

Texas Economy Strengthening December 16, 2010

The district economy continues to expand at a moderate pace, with recent signs of a pickup in growth after some slowing over the summer. Growth in total nonfarm jobs and manufacturing and energy production has recently increased, although the construction sector continues to be a drag. Leading indicators have generally been increasing over the past three months.

Job Growth Sees Slight Improvement

Total employment grew at a 3 percent annualized rate in October compared with a slight decline in September. A key source of the rise in total nonfarm employment was a partial bounceback in state and local government jobs after declines in the previous two months. Private sector jobs also edged up in October, growing at a 2.3 percent annualized rate, versus 1 percent in September.

Leading Index Signals Slightly Improved Pace of Job Growth

The Texas Leading Index increased for the second month in a row in October after falling in May, June and August (*Chart 1*). With the exception of the Help Wanted Index, the leading index components have been either flat or increasing. Declines in the Texas value of the dollar have been the biggest positive contributor to the increase in the leading index. Declines in the dollar relative to the countries to which Texas exports should provide further stimulus for Texas exports, which have increased strongly this year.

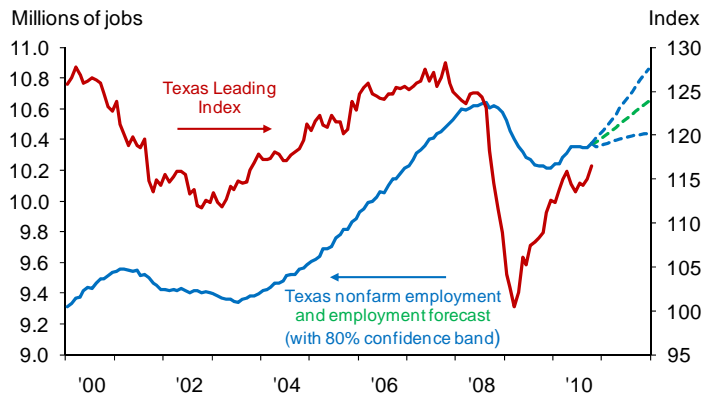
Stock prices of Texas-based companies have also increased solidly. Corporate profits in general have been one of the most positive indicators in the national economy, and the rise in stock prices in Texas is a reflection of growth in earnings and outlooks for companies in the state. Overall, movements in the leading index suggest that job growth will be about 2.4 percent in 2011, slightly faster than the 1.9 percent for 2010.

Consumer and Business Confidence Climb

Other leading indicators have also been increasing. Consumer confidence in the West South Central states, which includes Arkansas, Louisiana, Oklahoma and Texas, is now at its highest level since August 2008 (*Chart 2*).

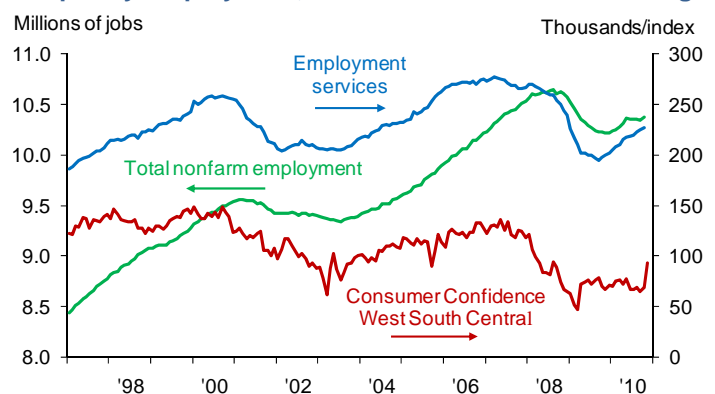
Employment agency jobs continue to grow at a healthy 15.2 percent annual pace through October. Jobs in employment agencies, which include temp jobs, typically begin to decline prior to the decline in total jobs and increase prior to the recovery in jobs. Dallas Beige Book respondents in this industry recently reported that there has been an increase in direct hires, a good sign that businesses are becoming more confident that demand will be sustained.

Chart 1
Job Growth Likely to Pick Up Slightly in 2011



SOURCES: Federal Reserve Bank of Dallas; Haver Analytics.

Chart 2
Temporary Employment, Consumer Confidence Growing



SOURCES: Conference Board; Federal Reserve Bank of Dallas; Haver Analytics.

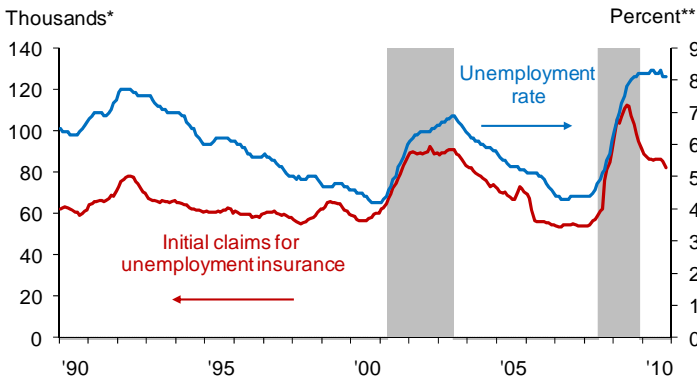
Initial Unemployment Claims Declining

Even though the Texas unemployment rate has only ticked down slightly this year, from 8.3 to 8.1 percent, initial claims for unemployment insurance have dropped by 31 percent since peaking in February 2009. In the past, such declines have led to steeper reductions in the unemployment rate (*Chart 3*). For example, from mid-2003 to the end of 2004, a similar decrease in initial claims coincided with a decline in the unemployment rate of 1.1 percentage points. During this period, job growth was 1.7 percent—slightly less than in 2010. Thus, the data on job growth and initial claims suggest that the unemployment rate is likely to fall more in 2011 than it has in 2010.

Manufacturing Shows Improvement

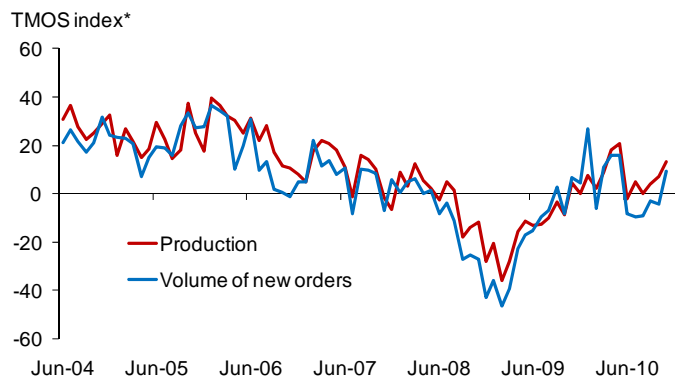
A key source of strength this year has been the manufacturing sector. While employment in this sector declined by 13 percent (120,000 jobs) between mid-2008 and December 2009, jobs have rebounded 1.8 percent this year.

Chart 3
Initial Claims Suggest a Drop in the Texas Unemployment Rate



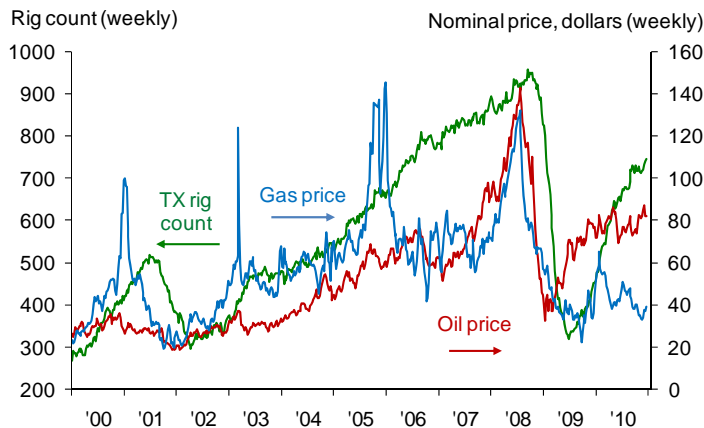
*Seasonally adjusted, six-month moving average.
**Seasonally adjusted.
NOTE: Shaded areas indicate Texas recessions.
SOURCES: Department of Labor; Haver Analytics.

Chart 4
Texas New Orders and Production Increase in November



*Seasonally adjusted
SOURCE: Texas Manufacturing Outlook Survey.

Chart 5
Rig Count Increasing



NOTE: Gas price is multiplied by 10.
SOURCES: *Wall Street Journal*; Baker Hughes, Inc; Haver Analytics.

Data from the November Texas Manufacturing Outlook Survey show 13.1 percent more respondents reported increases in production than reported decreases (*Chart 4*). The new orders index also increased strongly, the first increase in five months.

Along with the rise in new orders and increased production levels, manufacturers also became more optimistic about hiring over the next six months. Almost 38 percent more manufacturers expect to increase rather than decrease employment over the next six months, the largest percentage since February 2007.

Energy Sector Picking Up

The drilling rig count ticked up following some gains in oil prices (*Chart 5*). The disparity between oil and gas prices continues to drive more drilling toward oil. Beige Book contacts expect the overall rig count to level off or to increase more slowly through year-end as low natural gas prices continue to dampen drilling for gas.

Construction Still Weak

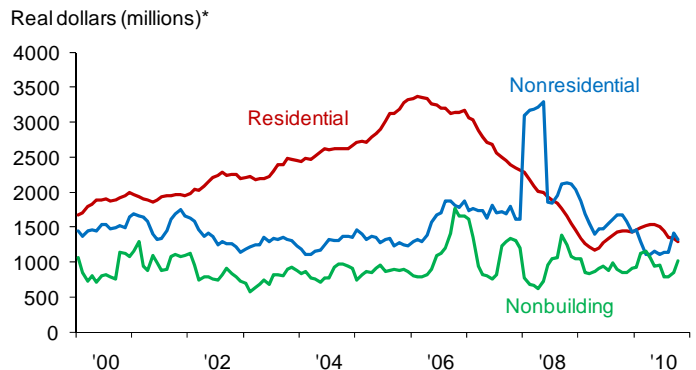
Most measures of Texas construction activity remain weak. The real value of residential construction continued to slide in October, and nonresidential activity fell after a slight pickup (*Chart 6*). According to the Beige Book, housing markets remain sluggish. Builders said sales weakened slightly in October after some firming in August and September. Real estate agents also said the higher end of the market is selling better, a reversal of the late 2009 and early 2010 trend. Prices were up slightly from year-earlier levels. Office construction is not likely to pick up anytime soon since vacancy rates remain elevated. One exception to the weakness in construction is a moderate boost in apartment construction. According to the Beige Book, apartment demand has risen steadily, and occupancies and rents have edged up.

—Keith R. Phillips and Yingda Bi

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Chart 6
Texas Construction Contract Values Remain Weak



*Seasonally adjusted, five-month moving average.
SOURCES: F. W. Dodge; Haver Analytics.