

Southwest's Economic Growth to Exceed Nation's

The Southwest economy grew moderately last year but was healthier than most regions of the United States. Nonfarm employment rose 1.6 percent in the Southwest during 1992 while rising only one-half of a percentage point nationally (*Chart 1*). The Southwest accounted for about 30 percent of the nation's net employment gains in the 12-month period from November 1991 to November 1992. (In this article, *Southwest* refers to Louisiana, New Mexico and Texas.)

Growth was uneven across the Southwest in 1992. Employment in Texas and New Mexico grew at a slightly faster pace than in the nation, while employment in Louisiana grew more slowly than in the nation.

While uneven geographically, the Southwest's economic growth was broad-based across the goods- and service-producing sectors. For much of the year, the region's strength was rooted in factors particular to the Southwest, such as exports to Mexico and a growing construction industry. More recently, an improving national economy has stimulated growth in industries that are more closely tied to the national economy.

In 1993, nonfarm employment growth in the Southwest is likely to accelerate slightly to about 2 percent and remain faster than the growth expected for the national

economy. Employment in the Southwest will be boosted by continued strength in the construction industry, further growth in exports to Mexico and an improving national economy.

As in 1992, however, economic growth will remain uneven across the Southwest's states. Texas and New Mexico are likely to see their employment grow slightly faster than the nation's. In contrast, Louisiana is likely to see its employment grow slower than the nation's.

The Southwest's Strengths and Weaknesses in 1992

Although most sectors of the Southwest economy outperformed their national counterparts in 1992, several sectors contributed more than others. These include the construction sector, sectors exporting to Mexico and some service-producing sectors. The energy industry was a drag on the Southwest economy.

The Southwest's construction industry was relatively strong in 1992. Despite almost no growth in commercial construction, total construction employment in the Southwest increased 2.1 percent. Stable and rising home values, very lean home inventories and low mortgage rates led to a surge in new home construction in the Southwest during 1992. Permits for new home construction rose to their highest level since 1986, the year in which the Southwest's construction industry

began its massive decline.

The strength of the Southwest's construction sector led to gains in most construction-related industries such as lumber and wood products; stone, clay and glass products; and fabricated metal products. During 1992, the growth of Texas construction-related manufacturing added 1,900 jobs to the 9,600-job gain in the state's construction sector (*Chart 2*). Rebuilding efforts after Hurricane Andrew also boosted employment in these industries. Nationally, construction-related employment declined last year.

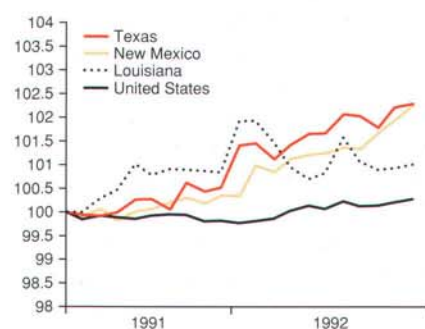
An expanding Mexican economy was another factor contributing strength to the Southwest economy in 1992. Increased trade boosted employment in Texas industries that export heavily to Mexico.¹ Employment in these industries grew by 0.9 percent in Texas while declining by 2.2 percent nationally. Of these industries, the strongest job growth was in apparel and in food and kindred products, which grew 3.7 percent and 3.1 percent, respectively.

The expanding Mexican economy had a stimulating effect on the Texas economy, boosting employment growth in border industries. In 1992 employment grew at a 4.1-percent rate in Texas' border cities—Brownsville, El Paso, Laredo and McAllen—while growing only 1.2 percent in the rest of the state. The strength in the border region comes from industries tied to cross-border traffic—mostly retailing, transportation and public utilities and manufacturing. In fact, as *Chart 3* shows, Texas manufacturing employment would not have risen in 1992 were it not for the growth in border manufacturing.

Another factor that helped strengthen the Southwest economy in 1992 was growth in the service-producing sector. The Southwest's service-producing sector, which represents roughly 80 percent of the region's total employment, grew at a 1.9-percent pace in 1992. That growth compares with a 1-percent rate at the national level. Narrowly defined services—particularly personal

Chart 1
Total Nonfarm Employment

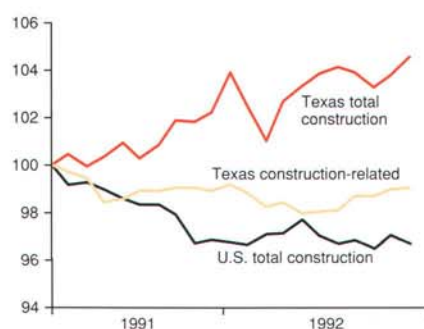
Index, March 1991 = 100



"The Southwest will benefit from several factors, including a relatively strong construction sector, increased trade with Mexico, a healthier banking sector and an improving national economy."

Chart 2
Construction and Construction-Related Employment

Index, March 1991 = 100



services, such as health and social services—recorded the strongest growth last year.

An increasingly weak energy sector restrained the Southwest economy's growth in 1992. The collapse of natural gas prices in 1991 led to a sharp contraction of the Southwest's energy sector during the first half of 1992, during which employment in oil and gas extraction fell at nearly a 10-percent annual rate. In the second half of the year, however, improving natural gas prices in the aftermath of Hurricane Andrew led to stabilized employment.

Improving National Economy Stimulates Southwest

As growth of the national economy accelerated in the second half of the year, the Southwest industries more closely tied to national economic activity began to show stronger growth. As Table 1 shows, all but three of the Texas industries with the closest links to the national economy showed accelerated employment growth at the end of 1992.

Several Texas industries that recorded employment losses in 1992—such as oil field machinery, nonelectrical machinery and hotels—rebounded forcefully in the second half of the year. Other industries that had experienced growth throughout the year—such as chemicals, rubber and plastics, apparel, amusements, business services, and engi-

neering and management services—became even stronger in the latter part of the year.

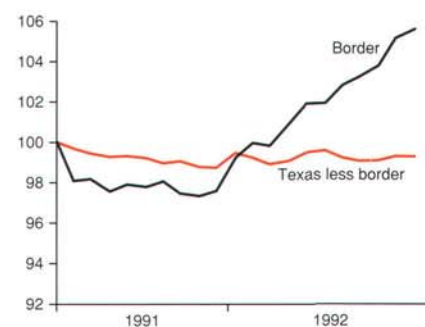
Industries in Louisiana and New Mexico that are closely tied to national economic activity also have begun to pick up. Recent months have shown employment gains in Louisiana industries—such as petroleum refining, transportation services, business services, engineering and management services, wholesale trade, and amusements. New Mexico, which has a relatively small manufacturing sector, has recorded rather rapid employment increases in its nonelectrical machinery industry. In the service-producing sector, New Mexico saw a pickup in transportation services, wholesale trade, and engineering and management services.

Signs of Strength for the Southwest in 1993

Overall, the Southwest looks poised for a year of stronger growth than it saw in 1992. The factors that have contributed to the Southwest's relative strength in the past year, including exports to Mexico and a relatively robust construction sector, remain in place. These factors, along with an improving national economy, should promote stronger employment growth in 1993. We expect growth of the Southwest economy to rise to about 2 percent from the 1.6 percent recorded in 1992.

Chart 3
Manufacturing Employment

Index, March 1991 = 100



Most leading indicators suggest near-term improvement in the Southwest's economic growth. For example, the Texas index of help-wanted advertising has risen for eight of the past 12 months, average weekly manufacturing hours worked in Texas recently reached a 25-year high, and initial claims for Texas unemployment insurance have fallen for five consecutive months. The Texas Leading Index of Economic Indicators, which combines the movements of nine of the most important leading indicators in the state, moved up moderately in the first half of 1992 and has accelerated in recent months (*Chart 4*).

Construction should continue to be a source of strength in 1993. Although the growth in residential construction activity may slow later in 1993, a surge in new home permits that occurred in late 1992 should spur employment gains early in the year. Further employment gains are possible if federal spending on infrastructure is increased. Continued weakness in most office markets suggests there is likely to be little growth in commercial construction.² Because the Southwest has already adjusted to the low levels of commercial construction associated with

weak office markets, however, the commercial construction sector should not be the drag it is nationally.

A number of factors point to stronger growth in the Southwest's manufacturing sector during 1993. Regional producers of manufactured products in industries that are closely tied to national performance—such as fabricated metals, electrical and nonelectrical machinery, and rubber and plastics—should benefit from a growing national economy. Renewed growth in construction at the national level would help the Southwest's construction-related manufacturing industries. Continued growth of exports to Mexico will further stimulate the manufacturing sectors that export to the south.

The energy industry should be less of a drag on Southwest employment this year. The most significant factor affecting our outlook for the energy sector is oil prices. Excess capacity and growing instability within the Organization of Petroleum Exporting Countries raises the possibility of weak oil prices in the near term, which would restrain the Southwest economy. On the other hand, a stronger than anticipated world economy could put upward pressure on oil prices, which would

“Employment in the Southwest is likely to increase moderately in 1993, continuing to grow faster than the national rate.”

benefit the Southwest. Most likely, these upside and downside risks are about equal.

The Southwest's service-producing sector should grow faster in 1993 than it did in 1992. Most of the growth in this sector will continue to come from personal-related services, such as health and social services, which recorded robust employment growth during 1992. Government employment growth also is likely to be near its historical average of around 2.5 percent. Although business and legal services saw some gains in late 1992, continued restructuring should keep employment in these industries from returning to the high rates of growth—over 10 percent—that were seen in the late 1980s.

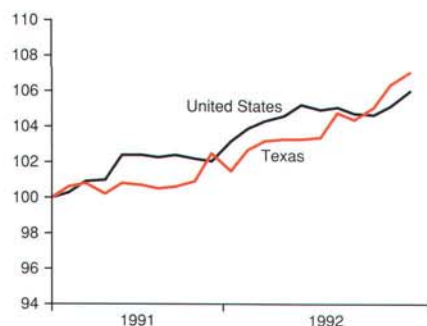
Credit conditions in the Southwest should not be a hindrance to employment growth. The condition of Southwest financial institutions

Table 1
Texas Industries with Strong Ties to National Economic Activity

	Employment growth	
	Nov. '91–Nov. '92	Sept., Oct., Nov. '92 (Annual rates)
Manufacturing		
Chemicals	2.1	5.1
Petroleum refining	–2.2	–1.5
Rubber and plastics	6.2	7.5
Apparel	3.7	6.8
Electric and electronic machinery	.5	.8
Nonelectrical machinery	–.3	.7
Oil field machinery	–8.1	3.3
Fabricated metals	–1.3	–.5
Service-Producing		
Wholesale trade	.6	1.9
Transportation	2.1	–.9
Business services	1.4	2.2
Hotels	–2.1	6.5
Amusements	2.5	53.5
Engineering and management	4.6	6.6

Chart 4
U.S. and Texas Leading Indexes
of Economic Indicators

Index, March 1991 = 100



has improved substantially over the past two years.

In the Eleventh District of the Federal Reserve System, the number of healthy banks has risen from 48 percent of the industry at year-end 1990 to 72 percent in the third quarter of 1992.⁵ This improvement in bank health together with an improving regional economy set the stage for increased bank lending. Over the four-quarter period ending in the third quarter of 1992, bank lending in the District rose 3.6 percent while it declined 1.5 percent in the rest of the United States.

The increase in District lending reflects special factors—such as the acquisition of failed thrift institutions by banks, the consolidation of certain types of lending by interstate banking organizations into their Texas units and some minor loan growth. Currently, Southwest banks are very liquid. As confidence continues to build in the viability of the national recovery, Southwest financial institutions will be capable of converting their holdings of U.S. Treasury securities into business loans.

Summary

Employment in the Southwest is likely to increase moderately in 1993, continuing to grow faster than the national rate. The Southwest will benefit from several factors, including a relatively strong con-

struction sector, increased trade with Mexico, a healthier banking sector and an improving national economy. Nonetheless, economic growth will remain uneven across Southwest states in 1993. Employment in Texas and New Mexico is likely to grow faster than in the nation, while employment in Louisiana is likely to grow at a somewhat slower rate.

Our outlook depends on national economic conditions, however. Lower than expected improvement in the national economy would restrain the Southwest's manufacturing sector and spill over into the construction and service sectors, lowering overall employment growth. A stronger than expected national economy, however, would boost employment growth in the Southwest. Our outlook also depends on the health of the world economy, especially that of Latin America. An acceleration of growth in Mexico could lead to higher than expected export demand for manufactured goods from the Southwest, boosting manufacturing employment and stimulating the border region, while unexpected weakness in the Mexican economy could restrain the Southwest economy.

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¹ Texas industries that export the most to Mexico are transportation equipment, industrial machinery, chemicals, primary metals, electrical and electronic machinery, food and kindred products, and apparel.

² For a discussion of the health of Texas' office real estate sector, see D'Ann M. Petersen, "Will Office Real Estate in Texas Ever Recover?" Federal Reserve Bank of Dallas *Southwest Economy*, September/October 1992.

⁵ The Eleventh District of the Federal Reserve System encompasses Texas, southern New Mexico and northern Louisiana.

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