

the Southwest ECONOMY

THE FEDERAL RESERVE BANK OF DALLAS

NOVEMBER/DECEMBER 1992

Southwest Economy Shows Strength After Second-Quarter Slowdown

Growth of the Southwest economy appears to be accelerating after a second-quarter slowdown. During July and August, the region's employment growth averaged a 1.8-percent annual rate. During the second quarter, the annual rate of growth in the region's employment slowed to 1 percent, down from 2.4 percent in the first quarter.

The Southwest economy has shown shifting pockets of strength and weakness. During the second quarter, oil and gas extraction and private service-producing employment accounted for much of the Southwest economy's weakness, while employment in durables manufacturing and construction

grew faster than it had in the first quarter. By contrast, oil and gas extraction and private service-producing employment accounted for the region's employment gains in the third quarter, while employment in durables manufacturing and construction fell.

Given a continuation of sluggish growth in the national economy, the region's economy is likely to perform about the same in the second half of 1992 as it did in the first half, when employment grew at a 1.7-percent annual rate. This outlook could change significantly if national economic performance, export demand or world oil market conditions change.

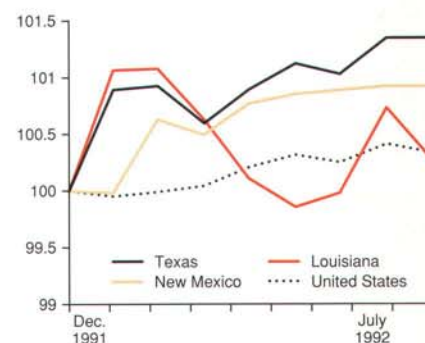
The Second-Quarter Slowdown

During the second quarter, weakness was evident in all three of the region's states (*Chart 1*). In Texas, the annual growth rate of employment slipped to 1.7 percent in the second quarter from 2.4 percent in the first. Louisiana lost jobs at a 2.5-percent rate during the second quarter after gaining them at the same pace in the first. New Mexico's employment growth fell to a 0.4-percent rate in the second quarter from a 2-percent rate in the first.

Declining employment in oil and gas extraction and private service-

Chart 1
Total Nonagricultural Employment

Index, December 1991 = 100



SOURCE OF PRIMARY DATA: U.S. Bureau of Labor Statistics.

producing employment accounted for much of the Southwest's weakness during the second quarter (*Table 1*). Oil and gas extraction showed more than a 10-percent annualized rate of decline. Finance, insurance and real estate (FIRE) and services also showed employment losses. Wholesale and retail trade evidenced slower employment growth. Although private nonagricultural employment fell during the second quarter, the strong growth of government

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Table 1
Southwest Nonagricultural Employment by Sector
(Annualized Rates of Growth)

	First Quarter	Second Quarter	July–August Average
Total	2.4	1.0	1.8
Private	2.8	–2	1.5
Goods-Producing	–.9	1.6	–1.1
Manufacturing	1.5	2.1	–1.1
Durables	.5	1.6	–4.1
Nondurables	2.8	2.8	2.8
Mining	–9.9	–9.8	1.6
Oil and Gas	–9.6	–10.3	2.2
Construction	–2.2	6.3	–2.6
Service-Producing	3.3	.8	2.6
Private Service-Producing	4.1	–.8	2.0
TCPU	–.8	1.5	.9
Trade	3.0	.9	1.2
FIRE	7.3	–1.0	2.1
Services	5.8	–2.9	1.3
Government	.5	6.3	3.0

SOURCE OF PRIMARY DATA: U.S. Bureau of Labor Statistics.

employment prevented total employment from declining.

Unemployment figures are generally consistent with a weak Southwest economy during the second quarter (*Chart 2*). The Texas unemployment rate rose from 7.6 percent in March to 8.2 percent in June. In Louisiana, the unemployment rate rose from 6.9 percent in March to 7.8 in June. In New Mexico, the unemployment rate was 7.2 percent in both March and June.

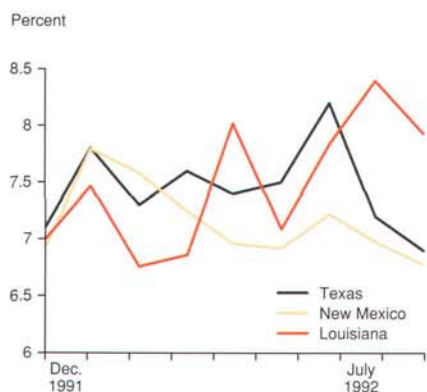
Despite the slowdown, during the second quarter the Southwest economy continued to generate new jobs at a faster rate than the national economy. Texas employment grew at more than twice the national rate, but New Mexico and Louisiana fared more poorly. Through the first half of 1992, the Southwest economy generated jobs at more than three times the national rate.

Signs of a Third-Quarter Pickup

During the first two months of the third quarter, the Southwest showed signs of accelerating economic growth. After growing at a 1-percent

annual rate during the second quarter, the region's employment averaged a 1.8-percent annual growth rate in July and August. In Texas, the rate of employment growth accelerated moderately to a 1.9-percent annual rate. Louisiana employment reversed its decline and showed growth at a 1.8-percent annual rate. In New Mexico, employment growth slipped to a 0.2-percent annual rate.

Chart 2
Southwest Unemployment Rates



SOURCE OF PRIMARY DATA: U.S. Bureau of Labor Statistics.

Reversing their second-quarter roles, the oil and gas extraction and private service-producing sectors accounted for much of the Southwest's employment gains during the first two months of the third quarter. All four private service-producing sectors—transportation, communication and public utilities (TCPU); trade; FIRE and services—saw accelerating employment.

In contrast, employment in durables manufacturing and construction fell. Employment in nondurables manufacturing grew at an unchanged rate.

Shifting Pockets of Strength and Weakness

In some respects, the shifting pockets of weakness in the Southwest economy reflect a sluggish national economy. The sharp decline of the region's employment in oil and gas extraction during the first half of the year is related to the weak international and U.S. economies, as well as supply conditions. Weak export demand, a sluggish national economy and declining demand for energy-related manufacturing now seem to be holding back growth in the region's manufacturing sector, particularly in durables.

What little weakness there is to be found in the Southwest's nondurables sectors points to the effects of a sluggish national economy. Among the region's weaker nondurables sectors are refining and petrochemicals, two industries that dominate the region's exports to the rest of the nation.

Nonetheless, the region's manufacturing sector continues to outperform the nation's. Regional demand for construction materials and exports to Mexico and the rest of Latin America likely are part of the explanation. Defense-related manufacturing shows signs of slipping after posting gains earlier in the year.

Although the capacity of the region's banks to fuel economic growth is greater than the national average, problems in small-business

finance may be restricting economic growth in the Southwest. Traditionally, many of the new jobs created during a recovery are in small businesses. Small businesses report that the credit necessary for expansion is difficult to obtain, but the region's bankers assess the demand for good loans as flat. Past asset devaluation in the region continues to hamper the financing of business investment, particularly for small businesses, whose assets are difficult to judge.

The Outlook

Given a continuation of slow growth in the national economy, the Southwest economy is likely to grow at about the same rate in the second half of 1992 as it did in the first half of the year (*Table 2*). The growth of private nonagricultural employment is likely to improve, while the growth of government moderates. With a larger and more diversified manufacturing sector than other Southwestern states, Texas may experience faster employment growth than the rest of the region.

The principal factor in an improving outlook for private nonagricultural employment in the second half of the year is an expectation of moderate employment gains in oil and gas extraction. Rising prices for natural gas are stimulating an increase in exploration, development and production.

If no major changes occur in exports or the national economy's rate of growth, the Southwest's manufacturing employment can be expected to grow at about the same rate it did in the first half of 1992.

After gains in the first half of the year, construction employment could slip during the second half. The gains in residential construction posted during the first half of the year are likely to slow in the second half.

Taken together, the private service-producing sectors should perform slightly better in the second half of the year than they did in the first. TCPU is likely to show

improved growth, with employment gains in transportation and communications partially offset by continued losses in public utility employment. Without a strong change in the remainder of the region's economy, wholesale and retail trade should continue to perform about as they have in the first half of the year. FIRE is likely to show slower growth. Consolidation of the Southwest's financial institutions should further reduce their employment. Growth in manufacturing should stimulate slight employment gains in services. With state and local governments constrained by their budgets, the growth of government employment is likely to slow in the second half of the year.

Risks to the Outlook

Numerous factors suggest that the Southwest economy's performance could deviate from this outlook. The region's economy would benefit from an improvement in national economic conditions, which would stimulate manufacturing and oil and

gas extraction in the Southwest. In turn, the region's service-producing sectors would benefit from spillover effects from the manufacturing and energy sectors.

An acceleration of growth in Latin America could lead to increased export demand for manufactured goods from the Southwest. A revival of European economic growth would also help but not as much.

A change in world oil supply conditions also could affect the outlook. Oil prices reflect the stalemate with Iraq and OPEC supply conditions. Resolution of the tension or increased OPEC supply could lead to increased world oil production and lower oil prices. Lower oil prices would hurt the Southwest's economy while providing a mild stimulus to the U.S. economy. Escalation of tension in the Persian Gulf could lead to sharply higher oil prices and an improvement in the Southwest economy while acting as a drag on the U.S. economy.

—Stephen Brown

Table 2
Southwest Nonagricultural Employment by Sector
(Annualized Rates of Growth)

	Actual First Half of 1992	Outlook for the Second Half of 1992
Total	1.7	1.8
Private	1.3	1.6
Goods-Producing	.3	1.1
Manufacturing	1.8	1.8
Durables	1.0	1.0
Nondurables	2.8	2.8
Mining	-9.8	2.0
Oil and Gas	-10.0	2.2
Construction	1.9	-1.0
Service-Producing	2.0	1.9
Private Service-Producing	1.6	1.8
TCPU	.3	1.2
Trade	2.0	1.9
FIRE	3.1	1.6
Services	1.3	1.8
Government	3.4	2.5

SOURCE OF PRIMARY DATA: U.S. Bureau of Labor Statistics.