SigmaBleyzer

Texas Economic Update

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

October 2012

- **Texas factory activity strengthened in September.**
- **Texas added 30 thousand new private-sector jobs in September.**
- **The Texas jobless rate dropped to 6.8% - its lowest reading since March 2009.**

Executive summary

The U.S. economic situation is gradually improving - factory activity resumed growing in September following three consecutive months of contraction. The broader economy is showing signs of life as well with business activity indices returning to growth rates last observed at the start of this year. Essentially, consumer spending on durable goods and, in particular, improving auto sales, is contributing to a steady growth of retail sales. Indeed, continued, albeit modest, recovery of private sector hiring is boosting consumer confidence. Meanwhile, low interest rates, increasing consumer credit as well as a faster growth of personal income add to households' buying power.

Equally important, housing appears to be slowly turning the corner as various metrics of construction activity point to a healthy uptick in homebuilding. Indeed, August saw a big jump in housing starts while increasing issuance of building permits indicates a brighter outlook for residential construction. This means that the housing sector may have already ceased to be a drag on the national economic recovery.

At the same time, weak new orders of manufactured goods imply that businesses remain cautious about increasing investment spending. For example, orders of new capital goods are still below last year's level, and it is partly the reason for sluggish growth of new private jobs as nebulous economic outlook deters expansion plans and saps business confidence. In particular, concerns over rising health care cost, increasing hostility of the business climate and looming spending cuts and tax hikes are emerging as key restraints on corporate America.

Turning to Texas, regional factory activity strengthened in September and business conditions in the service providing sectors improved as well. Meanwhile, the Houston Purchasing Managers Index hovers close to 60%, which testifies to the continuing strength of the state's largest metro economy. Lastly, a stronger rebound in the regional housing sector, driven by improving homebuilding activity in Houston and Dallas, is sustaining the better performance of the Texas economy and regional labor market.

In fact, in September the jobless rate in Texas stood at 6.8% - its lowest reading since March 2009. Thus, it remains a full percentage point below the national rate even though the Texas workforce is growing much faster. In fact, over the past twelve months, Texas added over 270,000 new private jobs – a 3.1% annual gain versus just 1.7% growth for the nation as a whole.

Admittedly, Texas added nearly 700,000 new private-sector jobs since the labor market recovery started in earnest at the end of 2009. And about 45% of these jobs were supported by more dynamic local economic conditions. On that note, the Texas labor market outshines many other large regional economies – for example, less than 15% of new private-sector jobs in California can be attributed to the competitiveness of that state.

A closer look at sector specific job gains may help explain a stronger labor market turnaround in Texas. First, nationwide, most new private sector jobs created since December 2009 were in service-providing sectors. In Texas, about one in five new private-sector jobs came from goods-producing industries, which attests to their underlying competitiveness. Moreover, a big portion of new private jobs in Texas service-providing industries can be attributed to state-specific factors that sustained more rapid growth versus the nation as whole. Thus, Texas is likely to outperform other U.S. regions in job creation, as its leading industries are getting bigger.

Lastly, September's employment numbers indicate that the Texas labor market continued to add jobs at a robust pace. About 30,000 new private-sector jobs were created in Texas thanks to increasing employment in manufacturing, professional and business services, education and healthcare, trade, transportation and utilities and leisure and hospitality. Faster job growth in the Texas service-providing industries is an important driver of job creation in the Lone Star State. Indeed, during the first three quarters of 2012, Texas created about the same number of private-sector jobs as a year earlier. Meanwhile, during the same three quarters, the national private sector added 16% fewer jobs than a year ago. As a result, the share of Texas in national job creation increased from 14% in 2011 to 16% in January-September 2012.

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Economic output

The national economic picture is slowly getting a little brighter. In particular, U.S. factory activity resumed growing in September following three consecutive months of contraction. Meanwhile, the broader economy is gradually returning to growth rates last observed at the start of this year (see chart 1). Increasing car sales, which in September hit their highest level in nearly five years (see chart 2), continue to underpin manufacturing activity. Equally important, a pickup in construction activity (see chart 3) is supporting economic recovery as well.

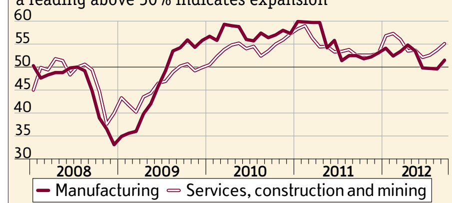
Spending on durable goods and, in particular, improving auto sales, remains behind the steady growth of consumer demand (see chart 4). A host of factors is contributing to stronger household spending. First, continued, albeit slow, recovery of private sector hiring is boosting consumer sentiment – according to the Conference Board, consumer confidence index jumped to 70.3 in September from 61.3 the month before on improving employment prospects. Second, low interest rates and increasing consumer credit (up by 5.5% in Augusts versus the year ago) help accommodate consumers' borrowing needs. Lastly, a slower growth of energy prices and falling debt-service costs[1] as well as faster growth of personal income drive up households' buying power.

The residential construction industry appears to be modestly improving as well. Indeed, various metrics of construction activity point to an uptick in homebuilding in 2012 (see chart 5). In August, the number of privately owned housing units started was 29% higher than a year ago, while the number of housing units authorized by building permits grew by 24%. This means that the housing sector may have already ceased to be a drag on national economic recovery.

As car sales are approaching their pre-crisis levels and housing markets stabilize, consumer behavior may be returning back to where it was before the Great Recession. On the other hand, a 5.2% drop of new orders of manufactured goods in August, albeit largely due to cancelled aircraft bookings, does imply that businesses' reluctance to increase investment spending is not subsiding. Indeed, orders of new capital goods, for example, machinery and computers, remain below their last year's level (see chart 6). And weak investment activity is partly the reason for sluggish growth of new private jobs. After all, companies still face a nebulous economic outlook, which deters expansion plans and saps business confidence (see chart 7). Anxiety over rising health care cost and increasing hostility of the business climate are impeding economic recovery as well. Lingering uncertainties over looming spending cuts and tax hikes do not add to investors' optimism either. In fact, a recent study by the Federal Reserve Bank of San Francisco states that greater instability has boosted the jobless rate by at least one percentage point.[2]

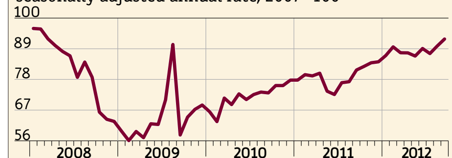
Turning to Texas, regional factory activity strengthened in September; business conditions in the service providing sectors improved as well (see chart 8). Equally encouraging, the

The national economic activity is improving 1
Purchasing Managers Indices,
a reading above 50% indicates expansion



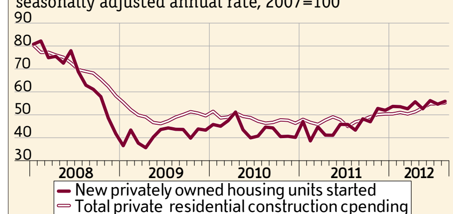
Source: The Institute for Supply Management

National car sales 2
seasonally adjusted annual rate, 2007=100



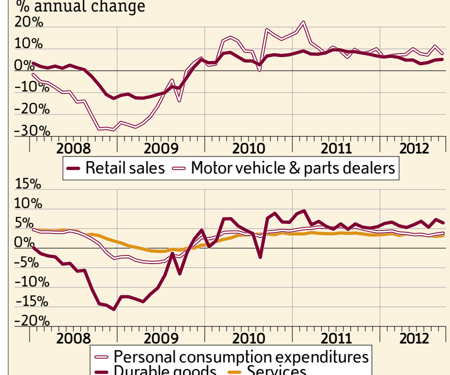
Source: The Federal Reserve Bank of St. Louise

Residential construction activity is gradually turning the corner 3
seasonally adjusted annual rate, 2007=100



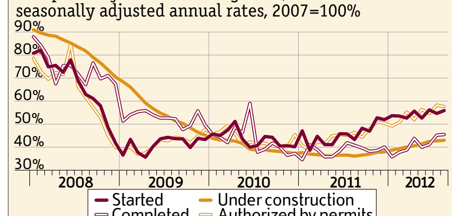
Source: The Federal Reserve Bank of St. Louise

Consumer spending 4
% annual change



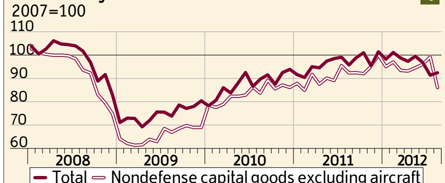
Source: The U.S. Census Bureau, The U.S. Bureau of Economic Analysis

The housing market is turning the corner 5
new privately owned housing units,
seasonally adjusted annual rates, 2007=100%



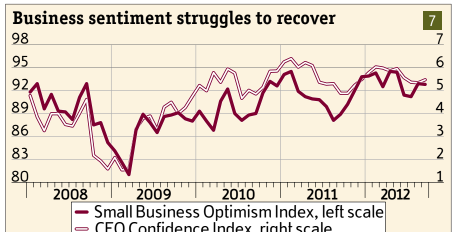
Source: The Federal Reserve Bank of St. Louise

New factory orders 6
2007=100



Source: The U.S. Census Bureau

Business sentiment struggles to recover 7



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

[1]In the second quarter of 2012, household debt service payments as a percent of disposable personal income stood at just 10.7% - its lowest level since 1984. Source: The Federal Reserve.

[2]Sylvain Leduc and Zheng Liu, Uncertainty, Unemployment, and Inflation, FRBSF Economic Letter.

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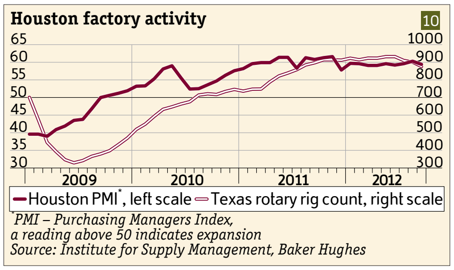
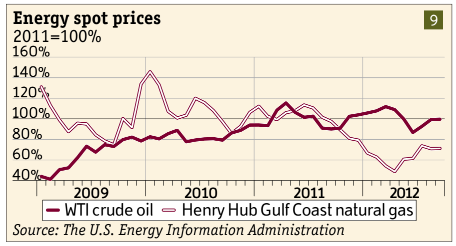
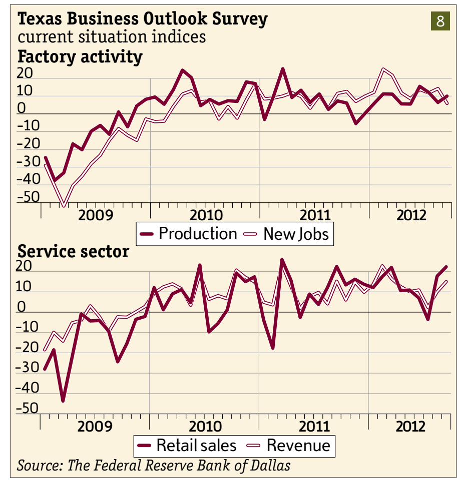

Houston factory activity

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

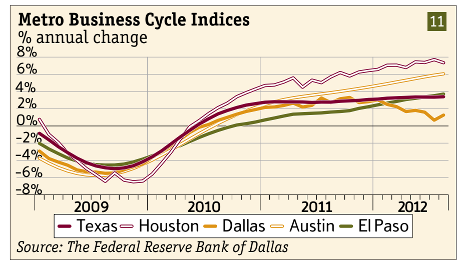

Energy spot prices
2011=100%

Source: The U.S. Energy Information Administration

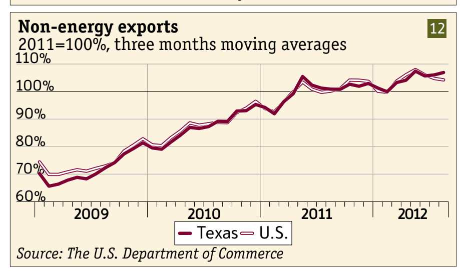

Texas Business Outlook Survey
current situation indices

Source: The Federal Reserve Bank of Dallas

Houston Purchasing Managers Index hovers close to 60%, which testifies to the continuing strength of Texas' largest metro economy. Admittedly, slower growth of energy prices (see chart 9) may weaken business activity in Houston (see chart 10). However, this metro economy remains an important driver in the overall economic rebound in the Lone Star State (see chart 11). And being the largest export hub helps - about 7% of all national exports and over 40% of all Texas exports depart from Houston. On that count, Texas exporters are less exposed to slowing economies in the Eurozone and Asia. Indeed, the European Union and China account for only 12% and 4% of all exports from Texas, respectively, compared to 18% and 7% nationwide. Meanwhile, over half of all exports from Texas go to Latin America, including Mexico, versus just a quarter nationwide. As demand for foreign goods remains relatively robust in Latin America, Texas is enjoying stronger growth of exports – in January-August, exports from Texas were up by 6.4% compared to 5.6% nationwide. Recently, Texas non-energy exports has been performing better versus the nation as a whole (see chart 12), which adds support to local manufacturers as well.


Metro Business Cycle Indices
% annual change

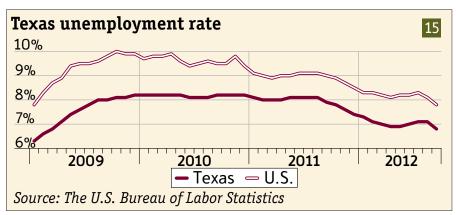
Source: The Federal Reserve Bank of Dallas


Non-energy exports
2011=100%, three months moving averages

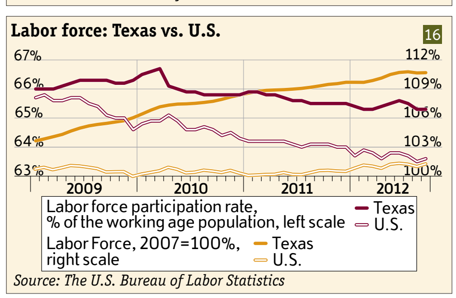
Source: The U.S. Department of Commerce

Lastly, a stronger rebound of the regional housing sector, driven by improving homebuilding activity in Houston and Dallas (see chart 13), sustains growth momentum of the Texas economy. Indeed, the Texas construction industry saw smaller job losses during the recession and a faster pick up in hiring in 2012 (see chart 14).

Employment

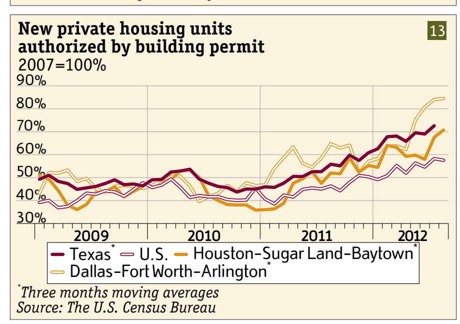

Texas unemployment rate

Source: The U.S. Bureau of Labor Statistics

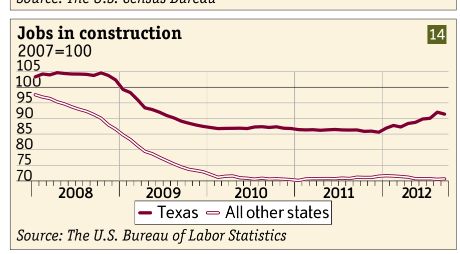

Labor force: Texas vs. U.S.

Source: The U.S. Bureau of Labor Statistics

In September, the jobless rate in Texas dropped to 6.8% - its lowest level since March 2009 (see chart 15). It is worth mentioning that the state's unemployment rate remains a full percentage point lower compared to the national rate even though the Texas workforce is growing faster (thanks to more rapid population growth and brighter jobs prospects) versus the nation as whole (see chart 16). In fact, over the past twelve months Texas has added over 270,000 new private jobs – a 3.1% annual gain versus just a 1.7% growth for the nation as a whole. A decomposition of the employment change may shed some light on this difference between the state and national jobs growth. Typically, a shift-share analysis is applied to break down the total change in employment into three components. The first component - national share, represents jobs gained due to growing national business activity and assumes that the state's industry grew at the industry's national growth rate. The second component - industry mix, stands for the number of new jobs that can be attributed to the state's mix of industries. It represents a gain in employment due to differences in industry and total nationwide growth. Lastly, the third component – regional shift, represents job gains due to state's competitiveness. In particular it helps identify the state's leading and lagging


New private housing units authorized by building permit
2007=100%

*Three months moving averages
Source: The U.S. Census Bureau


Jobs in construction
2007=100

Source: The U.S. Bureau of Labor Statistics

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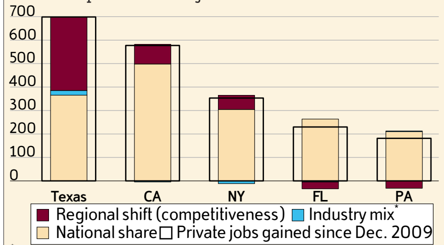
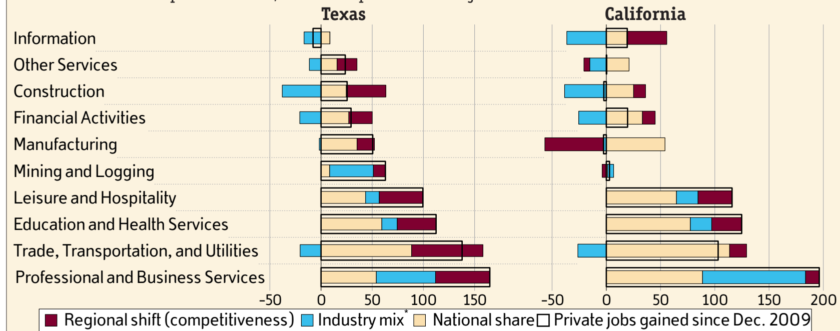


Decomposition of the employment change
December 2009 to September 2012, thousand private-sector jobs

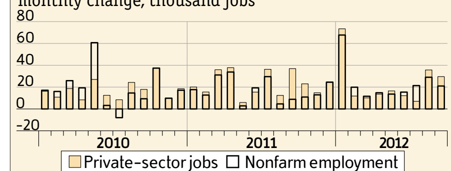
*A positive number indicates that the state has a bigger share of jobs (versus the nation as a whole) in better performing industries. In case of Texas, the mining sector is the best example. Mining accounts for nearly 3% of all private sector jobs in Texas versus just 0.8% nationwide. Yet this industry grew more than six times faster compared to the pace of job creation in the entire private sector.
Source: The U.S. Bureau of Labor Statistics, The Bleyzer Foundation



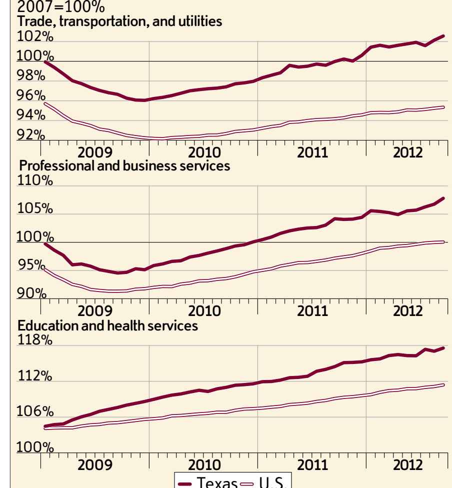
Decomposition of the employment change in Texas and California
December 2009 to September 2012, thousand private-sector jobs

*A positive number means that the sector added jobs at a faster pace than the overall growth rate of private sector employment.
Source: The U.S. Bureau of Labor Statistics, The Bleyzer Foundation

industries.



Job creation in Texas
monthly change, thousand jobs
Source: The U.S. Bureau of Labor Statistics



Jobs in the service-providing sectors
2007=100%
These three sectors account for over 55% of all private sector jobs in Texas and nationwide.
Source: The U.S. Bureau of Labor Statistics

Texas added nearly 700,000 new private-sector jobs since the labor market recovery started in earnest at the end of 2009. About 45% of these jobs came as a result of more enthusiastic hiring by local businesses versus a more sluggish pace of job creation nationwide. On that note, the Texas labor market outshines many other large state economies – for example, less than 15% of new private-sector jobs in California can be attributed to the competitiveness of that state (see chart 17). A closer look at sector specific job gains may help explain a stronger labor market turnaround in Texas. First, nationwide, most new private sector jobs created since December 2009 were in the service-providing sector thanks, in particular, to solid job growth in education and healthcare, and business and professional services. Indeed, only about one in nine private sector jobs were either in mining, manufacturing or construction. Yet, in Texas, about one in five new private-sector jobs came from goods-producing industries. This means that the state's goods-producing sectors added jobs faster than the nation as a whole, which attests to their underlying competitiveness. On the other hand, employment in construction and manufacturing has barely changed in California over the past three years (see chart 18) as these industries struggled to regain lost footing.

Equally important, chart 18 shows that a big portion of new private jobs in Texas service-providing industries (from about a third in business and professional services to over half in trade, transportation and utilities) can be attributed to state-specific factors that sustained more rapid growth versus the nation as whole. As the weight of these sectors in the Texas economy grows they will exert a stronger impact on the regional labor market. Thus, because a sizable share of new jobs in Texas is supported by a more dynamic local economy, the state is likely to outperform other U.S. regions in job creation, as its leading industries are getting bigger.

Lastly, September's employment numbers indicate that the Texas labor market continued to add jobs at a robust pace. In particular, about 30,000 new private-sector jobs were created in Texas (see chart 19) thanks to increasing employment in manufacturing (up by 3.8 thousand jobs in September), professional and business services (up by 13.6 thousand), education and healthcare (up by 6.6 thousand), trade, transportation and utilities (up by 9.1 thousand), and leisure and hospitality (up by 3.7 thousand). In fact, as we argued in the previous paragraph, faster growth rates in the Texas service-providing industries are sustaining job creation in the Lone Star State (see chart 20). Indeed, during the first three quarters of 2012, Texas created about 210,000 new private jobs or just 6,000 jobs (3%) less than in the same period a year ago. Meanwhile, the national private sector gained 16% less jobs in the first three quarters of this year compared to the same three quarters of 2011. As a result, the share of Texas in national job creation increased from 13.9% a year ago to 16% in January-September 2012.

Monetary Policy and Asset Prices

In September, the Federal Reserve announced its third round of quantitative easing, which will be implemented through the monthly

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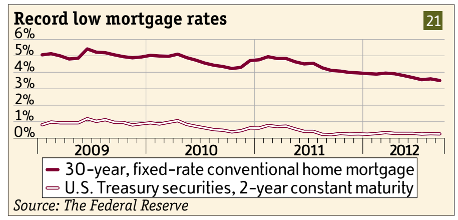
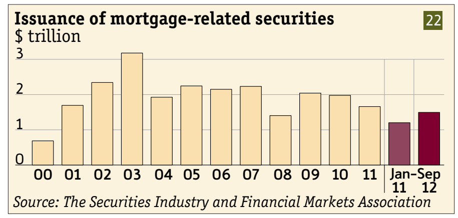
purchases of $40 billion of agency mortgage-backed securities.[3] Its main purpose is to keep long-term interest rates at levels that support residential mortgage markets. Record low borrowing costs (see chart 21) breathe much needed life into the housing market. For example, in its latest U.S. Economic and Housing Market Outlook, Freddie Mac gave credit to the Fed for the positive impact of its accommodative monetary policy on housing activity. More than that, Freddie Mac projects that about 7 million homeowners will refinance in 2012, which may result in total savings of $15 billion. There are signs that mortgage lending is recovering as well. According to the Securities Industry and Financial Markets Association, the issuance of new mortgage-related securities in the first three quarters of 2012 was 24% higher than a year ago (see chart 22). And according to the CRE Finance Council, September was the busiest month for the issuance of commercial mortgage based securities since the economic downturn.

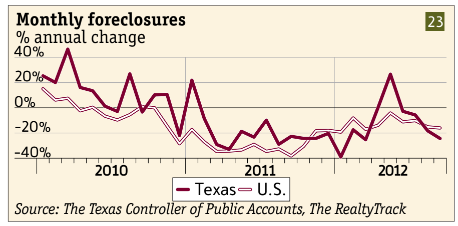
Not surprisingly, high housing affordability and record low mortgage rates are pushing up home buyer demand - houses are being sold faster and at higher prices. According to the National Association of Realtors, in September existing home sales were 11% higher than a year ago, while the national median existing-home price posted a gain of 11.3%. Meanwhile, the amount of time homes are staying on the market shortened to 95 days from 107 days a year earlier. Turning to Texas, the Real Estate Center at the Texas A&M University says that home sales saw an annual increase of 9% in September and median prices were 7% higher than a year ago. Equally important, foreclosures continued to decline both in Texas and nationwide (see chart 23), which points to improving financial conditions of American homeowners. And since Texas is one of the states where foreclosures do not have to be court-approved, this drop is a genuine sign of progress rather than a symptom of a backlog of delayed foreclosures, which pushes up foreclosure activity in such judicial foreclosure states such as Florida, New Jersey and New York (see chart 24).



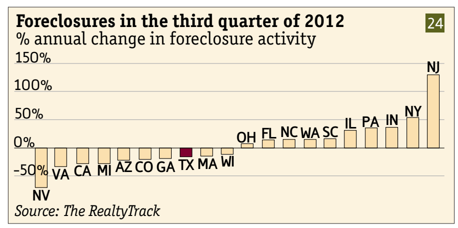
Source: The Federal Reserve



Source: The Securities Industry and Financial Markets Association



Source: The Texas Controller of Public Accounts, The RealtyTrack



Source: The RealtyTrack

[3]Securities issued by government-sponsored enterprises such as Ginnie Mae, Fannie Mae or Freddie Mac.

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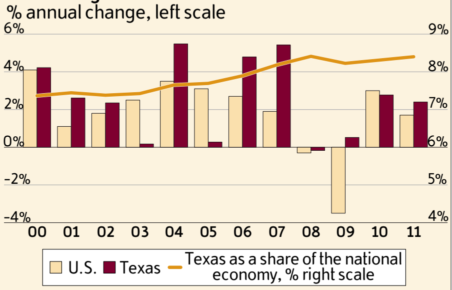
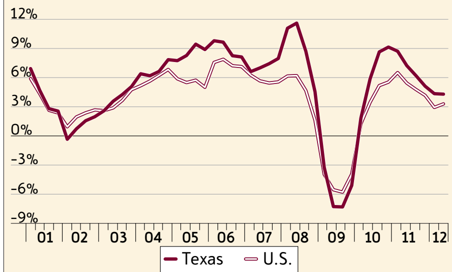
Economic growth: Texas vs. U.S.
% annual change, left scale



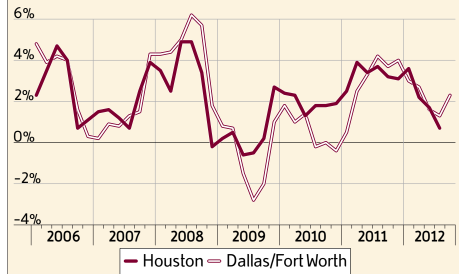
Source: The U.S. Bureau of Economic Analysis

Personal income
seasonally adjusted at annual rates, % annual change



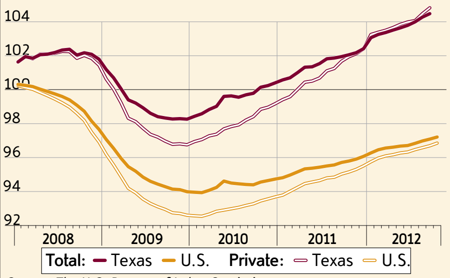
Source: The U.S. Bureau of Labor Statistics

Consumer prices
% annual change, data in alternating months



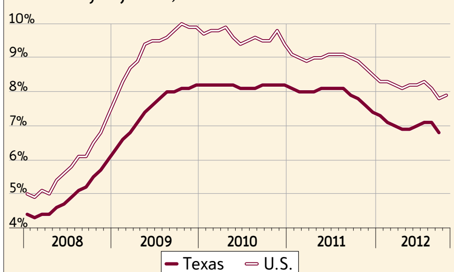
Source: The U.S. Bureau of Labor Statistics

Nonfarm employment
2007=100



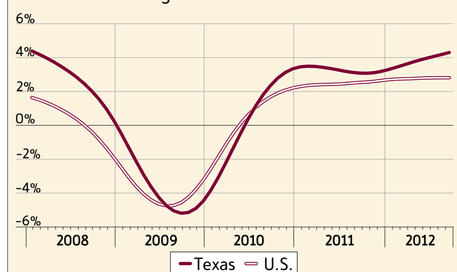
Source: The U.S. Bureau of Labor Statistics

Unemployment rates
seasonally adjusted, %



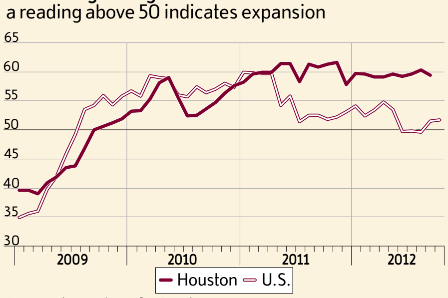
Source: The U.S. Bureau of Labor Statistics

State Coincident Indexes
12-month % change



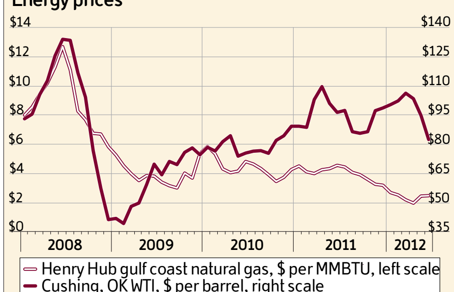
Source: The Federal Reserve Bank of Philadelphia

Purchasing Managers Index
a reading above 50 indicates expansion



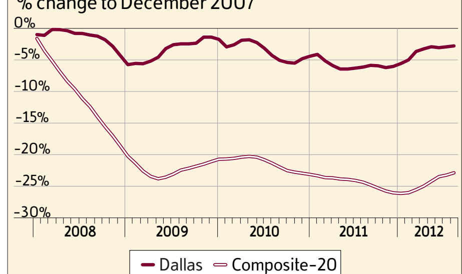
Source: The Institute for Supply Management

Energy prices



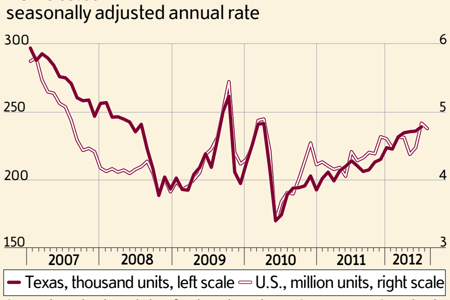
Source: The U.S. Energy Information Administration

Home values
% change to December 2007



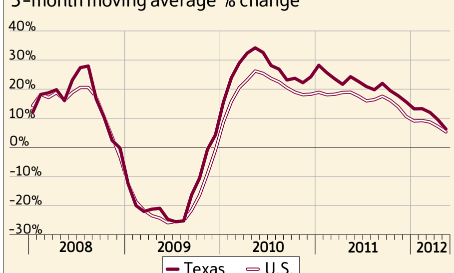
Source: The S&P/Case-Shiller Home Price Indices

Home sales
seasonally adjusted annual rate



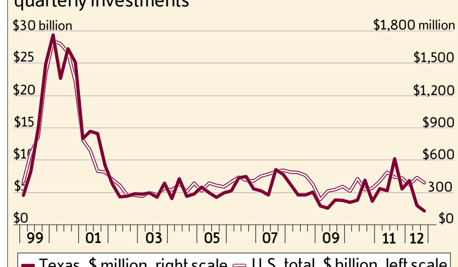
Source: The National Association of Realtors, The Real Estate Center at Texas A&M University

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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