SigmaBleyzer

Texas Economic Update

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

March 2014

- **In January, the jobless rate in Texas dropped to 5.7%, its lowest level in over five years.**
- **Texas factory activity grew stronger during the first two months of 2014.**
- **In February, the Houston Purchasing Managers Index jumped to its highest reading in four months.**

Executive summary

U.S. economic recovery proceeded at a somewhat slower pace at the start of this year, as unusually cold weather may have dampened business activity in construction and retail sectors. In addition, growing borrowing costs and increasing home values may have started to cool housing demand on falling housing affordability. Indeed, although February saw a pickup in factory output, business activity in non-manufacturing sectors weakened.

In January, retail sales saw their second consecutive monthly drop on falling car sales, which in January stood at their lowest level in over a year. On the upside, auto sales strengthened in February, leading to a modest uptick of consumer spending. Continued recovery in the jobs market is boosting consumers' income and sustaining recent gains in consumer confidence. In addition, increasing housing prices and solid gains on equity markets helped push households' net worth above $80 trillion last year. These improving household balance sheets are supporting consumers' demand for borrowing; in January, the volume of outstanding nonrevolving consumer credit (mostly car loans) grew at a 7.5% annual rate, following an 8% increase in 2013.

Meanwhile, worries over slow economic growth, regulatory burden and borrowing costs have been weighing on business sentiment. These uncertainties may discourage companies from pursuing more aggressive expansion plans. New orders for durable goods dropped by 1% in January versus the month before due to broad deceleration across major industrial sectors. Admittedly, the monthly data on new orders for durable goods tends to be highly volatile. However, a combination of falling orders, slowing business sales and accumulating inventories may point to weaker economic growth at the start of 2014. On the upside, new orders for non-defense capital goods bounced back in January, indicating that higher investment spending should help partly offset weakness in other parts of the economy.

Turning to Texas, factory activity in the Lone Star State strengthened during the first two months of 2014, while hiring in manufacturing improved for the third straight month. The mining industry and growing expansion of shale oil and gas exploration remains a big factor in the Texas success story. In January 2014, Texas had over 55% more mining jobs than the trough employment level in that industry four year ago. And in February, the Houston Purchasing Managers Index jumped to its highest level in four months thanks, in part, to the metro's booming petrochemical industry.

Clearly, Texas and other shale gas producing states have benefited from recent advancements in technology – shale gas production in Texas has tripled since 2007. And by providing new well-paid jobs, the mining industry has had a significant indirect impact on business activity and employment in the rest of the local economy. Yet private sector jobs in non-mining industries in other oil and gas producing states are still struggling to catch up with Texas. In essence, because Texas is a large diversified economy with established leadership in the petrochemical industry, its mining industry has been supporting a much broader turnaround of the regional economy compared to other shale gas producing regions.

The Texas job market continued to expand in January, adding nearly 34 thousand nonfarm jobs thanks to broad-based gains across major sectors. As a result, the state's jobless rate dropped to 5.7% – its lowest reading since November 2008, remaining a full percentage point below the national unemployment level. Thus, while private sector employment is just about where it was at the start of the Great Recession nationwide, Texas has nearly 9% more private sector jobs than six years ago. In fact, driven by a rapid rebound of jobs in goods-producing industries, the pace of hiring in the Texas private sector has been ahead of the national trend since the start of the economic recovery in mid-2010. In addition, contrary to the nationwide trend, private sector jobs growth has been accelerating in Texas since November 2013 and, in January, stood at 3.2% compared to the same month a year ago or a full percentage higher than the nation as a whole.

To conclude, January's employment data painted a rather promising picture – the private sector saw its strongest employment gain since February 2013. Jobs growth in mining and construction accelerated for the second straight month. Meanwhile, the annual employment growth in trade, transportation and utilities, the biggest sector by the number of private jobs, stood at its best reading since the start of the economic recovery. Jobs growth in education and healthcare remained strong

Investor Relations: Joshua Ballard
(E) jballard@sigmableyzer.com

Chief Economist Edilberto L. Segura
Editor Rina Bleyzer O'Malley

thanks to continued expansion of the healthcare industry and a strong gain of employment in education. New hiring in leisure and hospitality proceeded at above 4% annually. Finally, as a sign of regional public finances returning to more solid footing, the local and state government continued to increase employment, with the local government recording the fastest jobs growth in over four years.

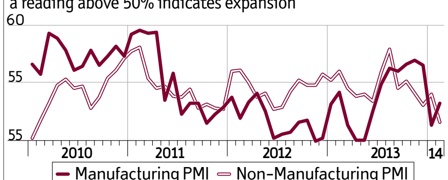
Economic output

The national economy continued to expand in 2014, albeit at a somewhat slower pace compared to the last quarter of 2013. Although February saw a pickup in factory output, business activity in non-manufacturing sectors weakened (see chart 1). Unusually cold weather may have dampened homebuilding activity as the number of housing starts, which are strongly affected by weather, and the issuance of building permits dropped in January (see chart 2). Colder weather aside, January marked the second straight month and the third straight month of falling construction permits and starts, respectively. This, coupled with a downtrend in home sales, implies that higher borrowing costs and increasing home values may have started to cool housing demand due to falling housing affordability.

The retail industry may have been hit by the cold weather as well – in January, total retail sales saw a second consecutive monthly drop, shrinking by 0.6% against the last month of 2013. Falling car sales, which in January stood at their lowest level in over a year (although they still run at above 15 million units annually – see chart 3), remained a drag on the retail sector. On the upside, auto sales strengthened in February, bringing a modest 0.3% monthly rebound of retail sales. Businesses continued to create new jobs, albeit at a moderate pace, boosting consumers' income and sustaining recent gains in consumer confidence (see chart 4). In addition, according to the Federal Reserve, increasing home values and strong gains on the equity markets helped push households' net worth above $80 trillion in 2013 (see chart 5). This improving household financial position appears to support consumers' demand for borrowing – in January, the volume of outstanding nonrevolving consumer credit – mostly car loans, grew at a 7.5% annual rate following an 8% increase in 2013.

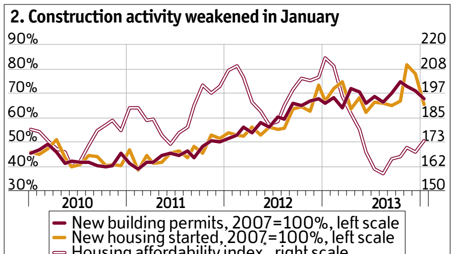
Meanwhile, business sentiment retreated somewhat from its year-end highs as worries over sluggish economic growth, an increasing regulatory burden and higher borrowing costs have been weighing on companies' willingness to expand. Business sales are entering a downtrend (see chart 6), reducing the need to place more orders for durable goods (see chart 7). Thus, in January, new orders for durable goods dropped by 1% versus the month before, although admittedly this was mostly due to falling orders for civilian aircraft. This more volatile component of durable goods orders aside, January's data revealed a broad deceleration across major industrial sectors; in particular, new orders for machinery, motor vehicles and parts, computers, household appliances and furniture registered monthly declines. One notable exception is new orders for mining machinery, which increased by over a quarter in January

1. The national factory activity improved in February
PMI - Purchasing Managers Indices, a reading above 50% indicates expansion



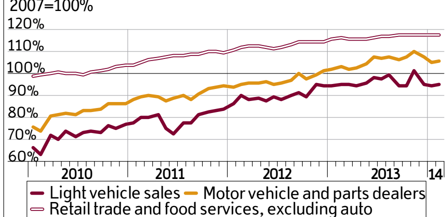
Source: The Institute for Supply Management

2. Construction activity weakened in January



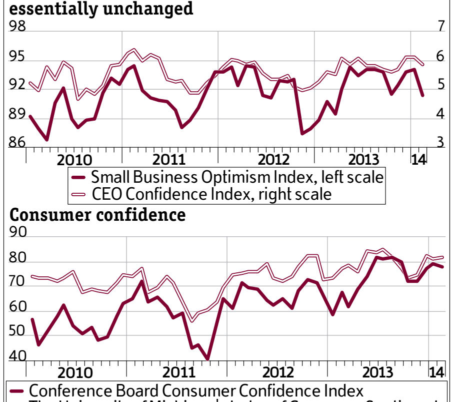
Measures the degree to which a typical family can afford the monthly mortgage payments on a typical home. Value of 100 means that a family with the median income has exactly enough income to qualify for a mortgage on a median-priced home. An index above 100 signifies that family earning the median income has more than enough income to qualify for a mortgage loan on a median-priced home, assuming a 20 percent down payment.
Source: The Federal Reserve Bank of St. Louise

3. Car sales weakened at the start of 2014
2007=100%



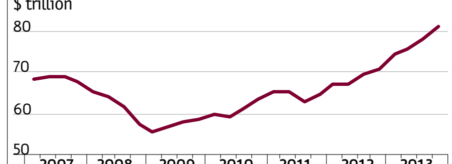
Source: The U.S. Census Bureau

4. Business and consumer sentiment remained essentially unchanged



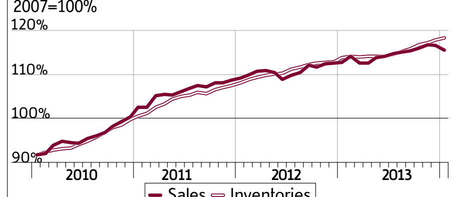
Source: The Conference Board, Haver Analytics, Chief Executive Magazine, The National Federation of Independent Business

5. Households' net worth reached a new high
$ trillion



Source: The Federal Reserve

6. Total business sales and inventories
2007=100%



Source: The U.S. Census Bureau

7. New orders of durable goods
2007=100%

Source: The U.S. Census Bureau

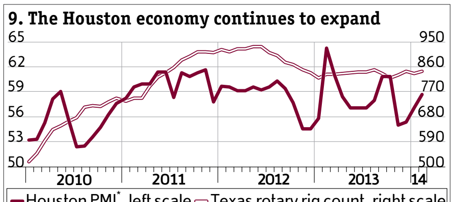
driven by the booming shale oil and gas industry. Still, notwithstanding the fact that the monthly data on new orders for durable goods tends to be highly volatile, a combination of falling orders, slowing business sales and accumulating inventories may point to weaker economic growth at the start of 2014. On the upside, new orders for non-defense capital goods bounced back in January. And because on average it takes companies longer to manufacture capital goods, this higher investment spending should help partly offset weakness in other parts of the economy.

8. Texas factory strengthened in January and February
Manufacturing Activity Indices,
The Texas Manufacturing Outlook Survey

Source: The Federal Reserve Bank of Dallas

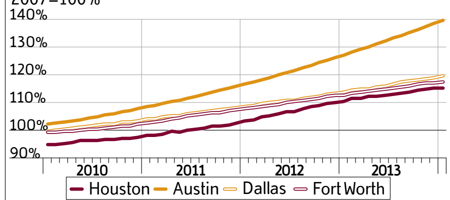
Turning to Texas, factory activity strengthened during the first two months of 2014, while hiring in manufacturing improved for the third straight month (see chart 8). Higher energy prices and, thus, a continued expansion of the mining sector, remain a key driver of the regional economy. In February, the Houston Purchasing Managers Index jumped to its highest reading in four months (see chart 9) thanks, in particular, to the metro's booming petrochemical industry. In fact, a nearly 40% jump of energy exports compared to the first month of 2013 helped Texas increase its export revenues by 11% in January, versus only a 3.4% increase nationwide. More than that, exports of industrial machinery and computers from Texas posted a solid gain of about 10% in January thanks to strong sales of semiconductors. Nationwide, exports of

9. The Houston economy continues to expand



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

10. Texas Business Cycle Indices
2007=100%

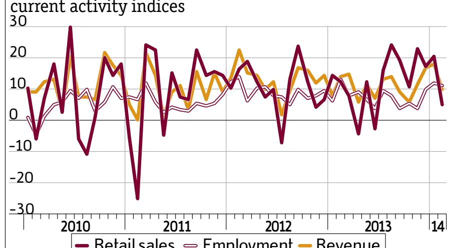


Source: The Federal Reserve Bank of Dallas

machinery and computers were up by less than 2% in January. This export driven resurgence of high tech manufacturing helps explain the rapid growth of the Austin metro economy (see chart 10) – home to the state's biggest information technology cluster.

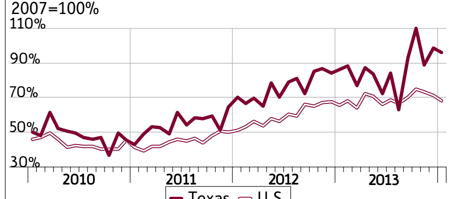
Texas service industries continued to expand in February, albeit at a somewhat slower pace compared to the stronger start of the year (see chart 11). On the upside, the employment index remained at its highest level in twelve months, indicating a pickup of hiring across major service-providing industries. And despite the impact of higher borrowing costs, homebuilding activity in Texas appears to be holding up better versus the nation as a whole (see chart 12). After all, according to the Real Estate Center at the Texas A&M University, housing availability in Texas dropped to its lowest level on record, or a 3.4-month supply at the current sales pace. Nationwide, housing supply is at about 5 months; according to the National Association of Realtors,

11. Texas Service Sector Outlook Survey
current activity indices



Source: The Federal Reserve Bank of Dallas

12. New housing units authorized by building permits
2007=100%

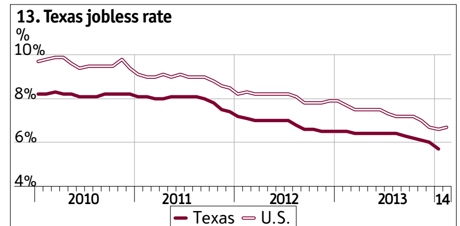


Source: The Federal Reserve Bank of St. Louise

a supply of 6-6.5 months indicates a housing market in rough balance between buyers and sellers. This tighter housing supply in Texas means that the state's construction sector will be strong thanks to increasing demand for residential properties. Meanwhile, a steady expansion of the Texas economy is sustaining demand for retail, industrial and office space – according to the Texas Controller of Public Accounts, January was the best month for the value of contracts for non-residential construction since September 2010.

Employment

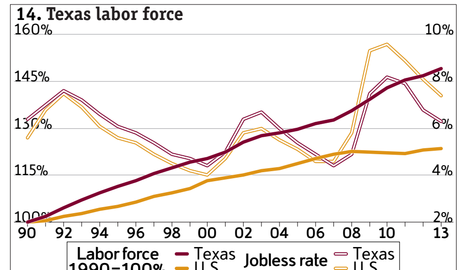
13. Texas jobless rate
%



Source: The U.S. Bureau of Labor Statistics

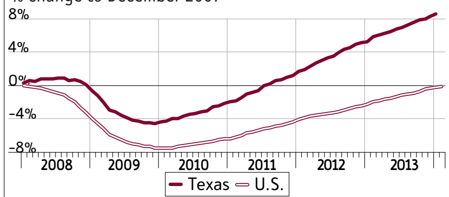
After growing by 2.3% in 2013, the Texas job market continued to expand in January, adding nearly 34 thousand jobs thanks to broad-based gains across major sectors. As a result, the state's unemployment rate dropped to 5.7%, its lowest level since November 2008, remaining a full percentage point below the national jobless rate (see chart 13). More than that, over the past six years the labor force in Texas grew by over 12% (versus just 1.5% nationwide), while the state's jobless rate remained consistently below the national average (see chart 14). These trends imply that the state's economy and the regional labor market are recovering stronger than the nation as a whole.

14. Texas labor force



Source: The U.S. Bureau of Labor Statistics

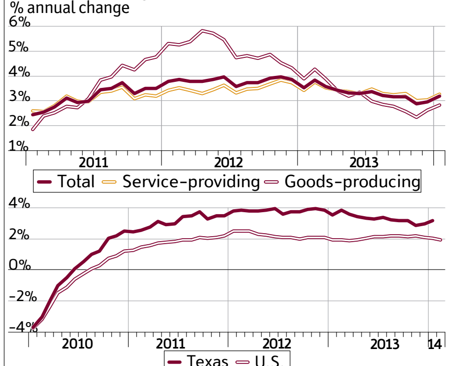
15. Private sector jobs
% change to December 2007



Source: The U.S. Bureau of Labor Statistics

In particular, nationwide, private sector employment is just about where it was at the start of the Great Recession; Texas has nearly 9% more private sector jobs than in December 2007 (see chart 15). Driven by a rapid rebound of jobs in goods-producing industries (see chart 16), the pace of hiring in the Texas private sector has been ahead of the national trend since the start of the economic recovery in mid-2010. An acceleration of jobs growth in the Texas good-producing and service-providing industries is a more recent trend that stretches back to November 2013, following a slowdown of hiring in mining and construction in mid-2013. In January 2014, private employment in Texas was up by 3.2% compared to the same month a year ago, or a full percentage more than the U.S. trend.

16. Private sector jobs in Texas
% annual change



Source: The U.S. Bureau of Labor Statistics

The booming energy industry, on growing expansion of shale oil and gas exploration, is a big factor in the Texas success story. Indeed, in January Texas had over 55% more mining jobs than during the trough employment level at the end of 2009. As a result, mining jobs now account for about one in six goods-producing jobs in the Lone Star State compared to less than 12% six years ago. Nationwide, mining provides only 5% of all goods-producing jobs. Obviously, Texas and other shale gas producing states, such as Louisiana, North Dakota, Oklahoma, Pennsylvania and Arkansas, have benefited from advancements in shale gas extraction technology; shale gas production in Texas has tripled since 2007 (see chart 17). Yet, the private sector jobs in non-mining industries in those other states are still struggling to catch up with Texas (see chart 18). In essence, by creating well-paid jobs, the mining industry has a significant indirect impact on the non-oil part of the local economy. And because Texas is a big and diversified economy with established leadership in the petrochemical industry, its mining industry has been supporting a much broader turnaround of the regional economy compared to other shale gas producing states.

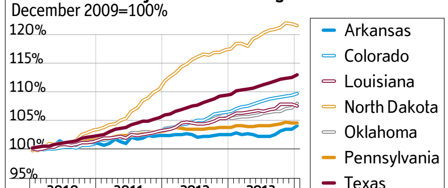
17.Gross withdrawals from shale gas wells
trillion cubic feet

	2007	2012
U.S.	1.99	10.3
Texas	**1.26**	**3.66**
Louisiana	0.01	2.13
Pennsylvania	0.00	2.04
Arkansas	0.08	1.02
Oklahoma	0.08	0.50
Colorado	0.14	0.23
North Dakota	0.01	0.22

Source: The U.S. Energy Information Administration

To conclude, January's employment data paints a rather promising picture – the private sector added 33.7 thousand jobs, the strongest gain since February 2013. In particular, jobs growth in mining and construction accelerated for the second straight month. Meanwhile, the annual employment growth in trade, transportation and utilities, the biggest sector by the number of private jobs, stood at 3.5% – its best reading since the start of the economic recovery.

18. Private sector jobs in non-mining sectors
December 2009=100%

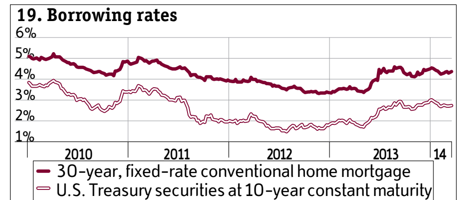


North Dakota is an outlier, as its shale gas industry is a substantial part of the state's economy – nearly 8% of all private sector jobs in North Dakota are in mining versus just 3% in Texas. In addition, the total number of private jobs in North Dakota is just about 15% of all private jobs in Houston.
Source: The U.S. Bureau of Labor Statistics

The number of new jobs in education and healthcare stood at 7.1 thousand thanks to continued expansion of jobs in healthcare and a strong gain in employment in education. The jobs growth in leisure and hospitality proceeded at above 4% annually. Finally, as a sign of regional public finances returning to more solid footing, the local and state government continued to increase employment, with local government, which provides jobs to about one in eleven employed Texans, recording the fastest jobs growth in over four years.

Monetary Policy and Asset Prices

19. Borrowing rates

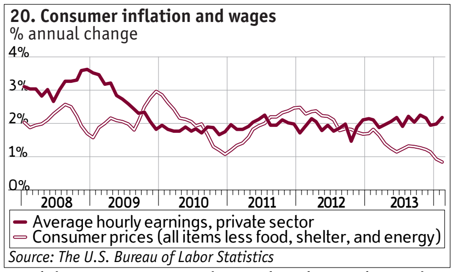


Source: The Federal Reserve

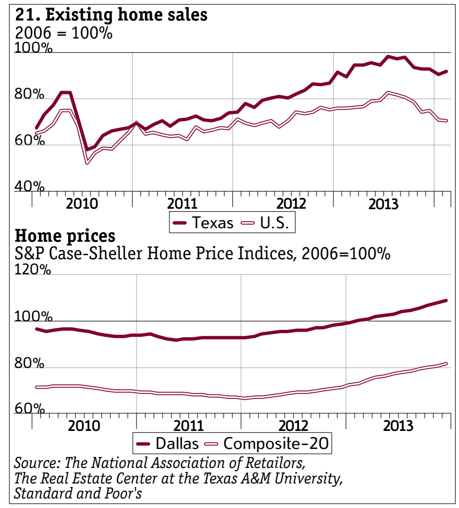
Uncertainties over the trajectory of borrowing costs continued to dominate financial markets during the first months of the year. As expected, the Federal Reserve continued to scale back its asset purchase program, reducing the pace of monthly bond-buying by another $10 billion to $55 billion. Meanwhile, anticipations that policy rates could rise sooner than expected, following a more upbeat assessment of the current economic situation by the Fed, has kept long-term borrowing costs on an uptrend (see chart 19).

In particular, although consumer prices are still expected to grow at about 2%, the Fed now forecasts labor wage growth to accelerate above the rate of inflation. This projection marks the first time in seven years that the Fed expects consumer prices to grow slower than wages. Although inflation still remains well within the Fed's implicit target of about 2% (see chart 20), stronger economic data is increasingly perceived by investors as a potential trigger for tighter monetary policy to dissipate inflationary risks.

Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 6213111 Fax: +1 (713) 6214666
Email: sbleyzer@sigmableyzer.com



A big concern is whether housing demand can remain resilient as mortgage rates continue to climb. The national data may already imply that higher borrowing costs and increasing home values are starting to hurt existing home sales – according to the National Association of Realtors, in February existing home sales dropped to their lowest level since mid-2012 (see chart 21). Admittedly, unusually cold weather has partly depressed activity on the residential housing market at the start of 2014. More importantly, higher housing prices (in February, the median price was 9% higher than a year ago) and a jump in the mortgage rate by nearly a full percentage point over the past twelve months, are throwing sand in the wheels of the housing recovery. On the upside, growing home values reflect a falling share of distressed homes, which usually sell at a big discount. In February, distressed homes accounted for only 16% of all sales versus a quarter of all sales a year ago. And housing affordability remains well above its level at the start of the financial crisis. Meanwhile, tight supply on the housing market and an ongoing labor market recovery should sustain a reasonably healthy level of business activity in the housing sector, even as the Fed continues to tighten its monetary stance.



Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 6213111 Fax: +1 (713) 6214666
Email: sbleyzer@sigmableyzer.com