

Crossroads

ECONOMIC TRENDS IN THE DESERT SOUTHWEST

ABSTRACT: Despite the recent sluggishness in the Texas economy, El Paso has had one of its strongest economic performances in the last two years. Local job growth outpaced the state and the nation in both 2015 and 2016. The robust manufacturing sector in Ciudad Juárez has boosted El Paso's service sectors. Additionally, health services is becoming a new economic driver for the local economy. El Paso's above-average growth has continued into 2017; however, El Paso's economy faces increased headwinds. A weaker Mexican economy, along with increased uncertainty, may pose challenges going forward.

El Paso Booms, Headwinds Increase

by Marycruz De León and Jesus Mendoza-Hernandez

In 2015, despite a soft Texas economy, El Paso's non-farm payrolls grew at their fastest pace since the Great Recession. This extended through 2016, with the metro adding over 6,000 jobs last year, and has continued into 2017 with over 4,000 jobs created in the first nine months of the year.¹ Employment gains in the metro have been broad based within the private sector, but much of the growth stems from flourishing manufacturing activity in Ciudad Juárez and the fast-growing regional health care sector.

Job growth is just one measure when considering the overall health of the El Paso economy. The El Paso Business-Cycle Index (BCI), a coincident index produced by the Federal Reserve Bank of Dallas, provides a broader view of the regional economy by including other key regional economic indicators such as the unemployment rate, real wages and real retail sales.² El Paso's BCI shows that after the Great Recession, the local economy expanded steadily until 2015 when it boomed and post-

ed growth of 3.8 percent (*Chart 1*). El Paso's economy slightly decelerated in 2016, but nonetheless still experienced strong growth of 2.1 percent. Growth through September 2017 has picked up and stands at 2.6 percent annualized. Although the overall recent story of the local economy is one of significant growth, analyzing the components of the BCI can shed more light on current economic trends.

Historically, El Paso's labor market has expanded faster than the U.S.' but slower than the Texas labor market. For instance, from 1990 to 2016, the local labor market grew approximately 1.6 percent annually compared with the nation at 1.1 percent and Texas at 2.1 percent. However, the recent steep decline in oil prices, coupled with the strength of the dollar—resulting in weaker exports—has decelerated the Texas economy, while El Paso's economy expanded strongly.³ In 2015, El Paso payroll employment grew 2.8 percent, more than twice as fast as the state's growth of 1.3 percent. The above-average gains continued

into 2016; El Paso added over 6,000 jobs in 2016, increasing 2.0 percent. Strong expansion has continued into 2017, with employment rising at a 2.1 percent annualized rate through September. El Paso's unemployment rate stood at 5.1 percent in 2015; it decreased slightly to 4.9 percent in 2016, and by September 2017, had declined even further to 3.7 percent. Unemployment is not only well

below the historical average of 8.6 percent but is also at its lowest point since the 1990s.

El Paso real wages, the total wage bill, rose by 4.6 percent in 2015—the largest increase since the end of the Great Recession. It is likely that the tight labor market, along with expanded economic activity, pushed real wages up. In 2016, real wages increased 1.8 percent.

Real retail sales in El Paso decreased 0.1 percent in 2015 and were nearly unchanged in 2016, rising only 0.3 percent. Retail sales stagnation is likely due to the sharp appreciation of the U.S. dollar against the Mexican peso. Retail sales are an important part of the local economy; this sector constitutes a significant share of total jobs.⁴

Maquiladora Activity Propels El Paso Economy

Real gross domestic product (GDP) is the broadest measure of economic activity at the national level. This indicator suggests that the U.S. economy slowed in 2016 compared with 2015. In 2015, the U.S. economy expanded by 2.0 percent, compared with 1.8 percent in 2016. So far in 2017, the economy has grown at a 2.4 percent average annual rate.

Although the national economy plays an important role in regional economic growth, the most important U.S. economic indicator for El Paso is industrial production, particularly the manufacturing sector. El Paso's economy is closely related to the U.S. industrial sector through the maquiladora industry in Ciudad Juárez. As U.S. industrial production picks up, work orders in Ciudad Juárez maquiladoras also rise and, eventually, demand for services in El Paso also picks up. U.S. industrial production fell starting in December 2014 through March 2016. Since then, it has moved higher.

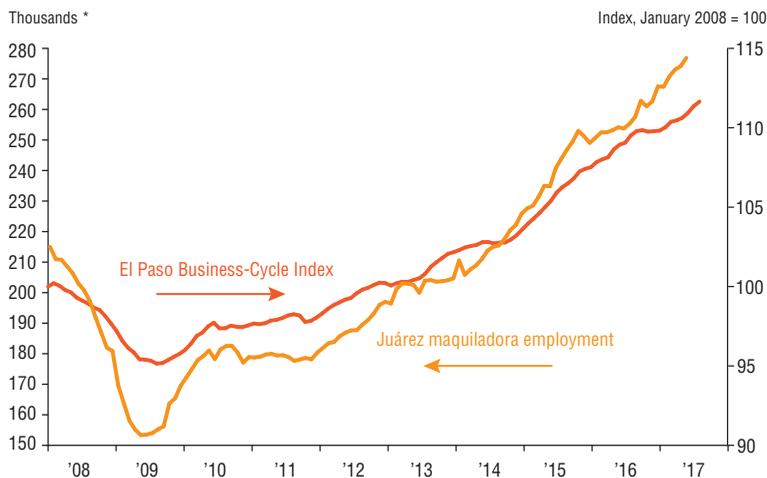
Maquiladora activity in Ciudad Juárez has boomed in recent years; employment has risen 56 percent since 2010 to an all-time high of nearly 280,000 in July of this year (Chart 2). Activity has been so strong that maquiladoras are short of workers. The boom in activity in Ciudad Juárez is partially responsible for the increases in total El Paso employment, particularly in the service sectors. According to Dallas Fed research, a 10 percent hike in maquiladora output in Ciudad Juárez leads to a 2.8 percent increase in nonfarm jobs in El Paso. Most of the created

Chart 1 | El Paso Economy on the Rise



NOTE: The El Paso Business-Cycle Index is a composite index that includes employment, unemployment rate, retail sales and wages.
SOURCE: Federal Reserve Bank of Dallas.

Chart 2 | El Paso BCI Posts Gains as Maquiladora Employment Booms



*Seasonally adjusted.
NOTE: The El Paso Business-Cycle Index is a composite index that includes employment, unemployment rate, retail sales and wages.
SOURCES: Federal Reserve Bank of Dallas; Instituto Nacional de Estadística Geografía e Informática (National Institute of Statistics and Geography).

jobs in El Paso are in service sectors such as transportation, accounting, finance, insurance and real estate.⁵ The boom in manufacturing in Ciudad Juárez boosted the trade, transportation and utilities industry in 2016—adding over 2,700 jobs and accounting for approximately 30 percent of total El Paso jobs gains in 2016.

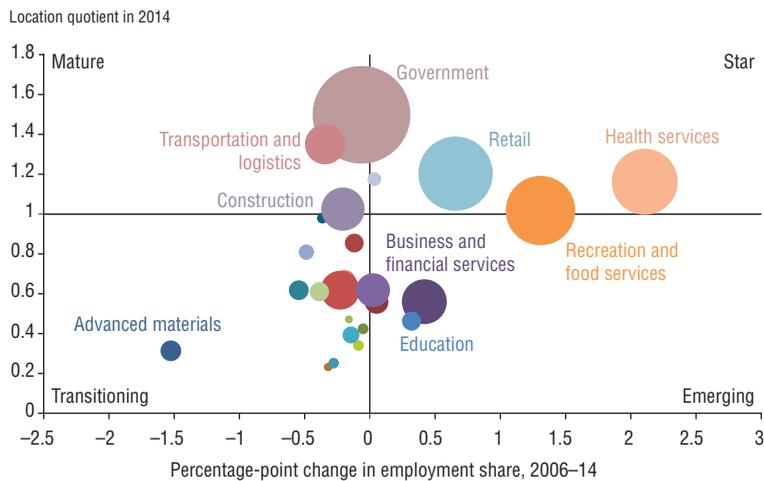
As maquiladora activity has grown, El Paso has become more concentrated in services jobs, which are typically better paying than goods-producing jobs. The higher-paying services jobs are partially responsible for the gains in real per capita personal income. Real per capita personal income in 2015 increased to \$32,598, up 4.9 percent from 2014. However, while the rise in income is good news for the region, and El Paso’s income gap from the rest of the country has decreased in recent years, there is still room for improvement. In 2015, El Paso’s real per capita personal income rose to 67.8 percent of the U.S. average compared with 62.0 percent in 2000.⁶

Fast-Growing Health Services a New Pillar for El Paso’s Economy

Health services has become increasingly important for El Paso’s economy (*Chart 3*). Industry cluster concentration is measured by location quotient (LQ). “Star” clusters such as health services are not only fast growing but are also heavily concentrated relative to the nation (an LQ greater than 1).⁷ Ten years ago, health services represented 1 in 8 jobs in the metro; it now accounts for 1 in 6 jobs. This industry growth is partially linked to the expansion of health care coverage under the Affordable Care Act. The percentage of El Paso’s population without health insurance decreased from 28.8 percent in 2012 to 25.3 percent in 2015.

Both private and public health care enterprises employ a significant number of workers. For instance, University Medical Center employs 2,800 people; Texas Tech University

Chart 3 | El Paso’s Economy Dependent on Government, Retail and Health Sectors



NOTES: Bubble size represents industry share of metropolitan statistical area employment. Clusters in the top half of the chart are referred to as base clusters. They have a larger share of employment relative to the nation and, thus, a location quotient (LQ) exceeding 1. These clusters are usually vital to an area’s economy and can be expanding rapidly (Star) or growing slowly (Mature). Those in the bottom half are less dominant locally than nationally. They generally produce services or goods for local consumption and, hence, have an LQ below 1. “Emerging” clusters are fast growing, while those growing slowly are termed “transitioning.”

SOURCES: Texas Workforce Commission; Bureau of Labor Statistics.

Health Science Center employs more than 1,500 workers; and Tenet Health, Del Sol Medical Center and Las Palmas Medical Center also rank among El Paso’s top employers. The number of health services establishments in the metro has grown by 40 percent in the last 10 years to over 1,600 establishments in 2016. The industry is set to continue to expand in the short and medium terms, given the initiatives of the Medical Center of the Americas to create a biomedical cluster, the growth of the Texas Tech Health Sciences Center and the \$648 million expansion of the William Beaumont Army Medical Center at Fort Bliss.⁸

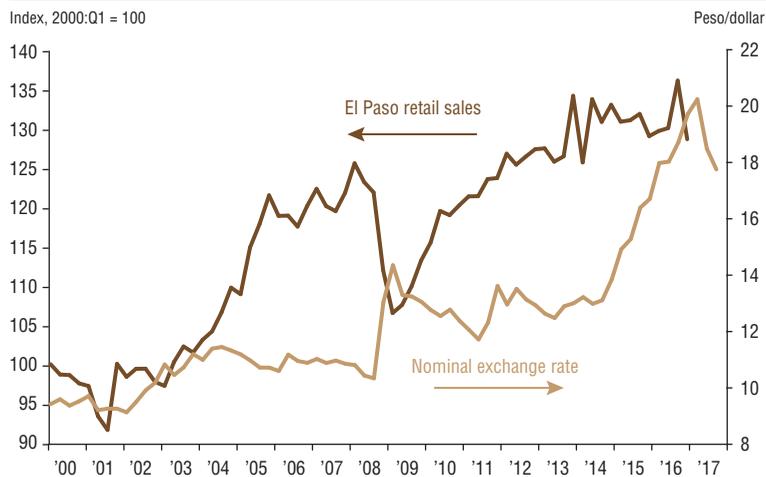
Retail Sales Hinge on Exchange Rate

Another important source of economic expansion for El Paso is cross-border shopping. It has been well documented that when the Mexican economy performs well, Mexican shoppers have additional disposable income to spend in El Paso’s retail sector. According to Dallas Fed research, Mexican nationals spend more than \$4.5 billion annually on food, clothing,

auto parts and other retail items in the Texas border cities of El Paso, McAllen, Brownsville and Laredo. Research also indicates that approximately 10 to 15 percent of El Paso’s retail trade can be attributed to Mexican nationals.⁹ Cross-border retail trade is crucial to border-city economies. Geographic proximity, border-crossing cards that expedite movement, attractive prices and broad product selection are among the draws.

Shoppers south of the border closely monitor the exchange rate for its influence on the relative price of goods and services north of the Rio Grande. On that count, the strong dollar has led to slightly weaker sales along the Texas border cities. In El Paso, retail sales have stagnated over the past couple of years. Sales in 2016 totaled \$11.8 billion, nearly on par with sales of \$11.7 billion in 2014 and 2015. Retail sales for the first quarter (latest data available) fell 6.4 percent from the same period a year earlier. Booming maquiladora activity and the strong Ciudad Juárez economy have likely shielded El Paso retailers from suffering a deeper decline in demand

Chart 4 Retail Sales React to Exchange Rate



NOTES: Retail data are for 2017:Q1. Exchange rate data are for 2017:Q3.
SOURCES: Texas Comptroller of Public Accounts; Federal Reserve Bank of Dallas.

given the sizeable depreciation of the peso. From mid-2014 to early 2017, the peso lost 35 percent of its value vis-à-vis the dollar (Chart 4). In 2017, the peso has gained some ground; the exchange rate was 17.8 peso to dollar in third quarter 2017. However, in recent weeks, the peso has lost ground against the dollar, posing additional challenges to the El Paso retail sector.

Uncertainty Clouds the Outlook

El Paso experienced economic gains in 2015 and 2016. Nonetheless, El Paso's economic drivers face challenges ahead, which cloud the horizon for the local economy. A weaker Mexican economy and a strong dollar are risks for the El Paso retail sector. These risks have been somewhat muted by strong growth and a tight labor market in the Ciudad Juárez

maquiladora sector. However, a stabilization in automobile demand and—more importantly—uncertainty in the future of tax and trade policy may change the growth trend in maquiladora activity in the near future. Auto sales are closely linked to the local economy because roughly half of maquiladoras in Juárez are auto related.

On the upside, the health services sector in El Paso is growing at a fast pace. This is good news as wages are slightly higher than average in this sector. Public spending, especially at the federal level, also affects the local economy through defense spending. In the past, the El Paso economy benefited enormously from the expansion at Fort Bliss, as it provided a cushion against the Great Recession. At this point, the idea of a scaleback in defense spending

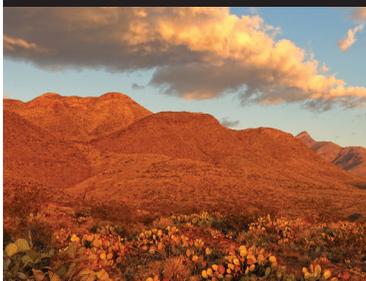
seems to have dissipated, while the possibility of increased investment has grown. To the extent defense spending picks up in the foreseeable future, El Paso should be poised to benefit.

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Notes

- ¹ Employment data subject to revision.
- ² The Federal Reserve Bank of Dallas produces business-cycle indexes for Texas and its major metropolitan areas. See more at www.dallasfed.org/research/econdata/mhci.cfm.
- ³ To learn more about the energy sector and its effects in the Texas economy, please refer to www.dallasfed.org/research/energy11.
- ⁴ For more information on the importance of different industry clusters in El Paso's local economy, please refer to El Paso's chapter in "At the Heart of Texas: Cities' Industry Clusters Drive Growth," www.dallasfed.org/research/heart/el Paso.aspx.
- ⁵ For more details, see "The Impact of the Maquiladora Industry on U.S. Border Cities," by Jesus Cañas, Roberto Coronado, Robert W. Gilmer and Eduardo Saucedo, *Growth and Change*, vol. 44, no. 3, 2013, pp. 415–42.
- ⁶ Source: Bureau of Economic Analysis, Local Area Personal Income.
- ⁷ For more information on the importance of different industry clusters in El Paso's local economy, please refer to El Paso's chapter in "At the Heart of Texas: Cities' Industry Clusters Drive Growth," www.dallasfed.org/research/heart/el Paso.aspx.
- ⁸ For more details, see the William Beaumont Army Medical Center website, www.wbamc.amedd.army.mil/NewHospital/default.aspx.
- ⁹ Note that our estimates represent net exportable retail sales. For more details, see "Exported Retail Sales Along the Texas–Mexico Border," by Roberto Coronado and Keith R. Phillips, *Journal of Borderlands Studies*, vol. 22, no. 1, 2007, pp. 19–38.

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