



Economic Outlook

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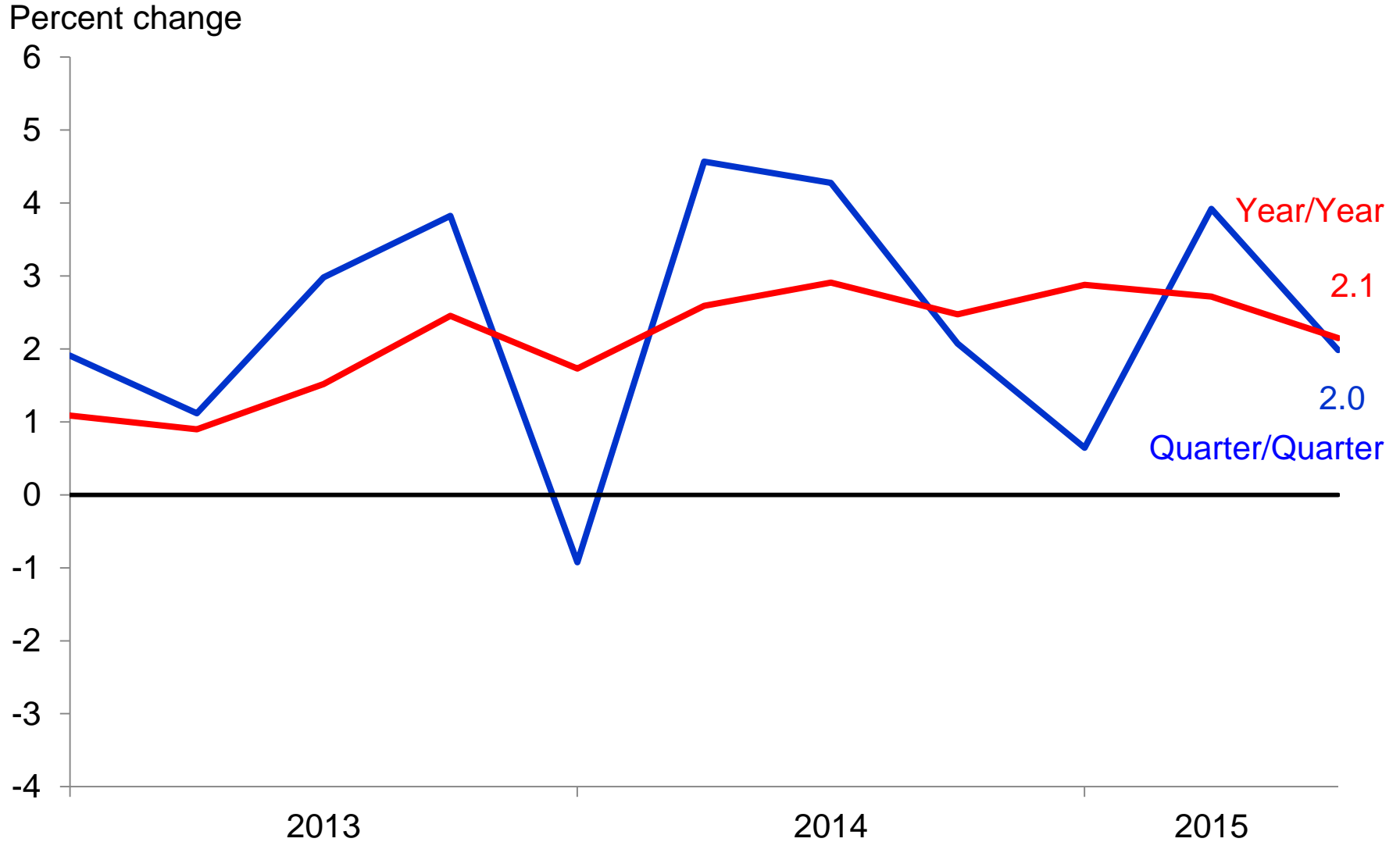


Real Activity

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.

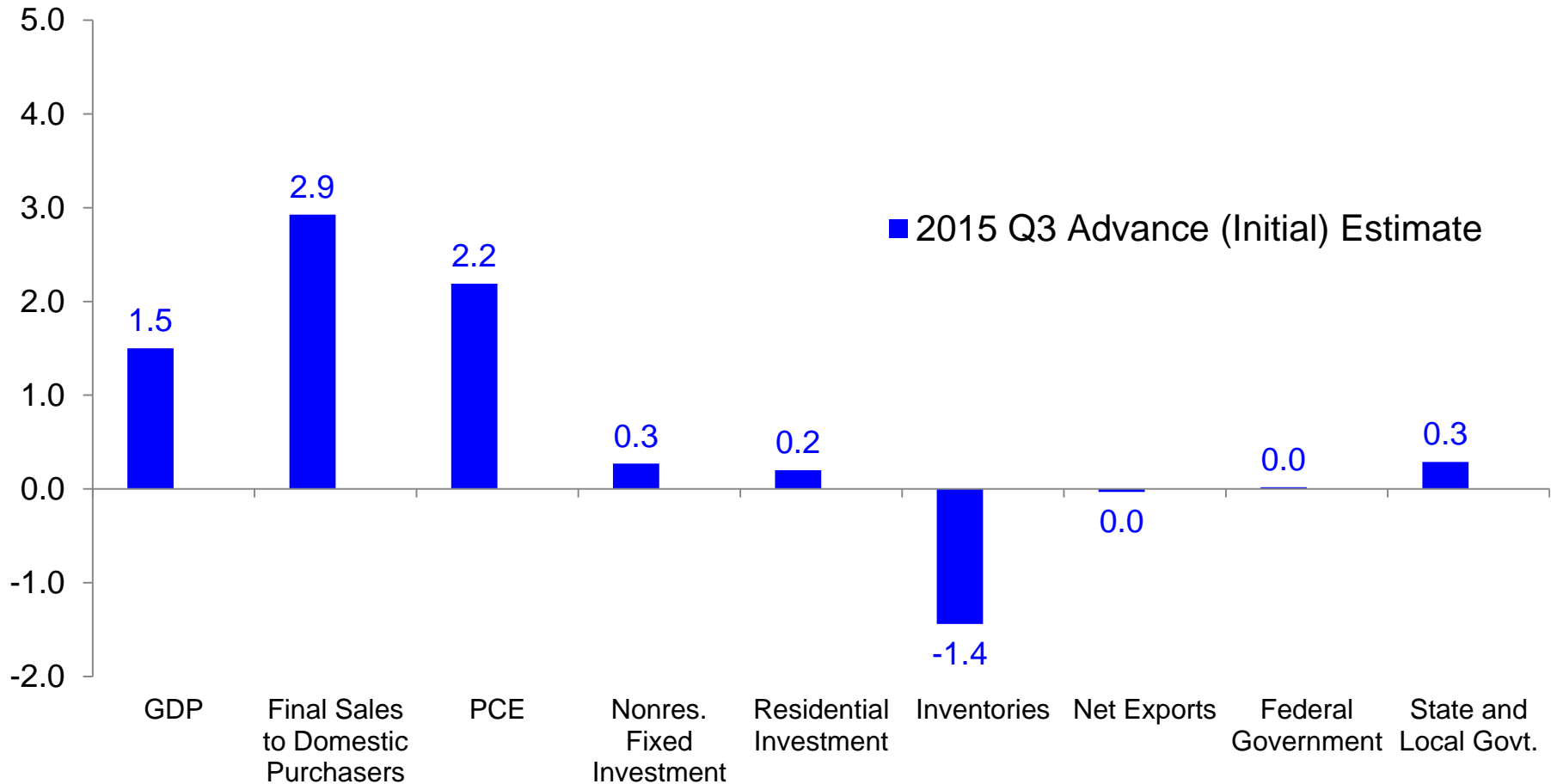
Underlying pace of growth nearing 2 – 2 ½ %



Source: Bureau of Economic Analysis.

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

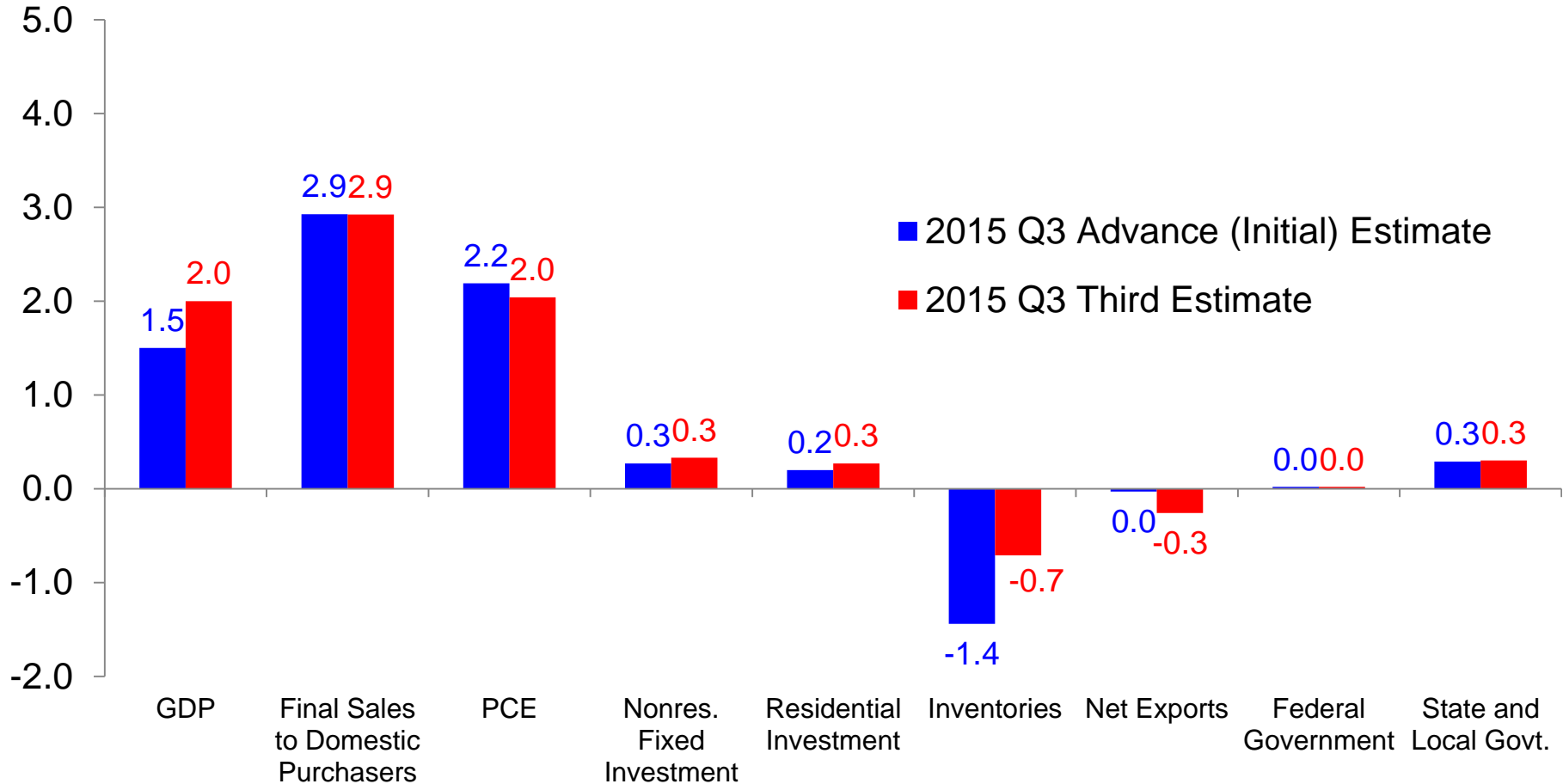
Contribution to real GDP growth,
percent change quarter/quarter, SAAR



Source: Bureau of Economic Analysis.

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

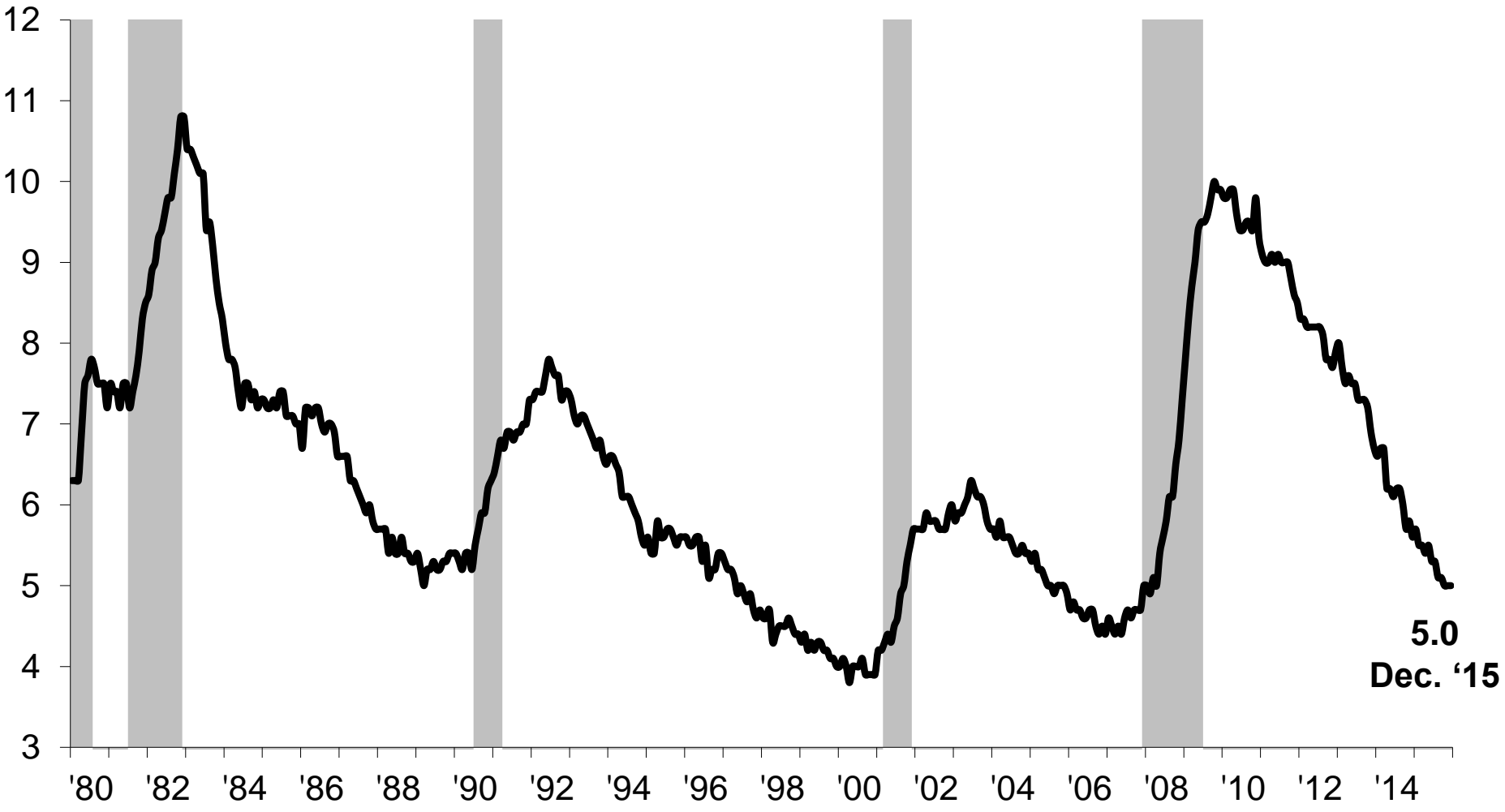
Contribution to real GDP growth, percent change quarter/quarter, SAAR



Source: Bureau of Economic Analysis.

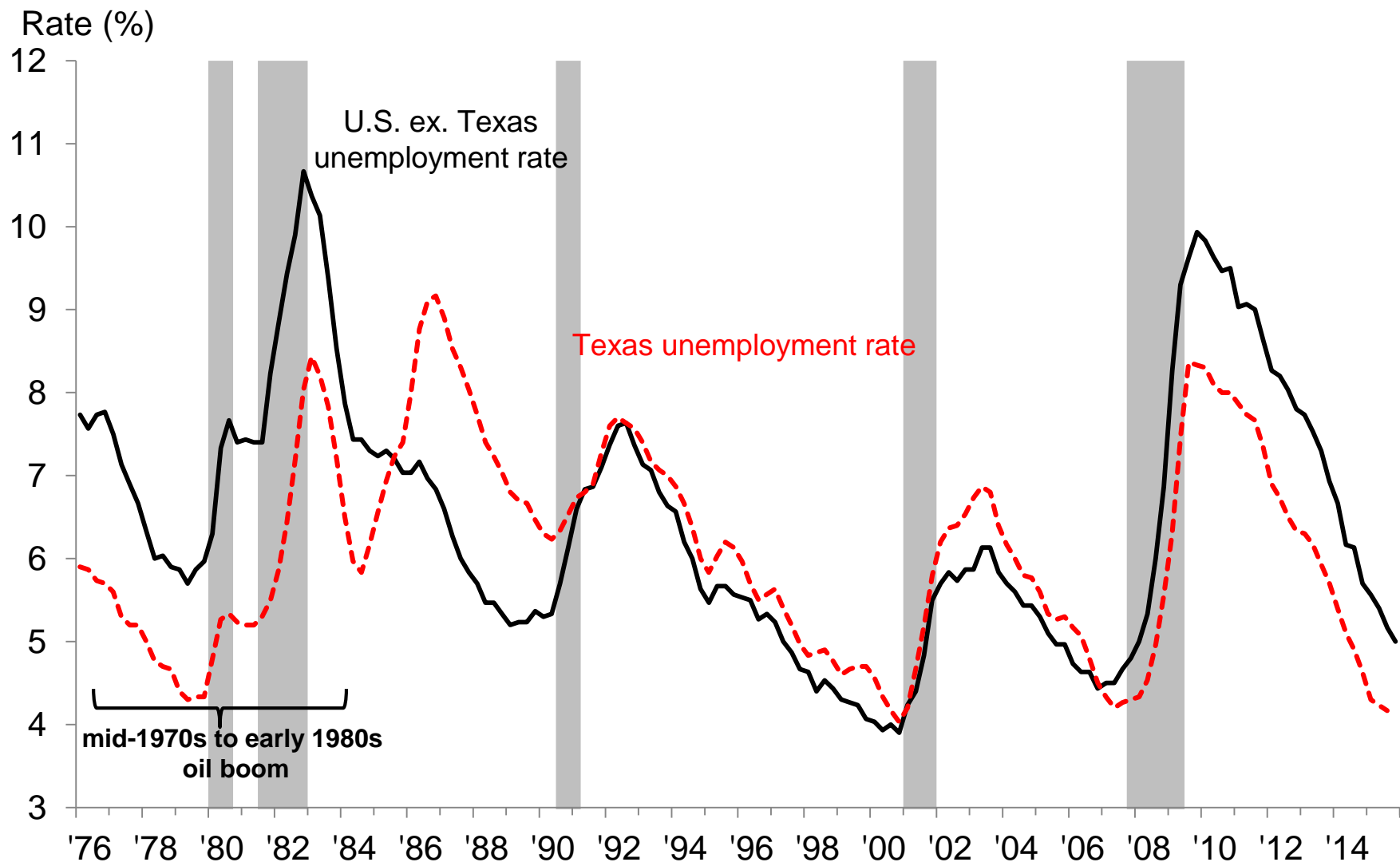
In 2013-14, unemployment fell rapidly, declines slowing as we near full employment

SA, Percent
Unemployed



Source: Bureau of Labor Statistics.

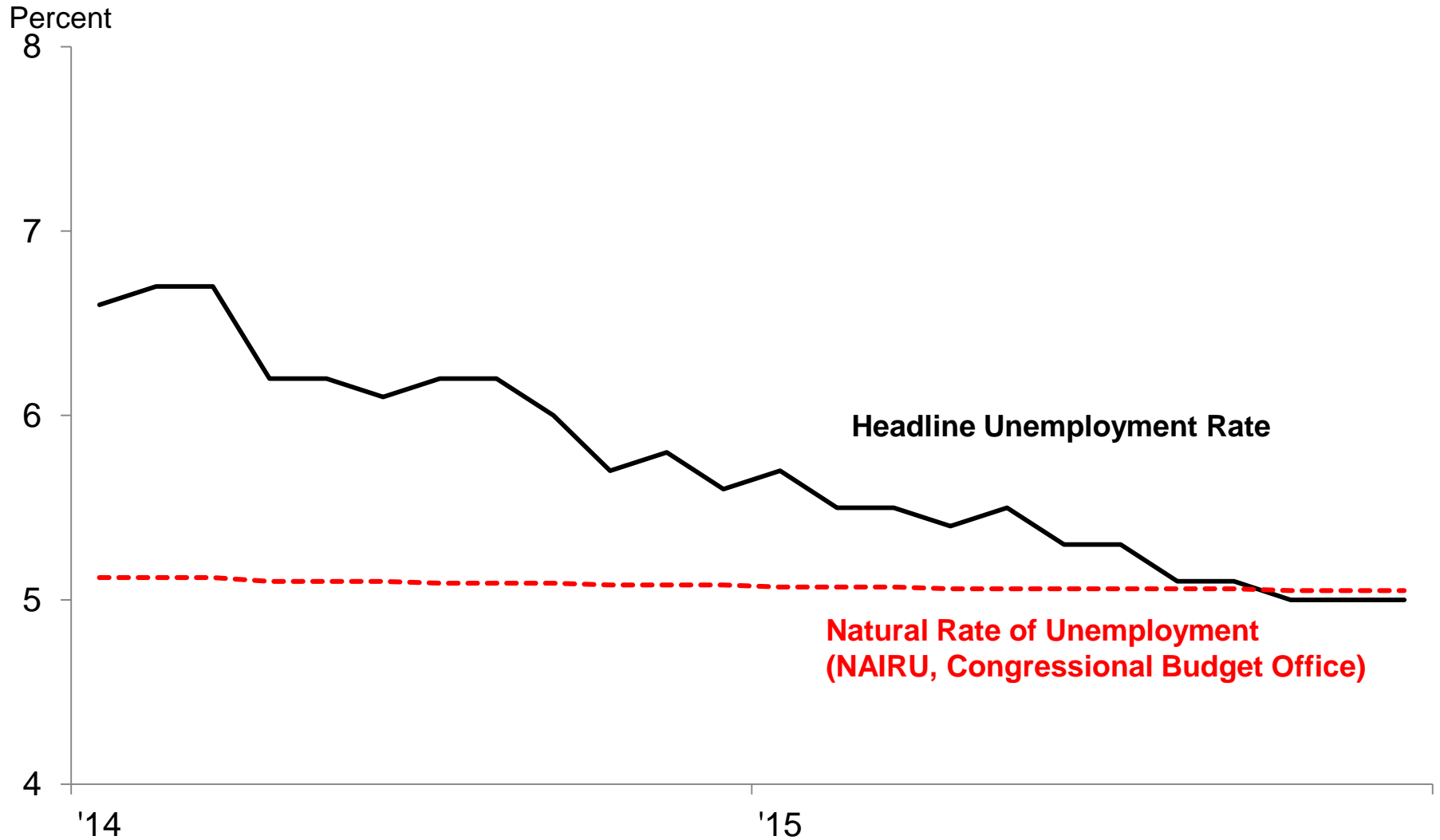
Unemployment rate in Texas below U.S. during energy booms of 1970s, early 1980s, and 2006-15



NOTE: Shaded bars indicate U.S. recessions.

SOURCE: Bureau of Labor Statistics.

Declines in unemployment imply little or no labor market slack left

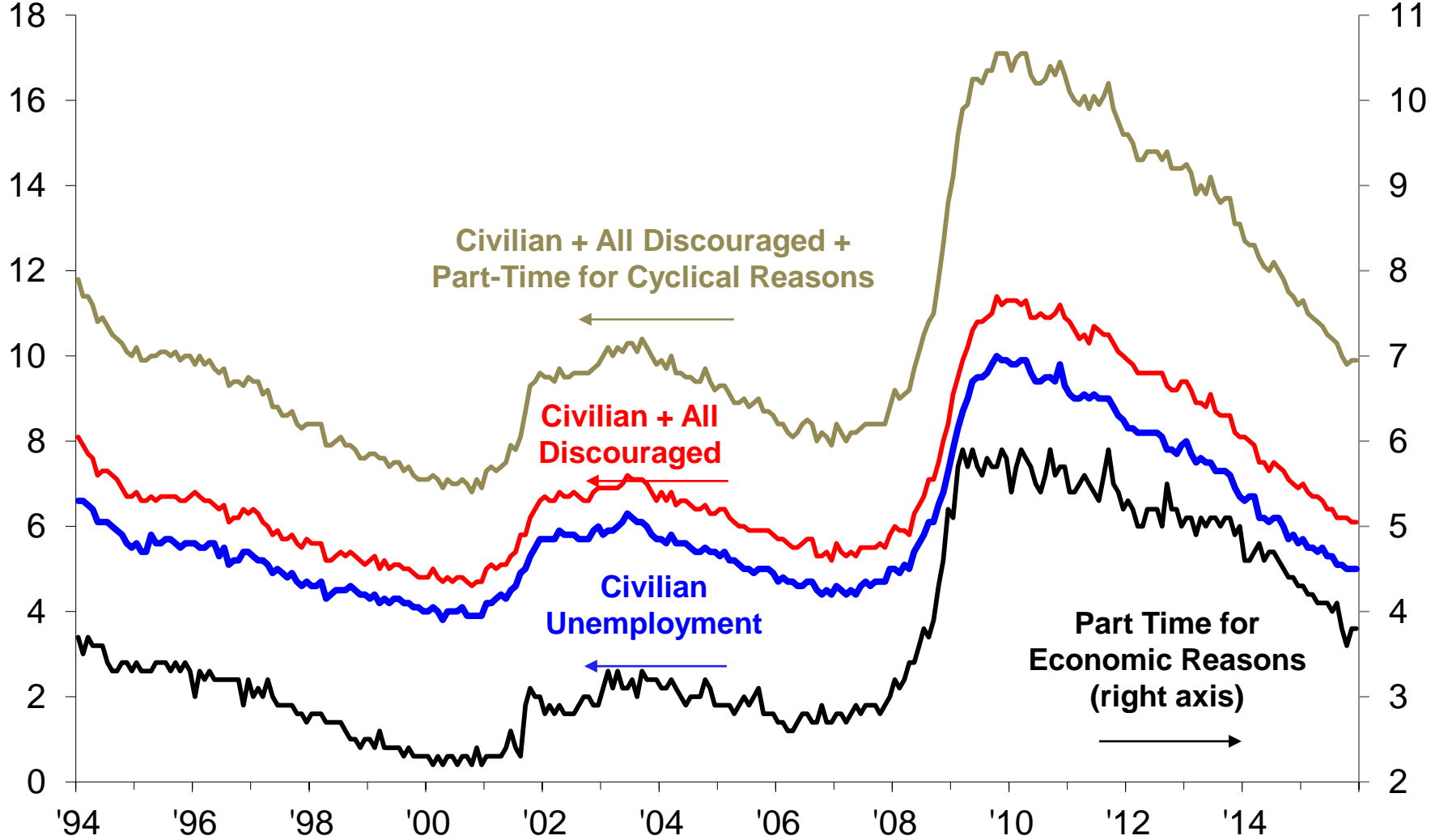


Sources: Bureau of Labor Statistics and Congressional Budget Office.

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

Unemployment Rate, Percent of Labor Force SA

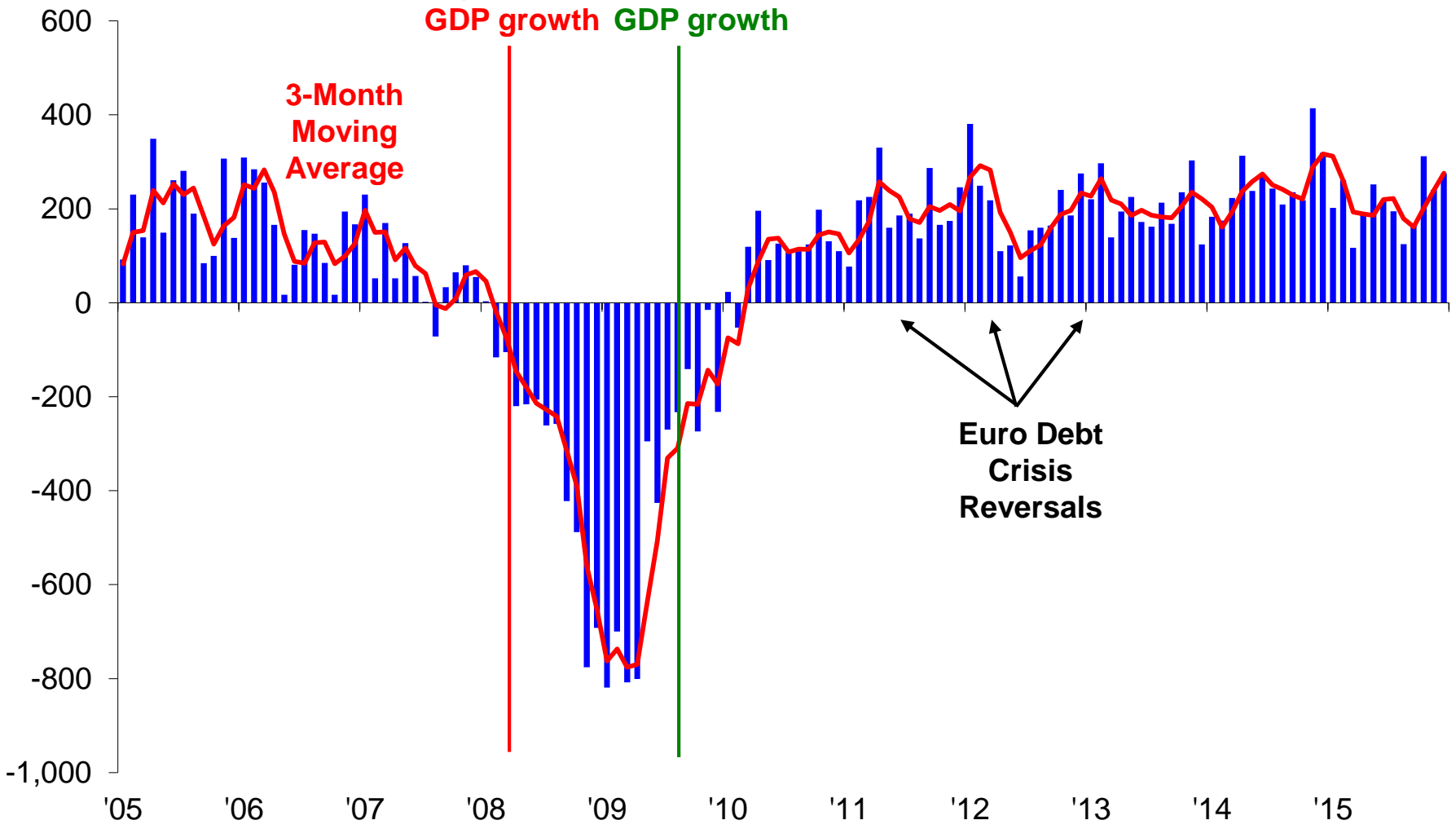
Part-Time Employment Rate, Percent SA



Source: Bureau of Labor Statistics.

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

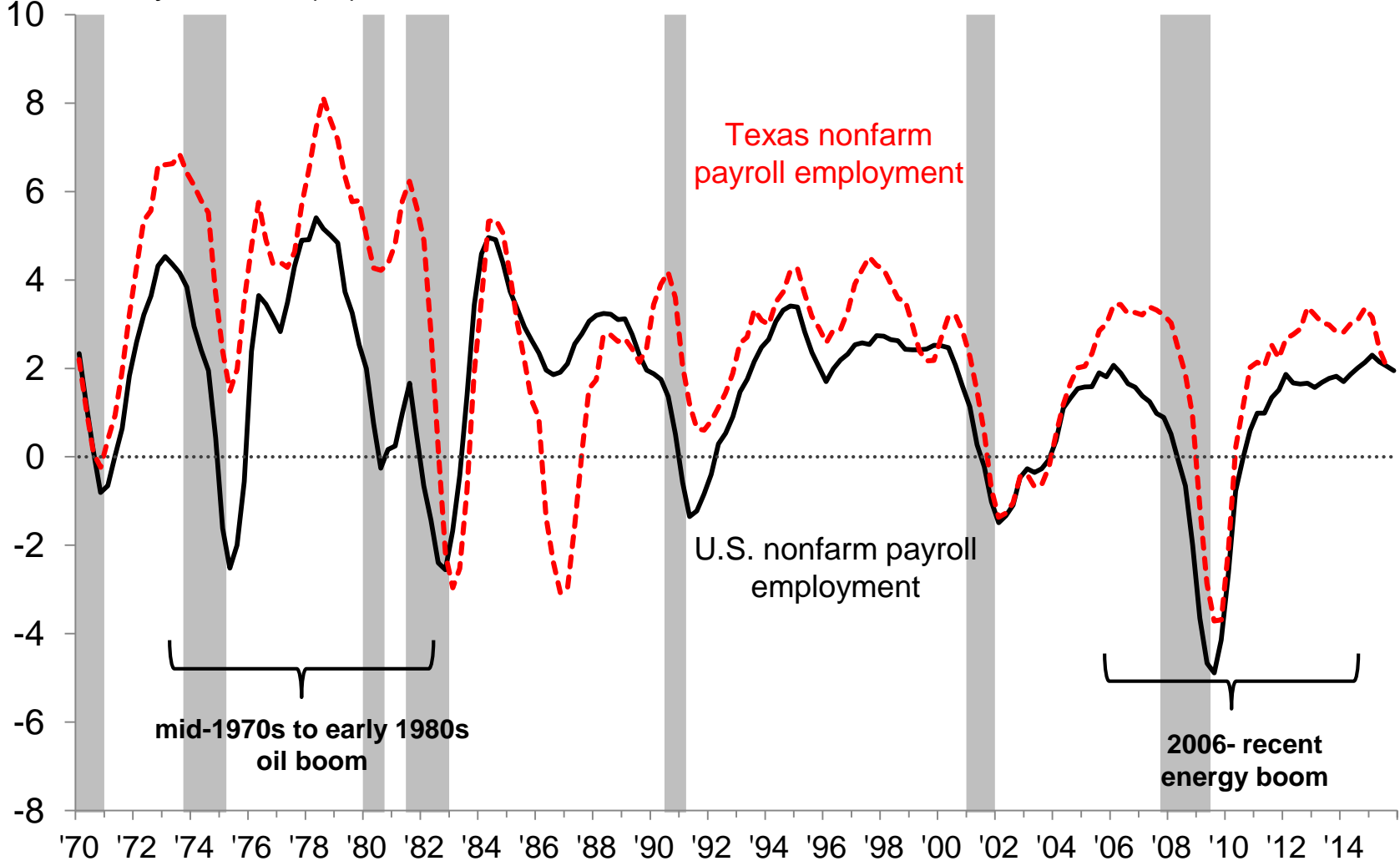
Private nonfarm payrolls,
Chg, thousands



Source: Bureau of Labor Statistics.

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

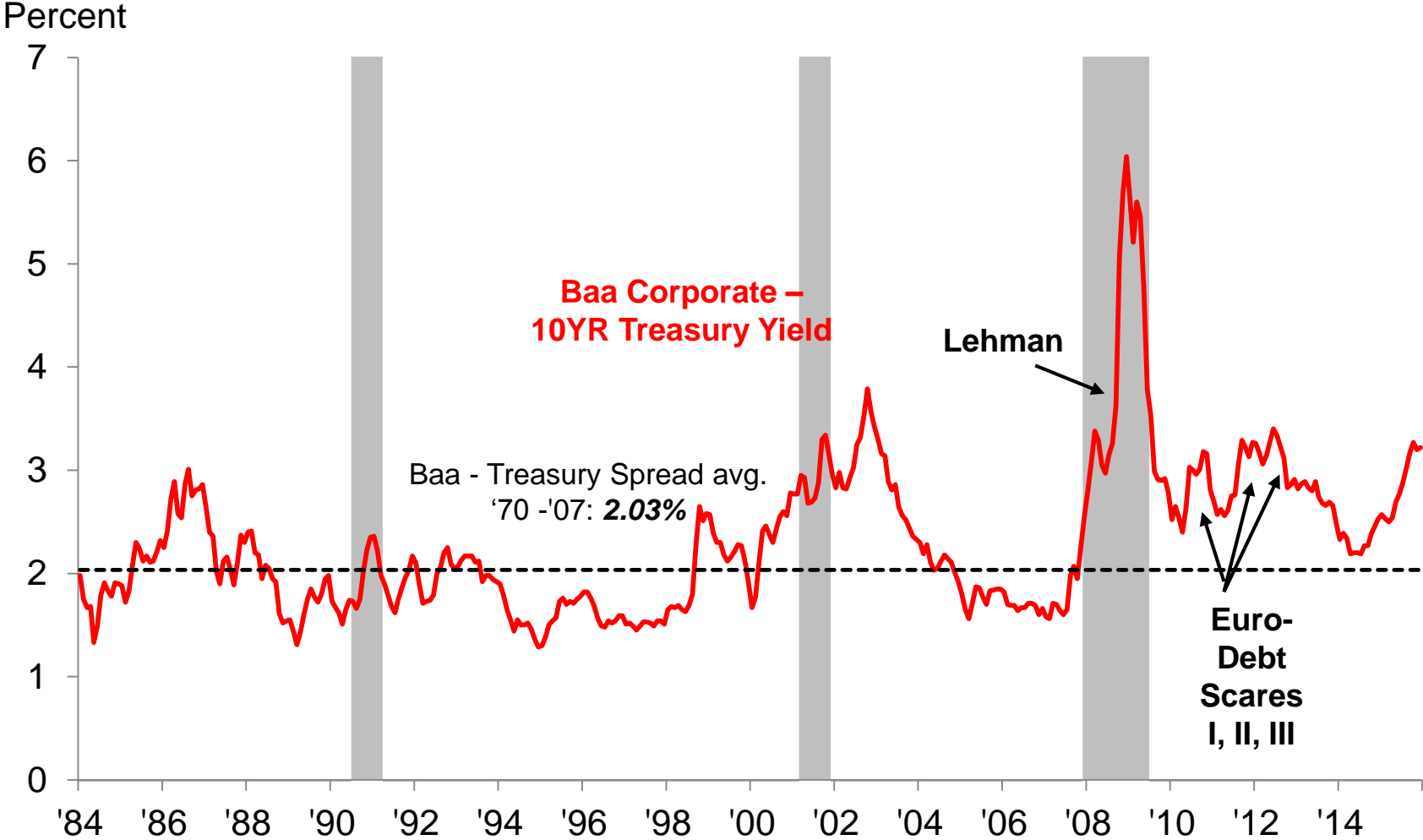
Year-over-year rate (%)



NOTE: Shaded bars indicate U.S. recessions.

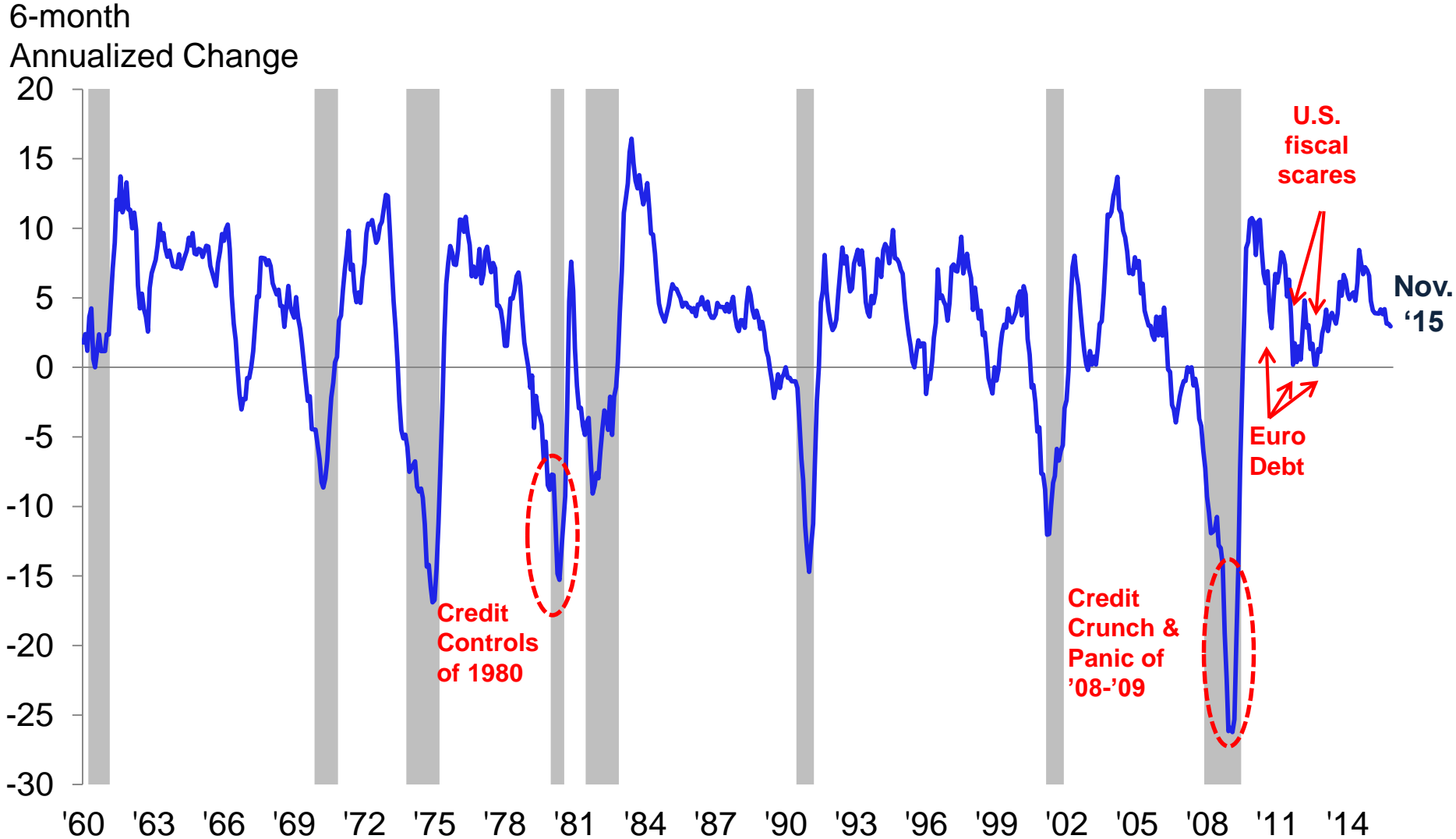
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; authors' calculations.

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



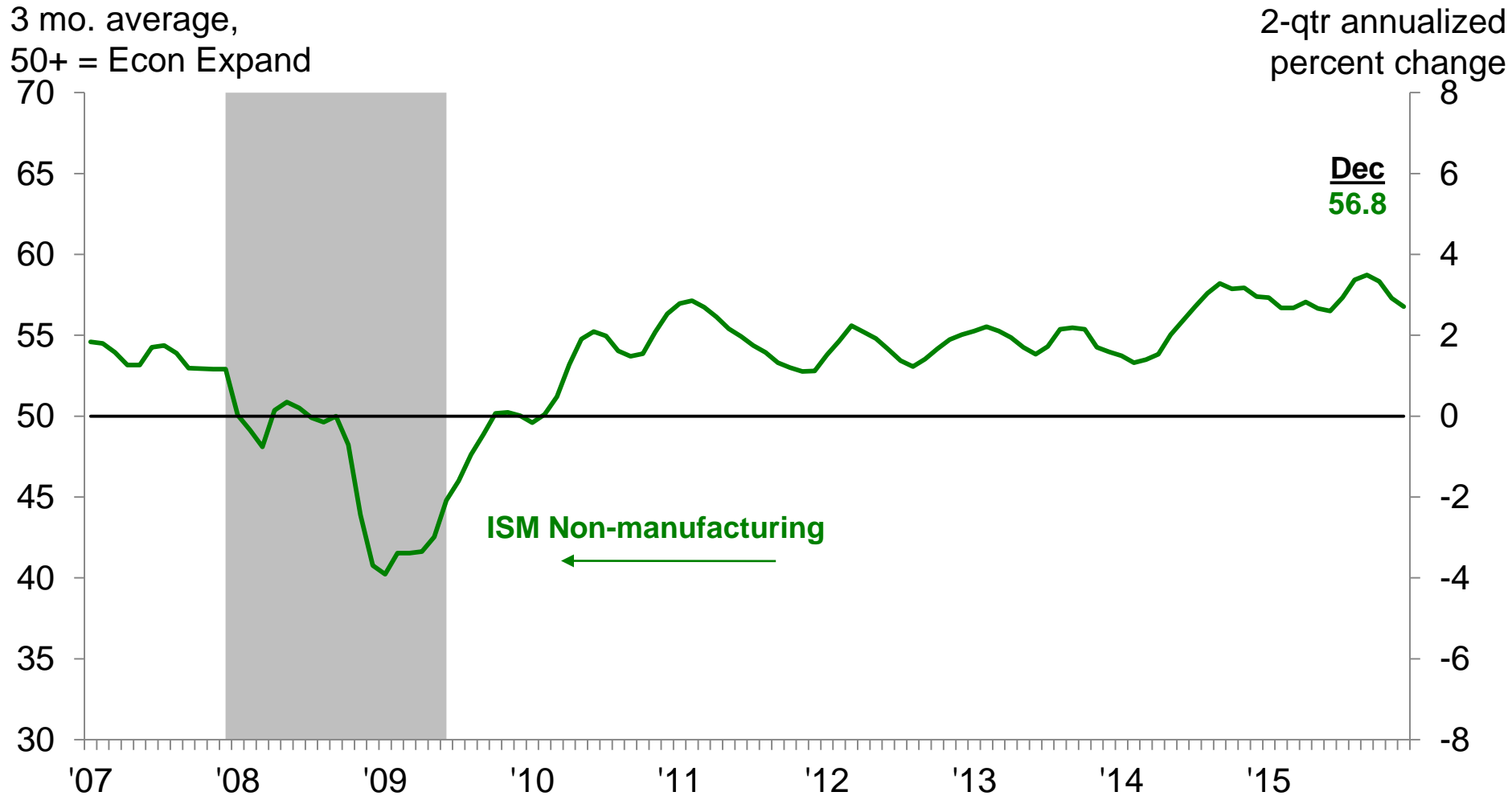
Sources: Federal Reserve and Moody's.

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



Sources: Conference Board and author's calculations.

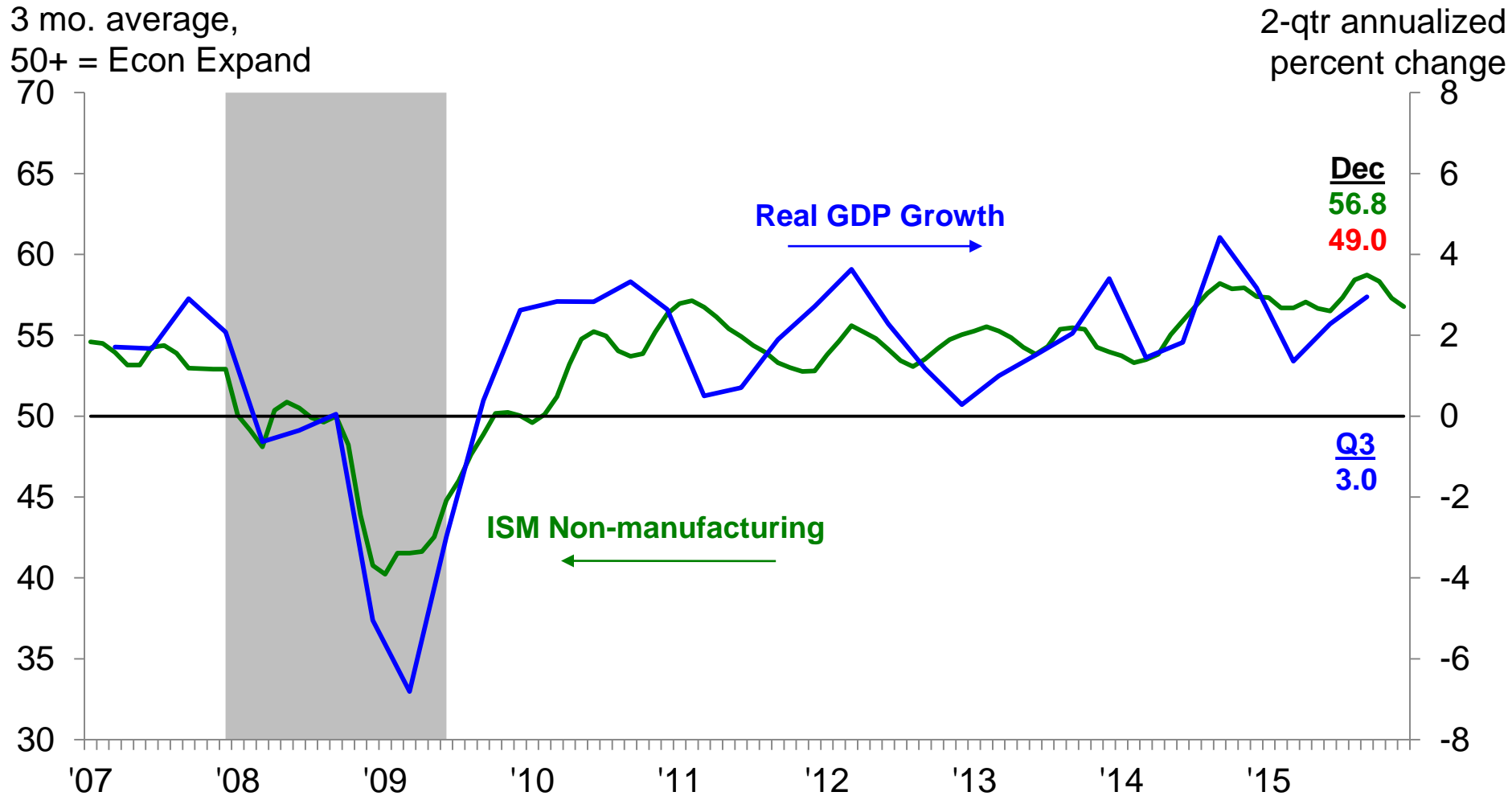
A tale of two cities: strong growth in services,



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,



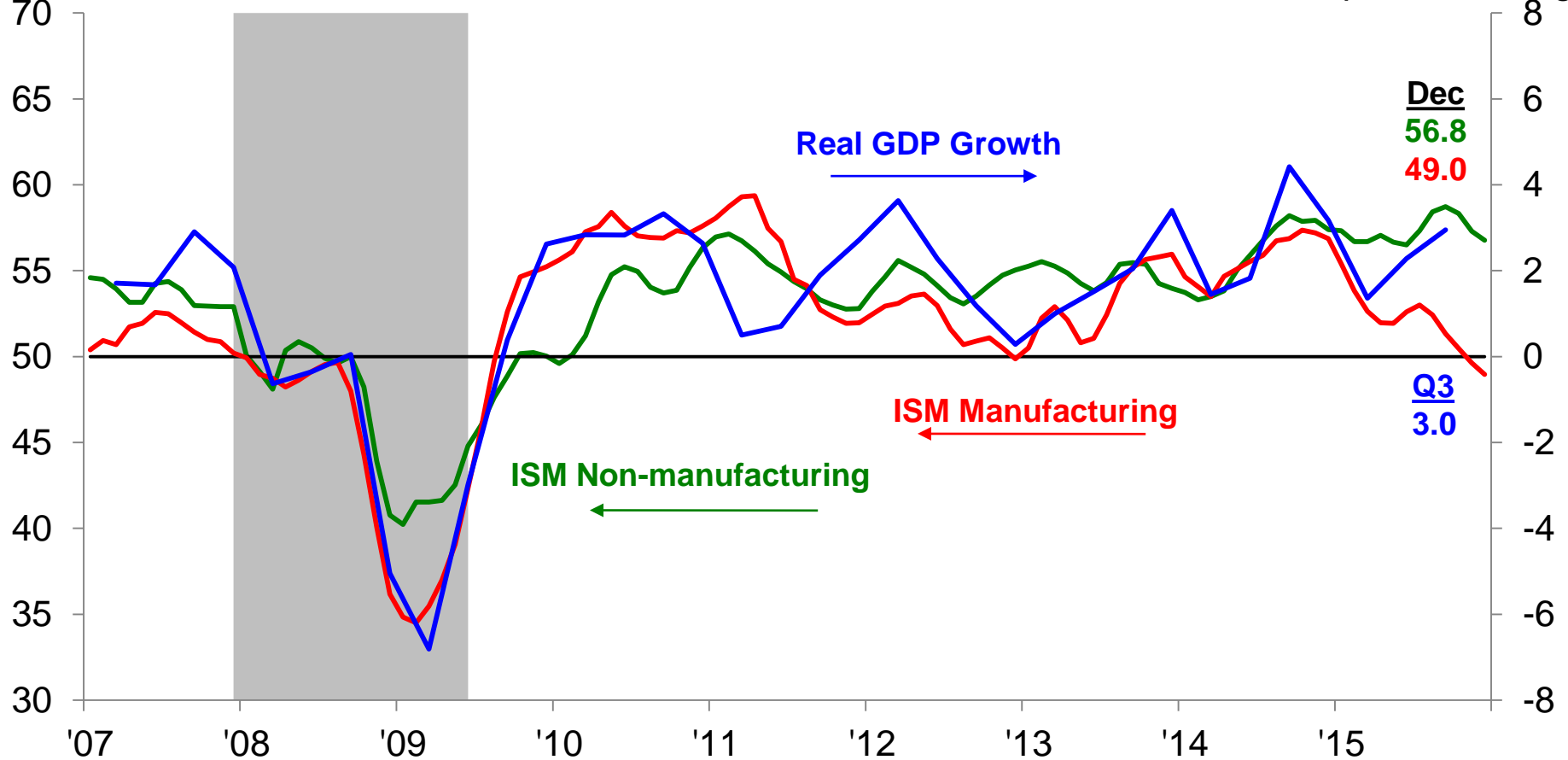
NOTE: Shaded areas indicate recession.

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

3 mo. average,
50+ = Econ Expand

2-qtr annualized
percent change

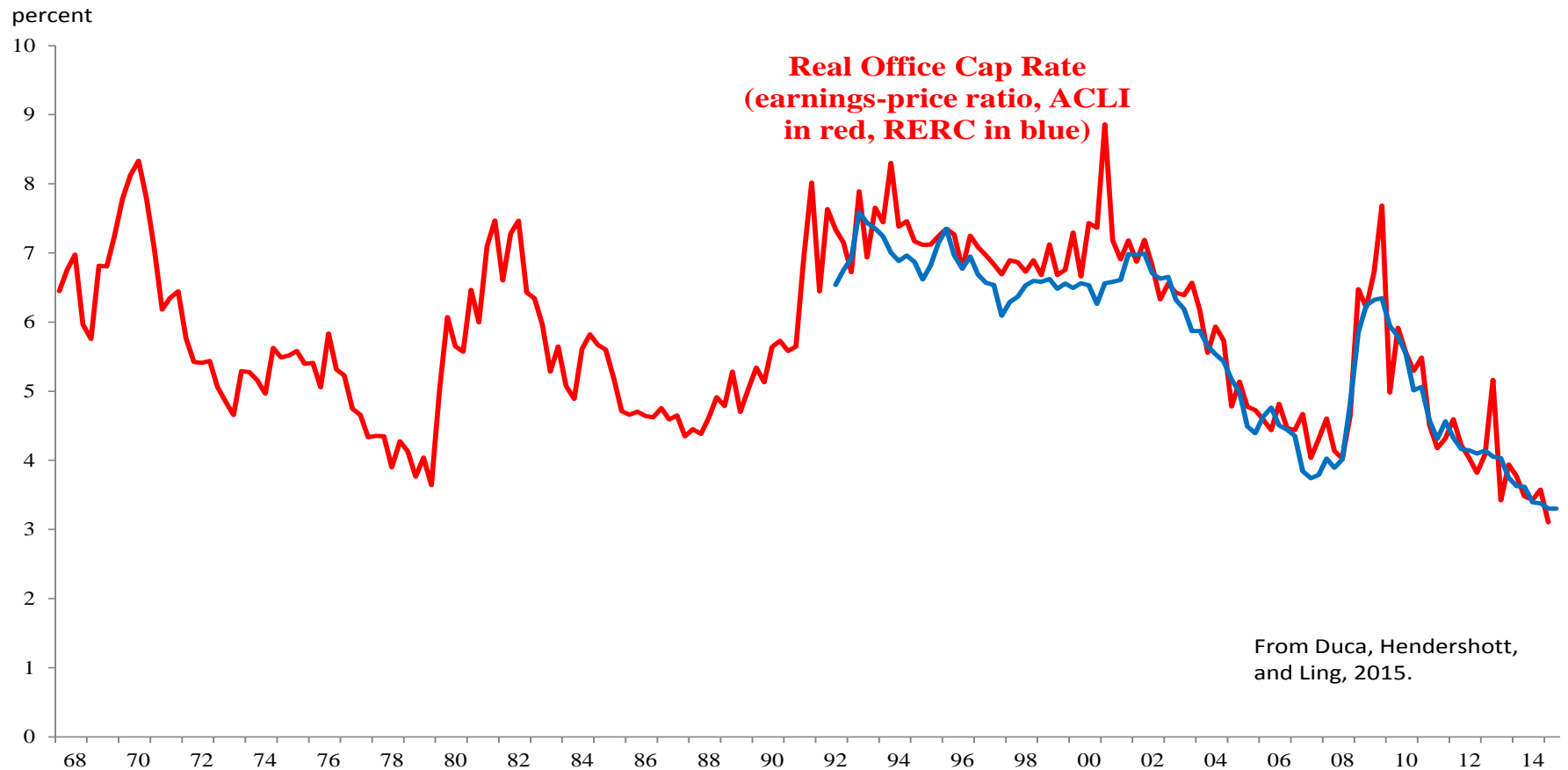


NOTE: Shaded areas indicate recession.

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



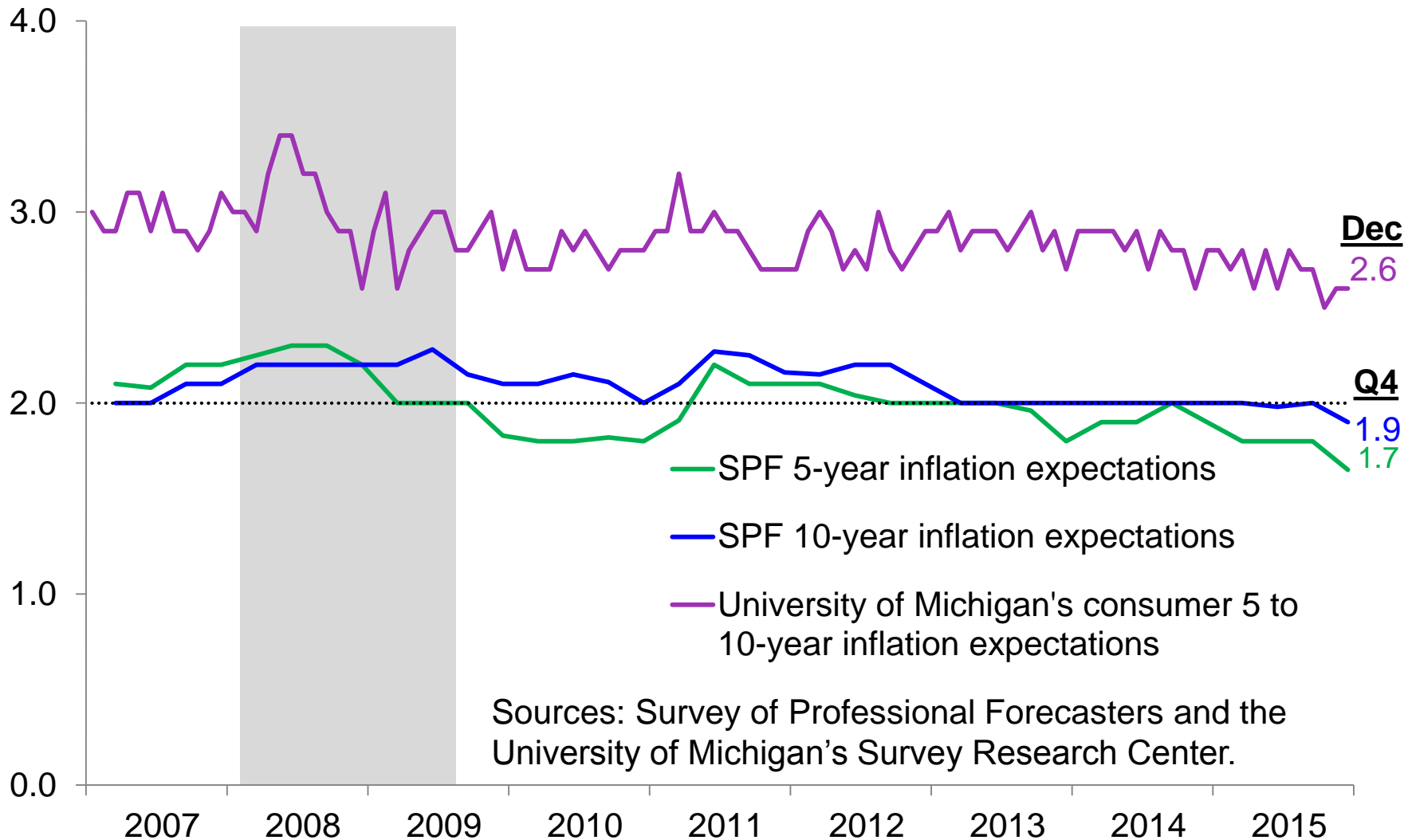
Shaded areas denote recessions. Sources: ACLI, RERC, Federal Reserve Board, and authors' calculations.



Inflation Developments

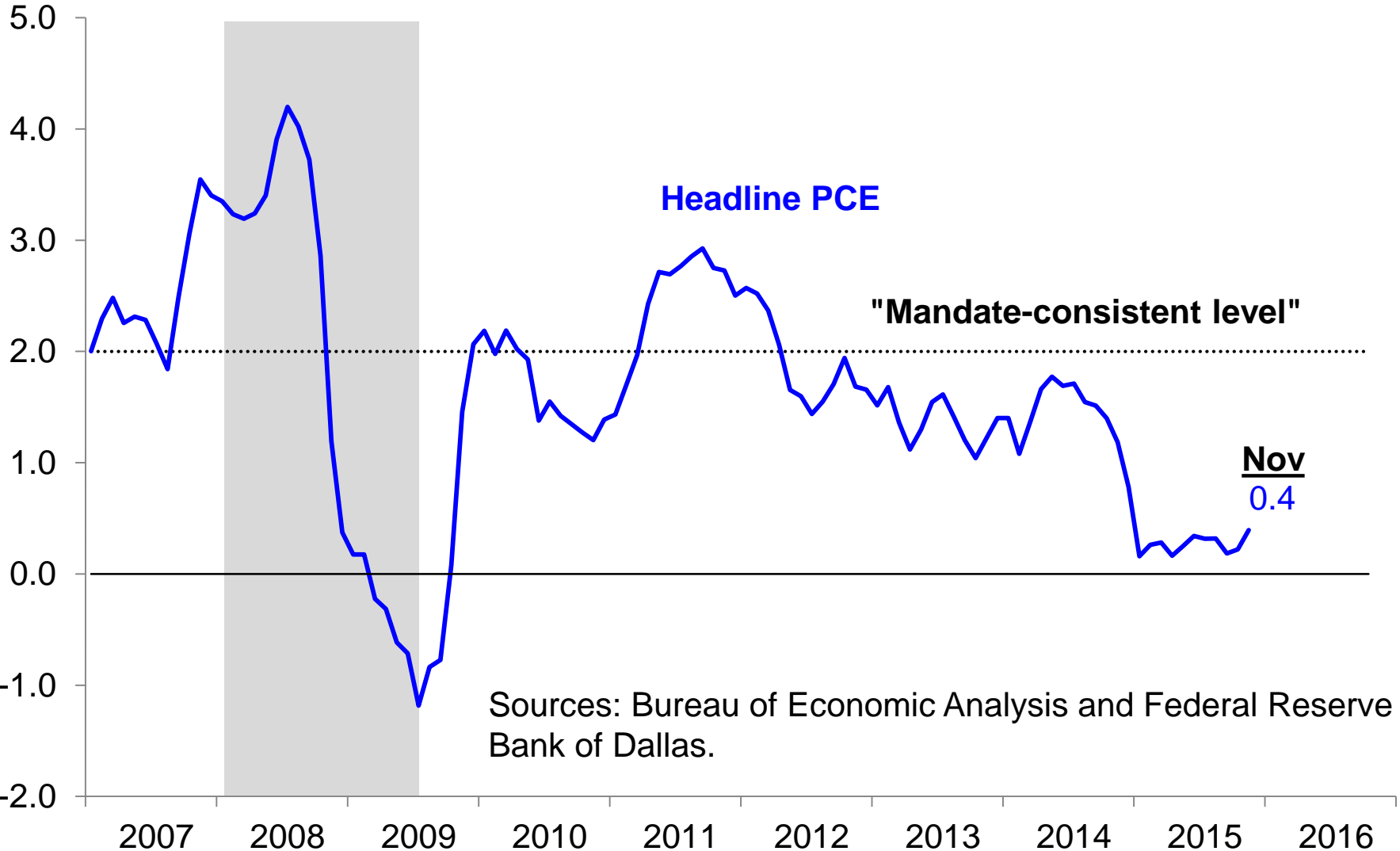
The long-run price-inflation expectations of households and economists dip recently

Percent, annual rate



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

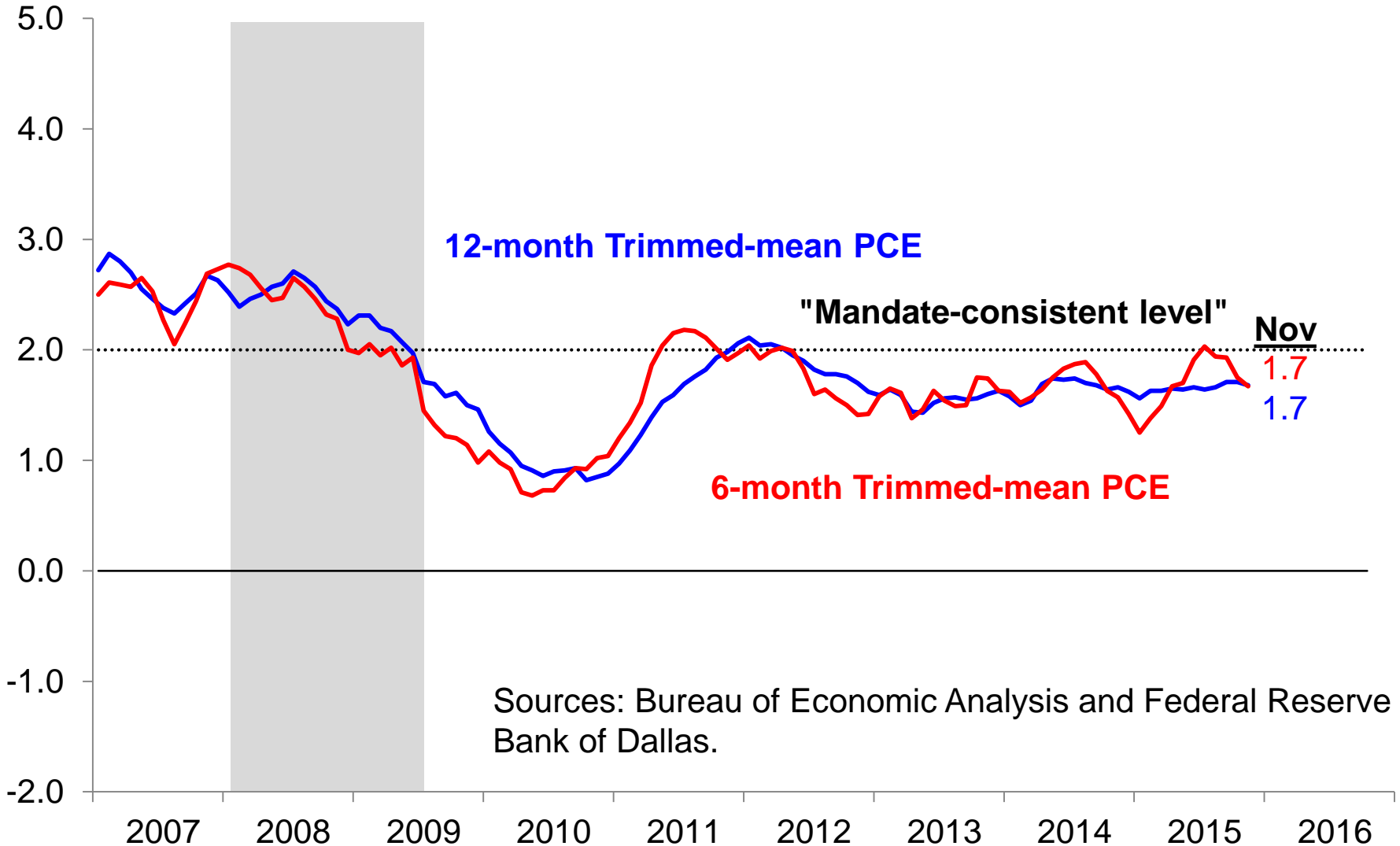
12-month % change



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

Annualized. % change



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.