

Regional

Regional Economy Presents Mixed Picture

September 17, 2015

While the Texas economy has picked up in recent months and offered glimmers of hope, some dark clouds have returned. July employment grew a strong 3.7 percent, but the jump is largely attributable to a rebound in the goods-producing sector, which is likely to slow again in coming months. Weakness in August's Texas Business Outlook Surveys and a decline in the Texas Leading Index also temper the July performance.

The state is beginning to see another round of deterioration from the recent fall in oil prices, although the slippage is smaller than it was earlier this year. Exports are down year over year, and the strengthening of the U.S. dollar and some global uncertainty pose additional downside risks to the Texas economy. However, Texas is still adding jobs, unemployment remains low and real estate activity is generally solid.

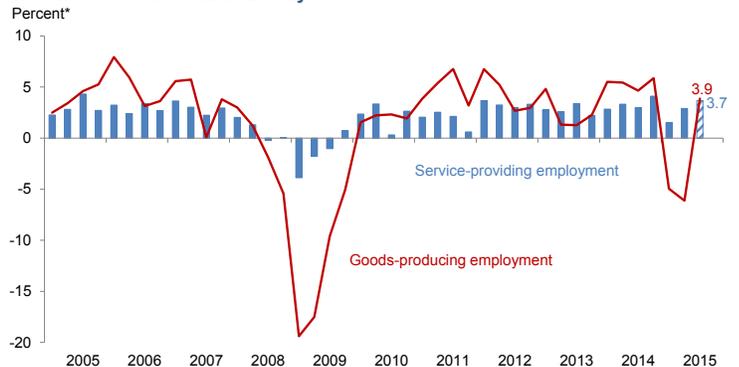
Goods-Sector Rebound Boosts Employment

Texas job growth is an annualized 1.3 percent year to date through July, weaker than last year's 3.6 percent rate. The goods-producing sector added jobs at an annualized 3.9 percent rate in July after posting fairly sharp declines in the first two quarters of the year (*Chart 1*). The most staggering rally was in the construction industry, which added jobs at an 8.8 percent annual rate in July after four consecutive months of declines. With extended wet weather delaying construction activity earlier in the year, the July spike is not surprising. The manufacturing industry also saw employment gains in July after hemorrhaging jobs for several months, and employment declines in the energy industry abated notably. The rebound in these sectors is not likely to continue as the construction catch-up effect peters out and, more notably, as a second round of oil price declines affect the manufacturing and energy industries.

Manufacturing Data Suggest Slowing

After five months of declines, manufacturing activity came in flat in August, as indicated by the near-zero reading of the Texas Manufacturing Outlook Survey (TMOS) production index (*Chart 2*). While this is an im-

Chart 1
Goods Sector Rebounds in July



* Quarter/quarter; seasonally adjusted, annualized rate.

NOTE: Quarterly employment is the last month of the quarter, except third quarter 2015, which reflects the July-over-June change.

SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

provement, forward-looking indicators in the survey paint an ominous picture. The survey's demand measure—the new-orders index—plunged 13 points to -12.5 in August.

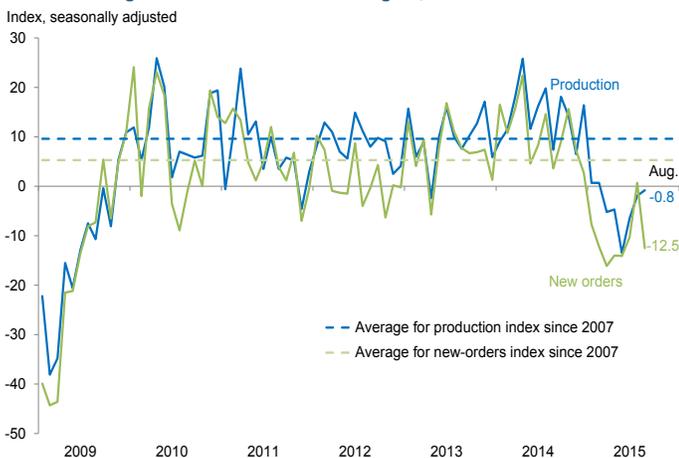
Texas Service Sector Outlook Survey (TSSOS) data show a slowdown in growth. The TSSOS revenue index posted its highest reading this year in July, mirroring July employment data, but it retreated in August to 9.3. The revenue index has averaged 12.4 year to date, well below the 2014 average of 20.8, and is also in line with employment data showing positive but markedly slower growth this year.

The retail sales index, a component of the TSSOS revenue index, dropped 15 points to -3.6 in August after posting positive readings in June and July. While this index has been quite volatile this year, the average reading has been much lower than in 2014 and reflects how the oil-related slowdown in Texas has dampened consumer spending. Another dampening factor has been the depreciation of the peso, which has lost 12 percent of its value against the dollar since December, significantly hurting retail sales along the border and, to a lesser degree, in areas such as San Antonio and Houston.

Housing Prices Continue to Rise

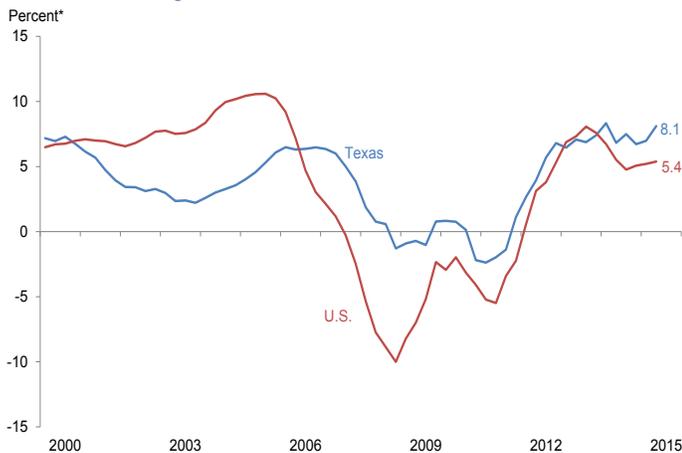
Home prices continue to climb at an unprecedented rate. The Federal Housing Finance Agency (FHFA) house price index for Texas rose 1.8 percent in the second quarter and is up a re-

Chart 2
Manufacturing Production Stabilizes in August, but New Orders Fall



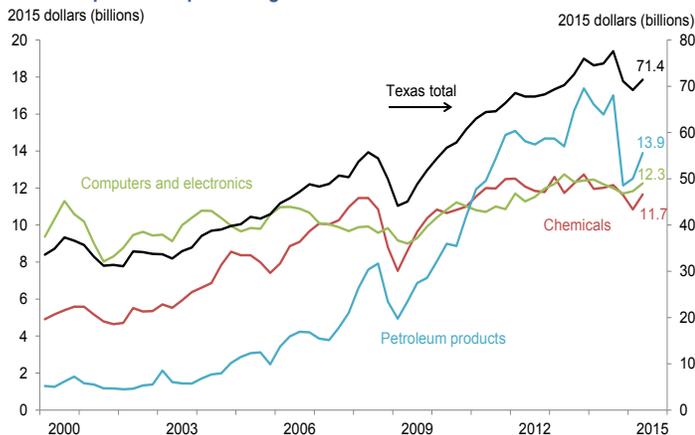
SOURCE: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS).

Chart 3
House Prices Rising Faster in Texas than U.S.



SOURCE: Federal Housing Finance Agency.

Chart 4
Texas' Top Three Export Categories Rise in Second Quarter



NOTE: Shares of Texas exports are as follows: Petroleum products (19.4 percent), computers and electronics (17.2 percent) and chemicals (16.3 percent).

SOURCES: Census Bureau; WISERTrade; adjustments by the Federal Reserve Bank of Dallas.

markable 8 percent from last year (*Chart 3*). This pace is notably faster than the rise in U.S. home values. However, quarter-over-quarter appreciation in Texas was slightly slower in the second quarter than in the first, a sign that some cooling may be ahead.

Energy Sector Faces Second Round of Oil Price Declines

The Texas rig count appeared to bottom out in June and rose 3.4 percent from the June weekly average to the first week of September. However, the second drop in oil prices may hinder the nascent recovery. Oil prices started sliding again as the average monthly oil price in August was down 16 percent from July. Natural gas prices have been weak all year but fairly stable over the summer.

Demand for oilfield services has remained depressed over the past six weeks despite a modest uptick in drilling in the Permian Basin. In addition to more layoffs, further cuts to capital spending have been announced. However, these cuts are smaller than they were in the initial round and are expected to be the last cutbacks for 2015. Multiple business contacts report that the credit situation is worsening for small to mid-size producers as balance sheets deteriorate and the likelihood of a significant increase in oil prices declines. In general, more contacts are resigned to "lower for longer" oil prices.

Exports Rebound but Are Still Down From Last Year

Texas exports rose 3.2 percent in the second quarter following two quarters of declines. Exports to Texas' top two trading partners, Mexico and Canada, increased in the quarter. Overall growth was led by Texas' biggest export category—petroleum products—which benefited from temporarily higher oil prices. Exports of chemicals and of computers and electronics, which round out Texas' top export categories, also increased markedly in the second quarter (*Chart 4*). Exports were down 5 percent year over year, however, and the weakness is reflective of lower oil prices, weaker global demand and a higher dollar—all factors that may continue to dampen Texas trade in coming months.

Manufacturing Prices Continue to Fall

Prices have been declining in the manufacturing sector since January, according to TMOS data, and this downward price pressure accelerated notably in August. The finished goods price index declined 13 points to -15.7, hitting its lowest level since October 2009, when Texas was working its way out of the recession (*Chart 5*). While prices on the services side had been slowly rising over the past few years, according to TSSOS, this upward pressure dissipated in August.

Texas Economy Shows Resilience

After rising in April and May, the Texas Leading Index has posted two months of declines, largely due to lower oil

prices and a stronger dollar (*Chart 6*). Further deterioration of the leading index is likely in August as oil prices dropped further from July and the dollar strengthened.

Despite the energy bust and other headwinds, the resilient Texas economy is set to add jobs this year. The Dallas Fed forecast for Texas employment growth is 1.3 percent in 2015. While this is the same rate the state has seen year to date through July (annualized), it is a percentage point lower than the May-to-July average and is down sharply from last year's 3.6 percent rate.

—Emily Gutierrez and Emily Kerr

About the Authors

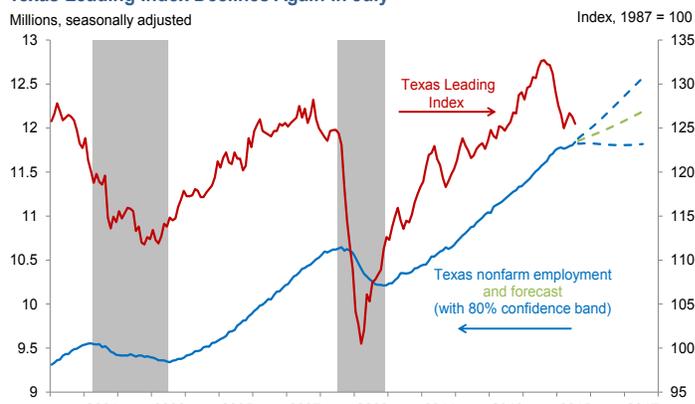
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Chart 5
August Survey Data Suggest Falling Prices



SOURCES: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS).

Chart 6
Texas Leading Index Declines Again in July



NOTES: Shaded areas represent Texas recessions. July value of Texas Leading Index estimated using the U.S. trade-weighted value of the dollar.
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; Federal Reserve Bank of Dallas.