Executive summary

The U.S. economic situation is gradually improving - factory activity resumed growing in September following three consecutive months of contraction. The broader economy is showing signs of life well with business activity indices returning to growth rates last observed at the start of this year. Essentially, consumer spending on durable goods and, in particular, improving auto sales, is contributing to a steady growth of retail sales. Indeed, continued, albeit modest, recovery of private sector hiring is boosting consumer confidence. Meanwhile, low interest rates, increasing consumer credit as well as a faster growth of personal income add to households’ buying power.

Equally important, housing appears to be slowly turning the corner as various metrics of construction activity point to a healthy uptick in homebuilding. Indeed, August saw a big jump in housing starts while increasing issuance of building permits indicates a brighter outlook for residential construction. This means that the housing sector may have already ceased to be a drag on the national economic recovery.

At the same time, weak new orders of manufactured goods imply that businesses remain cautious about increasing investment spending. For example, orders of new capital goods are still below last year’s level, and it is partly the reason for sluggish growth of new private jobs as nebulous economic outlook deters expansion plans and saps business confidence. In particular, concerns over rising health care cost, increasing hostility of the business climate and looming spending cuts and tax hikes are emerging as key restraints on corporate America.

Turning to Texas, regional factory activity strengthened in September and business conditions in the service providing sectors improved as well. Meanwhile, the Houston Purchasing Managers Index hovers close to 60%, which testifies to the continuing strength of the state’s largest metro economy. Lastly, a stronger rebound in the regional housing sector, driven by improving homebuilding activity in Houston and Dallas, is sustaining the better performance of the Texas economy and regional labor market.

In fact, in September the jobless rate in Texas stood at 6.8% - its lowest reading since March 2009. Thus, it remains a full percentage point below the national rate even though the Texas workforce is growing much faster.

In fact, over the past twelve months, Texas added over 270,000 new private jobs – a 3.1% annual gain versus just 1.7% growth for the nation as a whole.

Admittedly, Texas added nearly 700,000 new private-sector jobs since the labor market recovery started in earnest at the end of 2009. And about 45% of these jobs were supported by more dynamic local economic conditions. On that note, the Texas labor market outshines many other large regional economies – for example, less than 15% of new private-sector jobs in California can be attributed to the competitiveness of that state.

A closer look at sector specific job gains may help explain a stronger labor market turnaround in Texas. First, nationwide, most new private sector jobs created since December 2009 were in service-providing sectors. In Texas, about one in five new private-sector jobs came from goods-producing industries, which attests to their underlying competitiveness. Moreover, a big portion of new private jobs in Texas service-providing industries can be attributed to state-specific factors that sustained more rapid growth versus the nation as whole. Thus, Texas is likely to outperform other U.S. regions in job creation, as its leading industries are getting bigger.

Lastly, September’s employment numbers indicate that the Texas labor market continued to add jobs at a robust pace. About 30,000 new private-sector jobs were created in Texas thanks to increasing employment in manufacturing, professional and business services, education and healthcare, trade, transportation and utilities and leisure and hospitality. Faster job growth in the Texas service-providing industries is an important driver of job creation in the Lone Star State. Indeed, during the first three quarters of 2012, Texas created about the same number of private-sector jobs as a year earlier. Meanwhile, during the same three quarters, the national private sector added 16% fewer jobs than a year ago. As a result, the share of Texas in national job creation increased from 14% in 2011 to 16% in January-September 2012.
Economic recovery.

In the second quarter of 2012, household debt service payments as a percent of disposable personal income stood at just 10.7%—its lowest level since 1984. Source: The Federal Reserve.

Sylvain Leduc and Zheng Liu, Uncertainty, Unemployment, and Inflation, FRBSF Economic Letter.
Houston Purchasing Managers Index hovers close to 60%, which testifies to the continuing strength of Texas’ largest metro economy. Admittedly, slower growth of energy prices (see chart 9) may weaken business activity in Houston (see chart 10). However, this metro economy remains an important driver in the overall economic rebound in the Lone Star State (see chart 11). And being the largest export hub helps - about 7% of all national exports and over 40% of all Texas exports depart from Houston. On that count, Texas exporters are less exposed to slowing economies in the Eurozone and Asia. Indeed, the European Union and China account for only 12% and 4% of all exports from Texas, respectively, compared to 18% and 7% nationwide. Meanwhile, over half of all exports from Texas go to Latin America, including Mexico, versus just a quarter nationwide. As demand for foreign goods remains relatively robust in Latin America, Texas is enjoying stronger growth of exports – in January-August, exports from Texas were up by 6.4% compared to 5.6% nationwide. Recently, Texas non-energy exports has been performing better versus the nation as a whole (see chart 12), which adds support to local manufacturers as well.

Lastly, a stronger rebound of the regional housing sector, driven by improving homebuilding activity in Houston and Dallas (see chart 13), sustains growth momentum of the Texas economy. Indeed, the Texas construction industry saw smaller job losses during the recession and a faster pick up in hiring in 2012 (see chart 14).

**Employment**

In September, the jobless rate in Texas dropped to 6.8% - its lowest level since March 2009 (see chart 15). It is worth mentioning that the state’s unemployment rate remains a full percentage point lower compared to the national rate even though the Texas workforce is growing faster (thanks to more rapid population growth and brighter jobs prospects) versus the nation as a whole (see chart 16). In fact, over the past twelve months Texas has added over 270,000 new private jobs – a 3.1% annual gain versus just a 1.7% growth for the nation as a whole. A decomposition of the employment change may shed some light on this difference between the state and national jobs growth. Typically, a shift-share analysis is applied to break down the total change in employment into three components. The first component - national share, represents jobs gained due to growing national business activity and assumes that the state’s industry grew at the industry’s national growth rate. The second component - industry mix, stands for the number of new jobs that can be attributed to the state’s mix of industries. It represents a gain in employment due to differences in industry and total nationwide growth. Lastly, the third component – regional shift, represents job gains due to state’s competitiveness. In particular it helps identify the state’s leading and lagging...
industries.

Texas added nearly 700,000 new private-sector jobs since the labor market recovery started in earnest at the end of 2009. About 45% of these jobs came as a result of more enthusiastic hiring by local businesses versus a more sluggish pace of job creation nationwide. On that note, the Texas labor market outshines many other large state economies – for example, less than 15% of new private-sector jobs in California can be attributed to the competitiveness of that state (see chart 17). A closer look at sector-specific job gains may help explain a stronger labor market turnaround in Texas. First, nationwide, most new private sector jobs created since December 2009 were in the service-providing sector thanks, in particular, to solid job growth in education and healthcare, and business and professional services. Indeed, only about one in nine private sector jobs were either in mining, manufacturing or construction. Yet, in Texas, about one in five new private-sector jobs came from goods-producing industries. This means that the state’s goods-producng sectors added jobs faster than the nation as a whole, which attests to their underlying competitiveness. On the other hand, employment in construction and manufacturing has barely changed in California over the past three years (see chart 18) as these industries struggled to regain lost footing.

Equally important, chart 18 shows that a big portion of new private jobs in Texas service-providing industries (from about a third in business and professional services to over half in trade, transportation and utilities) can be attributed to state-specific factors that sustained more rapid growth versus the nation as whole. As the weight of these sectors in the Texas economy grows they will exert a stronger impact on the regional labor market. Thus, because a sizable share of new jobs in Texas is supported by a more dynamic local economy, the state is likely to outperform other U.S. regions in job creation, as its leading industries are getting bigger.

Lastly, September’s employment numbers indicate that the Texas labor market continued to add jobs at a robust pace. In particular, about 30,000 new private-sector jobs were created in Texas (see chart 19) thanks to increasing employment in manufacturing (up by 3.8 thousand jobs in September), professional and business services (up by 13.6 thousand), trade, transportation, and utilities (up by 9.1 thousand), and leisure and hospitality (up by 3.7 thousand). In fact, as we argued in the previous paragraph, faster growth rates in the Texas service-providing industries are sustaining job creation in the Lone Star State (see chart 20). Indeed, during the first three quarters of 2012, Texas created about 210,000 new private jobs or just 6,000 jobs (3%) less than in the same period a year ago. Meanwhile, the national private sector gained 16% less jobs in the first three quarters of this year compared to the same three quarters of 2011. As a result, the share of Texas in national job creation increased from 13.9% a year ago to 16% in January-September 2012.

Monetary Policy and Asset Prices

In September, the Federal Reserve announced its third round of quantitative easing, which will be implemented through the monthly...
purchases of $40 billion of agency mortgage-backed securities.\textsuperscript{3} Its main purpose is to keep long-term interest rates at levels that support residential mortgage markets. Record low borrowing costs (see chart 21) breathe much needed life into the housing market. For example, in its latest U.S. Economic and Housing Market Outlook, Freddie Mac gave credit to the Fed for the positive impact of its accommodative monetary policy on housing activity. More than that, Freddie Mac projects that about 7 million homeowners will refinance in 2012, which may result in total savings of $15 billion. There are signs that mortgage lending is recovering as well. According to the Securities Industry and Financial Markets Association, the issuance of new mortgage-related securities in the first three quarters of 2012 was 24\% higher than a year ago (see chart 22). And according to the CRE Finance Council, September was the busiest month for the issuance of commercial mortgage based securities since the economic downturn.

Not surprisingly, high housing affordability and record low mortgage rates are pushing up home buyer demand - houses are being sold faster and at higher prices. According to the National Association of Realtors, in September existing home sales were 11\% higher than a year ago, while the national median existing-home price posted a gain of 11.3\%. Meanwhile, the amount of time homes are staying on the market shortened to 95 days from 107 days a year earlier. Turning to Texas, the Real Estate Center at the Texas A&M University says that home sales saw an annual increase of 9\% in September and median prices were 7\% higher than a year ago. Equally important, foreclosures continued to decline both in Texas and nationwide (see chart 23), which points to improving financial conditions of American homeowners. And since Texas is one of the states where foreclosures do not have to be court-approved, this drop is a genuine sign of progress rather than a symptom of a backlog of delayed foreclosures, which pushes up foreclosure activity in such judicial foreclosure states such as Florida, New Jersey and New York (see chart 24).

\textsuperscript{3}Securities issued by government-sponsored enterprises such as Ginnie Mae, Fannie Mae or Freddie Mac.