

November 2015

Valentyn Povroznyuk, Edilberto L. Segura

- **The Bureau of Economic Analysis revised real GDP growth upwards to 2.1% quarter-over-quarter (qoq).**
- **National industrial output decreased again in October despite manufacturing's returned to growth.**
- **US exports decreases again after one-month of growth in September.**
- **Texas manufacturing activity posted the first decent growth this year in October.**
- **Texas exports decreased by 1.4% in Q3. In year-over-year terms, the decline accelerated to 9.1%.**
- **Employment in both the US in general and Texas posted increases above their 12-month averages in October.**
- **Unemployment in Texas further expanded but still remained below the national level.**
- **The all items index of consumer inflation inched up by 0.2% mom after two months of deflation.**

Executive Summary

National and Texas economies continued to expand at moderate rates in October and both showed signs of improvement. The revised estimates of real GDP growth proved the deceleration in growth was not as significant as reported earlier. Real GDP grew by 2.1% qoq in Q3 according to the latest data compared to 1.5% qoq reported in the advanced estimates.

Performance of the industrial sector did not improve at the national level in October. Total industrial output declined at the same rate observed in September despite some growth in manufacturing. Both mining and utilities decreased their output. The former did so due to a continued decline in oil prices, while the latter dropped due to a decline in electric utilities output as the weather became cooler and people use less air conditioning. Monthly dynamics just slightly impacted the year-over-year dynamics of industrial output.

Consumer confidence further softened at the national level in October. As surveys of the Conference Board showed, expectations of consumers worsened in relation to both current conditions in the economy and short-term outlook. Correspondents were the most concerned about the labor market developments. At the same time, they were less optimistic about future business conditions.

The situation in national level construction further improved in October. Total construction observed some acceleration in growth thanks to expansion of both private and public construction. Public construction, however, managed to grow faster thanks to better performance in the nonresidential sector. Private nonresidential construction returned to growth, which was still slower than private residential construction growth. Building permits also posted an increase in terms of their number. At the same time, valuation of permits remained almost unchanged in monthly terms. In year-over-year terms, building permits posted mixed performance as their number declined insignificantly, but their valuation posted decent growth.

National exports reversed the trend again in October. A 2.4% mom drop in exports of goods lowered total exports despite some growth in exports of services. In particular, the US observed a decline in exports of industrial supplies and materials and of capital goods, which was offset a bit by growth in exports of transportation and financial services.

The Texas economy further expanded thanks to both the manufacturing and nonmanufacturing sectors. Manufacturing activities posted the first significant growth in quite a long time. At the same time, problems in the sector were still far from being solved. The nonmanufacturing sector observed a slowdown in the pace of growth. Problems with recovery in manufacturing and deceleration in the nonmanufacturing sector began to impact consumer confidence in the state as people's expectations started to soften. Texas construction grew faster than at the national level. At the same time, Texas export activity and oil and gas extraction continued to face problems.

National labor market conditions further improved in terms of employment but saw only minor positive changes in terms of unemployment. At the same time, Texas posted some mixed labor market developments. The services sector fueled growth in employment above the 12-month average in US. Similar developments were observed in Texas. At the same time, the year-over-year growth of Texas employment fell below that of the US for the first time in quite a long while. The number of unemployed decreased insignificantly leaving the unemployment rate unchanged. Texas, on the contrary, observed quite a significant increase in the number of unemployed, which resulted in further growth of the

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unemployment level. The uneven labor market performance of Texas was reflected in developments at the metro level. Smaller metros observed worsening of labor market conditions, while larger ones performed much better.

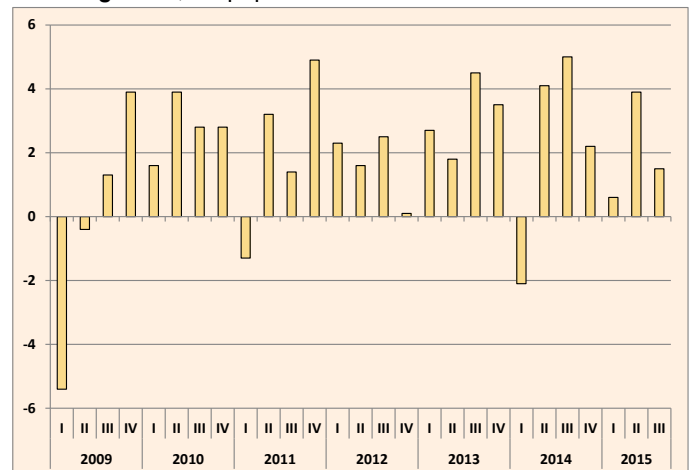
After two consecutive months of deflation, consumer prices increased again in October. All the major price indexes posted minor increases with the highest observed for the energy price index. This growth was attributed to an increase in gasoline prices. Both national and Texas housing markets posted sluggish performance during the reporting month. They both experienced declines in existing-home sales. At the same time, problems with improvement of housing supply led to further deterioration of unsold inventory at both the national and Texas level. Median existing-home prices grew faster in Texas.

Economic Growth

On November 24th, the Bureau of Economic Analysis released its updated estimates of US GDP growth. According to the update, real GDP grew by 2.1% qoq in Q3, which is an upward revision from the 1.5% qoq announced previously. The estimate for government consumption expenditures and gross investment remained unchanged at 1.7% qoq. At the same time, the estimate for growth in gross private domestic investment was revised upwards to -0.3% qoq. The rest of the major GDP components observed negative revisions of their dynamics. In particular, growth of personal consumption expenditures was revised downward by 0.2 percentage points to 3.0% qoq, while revised growth of exports was reported at 0.9% qoq down 1.0 percentage point from the previous estimate. Growth of imports inched up after revision to 2.1% qoq, which was the negative change for GDP as imports enter GDP with the negative sign.

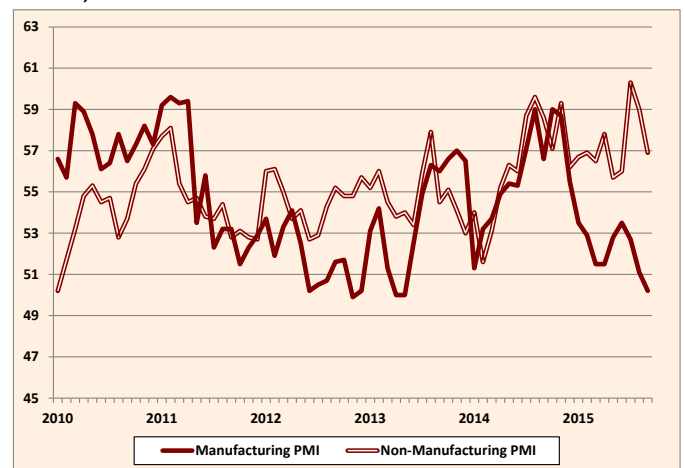
US industrial output reported a decline in October identical to that observed in September (0.2% mom). The overall decline was fueled by decreases in mining and utilities, while manufacturing posted 0.4% mom growth. Manufacturing output reversed the downward trend thanks to increases in output of both durable and nondurable goods. Nearly all major categories of durable goods industries increased their production. Gains above 1.0% mom were reported by nonmetallic mineral products, wood products, electrical equipment, appliances, and components, and by primary metals contributing to a total 0.5% mom growth. Nondurable goods industries posted a 0.3% mom increase mainly on the back of output of textile and product mills, which grew by 0.9% mom and on the back of growth in petroleum and coal products of 1.3% mom. At the same time, it could be higher if not for a 2.6% mom decline in production of apparel. The 1.5% decline in mining reflected significant declines in crude oil extraction, as well as in oil and gas well drilling and servicing. As for utilities output, it reversed the trend (from growth of 1.2% mom last month to a decline of 2.5% mom) due to a significant decrease in electric utilities production, which was only partly offset by

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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an increase in output of natural gas utilities. Sluggish monthly performance of industrial sector output led to further deceleration in its year-over-year growth. The total index inched up by 0.3% yoy, which is 0.1 percentage points lower than a month ago. This growth was fueled solely by growth of manufacturing output of 1.9% yoy, which more than compensated for the accelerated decline in mining (from 5.7% yoy last month to 6.9% yoy) and the negative 2.2 percentage point change in growth of utilities to a 1.2% yoy decline.

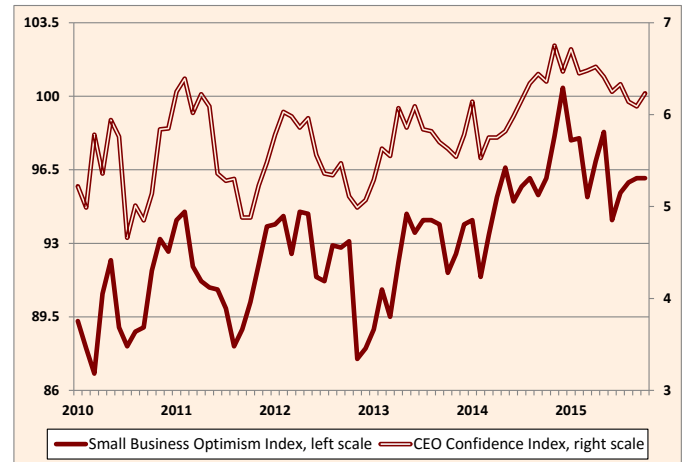
According to the Institute for Supply Management, both manufacturing and non-manufacturing activity continued to expand in October. However, the pace of growth in manufacturing activity continued to fade away, while growth in non-manufacturing activity recovered to a level slightly above that observed in August. In particular, the PMI index dropped 0.1 percentage points to 50.1%. The decline in the employment index accelerated (by 2.9 percentage points to 47.6%) the same as the decline in inventory index (by 2.0 percentage points to 46.5%). At the same time, there was an increase in new orders and production indexes, which may lead to accelerated growth of manufacturing activity in the upcoming months. The former grew by 2.8 percentage points to 52.9%, while the latter expanded by 1.1 percentage points to the same 52.9%. Just 7 out of 18 manufacturing industries reported growth in October. Nine manufacturing industries reported declines. The high price of the dollar and continued low price of oil were the main problems for the sector. On the other hand, several industries (fabricated metal products, transportation equipment, and electrical equipment, appliances, and components) showed cautious optimism about increasing demand. The NMI index grew by 2.2 percentage points to 59.1% in October after an almost identical 2.1 percentage point decline in September. Just 2 out of 10 NMI components posted declines, while all the other components either remained unchanged (just one) or expanded. Among components that posted growth were indexes of business activity/production, new orders, employment, and inventories. The 14 non-manufacturing industries reported growth, while only mining reported a decline.

Consumer confidence further softened in November.

The Conference Board Consumer Confidence Index lost 8.7 basis points from the revised 99.1 to 90.4. Similar to the previous month, both the Present Situation Index and the Expectations Index decreased. Both indexes suffered from consumer expectations related to the job market. The number of respondents claiming jobs are “plentiful” decreased and the number of those claiming jobs are “hard to get” increased in both the current situation assessment and in the short-term outlook. The Expectations Index was also negatively impacted by consumers’ assessment of business conditions. Influence of business conditions assessment on the Present Situation Index was rather mixed.

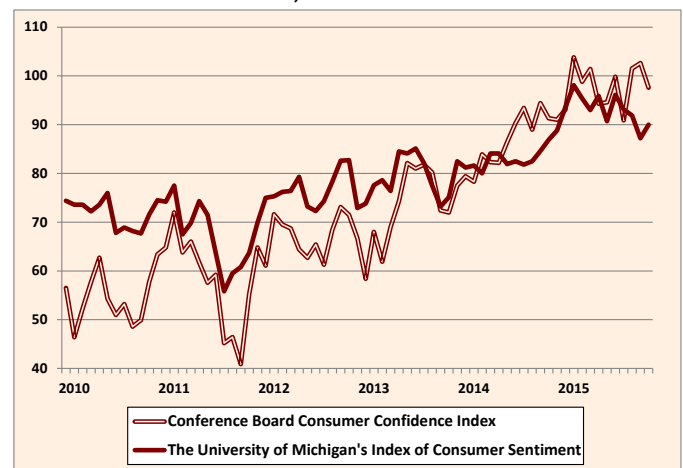
US construction continued to expand moderately in October. Growth of total construction slightly accelerated to 1.0% mom thanks to increases in both private and public construction. However, the latter grew faster on the back of nonresidential construction. A 1.4% mom increase in public nonresidential construction more than offset a 1.0 mom

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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decline in public residential construction. Private residential construction saw its growth almost halved at 1.0% mom compared to September. At the same time, private nonresidential construction returned to growth (0.6% mom) after one month of decline in September. Thanks to the mentioned monthly developments, the year-over-year growth of total construction accelerated by 1.2 percentage points to 11.7% yoy. Private construction not only continued to outpace public construction in terms of growth but also further widened the gap. Growth of private construction accelerated to 14.3% yoy, while growth of public construction decelerated to 5.6%. The number of construction permits slightly expanded in October on the back of permits on construction of multi-unit houses. The total number of permits increased by 1,000 (roughly 1.0% mom) to 98,200 as a decrease of 400 permits on construction of 3-4-unit houses was fully covered by an increase of 1,400 permits on construction of multi-unit houses. The number of permits on 1-unit and 2-unit houses remained unchanged. The valuation of construction permits remained almost flat, since changes in the number of issued permits was not very significant. The over-year dynamics of construction permits sustained more significant changes. In particular, the number of permits reversed the trend observing a 5.1 percentage point deceleration in growth from 4.9% yoy to -0.2% yoy. At the same time, the mentioned decline was fueled by a significant drop in the number of permits on construction of multi-unit houses (by 7% yoy), which was partly offset by growth in the number of permits on construction of single-unit houses (by 4.4). Therefore, the total valuation of permits even increased by 5.5% yoy as unit costs of construction of a single-unit house are higher than those of construction of a multi-unit house.

After a one-month increase in September, the national exports declined again in October. Total exports saw a 2.0% mom decline to USD 184.1 billion as the increase in exports of services was significantly lower than the decline in exports of goods. Exports of goods dropped 2.4% mom or USD 3.1 billion to USD 123.8 billion. The major negative contribution to growth of exports was made by industrial supplies and materials, the exports of which decreased by USD 1.6 billion (half of the decline was related to exports of fuel oil and other petroleum products). Exports of capital goods decreased by USD 0.9 billion, of which USD 0.5 billion was the decline in exports of industrial engines. Exports of services expanded by USD 0.4 billion to USD 60.3 billion on the back of equal contributions from transport and financial services.

Texas continued to perform modestly in terms of economic growth in October. One of the major contributions to growth was made by the manufacturing sector. Manufacturing activity expanded in October after nine months of flat or declining output. The Production Index, a key measure of state manufacturing conditions, rose to 4.8 marking the first month of decent growth this year. At the same time, the sector was far from getting rid of all its problems as important indexes remained in negative territory and deteriorated even further. In particular, the new orders index further declined by 3 basis points to -7.6. This was the third negative monthly reading in a row. Indexes related to broader business conditions remained negative in October meaning that respondents' perceptions remained weak. On the other hand, expectations regarding future business conditions remained almost flat.

The Texas services sector activity continued to expand in October but at a significantly decelerated pace. The Revenue Index measuring services sector conditions fell from 12.8 to 7.6, its lowest level in five months. At the same time, respondents' perceptions of broader economic conditions and their expectations regarding future business conditions were optimistic. Furthermore, most of the indexes related to future business conditions grew in October reflecting increased optimism of respondents.

Consumer confidence softened more significantly in Texas compared to the national level in November. The Conference Board Consumer Confidence Index for Texas dropped 14.7 basis points to 101.2 compared to the above mentioned 8.7 basis point decline of the Index for the US economy as a whole.

Texas construction grew faster than national construction in October. Similar to the US in general, the number of building permits expanded in Texas but expanded much faster. The total number of issued construction permits rose by 12.1% mom thanks to increases in categories of homes. The valuation of building permits grew by 9.3% mom, which was slower than their growth in numbers, since the number of permits on construction of multi-unit houses grew faster than the number of those on construction of single-unit houses. Because of high monthly growth in the number of building permits, its year-over-year growth improved and entered positive territory

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(8.8%). Similar over-year growth (8.5%) was reported for valuation of building permits, as the shares of different house types did not change much in a year. Nonresidential building construction continued to expand in Texas in October. In particular, the contract value for nonresidential building construction grew by USD 0.8 billion to USD 2.5 billion in one month.

The latest available data on Texas exports showed continued decline. In particular, total exports decreased by 1.4% in the third quarter leading to a 9.1% yoy decline. Declines were observed in exports to Texas' major trading partners including Canada, European Union, Asia, and Latin America (excluding Mexico). Exports to Canada decreased by 1.7% in Q3 after a 7.8% increase in Q2. In contrast, increases were observed in exports to China (by 2.0%) and to Mexico (by 0.7%) in Q3.

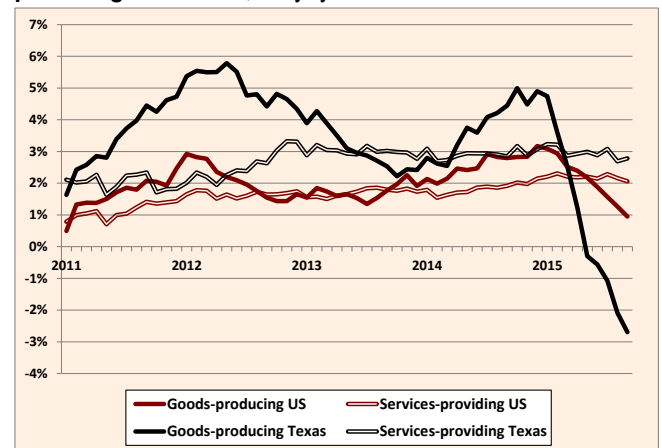
The Texas rig count further declined in October. The second consecutive monthly decline was equal to 4.9% mom (from 367 to 349). The year-over-year decline accelerated from 59.3% observed in September to 61.2%.

Employment

US labor market conditions further improved in October as employment growth accelerated under virtually unchanged unemployment. Total nonfarm payroll employment expanded by 298,000 which is significantly higher than the 12-month average of 231,000 and more than two times higher than the revised amount of 145,000 in September. In relative terms, the growth rate doubled to 0.2% mom. Services providing industries remained the driver of employment growth. The highest gain in employment in absolute terms was reported by professional and business services at 90,000 (0.5% mom). Health care, food and beverage services, and retail trade also posted high employment gains of 51,300 (0.3% mom), 44,600 (0.4% mom), and 40,600 (0.3% mom) respectively. Employment in mining continued to decline (5,100 or 0.7% mom). Such industries as manufacturing, wholesale trade, transportation and warehousing, information, financial activities, and government reported little or no change in employment in October. The year-over-year growth of employment returned to 2.0% thanks to a larger monthly gain. The number of unemployed remained almost flat at 7.9 million in October. Therefore, the unemployment rate sustained just a minor change decreasing to 5.0%. In year-over-year terms, the number of unemployed decreased by about one million leading to a 0.7 percentage point drop in the unemployment rate.

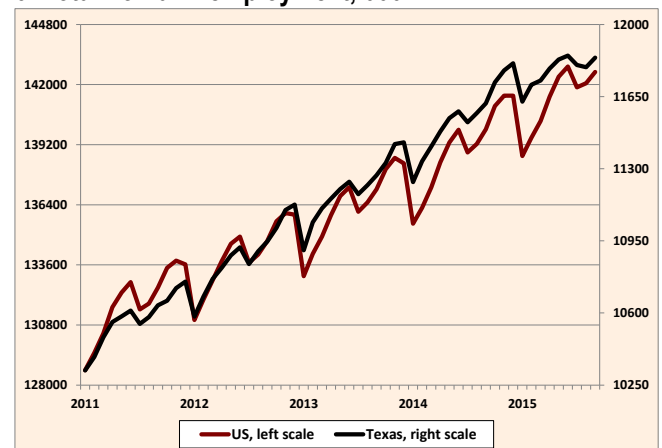
Contrary to the national level, Texas labor market conditions experience mixed developments in October as both employment and unemployment expanded in monthly terms. October was the eighth month of the year of growth in nonfarm jobs, which expanded by 20,000 (0.2% mom). This is lower than the number of new jobs generated last month (26,600) but higher than the average of the last 12 months (18,500). More than three-quarters of new jobs were generated by the services sector. In particular, leisure and hospitality generated 12,400

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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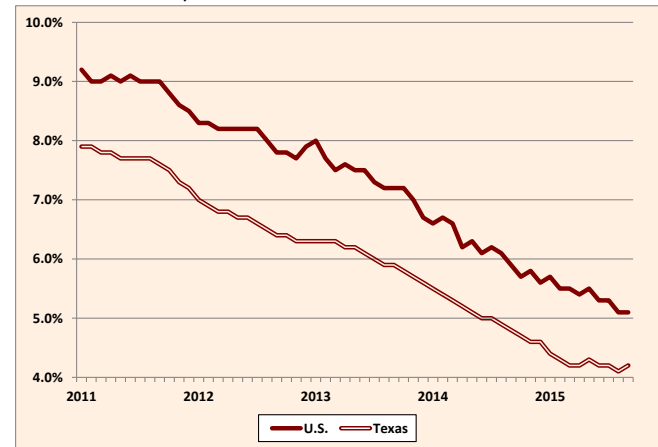
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jobs (1.0% mom), while employment in the professional and business services industry expanded by 3,300 positions (0.2% mom). The construction industry managed to generate 2,600 new jobs (0.4% mom). Employment in mining further declined in October. The industry lost 3,300 jobs, which is a 1.2% mom decline. On the other hand, the government sector reversed the trend generating 4,100 new jobs (0.2% mom). In year-over-year terms, growth of employment further decelerated in Texas in October. Total nonfarm employment growth was equal to 1.7% yoy, which is the lowest level since September 2010. The unemployment rate edged up again to 4.4% in October returning to the level observed in January. It still remained below the level observed in the US in general, but the gap is closing. The number of unemployed expanded to 570,084 individuals (by 4.5%).

7. Jobless rate, %



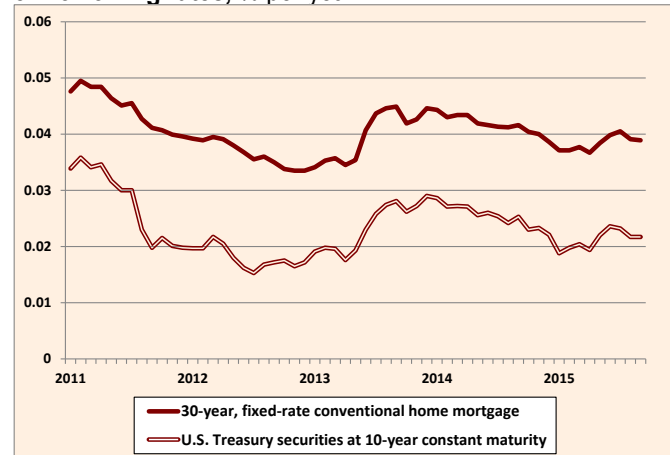
Source: Bureau of Labor Statistics

Labor market conditions deteriorated again at the metro level in Texas in October. The number of metros observing monthly declines in employment increased from 7 to 10. El Paso and Victoria posted no monthly changes in employment at all. 13 other metros expanded their employment. These include Austin-Round Rock, Dallas-Fort Worth-Arlington, Houston-The Woodlands-Sugar Land, and San Antonio-New Braunfels, which together constitute around 70% of total Texas employment. San Antonio-New Braunfels posted the fastest growth in employment among all Texas metros at 3.3% mom. The sharpest decline in employment was registered in Midland, which was the leader in employment growth for many months in 2014 and 2015. The situation with unemployment further deteriorated at the metro level in October. Just 3 metros saw no change in the number of unemployed, while all of the rest reported increases. Odessa, Midland, and Laredo posted the fastest growth in unemployment at 7.9% mom, 6.3% mom, and 5.9% mom respectively. At the same time, McAllen-Edinburg-Mission remained the metro with the highest unemployment rate (7.4%), while Amarillo still was the one with the lowest unemployment rate (3.2%).

Monetary Policy and Asset Prices

Consumer inflation reversed the trend in October. After two consecutive months of deflation, the all items index posted a 0.2% mom increase. This happened because all the major price indexes posted small increases. In particular, the energy price index grew by 0.3% mom as there was some growth in world oil prices resulting in a 0.4% mom growth of gasoline prices. This growth overwhelmed the continued decline in fuel oil prices (1.1% mom). Similarly, a 0.4% mom increase in electricity prices was more than enough to overcome a 0.7% mom decline in utility gas prices ensuring overall 0.2% mom growth for energy services price index. The food price index posted just a minor increase of 0.1% mom on the back of similar developments in both food at home and food away from home prices (0.1% mom and 0.2% mom increases respectively).

8. Borrowing rates, % per year



Source: Federal Reserve System

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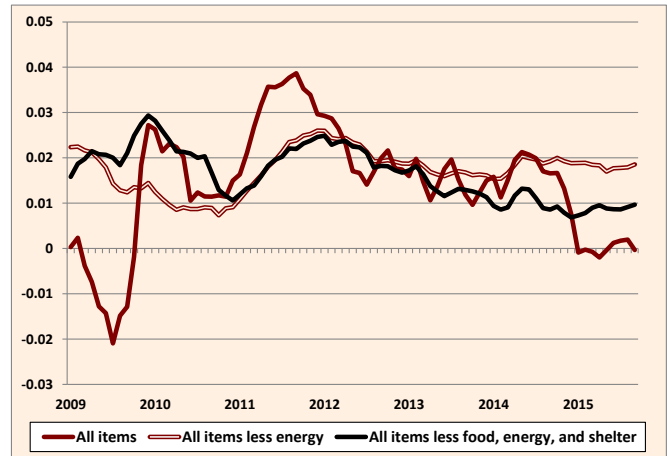
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The all items less food and energy index inched up by 0.2% mom thanks to services less energy services index. The latter posted a 0.3% mom increase because of an increase in prices of all services, with the sharpest increase in medical care services of 0.8% mom. Commodities less food and energy commodities edged down by 0.1% mom overall because of deflation for all the commodity groups except medical care commodities. The sharpest decline was observed in prices of apparel at 0.8% mom. The mentioned monthly price dynamics had little change on major year-over-year price index. In particular, the food price index and all items less food and energy price index remained unchanged again at 1.6% yoy and 1.9% yoy respectively. The decline in the energy price index saw a 2.3 percentage point deceleration to 17.1% yoy. As a result, the all items index inched up from 0 to 0.2% yoy.

9. CPI, % yoy change



Source: Bureau of Labor Statistics

The national and Texas housing market experienced some cooling in October, although the US housing market reversed the trend in October. Existing-home sales (seasonally adjusted annual rate) dropped 3.4% mom to 5.36 million. This slowed down the annual growth of sales by 4.9 percentage points to 3.9% yoy. Home sales suffered from both supply and demand shocks. In particular, the new and existing-home supply has struggled to improve in autumn, limiting choices for buyers. At the same time, mixed signals of volatility in the financial markets and deceleration in economic growth slightly tempered demand and slowed the pace of sales. The median existing-home prices marked the 44th consecutive month of year-over-year growth as it added 5.8% yoy to USD 219,600 in October. On the other hand, lower October sales led to a buildup in the unsold housing inventory to a 4.8-month supply at the current sales pace (4.7-month supply in September). Total housing inventory, however, continued to decline. In October, it decreased by 2.3% to 2.14 million existing homes available for sale, which is 4.5% yoy lower. The decline in total inventory under decreasing sales is one more proof that housing supply struggles to improve at the national level. Major housing market indicators also declined in Texas in October. In particular, actual existing-home sales decreased by 7.8% mom, which also negatively impacted year-over-year sales (which fell by 2.1%.) At the same time, housing supply failed to improve on decreasing sales. Unsold inventory reported a minor decrease from 3.6 to 3.5 months of housing supply under the current sales pace. As for median existing-home prices, they increased after one month of decline. Moreover, they grew faster than those at the national level (7.4% yoy compared to 5.8% yoy).

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