DALLASFED Economic Update
Regional

Texas Economy Positioned to Improve in 2017

December 15, 2016

The Texas economy continues to expand at a moderate pace, with payroll employment growing at a 2.1 percent annualized pace in the second half of the year versus the lackluster 0.8 percent rate in the first half. October job growth was subdued, but September data were revised up. The Texas Business Outlook Surveys (TBOS) point to stronger growth in both manufacturing and services in November. The [Texas Employment Forecast] suggests that job growth for the year will be 1.5 percent (December/December) and that growth next year will be close to the state's long-term trend rate of 2.1 percent.

The energy sector continues to stabilize as weekly West Texas Intermediate (WTI) crude oil prices have remained above $40 per barrel since mid-April. Mining employment continued to decline in the third quarter but at a much more subdued pace than in the first half of the year. Manufacturing activity has also improved, with the Dallas Fed's Texas Manufacturing Outlook Survey (TMOS) production index in positive territory for the fifth consecutive month in November. However, the strengthening of the Texas trade-weighted value of the dollar continues to be a headwind to recovery for Texas manufacturers.

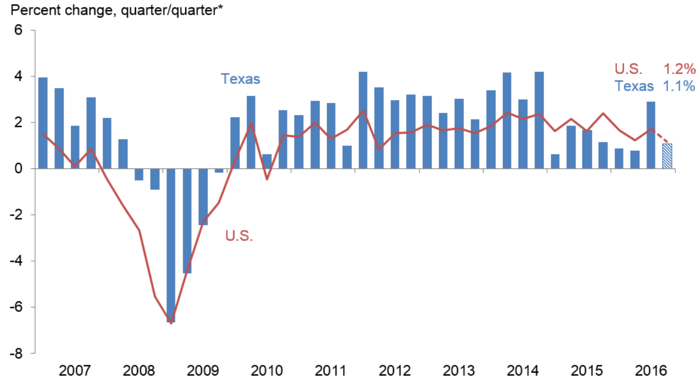
Job Growth Decelerates After Strong Third Quarter

Texas job growth slowed in October to an annualized 1.1 percent, slightly below the nation's 1.2 percent *(Chart 1)*. However, this follows upwardly revised growth of 2.9 percent in the third quarter—the fastest quarterly growth since fourth quarter 2014.

Job growth in most major Texas metros has accelerated since June. Dallas continues to lead growth, expanding at a rapid 4.6 percent annualized rate over the four months through October, while Fort Worth, benefiting from some improvement in the manufacturing sector, is up 3.1 percent. Improvements in the energy industry have boosted Houston's growth to 1.7 percent, a notable turnaround following a 1.0 percent decline in the first half. Exceptions to this recent acceleration are Austin and San Antonio, where hiring has slowed considerably since June.

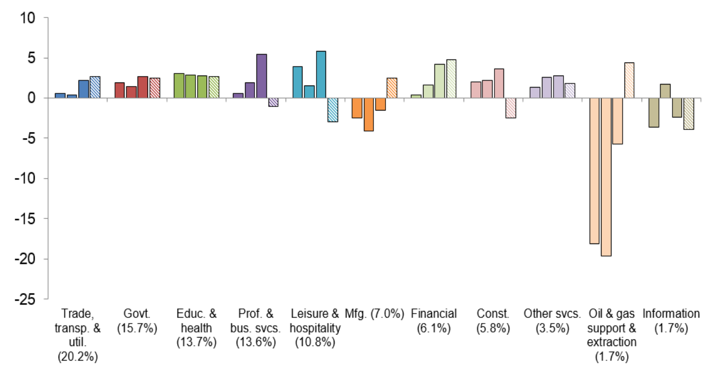
Recent job gains have been broad based across industries as service-providing sectors continue to add jobs at a healthy pace and goods-producing industries have improved significantly *(Chart 2)*. Declines in the energy and manufacturing sectors were far more muted in the third quarter than earlier in the year, and data for October suggest that both saw further improvement.

Chart 1
October Job Data Show Modest Growth Following a Strong Third Quarter



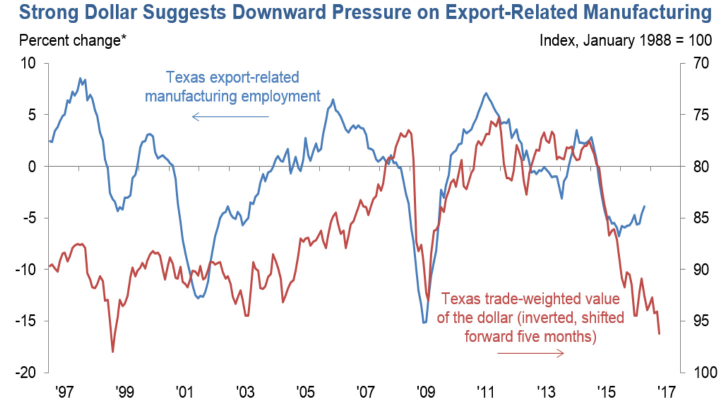
*Seasonally adjusted, annualized rate.
NOTE: Fourth-quarter data are October/September.
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Chart 2
Job Growth in Most Sectors Improves Since First Half



*Seasonally adjusted, annualized rates; striped bars represent October/September growth.
NOTES: Numbers in parentheses are shares of total Texas nonfarm employment.
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by Federal Reserve Bank of Dallas.

Chart 3
Strong Dollar Suggests Downward Pressure on Export-Related Manufacturing



*Six-month seasonally adjusted, annualized rate.
NOTES: Export-related manufacturing includes computer and electronic products, petroleum and coal, chemicals, transportation, electrical equipment and machinery, which represents approximately 46 percent of total Texas manufacturing. The November value of the Texas trade-weighted value of the dollar (TWVD) is estimated based on the U.S. TWVD.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Manufacturing Faces Mixed Outlook

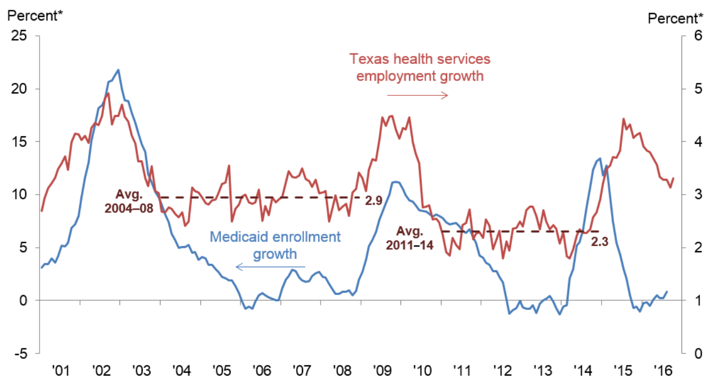
Manufacturing activity and employment have improved in recent months. The TMOS headline production index increased slightly to 8.8 in November. Other indexes, such as company outlook, general business activity and employment, increased to levels not seen since last year. Payroll employment data support this outlook as job declines steadily narrowed from May to September and slight job gains were seen in October.

Continued appreciation in the Texas trade-weighted value of the dollar presents a headwind to a more robust manufacturing recovery because much of what is manufactured in Texas is exported *(Chart 3)*. While overall manufacturing employment has flattened out in recent months, manufacturing jobs tied to exports continue to decline.

Energy Continues to Stabilize

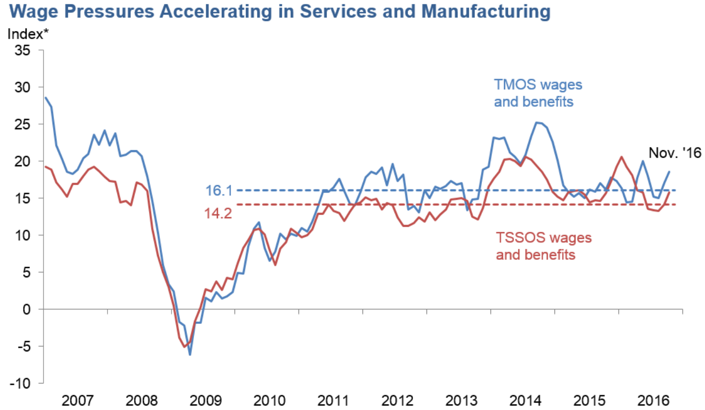
Energy prices have firmed up in recent weeks. WTI crude oil rose above $50 per barrel following the Organization of the Petroleum Exporting Countries (OPEC) announcement on planned production cuts. Perceptions of further stability in energy markets have boosted the Texas rig count, which has increased to 303 after bottoming out at 173 in late May.

Chart 4
Flat Medicaid Enrollments May Contribute to Weaker Health Care Job Growth



*Year-over-year change.
SOURCES: Texas Health and Human Services Commission; Bureau of Labor Statistics; adjustments by the Federal Reserve Bank of Dallas.

Chart 5
Wage Pressures Accelerating in Services and Manufacturing



*Three-month moving average, seasonally adjusted.
NOTE: Dashed lines represent 2010–16 averages.
SOURCES: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS).

Service Sector Growth Robust

Job growth in most service-providing sectors—particularly trade, transportation and utilities; professional and business services; and leisure and hospitality—all surged after lackluster performances in the first half of the year.

Health care services employment has been a notable exception this year, keeping a steady pace of growth after providing a significant boost in 2015. October year-over-year growth came in at 3.3 percent *(Chart 4)*. Some of the previous strength was likely attributable to rising health care utilization. Although Texas did not expand Medicaid coverage as part of the Affordable Care Act, many in the state who were eligible but not enrolled in Medicaid began signing up in 2014 and 2015. As this surge in enrollees dissipated, growth in health care jobs slowed. Going forward, hiring will likely moderate to its typical growth rate of 2 to 3 percent.

Commercial Real Estate in Good Shape Outside Houston

Office markets continue to be healthy in the large Texas metros except Houston. Vacancy rates in Austin and Dallas–Fort Worth are holding below their long-term averages, suggesting tight office markets in these areas *(Table 1)*. Contract values for new construction in both metros are growing sharply, with the average monthly value of new construction in DFW nearly double that of 2015. San Antonio's office vacancy rate is slightly above its long-term average but still indicative of a healthy market, while Houston's rate is well above its long-term rate and has risen sharply from a low of 11.8 percent in first quarter 2014.

Table 1: 2016 Office Vacancies Low in Most Major Markets

Vacancy rate (%)	Austin	Dallas–Fort Worth*	Houston	San Antonio
2016 Q3	8.1	17.0	19.2	16.5
Avg. 2000–16	15.4	19.4	15.0	16.0

*Based on population-weighted average of Dallas and Fort–Worth vacancy rates.
SOURCES: CBRE Econometric Advisors; adjustments by the Dallas Fed.

Price and Wage Growth Up in Texas

Despite an increase in the state unemployment rate from a low of 4.3 percent in March to 4.7 percent in October, wage pressures in Texas remain elevated. TBOS respondents indicated above-average wage pressures in both manufacturing and services *(Chart 5)*. Manufacturing wages showed some signs of picking up as the TMOS respondents reporting higher wages rose from 17.2 percent in October to 18.4 percent in November. Wage pressures in the service sector showed signs of an uptick as well after a slight easing mid-year.

The business outlook surveys suggest further price pressures in November. The TMOS price index rose to 8.0, its highest reading since November 2014, while Texas Service Sector Outlook Survey measures were positive but subdued compared with earlier in the year. However, both surveys indicated a sharp increase in expected price inflation, with six-month-ahead indexes rising to their highest levels this year.

—Christopher Slijk and Keith Phillips

……………………………………………………………………………………….

About the Authors

Slijk is a senior research analyst and Phillips is an assistant vice president and senior economist at the San Antonio Branch of the Federal Reserve Bank of Dallas.

……………………………………………………………………………………….