

January 2017

Valentyn Povrozhnyuk, Edilberto L. Segura

- According to estimates of the US Bureau of Economic Analysis, US real GDP expanded by 1.9% quarter-over-quarter in Q4 2016.
- National industrial production reversed a declining trend in December, posting a growth rate of 0.8% mom.
- In Texas, the energy sector and exports joined factory activity and service sector output as the factors promoting expansion of the state economy in December.
- The Texas rig count continued to recover, reaching 310 at the end of the year.
- Employment posted another small increase at the national level but saw almost no change in Texas.
- Thanks to several consecutive monthly increases, US consumer inflation reached the target level of 2% yoy in December.

Executive Summary

The US economy continued to grow in Q4 2016, but the pace of growth significantly decelerated compared to the previous quarter. The advance estimate of the Bureau of Economic Analysis shows that real GDP expanded by 1.9% qoq in Q4, which is twice as low as in Q3. Growth could have been faster if not for the negative impact of foreign trade.

National industrial production returned to growth after one month of decline. Utilities were the main drivers of growth, followed by some expansion of manufacturing. On the other hand, mining output remained unchanged. The high growth of utility output was caused by changes in weather. An increase in the production of durable goods more than offset a decline in production of nondurables and other manufacturing, ensuring a small rate of growth in total manufacturing.

Consumer confidence weakened slightly at the national level in January. This weakness was due to a deterioration of future prospects perception, which more than offset improvements in the appraisal of the present situation.

The Texas economy continued to expand in December on the back of more active factory activity and an expanding service sector. The energy sector and foreign trade also contributed to growth. Growth of manufacturing accelerated, while the service sector expanded at a lower rate. Despite some expansion in most major economic sectors, consumer confidence softened in December. The rig count continued to recover slowly but steadily.

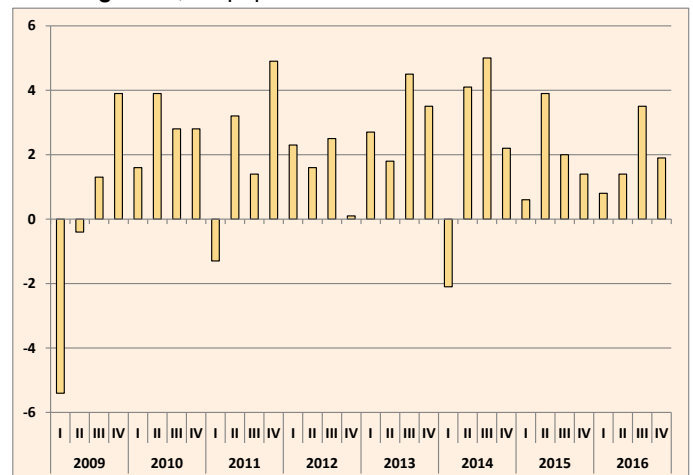
Labor market conditions improved at the national level but saw almost no changes in Texas. Nevertheless, the improvement of national employment slowed, as it saw a further deceleration in growth. Texas employment remained flat. The number of unemployed saw little change at both the national and Texas level leading to no changes in the respective unemployment rates.

Further acceleration in growth of energy prices led to some acceleration in total consumer inflation in December. Food prices remained flat for the sixth consecutive month. Prices of all items less food and energy inched up insignificantly. Both the national and Texas housing markets experienced mostly negative developments in December, especially in relation to total and unsold inventory.

Economic Growth

According to estimates of the Bureau of Economic Analysis, national real GDP increased at an annual rate of 1.9% qoq in Q4 2016. This is about 55% of the growth rate observed in Q3 of 3.5% qoq. Positive contributions to GDP growth were made by personal consumption expenditures (which grew by 2.5% qoq), gross private domestic investment (10.7% qoq) and government expenditures (1.2%

1. GDP growth, % qoq at annual rates



Source: The U.S. Bureau of Economic Analysis

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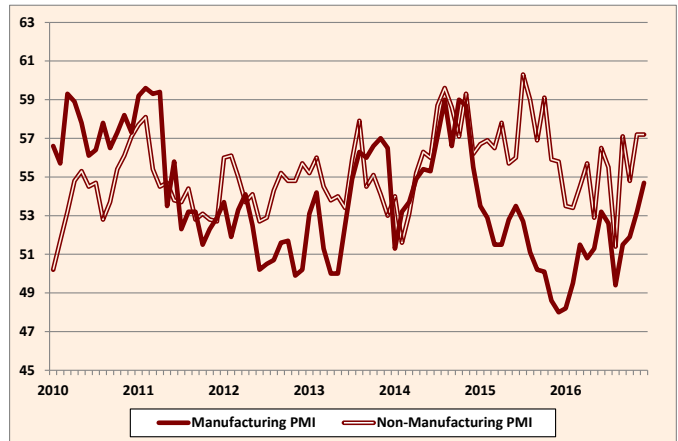
qoq). These positive growth rates were partially offset by declines in exports (4.3% qoq) and an even faster growth in imports (8.3% qoq).

US industrial production returned to growth in December 2016. After a 0.7% mom drop in November, it expanded by 0.8% mom in December. This output growth was supported by positive changes in utilities and manufacturing, while output of mining remained flat. A 6.6% mom growth in utilities was the result of the weather returning to more common colder temperatures, after unseasonable warmth in November. The increase in manufacturing of durable goods outweighed the declines in nondurable manufacturing, ensuring a 0.2% mom increase in total manufacturing. In particular, expansion of output in primary metals and motor vehicles and parts were the main factors of a 0.5% mom growth in durables. In turn, most of the nondurables industries posted declines in the reporting month with the biggest decreases registered in textile and product mills and in chemicals. From a year-over-year perspective, total industrial production posted a 0.5% yoy growth in December. A 6.2% yoy growth in utilities and a more moderate increase in manufacturing of 0.2% yoy were partially offset by a 2.8% yoy decline in mining.

The manufacturing sector expanded for the fourth consecutive month in December 2016 and may continue to expand in 2017. The Institute for Supply Management reported its PMI index value for the month, showing further expansion by 1.5 percentage points to 54.7%. Most of the PMI components posted increases including indexes for new orders, production, employment, and exports. At the same time, three indexes remained below the 50% threshold, meaning that those indexes are on the downward trend. In particular, the inventories index equaled 47.0, while indexes for customer inventories and backlog orders were at 49.0%. Eleven of the eighteen manufacturing industries reported growth in December including: petroleum and coal products; primary metals; food, beverage and tobacco products; machinery; electrical equipment; and chemical products. Many industries showed that good business conditions in general and growing demand in particular were the major reasons for growth. The NMI index posted no change in December compared to November. However, its value above the 50% threshold (57.2%) means that its upward trend is likely to continue. At the same time, there were declines in such important NMI components as the

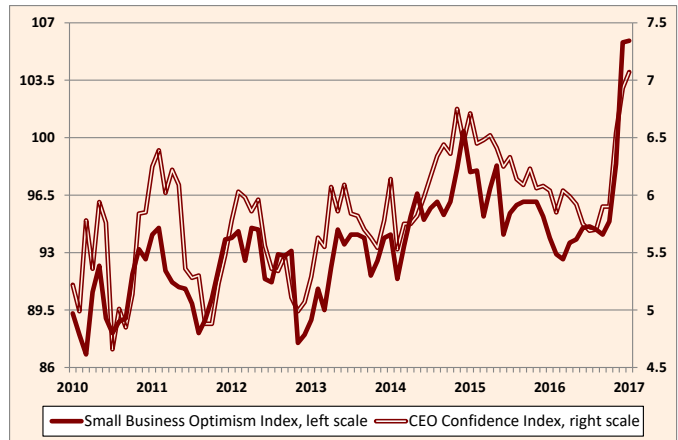
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2. PMI, indexes



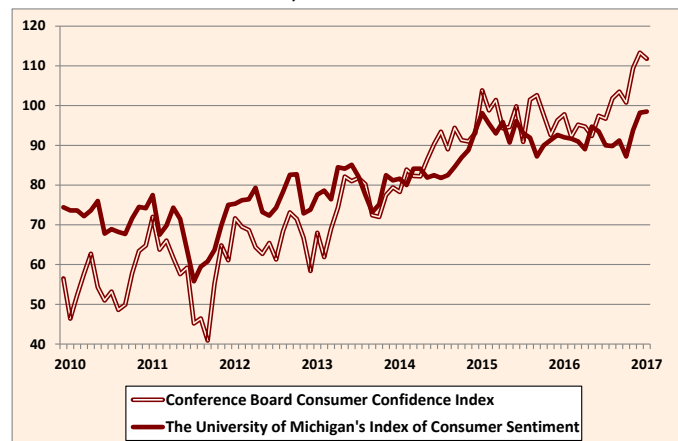
Source: Institute for Supply Management

3. Business confidence, indexes



Source: Chief Executive, National Federation of Independent Business

4. Consumer confidence, indexes



Source: Conference Board, The University of Michigan

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business activity/production index (by 0.3 percentage points to 61.4%) and employment index (by 4.4 percentage points to 53.8%). Overall, 12 non-manufacturing industries reported growth in December, citing increased demand thanks to holidays as the main factor stimulating growth.

Consumer confidence slightly weakened in January 2017. According to the Conference Board, the Consumer Confidence Index retreated from 113.3 to 111.8 basis points. The negative developments in evaluation of future prospects overwhelmed the positive changes in evaluation of the present situation. In particular, the present situation index expanded by 6.2 basis points to 129.7, while the expectations index dropped from 106.4 to 99.8. Customer appraisal of current conditions improved in relation to both business conditions and the labor market situation. More negative appraisal of future prospects was the result of a negative short-term outlook for business conditions and a rather mixed one for the labor market.

The Texas economy continued to grow in December 2016. Major factors of the increase were improvements in manufacturing and service sectors, the energy sector and exports. Texas manufacturing activity increased for the sixth month in a row in December. The production index added 5.0 basis points, reaching 13.8. Actually, most current manufacturing activity measures indicated further growth. Perceptions of broader business conditions also improved. Labor market measures were the only ones to show small declines, as expectations regarding future business conditions improved notably again.

The Texas service sector also expanded in December. The revenue index increased from 13.7 in November to 20.6. Labor market indicators indicated somewhat slower employment growth. But this was the only negative development, as perceptions of broader economic conditions and expectations regarding future business conditions both reflected more optimism.

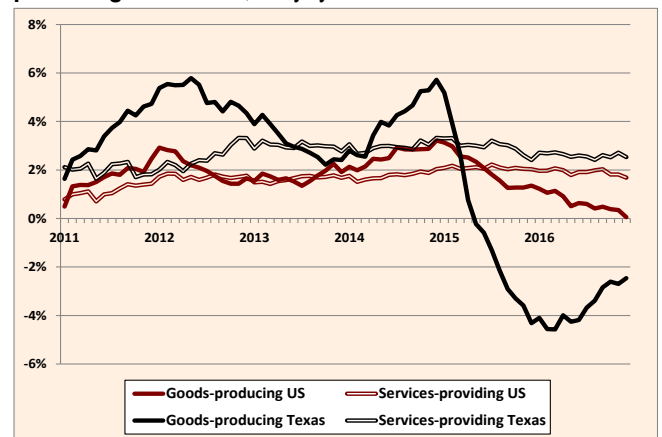
Similar to the national level, Texas consumer confidence weakened in January. Furthermore, the negative developments in consumer appraisal of the economic situation were more significant in Texas, as the Conference Board Confidence Index for the state dropped 5.7 basis points to 133.

Texas exports expanded in November 2016, despite still low oil prices and weak global demand. Total growth of exports equaled 2.6% mom. Furthermore, the Texas rig count further increased in December. It added 39 new rigs (14.4% mom) and reached 310. At the same time, this still remains 4.3% below a year-ago.

Employment

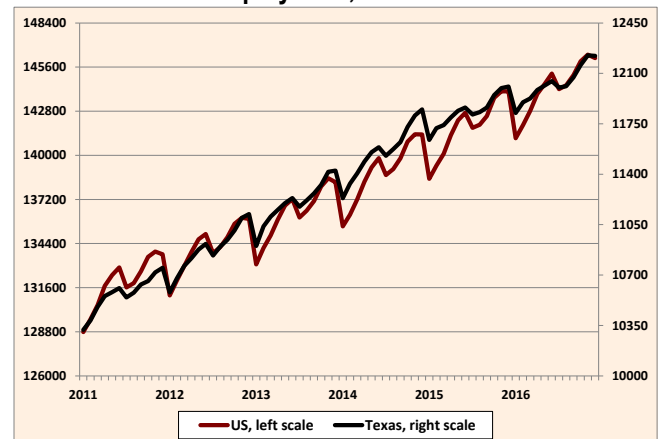
National labor market conditions posted another moderate improvement in December 2016. Employment posted an increase, but this increase was lower than the 12-month average. Therefore, there was no change in the unemployment rate. Total nonfarm payroll employment grew by 0.1% mom, being pushed upwards by the service sector. The most significant employment growth was registered for health care (0.3% mom), professional and business services (0.2% mom), and food services and drinking establishments

5. Jobs growth in private goods-producing and service providing industries, % yoy



Source: Bureau of Labor Statistics

6. Total nonfarm employment, 000



Source: Bureau of Labor Statistics

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(0.2% mom). Employment in mining increased by 0.3% mom. In addition, significant increases were reported in transportation and warehousing, and financial activities. Other major industries saw either few or no changes in the number of employed. In year-over-year terms, in December 2016, total nonfarm employment grew by 1.5%. The unemployment rate remained unchanged at 4.7% as the number of unemployed remained virtually unchanged at 7.5 million.

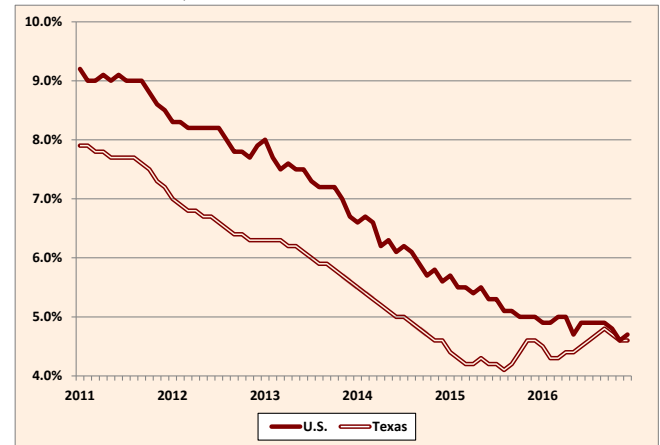
The Texas labor market saw little change in December. Both employment and unemployment remained almost flat. Texas employers managed to create just 800 new nonfarm jobs during the month. The largest increases were reported for education and health services (7,300 or 0.4% mom), leisure and hospitality (3,900 or 0.3% mom), manufacturing (1,400 or 0.2% mom), and mining (1,300 or 0.6% mom). At the same time, construction and trade, transportation, and utilities saw significant declines in employment (4,100 or 0.6% mom and 8,200 or 0.3% mom, respectively). In year-over-year terms, Texas employment grew by 1.8% (0.1 percentage points lower than a month ago). The number of unemployed changed insignificantly, leaving the unemployment rate unchanged at 4.6%.

Texas metropolitan areas sustained rather insignificant changes in employment in both monthly and over-year terms in December. Most of the metros reported over-year employment growth at rates comparable to those observed in previous months. Just four metros reported declines in employment. The number of unemployed increased slightly in all metros compared to November but, as mentioned above, the increase was too small to change the unemployment rate for the state in general. Amarillo, Austin-Round Rock, and Lubbock remained as the metros with the lowest unemployment rate of 3.2%, while McAllen-Edinburg-Mission was still the highest unemployment rate metro (8.2%).

Monetary Policy and Asset Prices

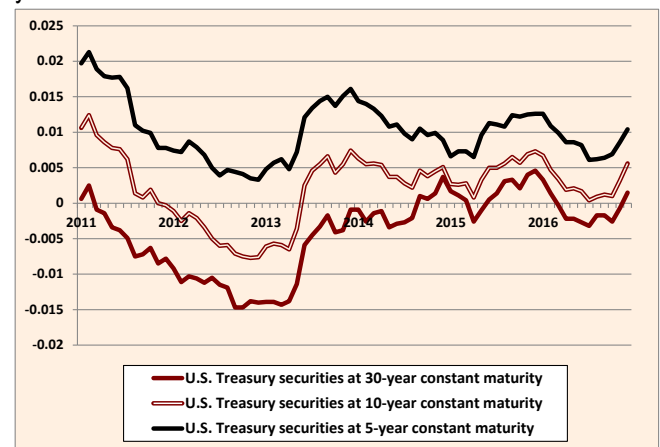
Growth of US consumer prices slightly accelerated again in December 2016. After inflation halved to 0.2% mom in November, it inched up to 0.3% mom in December. Increases in energy prices were responsible for this, as their growth accelerated from 1.2% mom to 1.5% mom from November to December. Food prices have remained flat for the last sixth months. Prices of all items less food and energy inched up by 0.2% mom, which is exactly the same as a month ago. This growth was fully attributed to growth in prices of services less energy prices, while commodities less food and energy commodities saw no growth in prices. In year-over-year terms, consumer inflation returned to its target level of around 2%. Actually, the all items index equaled 2.1% yoy in 2016. Energy prices were the main driver of overall consumer price growth, expanding by 5.4% yoy over the period. Prices of all

7. Jobless rate, %



Source: Bureau of Labor Statistics

8. Borrowing rates (quoted on investment basis), % per year inflation indexed



Source: Federal Reserve System

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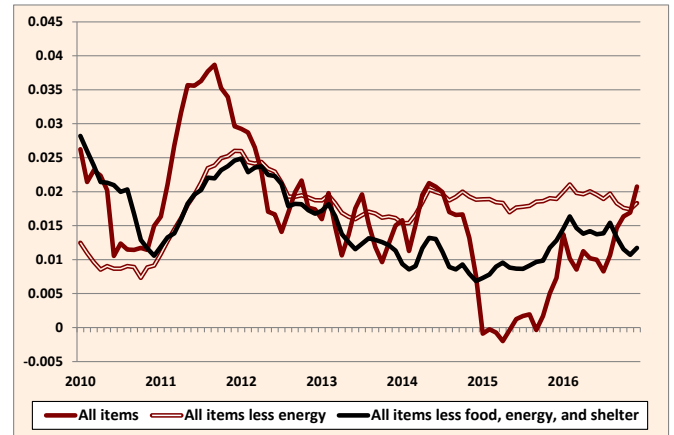
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items less food and energy expanded by 2.2% yoy, while food prices remained flat.

The national housing market situation deteriorated in December, while the Texas housing market observed mixed developments. Higher mortgage rates and home prices together with record low inventory levels led to significant declines in existing-home sales in most regions of the country. In fact, US home sales decreased by 2.8% mom in December. The total seasonally adjusted annual rate of existing sales totaled 5.5 million, which is just 0.7% above a year ago. On the other hand, the median existing-home price increased for the 58th month in a row, this time by 4.0% yoy to USD 232,200. Total housing inventory was at its lowest level from the beginning of tracking in 1999 after a 10.8% mom decrease to 1.65 existing homes available for sale in December. Unsold inventory decreased for the 19th month, reaching 1.76 million or a 3.6-month supply at the existing sales pace.

Texas actual existing-home sales returned to growth in December after a three-month decline streak. They grew by 9.1% mom to 26,278, which is 2.0% higher than a year ago. The median existing-home price continued to grow but at slower pace (8.0% yoy compared to 11.5% in November). Similar to the national level, housing construction expanded at a significantly slower pace compared to sales, as the unsold inventory decreased to a 3.3-month supply. This is the lowest rate since the beginning of tracking records in 1990, although it was also observed previously (in December 2015).

9. CPI, % yoy change



Source: Bureau of Labor Statistics

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