

January 2013

- Texas factory activity strengthened slightly in December, although fiscal policy uncertainties were a drag on job creation in the last months of 2012.
- Despite some weakening in mining-related businesses due to falling natural gas prices, December marked the 40<sup>th</sup> consecutive month of industrial recovery in Houston.
- Texas ended 2012 with the lowest jobless rate in four years, which at 6.1% remained well below the national rate of 7.8%.

### Executive summary

Economic headwinds grew stronger in the last quarter of 2012 as slowing recovery and fiscal policy uncertainties continue to deter investments and hiring. On the upside, global economic conditions appear to be stabilizing as the Euro crisis is receding.

Still, many economic indicators came in stronger than expected in December despite worries over the impact of never-ending negotiations on taxes and spending cuts. In December, retail and food services sales grew by 0.5% versus the month before thanks to improving car sales. And consumers, encouraged by increasing incomes and falling gas prices, appear to be in the mood to spend, which should prop up the broader economy.

Businesses seem to be gradually ramping up spending as well. In November, new orders of durable goods were up four of the past five months, while a downtrend in spending on capital goods was reversed in October and in November, new orders of nondefense capital goods, excluding aircraft, posted their first annual gain since May. Meanwhile, an ongoing rebound in construction is sustaining demand for construction equipment and building materials.

Economic conditions in Texas point to a moderate uptick in business activity. The state's manufacturing grew somewhat faster during the last month of the year, although the employment index turned negative as factory jobs struggled to grow at the end of 2012. On the upside, company outlook and general business activity indices moved into positive territory as businesses are shrugging off the rather sluggish performance of the past six months. More than that, employment indices indicate strengthening job growth in the service-providing sectors of the Texas economy – industries that account for over 80% of all private sector jobs.

Booming business activity in the state's largest metros is driving the Texas economy. Although lower natural gas prices created a drag on economic growth in Houston, energy-related activities are not the only source of regional economic success; growing exports and increasing international passenger traffic are strengthening the link between Texas and more dynamic parts of the world economy. In addition, a revival of multi-dwelling homebuilding is driving a solid turnaround in the local residential construction sector. Lastly, Texas metros are benefiting from a gradual rebound of domestic and global demand for technology products. For example, in November, global semiconductor sales posted their first annual gain in 2012, which helped lift business activity in Austin and Dallas, big centers of semiconductor manufacturing in the state as well as nationwide.

Texas is entering 2013 with its lowest unemployment rate in four years - just 6.1% in December. In fact, the state's jobless rate is 1.2 percentage points lower than at the start of 2012 and is nearly two percentage points below the national average. In December, Texas had 2.5% more nonfarm jobs compared to a year ago – the fastest year-end job growth since the start of the labor market recovery. This is mostly due to continued expansion of private sector jobs - up by 2.9% versus just 1.7% nationwide. As result, over the past five years, the Texas labor market has not only recovered all jobs lost in 2009, but has already created nearly 400,000 more. This means that all major sectors (except construction, manufacturing and information) in Texas already employ more workers than at the end of 2007. The nation as whole has regained just 4.7 million jobs out of close to 9 million lost in 2008 and 2009.

January 2013

**Economic output**

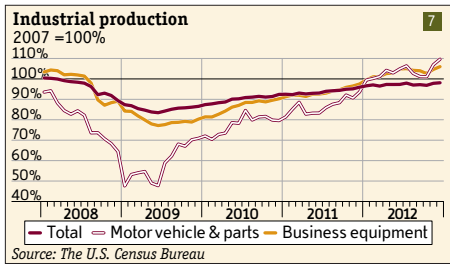
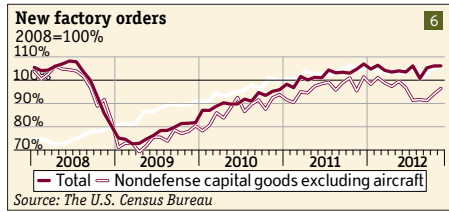
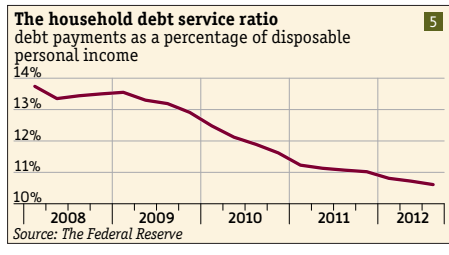
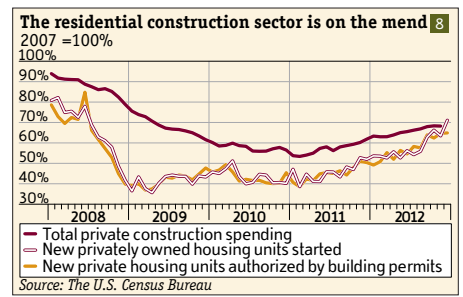
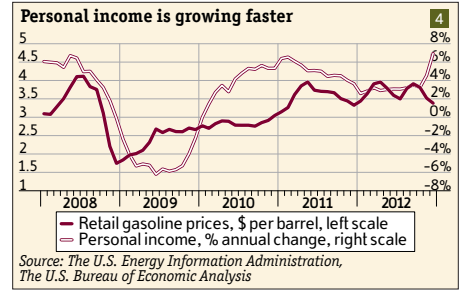
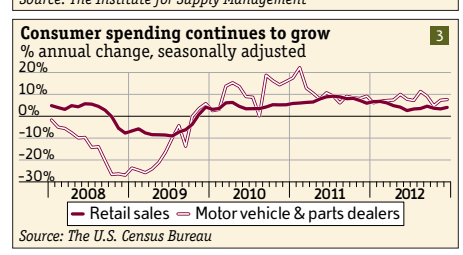
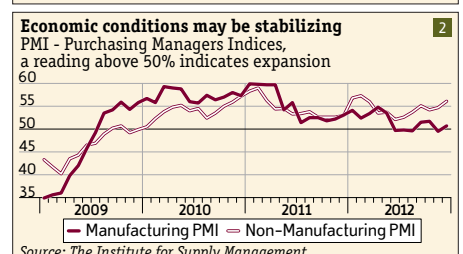
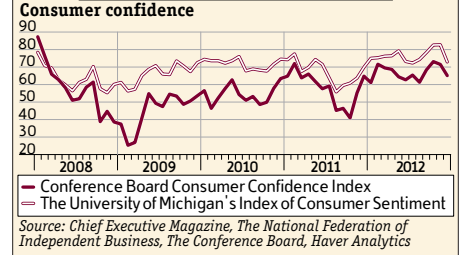
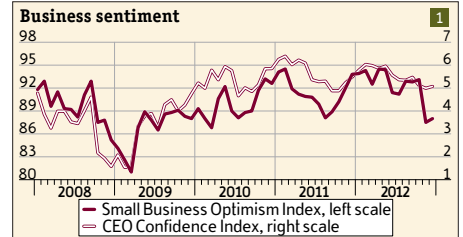
The U.S. experienced somewhat stronger economic headwinds in the last quarter of 2012 as weaker global economy and, more importantly, slow domestic recovery and fiscal policy uncertainties weighed on business and consumer sentiment (see chart 1). On the upside, the national economic climate may have started to stabilize at the end of 2012 as factory activity saw a modest uptick in December, while business conditions in services and construction continued to improve (see chart 2).

Many economic indicators came in unexpectedly strong in December despite worries over the impact of the stalled negotiations on taxes and spending cuts. In December, retail and food services sales increased by 0.5% versus the month before thanks to a 1.6% gain of sales at motor vehicles and part dealers. Still, excluding car sales, consumer spending on goods was more than 4% higher than a year ago (see chart 3) thanks to growing spending on such discretionary items as furniture, sporting goods and clothing. This means that consumer may be in the mood to spend, which should help the broader economy.

Several factors help explain this resilience in consumer demand. First, falling energy prices and faster growth of personal income (see chart 4), mostly due to continued job creation in the private sector, have boosted consumers' buying power. Second, thanks to consumer deleveraging, debt write-downs and low interest rates, household debt payments as a share of personal income are at their lowest level in nearly three decades (see chart 5), which means that consumers have extra cash to spend on goods and services. On top of that, consumers appear to be willing to borrow again – in November, consumer credit increased at a seasonally adjusted annual rate of 7%. In 2011, consumer credit was up by only 3.4% following two consecutive years of declining consumer borrowing.

Businesses seem to be ramping up spending as well. In particular, new orders of durable goods were up four of the past five months, increasing by 0.8% in November versus the month before (in October, new orders were up by 1.1%). More importantly, a downtrend in spending on capital goods was reversed in October (see chart 6) and in November, new orders of nondefense capital goods, excluding aircraft, posted their first annual gain since May. Growing new orders of business equipment as well as motor vehicles and components are a big part of the national industrial recovery (see chart 7). Meanwhile, an ongoing rebound in construction (see chart 8) is driving demand for construction equipment and building materials.

Economic conditions in Texas point to a moderate uptick in business activity at the end of 2012. According to the Texas Manufacturing Outlook Survey, the state's factory activity grew somewhat faster during the last month of the year, as the current production index inched up to 2.7 in December (see chart 9, next page). Meanwhile, the employment index turned slightly negative, which implies that factory employment in Texas struggled to grow at the end of 2012.



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January 2013

On the upside, company outlook and general business activity indices moved into the positive territory. This, coupled with more upbeat expectations about future economic conditions, may be the first sign of local businesses shrugging off the rather sluggish performance of the second half of 2012. In addition, employment indices indicate strengthening job growth in the service-providing sectors of the Texas economy (see chart 10) – industries that account for over 80% of all private sector jobs.

The Texas economic recovery is being propelled by improving business activity in the state's largest cities, specifically its biggest metro economy – Houston (see chart 11). Although lower natural gas prices (see chart 12) created a drag on metro factory activity at the end of the year (see chart 13), the Houston Business Cycle Index was 8% higher in November than a year ago – the fastest increase compared to all other major Texas regional economies. Indeed, energy-related activities, though a big driver of the Houston economy, is not the only source of regional economic success. In fact, just about one in twenty new private sector jobs created in the Houston metro last year were in mining. First, growing exports (see chart 14) as well as increasing international passenger traffic (according to the Houston Airport System, the total number of international travelers using George Bush Intercontinental Airport increased by over a million over the past five years) strengthen the link between Texas and more dynamic parts of the world economy. For instance, during the first eleven months of 2012, Texas exports to Latin America, including Mexico, grew by more than 10%. And because this region accounts for over half of the state's overseas shipments (versus just a quarter nationwide), total exports increased faster in Texas – up by 6.2% versus 4.6% for the nation as a whole.

Second, Houston, as well as other large Texas metros, is enjoying a solid turnaround in the residential construction sector thanks to a revival in multi-dwelling homebuilding (see chart 15). This is a key reason behind the faster recovery of the construction jobs in Texas. Lastly, Texas metros are benefiting from a gradual rebound of domestic and global demand for high-technology products. For instance, according to the Semiconductor Industry Association, in November, global semiconductor sales posted their first annual gain in 2012, increasing by 2% versus November 2011 thanks to a strong rebound in the Americas, where sales picked up by nearly 10%. And this helps lift business activity in Austin and Dallas – big centers of semiconductor manufacturing in Texas. Indeed, according to the Austin Purchasing Managers Index (PMI), the regional factory returned to growth in December as the Austin PMI increased to 55.3 versus as low as 44 two months earlier.

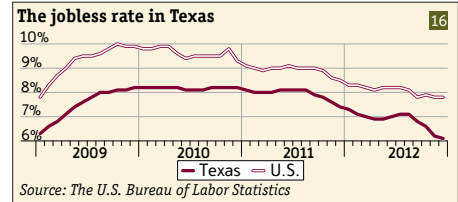
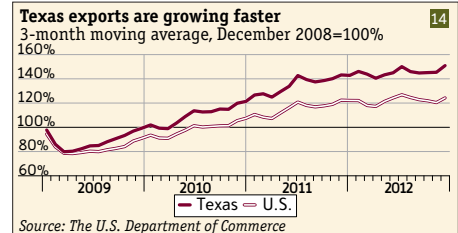
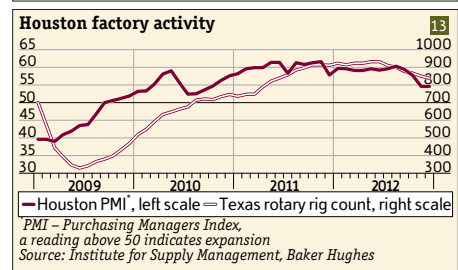
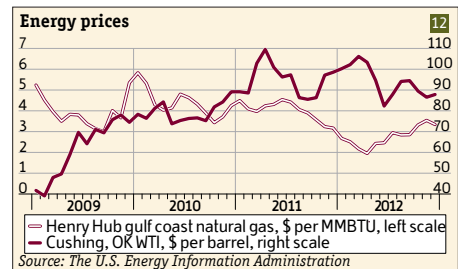
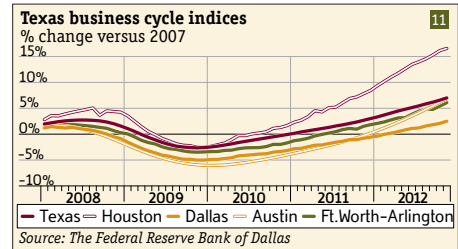
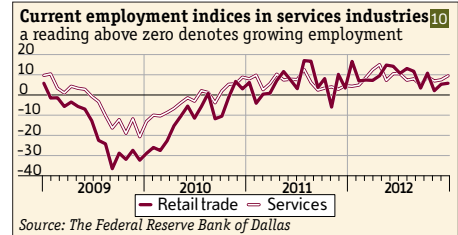
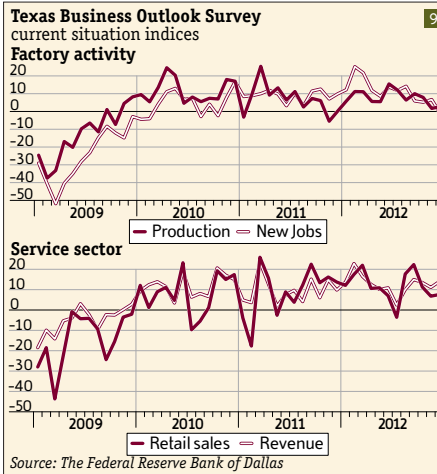
**New privately owned housing units authorized**  
% change in January-November

	Total	2012 vs. 2011		2012 vs. 2007
		1 unit	5 units or more	Total
U.S.	33.5%	24.4%	57.5%	-42.5%
<b>Texas</b>	<b>41.2%</b>	<b>24.2%</b>	<b>78.0%</b>	<b>-25.0%</b>
Houston-Sugar Land-Baytown	40.5%	25.4%	86.3%	-33.2%
Dallas-Fort Worth-Arlington	41.8%	28.4%	59.1%	-20.1%
Austin-Round Rock-San Marcos	86.8%	30.2%	181.7%	-6.9%

Source: The U.S. Census Bureau

## Employment

Texas is entering 2013 with the lowest jobless rate in four years - just 6.1% in December. In fact, the state's jobless rate is 1.2 percentage points lower than at the start of 2012 and is nearly two percentage points below the national average (see chart 16). In December, Texas had 2.5% more nonfarm jobs than a year ago – the fastest year-end job growth since



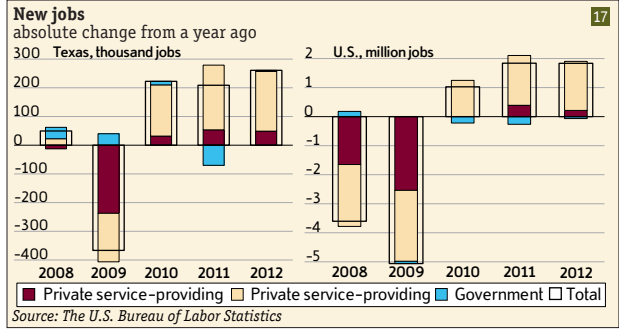
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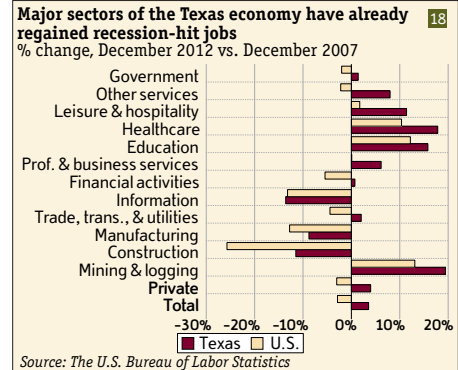
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January 2013

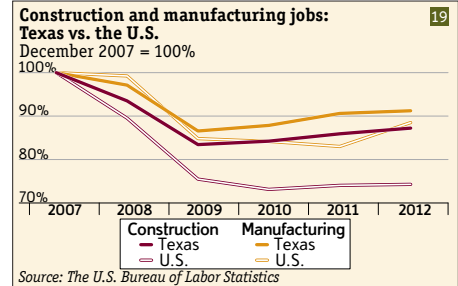
the start of the labor market recovery three years ago. The strength of the Texas labor market is sustained by growing private sector employment – up by 2.9% at the end of 2012 versus just 1.7% nationwide. As result, Texas saw the biggest annual job gains in three years as resumption of moderate job growth in the government sector (up by only 0.2%) added to the continued expansion of private sector employment. Nationwide, the government remained a drag on the labor market for the fourth straight year (see chart 17). Importantly, over the last five years, the Texas labor market has not only recovered all jobs lost in 2009, but has already created nearly 400,000 more. The nation as whole has regained just 4.7 million jobs out of close to 9 million lost in 2008 and 2009.



As a result, all major sectors (but construction, manufacturing and information) in Texas already employ more workers than at the end of 2007 (see chart 18). Meanwhile, the Texas manufacturing and construction industries are on track to regain jobs lost during the recession, which still remains a more remote prospect for the nation as a whole (see chart 19). Indeed, in Texas, both sectors have already recovered about a third of all jobs lost during the crisis; nationwide, the construction industry managed to regain just above 4% and manufacturing – only 23%. And this is another reason why the jobs market in Texas looks stronger compared to the national employment picture. Essentially, goods-producing industries bore the brunt of the job losses of 2008 and 2009, both in Texas and nationwide. However, during the past three years, Texas regained over 50% of all jobs lost in goods-producing sectors (versus just about 14% for the nation as a whole) - initially thanks to a solid pickup of hiring activity in mining and manufacturing, later joined by the construction industry (see chart 20). Nationwide, construction jobs are just beginning to come back.

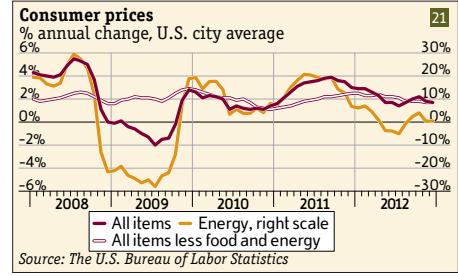
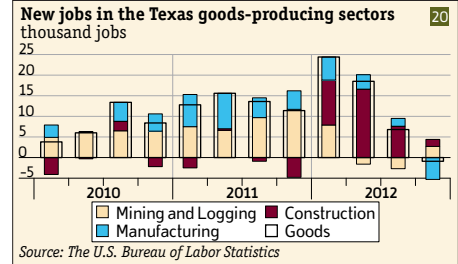
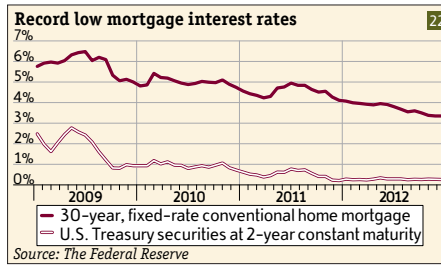


Having said all of the above, the Texas labor market was not entirely immune to the national economic woes as hiring cooled at the end of 2012 due to intensified fiscal policy uncertainties. Indeed, in December, Texas recorded just about 12,000 new private sector jobs – the lowest reading in the past five months. In particular, job losses in construction grew for the second straight month, although construction jobs disappeared at a slower pace – down by just 4,100 jobs in December versus a loss of 7,100 jobs the month before. Job cuts in the government resumed in November and gathered pace in December, when public-sector employment shrank by 7,700 jobs. On the upside, manufacturing added 3,000 jobs following November’s loss of 6,600 jobs - the largest drop in factory employment since the start of the recovery in mid-2009. More importantly, employment in business and professional services was up by 13,300 thousand jobs in December – the second strongest gain in 2012 since January.



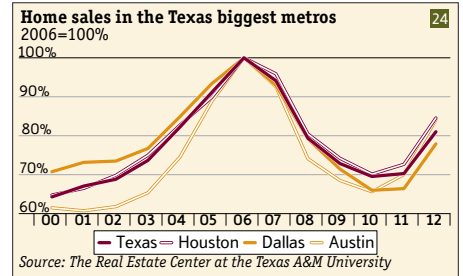
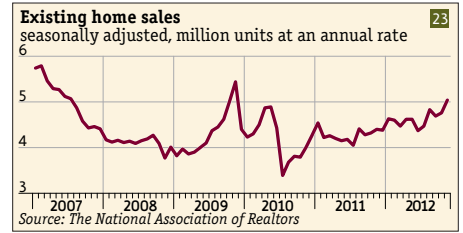
**Monetary Policy and Asset Prices**

As price pressures remain relatively well contained thanks to falling energy costs and a slowing economic recovery, the Fed is unlikely to curtail its accommodative monetary policy if the national jobless rate is stuck at around 8%. After all, in December, consumer prices were just 1.7% higher than a year ago (see chart 21), while core inflation slowed to 1.7% from 2.5% at the end of 2011. Meanwhile, record low interest rates (see chart 22) are providing a much needed boost to the national housing market – existing home sales are on track to hit their record level since the beginning of the global financial crisis (see chart 23). Increasing home values are yet more proof that

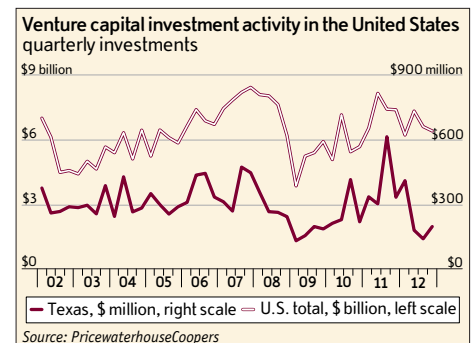
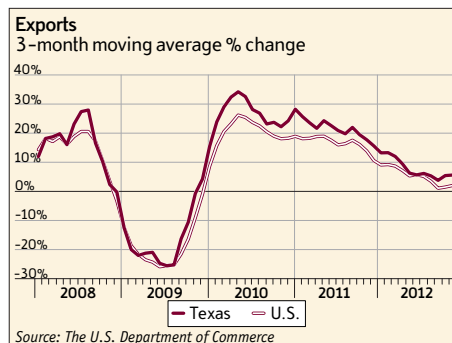
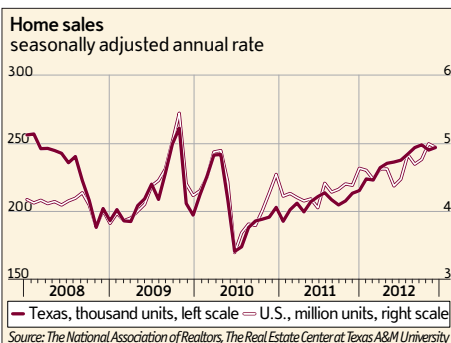
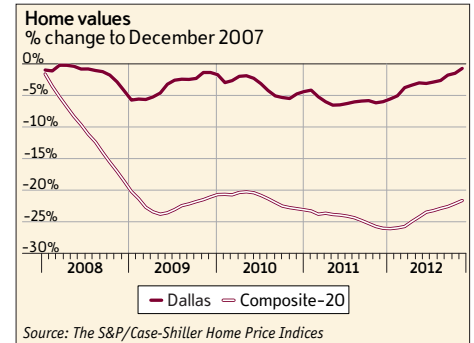
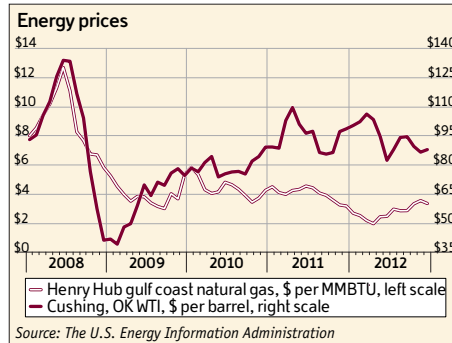
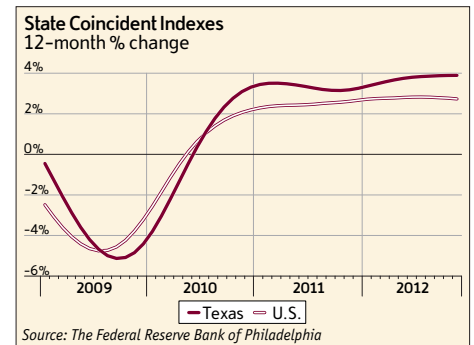
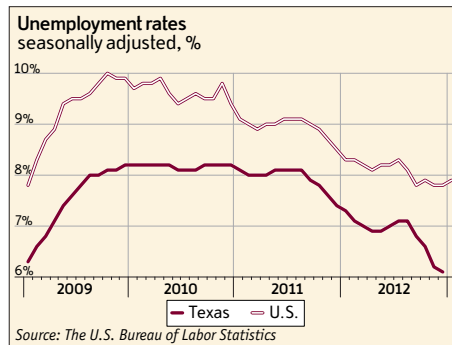
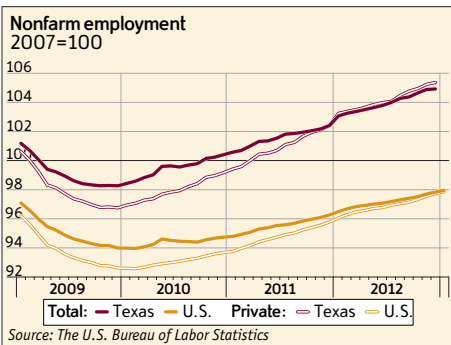
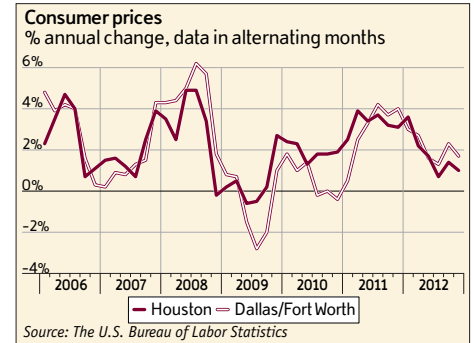
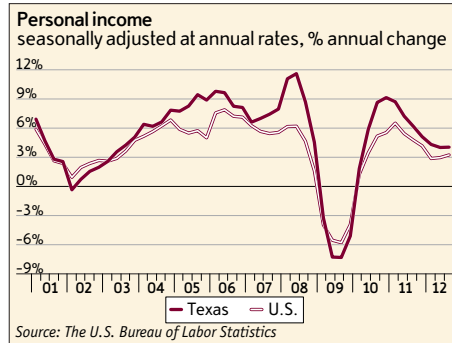
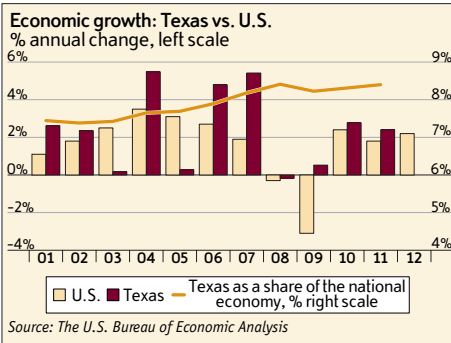


January 2013

the residential construction sector is turning the corner, especially considering the sharp rebound of housing prices in the worst hit metros, such as Phoenix and Las Vegas. Texas, although having experienced a much milder housing downturn, is enjoying a respectable recovery in demand for residential real estate as well (see chart 24) – in 2012, the state’s home sales were up by over 15%, driven by booming housing activity in Austin (up by over 20%), Houston (up by 16.4%) and Dallas (up by 17.3%). In fact, thanks to low housing inventory, which declined to its six-year minimum, home prices in the biggest Texas metros have already surpassed their pre-crisis peaks, which, together with increasing sales, is a sign of the regional housing market moving on a sustainable trajectory.



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