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• Revised data showed 5.0% yoy GDP growth in the U.S. in Q3 2014.
• National industrial output increased by 5.2% yoy in November 2014.
• Agricultural producers in Texas enjoyed quite a good year, with high yields and high output of milk and dairy products.
• Total national nonfarm employment reached a record high of 140,095 thousand people in November.
• Further decline in oil prices strengthened its effect on consumer prices.
• After one month of improvement, the housing market experienced a decline at both the national and Texas level.

Executive Summary

The U.S. economy posted good performance in November 2014 following seasonal trends observed over the last couple of years. However, some of the development indicators fell beyond the limits defined by the mentioned seasonal trends. Revisions of the economic data revealed better performance of the real sector in Q3 2014 in terms of GDP growth in general and manufacturing development in particular. The Texas economy still expanded faster than the national economy, but also sustained some negative developments.

Good performance of industrial output in October and November helped it to grow above the pre-recession peak of the end of 2007. The PMI index showed continued growth in both manufacturing and non-manufacturing sectors, as a majority of their correspondent industries reported growth. At the same time, both sectors experienced some difficulties. Furthermore, the services sector may report deceleration in growth in the nearest future because of capacity strain.

Consumer confidence further strengthened in November as consumers were more optimistic in their assessment of current economic conditions. This creates good preconditions for growth in personal consumption expenditures, especially taking into account revised data on GDP growth for the third quarter and its components.

Construction was the sector with the most controversial developments at the national level in November 2014. Its major performance indicators posted declines, which led to a slowdown in growth in year-over-year terms. The most significant developments were observed in the number of construction permits.

Monthly nationwide exports decreased for the second consecutive month. The decrease was not that significant, however, and was almost fully caused by a decline in exports of capital goods. Exports of services remained almost unchanged, with some marginal negative developments in transport services.

The Texas economy generally followed the seasonal developments trends observed at the national level. Most of the state’s performance indicators were better than the national ones, but with several exceptions. Texas non-manufacturing sector respondents have doubts about favorable developments in the near future, which led to deceleration of growth for the key confidence indexes in the industrial output sector. At the same time, agricultural producers once again benefited from good weather and market conditions.

Labor market conditions continued to improve in November 2014 at both the national level and in Texas. Labor market indicators were around historical highs for the national economy, but more significant progress was observed in new job creation. At the same time, Texas performance was still better compared to the US as a whole, from both the employment and unemployment perspective. The Lone Star state posted another record in job creation from the beginning of the year. As for Texas metros, longtime leaders in employment Houston and Dallas posted average performance in both lowering the jobless rate and expanding employment, while the Midland area was the leader in both categories.

Observing recent developments in economic development, inflation, and in labor market conditions, the Federal Reserve considered its current monetary policy measures as adequate. As a result, the target range for the federal funds rate will stay within the 0-0.25% through the next meeting of the Federal Open Market Committee. This means that the Federal Reserve assumes that inflation will converge to 2.0% yoy in the long-run, despite continued decline in oil prices which is currently lowering consumer prices. Under pressure of low inventories, the housing sector saw declines in monthly sales at both the national and Texas level. But negative developments in the housing sector were more apparent in Texas.
Economic Growth

Based on a more complete set of source data, the Bureau of Economic Analysis issued the third estimate for GDP growth in the third quarter on December 23rd. The previous estimate of 3.9% yoy growth released in November was significantly revised upwards to 5.0% yoy. As in the second estimate, personal consumption expenditures and gross private domestic investment (particularly, nonresidential private domestic investment) were the main drivers of GDP growth at the national level. Moreover, their contributions to GDP growth were also revised upwards. Acceleration of growth in Q3 as compared to Q2 reflected a decline in imports, upturn in federal government spending, and acceleration in private consumption expenditures.

The Federal Reserve data showed acceleration in industrial production growth in November, while growth data for August-October 2014 was revised upwards. Nationwide industrial output increased by 1.3% mom, which is a significant improvement over upwardly-revised 0.1% mom observed in October. Such high monthly growth pushed year-over-year growth to 5.2% from 4.0% observed in October. Manufacturing output was the only industry group sustaining revisions in previously reported data. After revisions, factory output is estimated to exceed its pre-recession peak of late-2007 in both October and November. In November alone, output of every major industry group increased or remained unchanged. Output of motor vehicles and parts posted one of the highest growth rates among durables at 5.1% yoy. As for nondurables, growth rates above 2% yoy were observed for petroleum and coal products and for apparel and leather. PMI data proves that the manufacturing sector continued to grow in November despite the negative developments in inventories, backlog of orders, and reverse of trend in prices. 14 of the 18 manufacturing industries reported growth in November. The same number in the non-manufacturing sector reported growth thanks to favorable business conditions. At the same time, non-manufacturing industries reported some strain on capacity because of an increase in activity in month-over-month terms, which may lead to deceleration in growth in the future.

Considerably more favorable assessment of economic and labor market conditions led to improvements in
consumer confidence. The Conference Board Consumer Confidence Index grew to 92.6 in December from 91.0 in November on the back of more optimistic assessment of both current conditions and short-term outlook by consumers. With growing consumer confidence, personal consumer expenditures will probably also increase. In the meantime, the U.S. Bureau of Economic Analysis revised its estimates of personal consumption expenditures in Q3. According to new data, personal consumer expenditures, contrary to previous estimates, actually grew at a higher rate in Q3 compared to Q2. More than one percentage point deceleration in growth of expenditures on goods was more than for compensated by 1.6 percentage point acceleration in growth of expenditures on services.

The construction industry observed some mixed developments in November 2014. Construction expenditures continued to grow in year-over-year terms at 2.4%, even though monthly data showed marginal decline. Nonresidential construction growth of 4.2% yoy exceeded the 0.6% yoy decline in residential construction expenditures. On the other hand, the number of construction permits dropped by almost 3% yoy in November, which is the first decline since May. The mentioned decline was conditioned by a significant monthly drop in the number of construction permits. The number of construction permits plunged by 26.0% mom, which was the largest decrease for the last five years. On the positive side, however, is the fact that a decline in construction permits valuation was smaller at 24.7% mom.

Exports decreased again at the national level in November. The 1% mom decline in exports to USD 196.4 billion was almost fully attributed to a decrease in exports of goods amounting to USD 1.9 billion on a Census basis. In particular, exports of capital goods dropped USD 2.3 billion, USD 1.1 billion of which was a decrease in exports of civilian aircraft. Exports of services saw just a marginal decline of USD 0.1 billion or less than 0.2% mom. This decrease reflected mostly a decline in transport services, including both passenger fares and freight and port services. From the beginning of the year, total exports reached USD 2,147.441 billion which is a 2.9% yoy increase. Exports of services grew faster at 3.3% yoy in January-November, being equal to USD 649.747 billion. Exports of goods grew by 2.7% yoy over the period to USD 1,497.694 billion.

The economy of Texas continued to expand, performing better than the national economy in November 2014. Performance indicators of the Lone Star state mostly followed the trends of the national economy. In particular, the number of construction permits dropped 23.1% mom in Texas similar to the nationwide dynamics of the indicator. Monthly exports dropped 2.4% in November and fell below the corresponding level of the previous year by 8.6%. Texas factory activity grew at an accelerated rate in December as perceptions of current and future economic conditions remained generally positive. Service sector activity also continued reflecting expansion in December. At the same time, perceptions of broader current and future economic conditions reflected less optimism. The key indexes showed deceleration in growth (general business activity index, company outlook and some others). Very good developments were observed in agriculture. Recent rainfall improved soil moisture on most of the territories of the state. Harvesting wrapped up for most spring crops with yields generally well above 10-year averages. Dairy producers had a tremendous year, despite recent decreases in prices of milk and dairy products.
Employment

In November 2014, labor market dynamics remained on the uptrend despite some mixed developments in unemployment. In fact, the number of the unemployed increased by 88 thousand people as compared to October. This had little effect on the national unemployment level but led to deceleration in the decrease of the number of unemployed from a year-over-year perspective by 3.4 percentage points to 16.0%. On the other hand, the mentioned 16.0% yoy decrease is still almost identical to the average decline in the number of unemployed observed over the January-October 2014 period. At the same time, the number of employed continued to increase in November. Total nonfarm employment reached a new high of 140,095 thousand people. Almost 98% of the 353,000 new jobs were created in the private sector. As usual, service-providing industries created more new jobs compared to goods-producing ones, but the latter saw faster over-year growth in employment (2.5% versus 1.9%). Furthermore, growth in employment of the goods-producing industries outpaced service-providing industries starting in July 2014. The last time the same trend was observed was in 2011 and the first half of 2012. Despite continued decline in oil prices, mining and logging in general and oil and gas extraction in particular still showed the fastest growth in employment among the major sectors of the U.S. economy.

The Lone Star state once again posted better than nationwide performance in both unemployment and employment in November. Similar to the national level, Texas experienced some deceleration in the year-over-year growth of both the number of employed and the number of unemployed. However, growth rates for both indicators still remained significantly higher than those observed at the national level. Compared to the previous month, Texas dropped to third place in over-the-month increase in nonfarm payroll employment, creating 34,800 new jobs. However, the state remained the leader in total nonfarm jobs added in year-over-year terms for the fourth consecutive month, ahead of second best California by almost 100,000 jobs. Seven of 11 major industries created new jobs in Texas in November compared to October. This includes professional and business services, which added 13,500 jobs, education and health services with 7,200 new jobs, and leisure and hospitality creating 6,000 jobs. Manufacturing created
4,500 new jobs in November, which is the largest monthly increase since the end of 2005.

Almost all Texas metro areas posted increases in employment in year-over-year terms in November. Only Wichita Falls and Abilene observed marginal declines in employment of 0.2% yoy and 0.3% yoy respectively. In general, employment growth ranged from 0.4% yoy for Amarillo and Waco to 6.2% yoy for Midland. In fact, Midland was the best performer in terms of both employment and unemployment. In addition to the highest growth in employment, Midland registered the lowest unemployment rate of 2.3% in November.

**Monetary Policy and Asset Prices**

The Federal Open Market Committee of the Federal Reserve System sees risks to the outlook for economic activity and the labor market as nearly balanced. At its meeting on December 17th, the Committee found existing policy measures adequate to economic conditions based on the latest statistical data. Therefore, the Committee left the 0-0.25% target range for the federal funds rate unchanged. The policy of reinvestment of principal payments from Committee’s holdings of agency debt and agency mortgage-backed securities into mortgage-backed securities and policy of rolling over maturing Treasury securities at auction also remained unchanged.

The effect of the continued decline in oil prices on consumer prices strengthened in November 2014. Negative dynamics of oil prices led to the sharpest decline of the gasoline index since the end of 2008. The index dropped 6.6% compared to the October value causing a 3.8% mom decline in the total energy index (decline for the fifth month in a row). As a result, the CPI lost 0.3% in one month. At the same time, CPI calculated for all items excluding energy inched up by 0.1%. The mentioned monthly dynamics also had an impact on annual dynamics of CPI. In year-over-year terms, CPI dropped by 0.4 percentage points to 1.3% yoy compared to October. Consumer prices in Texas followed the trend observed at the national level. CPI data for Dallas-Forth Worth area (calculated for odd-numbered months) showed a 0.6 percentage point difference between CPI for all items and CPI for all items less energy.

After one month of improvement, the housing sector lost momentum in November. Existing-home sales dropped 6.1% mom from 5.25 million in October (downwardly-revised, but still the highest level of the year). The sales slid because of tightening in housing supply, which caused a decline in all the major regions in monthly terms. The decline in total housing inventory accelerated to 6.7%. As of the end of November, total housing inventory stood at 2.09 million existing homes which is a 5.1-month supply if sales will continue at the current pace. If the downward trend in housing inventory continues, prices of housing will appreciate much faster next year, which will lead to a slump in housing sales. Incidentally, housing prices grew by 5.0% yoy in November, which was the 33rd consecutive month of price increases. On the positive side is continued growth in year-over-year existing-home sales.
at 2.1% growth in November. As for the housing market of Texas, it followed the seasonal trend of the last 10 years with a decrease in housing sales. However, the observed decline was significantly larger than expected. Sales plunged by more than 20% mom, which is the largest monthly decline since July 2010. The situation with housing inventory was also worse in Texas compared to the national level. On the one hand, the monthly decline in inventories was slower in Texas at 5.3% mom. On the other hand, housing inventory at the end of November corresponded to just 3.3 months of supply, which is the lowest level since January.