SigmaBleyzer

Texas Economic Update

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

March 2013

- **Texas factory activity continued to expand in February.**
- **In February, Houston saw a strong rebound of its manufacturing sector.**
- **The Texas jobless rate stood at 6.3% in January compared to 7.7% nationwide.**
- **Texas won the Governor's Cup for the number of capital investment projects in 2012.**

Executive summary

National factory activity strengthened in February with the Manufacturing Purchasing Managers Index posting its highest reading since mid-2011. Business activity in services and construction rose to its highest level in twelve months, pointing to improving economic conditions in the broader economy. Meanwhile, consumer and business confidence is gradually recovering thanks to a better jobs picture and increasing consumer wealth, as housing prices and the stock market continue to strengthen.

For now, consumer spending seems to be withstanding pressure from higher taxes, growing gasoline prices and the budget sequestration at the start of March. Consumer demand bounced back in February as retail sales advanced at the fastest monthly pace in five months. However, this gain was partly driven by growing fuel costs; excluding gasoline stations, retail sales still saw a solid gain thanks to growing sales of building materials and supplies, as well as increasing car sales.

Growing consumer credit, which in January increased at a seasonally adjusted annual rate of 7%, continues to drive domestic demand and, in particular, a recovery in national car sales. Meanwhile, improving credit availability is fuelling investment demand as well. Despite a 2% monthly drop in new orders of manufacturing goods in January (partly due to shrinking defense spending), new orders of nondefense capital goods surged to their highest level in nearly five years on growing demand for industrial machinery and, in particular, construction machinery. The recovery of the national construction industry is starting to support the growth momentum in the broader economy by sustaining business activity in industries producing construction equipment, building materials and supplies.

Similar to the nation as a whole, factory activity in Texas continued to expand in February, although at a somewhat slower pace compared to the start of the year. This may be partly attributed to weaker demand for semiconductors and a sluggish growth in the aerospace industry, which does not bode well for Dallas – a big regional center for aircraft and computer manufacturing. On the upside, growth in the Texas service sector proceeded at a healthy pace, while hiring activity in services strengthened to its strongest level in twelve months.

In February, the Houston Purchasing Managers Index posted its best reading since the start of the recession. Factory activity in Houston is benefiting from the booming energy sector and related activities. Thus, Houston is experiencing the strongest pickup in business activity of the large Texas metros. In January, the Houston Business Cycle Index saw an annual gain of 8% – twice as large as statewide growth. This points to a solid turnaround of the broader metro economy in Houston. In fact, Site Selection magazine ranks Houston as the top metropolitan area nationwide by the number of investment projects in 2012. Meanwhile, growing investment spending in energy, manufacturing and commercial real estate is driving demand for architectural and engineering services, where Houston has a competitive edge both at the state and national levels. In January, local employment in architectural, engineering, and related services was nearly 8% higher than a year ago.

The resilience of Houston in particular, and the Lone Star State's economy in general, is a manifestation of the remarkable success of the state's approach to economic development. Low taxes, business friendly regulations, good infrastructure and the availability of diverse and skilled labor make Texas a magnet for new private investments. This is why Site Selection awarded Texas the top spot in its 2012 ranking of the number of local capital investment projects. Texas' well-established reputation for stable and predictable policy and tax environment remains a solid foundation for the sustainable growth of private investments and jobs in future.

In January, the Texas jobless rate moved up a notch to 6.3% from 6.2% at the end of 2012, staying well below the national rate of 7.7%. This puts the gap between the unemployment rates in Texas and the nation as whole at or above 1.5 percentage points over the past four months. In addition to regaining jobs lost during the recession, Texas has had to provide employment for new entrants into the local labor market as its labor force continues to grow rapidly. The fact that the state's jobless rate is falling faster compared to the national average shows that the labor market recovery in Texas is driven by a genuine pickup in economic activity rather than the exit of discouraged job seekers – a labor market trend that prevails in many of hardest-hit states since the start of the economic recovery.

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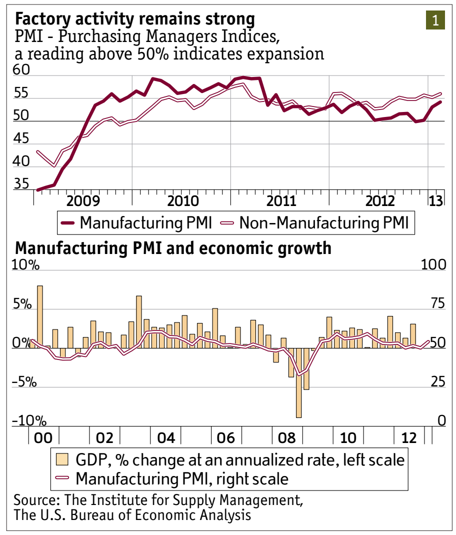
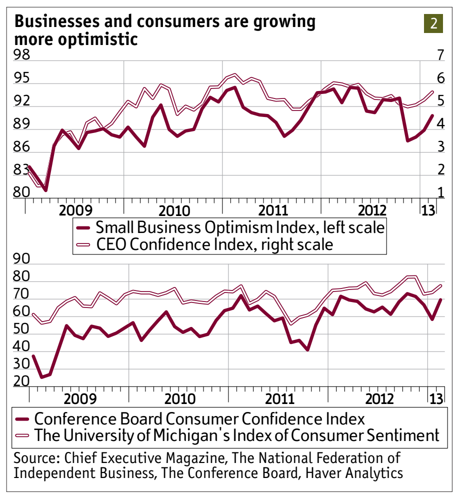
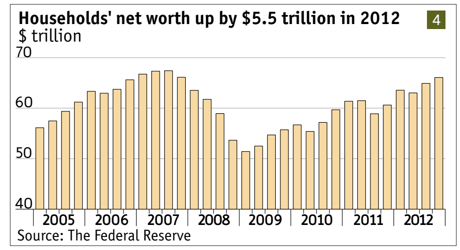
March 2013

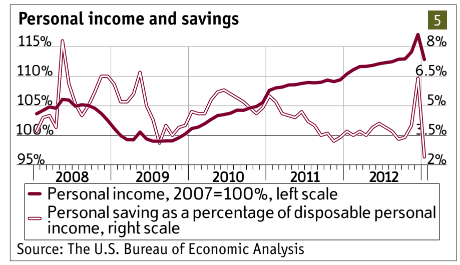
Economic output

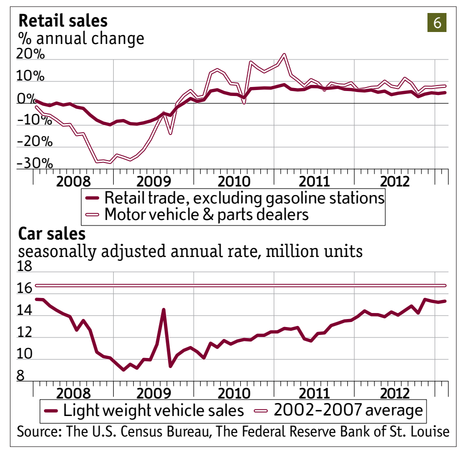
National factory activity continued to improve in February as the Manufacturing PMI, which tracks the performance of the U.S. manufacturing sector, moved to its highest level since mid-2011, indicating faster economic growth compared to the end of 2012 (see chart 1). Meanwhile, business activity in services and construction, measured by the Non-Manufacturing PMI, rose to its highest level in twelve months, pointing to improving economic conditions in the broader economy. Consumer and business confidence is gradually recovering (see chart 2) thanks to a pickup in private sector hiring (see chart 3) and increasing consumer wealth (see chart 4) as housing prices and the stock market are bouncing back.

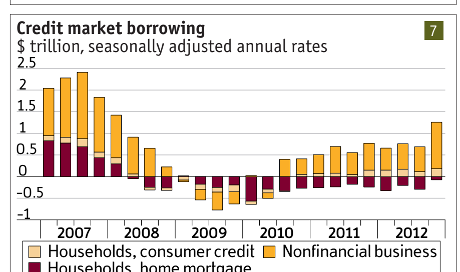


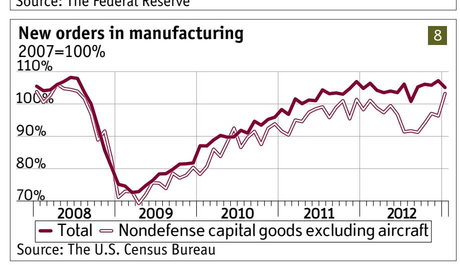












So far, consumer spending seems to be withstanding tax increases, growing energy prices and the budget sequestration. Higher personal income and dividend taxes may have prompted companies to pay out early dividends in December. Thus, mostly as a result lower dividend income, personal income fell by 3.6% in January – the biggest monthly drop in 20 years. However, consumer spending continued to grow as savings declined to offset this one-off decrease in income (see chart 5). This may imply that consumers are increasingly willing to tap savings and borrow more to keep spending.

Consumer demand bounced back in February, as retail sales advanced at the fastest pace in five months, increasing by 1.1% versus January – a big improvement when set against a paltry gain of just 0.2% during the first month of 2013. However, this gain was partly driven by a 5% increase in gasoline sales due to growing fuel costs – according to the U.S. Energy Information Administration retail gasoline prices were about 10% higher in February versus the month before. Retail sales, excluding gasoline stations, saw a gain of about 0.6% (or 4.8% against February 2012) thanks to growing sales of building materials and supplies and increasing car sales (see chart 6).

Recovering consumer credit, which in January increased at a seasonally adjusted annual rate of 7% thanks to growing automobile loans, is yet another factor driving domestic demand and, in particular, continued strength of national car sales. Improving credit availability (see chart 7) is fuelling investment demand as well. Although new orders across manufacturing industries fell by 2% in January versus the month before due to a sharp decline of new orders of defense aircraft (down by 64% versus December 2012), new orders of nondefense capital goods surged to their highest level in nearly five years (see chart 8) thanks in part to growing demand for industrial machinery and, in particular,

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construction machinery (up by 57% versus December 2012). The recovery of national residential construction (see chart 9) is sustaining growth momentum in the broader economy by supporting business activity in industries producing construction equipment, building materials and supplies. In January, private residential construction spending was 22% higher than a year ago, while 32% more private housing units were authorized with building permits nationwide. This pickup in private construction activity is starting to contribute to an economic rebound in sectors that suffered most during the latest economic downturn.

Similar to the nation as a whole, factory activity in Texas continued to expand in February, although at a somewhat slower pace compared to the month before. In particular, the current production index of the Texas Manufacturing Outlook Survey eased to 6.2 from over 12 in January (see chart 10). Meanwhile a drop in the employment index in February points to weaker growth of factory jobs as well. A recent deceleration of global demand for semiconductors (see chart 11) and sluggish growth in the aerospace industry may be creating headwinds for the expansion of factory output and employment in Dallas – a big regional center for aircraft and computer manufacturing. On the upside, the Texas service sector continued to grow at a healthy pace, while the service jobs index moved to its highest level in twelve months, indicating a generally stronger employment situation in the broader economy.

In February, the Houston Purchasing Managers Index posted its best reading since the start of the recession (see chart 12) as local factory activity continued to improve, driven by the energy sector and related activities. According to the Texas Metro Business Cycle Indexes, Houston experienced the strongest pickup in business activity compared to other big Texas metros (see chart 13) – in January, the Houston Business Cycle Index grew by 8% versus a year ago, or twice as fast as the statewide index. This success can be partly attributed to the recent energy boom and, in particular, the expanding exploration of natural gas found in shale formations. The energy industry aside, Houston appears to be experiencing a solid turnaround in the broader metro economy. In fact, Site Selection magazine, which tracks site selection and facility planning decisions, ranks Houston as the top metropolitan area nationwide by the number of investment projects in 2012, which totaled 325, followed by 311 in Chicago and 224 in Dallas. Meanwhile, these new investments in energy, manufacturing and commercial real estate are sustaining demand for architectural and engineering services, where Houston has a competitive edge both at the state and national levels. Indeed, in January, local employment in architectural, engineering, and related services was nearly 8% higher than a year ago. In addition, Houston remains one of the leading medical hubs in the nation, which attracts healthcare companies and producers of hospital equipment and medical supplies.

The continued resilience of the Houston metro in particular, and the Lone Star State's economy in general, is a manifestation of the remarkable success of the state's economic development model. Thanks to low taxes, business friendly regulations, good infrastructure and the availability of diverse and skilled labor, Texas has become a magnet for new private investments. Indeed, Site Selection magazine awarded Texas the top spot in its 2012 ranking for the number of local capital investment projects. With 761 new projects or expansions of existing facilities, Texas remains well ahead of its nearest rival Ohio (with just 491 investment projects – see chart 14). This recognizes Texas's well-established reputation for stable and predictable policy and tax environment, which creates a sustainable foundation for the future growth of private investments and jobs.

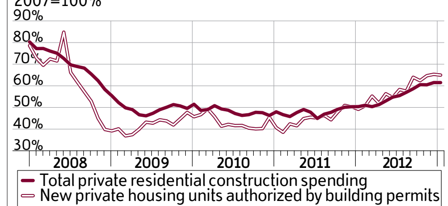
Texas wins the 2012 Governor's Cup for the number of investment projects 14

Rank	State	Count
1	Texas	761
2	Ohio	491
3	Pennsylvania	430
4	Michigan	337
5	Illinois	332
6	Georgia	296
7	North Carolina	280
8	Tennessee	231
9	Virginia	199
10	Kentucky	196

Source: The Site Selection Magazine

Residential housing activity remains strong 9

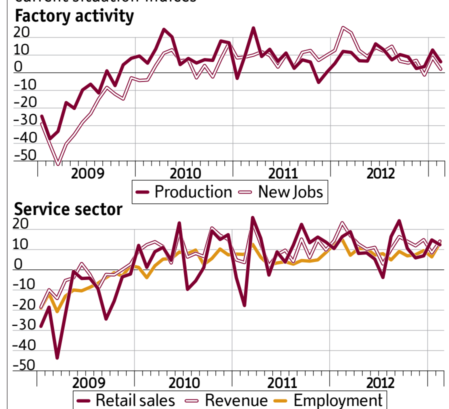
2007=100%



Source: The U.S. Census Bureau

Texas Business Outlook Survey 10

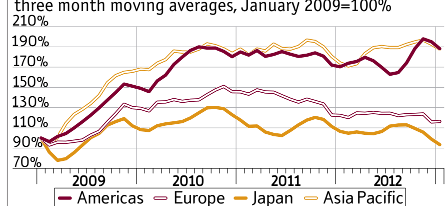
current situation indices



Source: The Federal Reserve Bank of Dallas

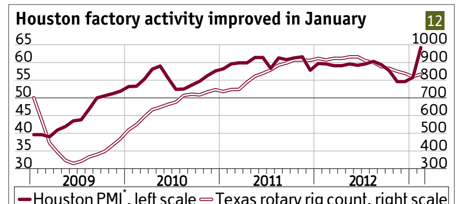
Global semiconductor sales 11

three month moving averages, January 2009=100%



Source: The Semiconductor Industry Association

Houston factory activity improved in January 12

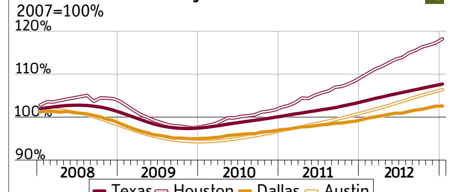


*PMI – Purchasing Managers Index, a reading above 50 indicates expansion

Source: Institute for Supply Management, Baker Hughes

Texas Metro Business Cycle Indexes 13

2007=100%



Source: The Federal Reserve Bank of Dallas

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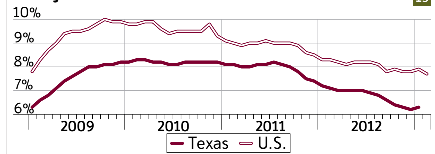
Employment

In January, the Texas jobless rate moved up a notch to 6.3% from 6.2% at the end of 2012, staying well below the national unemployment rate of 7.7% (see chart 15). In fact, the gap between the unemployment rates in Texas and the nation as a whole started to widen in mid-2011 and has been at or above 1.5 percentage points over the past four months. This is impressive, because unlike the nation as a whole, Texas saw a more modest drop of its labor force participation rate (see chart 16) and a 10% surge in the state's labor force (due to faster population growth and a large inflow of workers from other states) since the start of the economic downturn (versus a 1% increase nationwide). As a result, in addition to replacing jobs lost during the recession, Texas had to provide employment for new entrants into its labor market. The fact that the state's jobless rate is falling faster compared to the national average shows that improving economic conditions rather than the exit of discouraged job seekers are driving the labor market recovery in Texas.

The Texas private sector continues to add new jobs nearly twice as fast as the nation as whole (see chart 17). As a result, Texas is already providing 4.4% more private sector jobs compared to its previous employment peak; meanwhile, nationwide, there are still 2% fewer private sector jobs (or about 2.5 million) than five years ago. Clearly, the mining industry has helped the labor market recovery in Texas – the state has 20% more jobs in mining compared to mid-2008. Texas has also experienced fewer job losses in construction and manufacturing (see chart 18). Goods-producing sectors aside, service industries remain the most important driver of the state's labor market recovery. Unlike the nation as a whole, Texas saw across-the-board employment growth in service occupations, most importantly in education and healthcare as well as in business and professional services (see chart 19).

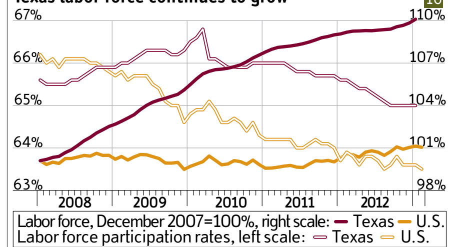
January employment figures pointed to some weakening in private hiring activity in Texas at the start of the year – private sector jobs increased by only 15.4k – the smallest gain since October 2011. Employment in professional and business services declined by 11k as worries over federal fiscal policy and cooling jobs growth may have dented demand for employment services, which account for about a fifth of all professional and business services occupations in Texas. On the upside, the construction industry continued to add jobs for the sixth straight month, adding up to 28.5k new construction jobs or a 5% increase over the last 12 months (nationwide, in January employment in construction was just 2% higher than a year ago). Lastly, the latest national jobs report and decreasing initial unemployment claims in Texas (see chart 20) indicate that the Texas jobs picture may have improved in February.

Texas jobless rate 15



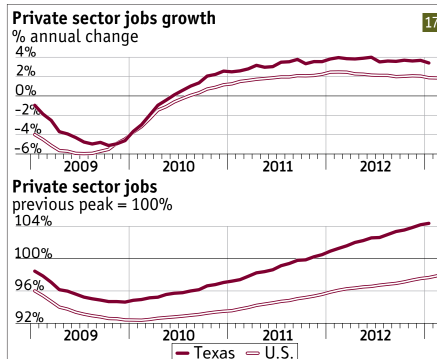
Source: The U.S. Bureau of Labor Statistics

Texas labor force continues to grow 16



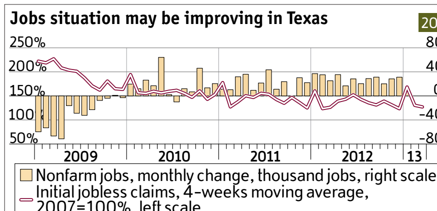
Source: The U.S. Bureau of Labor Statistics

Private sector jobs growth 17



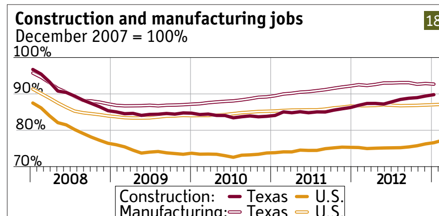
Source: The U.S. Bureau of Labor Statistics

Jobs situation may be improving in Texas 20



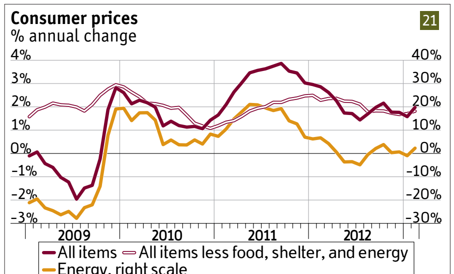
Source: The U.S. Bureau of Labor Statistics, The Federal Reserve Bank of St. Louis

Construction and manufacturing jobs 18



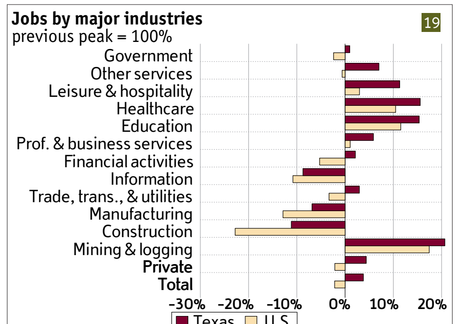
Source: The U.S. Bureau of Labor Statistics

Consumer prices 21



Source: The U.S. Bureau of Labor Statistics

Jobs by major industries 19

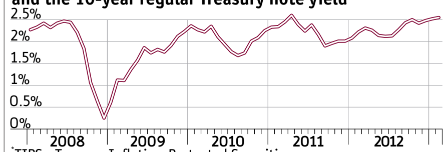


Source: The U.S. Bureau of Labor Statistics

Monetary Policy and Asset Prices

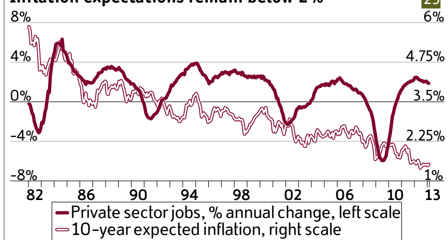
Higher energy prices (gasoline prices jumped by 9.1%) pushed monthly inflation higher by 0.7% in February; still, the annual growth of consumer prices stayed below 2% (see chart 21). Although investors, prompted by stronger economic data, may be revising their inflation expectations as the spread between the inflation-protected and regular treasury securities (usually an implicit gauge of the long-term inflation) has been widening (see chart 22), overall price pressures remain relatively well contained. A measure of implicit inflation expectations, developed by the Federal Reserve Bank of Cleveland, puts expected 10-year inflation well below 2% (see chart 23). The national private sector is creating new jobs at a pace that is still insufficient to produce a sustained pickup in inflation expectations. This seems to be enabling the Fed and its loose monetary policy, which continues to suppress interest rates (see chart 24). With wary businesses and consumers, low borrowing costs continue to drive the nascent recovery of the housing sector both in Texas and nationwide (see chart 25).

Difference between the 10-year TIPS* yield and the 10-year regular Treasury note yield 22



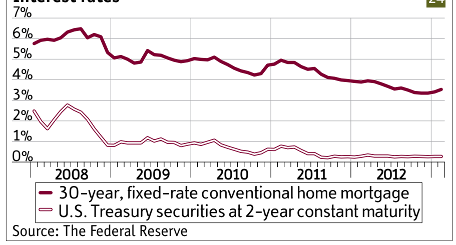
*TIPS - Treasury Inflation-Protected Securities
Source: The Federal Reserve

Inflation expectations remain below 2% 23



Source: The Federal Reserve Bank of Cleveland, The U.S. Bureau of Labor Statistics

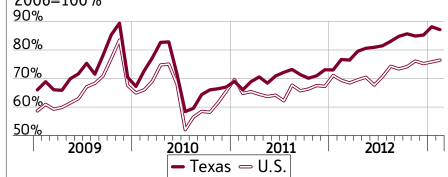
Interest rates 24



Source: The Federal Reserve

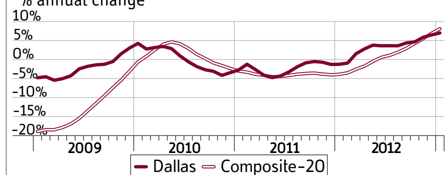
Home sales and prices continue to improve 25

existing home sales, seasonally adjusted annual rates, 2006=100%



S&P Case-Shiller Price Indexes

% annual change



Source: The Real Estate Center at the Texas A&M University, The National Association of Realtors, Standard & Poor's

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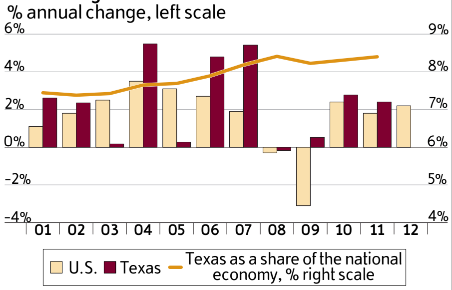
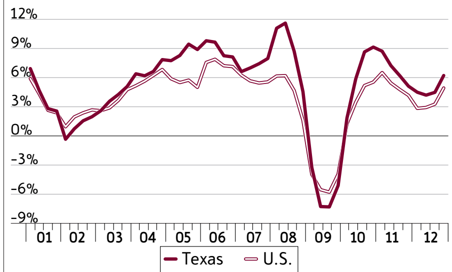
Economic growth: Texas vs. U.S.
% annual change, left scale



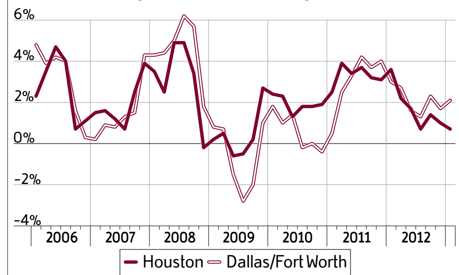
Source: The U.S. Bureau of Economic Analysis

Personal income
seasonally adjusted at annual rates, % annual change



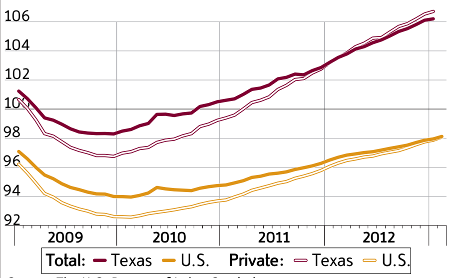
Source: The U.S. Bureau of Labor Statistics

Consumer prices
% annual change, data in alternating months



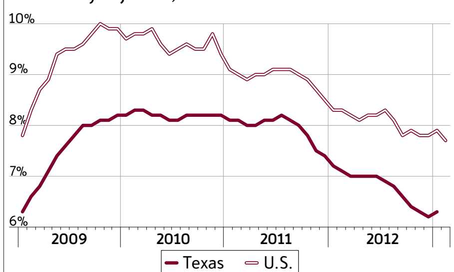
Source: The U.S. Bureau of Labor Statistics

Nonfarm employment
2007=100



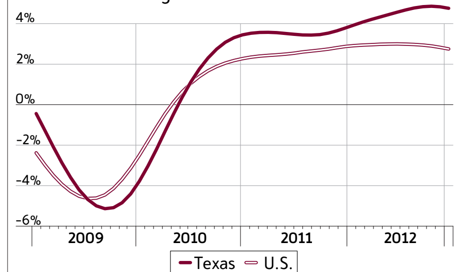
Source: The U.S. Bureau of Labor Statistics

Unemployment rates
seasonally adjusted, %



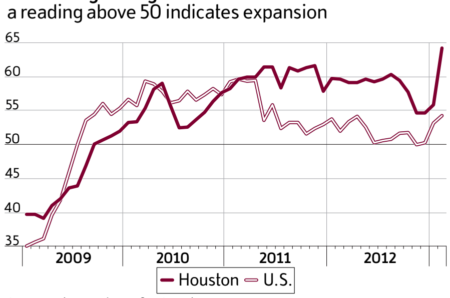
Source: The U.S. Bureau of Labor Statistics

State Coincident Indexes
12-month % change



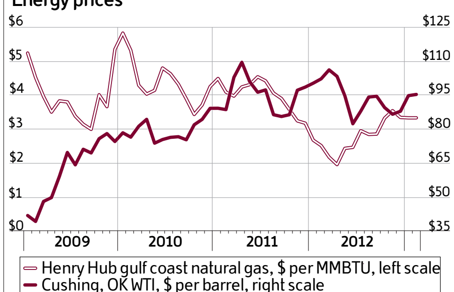
Source: The Federal Reserve Bank of Philadelphia

Purchasing Managers Index
a reading above 50 indicates expansion



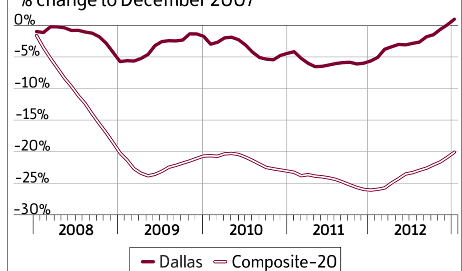
Source: The Institute for Supply Management

Energy prices



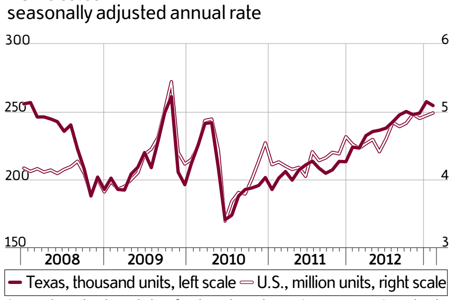
Source: The U.S. Energy Information Administration

Home values
% change to December 2007



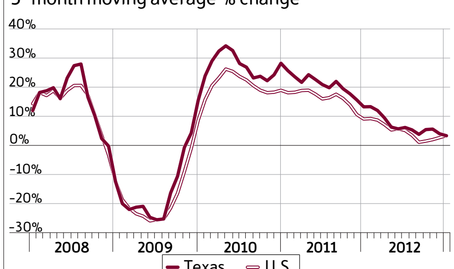
Source: The S&P/Case-Shiller Home Price Indices

Home sales
seasonally adjusted annual rate



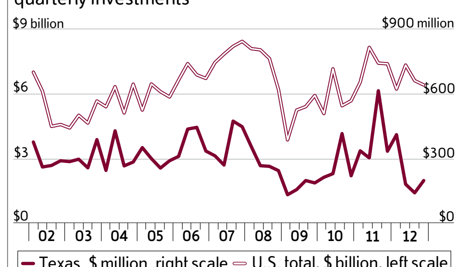
Source: The National Association of Realtors, The Real Estate Center at Texas A&M University

Exports
3-month moving average % change



Source: The U.S. Department of Commerce

Venture capital investment activity in the United States
quarterly investments



Source: PricewaterhouseCoopers

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