Texas to Remain a Top State for Job Growth in 2014

By Keith R. Phillips and Christopher Slijk

The Texas economy in 2014 is well positioned to continue expanding and will likely remain among the nation's fastest growing. Employment grew 2.5 percent last year, down from 3.3 percent in 2012 but 0.7 percentage points above the national average.

Weakness in manufacturing and cuts in federal spending contributed to the state's job growth slowdown. Still, the economy continued to expand broadly, with employment in oil and gas, leisure and hospitality, professional and business services, and construction growing strongly.

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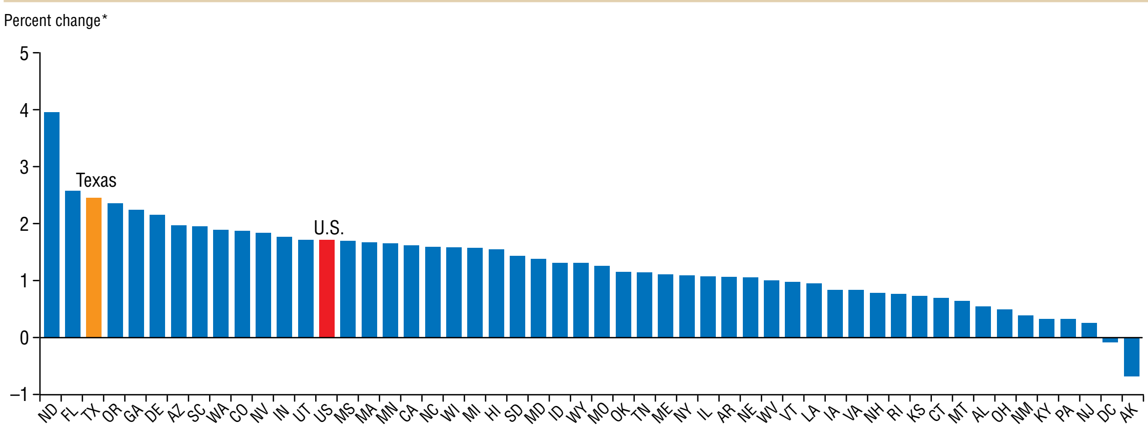
Even with slower job expansion, Texas remained the third-fastest-growing state in 2013, trailing only North Dakota and Florida (*Chart 1*). Oil- and gas-producing states—leaders in the early years of the U.S. recovery—no longer predominated. This reflects the energy sector's slowing expansion, although two states with the strongest shale activity, Texas and North Dakota, remained near the top. Meanwhile, several Sunbelt states hit hard by the housing crisis—Florida, Georgia and Arizona, for instance—are beginning to bounce back. In these states, employment remains significantly below the prerecession peak; in Texas, it is significantly above.

While Texas jobs grew at a healthy pace, the unemployment rate changed little overall, dropping to 6 percent in December 2013 from 6.2 percent at the end of 2012. The unemployment rate rose through May 2013 because new entrants to the workforce outpaced new jobs created by 0.4 percentage points.

As job growth continued in the latter half of the year and labor force expansion leveled, the unemployment rate fell steadily. As a result, the Texas unemployment rate in December remained below the 6.7 percent nationwide figure. Real gross domestic product in Texas also outpaced the nation, growing 3.8 percent on a year-over-year basis through third quarter 2013 compared with 2 percent for the nation (*see box, page 5*).

This year Texas will likely continue growing at a moderate, above-average pace and will outpace most U.S. states. Headwinds from cuts in federal gov-

Chart 1 Texas Posts Third-Fastest Job Growth Among States in 2013



*December-over-December change; seasonally adjusted.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

ernment spending should dissipate, while manufacturing sector expansion is expected to increase as U.S. and world economies improve. Energy and construction are anticipated to remain strong. Recent increases in leading indicators suggest that Texas nonfarm employment should pick up 2.5 to 3.5 percent in 2014.

Texas' Expansion Continues

Economic growth in Texas, unlike the nation, bounced back relatively strongly following the recession. Texas reached prerecession employment levels by late 2011, and jobs have since expanded 6.3 percent. Meanwhile, the nation is still 0.7 percent (1 million jobs) below its peak reached in January 2008 (*Chart 2*). Though the Texas recovery has been robust, the sources of strength have differed from past recoveries, which typically have been led by housing and consumer spending. Instead, growth in the early years of the recent recovery was driven more by gains in energy and exports.

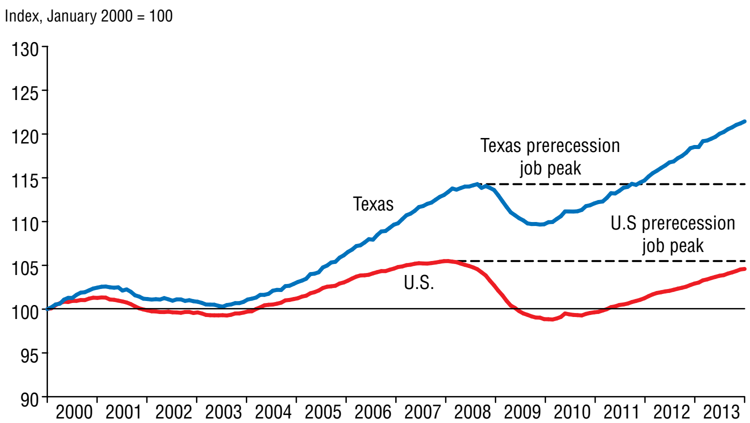
Growth in most industries in Texas moderated last year (*Chart 3*). Although construction expanded at a healthy 3 percent in 2013, this was a bit less than half the previous year's rate. Similarly, energy continued to decelerate from peak expansion in 2011, and sectors such as financial, business and health services experienced weaker growth.

The information services sector was the only area where growth significantly accelerated last year. Print publishing, which had declined sharply in previous years, accounted for much of the leveling off, along with a strong increase in data processing and telecommunications services.

Fiscal uncertainty was a constant throughout 2013, from federal budget sequestration cuts in the spring to furloughs in the summer and the federal government shutdown in October. This led to declines in federal government jobs, and even more importantly, to reduced economic growth among private contractors that provide goods and services to the federal government.

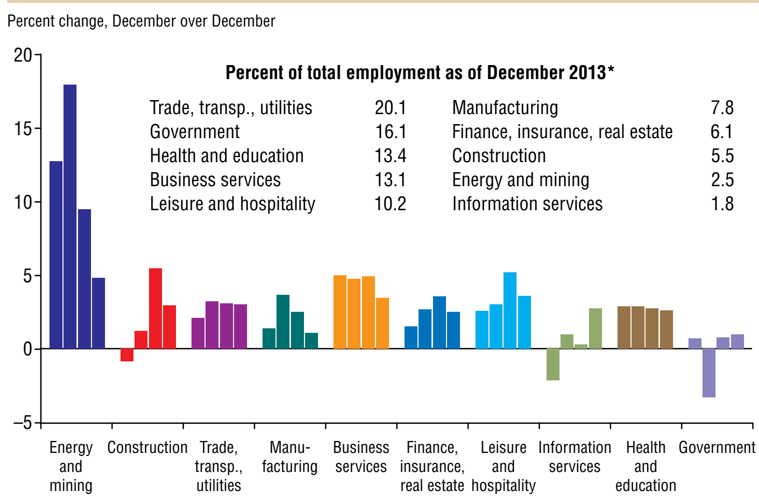
Nationally, on-budget federal outlays fell 11.3 percent from 2012 levels, which likely impacted Texas about as much as other states, as year-over-year federal government employment in December 2013 declined 2.7 percent in Texas and 2.8 percent nationally. State and local government jobs, on the other hand, which make up nearly 90 percent of total government employment in Texas, increased slightly, growing at an annual 1.4 percent rate through December.

Chart 2 Texas Jobs Continue to Grow Beyond 2008 Peak



SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Chart 3 Most Texas Industries Slowed in 2013
(Annual job growth by year, 2010–13)



*Not all industries included; percentages do not total 100.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Manufacturing Year-End Pickup

Manufacturing experienced very sluggish growth during 2013, with a moderate pickup toward year-end. Until October, sector employment was virtually unchanged. Jobs in manufacturing of durable goods fell slightly, while those involved in nondurable goods remained flat. Much of this is attributable to flat exports, a consequence of continued weakness of the world economy. In particular, the Mexican economy, which accounts for more than one-third of Texas exports, contracted 2.7 percent in the second quarter.

However, exports picked up in the second half of 2013, rising by an annualized 16.6 percent. Much of this growth came from Latin America and the European Union, where exports grew at a six-month annualized rate of 9.2 percent and 75.4 percent, respectively. This was closely related to an increase in Texas manufacturing employment, which expanded at a 4.9 percent annualized rate from September through December. Additionally, the Federal Reserve Bank of Dallas' Texas Manufacturing Outlook Survey employment index was consistently positive beginning in June 2013. If current trends hold and Texas exports maintain strong growth, manufacturing employment should continue expanding during 2014.

Energy Remains Strong

Measures of the energy industry suggest that, even while moderating in 2013, the sector remained strong. Job growth in energy extraction slowed to 4.9 percent in 2013 from a 9.5 percent rise in 2012 (*see Chart 3*). Oil and gas prices were higher in 2013 than in 2012, but the rig count was generally flat after declining in the second half of 2012 (*Chart 4*). Even though natural gas prices increased 35.4 percent to an average of $3.75 per million British thermal units (mmBtu), prices remained near historical lows. As a result, much of the drilling activity was concentrated in oil-producing areas, such as the Eagle Ford Shale in south central Texas and the Permian Basin in West Texas, and was less focused on natural gas regions, such as the Barnett Shale in north central Texas.

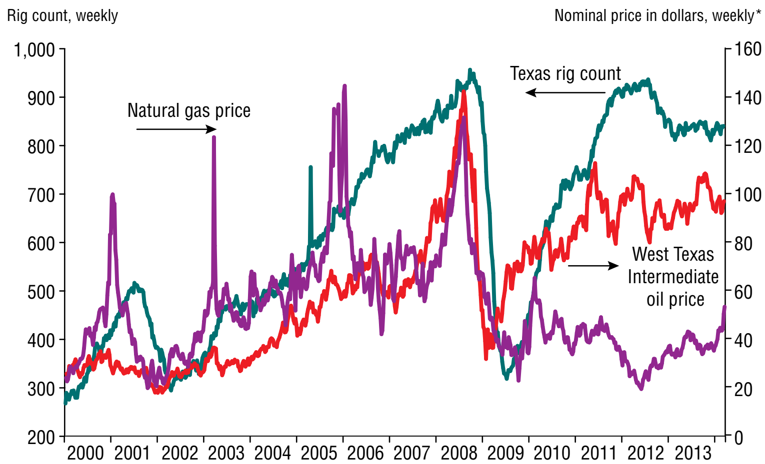
Abnormally cold weather and the resulting high heating-related demand have spiked natural gas prices this winter. However, prices are expected to return to previous levels as the weather warms up.

Average monthly drilling permits issued increased 6.6 percent in 2013 in the Eagle Ford Shale, reaching a new high, while in the Barnett Shale, permits fell 20.5 percent and were off 76.9 percent from their 2008 peak.

Drilling permits in the Permian Basin peaked in 2012 and declined in 2013. Because the region is experiencing a shift from traditional drilling to more expensive and productive horizontal hydraulic fracturing, the drop isn't likely representative of the value and production of drilling, which probably increased.

The energy sector should remain strong in 2014, with job growth the same as or slightly slower than in 2013. While oil and gas prices increased at the end of 2013, oil prices for benchmark West Texas Intermediate (WTI) crude have been generally stable at close to $100 per barrel. Natural gas was near $4 per mmBtu before winter demand pushed it

Chart 4 Rig Count Flat, Oil and Gas Prices Up From 2012 Levels



*Oil price is in dollars per barrel; natural gas price is in dollars per mmBtu and is multiplied by 10.
SOURCES: Baker Hughes; *Wall Street Journal*; Haver Analytics.

Addressing How Real GDP Is Measured for Texas

Real gross domestic product (RGDP) estimates produced by the U.S. Bureau of Economic Analysis (BEA) are an important data source for state economies. While not very timely, RGDP is a comprehensive measure of the value added of goods and services produced in a state.

In the estimates for Texas, the portion attributable to oil and gas extraction is puzzling. It is strongly negatively correlated with oil prices and with factors of production such as energy employment and the drilling rig count. For example, as energy prices collapsed in 2008–09, Texas energy employment slipped 12.8 percent, the rig count fell 73 percent and oil and gas production dropped. Nonetheless, the BEA's estimate of RGDP from oil and gas extraction grew 24.6 percent, calling into question the accuracy of the estimates for the sector.

A recent Dallas Fed working paper explores several potential alternatives to the official BEA estimates.[1] Several approximations of RGDP in oil and gas extraction are used to see which might be a good substitute for BEA-produced estimates. A measure based on changes in Texas' physical production of oil and gas generates an estimate that appears more reasonable and is positively correlated with energy employment and the rig count. Also, substituting this alternative measure yields an estimate of total RGDP that is more highly correlated with Texas job growth.

Note

[1] See "A Closer Look at Potential Distortions in State RGDP: The Case of the Texas Energy Sector," by Keith Phillips, Raul Hernandez and Benjamin Scheiner, Federal Reserve Bank of Dallas, Research Department Working Paper no. 1308, October 2013.

past $5. If prices remain near their 2013 levels, the rig count is likely to stay near the high levels of 2013, and the overall pace of activity will be similar to last year.

However, with the increased production observed last year and a lack of corresponding growth in pipeline and refining capacity, 2014 will likely see further increases in the midstream (transport and marketing) and downstream (refining and processing) sectors. This expansion will bolster overall economic growth. Still, the U.S. Energy Information Administration estimates that the price difference between WTI and the costlier Brent crude (the European light, sweet crude benchmark), which averaged $13 per barrel in January, will persist throughout 2014.

Construction Moderates

Construction job growth slowed from a very strong 5.5 percent in 2012 to a healthy but more moderate 3 percent last year (*see Chart 3*). The deceleration was concentrated in residential construction. While average monthly residential contract values rose 12.8 percent in 2013, that was down from a 27 percent increase in 2012. This year, residential construction is likely to continue expanding but at a slower pace. Mortgage rates increased during 2013, ending the year at 4.5 percent for 30-year fixed obligations, compared with 3.4 percent at the beginning of the year. The rise in mortgage rates as well as increasing home prices means that potential buyers could face more difficulty qualifying for mortgages. This is likely why seasonally adjusted single-family building permits fell 1.2 percent in the three months ended in December from the previous three-month period.

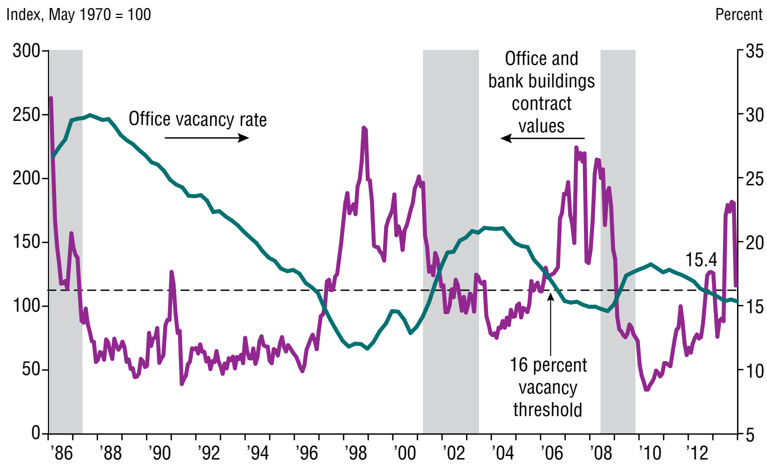
Meanwhile, a pickup in nonresidential construction is probable. The aggregated office vacancy rate for the Houston, Dallas, Fort Worth, Austin and San Antonio office markets fell below 16 percent in first quarter 2013 and remained there for the year, closing at 15.4 percent in the fourth quarter (*Chart 5*). In the past, growth in office-market construction occurred when vacancy rates fell below 16 percent. Given expected state economic expansion and tightness in office vacancies, construction should continue growing strongly in 2014.

Mixed Government Results

Government job growth in 2013 in Texas varied widely: While federal jobs fell 2.7 percent, state government saw no net change, and local government employment increased nearly 2 percent. Federal budget cuts led to a persistent decline in federal employment through much of 2013. This drag extended beyond the immediate sector, as industries that rely heavily on federal revenue experienced difficulty as well. Cuts to private-sector contractors and research organizations account for some of the weaker growth seen in other industries.

Federal government contracts are more likely concentrated in areas with larger numbers of federal jobs. El Paso, San Antonio and the Mexico border region (McAllen–Edinburg–Mission, Brownsville–Harlingen and Laredo) have more than twice the average share of federal government employment as the state average and, with the exception of Laredo, all grew more slowly than the state in 2013 (*Chart 6*). These areas also have a higher proportion of jobs in health

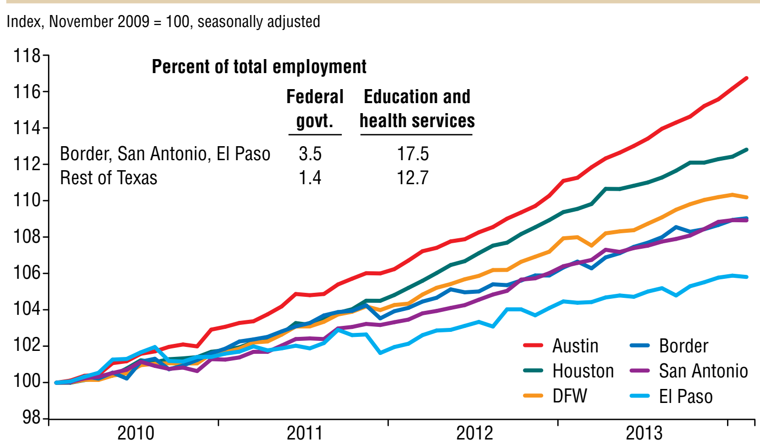
Chart 5 Low Vacancy Rate Suggests Further Growth in Office Construction



NOTE: Shading represents Texas recessions.

SOURCES: CBRE Commercial Real Estate Resources; McGraw-Hill Construction (www.construction.com/dodge/dodge-market-research.asp).

Chart 6 Areas With Large Federal Presence Grow More Slowly

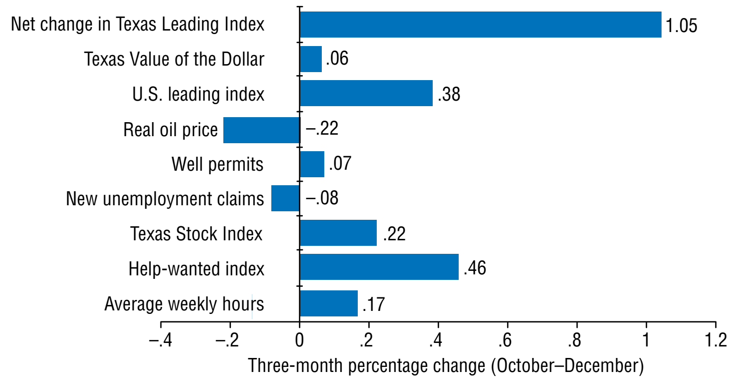


SOURCES: Bureau of Labor Statistics; Texas Workforce Commission.

care, which was negatively impacted last year by declining federal government grants and contracts.

Meanwhile, employment at state universities and public schools increased 1.9 percent, buoying overall government job growth. Although state and local government jobs expanded, they remain 1.6 percent below their peak in November 2010. The state budget is in good shape as 2014 unfolds, and net revenues (excluding trust funds) have increased 4.6 percent since the 2012 fiscal year. Continued state economic expansion, along with gains in property values, suggests that state and local tax revenues and jobs will continue growing at a healthy pace in 2014.

Chart 7 Texas Leading Index Components Point to Growth



NOTE: Overall index, 1987 = 100; December 2013 = 128.6.

SOURCES: Federal Reserve Bank of Dallas; Conference Board; *Wall Street Journal*; Texas Railroad Commission; Texas Workforce Commission; Bloomberg; Bureau of Labor Statistics; authors' calculations.

Indexes Pointing Higher

The Texas Leading Index combines movements in key state economic indicators and is used to forecast Texas job growth. Movements in the index's components in the three months ended in December have been positive, with the exceptions of slightly lower oil prices and somewhat higher unemployment claims, which result in a negative contribution (*Chart 7*). The strongest of the index's components was a three-month increase in help-wanted advertising in the state as measured by the Conference Board. Despite the slight increase in initial claims for unemployment insurance, this reflects an overal positive job outlook.

The gain in the U.S. leading index suggests that the national economy will improve this year, boosting demand for products and services produced in Texas. The stock prices of companies with a large presence in Texas also rose, indicating encouraging prospects for earnings growth and potential gains in employment and capital spending. An increase in average weekly hours worked in manufacturing and a slight decrease in the Texas export-weighted real Value of the Dollar are positive signs for Texas manufacturing.[1] Leading indicators of the energy sector were mixed, with drilling well permits up and oil prices down.

Movements in the Texas Leading Index are consistent with changes in Texas business outlooks measured by the Dallas Fed's Texas manufacturing, service sector and retail outlook surveys. The business outlook index reading is the difference between the percentage of firms reporting an improved versus worsened company outlook. The manufacturing, service sector and retail outlook indexes all increased in the final two months of the year, with manufacturing and retail outlooks the strongest since February 2012. Overall, all three suggest optimism about additional economic activity this year.

Positive Outlook for 2014

The Texas economy decelerated somewhat in 2013 from its strong performance in 2012. Slowing export growth and reduced federal government expenditures played important roles; moderate slowing was broad-based across most sectors. Despite that, Texas job growth maintained its ranking as the third-fastest in the nation.

2014 should be another good year. With many forecasters expecting improvement in world and U.S. economic activity, Texas should benefit as demand for its products and services increases. Federal government spending is unlikely to decline as much as in 2013. Recent increases in the Texas Leading Index have been strong and broad-based. Index gains along with a pickup in job growth suggest that 2014 employment will increase by 2.5 to 3.5 percent. Texas will likely continue growing faster than the national average and most other states.

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Note

[1] A decline in the Texas export-weighted real Value of the Dollar results in a positive contribution to the Texas Leading Index since a fall in the dollar makes Texas exports cheaper.