SigmaBleyzer

Texas Economic Update

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

February 2012

- **In January, the Texas jobless rate fell to 7.3% - its lowest level in nearly three years.**
- **So far this year, one in four new national private sector jobs have come from Texas.**
- **Texas factory activity and jobs saw a robust rebound in February.**
- **The Houston Purchasing Managers Index continues to point to strong expansion within the local metro economy.**

Executive summary

Economic recovery continues to gain traction in Texas. In February, the Houston Purchasing Managers Index was close to 60, which is a sign of a healthy expansion in metro factory activity. Of course, strong energy prices are a boon to the Houston metro economy, while cheap natural gas supports the local chemical industry. In addition, manufacturing activity is getting stronger across the state, spreading beyond energy and chemicals. The Texas Manufacturing Outlook Survey registered a solid uptick in factory output and jobs in February and the Texas Business Cycle Index points to a solid turnaround in broad economic activity across all major Texas metros.

A recovering national economy, and growing non-energy exports, are contributing to the manufacturing turnaround in Texas. Indeed, the national economic outlook appears to be improving as stronger jobs growth boosts consumption and business spending. Investor confidence is returning thanks to the Greek debt restructuring deal and positive results from the latest Federal Reserve stress test of major U.S. banks, which confirmed that most banks are in much better shape to endure a future (steep) economic downturn. As investor optimism improves, businesses appear increasingly likely to increase their investment spending and speed up hiring of new workers.

New jobs are needed to keep the U.S. economic recovery in self-sustaining mode. And the latest economic reports are encouraging – in February, retail sales saw the largest monthly gain since September 2011. Although, a big part of this was due to higher gas prices, car sales rebounded to their highest level in four years - thanks to both the stronger employment picture and a solid uptick in consumer borrowing. Lastly, a reduction in household debt, and low interest rates, means debt service now absorbs a much smaller share of consumers' income. This frees up personal incomes, which adds to shoppers' buying power and ultimately consumption.

Improving consumer spending is just a part of the national manufacturing recovery story. Growing demand for business equipment is energizing industrial growth as well. Meanwhile, a gradual turnaround in the construction sector is trickling down to industries producing building materials. All of this is especially beneficial to Texas, where factories tend to rely less on consumer demand.

Indeed, a faster job market recovery in Texas is a strong signal that the state is better equipped to benefit from recent economic trends. In January, the jobless rate in Texas fell for the fifth straight month to 7.3% - its lowest level in nearly three years, remaining a full percentage point below the national rate. More than that, the labor force in Texas jumped by over 1 million since the end of 2007, versus virtually no growth nationwide. Thus, the state is creating jobs at a rate fast enough not only to absorb new workers but also to rehire some of those who lost their jobs during the recession.

In January, about one in four national private sector jobs came from the Lone Star state alone. In particular, booming business activity in the oil and gas industry is pushing up the number of mining jobs. Meanwhile, both construction and manufacturing have been more resilient to the economic downturn, while Texas factory jobs are returning at a faster pace versus the nation as a whole.

Equally important, employment in most service-providing industries, which are more strongly linked to the health of the local economy, have already surpassed pre-recession levels. For example, the local business and professional services industry has already fully recovered jobs lost during the economic downturn and now employs 4% more workers than at the end of 2007.

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Economic output

A national economic recovery appears to be taking hold. The Greek debt restructuring deal has alleviated the gloom hanging over the global economy and helped improve investor sentiment as indicated by the major stock market indices, which have risen by over 20% from their October 2011 lows (see chart 1). This bullish trend in the stock market may be a harbinger of stronger economic growth in the future. And as businesses grow more optimistic about the economic outlook (see chart 2), they're increasingly likely to increase investment spending and speed up hiring new workers. In fact, according to Chief Executive Magazine, over half of all surveyed CEOs now plan to increase capital spending over the next year (compared to about 42% at the end of 2011). Meanwhile, the share of small businesses making capital outlays is at its highest level since March 2008.[1]

New capital spending should help cement the recent uptrend in private sector hiring. And these jobs are necessary to sustain any U.S. economic recovery, which is primarily driven by consumer spending. The latest reading on retail sales is indeed encouraging – in February, they jumped by 1.1% – the largest gain since September 2011. Although a large part of this was due to higher gas prices, a 1.6% increase in spending on automobiles points to some U.S. consumer resilience. In fact, car sales rebounded to their highest level in four years, thanks both to the stronger employment picture and a solid uptick in consumer borrowing (see chart 3). That being said, this spending recovery remains fragile, as, similar to the beginning of 2011 (see chart 4), consumer demand may stumble if gas prices continue to rise.

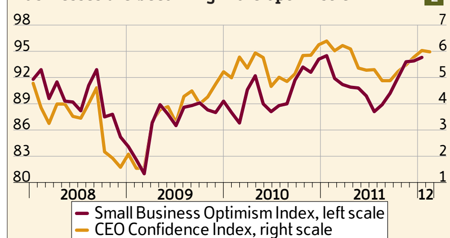
Still, the economy appears to be in much better shape to weather any fresh energy shock. First, year-on-year growth in retail gas prices stood at just 10% on average during the first two months of 2012, compared to a much faster growth of about 17% in January-February 2011. Second, since the end of the first quarter of 2011, the private sector has created nearly 2 million new jobs, which is a potent boost to consumer demand. Lastly, thanks to a reduction in household debt and low interest rates, consumers are now spending a smaller portion of their disposable income to pay off their debts (see chart 5). With disposable income of $11.6 trillion at the end of 2011, each half a percentage point drop in the financial obligations ratio implies consumers can spend about $60 billion more, which should certainly add to consumer demand and consumption.

Although, increasing car sales are driving a national manufacturing recovery, strong domestic and overseas demand for business equipment is also contributing to recent industrial growth (see chart 6). Indeed, business spending on aircraft, computers and industrial machinery helped push production to its highest level on record last month. Meanwhile, a gradual turnaround in the construction sector is starting to bring growth to industries producing construction materials, for example, cement and concrete products (see chart 7). According to the Institute for Supply Management, U.S. factory activity grew in February for the 31st straight month.

Market optimism is on an uptrend 1
September 1st 2011 = 100

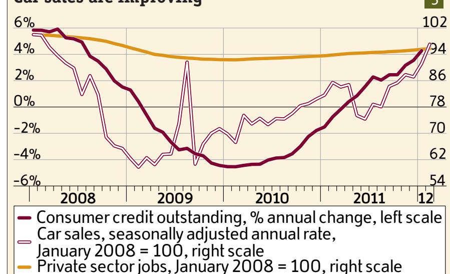
Source: S&P, NYSE

Businesses are becoming more optimistic 2



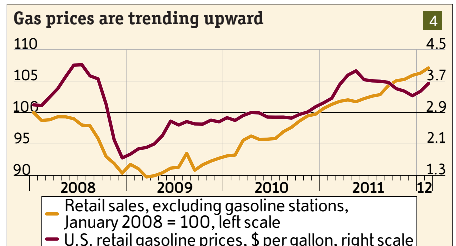
Source: The Chief Executive Magazine, The National Federation of Independent Business

Car sales are improving 3



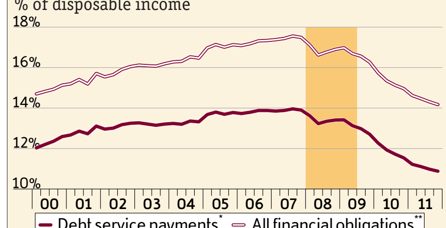
Source: The Federal Reserve, The Federal Reserve Bank of St. Louise, The U.S. Bureau of Labor Statistics

Gas prices are trending upward 4



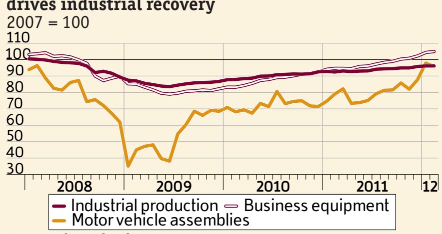
Source: The U.S. Census Bureau, The U.S. Energy Information Administration

Household financial costs are falling 5
% of disposable income



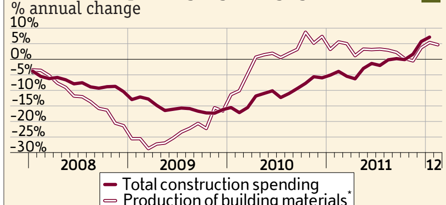
*Required payments on outstanding mortgage and consumer debt.
**Includes all household financial payments, such as debt service payments, rents, leases, property taxes and homeowners insurance.
Source: The Federal Reserve

Growing demand for business equipment drives industrial recovery 6
2007 = 100



Source: The Federal Reserve

Construction spending is growing again 7
% annual change



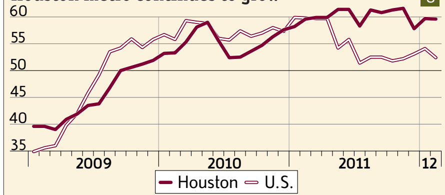
*Industrial production index for nonmetallic mineral product manufacturing, which, for example, includes products, such as bricks, glass, cement and concrete products, lime and gypsum.
Source: The Federal Reserve, The Federal Reserve Bank of St. Louise

[1]Source: The National Federation of Independent Business, Small Business Economic Trends, March 2012.

February 2012

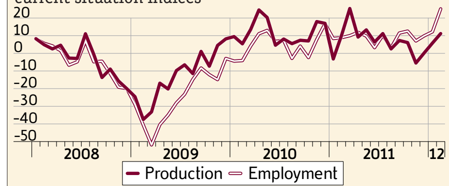
In February, the Houston Purchasing Managers Index remained close to 60, indicating strong growth in metro factory activity (see chart 8). The Texas rig count in February was 22.5% higher than a year ago, and record low natural gas prices are energizing the local chemical industry. In addition, there are encouraging signs that manufacturing activity is strengthening across the state, spreading beyond the energy and chemicals industries. In particular, the Texas Manufacturing Outlook Survey registered a healthy uptick in factory activity and manufacturing employment in February (see chart 9). Meanwhile, the Texas Business Cycle Index, which has already surpassed its mid-2008 peak, points to a solid turnaround in broader economic activity across all major Texas metros (see chart 10). And judging by past records, this implies the Texas economy is heading for even faster growth in 2012 (see chart 11).

Houston metro continues to grow 8



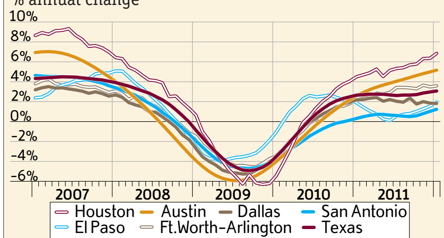
Purchasing Managers Index, a reading above 50% indicates expansion.
Source: The Institute for Supply Management

Texas manufacturing conditions 9
current situation indices



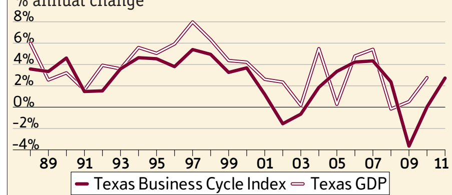
Source: The Federal Reserve Bank of Dallas

Texas metro economies continue to grow 10
% annual change



Source: The Federal Reserve Bank of Dallas

Texas economy is gathering speed 11
% annual change



Source: The Federal Reserve Bank of Dallas, The U.S. Bureau of Economic Analysis

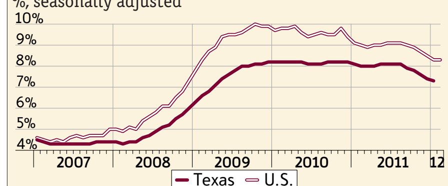
Employment

Acceleration in the labor market recovery in Texas is another sign that the regional economy is in better shape than most other parts of the country. Indeed, in January, the jobless rate in Texas fell for the fifth straight month to 7.3%, the lowest level since April 2009 (see chart 12). As a result, it is just 2.9 percentage points higher than at the beginning of the recession (December 2007), versus a wider gap of 3.3 percentage points, on average, nationwide. More than that, while a drop in the national jobless rate from a peak of 10% in October 2009 to 8.3% in February 2012 can be largely explained by a stagnant labor force, the Texas labor force is now nearly 9% higher (or up by over 1 million) than at the end of 2007 (see chart 13). Thus, a declining unemployment rate in Texas indicates that the state is creating jobs at a rate that is fast enough both to absorb new workers and rehire those who lost their jobs during the recession.

Indeed, the private sector in Texas continues to create new jobs at a faster pace than the USA as a whole (see chart 14). In January, about one in four national private sector jobs came from Texas (see chart 15). As business activity in the oil and gas industry steams ahead, the number of mining jobs in Texas continues to skyrocket – Texas now has 18% more mining jobs than a year ago. Meanwhile, a shallower recession in the residential housing sector, as well as greater reliance in infrastructure and industrial construction spending, helped shield Texas from a sharp increase in construction unemployment. As a result, there are now 17% fewer construction jobs in Texas versus a 26% drop nationwide.

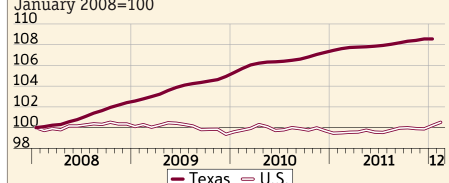
Manufacturing in Texas, which has been adding jobs at an annual rate of 3% over the past six months (versus about 2% nationwide) is also faring relatively better – there are about 10% fewer factory jobs in Texas compared to the peak of the previous business cycle. The nation as a whole has lost 15% of its manufacturing jobs over the past five years. Equally important, employment in trade, transportation and utilities, and finance is just a shade under its pre-recession levels in Texas; nationwide, these sectors are still short nearly 6% and 8% of their pre-crisis job levels, respectively. In addition, education and healthcare are adding new jobs faster than the nation as a whole – over the past six months Texas has been adding education and healthcare jobs at an annual rate of about 3% versus just 2% nationwide. Finally, the overall strength of the Texas economy fuels demand for business related services – the local business and professional services industry has already fully recovered jobs lost

The Texas unemployment rate 12
%, seasonally adjusted



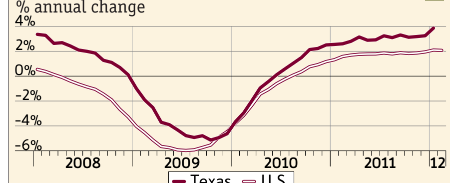
Source: The U.S. Bureau of Labor Statistics

Labor force is growing in Texas 13
January 2008=100



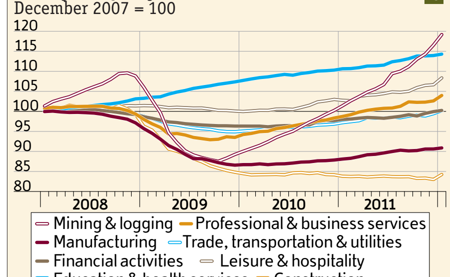
Source: The U.S. Bureau of Labor Statistics

Private sector jobs 14
% annual change



Source: The U.S. Bureau of Labor Statistics

Texas jobs by major industries 15
December 2007 = 100



Source: The U.S. Bureau of Labor Statistics

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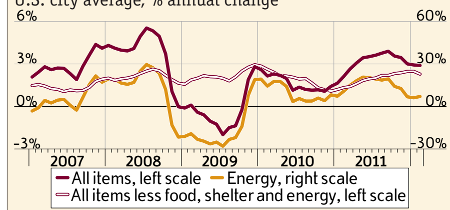
during the economic downturn and now employs 4% more workers than at the end of 2007. At the same time, there are still nearly 2% fewer business and professional services jobs in the nation as a whole. All told, these employment trends in Texas should help the Lone Star state maintain its lead in job creation as the national economic recovery continues to gain traction in 2012.

Monetary Policy and Asset Prices

Consumer inflation has been trending down since October 2011 – at 2.9% in February, it was at its lowest level since April 2011 (see chart 16). Yet the risk that higher prices at the pump may derail economic recovery continues to cloud the economic outlook. Indeed, one cannot help draw a parallel between last year's oil supply disruption in Libya, and its impact on oil prices, and today's concerns over the stability of crude oil shipments from the Gulf, Africa and Venezuela. In fact, the latest statement by the Federal Reserve did acknowledge a temporary increase in inflation pressures due to rising gasoline prices. However, we expect monetary policy to remain highly accommodative, and, in particular, the federal funds rate will be kept exceptionally low at least through 2014. This policy stance still implies the Fed expects any temporary inflationary pressures to fade away in the medium term.

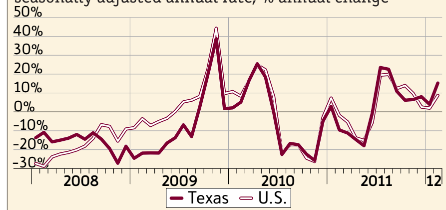
Indeed, low interest rates are still needed to sustain activity in the housing sector. At present many factors (such as the improving jobs picture, falling housing inventory, record housing affordability, and a substantial pent-up demand for housing due to the suppressed household formation rate during recession) will eventually lead to a favorable environment for a healthy rebound of the real estate sector. In fact, home sales appear to be gathering speed both in Texas and nationwide (see chart 17) as the improving economic climate makes homebuyers more confident about entering the housing market. However, Treasury yields are starting to increase on signs of the recovering economy and expectations for tighter monetary policy. Higher interest rates will eventually push up the costs of mortgages, although mortgage rates are still nearly a full percentage point lower than a year ago (see chart 18).

Consumer prices 16
U.S. city average, % annual change



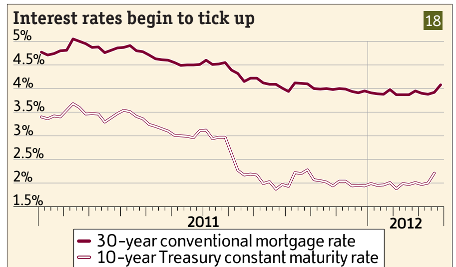
Source: The U.S. Bureau of Labor Statistics

Existing home sales 17
seasonally adjusted annual rate, % annual change



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

Interest rates begin to tick up 18



Source: The Federal Reserve Bank of St. Louise

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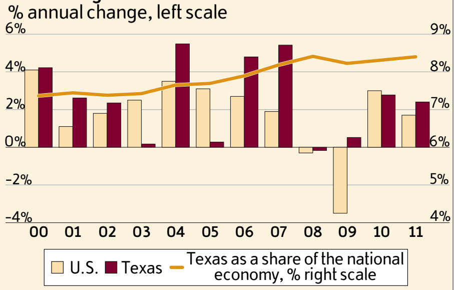
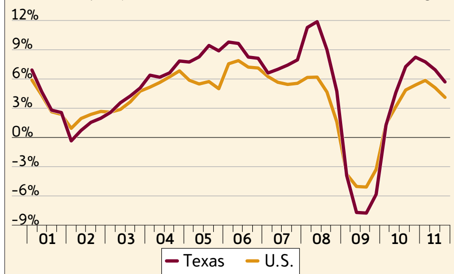
Economic growth: Texas vs. U.S.
% annual change, left scale



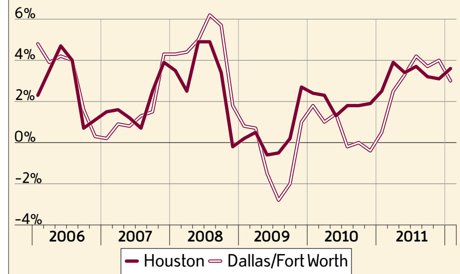
Source: The U.S. Bureau of Economic Analysis

Personal income
seasonally adjusted at annual rates, % annual change



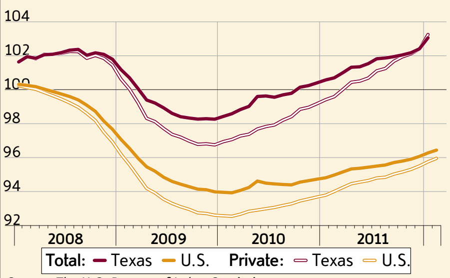
Source: The U.S. Bureau of Labor Statistics

Consumer prices
% annual change, data in alternating months



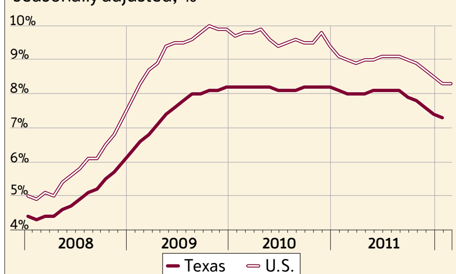
Source: The U.S. Bureau of Labor Statistics

Nonfarm employment
2007=100



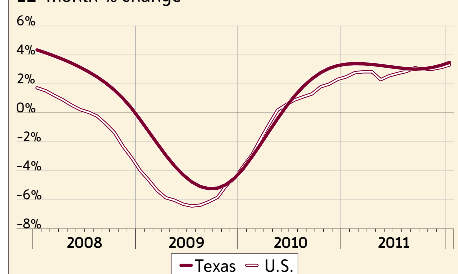
Source: The U.S. Bureau of Labor Statistics

Unemployment rates
seasonally adjusted, %



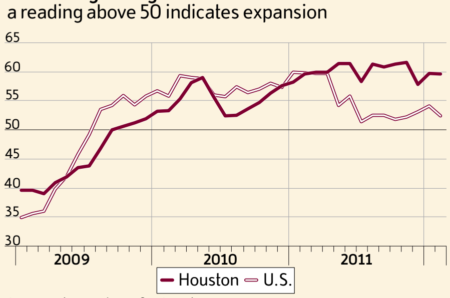
Source: The U.S. Bureau of Labor Statistics

State Coincident Indexes
12-month % change



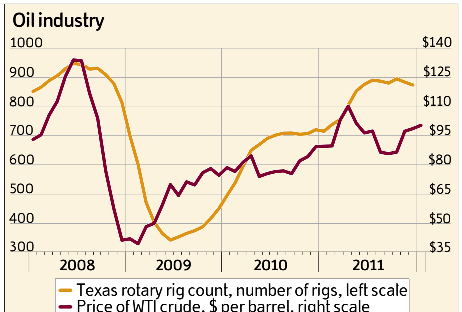
Source: The Federal Reserve Bank of Philadelphia

Purchasing Managers Index
a reading above 50 indicates expansion



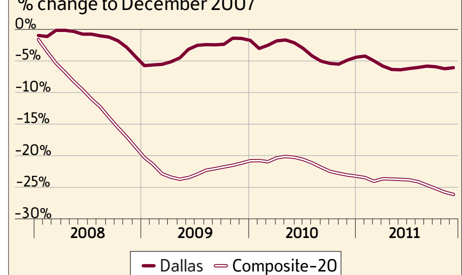
Source: The Institute for Supply Management

Oil industry



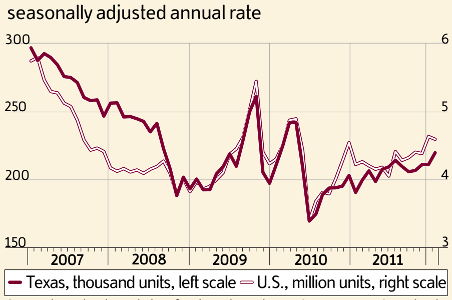
Source: The Federal Reserve Bank of Dallas

Home values
% change to December 2007



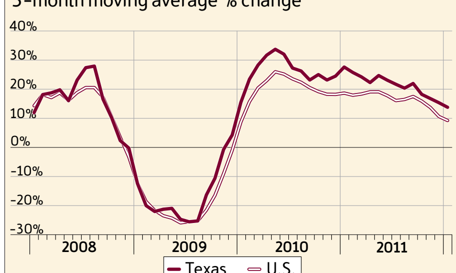
Source: The S&P/Case-Shiller Home Price Indices

Home sales
seasonally adjusted annual rate



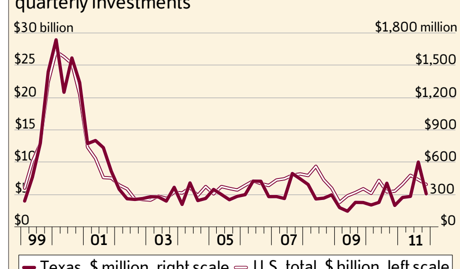
Source: The National Association of Realtors, The Real Estate Center at Texas A&M University

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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