2012 Outlook for the Texas Economy: Another Year of Moderate Growth

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Growth in US Economy Positive But Sluggish

- Market working to heal itself – asset prices falling, inflation and interest rates low – investment opportunities increasing
- Federal government and Fed also adding stimulus – so why is growth so timid?
- Housing and consumer spending typically ignite the recovery but not this time
- State and local government also atypically weak, US policy and European debt uncertainty also restraining growth
- But it is also true that we need fewer homes built, and consumers and governments need to pay down debt
Home Construction Not Igniting the Recovery

Source: Bureau of Economic Analysis, U.S. Census Bureau and author’s calculations.
Home Price Declines Suppressing Consumer Wealth, Spending
Household’s Deleveraging Also Restraining Consumer Spending

Ratio, personal debt per capita/personal income per capita

<table>
<thead>
<tr>
<th>Year</th>
<th>U.S.</th>
<th>Texas</th>
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<tr>
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Job Growth Positive but not as Strong as Typical
Rebound

Avg. Feb., March, April = 215,000
last 3 months = 137,000

Thousands (SA)
U.S. Leading Index Suggesting Recovery Likely to Continue

Annualized % change

12-month 6-month

Jan. Blue Chip Survey Projects Positive RGDP Growth to Continue but at a Slow Pace
10-yr./1-yr. Yield Spread Suggests Little Chance of Recession Over Next 4 Quarters

Percentage points


Through December

Only false signal
Current Recovery Similar to Past Recoveries that Followed Banking Crisis

Average path of GDP after banking crises (Selecting 2008 as the first year of the crisis in the US)

US

Mean of countries experiencing banking crises

Years after banking crisis; First year of crisis = year 0
In 2011 Texas Economy Grew Stronger than Nation but Moderately – 2012 Likely Similar

• In past two years growth in energy, high-tech, and exports provided a stimulus to Texas. Housing market also less of a drag than nationally.
• In 2011 Texas job growth has continued to be faster than the national average.
• Recent declines in local government employment and exports has weakened economic growth.
• In 2012 growth in energy and exports will slow while construction activity will pick up slightly.
• Overall I expect another year of about 2 percent job growth.
Texas Economy Growing Moderately

(Texas Business Cycle Index)

NOTE: Shaded areas represent Texas recession.
Texas Jobs Growing Faster Than Nation’s’s
Most Texas Industries Adding Jobs, Energy Booming, Govt. Shrinking

Texas Industry Employment 2010 Q4 : 2011 Q4

- Mining
- Construction
- Trade, Trans. & Utilities
- Manufacturing
- Business Services
- Financial Firms
- Leisure & Hospitality
- Information
- Health and Education
- Government
Household’s Deleveraging – Good for Long-Term but Weakens Spending in Short-Term

Ratio, personal debt per capita/personal income per capita

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U.S. Mortgage 75%
Texas Mortgage 68%

Credit Card 8%
Auto Loan 12%
HE Revolving 1%
Student Loan 7%
Other 4%
Texas Real Retail Sales Gradually Picking Up

Index, SA, Real $
Jan. 2000=100

Texas
U.S.
Business Cycle Pattern Similar Across Major Metros

Private Employment Index Jun. 2008=100

Jun-08  Jun-09  Jun-10  11-Jun

Austin  El Paso  Houston  Texas  S.A.  Ft. Worth  Dallas
Texas Construction Contract Values Generally Moving Sideways
Home Inventories Relative To Sales Below National Average and Falling

Months

Texas 6.9

U.S. 7.2

FEDERAL RESERVE BANK OF DALLAS
SAN ANTONIO BRANCH
Mortgage Foreclosures Flat, Delinquency Rate High but Falling, TX Better than US
Texas Mortgages Less at Risk of Default

Percent of Mortgages "Under Water"

- Nevada: 7%
- Arizona: 50%
- Florida: 46%
- Michigan: 44%
- California: 38%
- Idaho: 35%
- Texas: 3%
- U.S.: 23%

TX Apartment Vacancies Declining Sharply

2011 Apartment Vacancies

<table>
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<th>2011 Q1</th>
<th>2011 Q2</th>
<th>2011 Q3</th>
</tr>
</thead>
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<tr>
<td>All MSAs</td>
<td>6.0</td>
<td>5.4</td>
<td>5.0</td>
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<tr>
<td>Austin</td>
<td>5.9</td>
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<td>4.5</td>
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<tr>
<td>Dallas</td>
<td>7.8</td>
<td>6.7</td>
<td>6.3</td>
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<tr>
<td>Fort Worth</td>
<td>8.7</td>
<td>7.4</td>
<td>5.3</td>
</tr>
<tr>
<td>Houston</td>
<td>9.8</td>
<td>8.8</td>
<td>8.5</td>
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TX Office Vacancies Decreasing Slightly

2011 Office Vacancies

Percent

All MSAs  Austin  Dallas  Fort Worth  Houston

2011 Q1  2011 Q2  2011 Q3
Commercial Real Estate Sales Volumes
Rise in 2011

Millions, Real $
(U.S. in tens of
50,000)

2007 2008 2009 2010 2011 (YTD annualized)
TX Manufacturing Production and Orders
Decline in Nov. and Dec.
Recent Manufacturing Decline Related to Export Slowing

TX Exports (Percent Change in 3 MMA, Shifted Forward 1 Month)

Production Index

TMOS Index, SA
Texas Exports Slowing, Dollar Rising

Index, SA Real
Jan. 2000=100

Texas Value of the Dollar

U.S. minus Texas

FEDERAL RESERVE BANK OF DALLAS
SAN ANTONIO BRANCH
High-Tech Output Growth Has Weakened Sharply
Drilling Rig Count has Returned to Boom Levels –Not Likely to Grow Much in 2012
Recent State and Local Government Job Cuts have been Sharp – Not Likely to be Repeated in 2012

U.S. State and Local Share of Total Nonfarm Jobs - 14.4%
Texas State and Local share of Total Nonfarm Jobs - 15.0%
-3.3%
-4.3%
In Recent Months TLI Components Have Increased Slightly

Texas Leading Index Components, 3-month change
September - November

-0.96
0.48
0.30
0.25
0.22
0.12
0.50
0.93

Net Change in Texas Leading Index
Texas Value of the Dollar
U.S. Leading Index
Real Oil Price
Well Permits
New Unemployment Claims
Texas Stock Index
Help Wanted Index
Average Weekly Hours
Texas Jobs Likely to Grow About 2.0% in 2012 – About Same as 2011

Texas Nonfarm Employment and TLI Forecast (with 80% confidence band)
What Did I Forecast at this Event Last Year?
Texas Jobs Likely to Grow about 2.7 % in 2011 – Reach Previous Peak in 2011 Q4

Texas Nonfarm Employment and TLI Forecast (with 80% confidence band)

Census-adjusted Employment

Leading Index

Jan-00 Jan-02 Jan-04 Jan-06 Jan-08 Jan-10

95 100 105 110 115 120 125 130

9.0 9.2 9.4 9.6 9.8 10.0 10.2 10.4 10.6 10.8 11.0
Summary

- U.S. economy improved somewhat in the fourth quarter but 2012 outlook is for continued weak/moderate growth.
- Texas is facing similar headwinds (weak consumer spending, housing) but has grown faster due to strong growth in energy and exports and fewer problems in housing.
- 2012 TX job growth will likely be close to 2.0 percent for the third consecutive year.
- Risks to the outlook include political uncertainty in the Middle East, European Debt issues, U.S. Fiscal Crisis and many more.