Economic Commentary
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1989 Economic Outlook

In recent years, the national economy has outperformed the Southwest economy. In 1989, this pattern may be reversed. In much of the nation, output is straining against capacity while demand continues to grow strongly. The Southwest is one of the few areas of the country where there is some room for expansion.

National Overview

In 1988, an otherwise strong performance of the U.S. economy was obscured by the negative effects of drought. While real GNP grew by 2.7 percent in 1988, output in the non-farm sector grew by a more robust 3.3 percent.

Even a partial recovery of farm output from last year's depressed levels will boost economic growth in 1989. Such an increase in the economy's overall growth rate will mask a significant slowing in the non-farm economy, where firms are increasingly faced with capacity constraints.

Statistical indicators suggest that the national economy is operating near its limits. Capacity utilization has reached its highest level since 1978, and delivery lags are near their 1984 post-recession peak. In addition, the national unemployment rate of 5.3 percent is well below the 6-percent rate which many economists consider the lowest rate that can be sustained without inflation. The labor force participation rate is further evidence of tightness in the labor market; with sixty-two percent of the working age population now employed, the labor force participation rate is at a post-World-War-II high.

Capacity constraints, combined with a declining dollar, will add to inflationary pressures. The inflation rate generally increased in 1988 and is likely to be maintained in 1989.

Regional Overview

The Southwest economy (here comprising Louisiana, New Mexico and Texas) expanded for most of 1988. The strongest growth occurred during the latter half of the year. Despite improvement, the Southwest economy was still growing more slowly than the nation's. From November 1987 to November 1988, nonagricultural employment grew by 3.6 percent in the nation; by 0.8 percent in Louisiana; by 1.6 percent in Texas; and by 3.1 percent in New Mexico.

In 1989, growing capacity constraints in other parts of the nation should serve to stimulate economic growth in the Southwest, particularly in manufacturing and services. This optimism is tempered, however, by recent movements in the Texas index of leading economic indicators which suggest sluggish growth in Texas through the first quarter of the year.

Southwest Manufacturing

Southwest manufacturing continued to expand in 1988, but more slowly than it had in 1987 or than national manufacturing. During the second half of 1988, most of the region's growth in manufacturing employment came in the nondurable goods industries — especially paper, textiles, food, chemicals, and apparel.

Manufacturing industries in the region should continue to grow in 1989. A broad spectrum of manufacturers in the Southwest should benefit from the strained capacity and near full employment in most other areas of the country, and improving conditions in construction and energy should stabilize related industries. Together, these factors suggest stronger growth in Southwest manufacturing, even as U.S. manufacturing slows.

Southwest Services

Employment growth in services, the largest sector of the economy, accelerated during the latter half of 1988 and is likely to remain strong in 1989. Employment in the categories of business and personal services, and transportation and utilities has shown strong and consistent gains since the second quarter of 1988 and will probably continue to grow.

Retail sales reflected a stronger overall economy. During the Christmas season, retail sales in Dallas and Houston were more than 5 percent higher than a year earlier. Along the Texas border, retail sales were up about 30 percent — strengthened by rising consumer prices in Mexico and concerns about a possible devaluation in the peso.

Southwest Energy

The rig count declined during the second half of 1988 as oilfield exploration and development was cut back in response to falling oil prices. Increased OPEC production contributed to the fall in oil prices. From mid-1987 to November 1988, OPEC boosted world oil production by nearly 10 percent. Prices dropped below $13 a barrel in October of 1988.

In November, however, OPEC agreed to restrict output. Since then, the price of West Texas Intermediate crude has increased by more than 50 percent to just over $18 a barrel. An $18 price probably is not sustainable. In 1989, the average price of oil is likely to be only slightly higher than in 1988. With oil prices near 1988 levels, recent slippage in the energy industry should come to an end.

Southwest Construction

Since late 1985, a soft market for commercial and residential real estate has kept construction in the Southwest weak. Although it looked as though construction had reached bottom by late 1987, contract values and employment continued to drop. Recent gains in contract values, however, signal an improvement in construction. Employment will probably continue to decline in 1989, but at a slower rate.

Summary

In 1989, the Southwest is likely to see stronger economic growth than it did in 1988. Manufacturing and services are likely to grow somewhat more rapidly. The energy industry can be expected to stabilize, and the rate of decline in construction is likely to slow. With slowing national growth, these factors could mean stronger growth in the Southwest than the nation for the first time since 1984.