SigmaBleyzer

Texas Economic Update

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

October 2014

- TIn September, the jobless rate in Texas edged down to 5.2%.
- In the same month, the national unemployment rate fell below 6% for the first time since July 2008.
- Texas factory activity improved in September, while business activity in services and retail surged to its highest levels on record.
- The rapid economic ascent of Houston is supporting regional housing activity, on robust demand for multiunit dwellings.

Executive summary

In September, the national economy remained in expansionary mode as factory activity and business conditions in services and construction posted better readings than at the start of the year. Meanwhile, brighter consumer sentiment, boosted by improving access to jobs and cheaper gas prices, implies that the last quarter of this year holds a good chance of seeing sustained gains in consumer demand. Investment spending appears to be standing firm as well; in August, orders of new capital goods saw their best reading since the start of the recovery. Worries over the rapid rise in the borrowing costs are subsiding, which supports business activity in the residential housing industry.

However, the near term outlook for the national economy is still somewhat clouded on the eve of mid-term elections, with the reemergence of global economic and geopolitical risks. Low growth prospects in the Eurozone and the big emerging markets are creating downside risk for exporters, which may be a potential headwind for Texas as the regional economy has greater exposure to global trade flows compared to the nation as a whole.

Lower crude oil prices may have already started to affect the mining industry in Texas – the state's rig count has been trending down since the second week of September. On the upside, the sheer size and diversification of the state's economy makes Texas largely immune to the short-term fluctuations of energy prices. On many counts, September was one of the strongest months of the year, with business activity in manufacturing and services surging to their best levels in years. Furthermore, lower energy prices are a boon for the state's chemical industry as competitive feedstock costs help against foreign rivals.

In addition, the Texas construction industry seems to be emerging from the housing crisis in much healthier shape thanks to the strong rebound of multi-unit residential construction in Houston, as the booming metro economy is driving demand for housing. 2013 was the second straight year that the Houston economy grew faster than all other metros with more than $100 billion in total economic output. While a decade ago Houston was only the ninth largest U.S. metro economy, it is now the fourth largest and is 16% bigger than the economy of Dallas. This rapid economic ascent of Houston is an important driver of the overall economic performance of Texas. Houston now generates over a third of all economic activity in the Lone Star State.

Not surprisingly, this economic strength is translating into a superior job creation record. Houston alone contributed over one in three new jobs created in Texas from September 2013 to September 2014. September was a rather good month, both for the national and regional labor markets – the U.S. unemployment rate fell below 6% for the first time since July 2008, while the jobless rate in Texas remained on a downtrend staying below 5.2%.

This strength is mostly due to the faster pace of new job creation in private industries, with Texas adding new private jobs at twice the annual rate compared to the rest of the nation. As a result, the local economy has already created 15% more new private sector jobs than in all of 2013, which puts it on track to post a record high annual employment gain in 2014.

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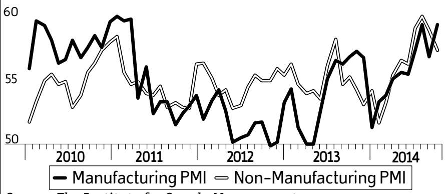
Economic output

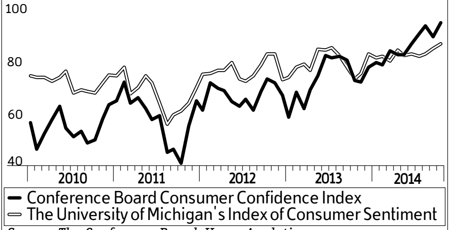
1. The national business activity remains strong
PMI – Purchasing Managers Index,
a reading above 50% indicates expansion



Source: The Institute for Supply Management

Recent data on the labor market and business activity indicate that the U.S. economy remains in expansionary mode. Despite some weakening in September, national factory activity and business conditions in services and construction are in better shape than at the start of the year (see figure 1). Consumer sentiment, boosted by improved hiring, continues to strengthen (see figure 2). According to the U.S. Bureau of Labor Statistics, the first nine months of 2014 saw a net gain of nearly 2 million jobs in the private sector – up by about 13% versus the same three quarters a year ago and the best commutative jobs gain since the start of the recovery five years ago. Meanwhile, by mid-October, initial unemployment insurance claims dropped to their lowest level since April 2000 and continuing claims for unemployment insurance stood at the lowest level since May 2006. And since there is a strong correlation between initial jobless claims and a monthly change in payroll employment (see figure 3), a recent acceleration of the job creation looks certain to continue in the last quarter of this year as well.

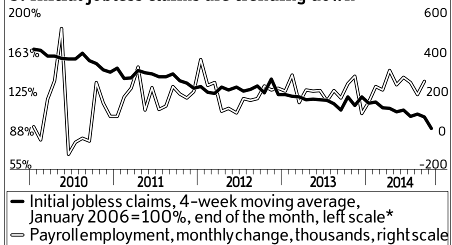
2. Consumer sentiment



Source: The Conference Board, Haver Analytics

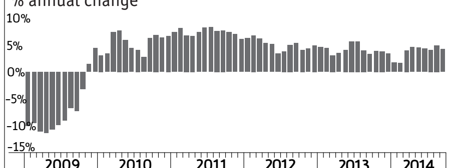
This brighter outlook for jobs, together with improving consumer access to credit, is a big reason behind the resiliency of consumer demand. Although, according to the U.S. Census Bureau, September saw a monthly drop in retail sales (partly due to a 0.8% decline of car sales), the annual gain in consumer spending on goods remained above 4% - a full percentage point ahead of the year before (see figure 4) and mostly on par with long-term trends. And thanks to encouraging economic trends and cheaper gas prices, the fourth quarter holds good chances of sustained gains in consumer demand. In fact, the International Council of Shopping Centers, which tracks chain-store sales nationwide, says that this year the November-December holiday shopping season looks set to post the strongest retail sales growth in three years.

3. Initial jobless claims are trending down



**first week of October*
Source: The U.S. Bureau of Labor Statistics, The U.S. Department of Labor

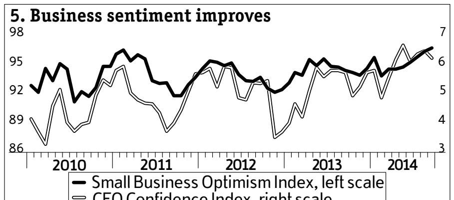
4. Retail sales
% annual change



Source: The U.S. Census Bureau

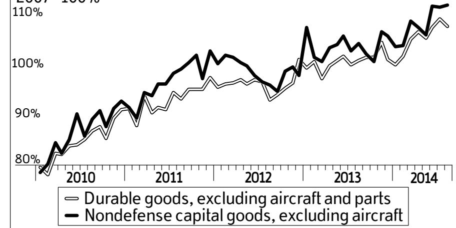
Investment spending, supported by more buoyant business sentiment (see figure 5), appears to be standing firm as well – in August, orders of new capital goods saw their best reading since the start of the recovery (see figure 6). As worries over a rapid rise of the borrowing costs subside, business activity in residential housing seems to be stabilizing (see figure 7) – in September, new private housing starts posted a monthly gain of 6.3%, increasing by nearly a fifth compared to the same month a year ago.

5. Business sentiment improves



Source: Chief Executive Magazine, The National Federation of Independent Business

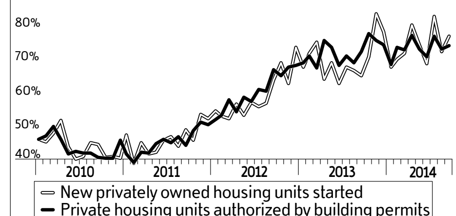
6. New orders of durable goods
2007=100%



Source: The U.S. Census Bureau

However, the second half of October saw a string of troubling data on the world economy that unsettled investors. Poor growth prospects in the Eurozone and large emerging markets are creating downside risk for exporters on weakening global demand for U.S. manufacturing goods and commodities. This risk may be even more serious for Texas, as the regional economy has greater exposure to global trade flows compared to the nation as a whole.

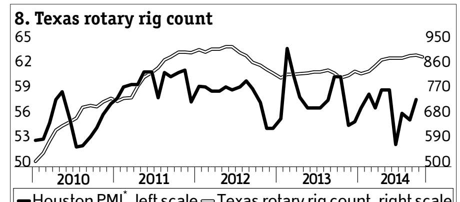
7. Construction activity improves in September
2007=100%



Source: The U.S. Census Bureau

Indeed, lower crude oil prices, both as a result of weaker global demand and expanding shale oil production in the U.S., may have already started to affect the mining industry in Texas – according to Baker Hughes, an oilfield service company, the Texas rig count has been trending down since the second week of September (see figure 8). On the upside, the sheer size and diversification of the state's economy make Texas largely

8. Texas rotary rig count



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

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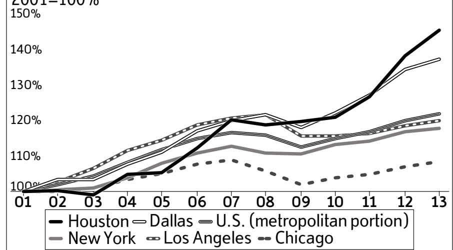
9. Texas business activity surges in September
current activity Indices

Source: The Federal Reserve Bank of Dallas

immune to the short-term fluctuations of energy prices. In fact, September was one of the strongest months of the year with business activity in manufacturing and services surging to their best levels in years (see figure 9). Furthermore, lower energy prices are a boon for the state's chemical industry, as competitive feedstock costs help against foreign rivals.

In addition, unlike the nation as a whole, the Texas construction industry is emerging from the housing crisis in a much healthier shape – in August (the latest data available from the U.S. Census Bureau), the number of newly issued building permits jumped by nearly a third compared to the same month a year ago; nationwide, the annual growth of building permits in August barely touched 6%. This is mostly due to the strong rebound of multi-unit residential construction in Houston as the booming metro economy is driving demand for housing. According to recent data from the U.S. Bureau of Economic Analysis, the Houston metro economy grew by 5.2% in 2013 (versus 3.7% statewide or just 1.7% for the entire U.S. metropolitan portion, which represents about 90% of U.S. GDP) and is now the fourth largest in the nation – after New York, Los Angeles and Chicago. In 2001, Houston was only the ninth largest U.S. metro economy and about 5% smaller compared to the economy of Dallas; last year, the Houston economy was 16% larger than Dallas. 2013 was the second year in a row that the Houston economy grew faster than all other metros, with more than $100 billion in economic output (35 such metros, including Houston, Dallas and Austin, account for nearly 60% of the entire annual national output). This rapid economic ascent of Houston (see figure 10) is an important driver of the overall economic

10. Metro GDP
2001=100%

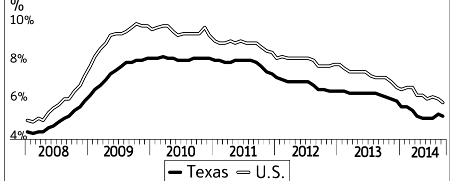


Source: The U.S. Bureau of Economic Analysis

performance of Texas. Houston now generates over a third of all economic activity in the Lone Star State.

Employment

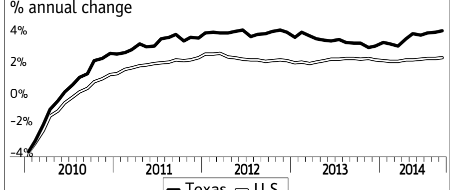
11. Jobless rate in Texas and nationwide
%



Source: The U.S. Bureau of Labor Statistics

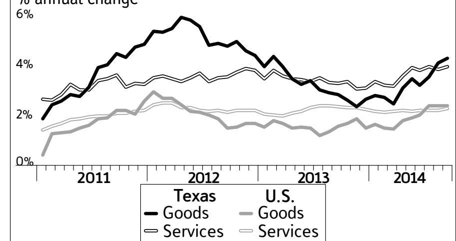
Labor market conditions continued to improve in September – the national unemployment rate fell below 6% for the first time since July 2008, while the jobless rate in Texas remained on a downtrend, staying below 5.5% for the sixth straight month (see figure 11). This strength is mostly due to the faster pace of new job creation in private industries (see figure 12). Compared to the nation as a whole, Texas has recently been adding new private jobs at nearly twice the annual rate, which touched 4% in September – as fast as during the initial phases of the economic recovery in 2011-2012. As a result, the local economy has already created 15% more new private sector jobs than in all of 2013, which puts it on track to post a record high annual employment gain in 2014. And the goods-producing industry (mining, construction and manufacturing) appears to be leading

12. Private sector jobs
% annual change



Source: The U.S. Bureau of Labor Statistics

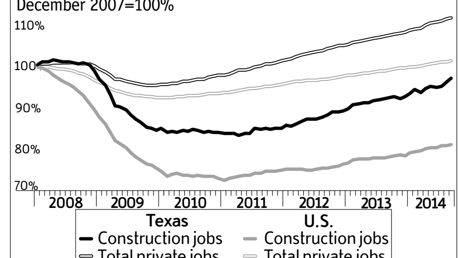
13. Jobs growth in private service-providing and goods-producing industries
% annual change



Source: The U.S. Bureau of Labor Statistics

the labor market recovery again, both in Texas and nationwide (see figure 13). In particular, over the first three quarters of this year, employment in mining, construction and manufacturing was up by over 66 thousand jobs (or nearly double the employment gain during the same period a year ago) mostly due to strong gains in mining and construction. Texas has only 4.4% fewer construction jobs compared to the peak employment level in that industry six years ago, while the number of local mining jobs is at a record high and is up by over 70% from the start of the employment recovery in that industry in the last quarter of 2009. Nationwide, there are still about 20% fewer construction jobs than at the end of 2007, which is a big reason why the nation as whole still trails Texas in the overall labor market recovery (see figure 14).

14. Construction jobs in Texas and nationwide
December 2007=100%



Source: The U.S. Bureau of Labor Statistics

Lastly, September brought encouraging news about the metro labor markets as well. The jobless rate in Houston fell to 4.9% compared to over 6% a year ago. Dallas reported an unemployment rate at 5% versus 6.1% in September 2013, while the jobless rate in Austin stood at 4.2% - a full percentage point below last year's level. These three metros are emerging as the engines of job creation in the Lone Star State –

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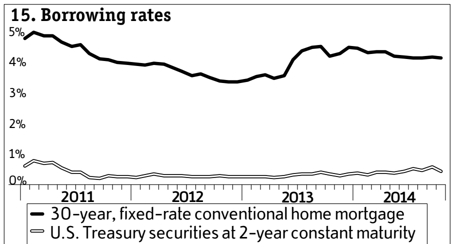
although they provide just about 60% of all nonfarm jobs in the state, they delivered nearly three quarters of the statewide employment gain over the past twelve months. Houston alone contributed over one in three new jobs created in Texas from September 2013 to September 2014.

Monetary Policy and Asset Prices

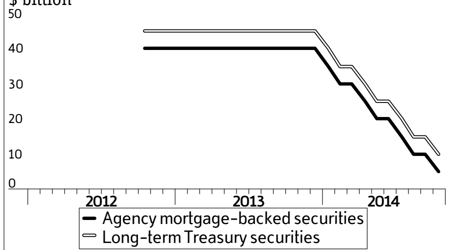
15. Borrowing rates



Source: The Federal Reserve

Positive economic news from the jobs market has been prompting investors to expect a sooner tightening of the monetary policy by the Federal Reserve. Indeed, borrowing costs have been creeping up since mid-2013 (see figure 15), after the Federal Reserve signaled its decision to start scaling back its $85 billion monthly security purchases program. The Federal Reserve has been steadily reducing its bond purchases and, beginning in October, buying of

16. Fed's asset buying program
$ billion

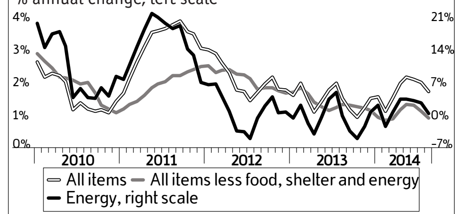


*In **January 2011**, the Fed decided to purchase $600 billion of longer-term Treasury securities by the end of the second quarter of that year.*
*In **September 2011**, The Fed announced its intention to increase the maturity of $400 billion of its Treasury securities holdings by purchasing bonds with remaining maturities of 6 years to 30 years and by selling an equal amount of Treasury securities with remaining maturities of 3 years or less.*
*In **June 2012**, the Fed extended its program to lengthen the average maturity of its holdings through the end of the year.*
***September 2012**, the Fed agreed to increase policy accommodation by purchasing additional agency mortgage-backed securities at a pace of $40 billion per month.*
Source: The Federal Reserve

agency mortgage-backed securities and longer-term Treasury bonds was already proceeding at a pace of just $15 billion a month (see figure 16).

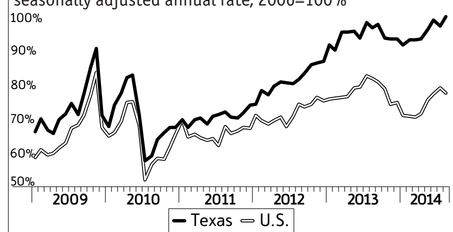
Having said that, the Fed may not tighten monetary policy until the national economic recovery becomes better established. In particular, falling energy prices and a stronger dollar have kept consumer inflation at bay – in August, the total price level was just 1.7% higher than a year ago (see figure 17). Moreover, global economic

17. Consumer prices
% annual change, left scale



Source: The U.S. Bureau of Labor Statistics

18. Existing home sales
seasonally adjusted annual rate, 2006=100%



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

weakness makes the risk of deflation more real, which should add to the Fed's reluctance to increase borrowing costs in the nearest future. And a longer period of accommodative monetary policy should help uphold a nascent rebound of the housing market, where activity stumbled in the last quarters of 2013 (see figure 18), mostly due to growing interest rates and worries over the strength of the U.S. economy.

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