarters**  
123 N. Post Oak Ln., Suite 410  
Houston, TX 77024 USA  
Tel: +1 (713) 6213111 Fax: +1 (713) 6214666  
Email: sbleyzer@sigmableyzer.com

*Where Opportunities Emerge*

Copyright © SigmaBleyzer, 2012.  
All rights reserved.