



Texas Service Sector Outlook Survey

DALLAS **FED**

July 29, 2014

TEXAS SERVICE SECTOR ACTIVITY STRENGTHENS FURTHER AND BUSINESS CONDITIONS IMPROVE

Texas service sector activity climbed in July, according to business executives responding to the Texas Service Sector Outlook Survey. The revenue index, a key measure of state service sector conditions, rose from 16.9 to 21.5, its highest level since February 2012.

Labor market indicators suggested continued positive, but somewhat slower, growth. The employment index remained positive but plunged 12 points to 4.6 in July, indicating employment rose at a slower pace than in June. The hours worked index fell from 7.3 to 3.9.

Perceptions of broader economic conditions reflected more optimism in July, rising to multiyear highs. The general business activity index edged up from 21.1 to 22.4, reaching its all-time high. The company outlook index moved up from 17 to 21.6, its highest reading since February 2012, with 26 percent of respondents reporting that their outlook improved from last month and 4 percent noting it worsened.

Price and wage pressures increased this month. The selling prices index was unchanged at 11.7, indicating prices increased at the same pace as in June. The wages and benefits index held steady at 20.3, suggesting labor costs increased at the same pace as last month, although the great majority of firms continued to note no change in compensation costs.

Respondents' expectations regarding future business conditions reflected more optimism in July. The index of future general business activity rose from 28.7 to 34.2. The index of future company outlook jumped 11 points to 40.3. Indexes of future service sector activity, such as future revenue and employment, also reflected more optimism this month.



RETAIL ACTIVITY STRENGTHENS

Retail sales grew in July, according to business executives responding to the Texas Retail Outlook Survey. The sales index rose from 16 to 22, reaching its highest level in eight months. Inventories increased at a faster pace than last month.

Labor market indicators were mixed this month. The employment index fell sharply from 19.5 to 0, indicating retail jobs were unchanged in July. The hours worked index remained positive but dipped from 4.5 to 2.1, suggesting a smaller increase in hours worked per week, although the great majority of firms continued to note no change.

Retailers' perceptions of broader economic conditions reflected less optimism in July. The general business activity index dropped 9 points to 21.3. The company outlook index fell slightly from 30.3 to 27.1, with 27 percent of respondents noting an improved company outlook over the prior month, compared with less than 1 percent reporting their outlook had worsened.

Retail price and wage pressures increased this month. The selling prices index inched up from 17.8 to 19.4. The wages and benefits index advanced from 14.3 to 23.4, although the great majority of firms noted no change in labor costs.

Retailers' perceptions of future broader economic conditions reflected more optimism in July. The future general business activity index ticked up from 32.7 to 35.4. The index of future company outlook rose from 35.8 to 41.5. Indexes of future retail sector activity also reflected more optimism this month.

The Texas Retail Outlook Survey (TROS) is a component of the TSSOS that uses information only from respondents in the retail and wholesale sectors.

The Dallas Fed conducts the Texas Service Sector Outlook Survey monthly to obtain a timely assessment of the state's service sector activity. Data were collected July 15–23, and 242 Texas business executives responded to the survey. Firms are asked whether revenue, employment, prices, general business activity and other indicators increased, decreased or remained unchanged over the previous month.

Survey responses are used to calculate an index for each indicator. Each index is calculated by subtracting the percentage of respondents reporting a decrease from the percentage reporting an increase. When the share of firms reporting an increase exceeds the share reporting a decrease, the index will be greater than zero, suggesting the indicator has increased over the prior month. If the share of firms reporting a decrease exceeds the share reporting an increase, the index will be below zero, suggesting the indicator has decreased over the prior month. An index will be zero when the number of firms reporting an increase is equal to the number of firms reporting a decrease. Data have been seasonally adjusted as necessary.

Next release: August 26, 2014

TEXAS SERVICE SECTOR OUTLOOK SURVEY

Business Indicators Relating to Facilities and Products in Texas Current (versus previous month)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Revenue	21.5	16.9	+4.6	Increasing	57	35.6	50.3	14.1
Employment	4.6	16.5	-11.9	Increasing	53	17.3	70.0	12.7
Part-time employment	7.5	6.1	+1.4	Increasing	9	13.0	81.5	5.5
Hours worked	3.9	7.3	-3.4	Increasing	6	9.6	84.7	5.7
Wages and benefits	20.3	20.8	-0.5	Increasing	62	22.3	75.7	2.0
Input prices	23.3	24.0	-0.7	Increasing	63	25.6	72.1	2.3
Selling prices	11.7	11.7	0.0	Increasing	44	15.5	80.7	3.8
Capital expenditures	13.2	14.1	-0.9	Increasing	59	20.7	71.8	7.5
General Business Conditions Current (versus previous month)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	21.6	17.0	+4.6	Improving	35	25.8	70.0	4.2
General business activity	22.4	21.1	+1.3	Improving	33	27.3	67.8	4.9
Business Indicators Relating to Facilities and Products in Texas Future (six months ahead)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Revenue	54.3	50.6	+3.7	Increasing	65	59.3	35.7	5.0
Employment	39.7	34.5	+5.2	Increasing	64	43.0	53.7	3.3
Part-time employment	19.0	13.4	+5.6	Increasing	25	23.5	72.0	4.5
Hours worked	11.2	8.4	+2.8	Increasing	8	14.2	82.8	3.0
Wages and benefits	43.5	42.9	+0.6	Increasing	91	44.4	54.7	0.9
Input prices	49.9	46.5	+3.4	Increasing	91	52.1	45.7	2.2
Selling prices	27.5	28.8	-1.3	Increasing	63	33.8	59.9	6.3
Capital expenditures	32.7	32.3	+0.4	Increasing	64	37.9	56.9	5.2
General Business Conditions Future (six months ahead)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	40.3	29.1	+11.2	Improving	35	44.1	52.1	3.8
General business activity	34.2	28.7	+5.5	Improving	34	37.5	59.2	3.3

*Indicator direction refers to this month's index. If index is positive (negative), indicator is increasing (decreasing) or improving (worsening). If zero, indicator is unchanged.

**Number of months moving in current direction.

Data have been seasonally adjusted as necessary.

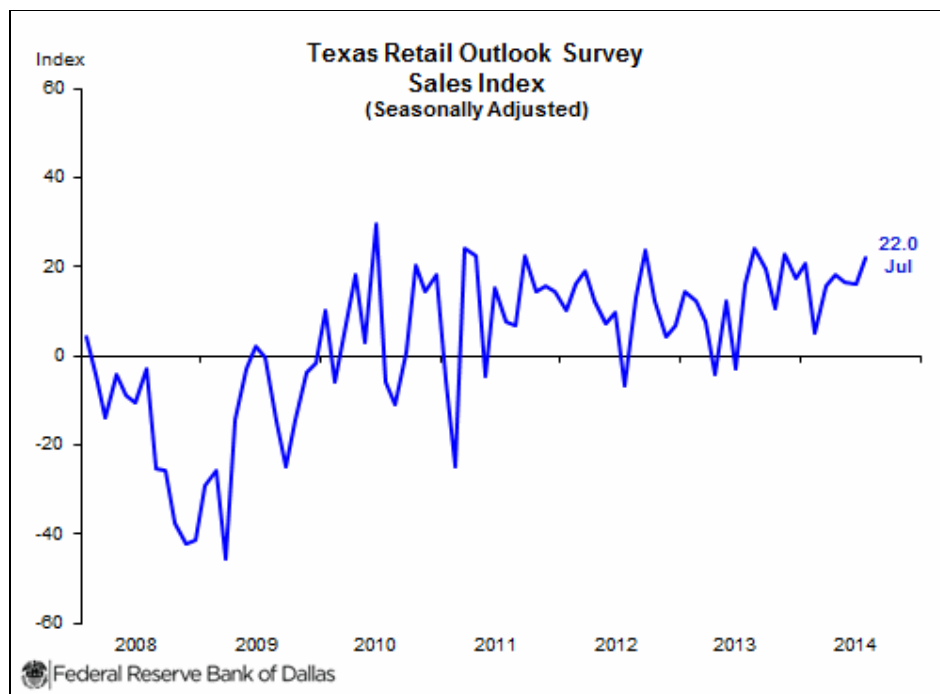
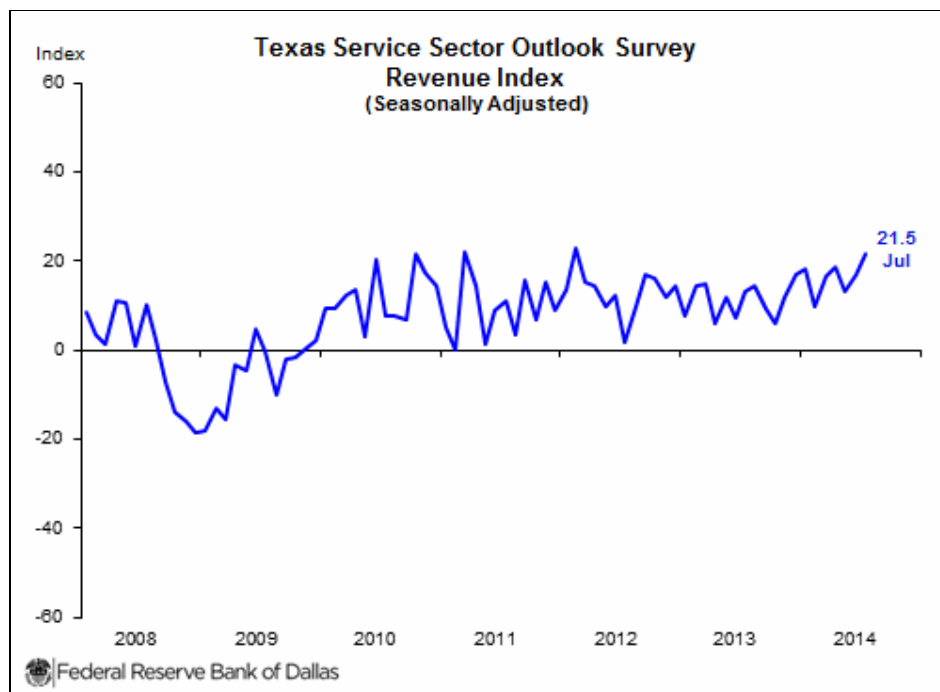
TEXAS RETAIL OUTLOOK SURVEY

Business Indicators Relating to Facilities and Products in Texas, Retail Current (versus previous month)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Retail Activity in Texas								
Sales	22.0	16.0	+6.0	Increasing	13	36.7	48.5	14.7
Employment	0.0	19.5	-19.5	No Change	1	9.4	81.2	9.4
Part-time employment	-1.9	1.8	-3.7	Decreasing	1	7.5	83.0	9.4
Hours worked	2.1	4.5	-2.4	Increasing	2	8.5	85.1	6.4
Wages and benefits	23.4	14.3	+9.1	Increasing	41	26.7	70.0	3.3
Input prices	20.2	13.2	+7.0	Increasing	48	23.4	73.4	3.2
Selling prices	19.4	17.8	+1.6	Increasing	24	25.3	68.8	5.9
Capital expenditures	12.5	3.6	+8.9	Increasing	9	19.6	73.2	7.1
Inventories	23.4	16.1	+7.3	Increasing	30	34.8	53.8	11.4
Companywide Retail Activity								
Sales	28.1	20.0	+8.1	Increasing	38	40.5	47.1	12.4
Internet sales	16.2	5.0	+11.2	Increasing	6	16.2	83.8	0.0
Catalog sales	12.1	0.0	+12.1	Increasing	1	12.1	87.9	0.0
General Business Conditions, Retail Current (versus previous month)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	27.1	30.3	-3.2	Improving	15	27.4	72.3	0.3
General business activity	21.3	30.3	-9.0	Improving	15	24.5	72.3	3.2
Business Indicators Relating to Facilities and Products in Texas, Retail Future (six months ahead)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Retail Activity in Texas								
Sales	47.7	42.9	+4.8	Increasing	65	53.3	41.1	5.6
Employment	26.7	26.3	+0.4	Increasing	55	31.9	62.9	5.2
Part-time employment	9.5	2.0	+7.5	Increasing	13	18.3	72.9	8.8
Hours worked	11.1	4.2	+6.9	Increasing	28	14.1	82.9	3.0
Wages and benefits	39.8	40.7	-0.9	Increasing	67	42.8	54.2	3.0
Input prices	38.9	37.7	+1.2	Increasing	63	42.6	53.7	3.7
Selling prices	35.1	39.6	-4.5	Increasing	63	40.7	53.7	5.6
Capital expenditures	29.6	24.6	+5.0	Increasing	40	33.3	63.0	3.7
Inventories	33.1	25.0	+8.1	Increasing	56	42.6	47.9	9.5
Companywide Retail Activity								
Sales	49.9	38.7	+11.2	Increasing	64	52.2	45.5	2.3
Internet sales	26.5	34.2	-7.7	Increasing	64	29.4	67.6	2.9
Catalog sales	19.9	7.6	+12.3	Increasing	9	20.1	79.7	0.2
General Business Conditions, Retail Future (six months ahead)								
Indicator	Jul Index	Jun Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	41.5	35.8	+5.7	Improving	64	42.1	57.3	0.6
General business activity	35.4	32.7	+2.7	Improving	34	36.0	63.4	0.6

*Indicator direction refers to this month's index. If index is positive (negative), indicator is increasing (decreasing) or improving (worsening). If zero, indicator is unchanged.

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COMMENTS FROM SURVEY RESPONDENTS

These comments are from respondents' completed surveys and have been edited for publication.

Credit Intermediation and Related Activities

- > We are beginning to see some increases in loan demand. This far out in the country there is compensatory delay to improvements in the banking industry. This lag in opportunity is offset by diversifying into bigger market places, but that is very competitive and requires strong relational contact to avoid taking greater risk. The biggest challenge is adapting to the accelerated regulatory environment. Other than the fact it is hot and we need a rain, all is well. Goats and cows are selling at record highs.
- > Capital expenses and employee increases are related to our new facility opening in September.

Securities, Commodity Contracts, and Other Financial Investments and Related Activities

- > Commodities are a strong base. Slower employment growth has slowed home construction.
- > Business is very competitive. We are concerned about the significant increase in federal income taxes due to the nonrenewal of the Section 179 expenditures, i.e., capital items that are expensed for tax purposes. Bonus depreciation and a couple of other items are also in this category. These are a significant amount of our capital expenditure program. We have cut back to only the essential capital expenditures—for example, maintenance—to offset the increase in taxes. These federal code sections have been renewed on an annual basis for several years; however, they have not been renewed for the current year.

Rental and Leasing Services

- > If bonus depreciation is not approved, it will be too costly to grow our business.

Professional, Scientific and Technical Services

- > The Texas business environment is good for now. We continue to be concerned about macroeconomic factors, especially those of a global nature. We are cautiously optimistic that current favorable trends will continue through Q3.
- > The real estate market continued on its brisk pace in June, and from what we are hearing in the market place, this trend will continue through the end of the year. The number of cranes in the sky is reminiscent of the late 80s, but this time around it is being fueled by demand instead of speculation. It is hard to get a feel for where we are in this cycle, but the number of people moving into the DFW area continues to fuel development both residentially and commercially.
- > We are seeing strong demand. We are picking and choosing between opportunities rather than taking everything that comes in the door. We are concerned about being able to get enough good people, but surprisingly we have not been losing associates.

Management of Companies and Enterprises

- > Regulatory mandates, costs and overreach continue to be the biggest hurdles for our business and that of our customers. About 15 to 20 percent of this company's earnings are going out on regulatory matters, and regulatory costs continue to escalate. Many of our customers continue to hold cash on the sidelines, uncertain of what to do because they cannot anticipate the future regulations being considered for their industry.
- > South Texas appears to be entering a mature stage of the Eagle Ford Shale boom.
- > Too much government regulation is hurting our ability to help customers.

Administrative and Support Services

- > We have a broad customer base spanning industrial, retail, office, restaurant and multifamily businesses. There are mixed signals coming from office, multifamily and retail, trending to a negative outlook as consumers cut back, and office and multifamily are seeing more competition from new construction. Overall most groups are being cautious on expenses, while vendors are raising our costs on products. Our sales are up as we acquire more new customers, not as a result of price increases for our products and services.
- > The Affordable Care Act is affecting our clients and our company because of the uncertainty and complexity. The ever-changing rules and the lack of policies to fit our industry are a big problem.
- > Interest rates continue to be an economic factor that will impact our ability to grow. Inflationary pressures are as high as we have witnessed in the last six years. While there may be a high unemployment rate, our ability to find good help with sound work ethic is a real challenge.

Ambulatory Health Care Services

- > It has been a quiet summer, but our medical practice has remained very busy. Proposed Medicare reductions on specific billing codes will impact ophthalmology beginning in January 2015, reducing revenue.
- > Summer is generally slower for health care, as both physicians and patients go on vacation. We generally see lower revenues. However, in anticipation of growth starting in the fall, we expect to see our costs rise in the short term as we increase staff.

Hospitals

- > Rural hospitals continue to get squeezed. Maintaining independence will be difficult in the health care environment.

Nursing and Residential Care Facilities

- > Government regulation and bureaucracy have had a negative impact upon our business in the second and third quarters, costing us hundreds of thousands of dollars a month.

Food Services and Drinking Places

- > Our business mirrors the consumer confidence index.
- > We opened a new unit and, for reasons we have not been able to identify, our sales across the board in all three restaurant concepts we now operate took a sharp turn up. Our new restaurant opened sharply higher than we expected, while sales in our core concept restaurants increased 3.5 percent, which is greater than our 2.3 percent price increase. Our third concept restaurants moved from double-digits down to double-digits up. The increase in employees both now and in the six-month horizon is because of the new unit. We still see little pressure on wages. We expect increases in employee benefits, particularly health care, in our annual renewal in January. Cost of goods has continued to be quite stable, but we don't expect that to continue. We just took a price increase in May, so we have no plans to raise prices again in the next six months. Our positive outlook on business conditions for our company and the general economy are mostly driven by the sudden increase in sales. We definitely recognize that it is far too soon to assume the uptrend will continue.
- > The cost of protein, including beef, poultry and pork, has skyrocketed. The labor market has tightened too.
- > The impact of new and continuing government regulations is having a very negative effect on small businesses like ours. Our inability to plan very far ahead is becoming a problem. Taxes are excessive, impacting employees as well as owners and obstructing the growth of our business.

Merchant Wholesalers, Durable Goods

- > Our decreases are seasonal changes.

Motor Vehicle and Parts Dealers

- > Business levels are up overall.

Building Material and Garden Equipment and Supplies Dealers

- > The last six months have been some of the best when compared with the last four to five years. Business is steady, and margins are holding. It is a nice change; we just hope it continues.
- > Things are slowing down a little, but business is still good and we think it will remain stable. There have been a few bumps in the road but no drastic drops. We think some volatility is due to the Affordable Care Act, and we are worried about a potentially large cost the first of year and how to pay for it.

Food and Beverage Stores

- > We have seen a lot of new retail competition chasing the strong growth in population. We continue to feel margin pressure on gross profit.

Questions regarding the Texas Service Sector Outlook Survey can be addressed to Amy Jordan at amy.jordan@dal.frb.org. The Texas Service Sector Outlook Survey can be found online at www.dallasfed.org/microsites/research/surveys/tssos/.

