

October 2015

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- **Advance estimates showed significant deceleration in GDP growth in Q3.**
- **Warmer temperatures were the major reason for the increase in output of the utilities industry at the national level in September.**
- **In September, US consumer confidence softened on a less optimistic appraisal of both current conditions and the short-term outlook.**
- **National exports rebounded after a significant decline in August.**
- **The Texas economy continued to expand moderately thanks to the services sector.**
- **The Texas rig count declined after two months of growth.**
- **Both the US in general and Texas expanded employment, but at rates below the average for 2015.**
- **Deflation continued nationally due to the continued downward trend of oil prices.**
- **Housing markets in the US and Texas followed different development patterns in September.**

### **Executive Summary**

Both the US in general and Texas posted moderate economic growth in September. However, growth in the US in general was slower on average in Q3 compared to Q2, which is reflected by significantly lower estimates of GDP growth. GDP growth decelerated from the upwardly revised 3.9% qoq to 1.5% qoq due to deteriorating performance in all the major components of GDP.

Industry was one of the sectors contributing to the decline in GDP, posting a small drop in output for the second consecutive month despite continued expansion of both manufacturing and nonmanufacturing activities in the country. Mining was the major reason for decline under almost flat manufacturing and some increase in output of utilities because of warmer weather. Sluggish monthly performance further decelerated the over year growth of industrial output to just 0.4%.

Consumers started to lose their optimism about development of the US economy in October. The Consumer Confidence Index declined after several consecutive months of increase. The respondents were less optimistic about both present conditions and short-term outlook. In particular, people have concerns about the current and future situation in the labor market and about current business conditions.

After somewhat mixed developments in August, national construction posted better performance in September. Monthly growth dynamics of total construction and its private and public sectors was almost identical to those observed in August. Residential construction posted higher growth rates in both private and public sectors. At the same time, nonresidential construction moved in opposite directions – grew in the public sector but declined at an identical rate in the private sector. Unlike in August, building permits remained unchanged in terms of both the number and valuation in monthly terms, but posted significant increases in year-over-year terms.

US exports increased in September, fueled by a notable expansion of exports of consumer goods (mainly luxury goods and jewelry) and capital goods. Exports of services also observed marginal progress over the reporting period. Total exports grew by 1.6% yoy in September.

Moderate growth of the Texas economy was supported by an expanding services sector and the first signs of recovery in manufacturing in September. At the same time, the construction industry posted sluggish performance during the reporting month, observing significant declines in building permits. This, however, was at least partially offset by growth in nonresidential building construction. The Texas rig count returned to decline after two consecutive months of growth. In year-over-year terms, the Texas rig count was 59.3% yoy lower in September.

Both the US in general and Texas posted some good growth in employment but were not very effective in fighting unemployment in September. The services sector continued to fuel expansion of employment at both the national and Texas level, while employment in mining continued to suffer from decreasing oil prices. The Texas government also observed a decline in employment. The number of unemployed did not change much at the national level in September, which is not the case for Texas. As a result, the unemployment rate remained unchanged in the US in general, but inched up by 0.1 percentage points in Texas. Further monthly improvements in employment were observed at the metropolitan

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area level in Texas. However, those improvements were not significant, taking into account changes in year-over-year dynamics of employment among Texas metros.

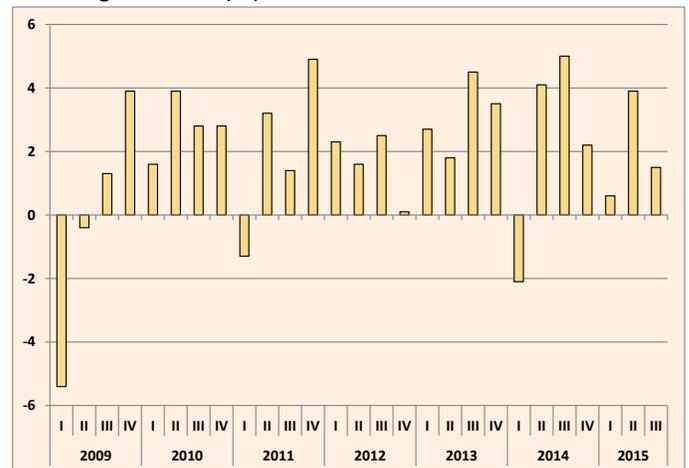
Being not fully satisfied with developments in the labor market and still observing lower than expected inflation, the Federal Open Market Committee left the policy rate unchanged within a 0-0.25% range. The continued decline in oil prices held consumer prices in general on a downward trend in September. Sharp declines in prices of energy commodities more than offset moderate increases in food prices and prices of all items less food and energy. The national and Texas housing markets moved in opposite directions in September. The US in general enjoyed increasing existing-home sales in monthly terms under growing median prices, which slightly decreased the unsold housing inventory. Texas, on the contrary, observed lower sales despite a monthly decline in median prices. Nevertheless, the housing inventory also declined in Texas.

## Economic Growth

According to the Bureau of Economic analysis, real GDP growth significantly decelerated in US in Q3 2015. The advance estimate shows that the national real GDP grew by 1.5% qoq in the reporting quarter compared to 3.9% qoq growth observed in Q2. Deceleration in GDP growth was the result of slower expansion in all its major components, but the most significant negative impact was made by dynamics of gross private domestic investments. The latter registered a 5.6% qoq drop in Q3 compared to 5.0% qoq growth in the previous quarter. Both exports and imports posted slower growth during the reporting quarter, but deceleration of growth in exports was more significant. As a result, exports and imports reported almost identical growth at 1.9% qoq and 1.8% qoq, respectively. Government consumption expenditures and gross investment same as in personal consumption expenditures observed less significant deceleration in growth (0.9 percentage points to 1.7% qoq and 0.4 percentage points to 3.2% qoq, respectively).

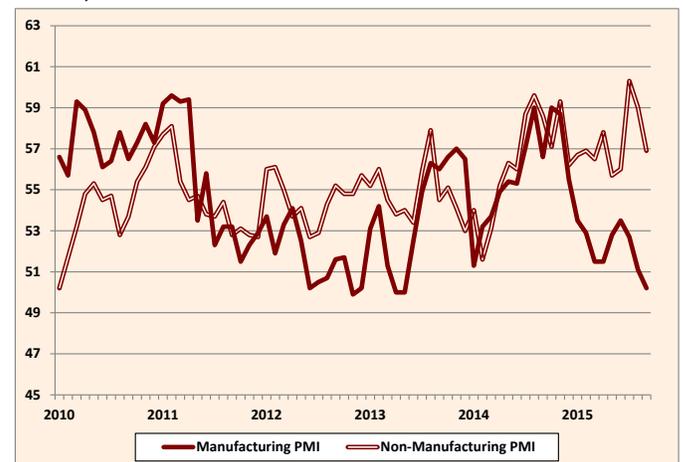
National industrial output posted another small decline in September. The total index inched down by 0.2% mom, which is a small change compared to a 0.1% mom decline in August (revised data). The decline in the total index was fueled mainly by a 2.0% mom decrease in mining. This decrease was partially offset by a 1.3% mom growth in utilities, while manufacturing remained almost flat. Decline in mining is the direct consequence of decreasing world oil prices, which led to a drop in both the extraction of crude oil and in the drilling of oil and gas wells. At the same time, warmer-than-usual weather conditions in September were the main reason for growth in utilities. In particular, higher temperatures led to strong demand for air conditioning, which boosted electricity output. On the other hand, the mentioned gain was partially offset by a decline in output of gas utilities because of the weaker demand for heating. The observed

### 1. GDP growth, % qoq at annual rates



Source: The U.S. Bureau of Economic Analysis

### 2. PMI, indexes



Source: Institute for Supply Management

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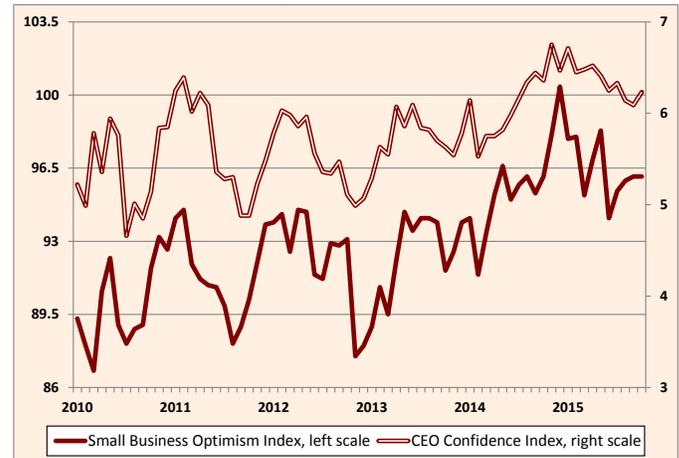
0.1% mom decline in manufacturing was the result of a 0.2% mom edging down in production of durables, as output of nondurables remained unchanged. The observed monthly decline of industrial output led to further deceleration of its growth in year-over-year terms. Growth of the total index more than halved to just 0.4% yoy. The decline in mining accelerated to 5.7% yoy, while growth in utilities further decelerated despite observed monthly growth (by 3.6 percentage points to 1.0% yoy).

The Institute for Supply Management reported tiny growth of manufacturing activity in September, while the non-manufacturing sector expanded faster. Most of the manufacturing sector indexes posted monthly declines, some of which were quite significant. In particular, the new orders index and production index posted similar declines of 1.6 and 1.8 percentage points respectively. The PMI index itself dropped 0.9 percentage points to 50.2%, which is the lowest level since May 2013. Only seven of eighteen manufacturing industries reported growth. The other eleven industries, which include primary metals production, machinery, computer and electronic products, and chemical products, posted contraction. Low oil and gas prices, the high value of the dollar, and concerns about a China downturn were among the reasons for such sluggish performance of the manufacturing sector as a whole in September. The non-manufacturing sector experienced even more significant deceleration in growth than in manufacturing but still grew faster. The NMI index decreased by 2.1 percentage points to 56.9%, indicating the 68th consecutive month of the sector's expansion. Such important indexes as new orders index and business activity/production index reported even faster declines (by 6.7 and 3.7 percentage points respectively). Thirteen non-manufacturing industries reported growth in September, while just four industries observed contraction, including mining and retail trade. However, growth may slow down soon as indexes for new orders, employment, and supply deliveries are very close to the no growth threshold of 50%.

After a couple of months of strengthening, consumer confidence softened in October. The Consumer Confidence Index retreated by 5 basis points to 97.6 on the back of declines in both the Present Situation Index and the Expectations Index. The former decreased from 120.3 to 112.1, while the latter dropped 11.2 basis points to 88.0. Appraisal of current conditions was less positive compared to the previous month because of less optimism in relation to both business conditions and the job market. At the same time, more subdued optimism about the short-term outlook was the result of changes in moods of consumers in relation to the job market, while expectations concerning business conditions remained virtually unchanged compared to September.

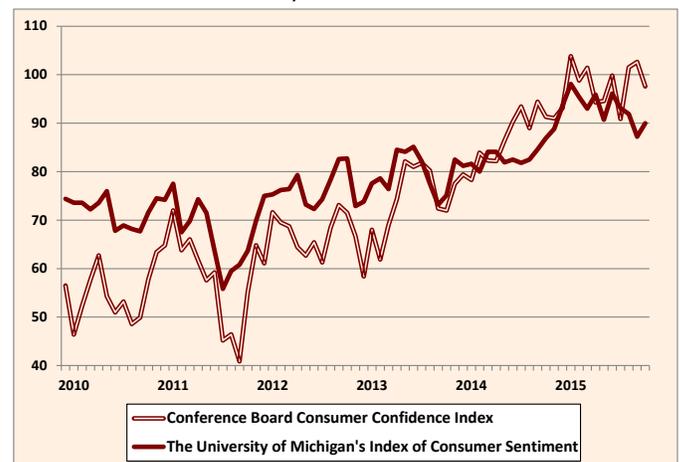
National construction expanded moderately in September. Similar to the previous month, the value of construction put-in-place edged up by 0.6% mom on the back of almost identical increases in private and public construction. Residential construction posted higher growth rates in both the private and public sector (1.8% mom and 1.2% mom respectively),

### 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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but in the public sector its share is too small to have any influence on overall construction dynamics. Nonresidential construction, in turn, posted identically opposite dynamics in two sectors. In particular, it declined by 0.7% mom in the private sector but grew at exactly the same rate in the public sector. Private nonresidential construction declined because almost all its segments reported contraction. Only religious, educational, and transportation private nonresidential construction posted monthly increases in September. In contrast, just three nonresidential construction segments posted significant monthly declines in the public sector and one more segment declined insignificantly (commercial construction inched down by 0.1% mom). Despite the above-mentioned monthly growth of total construction, industry observed deceleration in growth in year-over-year terms in September. Total construction grew by 10.5% yoy, which is 3.2 percentage points lower than in August. Private construction significantly outpaced public construction in terms of growth in the reporting month (12.2% yoy to 6.4% yoy). The number of construction permits remained unchanged in September compared to the previous month. At the same time, valuation of construction permits insignificantly decreased because of a higher share of permits on construction of multi-unit houses with a lower unit cost of construction than in August. In year-over-year terms, growth of the number of construction permits decelerated by 2.7 percentage points to 4.9% yoy, while growth of their valuation decelerated even faster (by 4.8 percentage points) to 10.7% yoy.

Additional exports of consumer goods led to an increase in total national exports in September after a significant decline in August. Total exports grew by 1.6% mom to USD 187.9 billion. Exports of goods expanded by USD 2.9 billion or by 2.3% mom to USD 127.3 billion. Consumer goods generated an additional USD 1.3 billion of exports, USD 500 million of which was received from an increase in exports of artwork, antiques, and stamps and USD 300 million was received from increase in exports of jewelry. National exports of capital goods expanded by USD 900 million in September. Exports of services remained almost flat in relative generating USD 100 million of additional export inflows to a total of USD 60.6 billion.

The Texas economy preserved modest growth in September as manufacturing activity started to recover and the services sector continued to grow. The Production Index measuring state manufacturing conditions grew from -0.8 to 0.9. This means that manufacturing output held generally steady but showed the first signs of recovery. Other indexes of current manufacturing activity also increased in September, but some important ones remained in negative territory. In particular, the new orders index was equal to -4.6 despite an 8 basis point increase. At the same time, perceptions of broader business conditions remained weak in September, while expectations regarding future business conditions posted just minor improvements.

The Texas services sector performed significantly better than manufacturing. The Revenue Index of the Texas Service Sector Outlook Survey expanded by 3.5 bps to 12.8. Furthermore, both perceptions of broader economic conditions and expectations regarding future business conditions reflected more optimism in September. In particular, the index of future company outlook posted a 4 bps increase to 16.1.

Similar to the national level, consumer confidence softened in Texas in October. At the same time, Texas consumers remained in general more optimistic than average US consumers as the Consumer Confidence Index remained higher (115.9) in Texas and declined slower (by 3 bps) in September.

Unlike the US in general, Texas saw continued decline in the number of construction permits in September. The total number of issued construction permits dropped 14.4% mom, which is a significant acceleration over 4.8% mom a month ago. Valuation of construction permits saw a similar monthly decline. Despite such a significant monthly decline in the number of issued permits, the year-over-year decline of the indicator slightly decelerated to 3.1%. A larger share of permits on construction of single-unit houses in September 2015 than a year ago helped keep valuation of total building permits at virtually the same level as in September 2014. The contract value for nonresidential building construction expanded from USD 1.4 billion in August to USD 1.7 billion in September.

After two months of consecutive increases, the Texas rig count fell again in September. It dropped from 385 in August to 367, which is lower than observed in July. Furthermore, the year-over-year decline in the Texas rig count accelerated by 2.1 percentage points to 59.3%.

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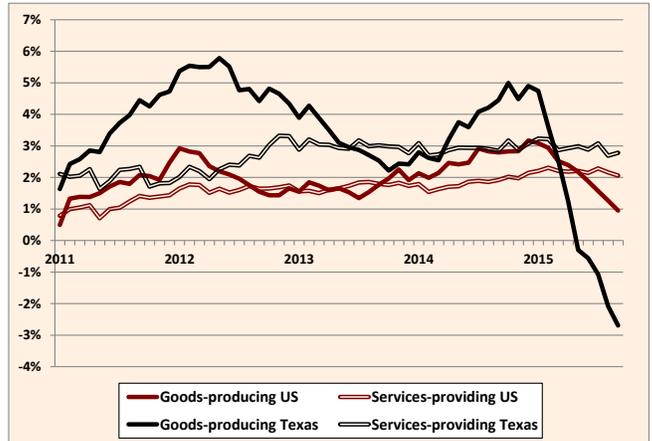
## Employment

US labor market conditions improved in terms of employment in September, while the situation with unemployment remained virtually unchanged compared to August. Total nonfarm payroll employment increased by 137,000 (or by 0.1%), which is significantly below the average for 2015 of 206,750. The services sector continued to fuel growth in total employment, more than offsetting the decline generated by mining. Employment in such major industries as manufacturing, wholesale trade, and several others saw very little or no monthly changes in September. Healthcare was the leader in job creation for the second consecutive month generating 41,500 new jobs (a 0.3% mom increase). Professional and business services were again the second best with 33,000 new jobs (a 0.2% mom growth). Information services generated 11,100 new jobs, which was equivalent to a 0.4% mom increase, the highest one in relative terms. Decline in employment of mining accelerated in September. The sector dropped 11,100 jobs, which is a 1.4% mom decrease. Deceleration in monthly growth of total nonfarm payroll employment also lowered its over year growth a bit (to 1.9%). In September, the unemployment rate held at 5.1% as the number of unemployed remained almost unchanged at 7.9 million. Over the year, the number of unemployed dropped 1.3 million, leading to a 0.8 percentage point decline in the unemployment rate.

Similarly to the national level, Texas labor market conditions posted good performance in terms of employment in September. On the other hand, the unemployment slightly expanded in Texas too. The state generated 26,600 nonfarm jobs (a 0.2% mom increase), which is a significant improvement over a revised decrease of 3,400 jobs in August. Most of the increase was attributed to just two industries. Trade, transportation, and utilities industry expanded by 11,400 jobs (a 0.5% mom increase), while education and health services industry created 10,900 new positions (a 0.7% mom increase). Small growth was also observed in other industries, including construction and manufacturing. Mining and government observed declines in employment. In particular, Texas government dropped 0.2% mom or 4,600 jobs, while the number of positions in mining declined by 1.4% mom (similarly to the national level) or 4,100 jobs. The year-over-year growth of total nonfarm payroll employment remained unchanged at

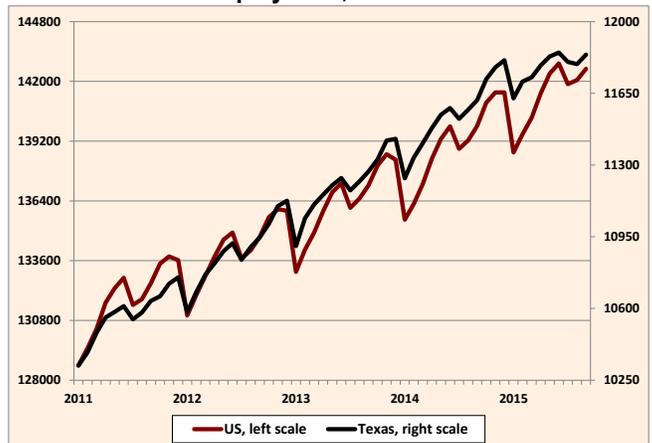
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## 5. Jobs growth in private goods-producing and service providing industries, % yoy



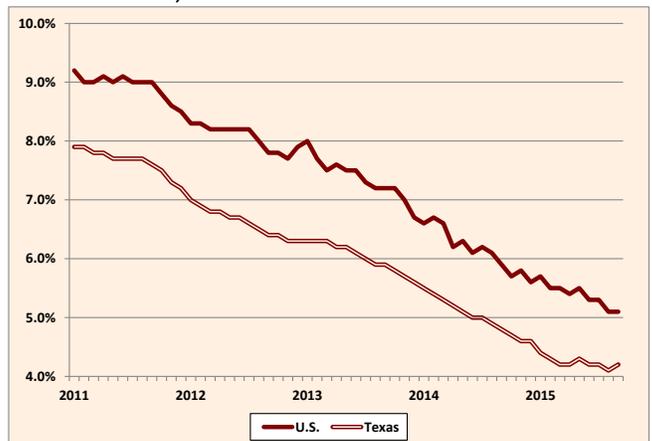
Source: Bureau of Labor Statistics

## 6. Total nonfarm employment, 000



Source: Bureau of Labor Statistics

## 7. Jobless rate, %



Source: Bureau of Labor Statistics

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1.9% in Texas in September. The unemployment rate inched up to 4.2% in September as the number of unemployed expanded by 6,765 persons to 544,735.

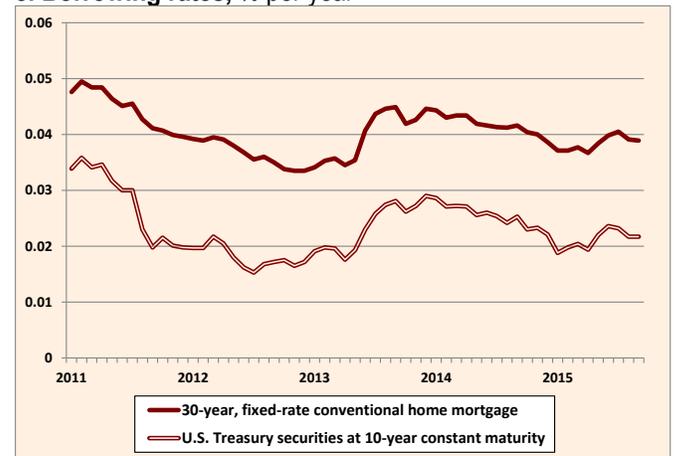
The labor market also saw some monthly improvements at the Texas metropolitan area level in September. According to the only available unadjusted data, the number of metros observing decline in employment reduced to seven. One metro reported no changes in employment. The highest growth in employment was observed in College Station-Bryan at 3.6% mom, while the sharpest decline was reported by Laredo at 0.5% mom. At the same time, the situation with unemployment deteriorated at the metros' level. Nine metros observed increases in the number of unemployed and ten more metros reported no changes in the number of unemployed. For comparison, all the Texas metros saw declines in the number of unemployed in August. The number of metros observing growth in the number of unemployed in year-over-year terms increased by one, as Victoria joined the club. McAllen-Edinburg-Mission observed the highest unemployment rate of 7.4%, while Amarillo remained the metro with the lowest unemployment rate at 3.1%.

### Monetary Policy and Asset Prices

Expectations of an increase in the policy rate were not fulfilled again in October. The Federal Open Market Committee (FOMC) reaffirmed its view that a 0-0.25% target range for the policy rate remains appropriate at its meeting on October 28th. The Committee made its decision based on the latest available information on the US economic situation. The data showed that the labor market in general shows diminishing underutilization of labor resources compared to the beginning of the year. At the same time, the labor market indicators still did not reach the levels the Committee judges consistent with its dual mandate. Inflation, in turn, is currently below the medium-term target of 2%, even though it is expected to gradually move back to this level. Thus, FOMC did not see any reasons why it should raise the policy rate.

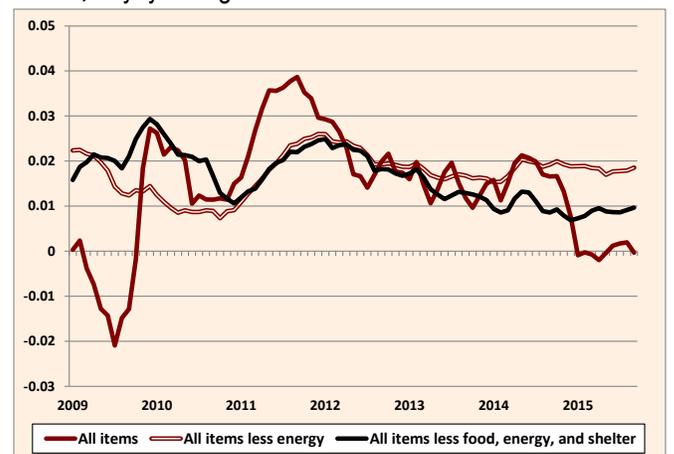
Consumer inflation remained on the downward trend in September. The rate of decline slightly accelerated to 0.2% mom compared to 0.1% mom in August. Similarly to the previous month, dynamics of the energy index was the major reason of decline in the all items index. The energy commodities index and energy services index both declined in September. However, the decline in the energy commodities prices was much faster at 8.6% mom compared to just 0.4% mom for energy services prices. That was the result of acceleration in decline of the gasoline prices (the rate of decline more than doubled to 9.0% mom), which fueled decline of the energy index despite significant deceleration in decline of fuel oil prices. Declines in prices of both electricity and utility gas led to reverse of trend in prices of energy services to the downward one

### 8. Borrowing rates, % per year



Source: Federal Reserve System

### 9. CPI, % yoy change



Source: Bureau of Labor Statistics

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(-0.4% mom). Food prices continued to growth at a modest rate. The pace of growth slightly accelerated due to faster growth in prices of food away from home. All items less food and energy posted another tiny increase in prices of 0.2% mom in September on the back of growth in prices of services less energy services. The price index of commodities less food and energy commodities remained unchanged. In year-over-year terms, the all items price index remained flat as accelerated decline in energy prices offset growth in food prices and prices of all items less food and energy. In particular, the energy index growth accelerated by 3.4 percentage points to 18.4% yoy, while both food and all items less food and energy saw little changes for the third consecutive month being equal to 1.6% yoy and 1.9% yoy respectively.

The national and Texas housing markets followed different trends in September. The national housing market saw positive changes, while the Texas housing market remained on the downward trend. Existing-home sales rebounded strongly at the national level after the decline observed in August. Total existing-home sales grew by 4.7% mom to a seasonally adjusted annual rate of 5.55 million. This is an 8.8% yoy increase and the second highest level since February 2007. The reason for growth in sales is the fact that housing affordability slightly improved despite faster growth in housing prices compared to that of wages (6.1% yoy versus 3.0% yoy). Increasing housing sales negatively impacted total housing inventory in September, which contracted by 2.6% mom to 2.21 million existing homes available for sale. Unsold inventories decreased to 4.8-month supply at the current sales pace compared to 5.1 months in August. Unlike the national housing market, the Texas housing market observed monthly declines in all major indicators. Actual existing-home sales decreased by 6.8% mom, which is faster than in August. At the same time, year-over-year growth in actual existing-home sales remained positive at a high rate of 9.2%. The over year growth of the median price of housing remained positive and identical to that at the national level despite a significant monthly decline (16.4%) in September. As for housing inventory, it declined insignificantly in Texas reaching a 3.6-month supply at the current sales pace.

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