Economic Outlook

(January 13, 2016)

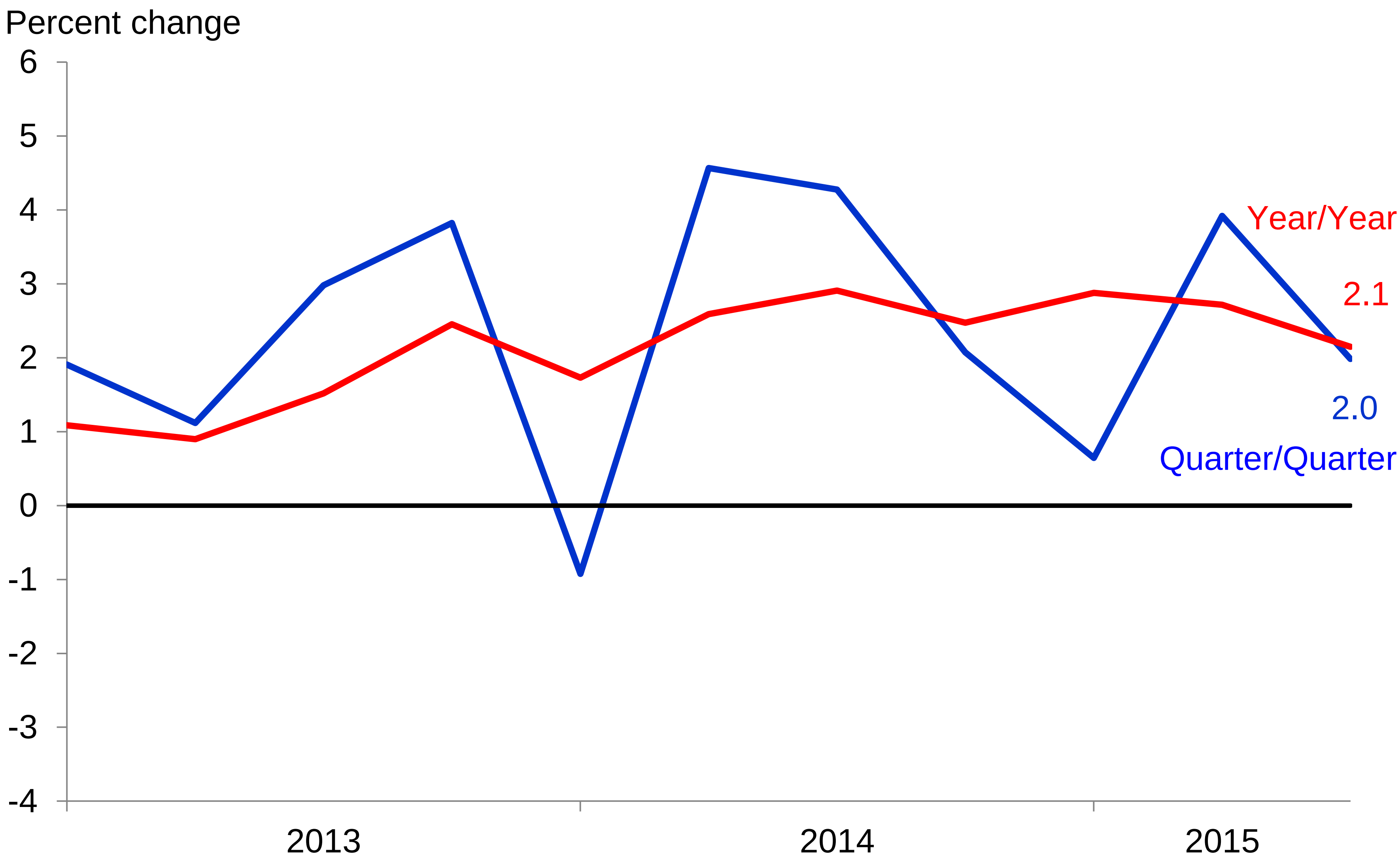
John V. Duca
Associate Director of Research and Vice President
and
Adjunct Professor, Southern Methodist University

Real Activity

Despite slowdown in Asian growth, U.S. economy ended 2015 on a solid note

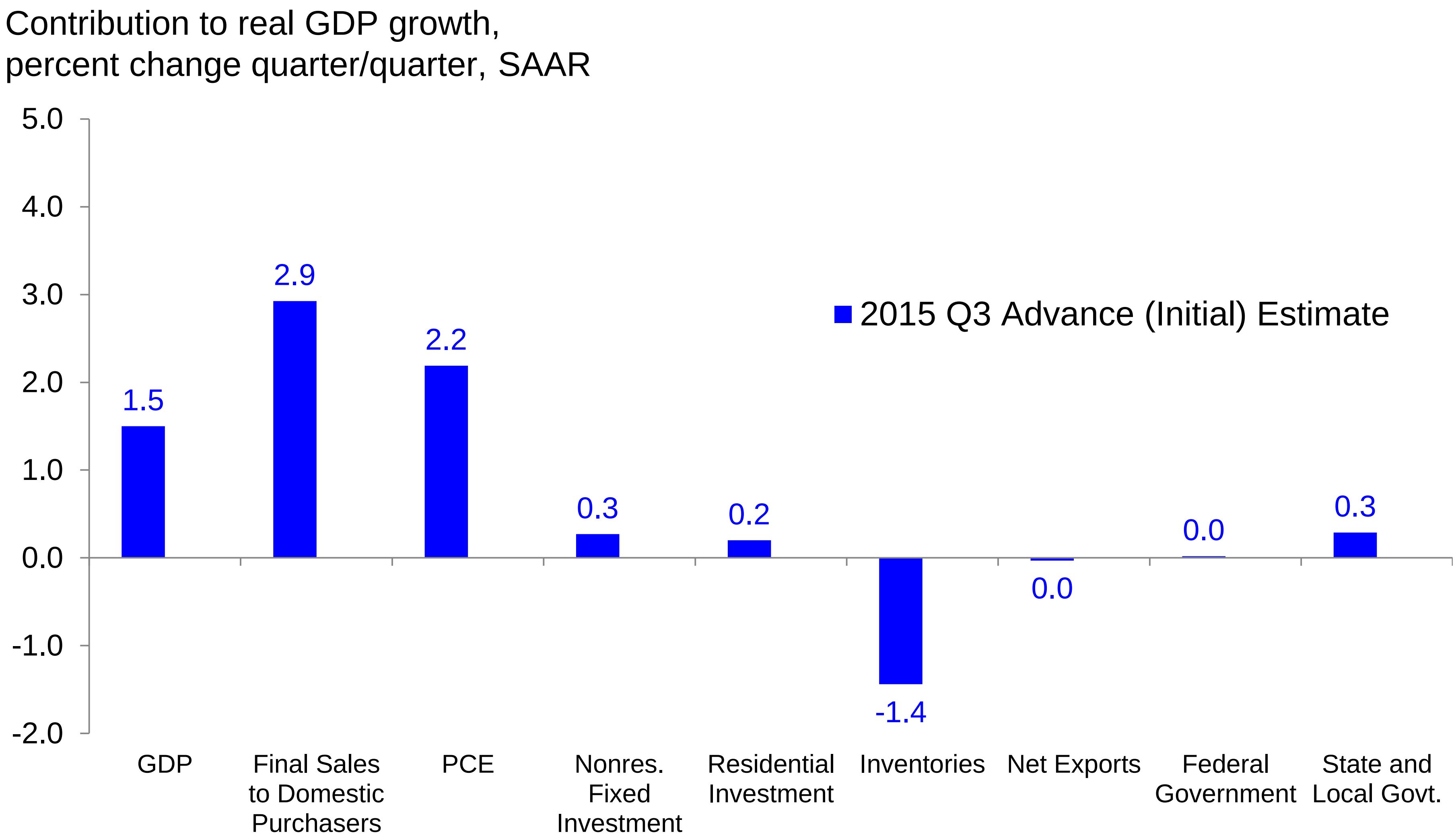
- Third quarter growth was upwardly revised
- December payroll job growth stronger-than-expected, with upward revisions to October and November
- But slowing global growth—especially in China—is restraining manufacturing/trade components of U.S. GDP
- A tale of two economies: domestic strength in services versus a stalling out of growth in the goods sector. Growth moderating as economy nears or is at full employment.

Underlying pace of growth nearing 2 – 2 ½ %



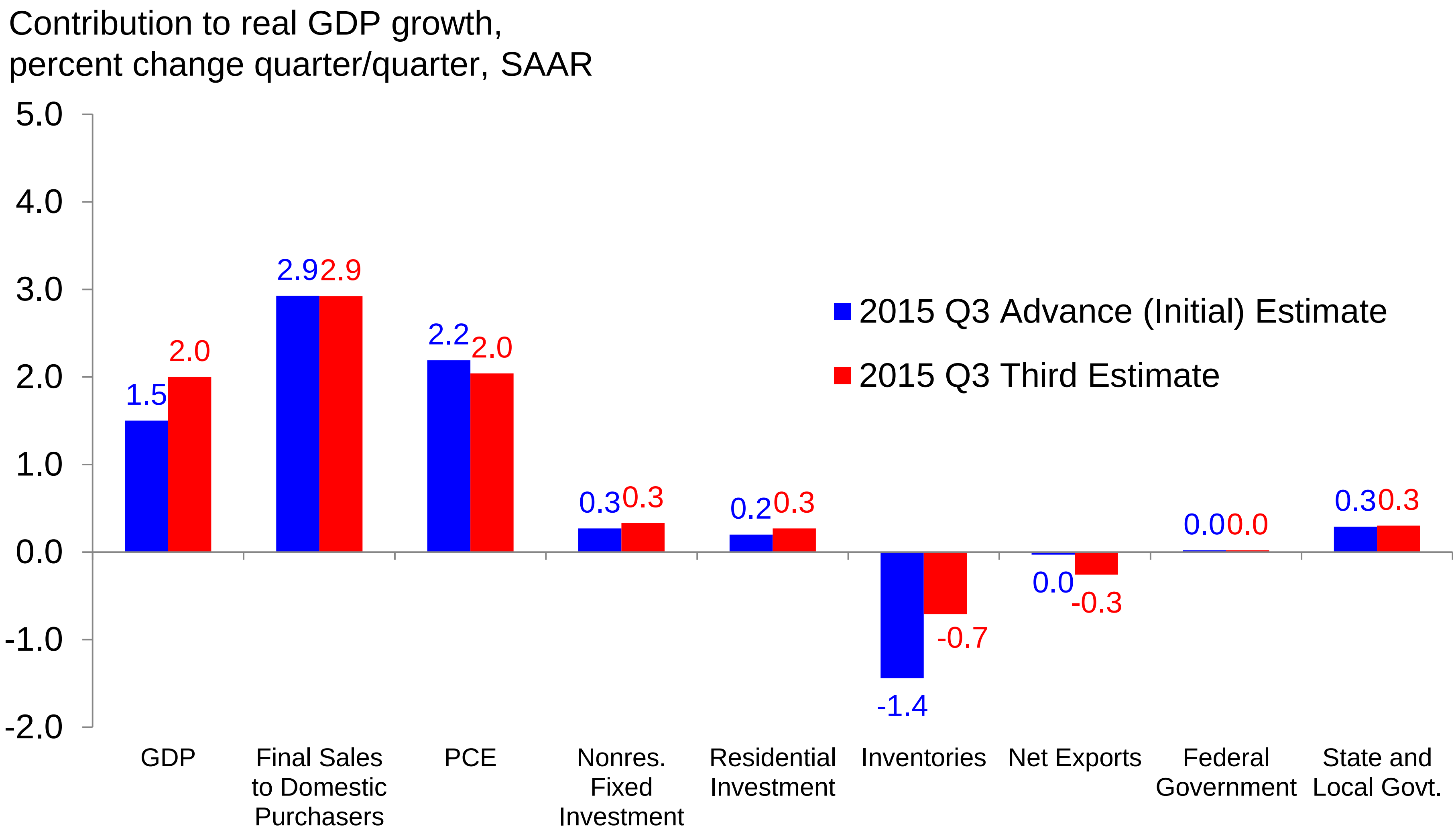
Source: Bureau of Economic Analysis.

Upward revision to GDP growth in 2015 Q3, less inventory drawdown, uptick in investment



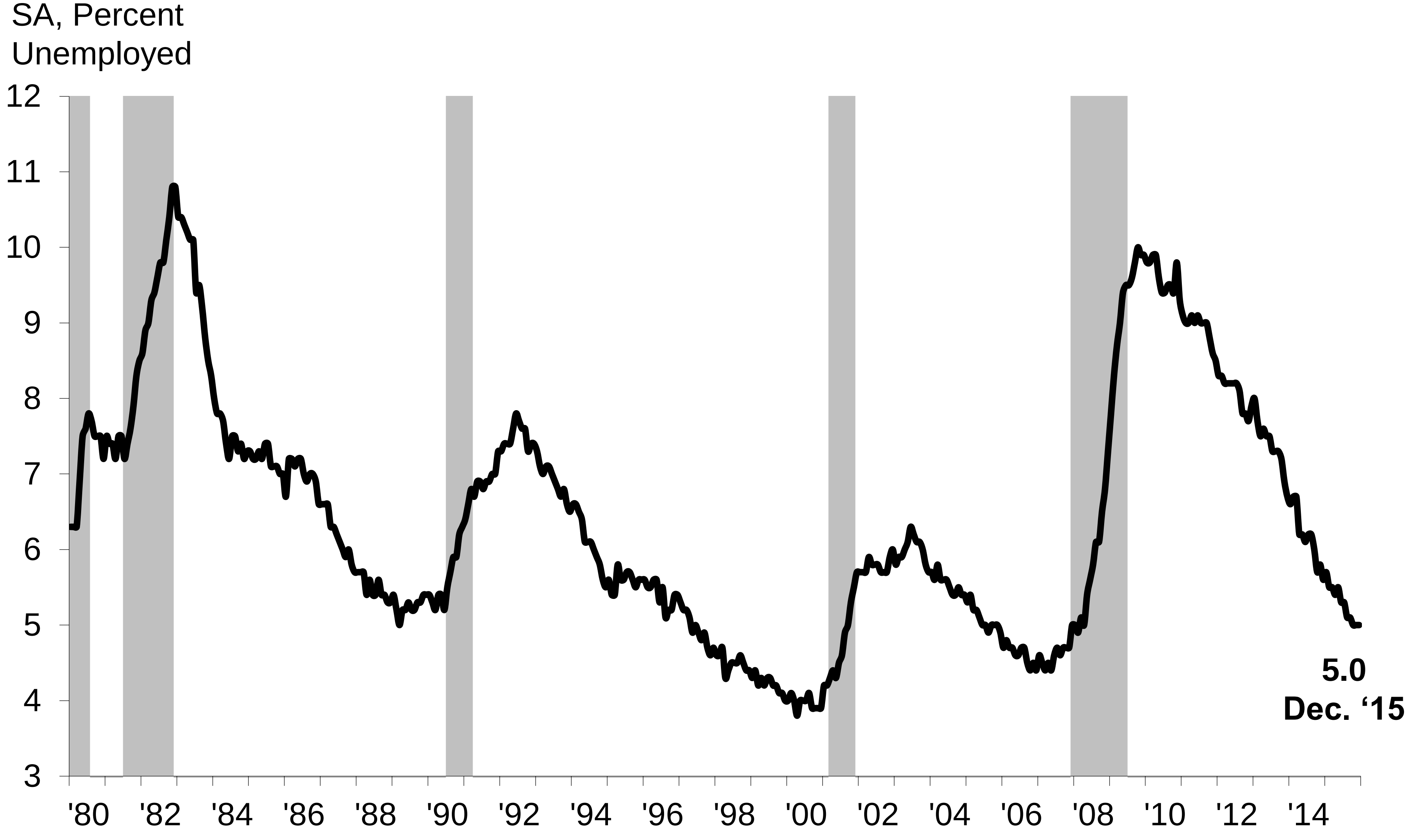
Source: Bureau of Economic Analysis.

Upward revision to GDP growth in 2015 Q3, less inventory drawdown, uptick in investment



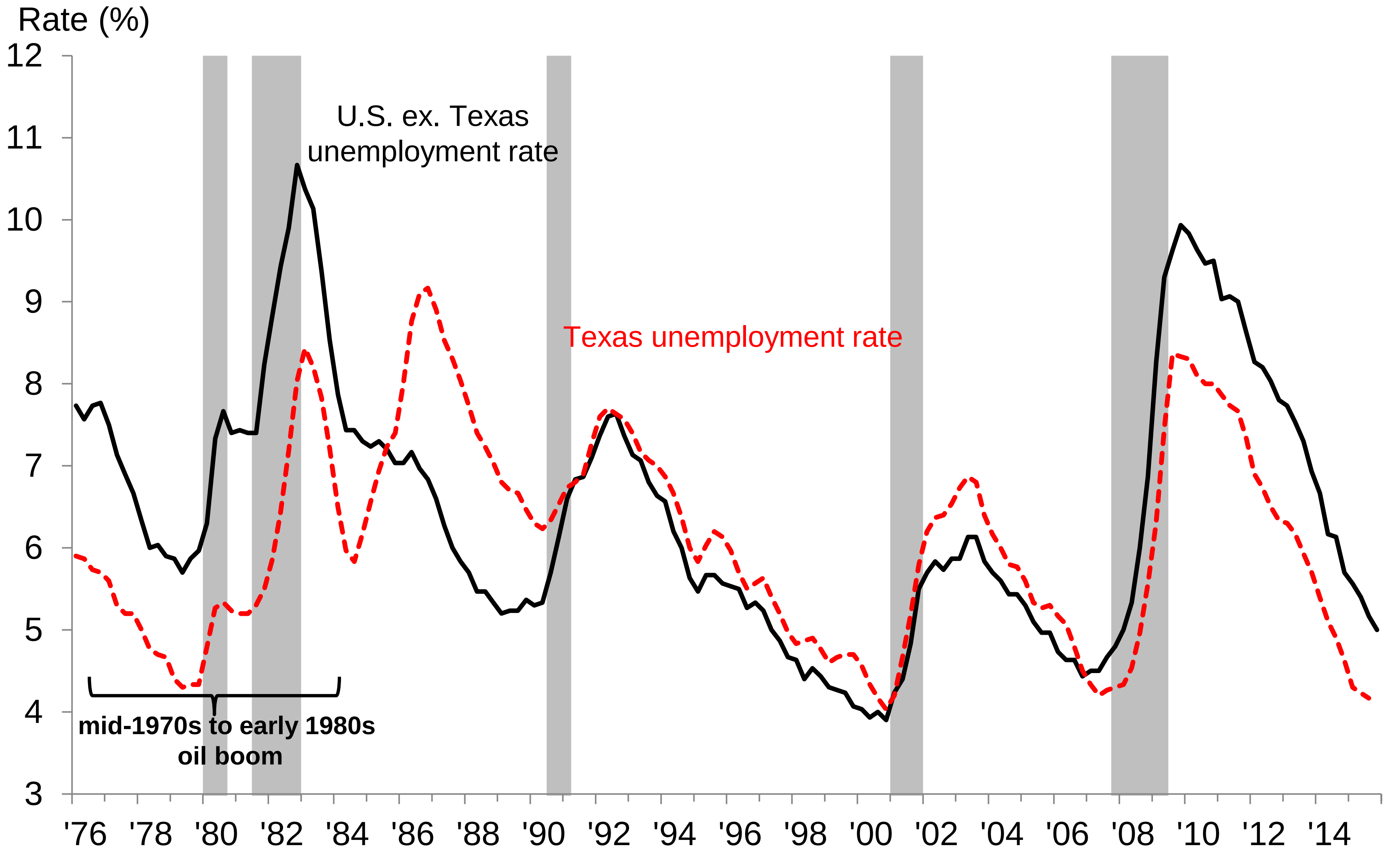
Source: Bureau of Economic Analysis.

In 2013-14, unemployment fell rapidly, declines slowing as we near full employment



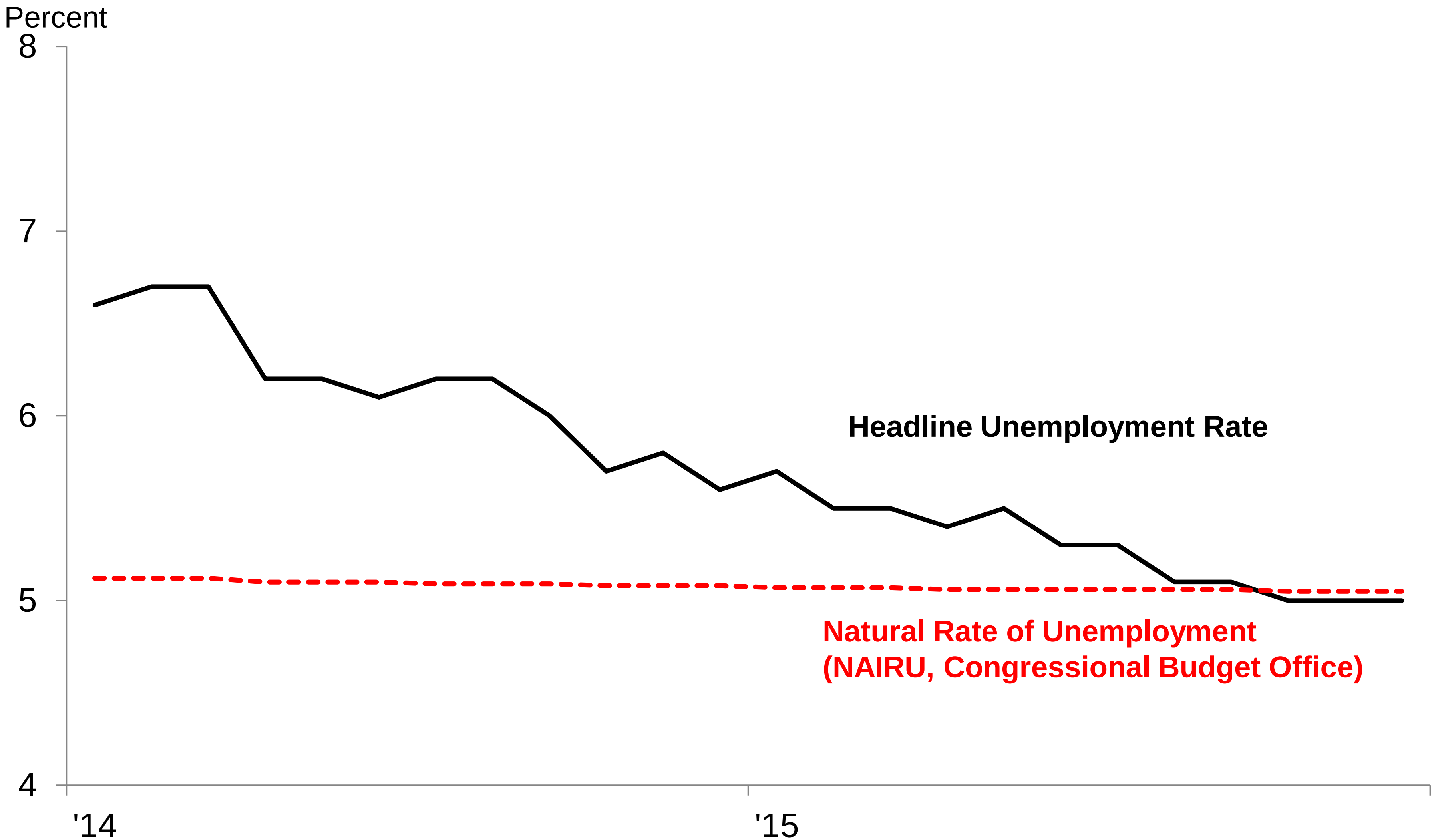
Source: Bureau of Labor Statistics.

Unemployment rate in Texas below U.S. during energy booms of 1970s, early 1980s, and 2006-15



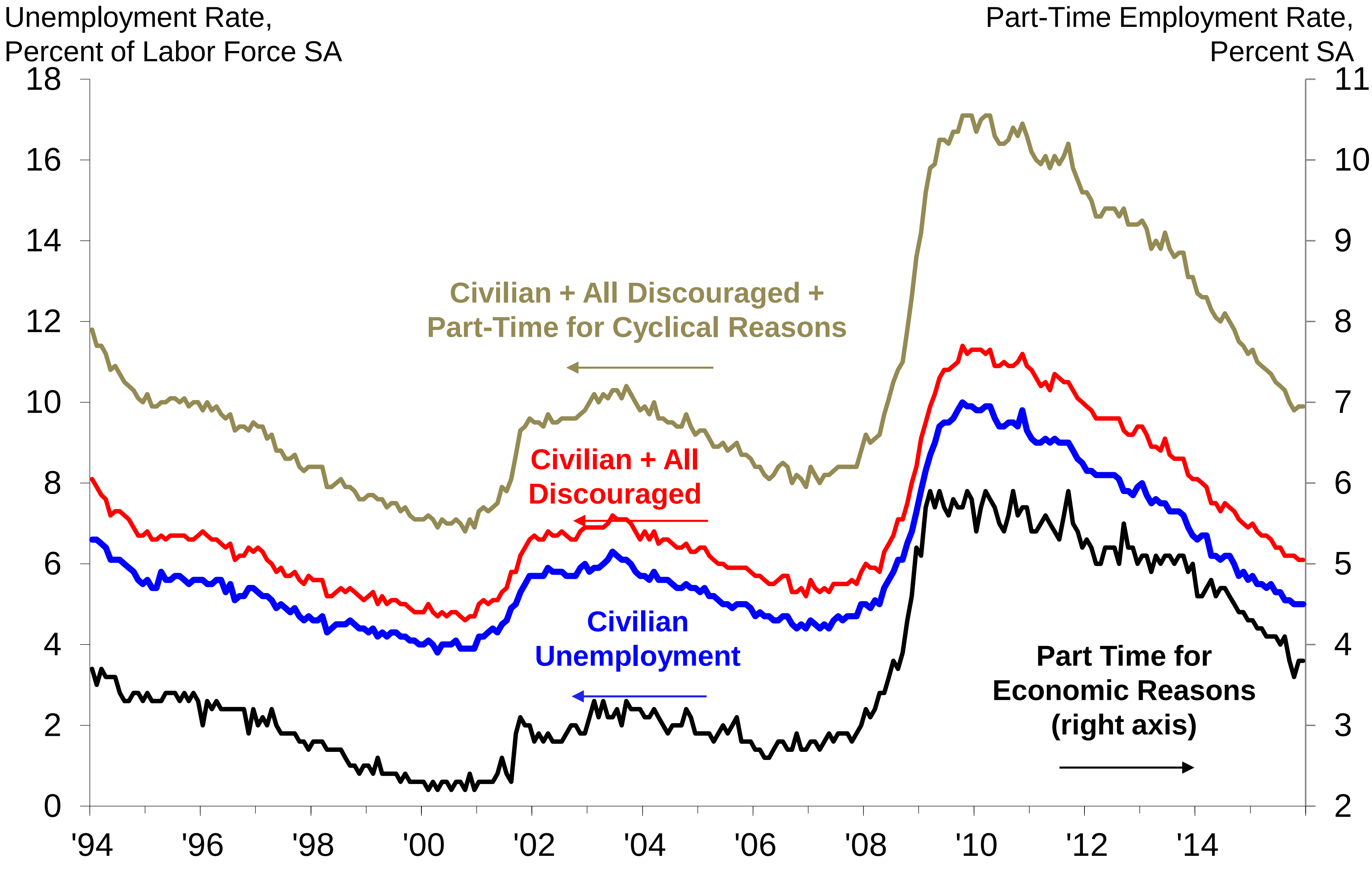
NOTE: Shaded bars indicate U.S. recessions.
SOURCE: Bureau of Labor Statistics.

Declines in unemployment imply little or no labor market slack left



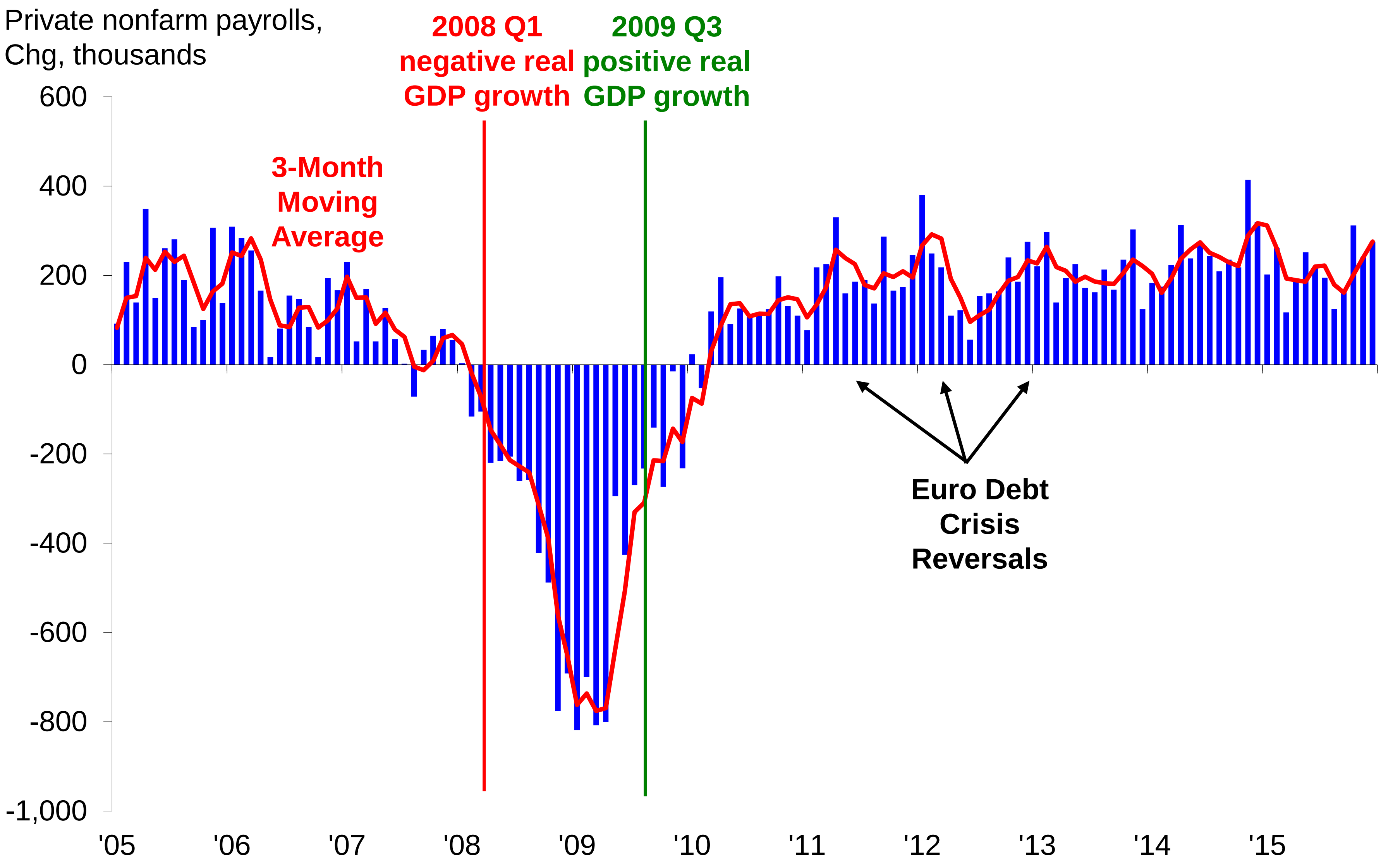
Sources: Bureau of Labor Statistics and Congressional Budget Office.

Alternative unemployment rates: somewhat more labor market slack than headline rate, but nearing pre-recession levels



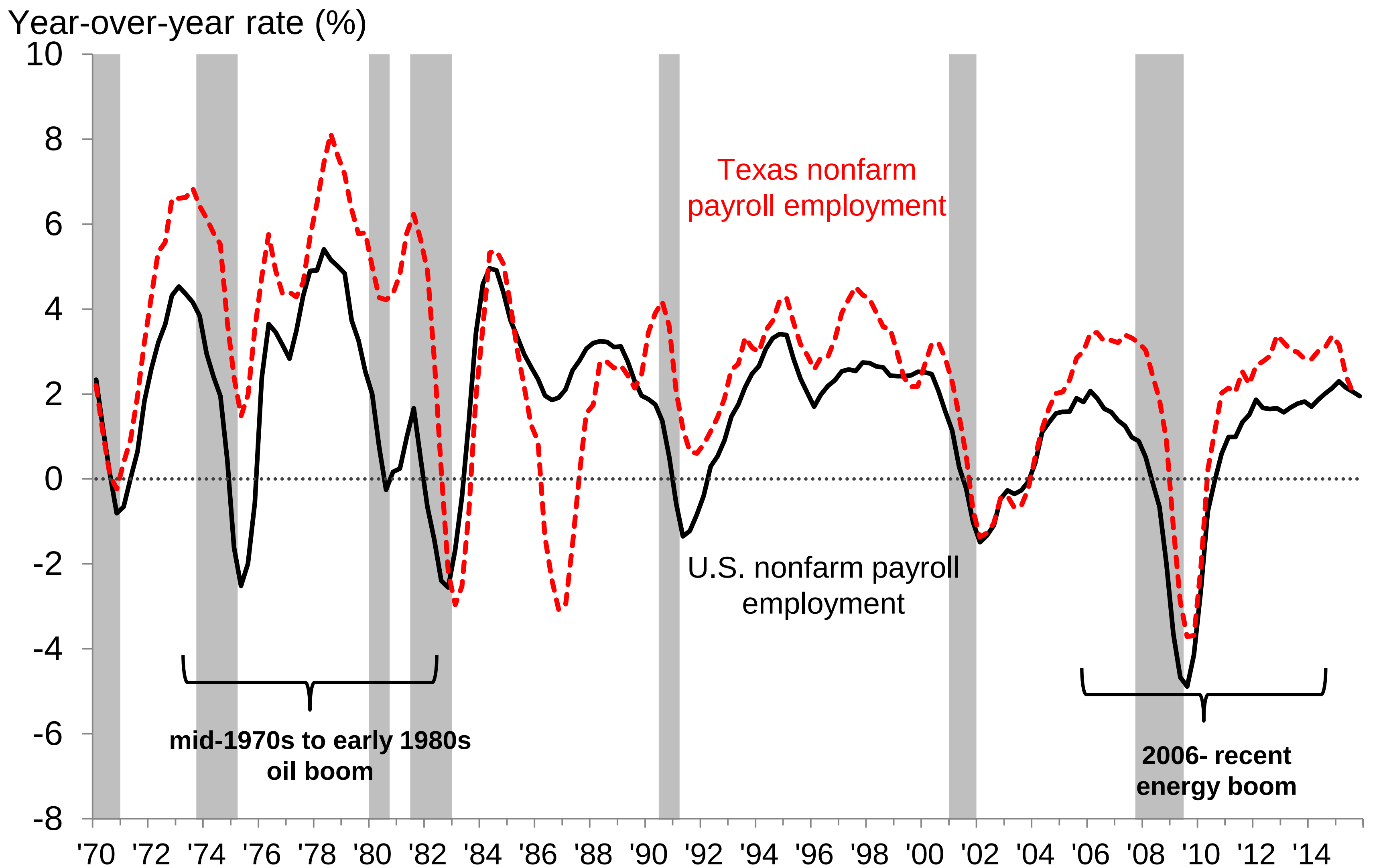
Source: Bureau of Labor Statistics.

Three-month trend in Private Payroll growth regained momentum, recently averaging near 275,000 per month



Source: Bureau of Labor Statistics.

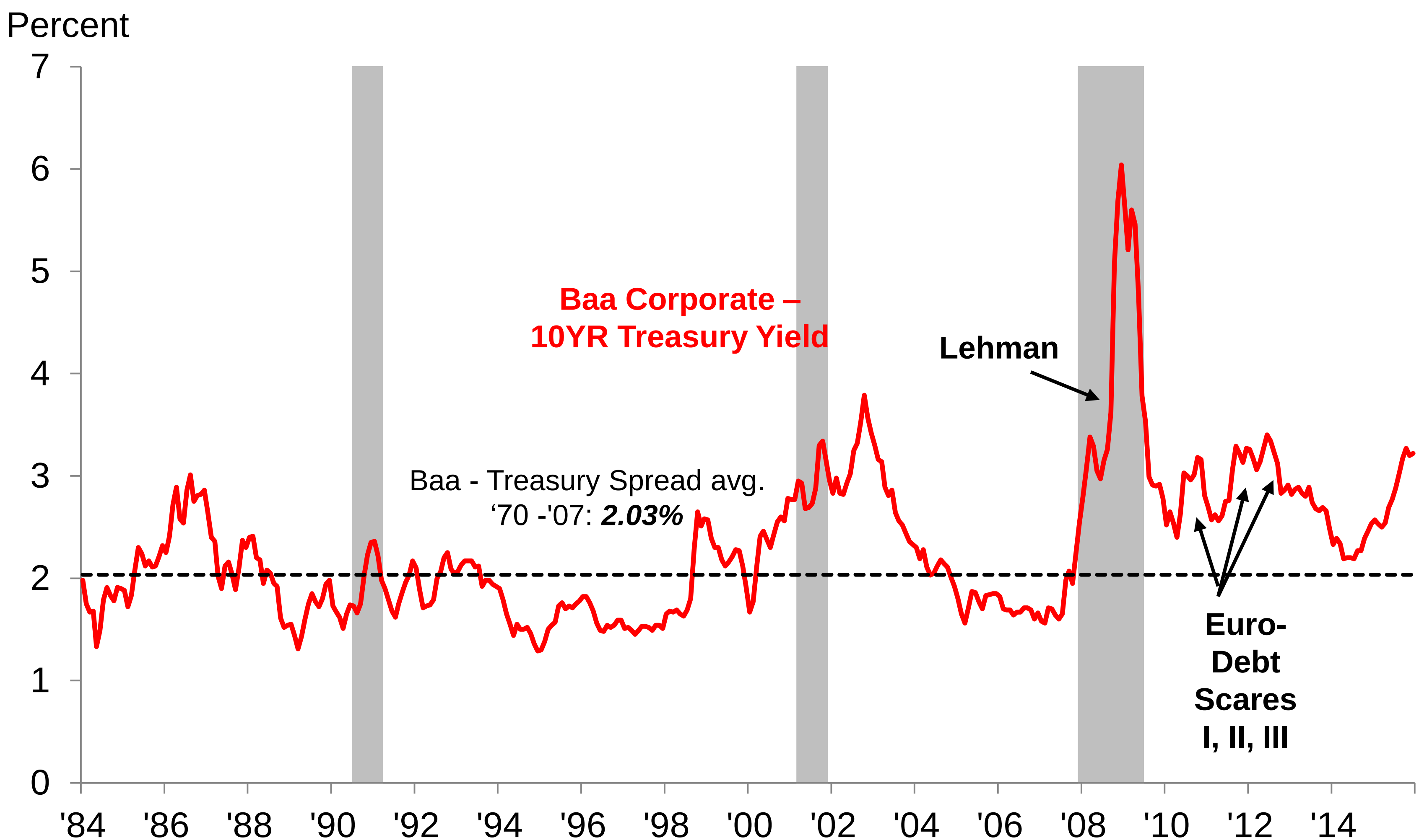
Job growth in Texas usually outpaces the U.S., especially during energy booms, near U.S. pace now



NOTE: Shaded bars indicate U.S. recessions.

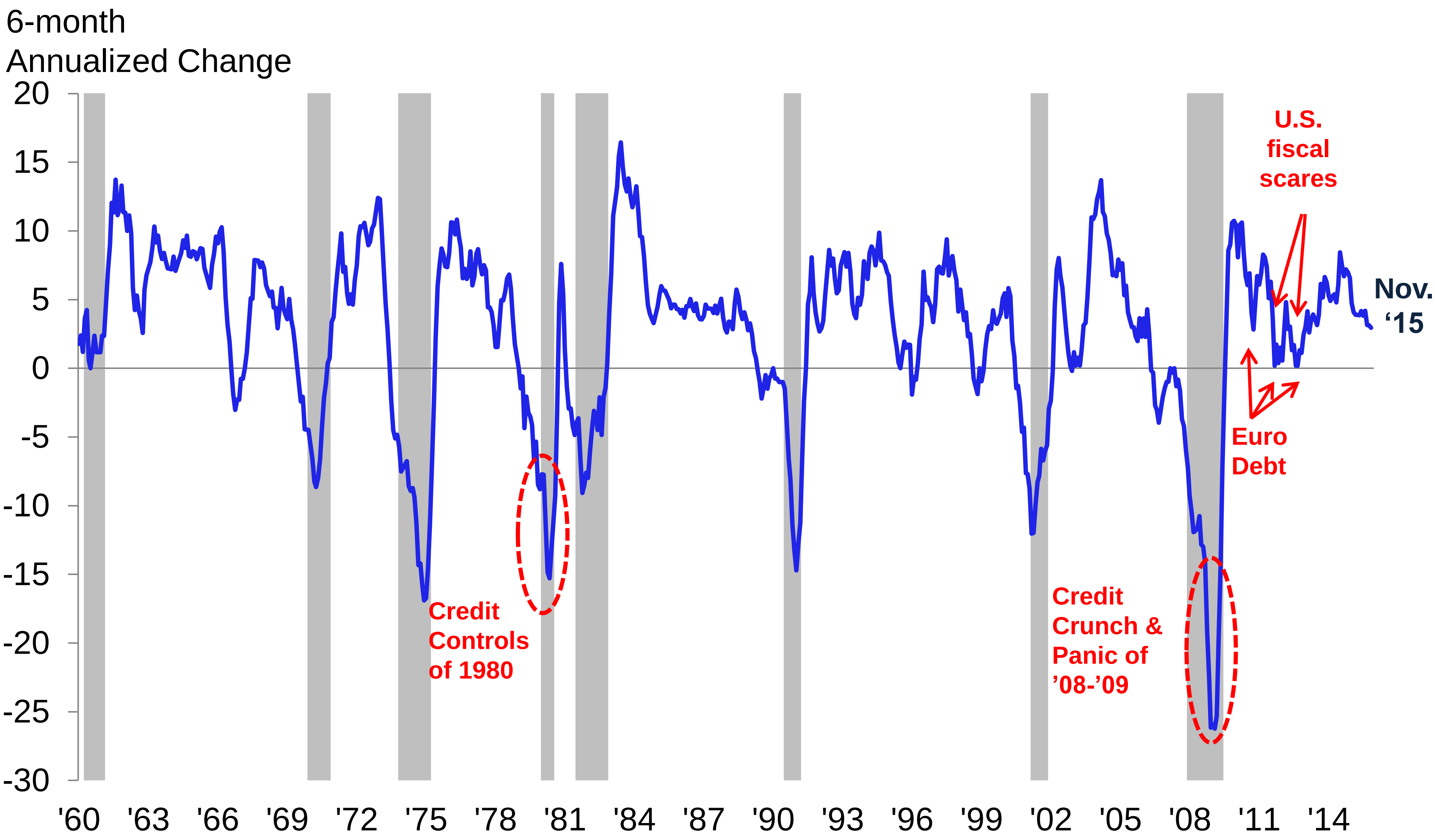
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; authors' calculations.

Bond risk spreads had unwound by early 2010 from depression highs, elevated from soft global outlook



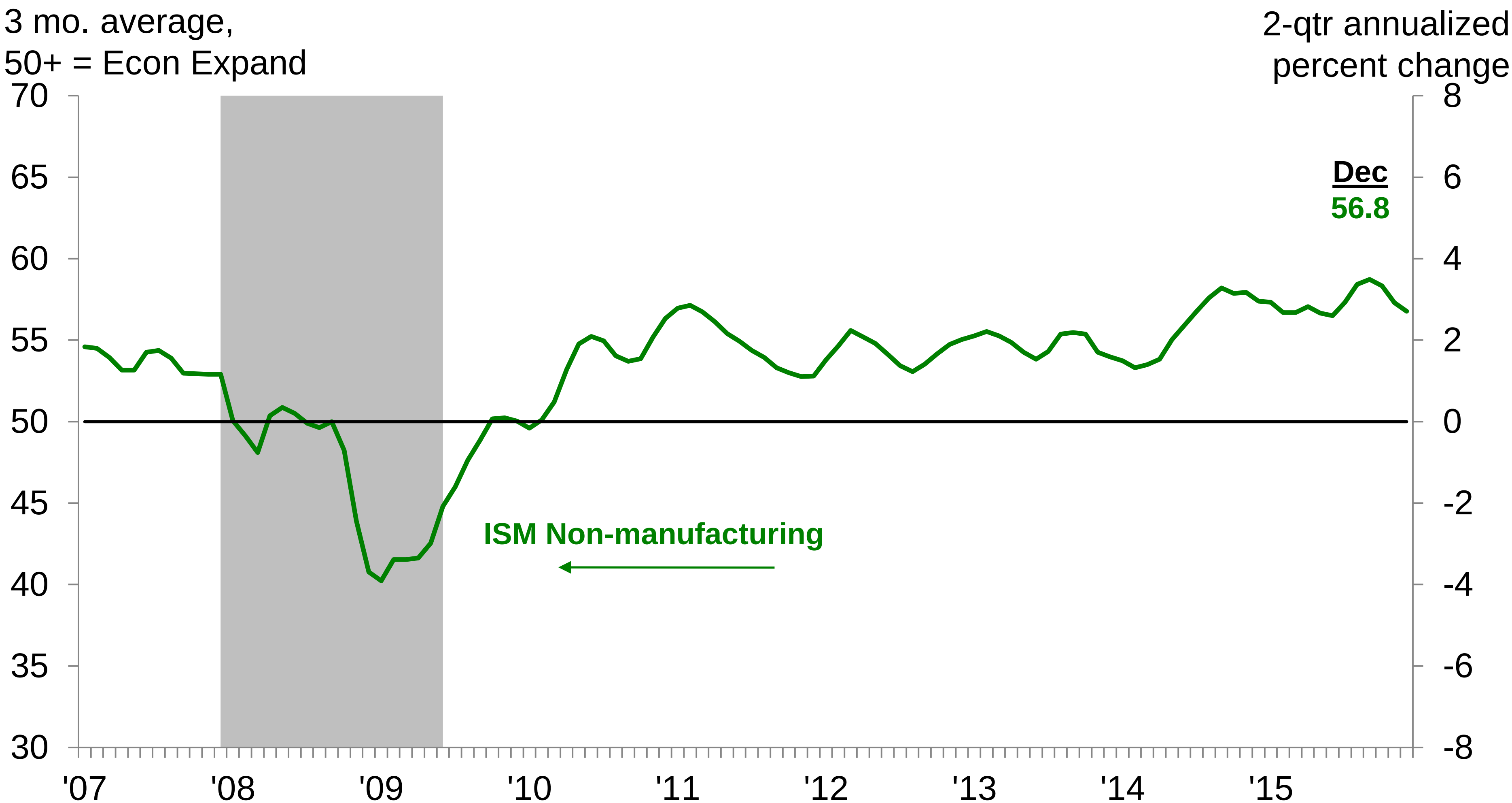
Sources: Federal Reserve and Moody's.

Growth in leading economic indicators suggests shift to more moderate, but sustainable growth



Sources: Conference Board and author’s calculations.

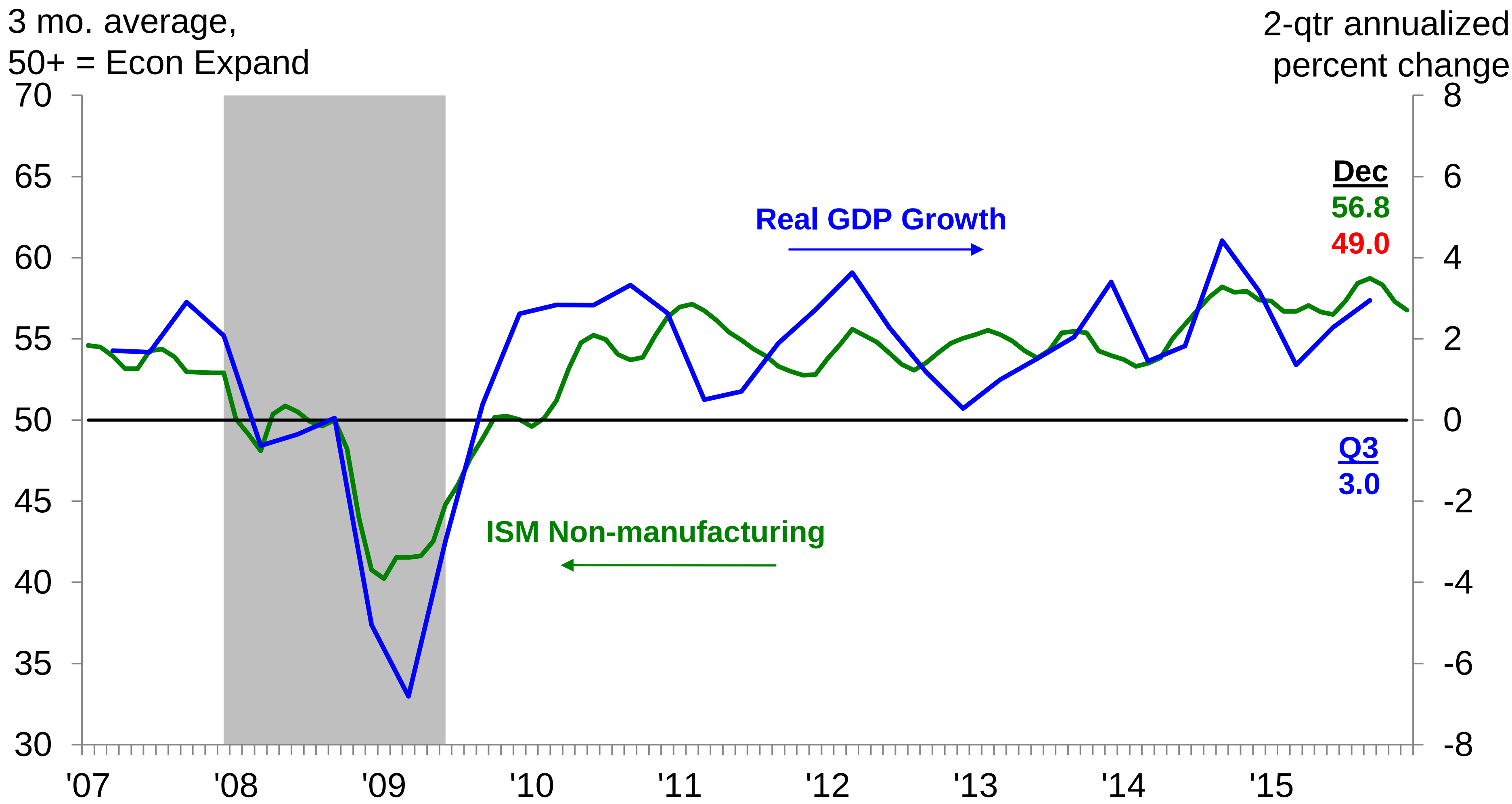
A tale of two cities: strong growth in services,



NOTE: Shaded areas indicate recession.

Sources: Institute for Supply Management, Bureau of Economic Analysis, and author's calculations.

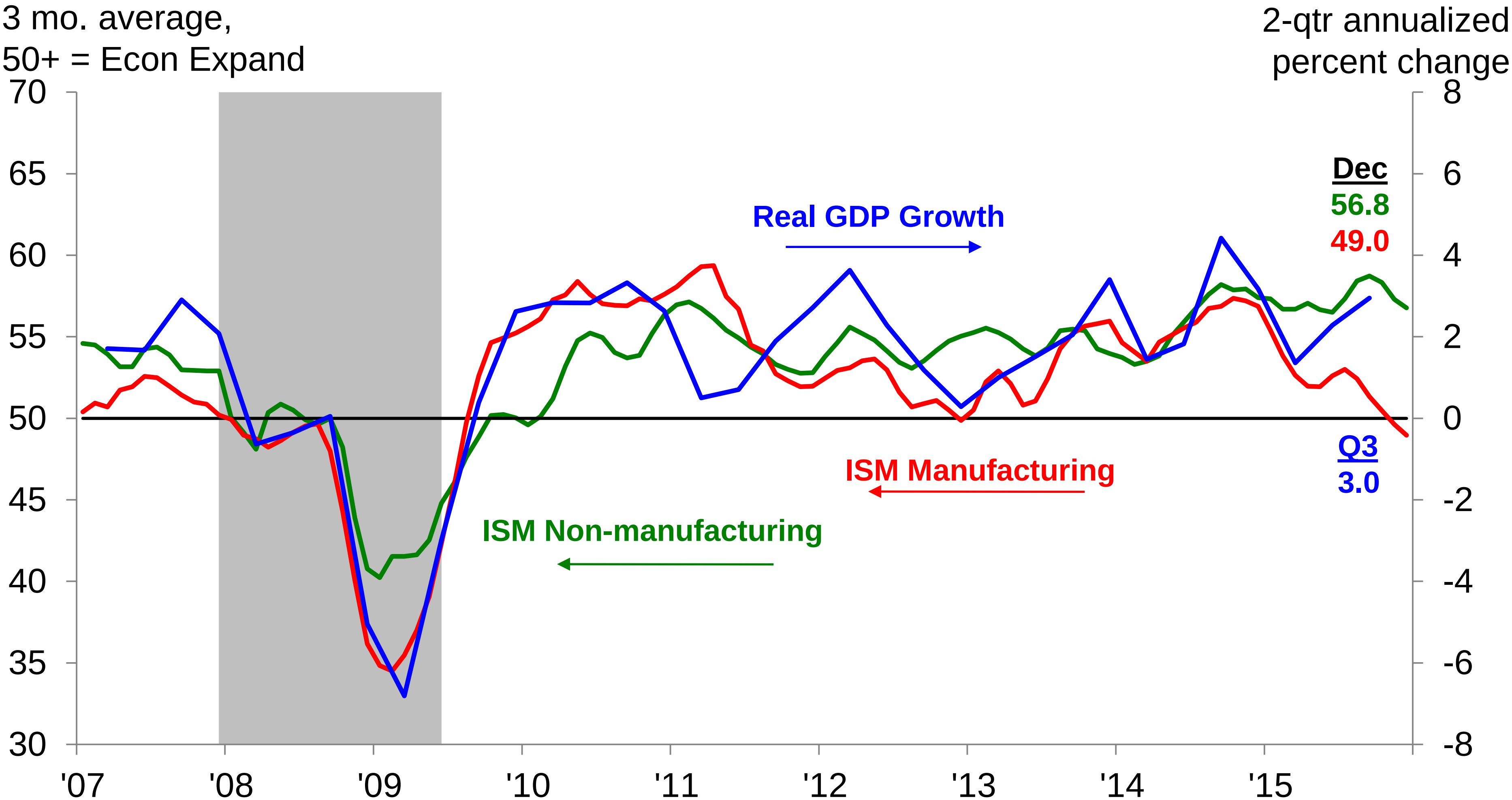
A tale of two cities: strong growth in services,



NOTE: Shaded areas indicate recession.

Sources: Institute for Supply Management, Bureau of Economic Analysis, and author's calculations.

A tale of two cities: strong growth in services, but slowing in manufacturing

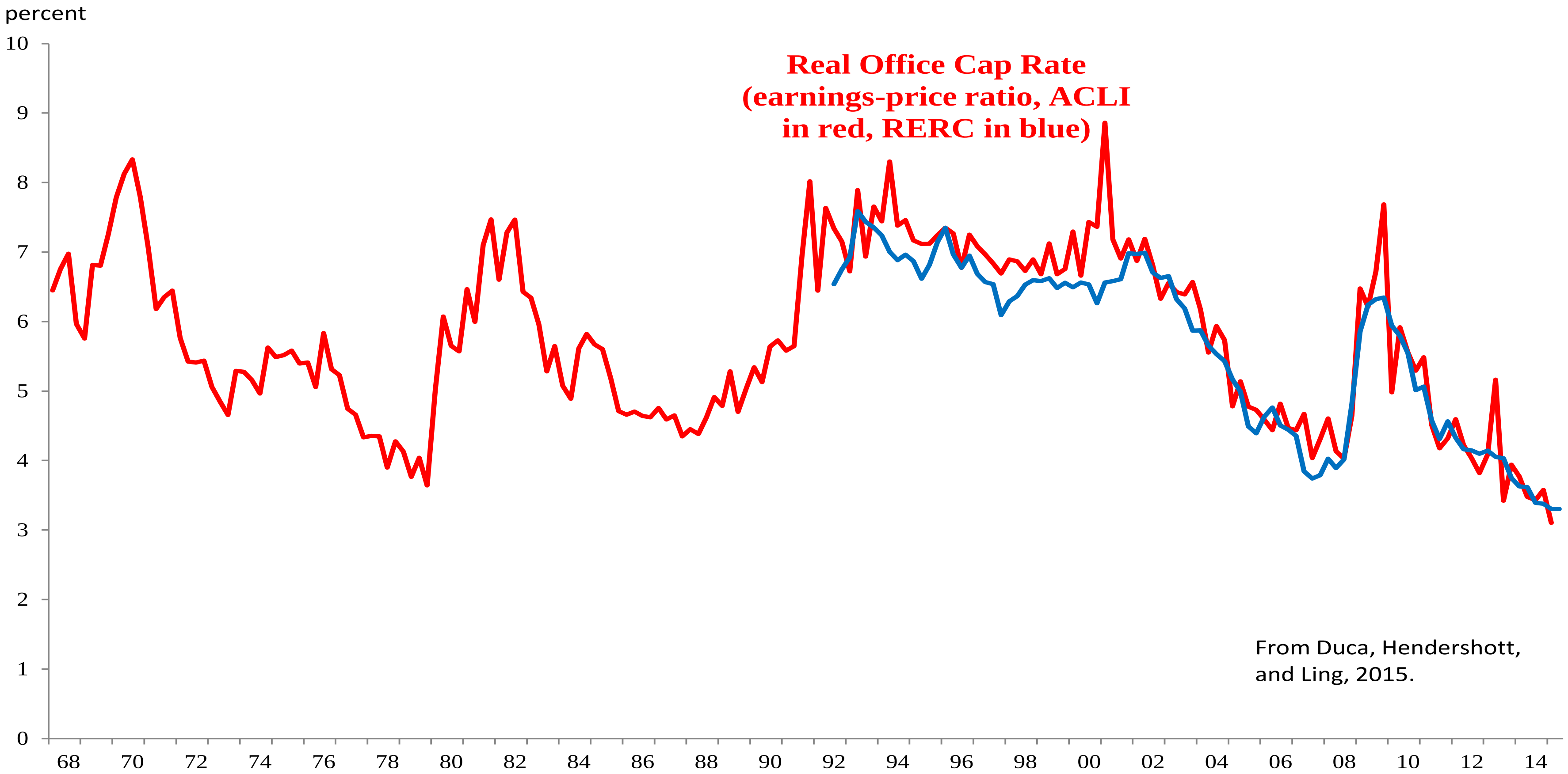


NOTE: Shaded areas indicate recession.

Sources: Institute for Supply Management, Bureau of Economic Analysis, and author's calculations.

Earnings-price ratios (Cap Rates) in commercial real estate suggest CRE valuations are elevated

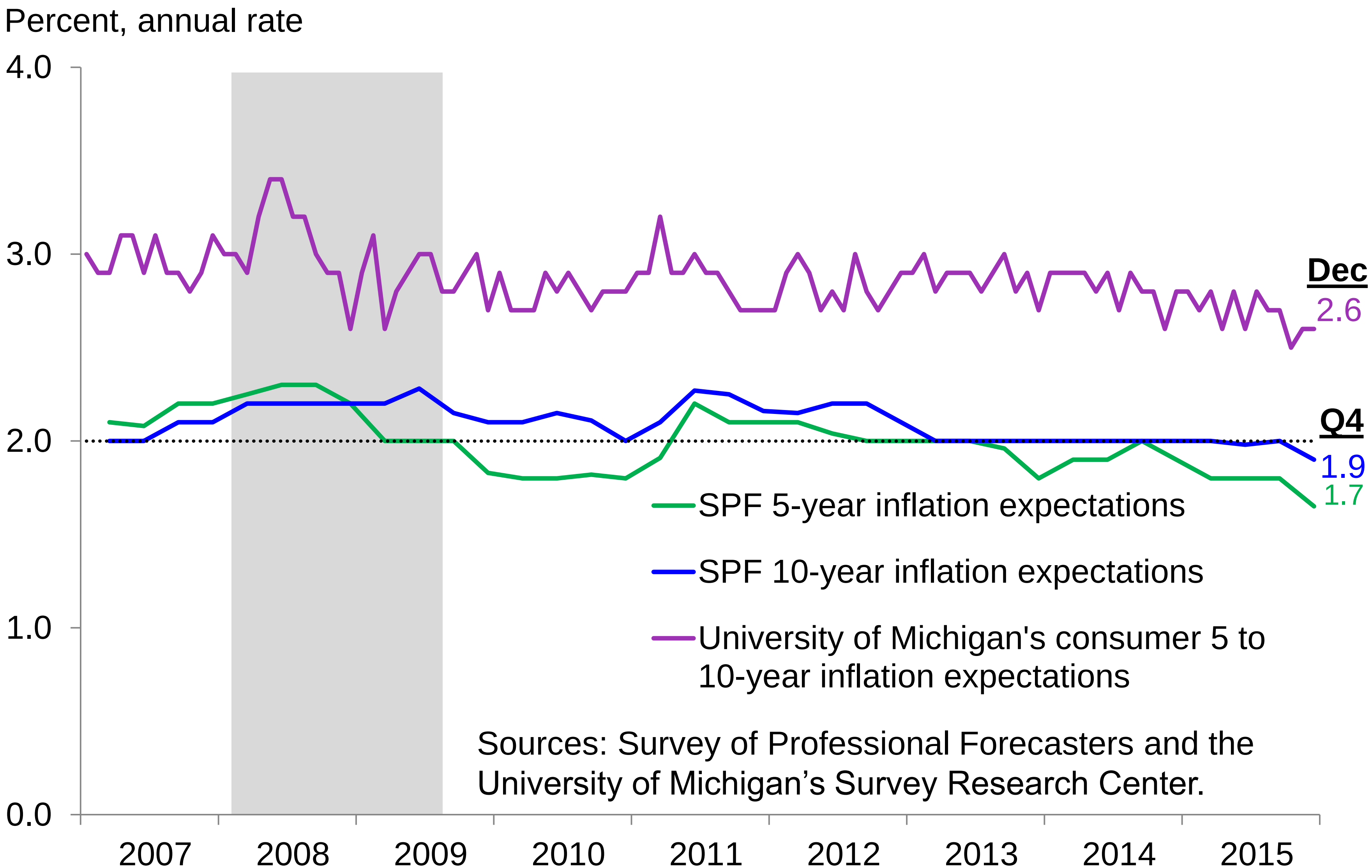
Real Cap Rates on Office Buildings Fall to Low Levels



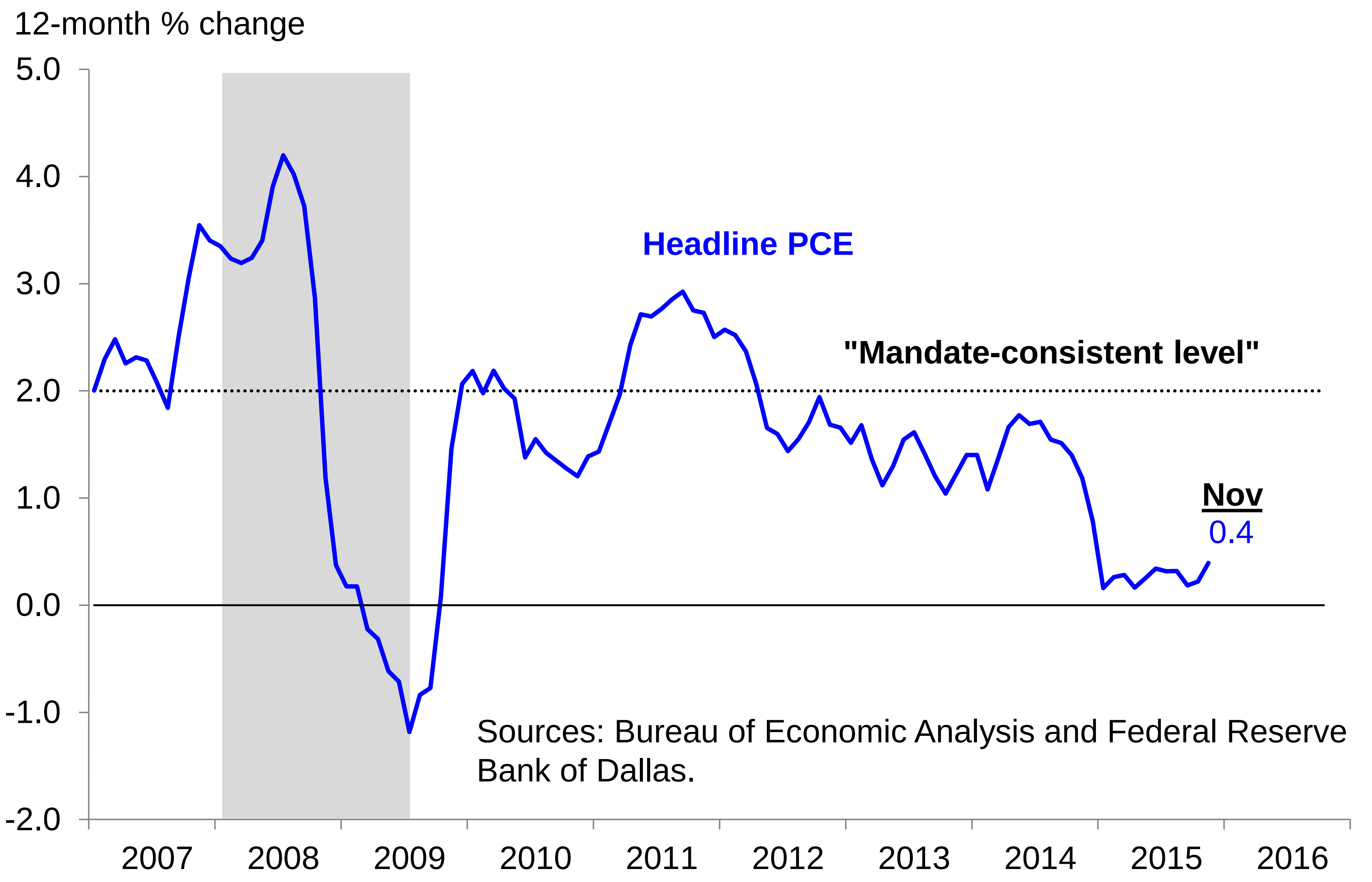
Shaded areas denote recessions. Sources: ACLI, RERC, Federal Reserve Board, and authors' calculations.

Inflation Developments

The long-run price-inflation expectations of households and economists dip recently

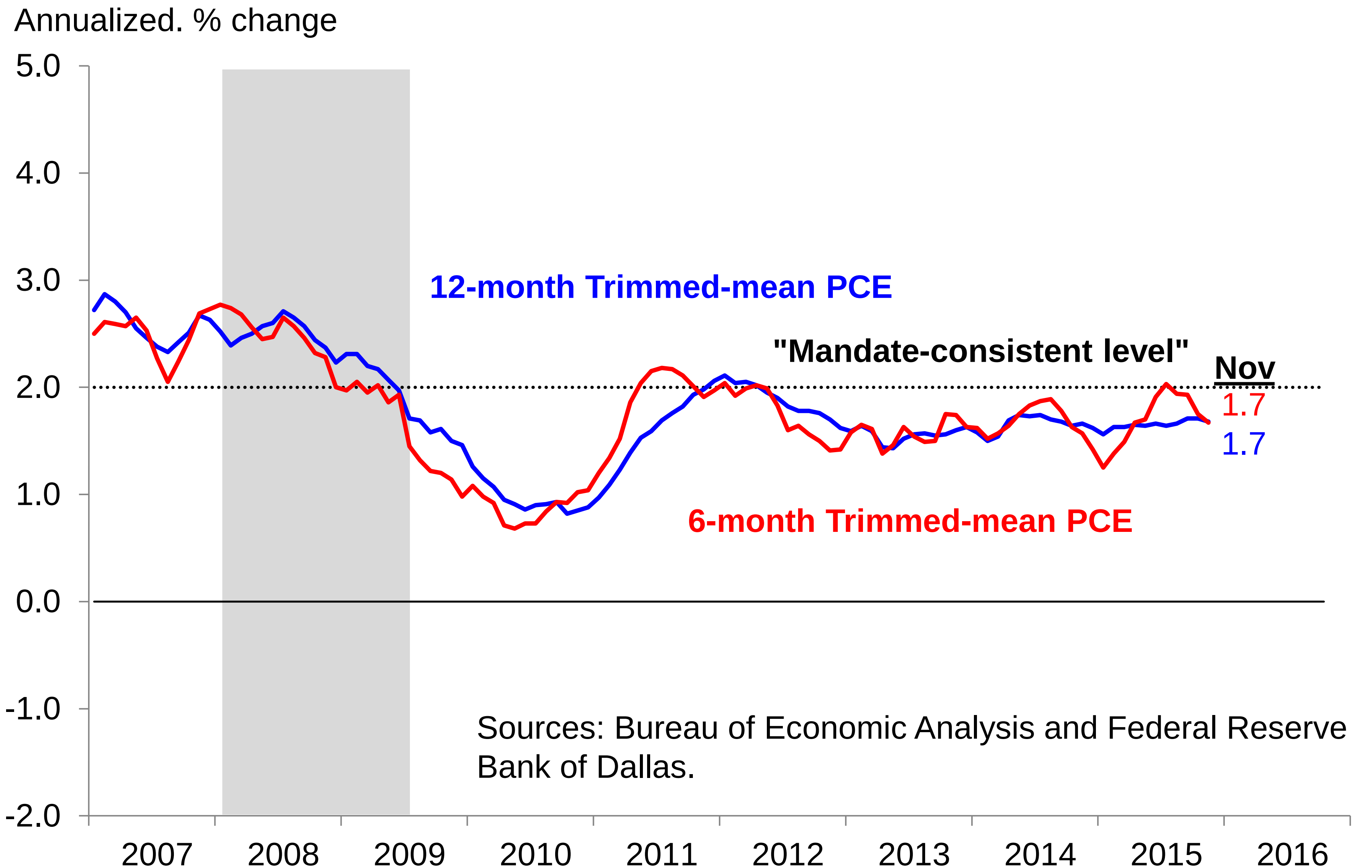


Headline PCE inflation remains well below target, but this owes to energy and other price outliers



Sources: Bureau of Economic Analysis and Federal Reserve Bank of Dallas.

Trimmed-mean PCE inflation steady on a 12-month basis, near 1 – ¾ percent on a 6-month basis



Sources: Bureau of Economic Analysis and Federal Reserve Bank of Dallas.

Summary

- Output growth solid heading into the third quarter, job growth robust in late 2015.
- Slow growth abroad is tempering U.S. GDP growth as the U.S. economy nears full employment.
- Domestic demand in U.S. robust, while softness in China plus oil bust slow U.S. manufacturing and mining growth, and delay progress toward restoring 2% inflation.
- Commercial real estate valuations seem elevated.
- 2016 GDP growth likely between 2 and 2-½ %. With unemployment low and growth moderating, 6-month trimmed mean PCE inflation near 1-¾ %, and long-term inflation expectations anchored, headline inflation likely to be low near-term but later rise to 2% over medium run.