

The Texas *Business Leaders Confidence Index*®, and all its components, decreased for the second consecutive quarter. Participants' attention was on the Gulf Coast as they reported their expectations for the fourth quarter of 2005. (The survey was open September 1st-25th.) Hurricane Katrina made landfall on the Gulf Coast on August 29th and Hurricane Rita landed on the Texas-Louisiana border on September 24th. Although the BLCI, at 56.9, is down 5.7 points from the previous quarter, most BLCI components are in line with previous index fluctuations. The exception is panelists' expectations for the national economy. This component index is down a significant 12.9 points to 46.8, the lowest value since the inception of the BLCI, signaling expectations for slower economic growth. Expectations for the national economy pulled the overall BLCI down to its lowest point since the second quarter of 2003.

Recently, other major indices have also experienced large declines. The September *UBS Index*, a measure of investor confidence, fell to its lowest point in two and a half years. The mid-September University of Michigan *Consumer Sentiment Survey* logged the largest one-month decline in 25 years. Dramatic drops in confidence are rarely supported in the long-term and there are reasons to view panelist expectations as a reflection of September's uncertainties.

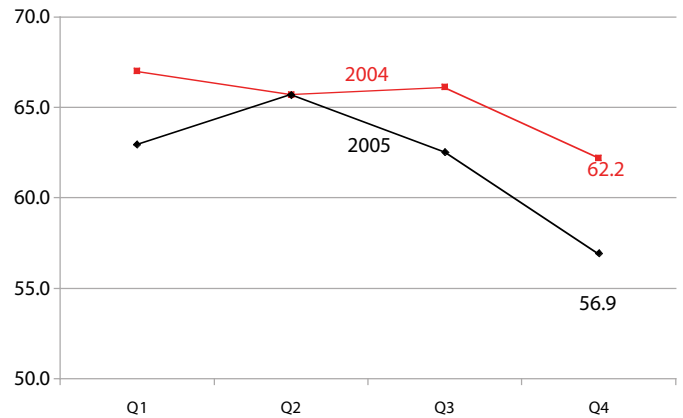
THE OUTLOOK	
National Economy	46.8
Texas Economy	59.0
Industry Sales	62.4
Industry Profits	57.4
Industry Hiring	58.5
Capital Expenditures	57.5
BLCI Composite	56.9

Index above 50 indicates expanding economy.
Red - decrease from previous quarter
Green - Increase from previous quarter

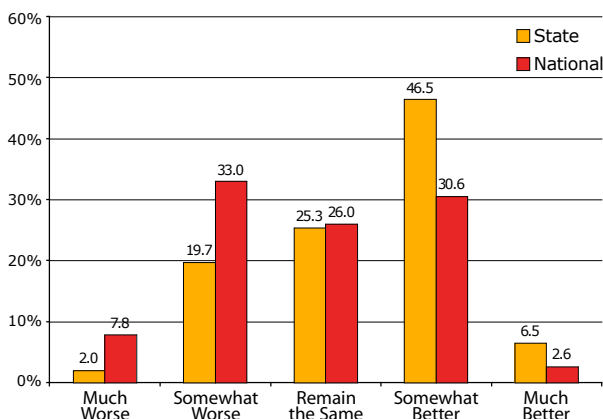
State Outlook Continues to Outshine National Outlook

Approximately 41% of BLCI panelists' expect a worse national economy for the coming quarter when compared to the third quarter. Economy.com expects a growth rate of 3.7% in Q4, revised downward from pre-Katrina expectations of 4.3%. GDP figures for the second quarter released September 29th report 3.3% growth, down slightly from the first quarter, but still strong. Growth drivers are the continued housing boom and business investment in equipment and software. Growth is expected to rebound in the first half of 2006 as government spending and insurance payments boost construction and infrastructure expenditures.

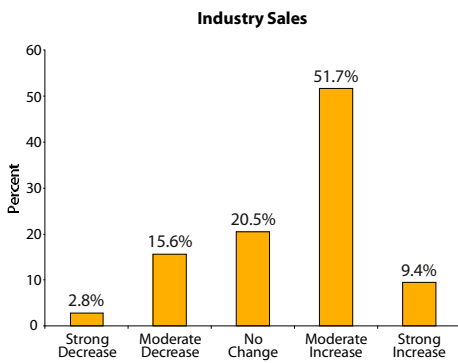
Texas BLCI - 2004 vs. 2005



National vs. State Economy Q4 2005

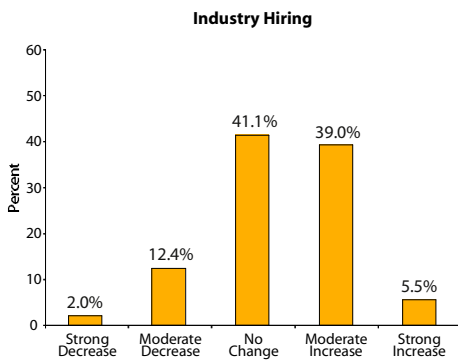
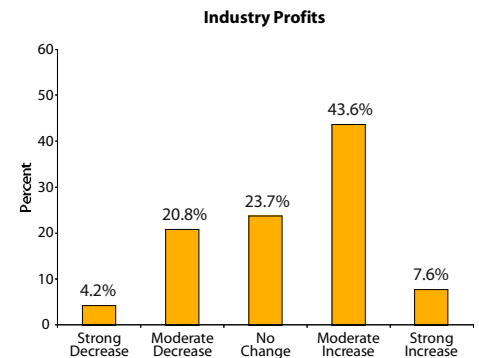


Expectations for the Texas economy slipped from a component index of 64.4 last quarter to 59.0 for the fourth quarter, but it remains one of the strongest BLCI components with 53% of the panelists expecting conditions to improve. In addition to a broad, if slow, economic expansion, it seems likely Texas will receive unsolicited benefits resulting from recent hurricanes. Possible outcomes include the relocation of Louisiana businesses, permanently or temporarily, to Houston and Dallas giving commercial real estate a boost. Metro areas in Texas may also be a destination for convention business relocated from New Orleans.



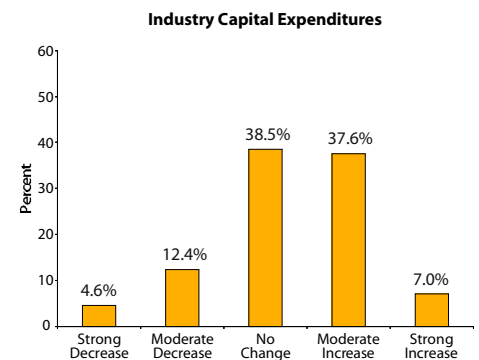
Sales Expectations Down but Remain Positive The component index for sales expectations in the fourth quarter continues to be robust despite slipping 4.1 points to 62.4. Approximately 61% surveyed see increased sales for their industry through the end of the year. However, high energy prices are already having an impact on consumer purchasing behavior. Every one-cent increase in a gallon of gasoline costs consumers \$1 billion, with half of the increase absorbed through reductions in other spending.¹ Although lower-income consumers are curbing non-energy spending, business spending and high-end consumer spending (including technology products and real estate) will support projected sales growth.

Energy Prices Cutting into Profit Margin Only half of the panelists surveyed expect profits to increase in the coming quarter, while the other half is split between expecting no change or expecting a decrease. Profit expectations slipped 5.6 points from last quarter to a component index of 57.4. Higher energy prices drive the cost of transportation, shipping and utilities, and many businesses are having difficulty passing these increased costs onto customers. According to recently released GDP results, profits grew in the second quarter but at a slower pace compared to the first quarter.



Panelists Optimistic About Hiring Participants in the Texas BLCI survey demonstrated a continued optimism with respect to job creation for the last quarter of 2005. Hiring is typically one of the weakest components of the BLCI with panelists expressing the least optimism. However, fourth quarter expectations are relatively high. Panelists are more optimistic about hiring than they are about the U.S. economy, industry profits, and capital expenditure components. The relative optimism is a reflection of improving job conditions. In August, U.S. unemployment was 4.9%, registering under 5% for the first time in three years. Layoff announcements and jobless claims continue a downward trend. Temporary staffing services are in demand, particularly in the light industry and oil and gas sectors. Texas' payrolls have been expanding slowly for ten months with particular strength in the construction, retail, transportation, education, health and government sectors. Unemployment claims resulting from recent hurricanes were already beginning to subside by the end of September.

Business Spending Remains Cautious BLCI panelist capital expenditure expectations retreated 4.1 points to a component index reading of 57.5, demonstrating continued caution. The reading for this index component has slipped slightly for the last three quarters. While 44.6% of the panelists project an increase in their capital spending levels, 38.5% foresee no change and 17% expect a decrease in expenditures. Many U.S. businesses are experiencing historically high profits and have assets from the liquidation of inventories in the second quarter. Business-spending growth is expected to remain in the double digits through the end of the year.



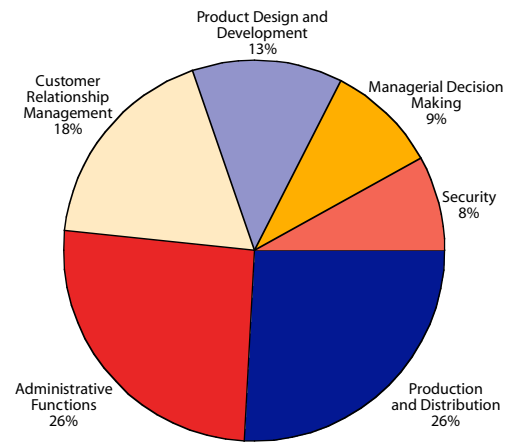
¹Zandi, Mark. 2005. Katrina: More Thoughts on the U.S. Macro Impact. www.economy.com.

Impact of IT Expenditures on Texas Business This quarter's topical questions probe Texas business leaders about their planned IT investment expenditures for 2006 and their perception of the impact of their IT expenditures over the past three years on product cost and quality, as well as revenue.

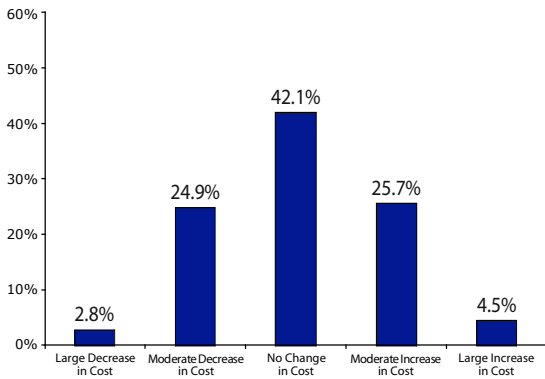
Panel members were asked to rank (from 1 to 6, according to size) their planned IT expenditures in six categories.

- IT investments related to administrative functions and production/distribution were tied for the highest planned 2006 IT expenditures with each ranked first by 26% of the panelists.
- Customer relationship management received the third highest investment ranking with 18% of panelists stating it was their first priority.
- Product design/development came in fourth with 13% of panelist identifying it as the highest planned expenditure.
- Managerial decision-making and security were the lowest spending priorities with 9% and 8% of the panelists respectively identifying them as the top IT planned investment.

Highest IT Investment



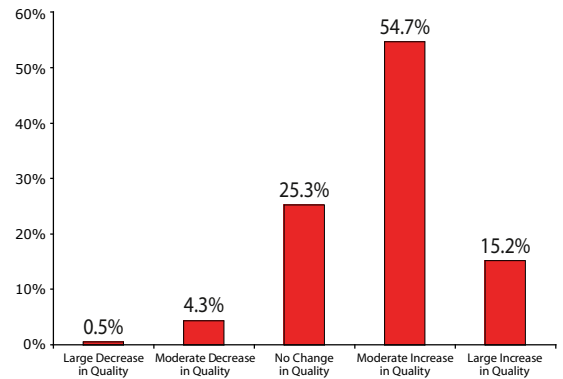
Impact of IT Expenditures on Product/Service Cost



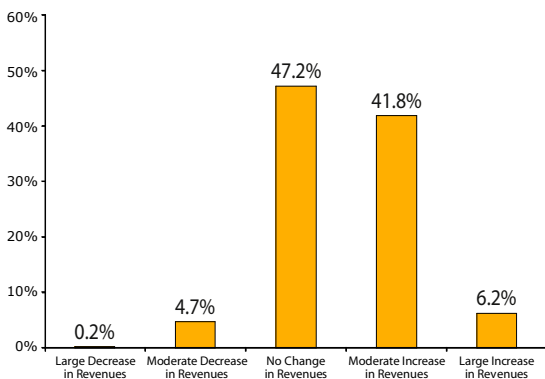
IT Investments have Varying Effects on Costs Panelists were asked to assess the impact of IT investments on product or service cost. Almost 28% of the BLCI panelists who responded indicated that IT investments over the last three years decreased the cost of producing their company's product or service. Just over 30% reported that IT investments increased the cost of producing their product and about 42% reported no change.

IT Investments Improve Quality The return on IT investments is clearly evident in BLCI panelist reports of increased quality. Approximately 70% of those who responded reported moderate or large increases in product or service quality as a result of IT investments. Over 25% reported no change and fewer than 5% reported a decrease in quality.

Impact of IT Expenditures on Product/Service Quality



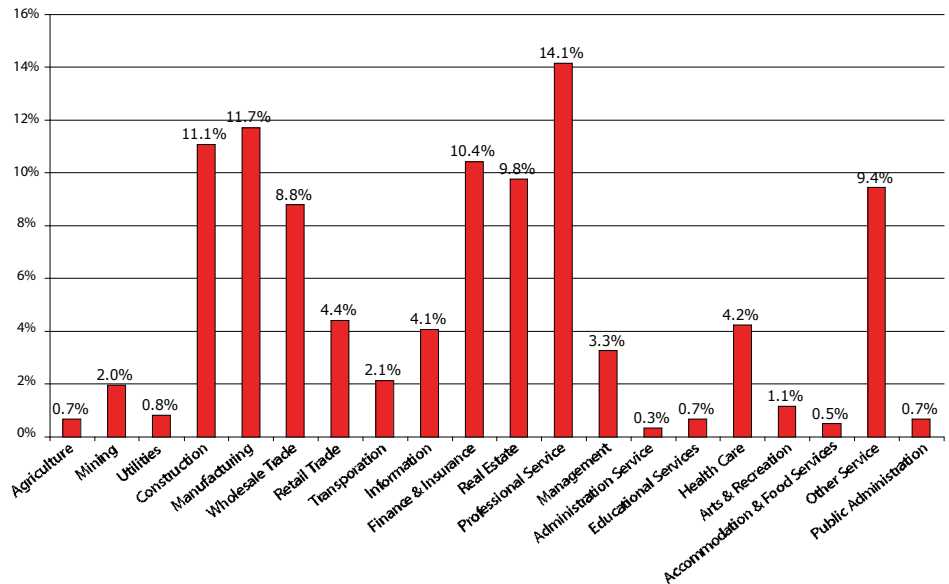
Impact of IT Expenditures on Revenues



Mixed Results on Revenue Generation Despite perceptions of IT investment impact on increased quality, BLCI participants report that these investments did not necessarily translate into improved revenues. Right at 48% reported a moderate or large increase in revenues resulting from IT investments, while over 47% reported no change and almost 5% reported a decrease in revenues.

A Look into the BLCI There were over 600 BLCI survey participants in the Fourth Quarter Survey. Although not a random sample, panelists are well distributed across all business sectors with strong representation in construction, manufacturing, finance and insurance and services. As total panel membership and the number completing the survey continue to expand, we will add further analysis of individual industries and sub-state areas.

Distribution of BLCI Panelists by Industry



Q4 2005 BLCI By Metro Region

	State		Metro Areas			
	Texas	change from Q3	Austin	DFW	Houston	San Antonio
Sales	62.4	-4.1	64.0	61.7	64.1	61.5
Profits	57.4	-5.6	60.3	57.9	57.1	56.2
Hiring	58.5	-1.7	58.8	58.3	59.7	58.8
Capital Exp	57.5	-4.1	58.8	57.9	58.6	54.6
Texas	59.0	-5.4	61.4	57.6	60.3	59.2
Nation	46.8	-12.9	45.6	49.3	44.8	43.1
BLCI	56.9	-5.7	58.1	57.1	57.4	55.6

The Texas metro areas continue to track each other. Out of the four markets shown, San Antonio continues to be the least optimistic. Houston's hiring outlook is slightly more optimistic when compared to the other metro markets. This may be the reflection of a tight oil and gas labor market that is likely to become tighter as production and refining capacity come back online.

Analysis provided by Eliza Evans, Ph.D., Program Manager for Research, IC² Institute, The University of Texas at Austin.



The BLCI is a
Compass on Business
initiative created in
collaboration with:



First Class Mail
U.S. Postage
PAID
Houston, Texas
Permit No. 5086

Log on to www.bci.com/texas. The next survey period begins December 1, 2005.