



Recession Arrives in Texas: A Rougher Ride in 2009

By Keith R. Phillips and Jesus Cañas

Through much of 2008, the Texas economy continued to expand while the nation fell into recession. Growth in the energy and high-tech sectors and rising home prices were key factors in making Texas' economy one of the nation's strongest.

In the last half of the year, however, the state's economic conditions deteriorated rapidly. The weakening was primarily due to the deepening global financial crisis and sharp declines in energy prices, high-tech activity and exports.

Based on available data, Texas was in recession when 2009 began and was probably on the brink weeks or months before then. The state's last recession came during the 2001–03 tech bust.

The beginnings and ends of recessions take time to pinpoint because of data revisions and economic noise. This is especially true for state economies because performance measures are less reliable.

Evidence of the current recession

comes from data on jobs and unemployment, composite gauges of current and future economic activity, various industry measures and anecdotal reports from Texas businesses.

These indicators suggest Texas trailed the official December 2007 start of the U.S. recession by at least six months. So far, the state's economic losses have been moderate compared with the rest of the country's, which means Texas is still faring better than the nation as a whole.

A Broad View

Texas' job growth of 0.4 percent in 2008 was greater than the U.S. decline of 1.9 percent and ranked eighth in the nation. However, the employment picture worsened toward the end of the year (*Chart 1*). At annual rates, jobs grew 1.5 percent through June, then declined 0.7 percent in the second half of the year.

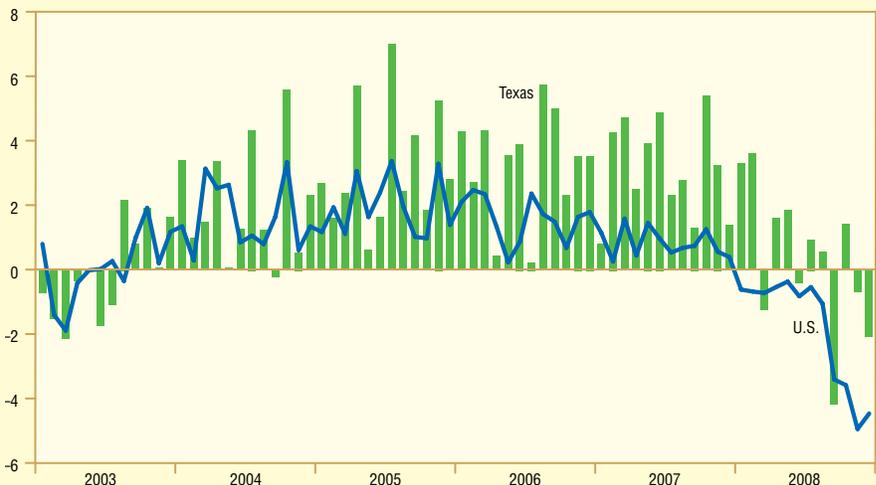
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Chart 1

Texas Loses Jobs in Year's Final Months

Month-over-month, annualized job growth (percent)



NOTE: Data are seasonally adjusted.

SOURCES: Bureau of Labor Statistics; Texas Workforce Commission.

September, the month Hurricane Ike delivered a blow to the Texas coast. It bounced back in October, but cyclical economic factors likely caused declines of 0.7 percent in November and 2.1 percent in December.

As job growth weakened, the Texas unemployment rate rose sharply from 4.4 percent in June to 6 percent in December. This compares with the U.S. rate's increase from 5.6 percent to 6.8 percent.

The roots of the rising unemployment rates are different. In the U.S., much of the increase has been due to lost jobs. In Texas, the rate has climbed because of slower but still positive employment gains and faster labor force growth.

A broad picture of the state's economy comes from the Dallas Fed's Texas Business-Cycle Index, which combines movements in employment, the unemployment rate and gross state product. The index is designed to distinguish between expansion and recession.

A moderate decline in July marked its first drop into negative territory since July 2003, when the state was in recession (*Chart 2*). The index continued falling through December. While it's subject to revision, the index has rarely declined in real time during an expansion period.

A Sectoral View

Some key components of the Texas economy echo the broad measures in showing a sudden weakening in the second half of 2008.

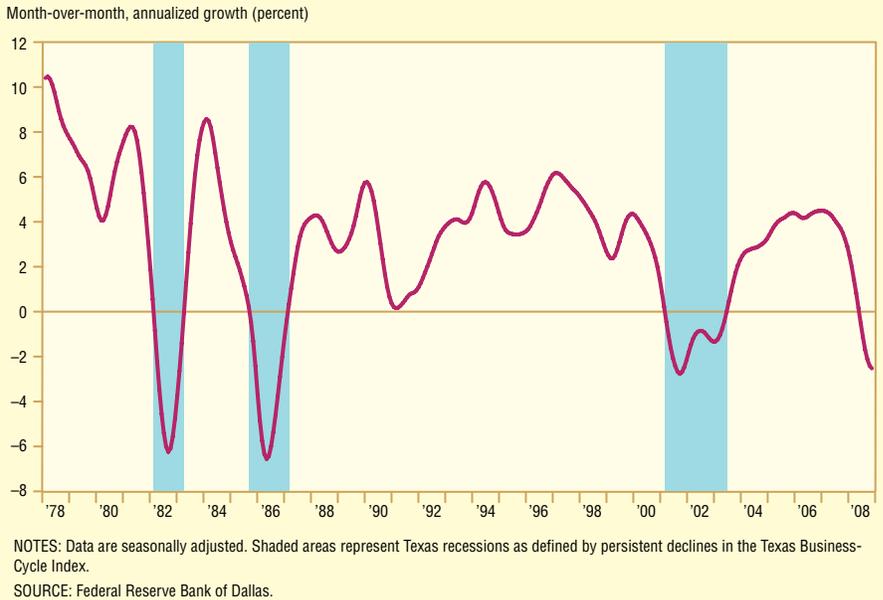
Take exports. Aided by a falling dollar and strong energy industry, they were a bright spot the first six months of 2008, surging 12.4 percent. Compared with a year earlier, sales were up 15.2 percent to Europe, 13.2 percent to Latin America and 5.7 percent to Asia.

However, slower growth overseas and the dollar's rising value have curtailed international demand, and Texas exports fell 16 percent from June to November (*Chart 3*).

Partly due to ebbing overseas sales, Texas manufacturers have experienced steep declines in business. Production, shipments, new orders and capacity utilization measures all fell sharply the final three months of the year, according to the Dallas Fed's Texas Manufacturing Outlook Survey. High-tech manufacturing output data aren't available at the state level, but national measures show this sector was hit hard the second half of 2008.

In the housing market, inventories,

Chart 2
Texas Business-Cycle Index Falls in Second Half of 2008



foreclosures and delinquencies all rose last year—but less in Texas than in the nation. Key to the divergence was home prices. They declined nationally but continued to rise in Texas on a year-over-year basis through the third quarter, according to the Federal Housing Finance Agency's measure of resold homes. Appreciation was broad based across Texas metro areas.

However, these price gains narrowed throughout the year, fading to 0.45 percent

from the second to third quarter. More broadly, the state's housing markets weakened, with new home construction falling sharply last year. Most likely, prices will dip slightly in 2009.

The energy industry was a key factor in the Texas economy's relative strength in the first half of 2008. Texas produces nearly a third of all U.S. natural gas, and it employs almost half the workers in the U.S. oil and gas extraction industry. Primarily

Chart 3
Texas Exports Drop Sharply

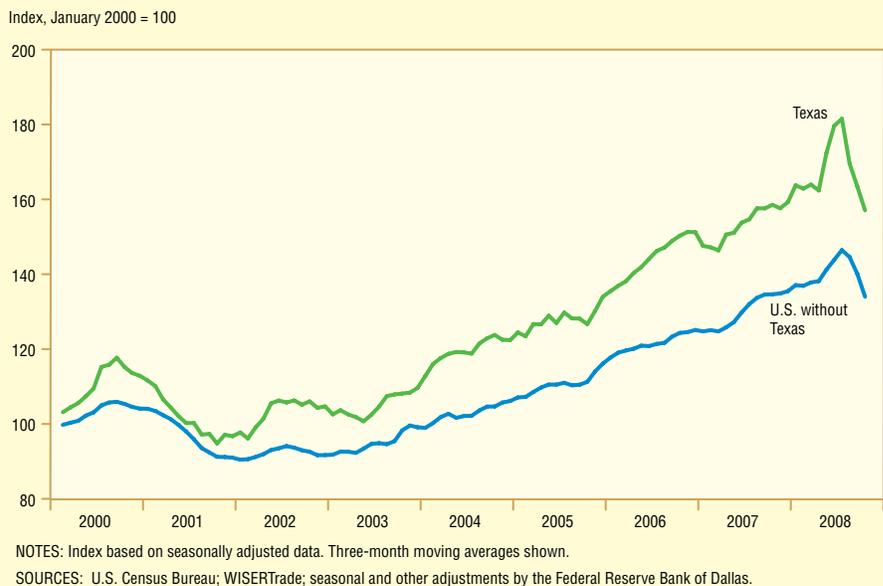
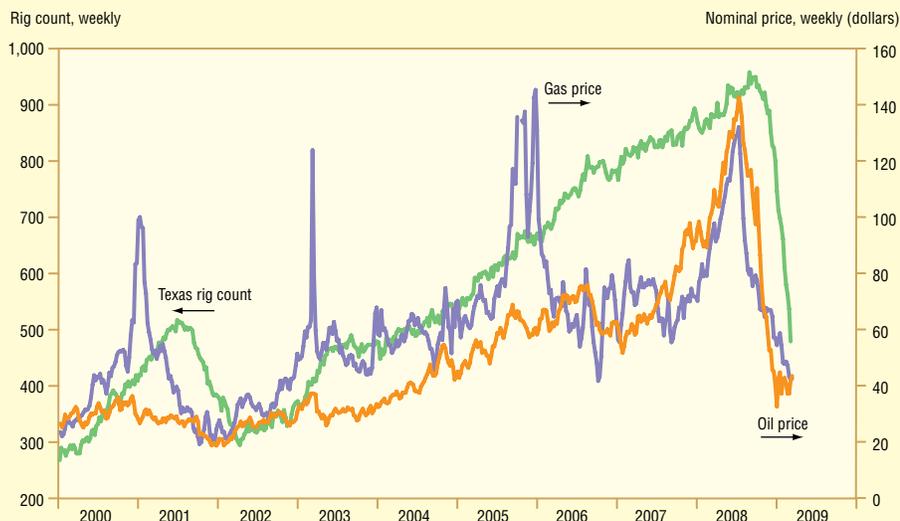


Chart 4
Rapidly Falling Energy Prices Lead to Contraction in Drilling



NOTES: Gas price is multiplied by 10. Oil price is West Texas Intermediate.
 SOURCES: Henry Hub; the *Wall Street Journal*; Baker Hughes.

Table 1
Major Metros Differ in Exposure to Recession

Cyclical industries	Austin	Dallas	Fort Worth	Houston	San Antonio	El Paso
Natural resources and mining	.4	.4	1.1	2.6	.5	.3
Construction	1.2	1.0	1.1	1.4	1.1	1.0
Manufacturing	.8	1.0	1.1	.9	.6	.8
Trade, transportation and utilities	.9	1.0	1.2	1.0	.9	1.1
Wholesale trade	1.2	1.4	1.1	1.2	.8	.9
Retail trade	.9	.9	1.1	.9	1.0	1.2
Information	1.3	1.6	.8	.7	1.2	.9
Financial activities	1.0	1.5	.9	.9	1.3	.7
Finance and insurance	.9	1.6	.9	.8	1.3	.6
Real estate and rental and leasing	1.1	1.4	1.0	1.3	1.2	1.0
Professional and business services	1.1	1.3	.9	1.1	1.0	.9
Noncyclical industries						
Education and health services	1.0	.8	.9	.9	1.1	1.2
Leisure and hospitality	1.0	.9	1.0	.9	1.2	1.0
Public administration	1.3	.5	.6	.5	.8	1.1

NOTE: Figures expressed as location quotients. A quotient of 1 means the city's share of jobs matches the nation's in that industry.
 SOURCE: Texas Workforce Commission Covered Employment and Wages.

because of high prices for natural gas, the Texas rig count by the middle of 2008 was at its highest level since the early 1980s.

The energy stimulus has deteriorated as oil and gas prices have plummeted. As a result, the Texas rig count fell by 410, or 50 percent, from the end of August to the first week of March (*Chart 4*).

The brunt of the decline has been borne by the land-based natural gas industry. The Beige Book, the Federal Reserve's anecdotal report on economic conditions, found that relatively expensive, nonconventional drilling in North Texas' Barnett Shale

and the Permian Basin's tight sands led the upturn—and these areas will lead the downturn as well. Offshore and international activity have held up better and should continue to do so, largely because of the involvement of companies with longer-term perspectives and deeper pockets.

As drilling activity slows, layoffs are becoming widespread in the energy industry and are expected to grow in 2009. Related manufacturing activity is experiencing cutbacks, especially among producers of bits, pipe and tools.

Meanwhile, Texas' financial sector has

expanded over the past several years, adding jobs while the industry has shrunk nationally. However, the current financial crisis will likely impact all regions significantly. Texas' financial-sector job growth has recently declined, and the trend is expected to continue.

In addition, troubled bank loans are increasing in the state, just as they are across the nation. Beige Book respondents continue to warn that a sharp tightening in lending will soon lead to a drop-off in commercial building. The Eleventh Federal Reserve District, which includes Texas and parts of New Mexico and Louisiana, has a high exposure to commercial real estate, at 29.4 percent of loans, compared with 13.9 percent for the nation. (See "*Noteworthy*" on page 15.)

A Metro View

According to the Dallas Fed's business-cycle indexes for Texas' major metro areas, the Austin and Dallas economies have slowed the most in recent months, while Houston has continued to grow.

In 2009, all the major metro areas in Texas will likely experience recessions. Their relative performance depends upon their industrial structures as well as local firms' competitiveness.

Location quotients based on jobs provide a way of looking at metro areas' vulnerability. Each quotient divides the local economy's share of jobs in an industry by the industry's share nationally.

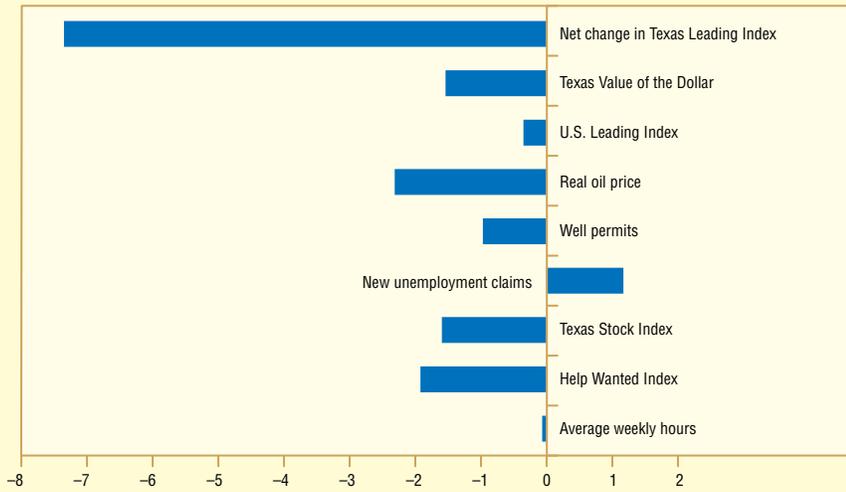
A quotient equal to 1 indicates that a metro area matches the national average for jobs in an industry. If the metro's share is 40 percent larger, the figure is 1.4. Texas metros with high quotients in cyclically volatile industries are likely to be hardest hit in a recession.

Dallas has larger shares of jobs in the finance and insurance and real estate industries, which are at risk in the downturn (*Table 1*). It also has large shares in such cyclically sensitive industries as wholesale trade, information, and professional and business services. Dallas has small shares in noncyclical industries such as health, leisure and government. Austin has large shares in such cyclically sensitive industries as construction, wholesale trade and information.

Based on Beige Book comments, past cyclical swings and the location quotients, Dallas and Austin will probably be hurt the most this year. If energy prices drop much

Chart 5 Texas Leading Index Components Decline Sharply and Broadly

Three-month change (October–December 2008)

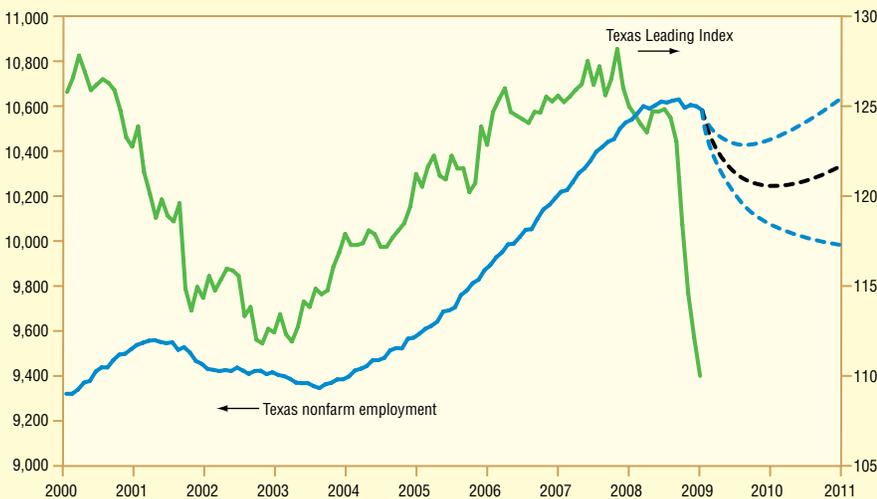


SOURCE: Federal Reserve Bank of Dallas.

Chart 6 Falloff in Texas Leading Index Suggests Job Losses Highly Likely

Thousands of jobs

Index, October 1971 = 100



NOTE: Broken lines represent the nonfarm employment forecast based on TLI, with an 80 percent confidence band.
SOURCE: Federal Reserve Bank of Dallas.

further, then Houston, with its heavy share of activity in natural resources and mining, will likely decline sharply as well.

The Forecast

The Texas Leading Index (TLI), the Dallas Fed's barometer of future economic activity, has weakened significantly in recent months. All but one of its eight indicators—new unemployment claims—declined the last three months of 2008 (*Chart 5*).

The biggest negative contributors have been the slide in real oil prices, sharp decline in help-wanted advertising, increase in the Texas export-weighted value of the dollar and decline in the stock index of Texas-based companies.

The stock index tumbled 37 percent from June to January, compared with a 35 percent decline in the Standard & Poor's 500. The performance likely reflects the steep drop in energy stock prices, which

have a heavier weight in the Texas index.

Based on TLI forecasts, Texas' nonfarm employment will decrease through March 2010—with the worst of it coming in the first six months of this year. The model estimates that jobs will recede at an annual rate of 3.9 percent through June, then improve to a 1.6 percent decline in the second half (*Chart 6*).

For all of 2009, the forecast is for employment to fall 2.8 percent, the equivalent of 296,000 jobs. Based on historical observation, this job loss is consistent with a rise in the unemployment rate to about 8 percent.

In sum, 2009 will be a difficult year in Texas as the state deals with the repercussions of the deep financial crisis plaguing the national and global economies.

Energy prices are hard to predict, and big movements could change the state's short-term outlook. At the same time, improvements in world financial markets and overall economic growth would enhance the state's growth prospects, particularly in the second half of the year.

While the short-term Texas outlook is weak, longer-term prospects remain healthy. Job growth, low business and living costs, and a young, fast-growing labor force remain positives that will help in recovery.

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Notes

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The business cycle and other indicators mentioned in this article can be found on the Federal Reserve Bank of Dallas website at <http://dallasfed.org/research/index.html>.