

Crossroads

ECONOMIC TRENDS IN THE DESERT SOUTHWEST

New Mexico Recovery Still Struggles in 2012

New Mexico has a long history of growing faster than the rest of the United States. The number of workers on statewide payrolls grew at 2.2 percent annually from 1990 to 2007, for example, while U.S. payrolls averaged only 1.4 percent growth over the same period. Since the U.S. economy bottomed out in June 2009, however, New Mexico has struggled to keep up with even the modest U.S. recovery that is now under way. So far, the national recovery has restored only 40 percent of the 8.8 million jobs lost to the Great Recession. New Mexico's job losses were similar to those of the U.S. if measured in percentage terms, but the state's performance in restoring lost jobs has been much poorer than the U.S.'s, adding back only 11 percent of the 52,700 jobs lost. New Mexico's recovery is still struggling to gain traction.

Among New Mexico's metropolitan areas, Albuquerque, Farmington and Santa Fe were all major contributors to job losses during the decline, but none except Santa Fe has been able to set a consistent trend toward job growth (*Chart 1*). Albuquerque is by far the largest metro area in New Mexico, and it lost 27,400 jobs, or 6.9 percent of its total payroll employment, by year-end 2011, and it has yet to give a clear signal that job losses have ended. The picture is similar in Farmington, with an 8.8 percent decline in jobs. Santa Fe lost 8.9 percent of its payroll employment and has added back just over one-third of the losses.

Las Cruces in southern New Mexico presents a different story. Although employment peaked near 70,000 in May 2008, the number of payroll jobs never declined significantly. But neither has it grown, as monthly employment has held steady near peak levels. Proximity to a strongly growing El Paso, Texas, certainly helped Las Cruces, which serves as a bedroom community for many El Paso workers. A large and relatively stable base of university and federal employees also helped minimize job loss, as did a strong farm sector. Las Cruces' cotton, pecans and chiles all earned windfall profits from rising commodity prices.

Continued economic weakness in New Mexico

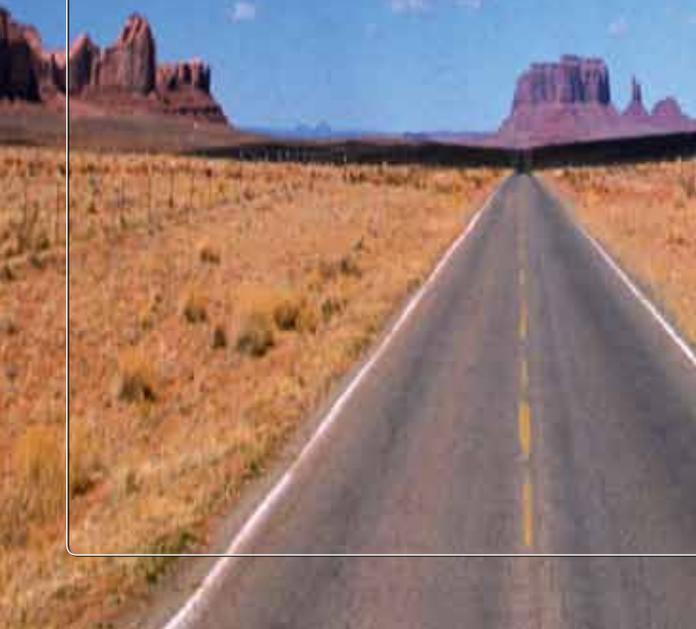
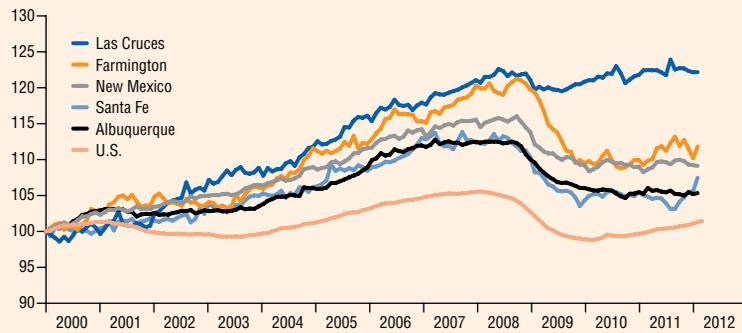


Chart 1
New Mexico Metros Swept into Recession, Struggle to Add Back Jobs

Nonfarm employment index, January 2000 = 100*



*Seasonally adjusted.
 SOURCE: Bureau of Labor Statistics.

has much in common with the struggles of the U.S. economy, particularly in the depth and scope of its housing downturn. After 2000, New Mexico became an attractive target for relocation by homeowners from states such as California and Florida, many of whom cashed out of rapidly rising housing markets and came to retire, start businesses or invest in New Mexico real estate. Although the bulk of New Mexico's population is in the northern half of the state, the southern city of Las Cruces perhaps flew the highest of all the state's real estate markets. Found at the top of many lists of the best places to live, retire or start a business, Las Cruces was a potent magnet for relocation from out of state. When the U.S. housing market crashed, the relocations stopped, and the overheated and overbuilt New Mexico housing markets crashed as well. The housing decline was widely shared across the state.

We currently see a significant difference between the economic performance of the northern and southern halves of New Mexico. Chart 2 compares employment in the northern half of New Mexico (from metro Albuquerque northward; see map) with employment in the south. The north clearly suffered a deeper recession and has seen a weaker recovery than

its southern neighbor. The data in Chart 2, from a household survey of employment conducted by telephone, form the basis of national and state unemployment measures. The data allow us to count the number of jobs monthly in New Mexico's four metropolitan areas, as well as in 15 micropolitan areas or smaller cities, 10 of which are in the less populous south. Just as rising agricultural prices benefitted Las Cruces, rising commodity prices have similarly supported other southern New Mexico communities—copper in Silver City, potash in Carlsbad, milk and cheese in Artesia and especially oil near Hobbs. Housing problems may

continue throughout New Mexico, but the ongoing global commodity boom has helped to offset the damage in communities of the south.

New Mexico is a small, open economy. It has about 800,000 workers, equivalent to Fort Worth or San Antonio, Texas. Its economic fate is subject to much larger external forces, such as the influence of emerging markets on commodity prices; oil and natural gas markets; and the U.S. economy. A careful look at each of these external forces helps us better understand New Mexico's current economic position, as well as its economic outlook for 2012 and beyond.

Emerging Markets

The rapid expansion of emerging markets such as Brazil, China and India has provided forward momentum to many of the commodity-based local economies of New Mexico. Chart 3 shows how rising oil prices led the upward push in commodity prices from 2003 to 2008, with metals trailing just behind. The commodity boom was interrupted by the global recession in 2009, but oil has once again led a surge upward.

High and rising commodity prices are often attributed to a

Chart 2
Total Employment — North vs. South

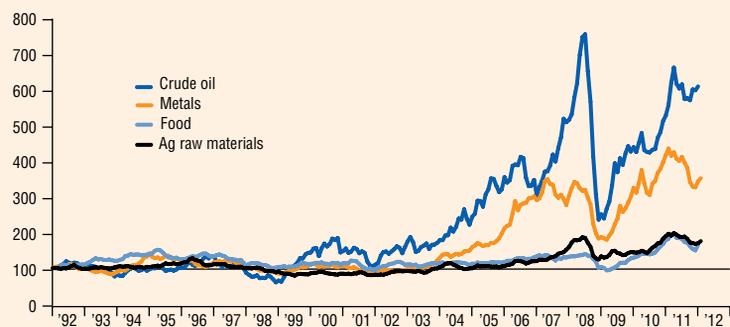
Index, January 2006 = 100



SOURCE: Bureau of Labor Statistics.

Chart 3 Oil Is Part of a Wider Boom in Commodity Prices

Index, 1992 = 100



SOURCE: International Monetary Fund.

slowdown in developing countries is already taking some of the air out from under commodity prices, as shown in Chart 3.³

Oil Versus Natural Gas

The past three years have been a remarkable period for the energy industry and for energy development in New Mexico. Recent years have been marked by high oil prices, the development of technology to take advantage of these high prices, and extraordinary differences between how the market has valued oil versus natural gas. This has worked to generate significant profits for New Mexico's oil producers, while hurting natural gas producers and increasing the wedge between the economic performance of northern and southern New Mexico.

During 2009, U.S. drilling activity was cut in half by the financial crisis and recession. In recent months, the domestic rig count has returned to prior peak levels of drilling activity. However, the route to complete recovery in drilling has been complicated, and the rig count of 2012 is not comparable to the rig count of 2008. What happened?

- New technology using horizontal drilling and fracturing was first widely applied in the 1990s to produce natural gas from shale. It

variety of causes, including low interest rates and a depreciating dollar. But there is little doubt that the growth of emerging countries is the dominant factor. The International Monetary Fund estimates that from 2001 to 2007 these countries accounted for half the increase in oil consumption, all the increase in aluminum and copper use and nearly all the growth in the consumption of major food crops.¹

Table 1 is a recent economic forecast from the Organization for Economic Cooperation and Development's (OECD) *Economic Outlook* published in December.² Note how quickly the emerging countries of Brazil, China and India bounced back from the global downturn in 2010 and 2011, compared with the developed nations that limped out of recession. In the 2012 and 2013 forecasts, the same fast/slow pattern continues, except Brazil sees growth cut in half after 2010. Even so, its 3.0–4.0 percent growth is better than any of the developed regions listed in the table.

Some potential risks to commodity prices (and to the New Mexico economy) can be read from Table 1. First, some countries in the euro zone fall into or remain in recession, although the entire region skirts a down-

turn. Second, 2012 is the second year of slowdown for the emerging countries. Some of this is deliberate. Their central banks reacted to rising inflation and have engineered slower growth through higher interest rates. This forecast assumes this policy leads to a soft landing, not slowing these economies too much, and that no real estate or banking bubbles burst in response to tighter credit.

The table also points to less global stimulus for New Mexico in 2012. The risk of a crisis in Europe should work to keep the dollar relatively strong, perhaps lowering oil prices and hurting regional exports. The modest

Table 1
Global Growth Slows in 2012 Forecast

	GDP growth (percent)			
	2010	2011	2012*	2013*
Developed economies				
Europe	1.4	0.9	0.6	1.7
Japan	1.6	0.8	1.7	1.6
U.S.	2.5	1.5	2.0	2.7
Emerging economies				
Brazil	7.5	3.4	3.2	3.9
China	10.4	9.3	8.5	9.5
India	9.9	7.7	7.2	8.2

*These numbers are forecasts.
SOURCE: "OECD Economic Outlook No. 90," OECD Economic Outlook: Statistics and Projections database, December 2011.



proved enormously successful in bringing new supplies of natural gas online, with U.S.-marketed production rising nationwide by one-third between 2006 and 2011. Unlike oil, natural gas is not traded internationally, and large new supplies of natural gas trapped in a weak U.S. economy brought the price of natural gas down to \$3–\$4 per thousand cubic feet (Mcf). Natural gas has become a bargain for the consumer and a drag on profits for the producer.

- High oil prices invited new technology for oil production, and horizontal drilling and fracturing, along with other innovative techniques, were successful in producing large quantities of crude oil from shale, as well as natural gas liquids such as ethane, propane and butane. Since January 2007, the share of working rigs engaged in horizontal drilling has grown from less than 20 percent of activity to 59 percent.

- Strong financial incentives to drill for oil, and the new technology to do so, have prompted U.S. producers to shift away from gas-directed to oil-directed drilling. Between December 1999 and December 2008, only 17 percent of active U.S. rigs drilled for oil. Today over 60 percent of working rigs are directed to oil and other liquids.

Drilling activity in New Mexico is found mostly in two regions. The northwest corner of

New Mexico around Farmington is a heavy gas-producing area, using traditional vertical drilling methods.⁴ Cheaper production from shale and the sharp drop in the price of natural gas have kept this region near crisis-level lows in drilling activity, with only a dozen active rigs, even though the U.S. and New Mexico rig counts have risen sharply. Oil-directed rigs and the use of horizontal drilling remain rare.

The reduced activity around Farmington has been a key contributor to the general decline in natural gas production in New Mexico (*Chart 4*). The fall in the volume of gas produced, along with the sharp decline in natural gas price, contributes to significant losses in state government revenue. A 10 cent change in the price of natural gas translates into an \$11 million change in general revenue for the state.⁵ The price of natural gas averaged near \$8 per Mcf in 2007 versus \$4 in 2011.

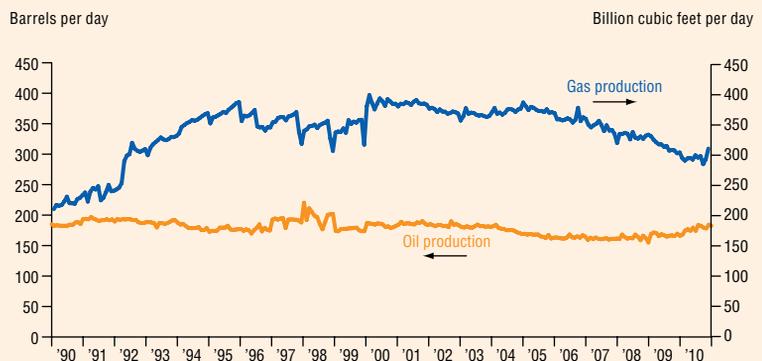
The southeast corner of New Mexico is part of the Permian Basin, one of the largest and oldest oil fields in the U.S. Revitalized by high oil prices and new technology, the rig count in New Mexico has rebounded sharply on the basis of activity in this area, with virtually all the increase in activity directed to oil (*Chart 5*) and

using the new horizontal drilling methods (*Chart 6*). Oil-directed activity has spread from the Hobbs area and across southern New Mexico into Artesia, Carlsbad and other communities. The state's energy and mining sector has added 4,000 jobs since September 2009, while all other sectors of the state economy combined have added 2,400 over the same period. Southern New Mexico is the chief beneficiary of the ongoing surge in commodity prices.

U.S. Provides Little Stimulus

The U.S. recovery from the Great Recession has been slow and uneven. The best and broadest measure of the U.S. economy is gross domestic product (GDP), and through 10 consecutive quarters of recovery, the average annual growth rate has been only 2.5 percent. Before the crisis, the potential long-term growth rate of the U.S. economy was well above 3.0 percent, but even this is slower than the pace at which an economy with so many slack resources—8.5 percent of the workforce unemployed and 35 percent of factory capacity unused—should be capable of growing. Given the sharp, deep recession we suffered, the recovery was expected to be much faster.

Chart 4
Gas Production Declines; Oil Holds Steady



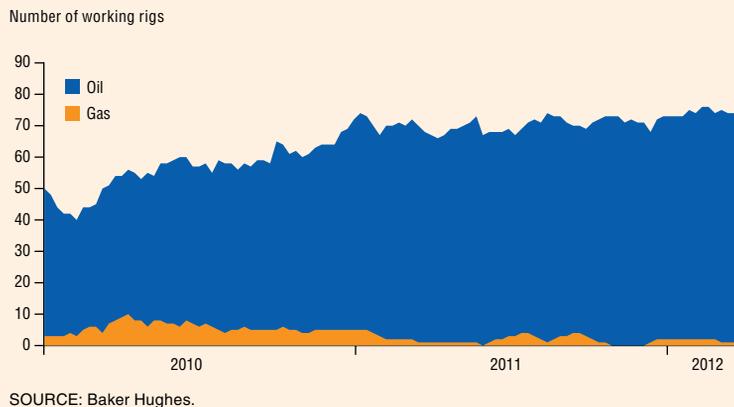
SOURCE: New Mexico Oil Conservation Division.

However, this was not a typical recession, as it was accompanied by the first U.S. financial crisis since the Great Depression, and a pattern of slow recovery often follows on the heels of a financial collapse. A recent study of 88 countries that have passed through a significant financial crisis showed a strong and consistent tendency for the pace of their recoveries to fall well below the growth trend that prevailed before the crisis. On average, there was a permanent loss of 6–8 percent of GDP incurred over several years compared with where these countries would have been if there had been no crisis.⁶ In fact, the U.S. recovery tracks quite closely with the average of the 88 cases studied, making this recovery an entirely representative example of what happens when financial institutions are damaged, credit tightens and speculative excesses must be corrected.

Large sectors of the U.S. economy still have much work to do to repair the financial and speculative damage of 2008. For example, we should be building a million or more new homes per year in a healthy economy, and today we are building only 400,000. New Mexico is typical of too many U.S. housing markets, with high foreclosure rates and home prices still falling in all four of its metropolitan areas (*Chart 7*). Existing-home sales appear to have bottomed out but show no signs of an upturn. And no upturn can be expected before home prices stabilize because potential homebuyers are unlikely to buy an expensive asset today that will be cheaper tomorrow.

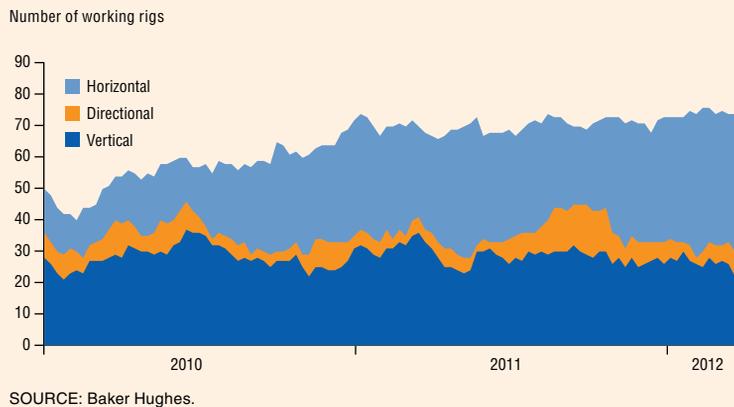
Or consider the U.S. consumer, with a debt-to-income ratio of 90 percent in 2000, peaking at 130 percent in 2008, and today worked down to 110 percent. This means constraints on household spending as more debt is paid down and deleveraging continues. The ability to borrow against home equity, which was jet fuel for the con-

Chart 5
Drilling in Southeast New Mexico Directed to Oil



SOURCE: Baker Hughes.

Chart 6
Horizontal Drilling Leads Recovery in New Mexico's Permian Basin



SOURCE: Baker Hughes.

sumption binge that led up to the crisis, is now greatly diminished. Losses of wealth from falling home prices and the stock market now force the consumer to spend less and save for long-term needs such as retirement or college education. Nationally, core retail sales (excluding autos and gasoline) have settled into a moderate pace near 4 percent per year, far slower than the precrisis growth rates. So far, there is no recovery in New Mexico spending as retail sales continue to slowly decline, now down about 15 percent from the peak (*Chart 8*).

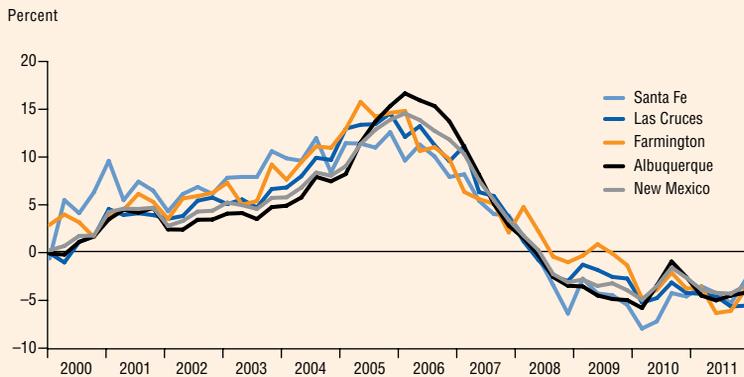
Despite recent data on the U.S. economy indicating that growth may have strengthened

significantly in recent months, it is difficult to see a sharp break with the mold of moderate expansion set since 2009. Most forecasters expect only a small pickup in growth this year.⁷ New Mexico, a laggard in the recovery, will receive little additional stimulus in 2012 from the U.S. recovery.

Conclusion

The New Mexico economy continues to languish, having added back only 11 percent of the nearly 55,000 jobs lost to the downturn. New Mexico was hit hard by the housing crisis and is working through a backlog of foreclosures. Falling home prices persist across the state, suggesting that stable

Chart 7
Home Prices Still Falling in New Mexico Metro Areas
(Year-over-year price changes)



SOURCE: Haver Analytics, Federal Housing Finance Agency House Price Index.

Chart 8
New Mexico Retail Sales Remain Weak
(Index of real seasonally adjusted sales)

Index, 2000:Q1 = 100



SOURCE: Bureau of Business and Economic Research, University of New Mexico.

housing markets and a turnaround in sales are many months away. The bright spot for the state is high and rising commodity prices, driven by the powerful growth of emerging markets. The benefits of high commodity prices have been felt disproportionately in the southern half of the state.

With New Mexico housing markets still healing, stimulus from the U.S. economy still modest and commodity prices perhaps backing off a bit in 2012, New Mexico's current slow recovery seems likely to continue into 2013.

—Monica Bonilla-Romero
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Notes

- ¹ "Riding a Wave," by Thomas Helbling, Valerie Mercer-Blackman and Kevin Cheng, *Finance and Development*, vol. 45, no.1, 2008.
- ² "OECD Economic Outlook No. 90," OECD Economic Outlook: Statistics and Projections database, December 2011.
- ³ Oil prices rose sharply in March, responding to a combination of strong fundamentals in oil markets and the threat of violence in the Middle East. Continued political risk will keep oil prices high, but also will slow the U.S. economy and possibly put the U.S. expansion at risk.

- ⁴ The Farmington area also produces significant quantities of coal seam gas, using small truck-mounted rigs that are not tracked by Baker Hughes or other counts of drilling activity. However, coal seam gas faces the same low market price as other sources of natural gas and is unlikely to be expanding.
- ⁵ As oil revenues grow, they add about \$3.4 million for every dollar of increase in the price of oil. Historically, natural gas revenues outweighed oil by about two to one. "Oil and Natural Gas," *LFC Finance Facts: Understanding State Financial Policy*, New Mexico Legislative Finance Committee, October 2008, www.nmlegis.gov/lcs/lfc/lfedocs/finance%20facts%20oil%20and%20gas.pdf.
- ⁶ "The Sluggish Recovery from the Great Recession: Why There Is No 'V' Rebound This Time," by Mark A. Wynne, Federal Reserve Bank of Dallas *Economic Letter*, vol. 6, no. 9, 2011.
- ⁷ For example, the March 10, 2012, release of the *Blue Chip Economic Indicators* included a small increase in the full-year 2012 forecast of GDP to 2.3 percent, rising to 2.6 percent in 2013.

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