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TEXAS *ECONOMIC* OUTLOOK



TEXAS A&M UNIVERSITY
Texas Real Estate Research Center

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U.S. ECONOMIC OVERVIEW

U.S. Unemployment Rate

= **4.2%**

U.S. Average Hourly Wage

▲ **3.9% YOY**

U.S. Consumer Price Index

▲ **2.3% YOY**

U.S. Total Nonfarm Employment

▲ **139,000 JOBS**

The U.S. economy showed signs of resilience in May as concerns over the global trade war mounted. The macroeconomic data indicated a growing divergence between “hard data,” reflecting actual economic activity, and “soft data,” reflecting general economic sentiment and the business outlook. First quarter 2025 gross domestic product declined 0.2 percent, largely resulting from efforts to front-load imports ahead of tariffs.¹ Aside from this preemptive shift, macroeconomic aggregates remained largely unchanged. May labor market data showed almost no signs of impact from the trade war. Unemployment, labor force participation, hiring, and separations all remained roughly constant, indicating signs of current labor market stability.

While the historical data shows signs of resilience, the soft data paints a different picture of the macroeconomic outlook. The University of Michigan’s Consumer Sentiment Index remained low in May after dropping sharply to one of its lowest levels on record in April. The business outlook also deteriorated as uncertainty over the trade war affected business planning. Business survey data from several sources showed declines in expected hiring, which could lead to a spike in the unemployment rate.² Although the soft data is showing signs of concern among consumers and businesses, the outlook could change quickly with a de-escalation of the global trade war.

Federal trade and fiscal policy also weighed on financial markets as the 10-year Treasury yield rose more than 25 basis points (bps) in May. Three policy-related factors are placing upward pressure on long-term interest rates. First, the recent passage of the federal budget in the U.S. House of Representatives is expected to add \$4.3 trillion to U.S. debt over the next ten years, contributing to rising long-term interest rates.³ Second, tariffs have introduced upside inflation risk, raising both the inflation premium and an interest rate premium, accounting for the monetary policy response. Finally, the trade war introduces risk to foreign investors in U.S. assets, which increases domestic interest rates. Rising interest rates further constrain households and businesses seeking to finance expenditures.

¹ <https://www.bea.gov/news/2025/gross-domestic-product-second-estimate-corporate-profits-preliminary-estimate-1st-quarter>

² These sources include the Federal Reserve Bank of Atlanta, the Federal Reserve Bank of Dallas, and the National Federation of Independent Businesses.

³ <https://budgetmodel.wharton.upenn.edu/issues/2025/5/23/house-reconciliation-bill-budget-economic-and-distributional-effects-may-22-2025>

STORIES WE'RE FOLLOWING

Tariffs

- *The issue*: On April 2, 2025, President Trump initiated a series of tariffs on global imports. These tariffs and the retaliatory tariffs levied by other countries impacted trade and capital markets while adding risk to the macroeconomic outlook. As uncertainty over the duration and magnitude of the tariffs hangs over consumers and businesses, the possibility of sustained tariffs could contribute to disruptions and restructuring of economic activity.
- *Updates*: Aside from preemptive spending shifts to avoid tariffs, the macroeconomic landscape remains largely unchanged and the outlook largely uncertain. The current macroeconomic data shows no signs of impact on labor markets and a modest impact on financial markets. However, the Fed's May 2025 *Beige Book*, which highlights regional economic activity in the 12 Federal Reserve Bank districts, showed growing concerns over the economic outlook, largely stemming from tariffs and policy uncertainty.⁴

Federal Tax Reform

- *The issue*: President Trump and Congressional Republicans are working on a fiscal package that could extend several provisions of the 2017 tax reform. While reducing rates could stimulate economic growth, restructuring deductions could have implications for real estate and economic growth in Texas. Expanding the state and local tax deduction, for example, could dampen Texas' low-tax appeal, impacting future migration decisions.
- *Updates*: On May 22, 2025, the U.S. House of Representatives passed the One Big Beautiful Bill Act, which is expected to grow the deficit. Financial markets responded by increasing yields on long-term government debt, reflecting tightening capital supply, heightened inflation risk, and rising credit risk on federal debt.

Federal Reserve Policy

- *The issue*: Since the middle of 2022, the Federal Reserve (Fed) has been implementing contractionary monetary policy to combat inflation. The federal funds rate, which the Fed targets to influence the broader economy, remains elevated. As part of a larger asset reduction effort, the Fed is also reducing its holdings of certain private assets, including mortgage-backed securities (MBS)

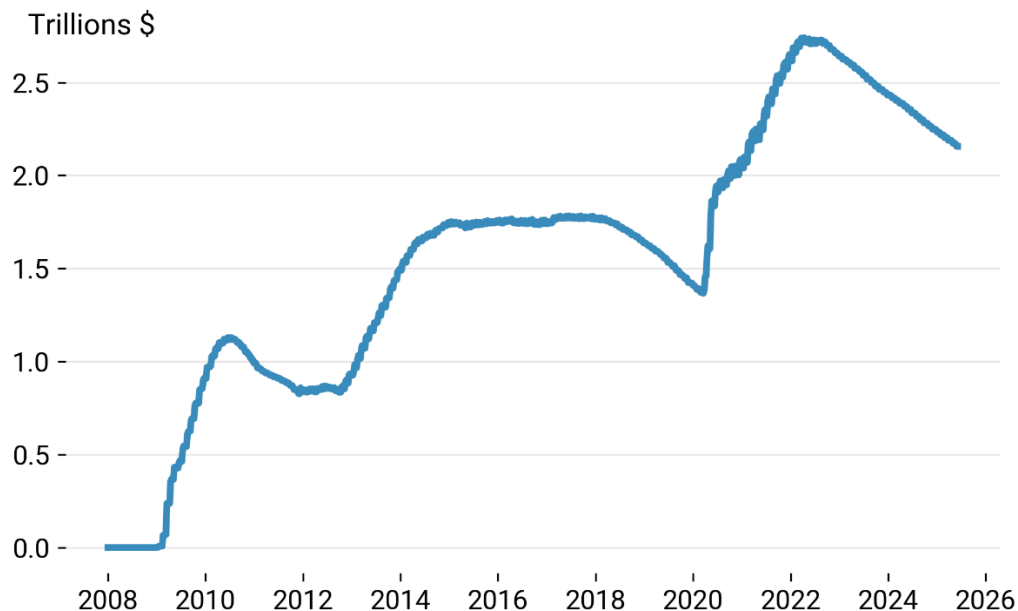
⁴ <https://www.federalreserve.gov/monetarypolicy/beigebook202505-summary.htm>

(Figure 1). Reducing the share of mortgages held by the Fed causes other private investors to absorb the new debt issuance, which contributes to heightened mortgage rates.

- Updates: In March 2025, the Fed reaffirmed its commitment to allowing MBS to run off its balance sheet and reinvest debt payments in Treasuries instead of new MBS. Although the Fed caps this MBS runoff at \$35 billion per month, the actual average monthly runoff is roughly half of this amount.⁵ As long as the Fed continues reducing MBS holdings, the policy will contribute to elevated mortgage rates, adding to headwinds in the real estate market.

Figure 1

FEDERAL RESERVE ASSETS: MORTGAGE-BACKED SECURITIES



Source: Board of Governors of the Federal Reserve.

Immigration

- The issue: Immigration—both legal and illegal—influences domestic population growth and labor markets. An estimated 8.1 percent of the Texas labor market and 4.8 percent of the U.S. labor market is comprised of unauthorized immigrants.⁶ The Trump administration is increasing enforcement of immigration

⁵ <https://www.federalreserve.gov/econres/notes/feds-notes/the-evolution-of-the-federal-reserves-agency-mbs-holdings-20240920.html>

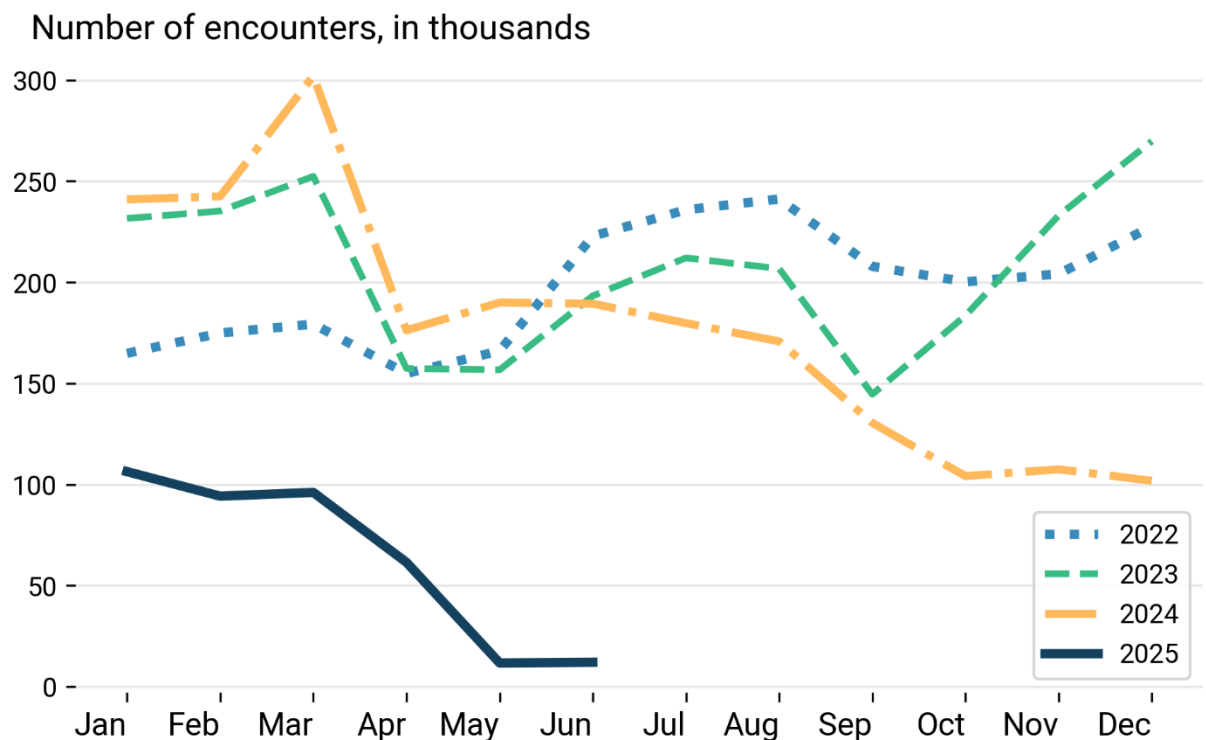
⁶ <https://www.pewresearch.org/short-reads/2024/07/22/what-we-know-about-unauthorized-immigrants-living-in-the-us/>

laws, leading to a sharp reduction in border crossings (Figure 2).⁷ This, combined with possible deportations, could impact certain industries, like the construction industry, that employ a disproportionately large share of undocumented immigrants. Moreover, stemming the flow of legal immigration could also contribute to changes in economic activity.

- Update: A recent survey of Texas business executives conducted by the Federal Reserve Bank of Dallas showed that 18 percent of firms expect immigration policy to impact their ability to hire and retain workers this year.⁸ Many of these firms indicated an inclination to respond by increasing current worker productivity, implementing labor-saving technology, and taking other actions.

Figure 2

ENCOUNTERS ON THE SOUTHWESTERN BORDER



Source: U.S. Customs and Border Protection.

⁷ <https://www.axios.com/2025/03/04/illegal-border-crossings-february-decline-trump>

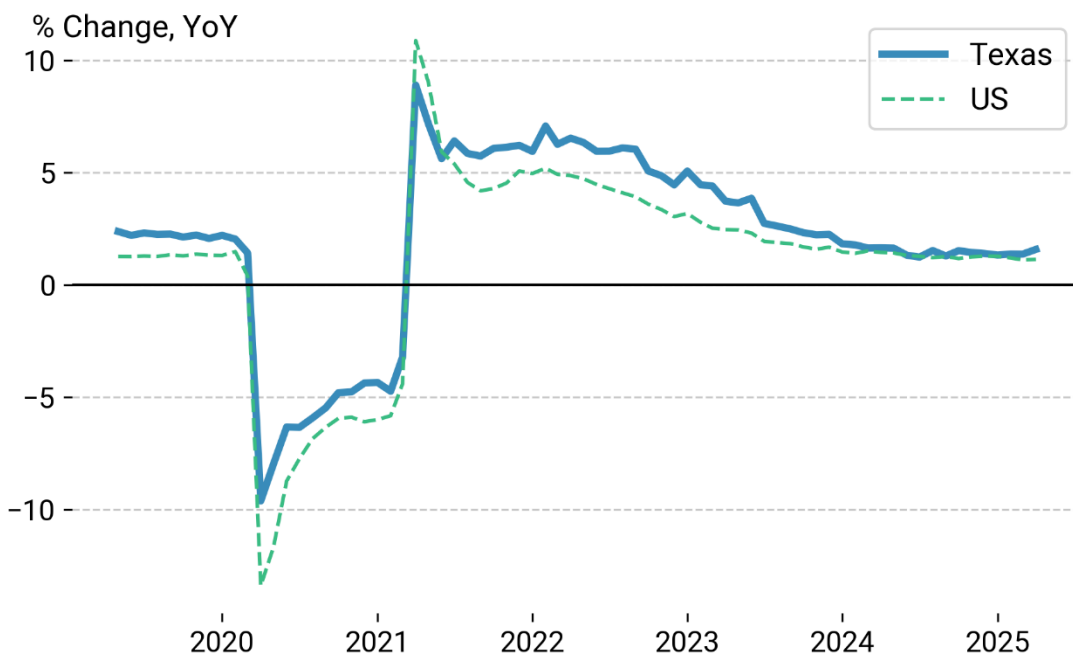
⁸ <https://www.dallasfed.org/research/surveys/tbos/2025/2502q>

TEXAS ECONOMIC INDICATORS

The Texas economy mirrored the national economy in the disparity between the historical “hard” data and the forward-looking “soft” data. Employment growth remained strong and slightly above the U.S. employment growth rate (Figure 3). Survey data from the Federal Reserve Bank of Dallas, however, showed growing weakness in the business outlook, which could materialize as a decline in economic activity in the coming months.⁹

Figure 3

U.S. AND TEXAS EMPLOYMENT GROWTH



Source: U.S. Bureau of Labor Statistics and the Federal Reserve Bank of Dallas.

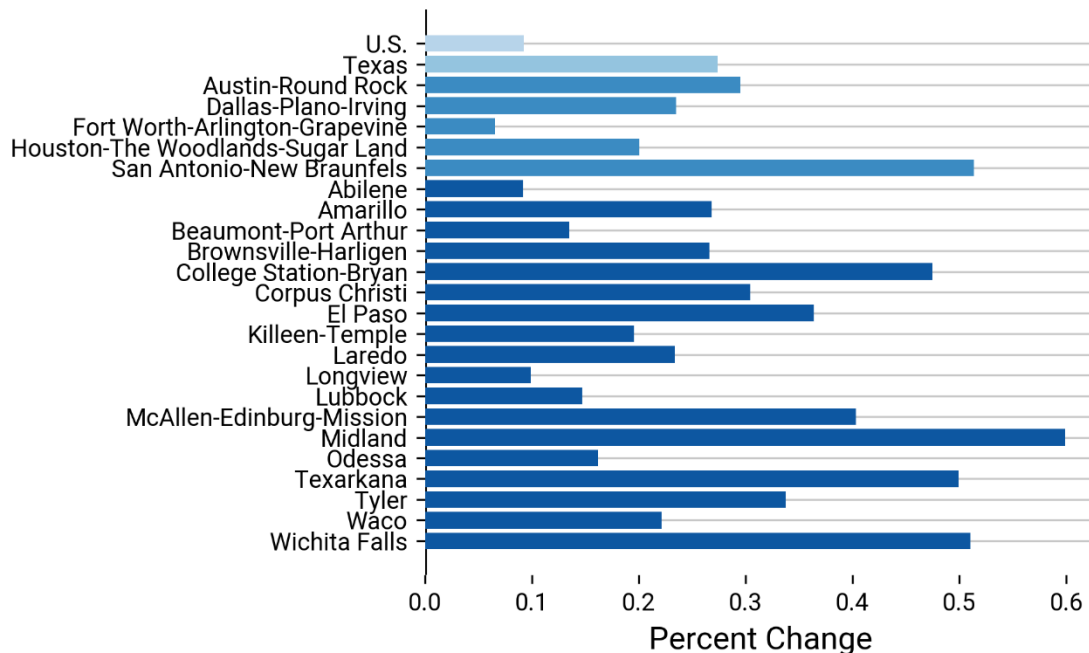
⁹ <https://www.dallasfed.org/research/swe/2025/swe2508>

Employment

Month-over-month (MoM) employment growth was positive in every metropolitan area of Texas (Figure 4). The San Antonio metropolitan area experienced extraordinary employment growth in April, led by significant growth in the service industry.¹⁰

Figure 4

REGIONAL EMPLOYMENT GROWTH, APRIL 2025



Notes: U.S., Texas, major metropolitan areas, and other metropolitan areas shown in different shades of blue.

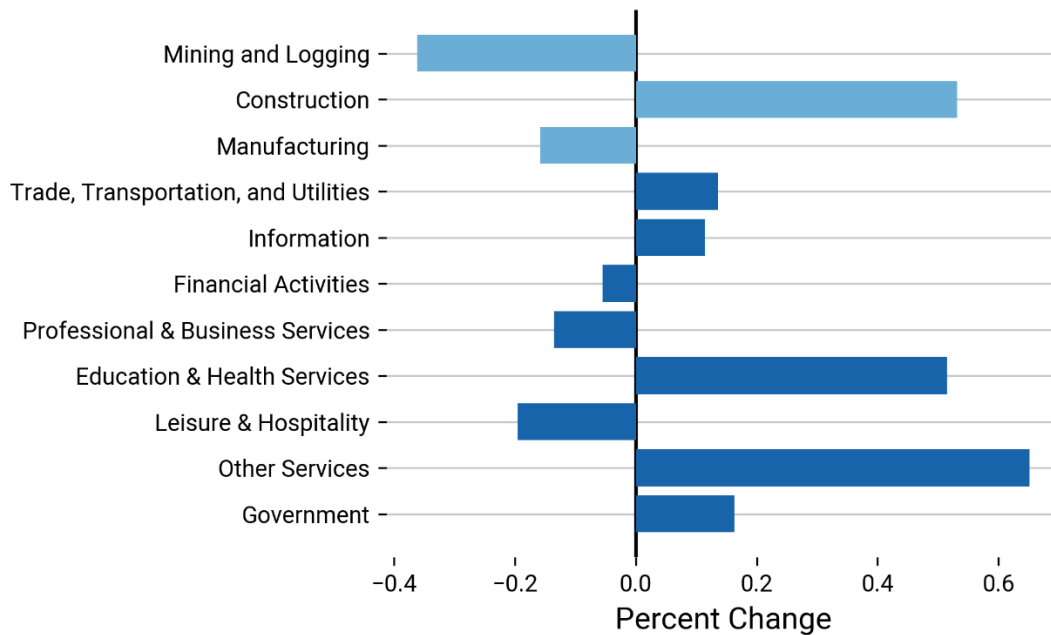
Source: Federal Reserve Bank of Dallas (using U.S. Bureau of Labor Statistics data).

Industrial MoM employment growth in Texas varied significantly across the sectors, with five of the 11 sectors showing negative growth in April (Figure 5). Mining and logging experienced the largest losses with a 0.36 percent decline in employment, while Construction, Education, and Health Services, and Other Services led employment gains with 0.53 percent, 0.51 percent, and 0.65 percent increases, respectively.

¹⁰ https://www.bls.gov/regions/southwest/tx_sanantonio_msa.htm

Figure 5

INDUSTRIAL EMPLOYMENT GROWTH, APRIL 2025



Notes: Goods-producing and service-providing industries are shown in different shades of blue.

Source: Federal Reserve Bank of Dallas (using U.S. Bureau of Labor Statistics data).

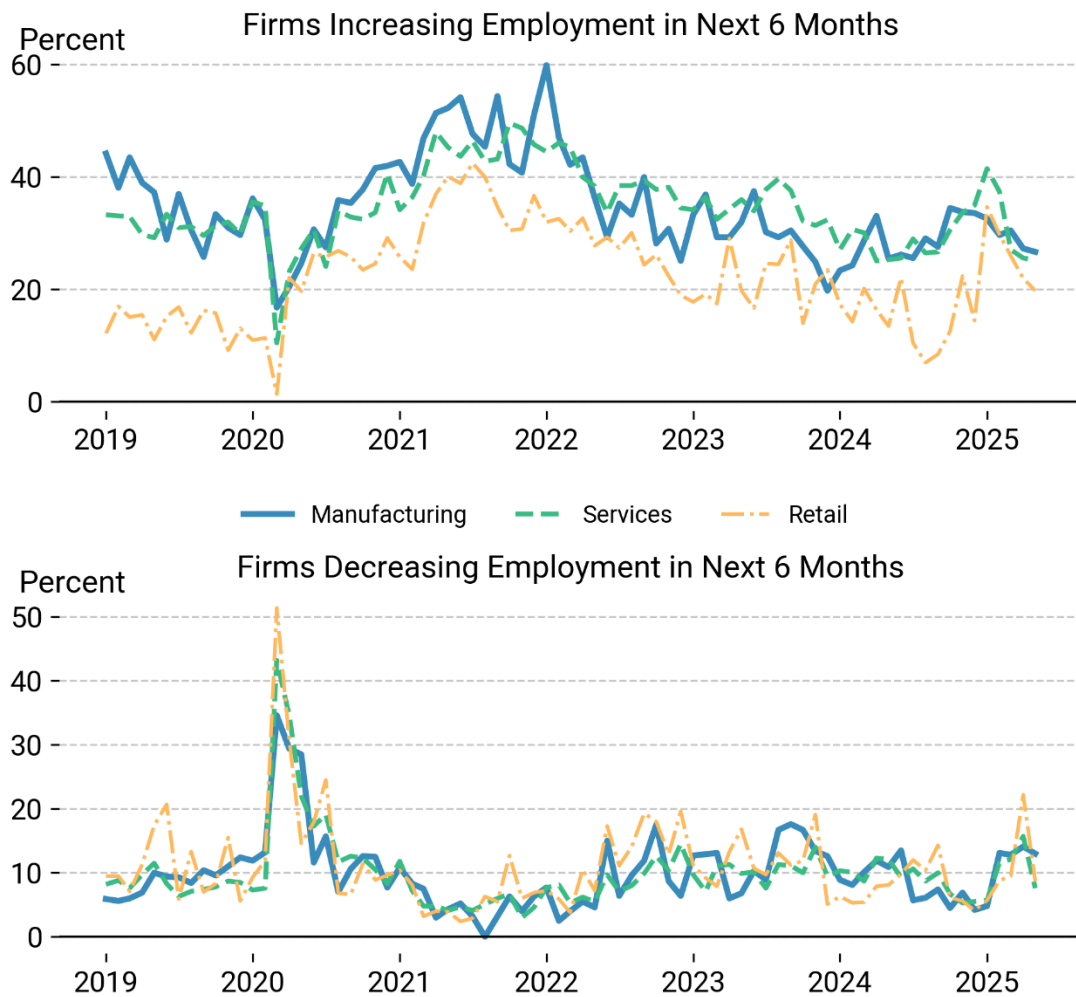
Employment Outlook

The business outlook survey administered by the Federal Reserve Bank of Dallas provides a summary of Texas firms' expectations of employment changes over the next two quarters (Figure 6). The share of firms planning on hiring remained low in all major sectors, reflecting the impact of tariff announcements. The number of firms planning to decrease employment has also dropped significantly in every industry. This reflects a moderation in the employment outlook as many firms wait for more clarity on the

economic outlook before making employment changes. However, even if layoffs remain low, a slowdown in hiring could lead to an increase in the unemployment rate.

Figure 6

TEXAS EMPLOYMENT OUTLOOK, MAY 2025



Notes: Share of Texas firms planning to increase (top) or decrease (bottom) employment in the next six months, by major sector.

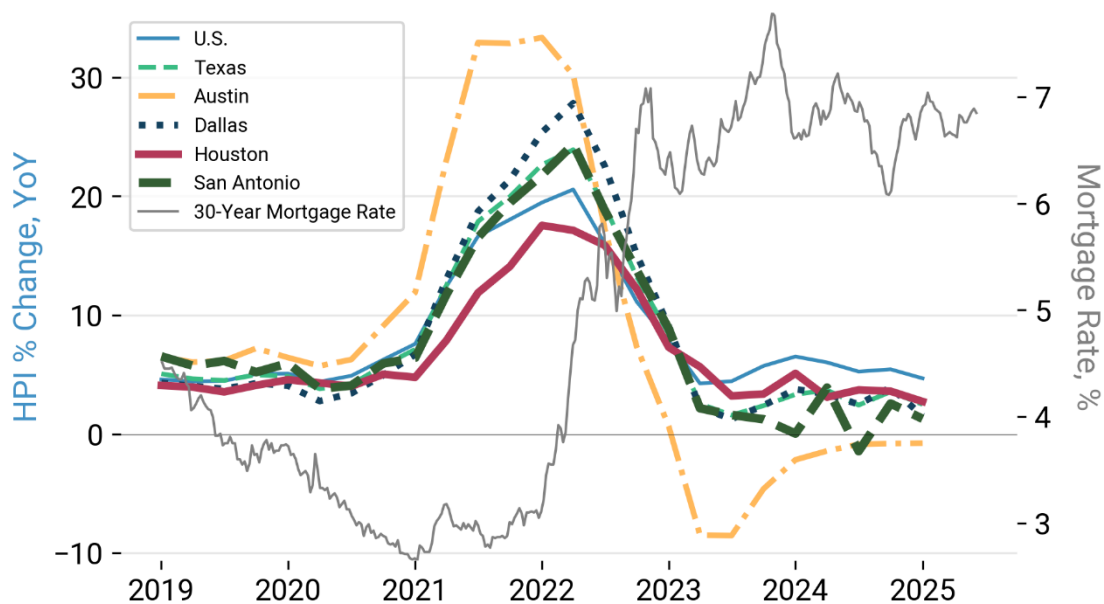
Source: Federal Reserve Bank of Dallas.

Housing

High mortgage rates continued weighing on house prices in the U.S. and across Texas. According to first quarter 2025 house price index data, Texas house prices grew below the national average (Figure 7), but price growth was positive at the state level. The Austin metropolitan area experienced the slowest growth and remains the only large Texas metropolitan area in negative territory.

Figure 7

HOUSE PRICE GROWTH AND MORTGAGE RATES

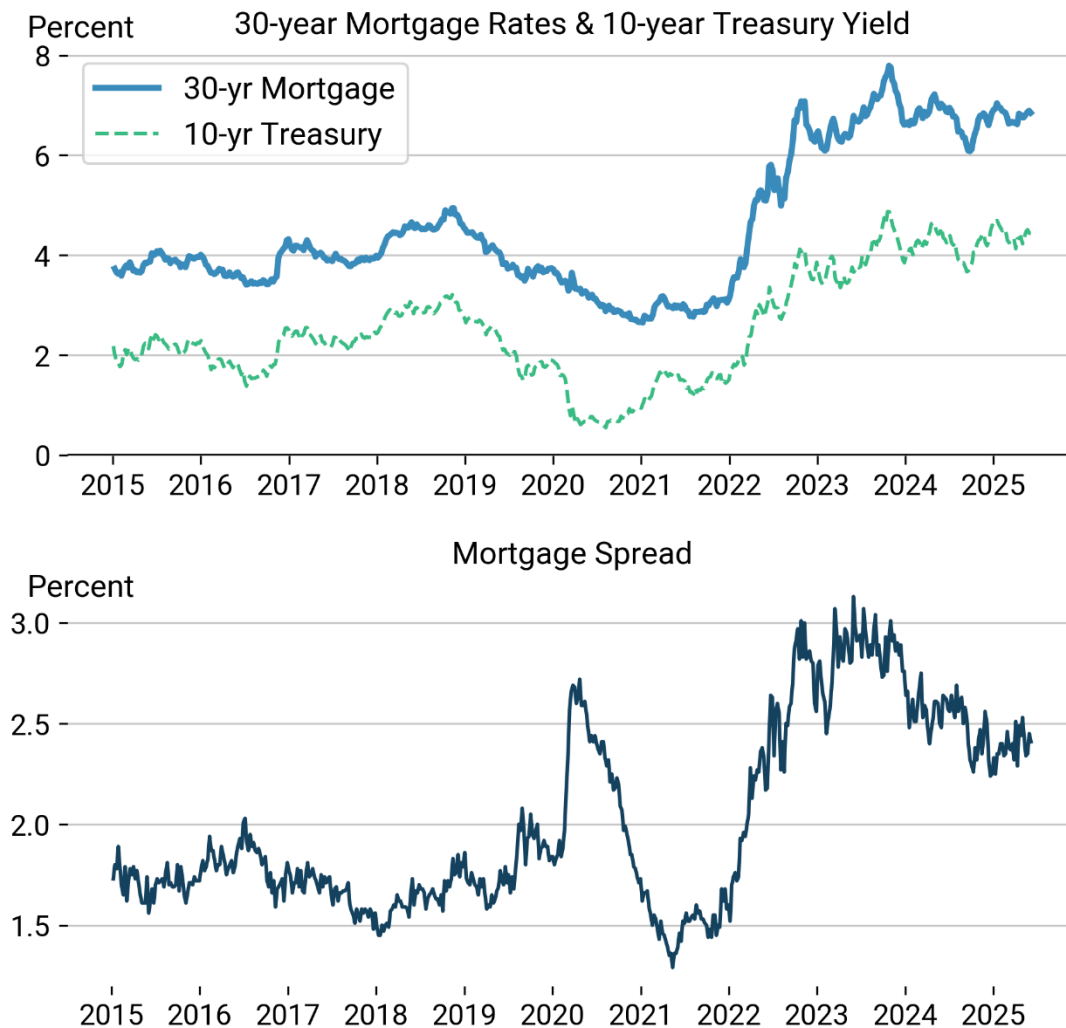


Source: FHFA and Freddie Mac, accessed via FRED.

The average mortgage rate remains elevated and continues to create headwinds in the housing market. The mortgage spread, conventionally defined as the difference between the average 30-year mortgage rate and the ten-year Treasury yield, indicates an interest rate premium paid by mortgage borrowers. Although the mortgage spread remains well above its typical range of around 150-175 bps, it has been steadily declining since the middle of 2023 (Figure 8). This means the mortgage rate could follow the ten-year Treasury yield more closely as the economic expansion matures.

Figure 8

INTEREST RATES AND THE MORTGAGE SPREAD



Notes: The mortgage spread is defined as the 30-year mortgage rate minus ten-year Treasury yield.

Source: Freddie Mac, Board of Governors of the Federal Reserve, and author calculations; data accessed via FRED.

For more information on the Texas housing outlook, read TRERC's monthly [Texas Housing Insight report](#).





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