DALLASFED Economic Update

Regional

Regional Growth: Full Steam Ahead

September 18, 2014

The regional economy is surging, with the Texas Business Outlook Survey (TBOS) production and revenue indexes at multiyear highs and annualized job growth of 3.6 percent year to date. Second-quarter job growth was 4.6 percent annualized, and July job growth was just as fast. Energy production continues to increase, and the rig count has risen since last August in spite of a decline in oil prices. Texas exports rebounded in July.

Housing markets have cooled off just enough to slow the frenetic pace of house price appreciation the past three years; however, prices are still rising, construction is increasing and sales volume is rebounding.

Commercial real estate markets are also characterized by rising rents, continued construction and low vacancy rates, although there are early signs that activity may be slowing from very high levels.

Texas Job Growth Spikes; Dallas Heating Up

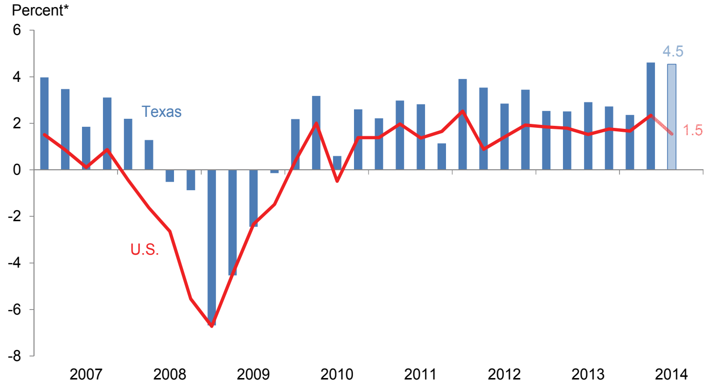
Texas employment grew an annualized 4.5 percent in July, about the same as the 4.6 percent growth realized in the second quarter—the strongest quarterly growth since 1997 (Chart 1). Employment gains are broad based, with the energy sector still adding jobs at a faster rate than all other sectors. The unemployment rate remained unchanged at 5.1 percent in July.

Among Texas metropolitan areas, Dallas has seen the fastest employment growth at 4.6 percent year to date, outpacing Austin and Houston. Employment has grown at a slightly slower rate in major metros with a relatively large federal government presence and/or manufacturing industry, namely San Antonio, Fort Worth and El Paso.

TBOS Indexes Indicate Continued Robust Growth

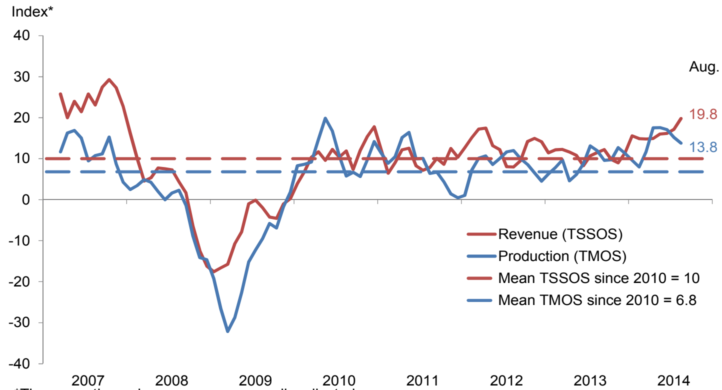
The three-month moving averages of the Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS) headline indexes suggest that economic activity in the state continued to grow at a robust pace in the first half of the year and may have accelerated in the second quarter (Chart 2). Both indexes are well above their average values for the postrecession period.

Chart 1
Texas Employment Growing at Blistering Pace



*Seasonally adjusted, annualized rate.
NOTES: Growth is quarter/quarter; shading represents an incomplete third quarter for 2014, which is July/June for Texas and August/June for U.S.
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal adjustments by the Federal Reserve Bank of Dallas.

Chart 2
TBOS Production and Revenue Growth at Multiyear Highs



*Three-month moving average; seasonally adjusted.
SOURCES: Federal Reserve Bank of Dallas Texas Business Outlook Surveys (TBOS): Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS).

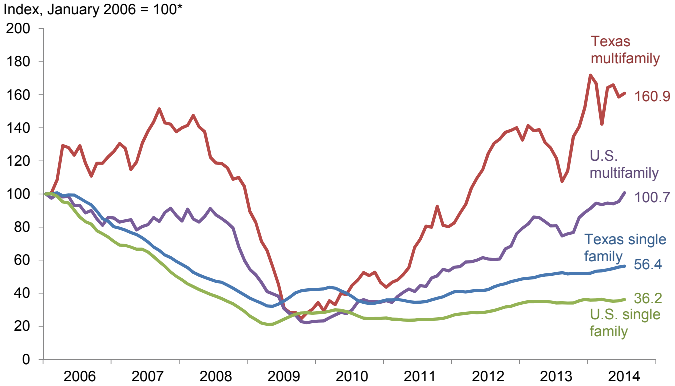
Contract Values Bolstered by New Petrochemical Plant

Texas construction contract values reached a record in July when plans for a new petrochemical plant in Freeport caused a spike in the data. As a result, inflation-adjusted construction contract values in the state surpassed their prerecession peak by 2.2 percent.

Residential Permits Strong; Commercial Rents Climb

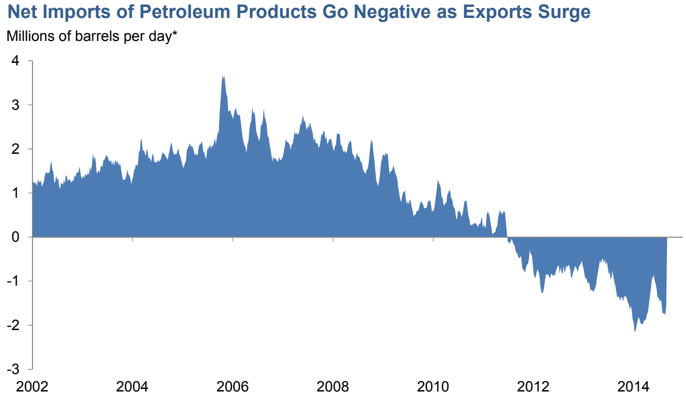
Multifamily building permits have surpassed prerecession highs in Texas and the nation this year (Chart 3). Texas

Chart 3
Permits Data Suggest Texas Multifamily Building May Cool Off After a Remarkable Run



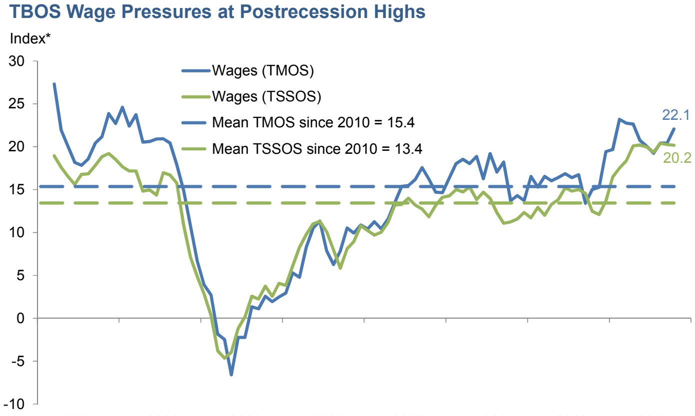
*Five-month moving average; seasonally adjusted, annualized rates.
NOTE: Last data point is July.
SOURCE: U.S. Census Bureau.

Chart 4
Net Imports of Petroleum Products Go Negative as Exports Surge



*Four-week moving average.
NOTE: Last data point is the week of Aug. 29.
SOURCE: Energy Information Administration.

Chart 5
TBOS Wage Pressures at Postrecession Highs



*Three-month moving average; seasonally adjusted.
SOURCES: Federal Reserve Bank of Dallas Texas Business Outlook Survey (TBOS): Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS).

multifamily construction has been very strong, but a decline in permits since the start of the year suggests apartment construction may begin to slow. Despite the increased supply of apartments, rents continue to rise in all major Texas metros due to continued solid demand.

In contrast to the roaring growth in multifamily, single-family home construction has increased gradually. This slower growth is in part due to constraints on the supply side, such as a shortage of developed lots, higher construction costs and widespread labor shortages. Texas home price appreciation is slowing, increasing 0.2 percent in the second quarter, according to the Federal Housing Finance Agency purchase-only house price index. Year over year, prices are up 6.5 percent.

Office markets are healthy, marked by rising rents in all major metros. Lease rates in Houston are nearing those in Austin—the city with the highest office rents in the state—while rents are rising more slowly in Fort Worth and San Antonio. Rising rents have spurred office construction enough that some observers are concerned new supply will depress rent growth, particularly in Houston.

Rig Counts Rise, While Oil Prices Dip

Crude oil prices have trended downward since late July, while natural gas prices have firmed slightly. Drilling activity has picked up slightly in the Eleventh Federal Reserve District. Since August, the Texas rig count has been over 900—the highest in two years—and New Mexico is at 96 rigs—its highest level since 2006.

Plentiful supplies of relatively inexpensive oil and natural gas liquids in the Gulf Coast region have led to record exports of petroleum products. The U.S. has been a net exporter of petroleum products since July 2011 (Chart 4). A recent U.S. ruling allowing some exports of condensate could further boost this trend.

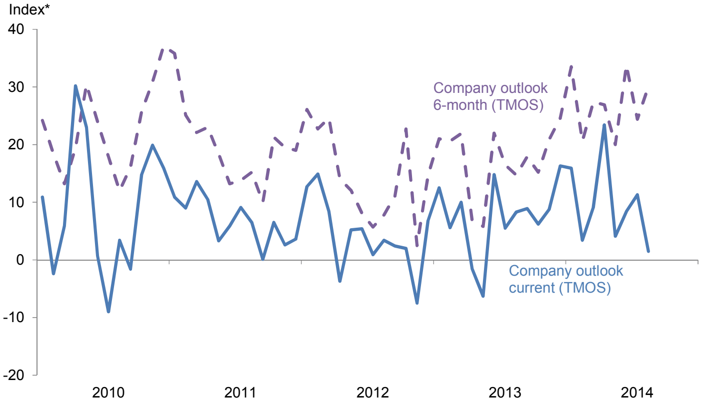
July Exports Surge

Texas exports rose in July after six straight months of no growth. The July total of $26.5 billion surpassed the prior peak earlier this year (in January). Year to date, exports are up 7.8 percent over the same period last year. Weak global demand is contributing to slow export growth. Texas exports are likely helped by the dominance of refined petroleum products and the extent of intra-industry trade, which reflects domestic demand more than international demand.

Prices and Wage Pressures Growing

Both the TMOS finished goods prices and the TSSOS selling prices indexes have been rising at above-average rates this year, with August readings well above their postrecession averages.

Chart 6
Current Company Outlook Stumbles; Future Outlook Remains Bright



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

The payroll survey data on average hourly earnings for all private sector workers suggests wages are rising faster in Texas than in the U.S. Texas hourly earnings rose 3.6 percent in the past year, compared with a U.S. increase of 1.7 percent over the same period. Wage pressures remain far above their average levels, according to both TMOS and TSSOS (Chart 5). At index values around 20, TSSOS wage pressures remain near their series high reached earlier this year (in April). The TMOS wage index hit 23.7 in August and is at levels not seen since January 2008.

Outlook Positive, but Growth Pace Unsustainable

The Dallas Fed leading index grew in June for the fifth consecutive month, rising 0.4 percent. Combined with strong July employment gains, the Dallas Fed forecast is for 3.6 percent job growth in 2014.

All told, the regional economy is growing at an unsustainable pace. Texas employment has grown at more than twice its long-run average rate over the past four months. Declines in unemployment measures have slowed, suggesting Texas is near full employment and slack is being depleted. The rapid growth has led to labor shortages, which can cause bottlenecks in production and hurt productivity. Tight labor and housing markets are leading to mounting wage pressures and increasing prices.

A sign of possible slowing is the TMOS current company outlook index, which turned sharply downward in August, falling 9.8 points from July. Comparing that with the future (six-month-ahead) company outlook index that ticked up slightly in August, the slowdown may be just temporary (Chart 6).

—Sarah Bindner and Pia Orrenius

About the Authors

Bindner is a research assistant and Orrenius is vice president and senior economist in the Research Department at the Federal Reserve Bank of Dallas.