

Texas Economy Continues Expansion but Shows Signs of Cooling

November 14, 2018

Texas economic growth remains robust but is showing signs of moderating. While many major Texas metros saw employment gains in the third quarter, state job growth was slower compared with the first half of the year. On the whole, the Texas labor market continues to tighten. The unemployment rate hit a record low in September, and reports of wage pressures persist. Housing indicators suggest supply and demand constraints, with a drop in home sales and affordability coinciding with low inventories.

Though the Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS) headline indexes dipped in October, both remained above their long-term averages. Respondents indicated rising input price pressure related to tariffs and wages, but their comments and selling-price indexes indicate firms are struggling to pass these costs onto consumers. Oil production continues to grow in Texas despite ongoing concerns about Permian Basin pipeline capacity.

Job Growth Cools in Third Quarter

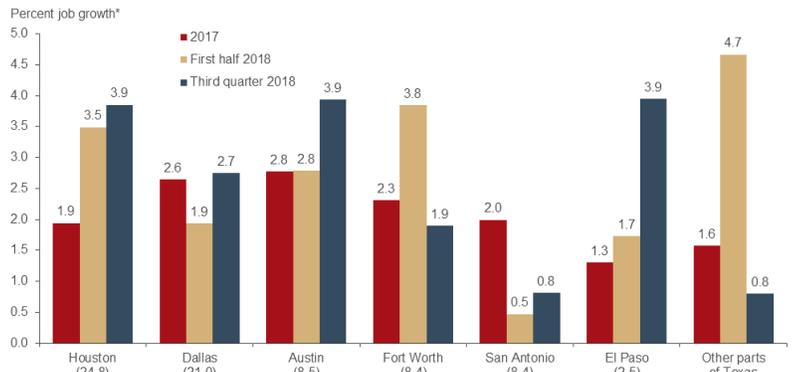
Texas employment expanded at an annualized 2.4 percent rate in third quarter 2018, slower than in the previous two quarters. Even so, Texas is still outpacing the nation in job growth. Many major metros saw stronger growth in the third quarter than in the first half of the year (*Chart 1*). Houston, Austin and El Paso led the way, with all three metros growing at a 3.9 percent annualized rate. This growth coincided with expansion in the energy, technology and defense sectors. Slowing in Texas' overall rate of job growth is related to more sluggish activity in the state's smaller metro and nonmetro areas as well as in Fort Worth. The Texas Business Outlook Surveys (TBOS) continue to show that respondents on net are increasing employment and expanding the number of hours worked.

The Dallas Fed forecasts that Texas employment growth will be between 2.2 and 3.2 percent in 2018. This would be above the 2017 growth rate (2.1 percent) as well as the state's long-run average of 2.0 percent.

Unemployment Reaches Historical Low

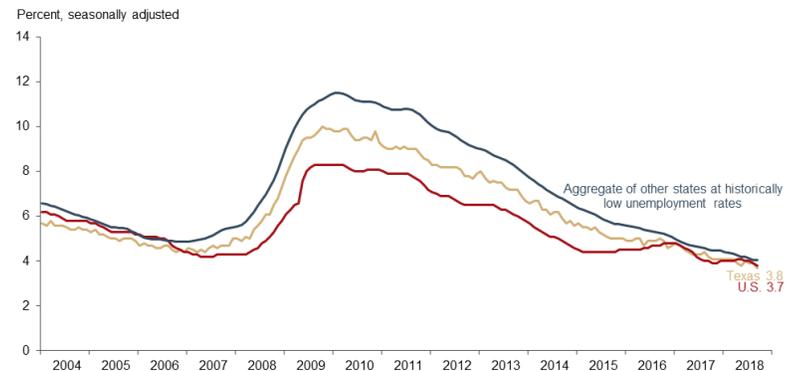
Texas' unemployment rate fell to a historical low of 3.8 percent in September, suggesting that labor markets have continued to tighten (*Chart 2*). Broader measures of labor market slack—including discouraged and marginally attached workers and those working part-time for economic reasons—also fell in September. TBOS wages and benefits indexes remained elevated in October, and many respondents noted upward wage pressures and difficulty finding qualified labor. Despite the new low, the Texas jobless rate was slightly above the nation's 3.7 percent rate.

Chart 1
Job Growth Strong in Most of State's Large Metros



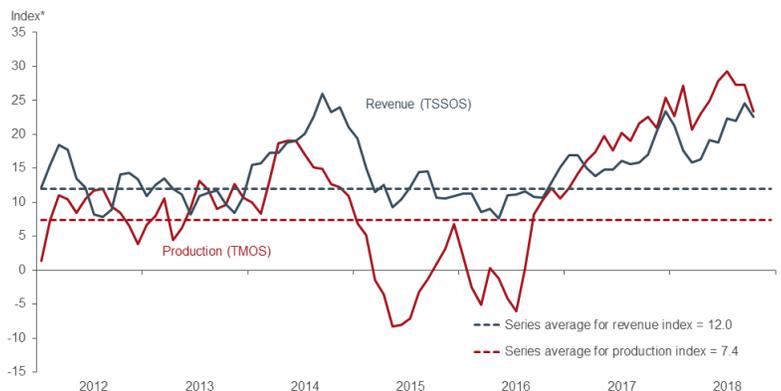
*Seasonally adjusted annualized rate.
NOTE: Numbers in parentheses refer to share of state employment in September 2018.
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Chart 2
Texas Unemployment Rate Closely Tracks Nation



NOTES: The last data point is September 2018. "Other states" includes Arkansas, California, Idaho, Washington, South Carolina and Illinois, which make up 22 percent of the total U.S. labor force. If Texas—which is also at a historical low—is included, the share increases to 31 percent.
SOURCES: Bureau of Labor Statistics; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Chart 3
TMOS and TSSOS Headline Indexes Dip in October



*Three-month moving average, seasonally adjusted.
SOURCES: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS).

Revenue, Production Soften but Remain Above Average

The three-month moving averages of the TSSOS revenue index and TMOS production index fell but remained positive in October, indicating continued growth (*Chart 3*). Both indexes are still well above their long-term averages. The TSSOS and TMOS company outlook indexes have ticked down in recent months but remained elevated in October, suggesting continued optimism among respondents. However, TBOS and Beige Book comments indicated that tariffs were increasing uncertainty, and labor shortages were impeding growth.

Selling Prices Rise for Manufacturing, Service Sector Firms

The TMOS prices for raw materials index reached a seven-year high in October, and the TSSOS input price index has jumped as well. Selling price indexes have also increased, but not nearly as quickly as the input price indexes (*Chart 4*). This is consistent with survey comments noting that, while labor constraints and tariffs have increased costs, businesses are struggling to pass these costs on to consumers.

Home Sales Moderate amid Tight Housing Market

The Texas housing market has decelerated somewhat over the past few months in what could be a sign of both supply and demand issues. Home sales in September slowed across most price categories, including the \$250,000 to \$749,999 range, which has driven growth in recent years (*Chart 5*). Sales in that price range, while slowing, remain elevated. Existing-home inventory of 3.7 months in September suggests that a tight housing market could be constraining Texas home sales, but rising mortgage rates and the subsequent dip in housing affordability across Texas metros also could be factors. The Federal Housing Finance Agency's purchase-only House Price Index for Texas rose about 6 percent between second quarter 2017 and second quarter 2018.

Texas Oil Production on the Rise

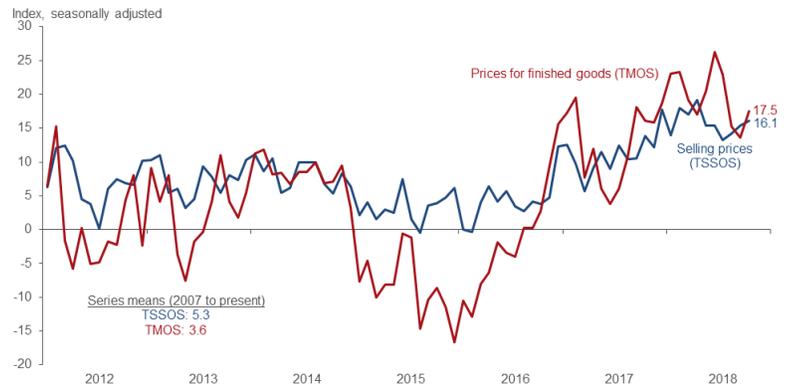
Texas oil production continues to set new records, with West Texas Intermediate (WTI) oil prices hovering around \$70 per barrel in October. Permian Basin oil production is forecast to reach 3.5 million barrels per day (b/d) in October, while Eagle Ford production is expected to reach 1.4 million b/d (*Chart 6*). The Texas rig count expanded to 533 in October from 528 in September. Pipeline capacity constraints, which affected prices received for oil in the Permian, may have contributed to slower growth in Texas rig counts. However, the spread between WTI Cushing and WTI Midland narrowed from \$12 per barrel in September to \$6 in October, which could in part be due to the announcement of new pipeline capacity coming online. A headwind to the energy sector is steel tariffs, which 52 percent of respondents to the third-quarter Dallas Fed Energy Survey said had either a slight or large negative effect on their business.

—Dylan Szeto, Christopher Slijk and Jason Saving

About the Authors

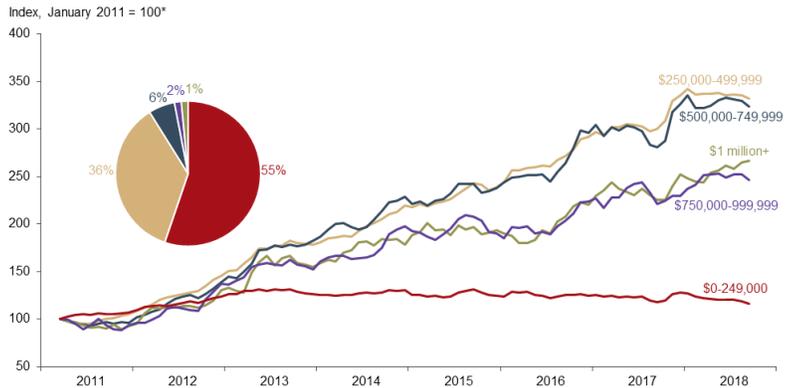
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Chart 4
TMOS and TSSOS Prices-Received Indexes Down from Record Highs



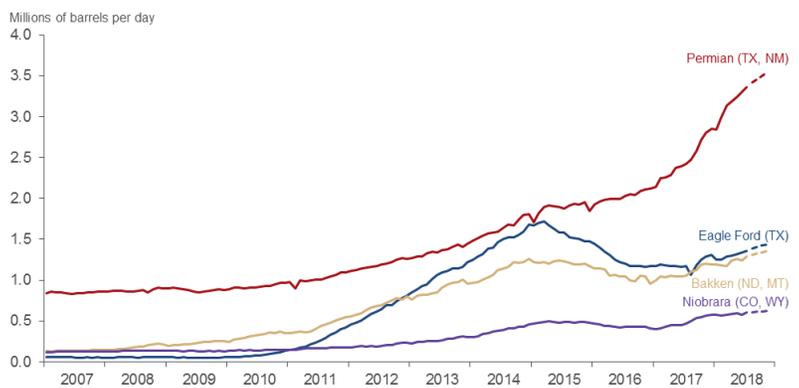
NOTE: Last data point is October 2018.
SOURCES: Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey (TMOS) and Texas Service Sector Outlook Survey (TSSOS).

Chart 5
Texas Home Sales Decline in Most Price Categories



*Three-month moving average, seasonally adjusted.
NOTES: Sales data are through September 2018. Pie chart shows share of sales by price range; shares are for 2018 year to date and are not seasonally adjusted.
SOURCES: Multiple Listing Service, seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Chart 6
Oil Production Continues to Rise in Permian, Other Shale Regions



NOTES: Plotted are production data for the top four oil-producing regions. Locations of regions are noted in parentheses. Actual data are through July 2018, estimates are through September 2018 and forecasts are through November 2018. Dashed lines denote estimates and forecasts.
SOURCE: Energy Information Administration.