Economic Update
TEXAS
Federal Reserve
Bank of Dallas

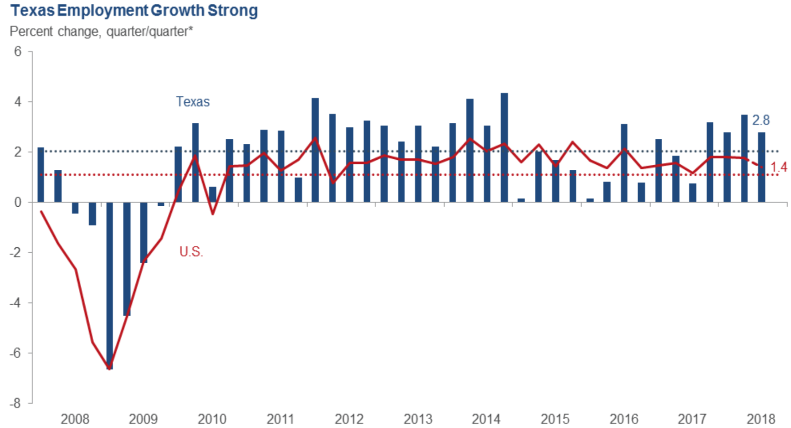
Texas Economy Keeps Growing but Signs of Supply-Side Constraints Emerge

October 3, 2018

The regional economy continues to post strong growth and outpace the nation. Year to date, Texas employment growth is an annualized 3 percent, well above the U.S. growth of 1.7 percent. Regional activity is also expanding rapidly, with the September readings of the Dallas Fed Texas Business Outlook Surveys (TBOS) remaining near multiyear highs for production and revenue. Moreover, Texas personal income growth in the second quarter was the highest in the nation at 6 percent, which bodes well for second-quarter gross domestic product (GDP) growth (available on Nov. 14). First-quarter real GDP, the most recent GDP data available at the state level, shows the Texas economy grew an annualized 2.9 percent quarter over quarter compared with 2.2 percent for the nation.

While Texas job growth is very robust, it has slowed just a bit from the second quarter. Employment grew an annualized 2.8 percent from June to August, twice as fast as the nation's growth of 1.4 percent, but still down from its pace of 3.5 percent in the second quarter (*Chart 1*). The Texas employment growth forecast for the year is 2.8 percent (December/December, with a range of 2.3 percent to 3.3 percent), suggesting growth in the remaining four months of the year will slow further from the current pace.

Chart 1
Texas Employment Growth Strong

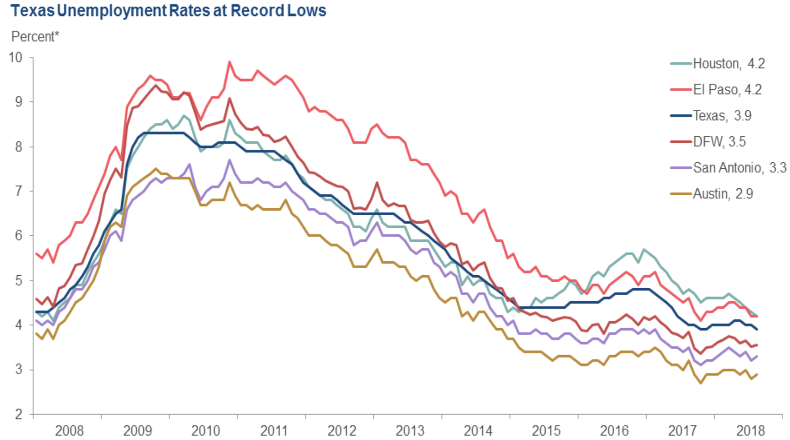


*Seasonally adjusted, annualized rate.
NOTES: Partial third quarter 2018 is June over August percent change. Dashed lines indicate long-run average from January 1990 to December 2017.
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Labor Market Remains Tight

The Texas economy is likely growing above potential, which means there may be capacity constraints acting as bottlenecks or speed limits on the expansion. Tight labor markets, for example, have made hiring difficult for local firms. Two-thirds of Texas firms noted difficulties finding qualified workers in the August release of the Dallas Fed's TBOS Special Questions survey. Meanwhile, the state unemployment rate has never been this low for this long, at least not since the advent of modern recordkeeping. The state unemployment rate moved down to 3.9 percent in August, and several metros have unemployment rates below the state's average, including Austin, Dallas–Fort Worth, Midland–Odessa and San Antonio (*Chart 2*). Business contacts report labor shortages are particularly severe for construction workers and truck drivers. The lack of truck drivers, even delivery trucks in some cases, has resulted in longer delivery times and supplier backlogs.

Chart 2
Texas Unemployment Rates at Record Lows

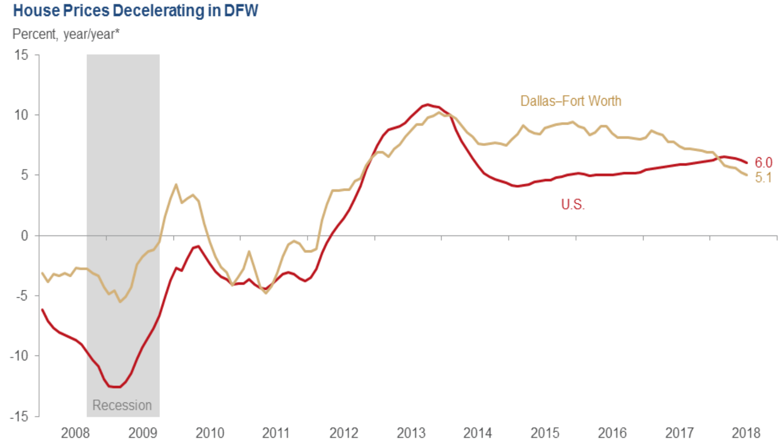


*Seasonally adjusted.
NOTE: Data are through August 2018.
SOURCES: Bureau of Labor Statistics; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Texas Housing Market Begins to Cool Down

Another force acting to slow the economy is the rising cost of credit. Housing markets in particular are sensitive to higher mortgage rates, and Texas house prices appear to be decelerating slightly. U.S. house prices may also be slowing, likely for the same reason. Growth in the S&P Case-Shiller Home Price Index for Dallas–Fort Worth has been falling, albeit from high

Chart 3
House Prices Decelerating in DFW



*Seasonally adjusted.
NOTES: Data are through July 2018. The Case-Shiller Home Price Index for DFW is used to approximate Texas.
SOURCE: Standard & Poor's CoreLogic Case-Shiller Home Price Index.

levels, since the start of 2017 (*Chart 3*). The latest reading puts year-over-year home price appreciation at 5.1 percent compared with 6.0 percent for the nation as a whole.

Energy Indicators Slow Due to Lack of Pipeline Capacity

Texas continues to hit new records in oil production, particularly in the Permian Basin; however, limited pipeline capacity is trapping a surplus of oil in West Texas, leading to a stagnation of drilling activity and energy-sector employment growth (*Chart 4*). Producers can use rail or trucks to move the oil closer to customers, but the cost of transporting crude via these alternative methods is at least two to five times the cost of moving it out via pipeline.

Texas Exports Rising Despite Stronger Dollar, Retaliatory Tariffs

Texas exports rose sharply in July and are up 16 percent year to date compared with the same period last year (*Chart 5*). U.S. exports increased at a slower 5.2 percent so far this year. Texas exports remain strong despite a rising dollar, higher tariffs and widespread uncertainty around future U.S. trade policy.

The secret to Texas' outsized success in export markets is the growth of oil and gas exports, which were up 126 percent year over year in the second quarter. Petroleum and coal product exports strengthened 24 percent, followed by transportation equipment at 16 percent. Chemicals exports rose 9.5 percent, and primary and fabricated metals exports increased 4.4 percent.

In two and a half years, oil and gas exports have gone from making up 5.2 percent of state exports to the largest share at 18 percent, equivalent to $45 billion in exports over the last 12 months. The fracking boom combined with the removal of the crude oil export ban by the U.S. Congress were instrumental in unleashing this growth.

Wage Pressures Accelerate in Texas

Strong economic growth and tight labor markets should bring rising wages for the state's workers. However, since the recession, rising wages have either been slow to materialize or hard to measure (or both), but that may be changing. There are now more signs of mounting wage pressures in Texas. Data from the Employer Costs for Employee Compensation (ECEC) from the Bureau of Labor Statistics suggest that wage and salary growth for private-industry workers spiked this year in Houston and DFW, with hourly wages up nearly 13 percent and 9 percent, respectively, in the first quarter (relative to the same period one year prior) (*Chart 6*). In the U.S. as a whole, however, hourly wages rose only 3 percent over the same period. Consistent with these data are the wage and benefit indexes of the Dallas Fed TBOS, which either hit new records or had near-record readings in September.

—Benjamin Meier and Pia Orrenius

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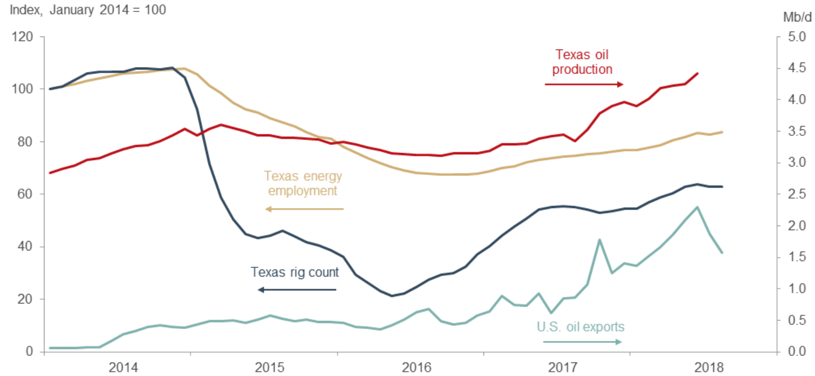
About the Authors

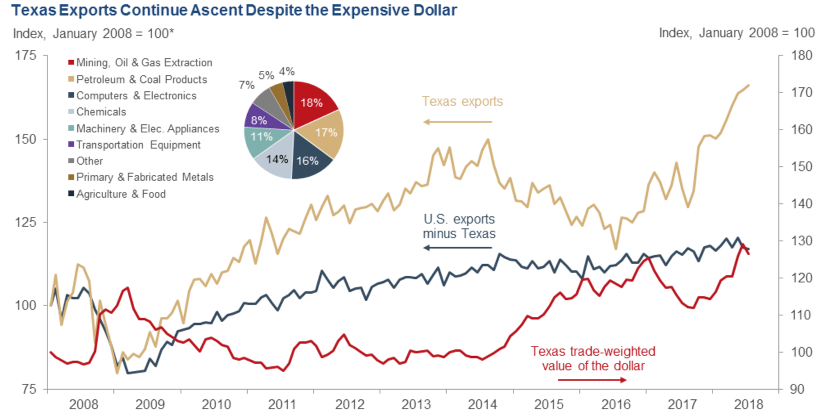
Meier is a research assistant and Orrenius is a vice president and senior research economist in the Research Department at the Federal Reserve Bank of Dallas.

Chart 4
Slowing in Energy Apparent in Several Indicators, but Not Production



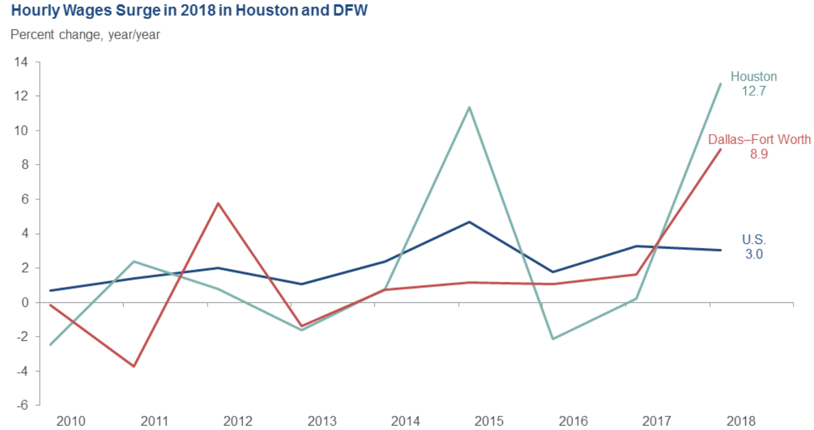
NOTES: Texas energy employment, rig count and U.S. oil exports are through August. Texas oil production is through June. Employment data are seasonally adjusted. Mb/d is million barrels per day.
SOURCES: Baker Hughes; Energy Information Administration; Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Chart 5
Texas Exports Continue Ascent Despite the Expensive Dollar



*Seasonally adjusted.
NOTES: Pie chart data are for second quarter 2018. Time series data are through July 2018. Data are in real dollars.
SOURCES: Census Bureau; WISERTrade; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Chart 6
Hourly Wages Surge in 2018 in Houston and DFW



NOTES: Data include only private firms. Data are through first quarter 2018.
SOURCE: Bureau of Labor Statistics Employer Costs for Employee Compensation.