

Texas Economy Expanding at a Moderate Pace

May 5, 2017

Recent data signal moderate growth in Texas economic activity. While payroll employment growth in the first quarter decelerated slightly from the third and fourth quarters, Texas continued to exceed the U.S. rate. The state unemployment rate edged up to 5 percent in March but remained below its natural rate. Texas Business Outlook Survey (TBOS) headline indexes in April pointed to somewhat slower growth in manufacturing and services but a pickup in retail.

House prices continued to rise in Texas, and an examination of the data suggests that homes may be overvalued relative to key economic fundamentals. Exports have picked up recently. Positive job growth and rising rig counts indicate an ongoing energy sector recovery. The latest forecast for 2017 job growth is 2.4 percent. Sharp declines in oil prices, continued strength in the dollar, and uncertainty regarding U.S. trade and tax policy remain key downside risks.

Job Growth Decelerates Slightly in First Quarter

Texas payroll employment expanded at a 1.5 percent annual rate in March, stronger than February's 0.2 percent increase. Job growth moderated slightly from an annualized 2.6 percent in the fourth quarter to 2.4 percent in the first but remained higher than the nation's 1.5 percent increase (*Chart 1*).

The energy, manufacturing and construction sectors saw strong job gains in the first quarter as activity in the oil and gas sector improved, oil prices stabilized and the effect of a strong dollar on exports moderated.

Job growth in the goods-producing sector accelerated from an annualized 0.3 percent in the fourth quarter to 6.7 percent in the first, while job gains in the service sector decelerated from 3 percent to 1.7 percent. Trade, transportation and utilities; leisure and hospitality; and government accounted for most of the first-quarter slowing in service sector job growth. The energy sector has made significant job gains since fourth quarter 2016, after losing about a third of its employment from the previous peak, reached in fourth quarter 2014.

Unemployment Edges Up, but Labor Market Still Tight

The Texas unemployment rate ticked up 0.1 percentage point to 5 percent in March and has risen 0.6 percentage points from its postrecession low of 4.4 percent in August 2015 (*Chart 2*). While higher than the nation's 4.5 percent unemployment rate, the March value is below the 5.4 percent estimate of Texas' natural rate of unemployment—the rate compatible with stable inflation in the long run.¹ The state's labor market remains healthy as strong labor force growth has driven recent increases in the unemployment rate. Moreover, the insured unemployment rate—continuing unemployment insurance claims as a share of covered employment—edged down to 1.2 percent in Texas, slightly below the nation's 1.4 percent rate.

Chart 1
First-Quarter Job Growth Exceeds Texas' Long-Term Average as Well as U.S. Pace



*Seasonally adjusted, annualized rate.
NOTES: Data are through first quarter 2017. Dashed lines represent the annual average growth rate from 1990 to 2016.
SOURCES: Bureau of Labor Statistics, Texas Workforce Commission, seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Chart 2
Texas Unemployment Exceeds U.S. Rate, Remains Below Its Natural Rate



NOTE: Data are through March 2017.
SOURCES: Bureau of Labor Statistics, Texas Workforce Commission, seasonal adjustments by the Federal Reserve Bank of Dallas.

Chart 3
TMOS Points to Strong Recovery in Manufacturing



*Seasonally adjusted, three-month moving average.
NOTE: Data are through April 2017.
SOURCES: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS), Texas Service Sector Outlook Survey (TSSOS) and Texas Retail Outlook Survey (TROS).

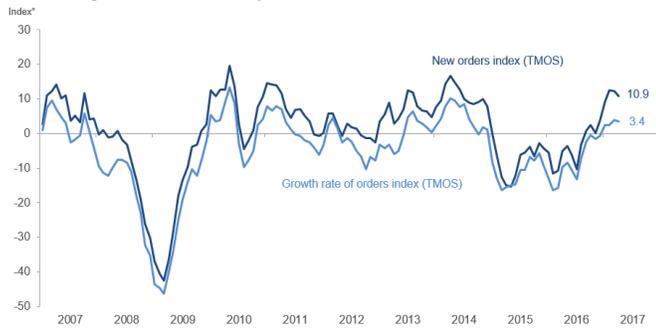
Economic Activity Expands, Especially in Manufacturing

Three-month moving averages of the TBOS headline indexes reveal a strengthening recovery in manufacturing during recent months but some slowing in service sector growth (*Chart 3*).

Perceptions of broader business conditions among TBOS respondents improved further in April but to a lesser extent than in March. Slight dips in the three-month moving averages of the general business activity indexes from the Texas Manufacturing Outlook Survey (TMOS), Texas Service Sector Outlook Survey (TSSOS) and Texas Retail Outlook Survey (TROS) suggest that optimism ebbed slightly, with retail sector respondents significantly less upbeat than TMOS and TSSOS respondents. Most forward-looking TBOS indexes remained strongly positive and well above their long-term averages.

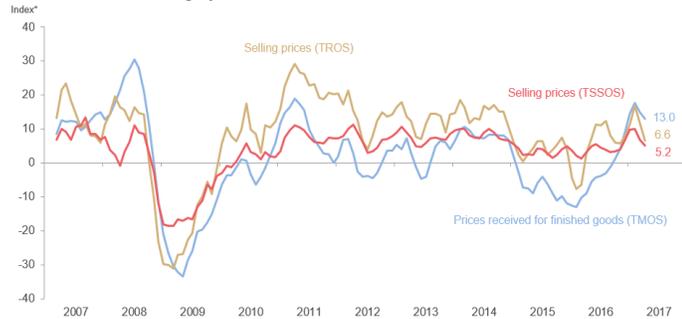
Recent improvements in the outlook among TMOS respondents, relative to TSSOS and TROS, are particularly striking and indicative of the manufacturing sector's close linkages with a rebounding energy sector. The growth rate of orders and new orders indexes from TMOS ticked up in April and their three-month moving averages were positive, confirming that manufacturing demand continued to improve (Chart 4).

Chart 4
Manufacturing Demand Continues to Improve



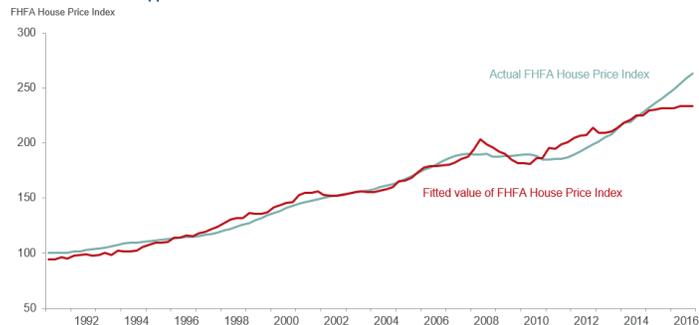
*Seasonally adjusted, three-month moving average.
NOTE: Data are through April 2017.
SOURCE: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS).

Chart 5
Price Pressures Subside Slightly



*Seasonally adjusted, three-month moving average.
NOTE: Data are through April 2017.
SOURCES: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS), Texas Service Sector Outlook Survey (TSSOS) and Texas Retail Outlook Survey (TROS).

Chart 6
Texas House Prices Appear Overvalued Relative to Fundamentals



NOTE: Fitted values are based on a regression of the FHFA house price index for Texas on population growth, employment growth, mortgage rate, unemployment rate, housing starts and per-capita personal income.
SOURCES: Federal Housing Finance Agency (FHFA); Bureau of Economic Analysis; Bureau of Labor Statistics (with adjustments by the Federal Reserve Bank of Dallas); Bank of Tokyo-Mitsubishi UFJ, author's calculations.

Price and Wage Pressures Moderate Slightly

April readings of TBOS selling-price indexes suggest upward price pressures increased in manufacturing and services but were largely unchanged in retail. However, the three-month moving averages of TBOS price indexes show moderation in price pressures (Chart 5).

Similarly, three-month moving averages of the TBOS wages and benefits indexes suggest that wage growth has slowed slightly, though the indexes remain above their series averages.

Housing Market Strength Stokes Home Price Concerns

Most indicators of residential construction, including housing starts, multifamily permits and real residential contract values, receded in February after posting strong growth in January. March data show a return to positive growth in the latter two indicators. Given that month-to-month movements in these indicators can be particularly volatile, a look at five-month moving averages reveals that residential construction activity remains steady.

With overall single-family construction still below prerecession levels, the supply of homes remains tight in most metros. Existing-home inventory in Texas held steady at 3.7 months in March, and inventories in all major metros remained more than two months below the six months of supply considered balanced.

With strong demand and inadequate supply, almost all house price measures suggest that house-price appreciation is continuing (Table 1).

The recent run-up in Texas house prices has led to concerns about home affordability and overheated housing markets. Comparing the actual Federal Housing Finance Agency House Price Index with its predicted value suggests that recent movements in Texas house prices cannot be explained by economic fundamentals alone and that homes are potentially overvalued (Chart 6). The predicted index is derived from key variables that typically determine home values—population and employment growth, mortgage rate, unemployment rate, housing starts and per-capita personal income.²

—Alex Abraham and Anil Kumar

Notes

1. See "The NAIRU in Theory and Practice," by Laurence Ball and N. Gregory Mankiw, *The Journal of Economic Perspectives*, vol. 16, no. 4, 2002, pp. 115–36.
2. See "Is There a Bubble in the Housing Market?" by Karl E. Case and Robert J. Shiller, *Brookings Papers on Economic Activity*, 2003, vol. 2, pp. 299–342.

About the Authors

Abraham is a research assistant and Kumar is a senior research economist and advisor in the Research Department at the Federal Reserve Bank of Dallas.

Table 1: House Prices Surge in Texas and the U.S.

	Latest period		Previous period		Year/year	
	Texas	U.S.	Texas	U.S.	Texas	U.S.
Federal Housing Finance Agency House Price Index (Q4)	6.1	6.1	9.4	6.5	7.7	6.2
S&P CoreLogic Case-Shiller Home Price Index (Feb.)	16.1	8.5	10.0	10.8	8.8	5.8
Multiple Listing Service Median Sales Price (March)	-0.2	-3.6	20.9	3.6	6.5	3.9

NOTES: Dallas used to approximate Texas for the S&P CoreLogic Case-Shiller index.
All data are annualized.
SOURCES: Federal Housing Finance Agency; Standard & Poor's; Multiple Listing Service.