

September 2016

Valentyn Povroznyuk, Edilberto L. Segura

- **The Bureau of Economic Analysis revised its estimate for GDP growth in Q2 upwards to 1.4% quarter-over-quarter.**
- **US industrial production returned to a decline, posting a 0.4% mom decrease in August after two months of growth.**
- **The Texas economy continued to expand in August thanks to expansion in manufacturing and service activity.**
- **The Texas rig count grew for the third month in a row but still remained significantly below the level observed a year ago.**
- **Labor market conditions in the US improved in general, but observed both positive and negative developments in Texas.**
- **The Federal Reserve left the policy rate target range unchanged at 0.25-0.5%, despite some obvious preconditions for growth.**
- **The housing market saw mostly negative developments for the US in general and rather mixed developments in Texas in August.**

Executive Summary

The US economy moderately expanded further in August. The third estimate of the Bureau of Economic Analysis showed revised upward growth for real GDP in Q2 at 1.4% qoq. At the same time, there was little change in the structure of GDP. The Texas economy also saw growth in August.

National industrial production reported a decline after two consecutive months of growth. Manufacturing and utilities were drivers of the decline, as mining continued to grow. Furthermore, growth in mining significantly accelerated in August. The decline in manufacturing production was the result of lower output in all segments of manufacturing. But the most significant effect on manufacturing production was the lower output of durables.

Consumer confidence continued to improve in September. Similar to previous months, perceptions of both the present situation and short-term outlook improved. At the same time, the mentioned improvements were the result of more optimism in relation to the labor market, while assessment of business conditions saw both positive and negative developments compensating each other.

The Texas economy expanded again in August. Both manufacturing and service sectors promoted growth, showing quite significant expansion in activity. However, expansion of the service sector decelerated compared to the previous month. Consumer confidence further strengthened in August. The Texas rig count increase for the third consecutive month and at an accelerating rate, which did not change its year-over-year dynamics much.

US labor market conditions improved again in August. Employment further expanded, while unemployment remained almost unchanged. In line with the trend of the last few months, growth in employment was the result of positive developments in the service sector industries. The labor market developments were rather mixed in Texas during the reporting month. On the one hand, Texas saw the same growth in employment as the US in general in relative terms. On the other hand, the number of unemployed also increased in Texas.

The Federal Reserve Open Market Committee saw preconditions for the increase in the policy rate target range, but decided to wait until they become more evident. Therefore, the Committee left the target range unchanged at 0.25-0.5%. Consumer prices returned to growth in August. Prices of food and energy remained flat, but prices of all items less food and energy posted a minor increase. Housing markets in Texas and the US in general saw similar and opposite developments. In particular, they both saw a decline in inventory and growth in median price. At the same time, sales in Texas increased but fell in the US in general.

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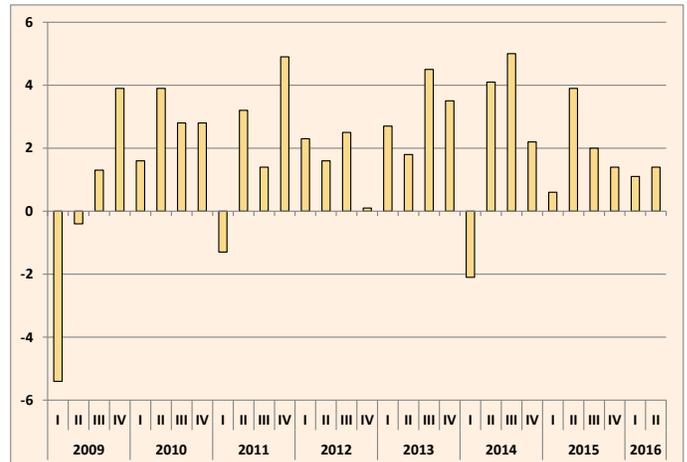
Economic Growth

The Bureau of Economic Analysis upwardly revised the GDP growth estimate for Q2. According to the third estimate, real GDP expanded by 1.4% qoq at an annual rate in Q2. This is 0.3 percentage points higher than in the second estimate published earlier. The only significant change in GDP components from the second to third estimate was the increase in nonresidential fixed investment as it was reported to be declining earlier.

National industrial production saw a trend reversal in August. It declined (by 0.4% mom) after two months of growth. Dynamics in manufacturing and utilities was the major reason for the decline as mining continued to grow. Furthermore, growth in mining accelerated from 0.2% mom to 1.0% mom as a decline in coal mining was overwhelmed by increases in oil and gas extraction, oil well drilling and servicing, and metal ore and nonmetallic mineral mining. At the same time, despite four-month monthly growth, the mining index still remained 9.3% below its year-ago level because of a prolonged period of monthly declines earlier this year. Utilities posted a much faster monthly slowdown compared to manufacturing (by 3.3 percentage points to a 1.4% mom decline, compared to a 0.8 percentage point deceleration to a 0.4% mom decline). At the same time, increased usage of air conditioning due to the hot summer ensured a 1.7% yoy growth of utilities. Other manufacturing posted the sharpest monthly decline at 0.7% mom in August, but production of durables was the actual reason for the overall decline in manufacturing because of its share. Many durable goods industries saw declines of around 1% mom and more with the largest drop registered for machinery at 1.9% mom. As a result, the overall decline of durables was at 0.6% mom. As for nondurables, quite significant gains in some industries were offset by declines in others. Overall, the effect for the subsector was negative as it posted a 0.2% mom decline. The year-over-year change in manufacturing was also negative at 0.4%.

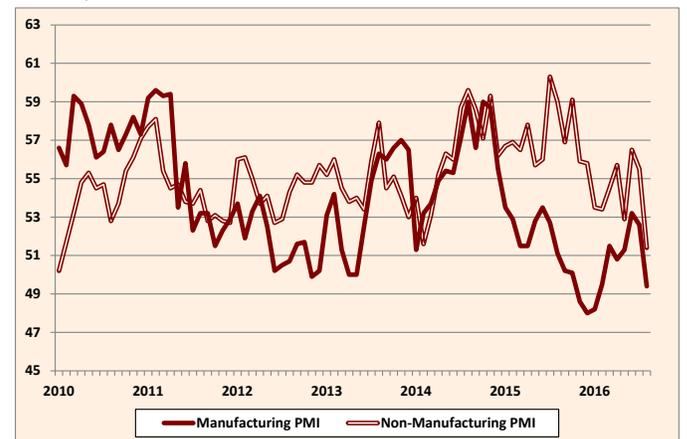
After five months of expansion, manufacturing sector economic activity contracted in August. According to the Institute for Supply Management, the PMI index dropped 3.2 percentage points to 49.8%. Furthermore, all the PMI components posted negative monthly changes in dynamics except for new export orders index. As a result, most of the indexes dropped below the 50% threshold meaning that they reversed the trend to the downward one. Among those indexes were new orders, production, employment, and inventories. Just 6 of 18 manufacturing industries reported growth in August: printing and related support activities; nonmetallic mineral products; computer and electronic products; miscellaneous manufacturing; food, beverage and tobacco products; and chemical products. Unlike the economic activity of the manufacturing sector, the one of the non-manufacturing sector continued to expand in August. However, its growth rate significantly decelerated. In particular, the NMI index dropped 4.1 percentage points to 51.4%. This is because all its components, except for

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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supplier deliveries and inventory sentiment indexes, posted negative changes in dynamics. This includes such important indexes as business activity, new orders, employment, and inventory indexes. The latter one reversed the trend as its value dropped below the 50% threshold. Eleven non-manufacturing industries reported growth in August. Among them were utilities and construction.

Consumer confidence continued strengthening in September. The Conference Board Consumer Confidence Index moved up by 2.3 basis points to 104.1, reaching the highest level since the recession. The overall index benefited from improvements in perceptions of both present and future conditions. In particular, the Present Situation Index expanded by 3.2 basis points to 128.5, while the Expectations Index improved from 86.1 to 87.8 in one month. Improvements were driven by more favorable assessment of labor market, while consumers remained quite cautious about progress in business conditions. The number of those saying business conditions are “good” decreased in relation to both current situations and short-term outlook. At the same time, the number of those saying business conditions are “bad” also increased almost identically, preserving status quo. On the other hand, assessment of labor market conditions saw only positive changes in September. The number of consumers expecting more jobs increased in relation to both the current situation and short-term outlook. Similarly, the number of those expecting fewer jobs declined.

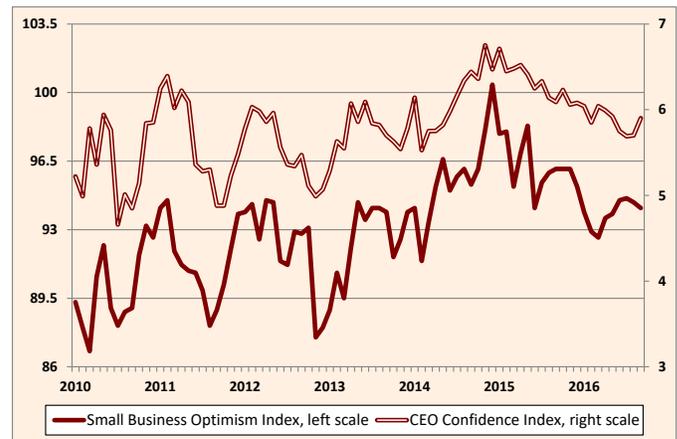
The Texas economy expanded again in August. Among the factors ensuring growth was factory activity. After being around zero in July, the production index of the Texas Manufacturing Outlook Survey expanded to 4.5 suggesting output picked up in August. Other measures of current manufacturing activity also reflected expansion even though perceptions of broader business conditions remained fairly pessimistic. Both labor market measures and expectations regarding future business conditions improved in August, but the latter saw more significant changes.

Texas service sector activity expanded again in August. However, expansion significantly decelerated compared to the previous month. As the data of the Texas Service Sector Outlook Survey showed, the revenue index reading fell from 10.3 to 6.5. Quite significant improvements were reported for labor market indicators. Perceptions of broader economic conditions were mixed during the reporting month. Expectations of respondents regarding future business conditions were less optimistic.

Texas consumer confidence further improved in September. It strengthened more significantly compared to the national level. The Conference Board Consumer Confidence Index for Texas increased by 14.8 basis points to 122.3.

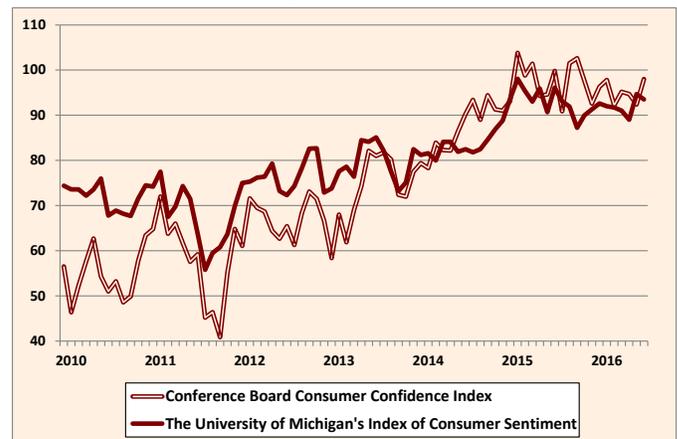
The value of nonresidential construction contracts bounced back, increasing from USD 1.7 billion to USD 2.3 billion.

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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Texas exports remained on a downward trend in July. Furthermore, the rate of decline accelerated to 7.0% mom, which was the sharpest monthly decline since January 2009. In year-over-year terms, exports decreased by 14.7% to their lowest level since March 2011.

The Texas rig count continued to grow in August. It expanded for the third month in a row, this time by 11.6% mom to 231. The rig count has been increasing at an accelerating rate, meaning that the situation in the energy sector is stabilizing. On the negative side, the rig count was still 40% below its level a year ago despite the recent recovery.

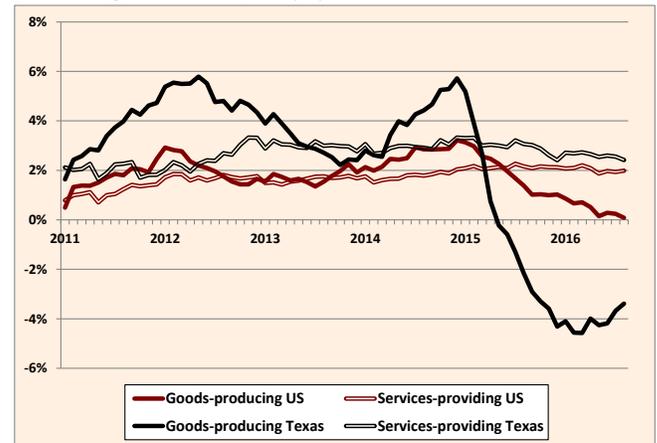
Employment

National labor market conditions followed the trend observed for the last couple of months in August. Employment expanded, while unemployment remained virtually unchanged. In particular, total nonfarm payroll employment rose by 167,000 positions (0.1% mom) in August, which is lower than the average monthly increase of 204,000 registered over the last 12 months. Most of the increase was attributed to gains in several service-providing industries. The largest gain was reported by food services and drinking places at 29,600 new jobs (0.3% mom). Professional and technical services and social assistance followed with 24,600 (0.3% mom) and 23,000 (0.6% mom) new jobs respectively. Financial activities and health care industries also reported employment growth but less significant. Mining saw further decrease in employment despite recent positive

changes stimulated by some recovery in oil prices (4,000 positions or % mom). Other industries, including construction, manufacturing, trade, and transportation saw little or no changes in employment during the month. In year-over-year terms, total nonfarm employment posted 1.7% growth (2.4 million positions) to 144.4 million in August. The number of unemployed remained virtually unchanged at 7.8 million in August. Therefore, the unemployment rate stayed at 4.9% for the third month in a row.

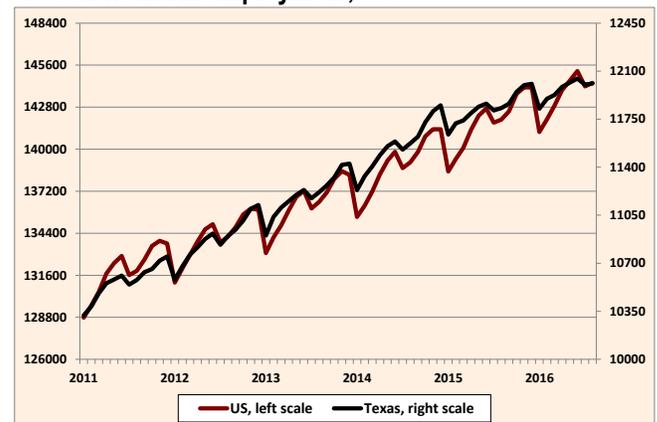
The Texas employment market experienced both positive and negative developments in August. On the positive side was expansion in employment. At the same time, unemployment also expanded. Texas added 14,500 of total nonfarm jobs, which was equivalent to 0.1% mom growth. Two industries ensured half of the mentioned increase in employment. The financial activities industry generated 2,300 new jobs (0.3% mom increase). Employment of trade, transportation and utilities expanded by 5,000 positions (0.2% mom). In over-year terms, Texas employment expanded by 179,800 new positions (1.5% growth). As for the unemployment, it inched up by 0.1 percentage points to 4.7%, but still remained below the national level.

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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The number of Texas metros observing a monthly increase in employment was almost equal to the number of metros observing a monthly decline in employment in August. However, the over-year decline in employment was reported only by Odessa at 0.8%. The rest of the metros reported employment growth ranging from 0.3% yoy in Midland to 4.3% yoy in College Station-Bryan. There were some positive changes in unemployment among the Texas metros as only Tyler and Beaumont-Port Arthur reported monthly growth in the number of unemployed. However, this did not improve the year-over-year dynamics of unemployment in metros because of negative monthly developments in previous months this year. McAllen-Edinburg-Mission reported the highest unemployment rate at 8.4%, while Amarillo reported the lowest unemployment rate at 3.4%.

7. Jobless rate, %



Source: Bureau of Labor Statistics

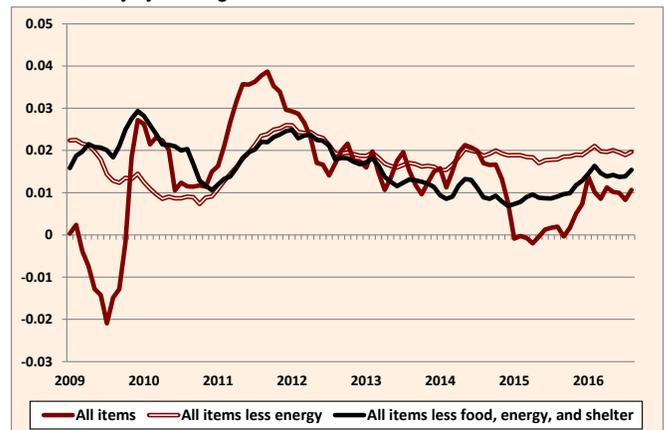
Monetary Policy and Asset Prices

The Federal Reserve again left the target range for the federal funds rate unchanged at 0.25-0.5% in September. During its meeting on September 21st, the Federal Open Market Committee analyzed the most recent economic data and reached the conclusion that there were enough preconditions for the increase in the federal funds rate, but decided to wait for further evidence of continued progress towards fulfilling its mandate objectives. In particular, there were solid job gains on average, with little changes in unemployment, but inflation remained below the longer-run objective of 2%.

Consumer prices returned to growth in August after one month of stability. A 0.2% mom growth in all items prices was fully attributed to the increase in prices of all items less food and energy, as both food and energy price indexes posted no change in August. In particular, a 0.2% mom increase in the food away from home price index was fully offset by a 0.2% decline in food at home price index. At the same time, a 0.8% mom increase in energy services price index, fueled by higher prices of both electricity and utility gas service, was fully offset by a 0.9% mom decline in energy commodities price index because of declines in prices of both gasoline and fuel oil. Prices of commodities less food and energy commodities remained almost flat in August. Thus, the overall monthly increase in consumer prices was the result of a 0.3% mom growth of prices of services less energy services. In year-over-year terms, the all items index expanded by 1.1% as a 2.3% growth in the price index of all items less food and energy more than compensated for a 9.2% decline in the energy price index. The food index remained unchanged.

The national housing market saw negative developments again in August. Little progress in inventory and growing prices led to one more monthly decline in existing-home sales of 0.9% from a downwardly revised seasonally adjusted annual rate of 5.38 million observed in July. At 5.33 million, existing-home sales were at their second-lowest level in 2016. At

8. CPI, % yoy change



Source: Bureau of Labor Statistics

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the same time, they were 0.8% higher than a year ago. The median existing-home price followed the development trend observed over the last couple of months, increasing by 5.1% yoy to USD 240,200 in August. Total housing inventory dropped 3.3% mom to 2.04 million of existing homes available for sale. This monthly decline also worsened the over-year dynamics of inventory as it posted a 10.1% yoy decrease. The negative trend of total housing inventory extended to 15 straight months. As for unsold inventory, it also declined to 4.6 months of supply at the current sales pace. The Texas housing market posted better performance than the national one. In particular, actual existing-home sales increased by 8.2% mom to the second largest level this year of 32,676. In over-year terms, the dynamics of existing-home sales was also positive as they expanded by 7.6%. Growth of housing prices in Texas remained higher than at the national level, as the median existing-home price expanded by 7.5% yoy in the state. At the same time, housing prices were still lower in Texas than in the US in general. Similar to the national level, Texas unsold housing inventory posted a minor decline from 4.0 to 3.9 months of supply under the existing sales pace.

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