September 2013

- **Texas factory activity continued to expand in August.**
- **The Texas jobless rate stood at 6.5% in July.**
- **Private sector employment returned to growth in Texas.**
- **The national economy grew by 2.5% in the second quarter of 2013.**

Executive summary

A stronger construction sector, a pickup in exports and increased consumer spending on durable goods helped lift second quarter GDP growth to 2.5%. This implies that economic recovery is becoming increasingly driven by improving business activity in home building, the automobile industry and export-driven manufacturing. Indeed, August data points to accelerated output growth in manufacturing on growing foreign demand and stronger orders of durable goods. Car sales passed 16 million units in August for the first time since the start of the recession, as continued jobs growth and increasing consumer credit are supporting domestic carmakers.

Meanwhile, economic activity in service providing industries increased to its highest level in over five years. This may reflect the broadening of the national economic recovery, as continued growth of mining, manufacturing, construction, and retail sales is fueling business activity across a wide range of industries. Lastly, higher home affordability, growing employment and improving economic conditions are supporting housing demand, which helps move the home-building industry onto more sustainable footing.

As a result, U.S. economic outlook for the second half of 2013 looks somewhat brighter. Above all, a more stable and faster growing global economy should help sustain a recent rebound in exports. Second, loose monetary policy has contributed to the housing recovery and has unlocked credit flow to businesses and consumers. Considering that the likelihood of a sudden reversal of the monetary stance remains rather remote, low interest rates and easier access to credit will continue to support the national economy. True, sharp tightening of financial conditions in summer on expectations of fewer bond purchases by the Fed emerged as the biggest destabilizing factor for the U.S. and global economic prospects. However, low inflation and slow jobs growth mean that only minor adjustments to the current bond purchases program are likely.

Still, economic sentiment was hit by interest rate gyrations and increasing gasoline prices on heightened tensions in the Middle East. In particular, retails sales grew by just 0.2% in August versus the month before, mostly thanks to continued automobile purchases. Meanwhile, factory orders of durable goods cooled in July on falling aircraft orders and a lull in investment spending, which may have dampened demand for computers, electronics and industrial machinery. This sluggishness of domestic demand means that economic and policy uncertainties are still a major deterrent to stronger consumer and investment spending.

Texas is benefiting from growing foreign demand and domestic economic activity. In addition, the energy sector, a dynamic labor market and a diverse regional economy are sustaining a more vigorous recovery in Texas than in other states and the nation as a whole. In particular, Texas factory activity continued to expand in August, while hiring in manufacturing strengthened to its best in a year. Services and retail trade sectors also improved in August, as local economic growth continued to spread beyond mining and manufacturing. On that count, the economic performance of Houston exemplifies the overall resiliency of the Texas economy. True, the metro's economic rebound owes much to its energy sector, as high world energy prices and an abundant supply of natural gas have boosted Houston's position as the global petrochemical hub. However, Houston has also enjoyed a boom in export-oriented manufacturing and professional and business service industries. This economic diversity combined with business friendly regulations has helped boost the post-crisis strength of the Texas economy.

Indeed, the fact that the local employment situation remains healthier than the nation as a whole testifies to much stronger economic fundamentals. In July, the jobless rate in Texas held steady at 6.5% for the third straight month, remaining well below the national rate of 7.4%. Meanwhile, the annual growth of Texas private sector employment continued to outperform the national rate by a full percentage point, which puts Texas well ahead of other big states in terms of the labor market recovery. In particular, private job gains resumed in July (following a decline of over 9,000 private jobs the month before) on a big monthly increase in mining jobs and strong hiring in information and financial industries. Importantly, job creation in Texas appears to be shifting toward service-providing sectors, as a rapid recovery of jobs in construction and manufacturing is leveling off. This may also imply that the jobs market in Texas is entering a more sustainable long-term growth trend, as service jobs are less susceptible to fluctuations of commodity prices and export demand.

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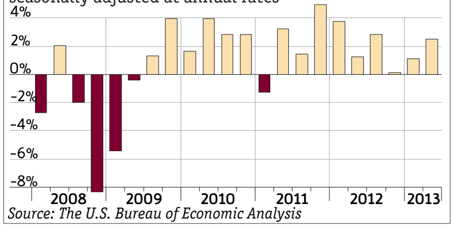
Economic output

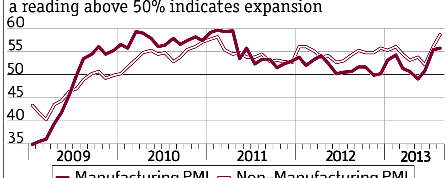
1. Economic growth
seasonally adjusted at annual rates



Source: The U.S. Bureau of Economic Analysis

At the end of August, second quarter economic growth was revised from 1.7% to 2.5% (see chart 1) due to a solid pickup in nonresidential construction spending, which grew at the fastest pace in six quarters, improving home-building activity, strong growth of exports and continued resilience of consumer spending on durable goods. This, in particular, may imply that the U.S. economic recovery is becoming increasingly driven by the strength of business activity in construction and manufacturing. Readings on the national factory activity indicate that output growth in manufacturing accelerated in August, thanks to increasing exports and consumer spending on durable goods. Indeed, in August, car sales passed 16 million units for the first time in over five years, which helps fuel growth momentum in the national automobile industry. Meanwhile, economic activity in service providing industries and construction increased to its highest level since the start of the economic downturn five years ago (see chart 2). On that note, an

2. National economic activity strengthened in August
PMI - Purchasing Managers Indices,
a reading above 50% indicates expansion

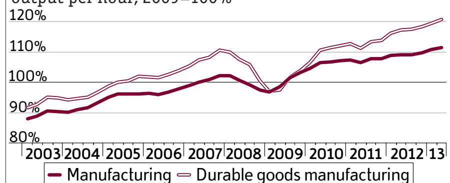


Source: The Institute for Supply Management

uptrend in private construction spending and home-building activity is supported by higher home affordability, growing employment and improving economic conditions, all of which adds to the stronger demand for housing.

All of the above suggest that the U.S. economic outlook for the second half of 2013 may be somewhat brighter. First, the global economy appears to be stabilizing – business activity in China and the Eurozone, where economic growth cooled sharply in the first half of this year, points to improving economic conditions. As a result, a healthier world economy should help sustain a recent rebound of foreign demand for the U.S. exports. In addition, thanks to cost cutting and innovations (see chart 3), American manufacturers are rapidly regaining international

3. Labor productivity
output per hour, 2009=100%



Source: The U.S. Bureau of Labor Statistics

competitiveness. This, coupled with lower energy costs (largely due to rapidly increasing shale gas production), will help national exporters capture a bigger slice of foreign markets in the future.

Second, the Fed's policy of keeping interest rates at record low levels has helped support the national construction industry. Loose monetary policy contributes to growing credit use as well, which encourages the growth of household consumption, and which in turn has pushed automobile sales to their precrisis levels. In July, consumer nonrevolving credit, which mostly includes automobile loans, was up by 8.1% compared to the same month a year ago. Meanwhile, the impact of fiscal tightening proved to be less severe than anticipated, partly because households reduced personal savings to offset a slower growth of income (see chart 4). Although financial conditions have recently tightened sharply as worries over fewer bond purchases by the Fed drove interest rates higher, the

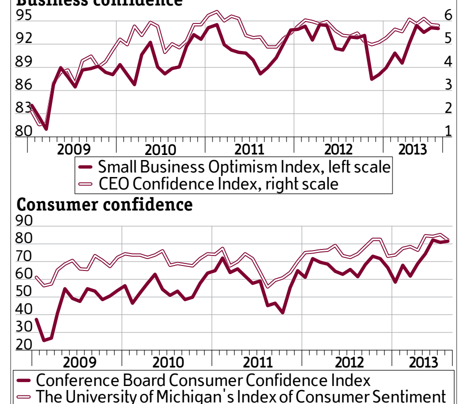
4. Household savings
% of disposable personal income

Source: The U.S. Bureau of Economic Analysis

likelihood of a sudden reversal of the monetary policy is still rather remote. In fact, recent sluggishness in the jobs market may tip the balance toward monetary actions that expand credit availability and curb borrowing costs.

Still, despite the fresh signs of stronger recovery in national manufacturing and construction, American consumers and companies remained in cautious – business and consumer confidence barely budged in August (see chart 5). Economic sentiment was hit by interest rate gyrations and increasing

5. Sentiment recovery stalls in August



Source: The Conference Board, Haver Analytics, Chief Executive Magazine, The National Federation of Independent Business

gasoline prices on heightened tensions in the Middle East. Retail sales grew by just 0.2% in August versus the month before, and mostly thanks to continued consumer spending on cars. Meanwhile, manufacturers' orders of durable goods cooled in July; this weakness was primarily observed in industries outside of the automobile sector. For example, new orders of non-defense aircraft fell by over half in July, while a lull in investment spending dragged down new orders of computers and electronics and industrial machinery. Economic and policy uncertainties are still a major deterrent to stronger consumer and investment spending.

Texas is benefiting from returning foreign demand and growing domestic economic activity. In addition, a booming energy sector, a dynamic labor market and a diverse regional economy are sustaining a more vigorous recovery in Texas than in other states and the

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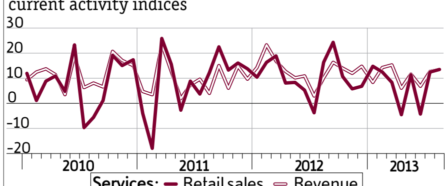
6. Economic activity remains strong in Texas
current activity indices

Source: The Federal Reserve Bank of Dallas

nation as a whole. Factory activity in the Lone Star State remained in expansionary mode in August, while the jobs picture in manufacturing continued to improve as the current employment index of the Texas Manufacturing Outlook Survey increased to its strongest reading in a year (see chart 6). Lesser exposure to markets where growth was weak in the first half of 2013 – for example, EU member states, where nearly 17% of all U.S. exports are shipped versus just 9.6% of all Texas exports – helped Texas achieve stronger gains in exports than the rest of the country. In January-July, exports from Texas were up by 4.4% over the same six months a year ago, while exports for the nation as whole grew by just 1.6%. Energy exports aside, this is mostly due to the solid growth of exports of durable manufacturing goods – in January-July, Texas exports of computer and industrial machinery grew by 17.4% versus the same period a year ago, compared to a 2.5% drop nationwide.

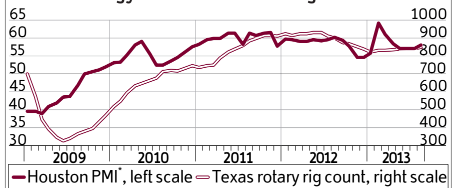
7. Service industries grew faster in August
current activity indices



Source: The Federal Reserve Bank of Dallas

Services and retail trade sectors also improved in August (see chart 7) as solid job gains and improving business activity boosted demand for business and consumer services. Above all, this strength is driven by the expanding energy sector – the Texas rig count continued to edge up in August, which supports factory activity in Houston (see chart 8). Rising construction activity is a big part of the metro success story as well – in January-July,

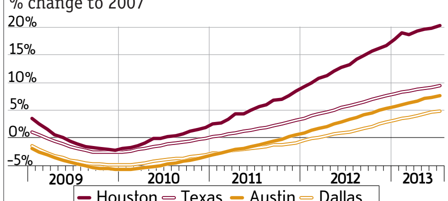
8. Texas energy sector remains strong



*PMI – Purchasing Managers Index,
a reading above 50 indicates expansion
Source: Institute for Supply Management, Baker Hughes

24% more construction permits were issued in Houston as the number of permits issued for single-family homes jumped by 26%. In fact, the economic performance of Houston may serve as a good example of the overall resiliency of the Texas economy. Obviously, the metro's economic rebound owes much to its petrochemical industry, as high world energy prices and an abundant supply of natural gas have considerably strengthened Houston's position as the global hub for the energy and chemical industries. However, Houston has also enjoyed a boom in export-oriented manufacturing and services industries (for example, healthcare, oilfield and shale gas services, science and engineering services, and architectural services). Thus, unlike Dallas, where a downturn in construction and the financial industry left a bigger dent in the local economy, Houston is leading the economic recovery of the Lone Star State (see chart 9).

9. Metro Business Cycle Indices
% change to 2007

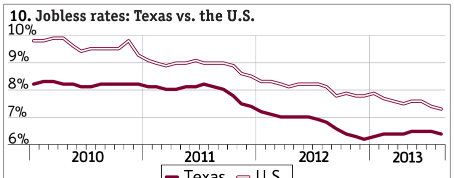


Source: The Federal Reserve Bank of Dallas

Employment

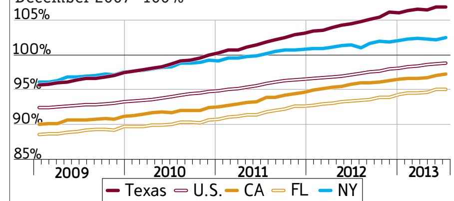
In July, the jobless rate in Texas held steady at 6.5% for the third straight month, remaining well below the national rate of 7.4% (see chart 10).

10. Jobless rates: Texas vs. the U.S.



Source: The U.S. Bureau of Labor Statistics

11. Private sector jobs
December 2007=100%

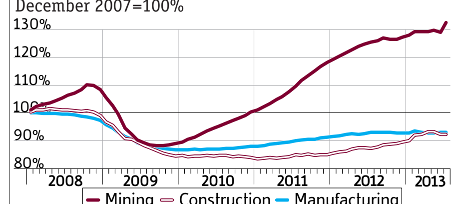


CA, NY, FL and Texas jointly provide roughly one in three private sector jobs in the nation
Source: The U.S. Bureau of Labor Statistics

Nearly 20,000 new jobs were created in Texas, which brings the 12-month total to 293,000 jobs – an annual jobs growth of 2.7% versus just 1.6% nationwide. The annual growth in Texas private sector employment beats the national rate as well – in July, the Lone Star State had 3.1% more workers in the private sector compared to 2.1% for the nation as a whole. This faster growth in private sector employment also means that unlike other big states, Texas already employs more workers than at the start of the recession (see chart 11).

A return to private job growth in July (following a decline of over 9,000 private jobs the month before) was brought on by a 2.9% monthly increase in private sector employment in mining, job gains in trade and transportation, as well as strong hiring in information technology and the financial industry. Job creation in Texas appears to be shifting toward service-providing sectors just as the rapid recovery of jobs in construction and manufacturing is leveling off (see chart 12). This means that overall job

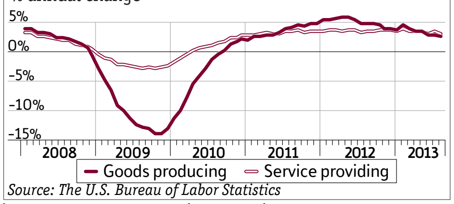
12. Jobs in goods producing sectors
December 2007=100%



Source: The U.S. Bureau of Labor Statistics

growth in Texas will be increasingly driven by employment gains in service industries (see chart 13). Because job growth in service-providing sectors is less responsive to commodity markets and foreign demand and relies more on the strength of the local economy, the labor market in Texas looks likely to gradually move toward a more stable

13. Jobs in goods producing and service providing sectors
% annual change

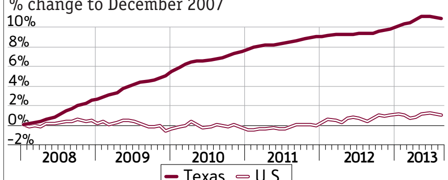


Source: The U.S. Bureau of Labor Statistics

long-term growth trend.

July was the second straight month when both the labor force and the workforce participation rate declined in Texas. This points to a continued lull on the regional labor market, as weakened employment prospects are discouraging workers from searching for jobs. In fact, the drop in the national jobless rate to 7.3% in August was almost entirely driven by a shrinking labor force – the national labor force participation rate dropped to 63.2% – its lowest level in over three decades. Yet, unlike the nation as a whole, the labor force in Texas has started to flatten out only recently (see chart 14). Broader growth of the national economy and a recovery in regional housing markets may have finally slowed the migration of workers to Texas. If this trend persists, the unemployment rate in Texas will continue to drop faster than the national average.

14. Labor force
% change to December 2007

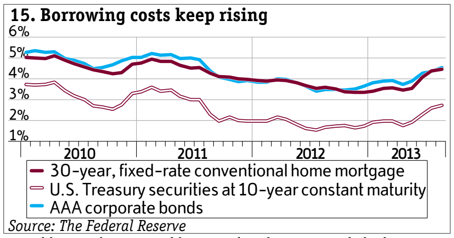


Source: The U.S. Bureau of Labor Statistics

Monetary Policy and Asset Prices

A rapid increase in borrowing costs, driven by market expectations of fewer bond purchases by the Fed, has recently emerged as a major vulnerability of the national economy. In August, yields on 10-year U.S. Treasury bonds were more than a full percentage point higher than a year ago. As a result, higher long-term funding costs pushed up borrowing costs for businesses and households (see chart 15). The Fed has yet to

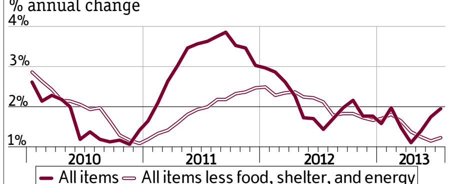
15. Borrowing costs keep rising



Source: The Federal Reserve

outline its policy choices, which may become clearer at the end of September. Yet a recent downtrend in interest rates may indicate that both low inflation (see chart 16) and slow jobs growth point to a relatively minor adjustment of the current bond purchases program. Core inflation (which excludes more volatile prices of food and energy) is still below the Fed's implicit target of 2%, suggesting that at present the Fed believes its loose monetary policy is not a threat to price stability. Thus, the Fed may continue to keep long-term borrowing costs at record low levels.

16. Consumer prices
% annual change



Source: The U.S. Bureau of Labor Statistics

Despite higher borrowing costs, the housing market continued to post solid gains in July – according to the National Association of Realtors, existing home sales grew by over 17% versus the same month a year ago to 5.4 million units – the strongest reading since 2007. Home prices posted an annual gain of nearly 14%, as a lower share of distressed home sales and falling inventories sustained an uptrend in housing values. Turning to Texas, low inventory (about 4 months of supply versus nearly 6 a year ago) and brisk sales (according to the Real Estate Center at the Texas A&M University, home sales were 26% higher than during the same month of 2012) are sustaining home valuation in Texas as well. All of this points to the fact that the residential housing market is on a path of sustained recovery thanks to growing jobs and healthier market fundamentals, mostly due to large price corrections and distressed sales in the worst hit metros. These factors should help compensate for higher borrowing costs and support demand for housing in the future.

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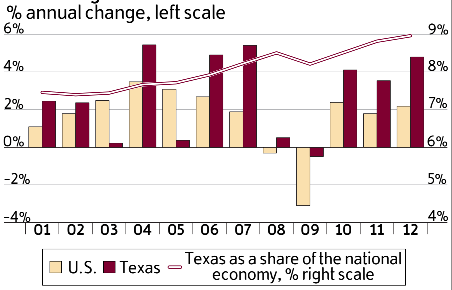
Texas Economic Update

SigmaBleyzer

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

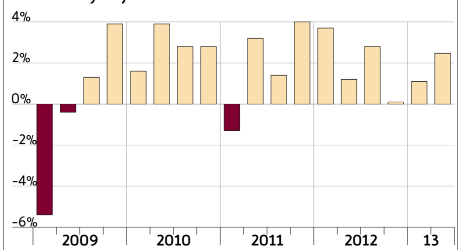
September 2013

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



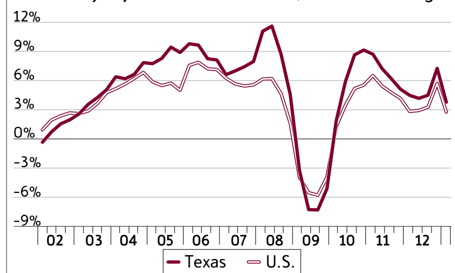
Source: The U.S. Bureau of Economic Analysis

U.S. quarterly GDP
% change from preceding period
seasonally adjusted at annual rates



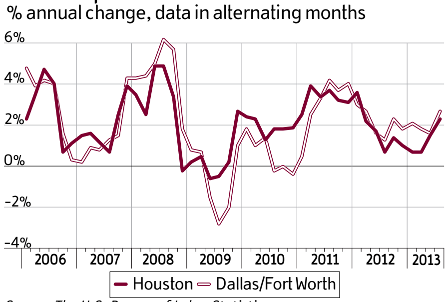
Source: The U.S. Bureau of Economic Analysis

Personal income
seasonally adjusted at annual rates, % annual change



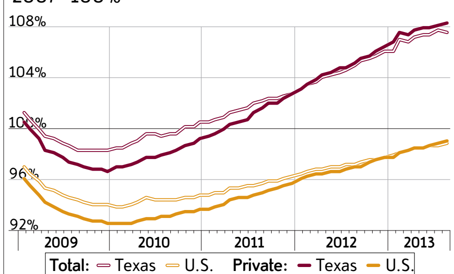
Source: The U.S. Bureau of Labor Statistics

Consumer prices
% annual change, data in alternating months



Source: The U.S. Bureau of Labor Statistics

Nonfarm employment
2007=100%

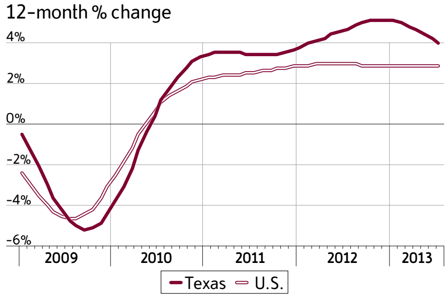


Source: The U.S. Bureau of Labor Statistics

Unemployment rates
seasonally adjusted, %

Source: The U.S. Bureau of Labor Statistics

State Coincident Indexes
12-month % change

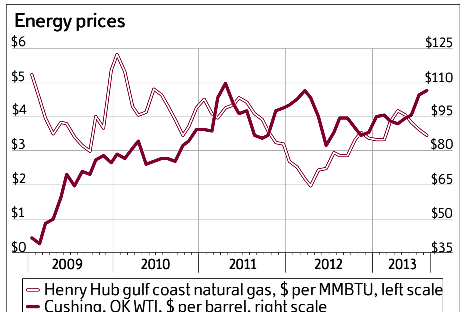


Source: The Federal Reserve Bank of Philadelphia

Purchasing Managers Index
a reading above 50 indicates expansion

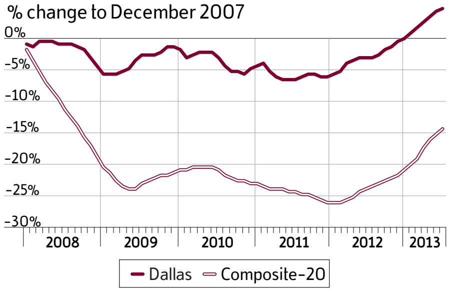
Source: The Institute for Supply Management

Energy prices



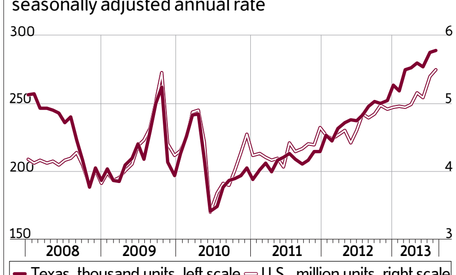
Source: The U.S. Energy Information Administration

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

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