Texas Service Sector Outlook Survey

DALLASFED

November 25, 2014

Texas Service Sector Activity Picks Up

What's New This Month

For this month's survey, Texas business executives were asked supplemental questions on employment expectations and the labor market. Results for these questions from the Texas Manufacturing Outlook Survey (TMOS), Texas Service Sector Outlook Survey (TSSOS) and Texas Retail Outlook Survey (TROS) have been released together.

Texas service sector activity improved notably in November, according to business executives responding to the Texas Service Sector Outlook Survey. The revenue index, a key measure of state service sector conditions, surged from 14 to 25.4.

Labor market indicators reflected slightly faster employment growth and longer workweeks. The employment index moved up from 12.3 to 15.3 in November. The hours worked index was largely unchanged at 4.4 this month.

Perceptions of broader economic conditions continued to reflected optimism in November. The general business activity index held steady at 17.3. The company outlook index edged up from 15.9 to 17, with 22 percent of respondents reporting that their outlook improved from last month and 5 percent noting it worsened.

Price pressures increased while wage pressures held steady this month. The selling prices index rose slightly from 6.6 to 9.3, indicating prices increased at a slightly faster pace than in October. The wages and benefits index held steady at 17.6, 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 November. The index of future general business activity advanced almost 10 points to 33.1. The index of future company outlook ticked up from 29 to 31.1. Indexes of future service sector activity, such as future revenue and employment, also reflected more optimism this month.

Retail Sales Continue to Grow

Retail sales continued to reflect expansion in November, according to business executives responding to the Texas Retail Outlook Survey. The sales index was unchanged at 16.7, suggesting sales grew at the same pace as last month. Inventories increased at a faster pace than last month.

Labor market indicators were mixed. The employment index advanced 8 points to 10.9, indicating retail jobs increased at a faster pace than in October. The hours worked index fell slightly from -1.3 to -2.9, suggesting shorter workweeks, although the great majority of firms continued to note no change.

Retailers' perceptions of broader economic conditions reflected less optimism in November. The general business activity index dipped 3 points to 26.7. The company outlook index ticked down from 26.8 to 25.1, with 29 percent of respondents noting an improved company outlook over the prior month, compared with 4 percent reporting their outlook had worsened.

Retail price and wage pressures increased this month. The selling prices index rose slightly from 13 to 15.4. The wages and benefits index moved up from 11.6 to 14.8, although the great majority of firms noted no change in labor costs.

Retailers' perceptions of future broader economic conditions reflected more optimism in November. The future general business activity index rose from 33.9 to 41.3, reaching an all-time high. The index of future company outlook advanced from 34.9 to 42.6, its highest reading in almost four years. Indexes of future retail sector activity remained in solid positive territory 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 Nov. 10–19, and 247 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: December 30, 2014

Texas Service Sector Outlook Survey

Business Indicators Relating to Facilities and Products in Texas
Current (versus previous month)

Indicator	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Revenue	25.4	14.0	+11.4	Increasing	61	35.4	54.6	10.0
Employment	15.3	12.3	+3.0	Increasing	57	20.1	75.1	4.8
Part-time employment	5.7	6.3	-0.6	Increasing	13	10.1	85.5	4.4
Hours worked	4.4	4.1	+0.3	Increasing	10	9.4	85.6	5.0
Wages and benefits	17.6	18.0	-0.4	Increasing	66	18.9	79.8	1.3
Input prices	25.3	22.9	+2.4	Increasing	67	28.7	67.9	3.4
Selling prices	9.3	6.6	+2.7	Increasing	48	14.0	81.3	4.7
Capital expenditures	9.9	11.1	-1.2	Increasing	63	16.0	77.9	6.1

General Business Conditions
Current (versus previous month)

Indicator	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	17.0	15.9	+1.1	Improving	39	22.2	72.6	5.2
General business activity	17.3	18.0	-0.7	Improving	37	22.9	71.5	5.6

Business Indicators Relating to Facilities and Products in Texas
Future (six months ahead)

Indicator	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Revenue	49.4	47.6	+1.8	Increasing	69	56.3	36.8	6.9
Employment	42.6	33.0	+9.6	Increasing	68	44.0	54.6	1.4
Part-time employment	13.1	13.7	-0.6	Increasing	29	18.1	76.9	5.0
Hours worked	5.1	5.6	-0.5	Increasing	12	9.9	85.3	4.8
Wages and benefits	44.1	41.5	+2.6	Increasing	95	44.5	55.1	0.4
Input prices	47.4	45.5	+1.9	Increasing	95	50.3	46.9	2.9
Selling prices	30.8	29.0	+1.8	Increasing	67	36.6	57.6	5.8
Capital expenditures	31.3	29.9	+1.4	Increasing	68	38.1	55.1	6.8

General Business Conditions
Future (six months ahead)

Indicator	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	31.1	29.0	+2.1	Improving	39	38.3	54.5	7.2
General business activity	33.1	23.4	+9.7	Improving	38	37.9	57.3	4.8

*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	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Retail Activity in Texas								
Sales	16.7	16.7	0.0	Increasing	17	34.3	48.1	17.6
Employment	10.9	2.9	+8.0	Increasing	4	18.0	74.9	7.1
Part-time employment	-1.8	3.5	-5.3	Decreasing	1	10.9	76.4	12.7
Hours worked	-2.9	-1.3	-1.6	Decreasing	2	9.5	78.1	12.4
Wages and benefits	14.8	11.6	+3.2	Increasing	45	20.3	74.2	5.5
Input prices	22.4	13.1	+9.3	Increasing	52	25.9	70.6	3.5
Selling prices	15.4	13.0	+2.4	Increasing	28	22.3	70.8	6.9
Capital expenditures	8.7	6.8	+1.9	Increasing	13	14.0	80.7	5.3
Inventories	19.0	15.1	+3.9	Increasing	34	27.1	64.8	8.1
Companywide Retail Activity								
Sales	17.3	15.8	+1.5	Increasing	42	31.9	53.5	14.6
Internet sales	0.0	11.7	-11.7	No Change	1	7.1	85.7	7.1
Catalog sales	-2.6	0.0	-2.6	Decreasing	1	5.3	86.8	7.9

General Business Conditions, Retail
Current (versus previous month)

Indicator	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	25.1	26.8	-1.7	Improving	19	28.7	67.7	3.6
General business activity	26.7	29.8	-3.1	Improving	19	29.7	67.3	3.0

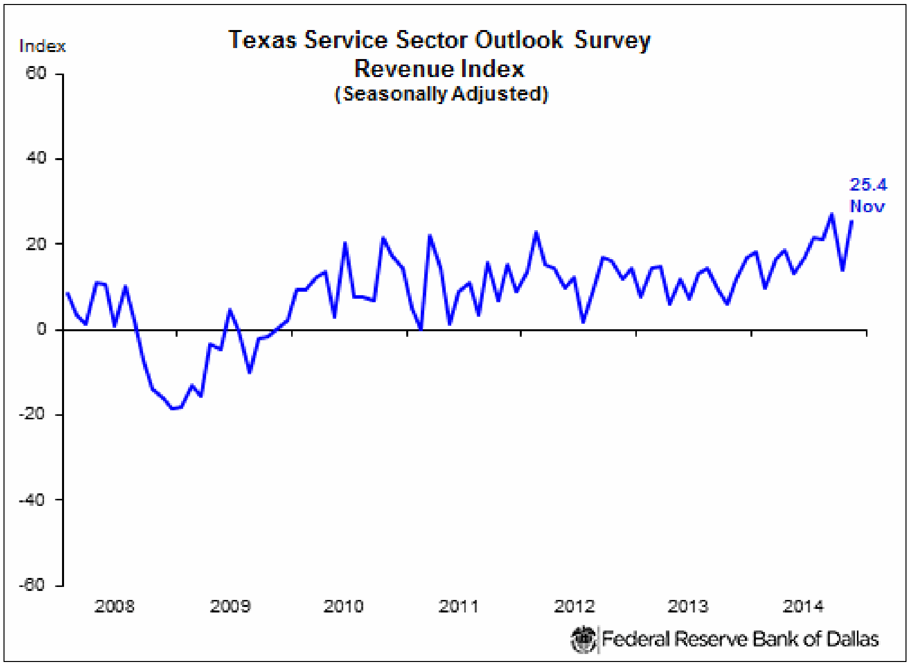
Business Indicators Relating to Facilities and Products in Texas, Retail
Future (six months ahead)

Indicator	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Retail Activity in Texas								
Sales	54.2	56.3	-2.1	Increasing	69	61.4	31.4	7.2
Employment	32.9	27.1	+5.8	Increasing	59	37.1	58.7	4.2
Part-time employment	4.6	10.7	-6.1	Increasing	17	18.6	67.4	14.0
Hours worked	6.5	8.5	-2.0	Increasing	32	13.5	79.5	7.0
Wages and benefits	39.8	39.1	+0.7	Increasing	71	42.1	55.6	2.3
Input prices	35.8	31.6	+4.2	Increasing	67	42.9	50.0	7.1
Selling prices	39.3	38.6	+0.7	Increasing	67	46.4	46.4	7.1
Capital expenditures	35.8	25.0	+10.8	Increasing	44	42.9	50.0	7.1
Inventories	25.9	20.9	+5.0	Increasing	60	37.6	50.7	11.7
Companywide Retail Activity								
Sales	46.8	47.9	-1.1	Increasing	68	48.9	49.1	2.1
Internet sales	29.3	26.2	+3.1	Increasing	68	29.3	70.7	0.0
Catalog sales	11.0	7.6	+3.4	Increasing	13	14.5	82.0	3.5

General Business Conditions, Retail
Future (six months ahead)

Indicator	Nov Index	Oct Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company outlook	42.6	34.9	+7.7	Improving	68	48.0	46.5	5.4
General business activity	41.3	33.9	+7.4	Improving	38	46.3	48.6	5.0

*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 Service Sector Outlook Survey
Revenue Index
(Seasonally Adjusted)
Index
60
40
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-20
-40
-60
2008
2009
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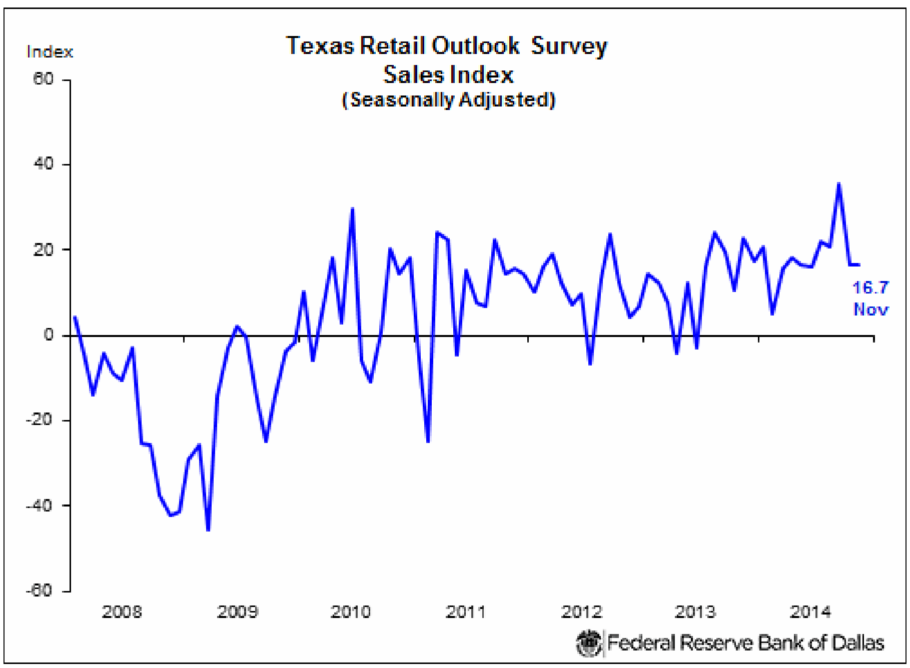
2011
2012
2013
2014
25.4
Nov
Federal Reserve Bank of Dallas


Texas Retail Outlook Survey
Sales Index
(Seasonally Adjusted)
Index
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2008
2009
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2012
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Federal Reserve Bank of Dallas

Comments from Survey Respondents

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

Credit Intermediation and Related Activities

- There is some concern about oil prices and the impact they have on multiple ancillary industries. Livestock prices remain at historical highs and will for several years, especially if the drought is on the way out of Texas.

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

- We continue to see increases in regulations and taxes, particularly from the expiration of the capital expenditures and bonus depreciation tax incentives. This is a significant tax increase for our businesses, which means no expansion of facilities or capabilities in the manufacturing process. We continue to monitor these; plus, illegal immigration and local taxes are becoming somewhat of a problem. These things are beginning to really hurt the bottom line.
- Slower job growth is hurting retail sales. Lower prices for oil and other commodities hurt future prospects.

Publishing Industries (except Internet)

- Our average employee workweek for November includes significant overtime.

Rental and Leasing Services

- We think if bonus depreciation passes now, it will help escalate sales and revenue through the end of the year and into next year. If it does not pass, we think sales and revenue will slowly sink back in the sand.

Professional, Scientific and Technical Services

- In addition to the upcoming Affordable Care Act employer mandate, we are having numerous issues with prevailing wage law as it relates to our H2-B visa employees. Essentially, we are being required to increase our H2-B wages by more than 20 percent, causing our outlook for the future to be somewhat bleak. We entered into contracts months ago at the currently approved rates, but the methodology has changed midstream. These are exactly the types of issues that drive businesses crazy.
- The real estate market in Texas is still on fire. No one could have forecast that interest rates would remain at such low levels, and everyone is doing their best to take advantage of it. With the level of business activity, we feel confident that this market still has a long way to go, but we are trying to remain cautious about staffing needs due to the unknown of what is going to happen once these rates begin to move up.
- The low price of oil does not help.

Management of Companies and Enterprises

- Regulatory burden is beginning to erode earnings.

Administrative and Support Services

- We service many business lines and industries. We are seeing weakness in the restaurant sector. The real estate sector is mixed, with properties changing hands and new owners trying to adjust to a higher cost basis, while existing owners have increased budgets for service. Industrial and manufacturing are showing improvement but are keeping tight reins on costs.
- Health insurance rates are unbelievable. We will not be able to afford them.
- There is still a very pronounced lack of urgency in full-time hiring. IT professionals are receiving multiple offers, making it an employee market, but hiring managers remain tentative about deciding.

Educational Services

- There was a slight increase in full-time employees due to concentrated recruiting efforts to fill vacant instructor positions as well as job fairs to recruit adjunct part-time instructors for the spring 2015 semester.

Ambulatory Health Care Services

- We are expecting an increase in benefit costs but no wage increases. Revenue will decline as Medicare reduces some fees paid to physicians.
- Since we are a health care provider, decreasing reimbursement is forcing us to focus on increasing productivity of our staff in order to absorb lower revenue per patient. The bottom line is that small- and medium-sized health care businesses are trying to stay ahead of the slope of decreasing reimbursement even as increased accountability on quality and outcomes is adding cost because additional qualified staff is required.

Food Services and Drinking Places

- Sales have slowed slightly, but they are still at levels reflecting a very substantial increase over last year, even after adjusting for price increases. Other factors have remained almost exactly the same compared with last period. We are expecting continued improvement in sales in the next six months. We still don't see much in the way of pressure to increase wages, but we are about at the point where the increased sales are going to start requiring a longer employee workweek. However, the biggest factor in our projected increases in wages and benefits is benefits. Last year we offered medical benefits to a little over 150 people, and this year we are required to offer benefits to more than 500 people. Additionally, our existing policy ended up being almost 20 percent more expensive. We expect the signup rate among the newly eligible group to be somewhere in the 10 to 15 percent range. We are already being advised that there will be major increases for almost all of our key input products at the beginning of the year. We are planning to take a price increase later this month because of the expected increases in the cost of employee medical insurance.
- Our costs continue to increase and there is no relief is in sight. The price of protein—beef and chicken—is at record levels. We are starting high school aged workers at $10 an hour. Every increase in our menu items is greeted with complaints and loss of customer count.

Merchant Wholesalers, Durable Goods

- Business slowed some this quarter. We expect to see some nice increases next year.
- Long-term agricultural commodity prices are weak.

Motor Vehicle and Parts Dealers

- We continue to be impacted by the problems with our chief supplier.

Food and Beverage Stores

- Total sales are down because of the decline in retail fuel prices. Volumes and profits are up. Lower fuel prices are driving improved grocery sales, which is a big plus.

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/.

November 24, 2014

Special Questions

Data were collected Nov. 3–6, and 179 Texas business executives responded to the survey.

1. Do you expect your firm to increase employment, leave employment unchanged, or decrease employment over the next six to twelve months?

	Mar. '12 (percent)	May '14 (percent)	Nov. '14 (percent)
Increase	49.0	43.1	48.6
Leave Unchanged	40.7	47.9	46.4
Decrease	10.3	9.0	5.0

2. Are you having problems finding qualified workers when hiring?

	May '14 (percent)	Nov. '14 (percent)
Yes	71.4	71.9
No	28.6	28.1

3. If you are having problems finding qualified workers, what are the main reasons why? Please check all that apply.

	May '14 (percent)	Nov. '14 (percent)
Lack of available applicants/no applicants	46.5	52.7
Lack of technical competencies (hard skills)	55.9	50.4
Looking for more pay than is offered	37.8	39.7
Lack of workplace competencies (soft skills)	44.1	38.9
Lack of experience	44.9	37.4
Inability to pass drug test and/or background check	29.1	22.9

4. What, if anything, are you doing to recruit and retain employees? Please check all that apply.

	May '14 (percent)	Nov. '14 (percent)
Intensify recruiting, including advertising, paying recruiting bonuses, utilizing employment agencies, etc.	58.0	64.7
Increase wages and or benefits	47.3	52.6
Offer additional training	39.3	39.7
Increase variable pay, including bonuses	34.0	36.5
Improve working conditions	16.7	24.4
Reduce education and other requirements for new hires	6.7	5.1
Other	13.3	5.8

5. If labor costs are increasing, are you passing the cost on to customers in the way of price increases?

	May '14 (percent)	Nov. '14 (percent)
Yes	41.8	34.3
No	43.0	52.2
Not Applicable	15.2	13.5

Special Questions Comments

These comments have been edited for publication.

Credit Intermediation and Related Activities

- The most recent trend that we have seen is a notable increase in applicants in our rural market. This is the most qualified applicant pool we have had to consider going back at least five years. It will be interesting to ask the ones we hired what the key factor was in their decision to come to work here.
- We always have endeavored to retain qualified staff. Over the past couple decades, this has meant minimizing debt so that in downturns we can retain our staff and continue development. We are a small company and 18 percent of our staff has been with us about 20 years.

Publishing Industries (except Internet)

- Our health care insurance costs per employee continue to go up every year. In addition, brokers selling us insurance are struggling to keep up with changes in the health care law and implementation. This uncertainty is a major drag on our business, especially for planning and hiring.

Telecommunications

- In the Houston market, the economy is doing well, but finding qualified technicians is driving our hiring and compensation costs higher than expected.

Rental and Leasing Services

- The Texas oil fields are obviously a blessing, but it is also a curse as that industry has no ceiling on what they can and will pay prospective employees. Most businesses do not enjoy that business latitude. In Texas, finding and keeping good people is our greatest challenge.

Professional, Scientific and Technical Services

- We are able to acquire talent and are paying for those hires. We do not want to relax our requirements as that could impact the quality of service we deliver.
- To be awarded most of our work, our proposed fees must be competitive in the marketplace; therefore we are not always able to pass along employment and other cost increases. We are able to more directly pass on these costs on noncompetitive proposals and on hourly fee projects.

Management of Companies and Enterprises

- Because of regulations and associated compliance costs, we have had to significantly increase the cost to the consumer. The cost of generating a note document, from the annual maintenance fee to the software provider on loan forms, runs around $135 per loan. We have added a cost of $50 per consumer loan and $250 per commercial loan. To comply with loan requirements, we must do additional analysis not previously required on virtually every commercial loan over $250,000. Compliance is now running our bank, versus safety and soundness.
- Retaining employees is difficult due to Dodd–Frank compliance in terms of offering bonuses.

Administrative and Support Services

- We are expanding by adding new territories to our service area. Cost increases, such as labor, have been difficult to pass along due to competition, but we continue to work to elevate our prices. There has been margin erosion as a result of the cost increases in both labor and product.
- We are unable to pass on additional costs because most of our revenues come from insurance reimbursements.
- The biggest labor cost increase that we have ever faced is the Affordable Care Act, including the administrative burden and risks associated with complying with a law that is so complex and not well understood. It is hard to pass along the cost of an unknown risk.
- We are unable to pass any additional costs on to our clients—given our fixed rate contractual relationships—making the increased costs of talent a reduction in our profitability. There is no room for margin expansion in our business, only contraction.

Ambulatory Health Care Services

- Since we are medical services providers, we cannot pass along cost increases, like labor, as contracts do not allow it. Most contracts are tied to Medicare, so reimbursement is still dropping while costs go up.

Hospitals

- Our ability to pass along cost increases to customers is very limited due to long-term contracts and governmental payers, but we do so wherever we can.

Food Services and Drinking Places

- We are in the restaurant industry so we are not yet experiencing a significant tightening in the labor market. We do expect to start having trouble hiring quality applicants in the near future. In the last year, we have greatly increased the training we offer our management staff, both to help improve company results and to help them in their own careers by developing the managerial skills needed to succeed. We have also reviewed and updated our hourly training methods and materials, although we have not specifically expanded the scope of training offered at the hourly level. Both of these actions have been taken simply as the result of a decision that they would be good for the company and the employees, not in response to tightening labor market conditions.

Pipeline Transportation

- Shortage of talent is a chronic situation in the oil and gas industry and for certain classifications, such as engineering, and experience levels, i.e., 15 to 20 years. The lack of candidates is severe.

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Special Questions

Data were collected Nov. 3–6, and 47 Texas retailers responded to the survey.

1. Do you expect your firm to increase employment, leave employment unchanged, or decrease employment over the next six to twelve months?

	Mar. '12 (percent)	May '14 (percent)	Nov. '14 (percent)
Increase	50.9	47.5	42.6
Leave Unchanged	43.9	50.0	51.1
Decrease	5.3	2.5	6.4

2. Are you having problems finding qualified workers when hiring?

	May '14 (percent)	Nov. '14 (percent)
Yes	82.5	82.6
No	17.5	17.4

3. If you are having problems finding qualified workers, what are the main reasons why? Please check all that apply.

	May '14 (percent)	Nov. '14 (percent)
Lack of technical competencies (hard skills)	50.0	57.5
Lack of workplace competencies (soft skills)	55.9	50.0
Lack of available applicants/no applicants	50.0	45.0
Looking for more pay than is offered	35.3	37.5
Inability to pass drug test and/or background check	47.1	35.0
Lack of experience	52.9	27.5

4. What, if anything, are you doing to recruit and retain employees? Please check all that apply.

	May '14 (percent)	Nov. '14 (percent)
Intensify recruiting, including advertising, paying recruiting bonuses, utilizing employment agencies, etc.	70.0	79.1
Increase wages and or benefits	50.0	46.5
Increase variable pay, including bonuses	42.5	41.9
Offer additional training	40.0	41.9
Improve working conditions	17.5	20.9
Reduce education and other requirements for new hires	12.5	7.0
Other	5.0	4.7

5. If labor costs are increasing, are you passing the cost on to customers in the way of price increases?

	May '14 (percent)	Nov. '14 (percent)
Yes	51.3	25.5
No	41.0	63.8
Not Applicable	7.7	10.6

Special Questions Comments

These comments have been edited for publication.

Merchant Wholesalers, Durable Goods

- Price increases have been hard to pass on. The Texas construction market is continuing to improve. However, we saw a flatter market than what was projected earlier in the year. We beefed up employee head count and inventory for this projected growth, and even though it has not come to fruition, we took the profit hit this year and will see better results in 2015.
- The oil and gas fields are our major competitors, offering tremendous pay packages.
- We have not introduced wage increases into pricing yet. We will do so when we feel the market will accept increases.

Motor Vehicle and Parts Dealers

- Basically we are unable to compete with the oil industry on service personnel. We have to resell our tech time. This is a growing problem.
- One of our operations is in major jeopardy due to minimum wage planned increases in the next two years.

Building Material and Garden Equipment and Supplies Dealers

- All of our hiring plans depend on the elections. If Republicans control the Senate, we will hire more.

Food and Beverage Stores

- We are experiencing localized hiring pressures in the Permian Basin, Eagle Ford and Houston areas. Otherwise, labor is manageable.

Nonstore Retailers

- Since most of our hiring is for vending route drivers, we can't lower our requirements related to driving records or drug screening. Also, since these positions handle a lot of cash, we will not lower standards on our background checks for certain criminal activity. We are able to temporarily draw upon assistant managers and supervisors to fill open route positions until we ultimately find someone suited to the position.