The Southwest's Stop-and-Go Economy

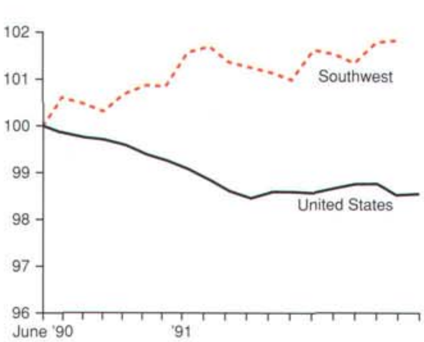
The Southwest economy continued to expand for the first eight months of the national recession. From June 1990, when the nation's economy peaked, until February 1991, the Southwest's nonagricultural employment grew at a fairly robust rate of 2.6 percent annually (*Chart 1*).

After February, however, the region showed evidence of recessionary pressure. From February to June, employment declined at a 2.1-percent annual rate. After June, the Southwest's employment rebounded, but recent surveys suggest that the region's economy may again be faltering.

(In this article, *Southwest* refers to Texas, Louisiana and New Mexico. For a more detailed description of developments in the U.S. and Southwest economies, see the box titled *"A Timeline of the Southwest Economy."*)

Several factors contributed to the Southwest economy's stop-and-go performance over the past 18 months.

Chart 1
U.S. and Southwest
Nonagricultural Employment



SOURCE: U.S. Bureau of Labor Statistics.

The national recession restrained the region's growth. Stability in the Southwest's real estate and banking sectors softened the recession's effects on the region. And differences in the makeup of the Southwest's economy from that of the nation's added to the region's variable economic performance.

For 1992, the outlook for the Southwest economy is somewhat brighter than for the nation's economy. Stability in real estate values and growing strength in banking bodes well for the region's economic growth in 1992, as does the region's greater sensitivity to international trade. Nonetheless, the Southwest's economic growth is becoming increasingly linked to the nation's. An anemic national recovery or a double-dip recession would restrain the Southwest's economic growth in 1992.

Evidence of the National Recession

Studies by the Federal Reserve Banks of Dallas and San Francisco indicate that the Southwest's economic composition and performance have become more like the nation's since oil prices began falling in 1981.[1] In 1981, the region had a more prominent mining sector and less prominent service

A Timeline of the Southwest Economy

June 1990 — National employment peaks, and the nation enters recession. The Southwest economy continues to expand.

November 1990 — National employment declines sharply for the next five months. National manufacturing output declines sharply for four of the next five months.

January 1991 — Texas manufacturing output begins to decline.

February 1991 — Southwest employment peaks and begins a four-month decline. The nation shows the largest losses in nonagricultural employment over the next two months.

March 1991 — National manufacturing output hits bottom. Texas manufacutirng output hits bottom.

April 1991 — National employment hits bottom. Southwest employment continues to decline.

June 1991 — Southwest emloyment hits bottom.

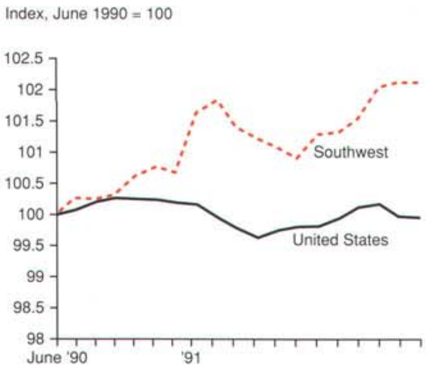
July 1991 — Southwest employment rebounds for the next five months. Most of the Southwest's employment growth comes from the service-producing sectors. Together, the Southwest's goods-producing industries contribute further employment declines over the next four months. Texas manufacturing output grows more rapidly since the trough than before the peak.

November 1991 — Southwest employment continues to register positive growth. The national recovery that began early in the spring has stalled.

December 1991 — Preliminary surveys suggest that the Southwest economy has again flattened.

NOTE: Data included are for Texas, Louisiana and New Mexico, except those for goods-producing output, which are limited to Texas.

Chart 2
U.S. and Southwest Private
Service-Producing Employment



SOURCE: U.S. Bureau of Labor Statistics.

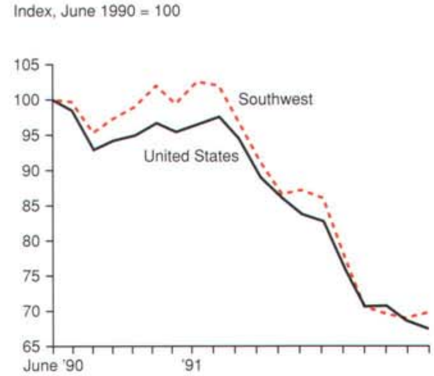
and manufacturing sectors. Since that year, the Southwest's mining sector contracted, its service sector grew in importance, and its manufacturing sector declined less in prominence than the nation's manufacturing sector.

The growing similarity between the regional and the national economies suggests that a weak national economy contributed to the Southwest's slow economic growth in 1990 and 1991. The influence of the national recession on the Southwest economy was most apparent during the first two quarters of 1991. The national economy experienced its sharpest contractions from November 1990 through March 1991. Texas manufacturing output fell from January through March 1991. Both Texas and national manufacturing output hit their troughs in March. Although data are not available, output in the region's service-producing sector most likely fell from February through June. Although the Southwest technically avoided a recession, the region's total output probably fell for several months during the first and second quarters of 1991.

Employment in the Southwest reached a peak in February 1991 and then fell at a 2.1-percent annual rate over the next four months (*Table 1*). Texas, Louisiana and New Mexico all felt the downturn. Only New Mexico's service-producing sector, buoyed by growth in government employment, avoided an employment loss. In June, two months after the national employment trough, nonagricultural employment in the Southwest hit bottom.

Since its June trough, the Southwest's nonagricultural employment has grown slowly. A shift toward more capital-intensive manufacturing, increased labor productivity, longer hours worked in manufacturing and large declines in oil and gas extraction have restrained employment gains in the Southwest. From June to November, Southwest nonagricultural employment grew at a 2-percent annual rate, while national employment has been relatively flat.

Chart 3
U.S. and Southwest Rig Count



SOURCE: U.S. Bureau of Labor Statistics.

Stability in Real Estate and Banking

The Southwest economy's 1986 recession—one that the nation did not experience—resulted in a tremendous upheaval in the region's real estate and banking sectors. Because the Southwest's real estate and banking industries had been through this experience, evidence of the national recession may have been less pronounced in the Southwest than in the nation as a whole.

While national real estate property values tumbled in 1990 and 1991, Southwest real estate property values were already close to the bottom in 1990. Stabilizing real estate values provided an edge for the Southwest economy during

Table 1
Growth of Nonagricultural Employment in the Southwest, Annualized Rates

	June 1990 to November 1991	June 1990 to February 1991	Month of Peak	February 1991 to June 1991	June 1991 to November 1991	February 1991 to November 1991	Employment Share (Percentage)
Total	1.83	2.55	Feb. 91	–2.07	2.00	.17	100.0
Service-Producing	2.32	2.49	Feb. 91	–1.45	2.78	.88	79.2
Private Service-Producing	2.11	2.77	Feb. 91	–2.70	2.90	.37	60.2
Goods Producing	–.06	2.80	Jan. 91	–4.43	–.94	–2.51	20.8
Manufacturing	–1.18	.33	Jan. 91	–3.18	–.80	–1.86	13.0
Construction	3.93	9.09	Feb. 91	–8.55	2.51	–2.56	5.0
Mining	–1.84	3.56	Feb. 91	–2.55	–7.66	–5.42	2.7
Oil and Gas Extraction	–2.02	3.69	Feb. 91	–2.49	–8.30	–5.76	2.6

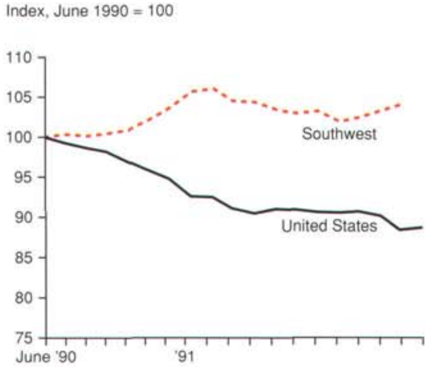
NOTE: The Southwest includes Texas, Louisiana and New Mexico.
SOURCE: U.S. Bureau of Labor Statistics.

the national recession by stabilizing household wealth and attracting real estate investment away from other parts of the country where prices were falling. Stable real estate prices made it easier to sell houses, improving the efficiency of the labor force by making it easier for workers to take new jobs.

Recent data show that banks in the Southwest are now healthier than their national counterparts, with improving profitability and proportionally fewer troubled loans. Although bank lending continued to contract in the Southwest during the past year, it contracted less than the national average.

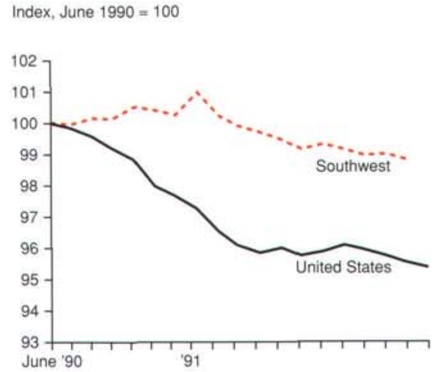
The effects of a somewhat healthier banking industry may help explain why the Southwest's weakly growing private service-producing sector outperformed the nation's (*Chart 2*). Service-producing industries have proportionally more small businesses with fewer physical assets to collateralize than the goods-producing industries. Even though service-producing firms have smaller capital needs than most manufacturing firms, a lack of credit for such businesses restricts their growth. In other areas of the country where many banks are too sick to lend, small businesses with few physical assets to collateralize are having a hard time getting credit.

Chart 4
U.S. and Southwest
Construction Employment



SOURCE: U.S. Bureau of Labor Statistics.

Chart 5
U.S. and Southwest
Manufacturing Employment



SOURCE: U.S. Bureau of Labor Statistics.

Other Economic Variations

Several other factors contributed to the Southwest economy's taking a course different from the nation's in 1990 and 1991. Industries contributing to the differences include energy, construction, manufacturing, defense and air transportation.

Energy. The oil and gas extraction industry accounts for a much smaller share of the Southwest economy than it did 10 years ago, but the sector's volatility still has a considerable effect on the Southwest economy. From June 1990 to February 1991, higher oil prices brought about by anticipation of the Persian Gulf war encouraged a modest expansion of the nation's oil and gas industry (*Chart 3*). As an energy-exporting region, the Southwest benefited from higher energy prices, while the nation suffered.

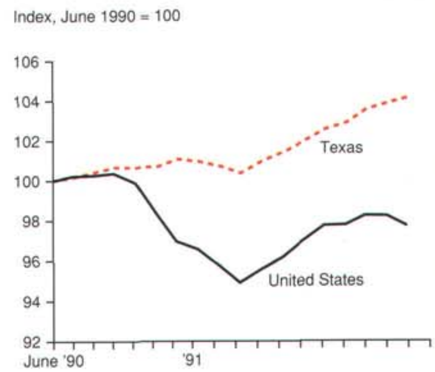
After February 1991, lower oil prices and extremely low wellhead prices for natural gas brought a sharp contraction to the oil and gas extraction industry. Even as the Southwest economy resumed growing in July 1991, output and employment in oil and gas extraction continued to fall, but at a slower rate.

Construction. Construction in the Southwest has countered national patterns (*Chart 4*). Throughout 1990 and during the first few months of 1991, construction of new petrochemical facilities along the Texas Gulf Coast contributed to strong gains in construction. At the same time, relatively stable real estate values and high occupancy rates in single- and multifamily housing encouraged the construction of new housing. And although office vacancy rates in the Southwest remain high, firms relocating in the region often build new offices after failing to find large blocks of suitable space.

Manufacturing. Manufacturing employment in the Southwest roughly followed national patterns. For the first seven months of the national recession, however, manufacturing employment grew in the Southwest while contracting sharply in the nation (*Chart 5*). From January to March 1991, manufacturing employment and output fell in both the Southwest and the United States. Since the March trough, manufacturing output has grown more rapidly in Texas than in the nation (*Chart 6*).

While manufacturing output has grown in Texas since March 1991, manufacturing employment continued to decline after that date. One reason output is growing faster than employment is because the region's manufacturing sector has become more capital-intensive. One capital-intensive industry that has shown tremendous growth in the Southwest is the chemical and allied products industry. In addition, numerous manufacturing

Chart 6
U.S. and Texas Manufacturing Output



SOURCE: Federal Reserve Bank of Dallas (Texas data); Federal Reserve Board of Governors (U.S. data).

Table 2
Balance Sheet of the Southwest Economy

	Growth in 1992	Relative to the Nation
Total Southwest Economy	Growth	Better
Service-Producing	Growth	Better
Private Service-Producing	Growth	Better
Wholesale and Retail Trade	No Growth	Same
Narrowly Defined Services	Growth	Same
Transportation and Public Utilities	Growth	Better
Finance, Insurance, Real Estate	Decline	Better
Government	Growth	Better
Goods-Producing	Growth	Same/Better
Manufacturing	Growth	Better
Nondurables	Growth	Better
Durables	Decline	Worse
Construction	Growth	Better
Mining	Decline	Worse
Oil and Gas Extraction	Decline	Same
Agriculture	Decline	Better

industries are showing gains in labor productivity or hours worked, which means they are producing more output with fewer workers.

Defense. In general, the Southwest is slightly less sensitive to cuts in defense spending than the national average. Only two metropolitan areas in the region, Dallas/Fort Worth and New Orleans, are more sensitive than the national average. Nonetheless, the Southwest still remains vulnerable to defense cuts aimed at specific, locally produced weapons systems.

The cancellation of the A–12 attack plane in December 1989 caused substantial employment losses in the Dallas/Fort Worth area. The job losses were not recorded until February 1990 because the affected workers were given 60-day notices. Multiplier effects and defense cuts affecting other manufacturers contributed to defense-related employment declines in the Metroplex.

Air Transportation. Air transportation is one sector in which the Southwest is greatly outperforming the nation. While the nation lost employment in air transportation from October 1990 to October 1991, Texas gained more than 9 percent. The regional advantage appears to be primarily a function of favorable weather, geography and good management. Two of the nation's healthiest airlines—American and Southwest—are based in Dallas/Fort Worth.

Signs of Health for 1992

The national recession weakened economic growth in the Southwest during 1990 and 1991. Differences in key industries, the relative stability of the region's real estate values and improving banking conditions in the Southwest combined with the national recession to create a stop-and-go economy in the Southwest.

On balance, the Southwest economy looks fairly healthy. Broad indicators of the Southwest economy suggest continued growth in 1992. The strength of expansion in the Southwest economy will depend on the strength of the national economy and on export demand. If the nation continues its weak recovery (as outlined in the preceding article), nonagricultural employment in the Southwest should grow by 1.5 percent to 2 percent in 1992, up from an estimated 1.1 percent in 1991.

Most industries in the region can be expected to outperform or perform as well as their national counterparts in 1992 (*Table 2*). Industries that should fare better in the region than in the nation during 1992 include construction, government and private service-producing sectors. Manufacturing employment is likely to decline at about the same rate it did in 1991, but manufacturing output should continue to grow. With low natural gas prices, oil and gas extraction employment is likely to fare worse in 1992 than it did in 1991.

Because the Southwest's economy has become more dependent on the nation's, an anemic recovery or a double-dip recession would tend to restrain growth in the Southwest. On the other hand, because the region's economy is somewhat more sensitive to international trade than is the rest of the nation, the Southwest would fare even better if export demand strengthened. An increase in growth in Mexico and approval of the North American Free Trade Agreement would help the Southwest states more than the rest of the nation.

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[1] Thomas B. Fomby and Joseph G. Hirschberg (1989), "Texas in Transition: Dependence on Oil and the National Economy," Federal Reserve Bank of Dallas *Economic Review* January, and Carolyn Sherwood-Call (1988), "Exploring the Relationships between National and Regional Fluctuations," Federal Reserve Bank of San Francisco *Economic Review* Summer.

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