



THE UNSINKABLE TEXAS ECONOMY

THE 1990s WILL GO down in history as the decade of buoyant economic growth in Texas. 1999 was no exception. After a slow start due to the lingering effects of the Asian crisis, the Texas economy bounced back in the second half and finished the year only moderately weaker than in 1998. As shown in Chart 1, job growth was positive and exceeded the national average in each year of the decade.

During 2000, Texas exports, particularly of technology-related products, should accelerate. Although oil and gas prices are hard to predict, the unexpectedly high prices since March 1999 should pump up the budgets of Texas drilling companies, which have only recently begun to add jobs. And, after several strong years, construction activity has begun to slow. An election year always poses a challenge for Mexico, but current indicators suggest that the country will maintain its current economic expansion into 2000 and, thus, will continue to stimulate Texas exports and the border economy. Although tight labor markets will likely restrain Texas job growth, overall these factors suggest that growth in 2000 will be stable to slightly higher than in 1999.



INSIDE

*Productivity, the Stock Market
and Monetary Policy
in the New Economy*

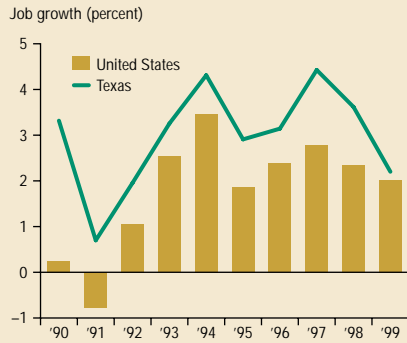
Trade, WTO and the Environment

High Oil Prices Providing a Boost

In Texas, we “dance with the one that brung us,” and the energy industry has been our partner for a long time. While oil and gas pro-

If price expectations hold up, the energy sector will be an important source of growth in 2000.

Chart 1
Texas Economy Strong Throughout the '90s



SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

duction in Texas has declined steadily since the early 1970s and technology-related industries are a growing share of the state's economy, big swings in oil prices can still have a significant economic impact. As shown in Chart 2, broad deviations in Texas employment growth from its trend have correlated highly with oil price movements.

Dallas Fed economists Stephen Brown and Mine Yücel estimate that the state is 75 percent less sensitive to oil price fluctuations today than it was in 1982.¹ Even with the reduction, however, the economists estimate that a 10 percent decline in oil prices that is perceived to be long-lasting would decrease total Texas employment by 0.36 percent. The price of West Texas Intermediate crude averaged \$14.39 per barrel in 1998—a 31.2 percent decline

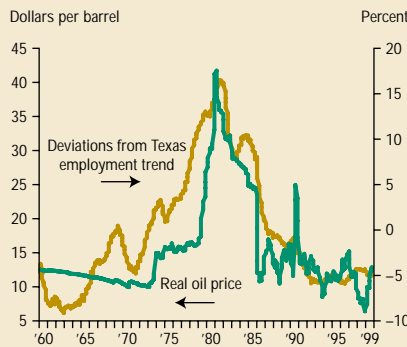
from 1997 after adjusting for inflation. At the end of 1998, most forecasters believed oil prices would remain below \$14 per barrel throughout most of 1999. As shown in Chart 3, both the rig count and oil and gas extraction employment dropped sharply from early 1998 through early 1999.

Production cutbacks by OPEC countries and a pickup in world demand for oil caused prices to jump beginning in March 1999, and by year-end the futures market was suggesting oil would average about \$23 per barrel in 2000. Although the rig count has bounced back, oil and gas extraction employment is just beginning to recover. Based on the Brown/Yücel model, oil price swings were likely responsible for a significant portion of the overall slowdown in first quarter 1999, and if price expectations hold up, the energy sector will be an important source of growth in 2000.

Technology-Related Industries Growing Strongly

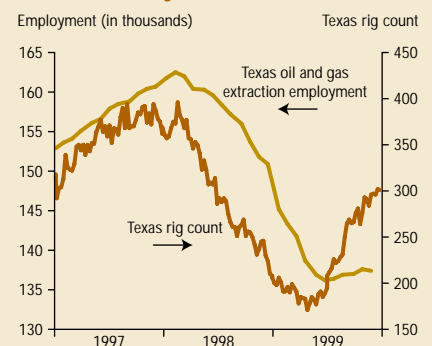
As shown in Chart 4, technology-related industries have been an important source of strength for the Texas economy in the 1990s. These industries grew at an average annual rate of 5.6 percent from 1990 to 1998, almost twice the rate of total nonfarm job growth, which averaged 3 percent. The strongest sector was computer-related services, which increased at an annual rate of 10.1 percent. The weakest sector was electronic components including semiconductors,

Chart 2
Real Oil Price Influences Texas Job Growth



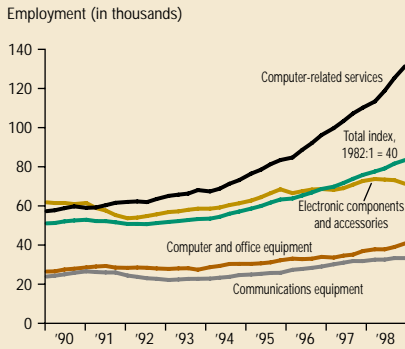
SOURCES: Bureau of Labor Statistics; Department of Energy; Federal Reserve Bank of Dallas.

Chart 3
Oil Industry on the Rebound



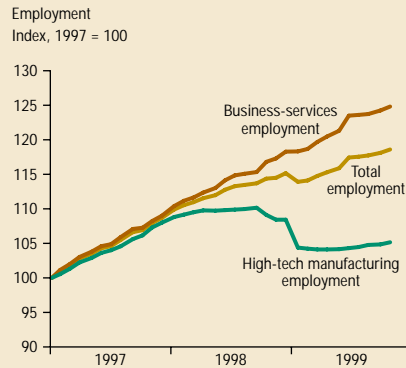
SOURCES: Bureau of Labor Statistics; Baker Hughes Inc.

Chart 4
High-Tech Industry
Important Source of New Jobs



SOURCE: Texas Workforce Commission.

Chart 5
High-Tech Jobs
Beginning to Pick Up



SOURCE: Bureau of Labor Statistics.

which increased at an annual rate of 1.4 percent. The semiconductor industry has achieved very high productivity growth rates; thus, output in this industry has risen at a much faster pace than employment.

While data from the narrowly defined industries shown in Chart 4 are not available on a timely basis, the more broadly defined categories shown in Chart 5 suggest that the high-tech industries slowed in the first quarter but have since shifted into high gear. According to most market experts, the outlook for semiconductor sales is strong. Industry contacts say that strengthening world demand and the introduction of

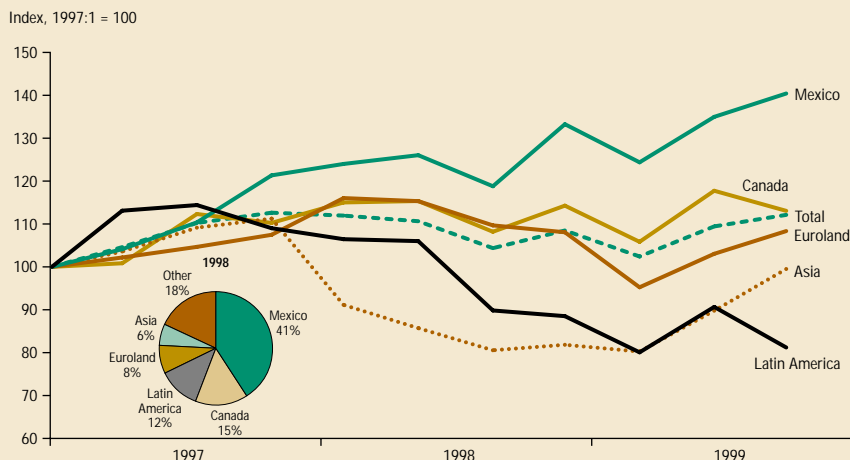
new products, particularly in communications, will likely stimulate demand across a wide range of electronic products in 2000.

Exports Continuing Recovery

A main factor driving the slowdown and recovery of the high-tech sector in 1998 and 1999 has been fluctuations in exports due to changing international conditions. As shown in Chart 6, between the fourth quarter of 1997 and the first quarter of 1999 growth in exports to Mexico slowed and exports to

According to most market experts, the outlook for semiconductor sales is strong.

Chart 6
Exports Continue to Bounce Back

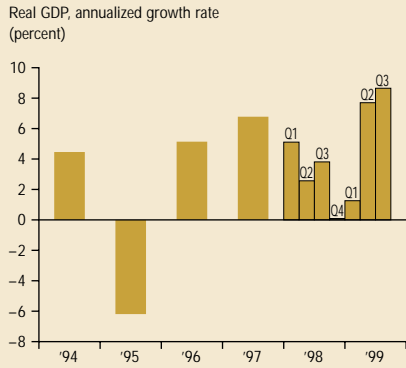


NOTES: Data are seasonally adjusted. Euroland includes Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.

SOURCE: Massachusetts Institute for Social and Economic Research.

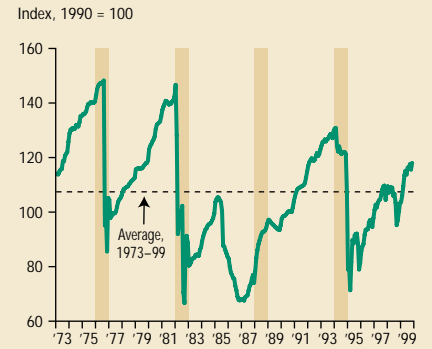
Mexico looks much less vulnerable to recession than in the years before previous elections.

Chart 7
Mexican Economy Strengthens



NOTE: Data are seasonally adjusted.
SOURCE: Federal Reserve Board of Governors.

Chart 8
Real Value of the Peso Not High by Historical Standards



NOTE: Bars indicate election years.
SOURCE: Federal Reserve Board of Governors.

other Latin American countries, Asia and Europe declined. The weakening and rebound have been particularly acute in chemicals and high-tech products such as electronic equipment and nonelectrical machinery.

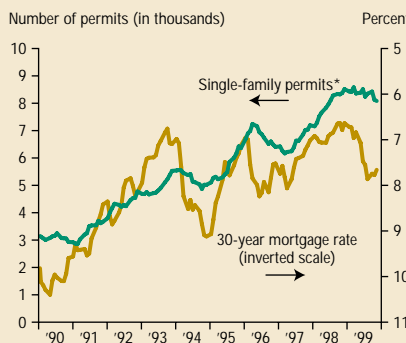
Demand from Mexico is likely to continue even as that country goes into an election year. Weak oil prices and the Russian financial crisis stalled Mexico's real output in fourth quarter 1998 and first quarter 1999. With a greater sense of calm in the international markets and strongly rising oil prices, Mexico bounced back in the second and third quarters of 1999 (*Chart 7*). As David Gould highlights in the November/December 1999 issue of *Southwest Economy*, Mexico looks much less vulnerable to recession than in the years

before previous elections.² Subdued levels of domestic credit, government spending and the current account deficit all bode well for the Mexican economy going into 2000. The adoption of a flexible exchange rate has also reduced the chance of a currency devaluation and economic crisis. As shown in *Chart 8*, the real value of the peso in November 1999 was low relative to the average levels prior to past election year devaluations.

Construction Activity Slowing

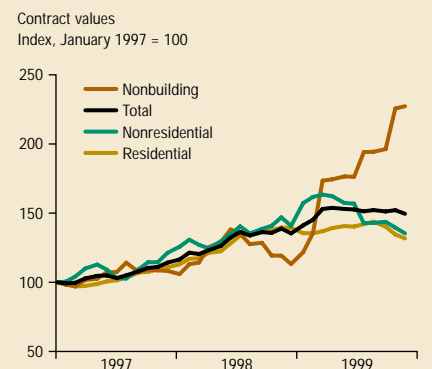
Although mortgage rates have eased slightly, the overall rise in rates since the end of 1998 has led to a slowing in single-family housing permits (*Chart*

Chart 9
Single-Family Permits Starting to Slow



* Four-month moving average.
SOURCES: Bureau of the Census; Federal Home Loan Bank.

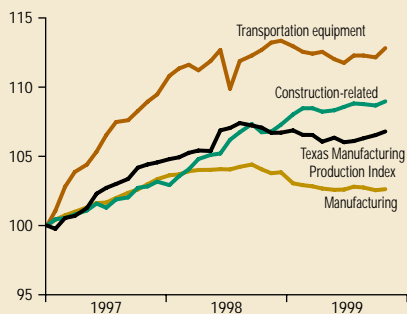
Chart 10
Nonbuilding Construction Remains Strong



SOURCE: F. W. Dodge Inc.

Chart 11
Manufacturing Activity
Picking Up

Index, January 1997 = 100



SOURCE: Bureau of Labor Statistics.

9). Continued strength in nonbuilding activity (*Chart 10*), however, has kept overall contract values from slipping significantly. In 1998, Congress adopted a slightly different version of the transportation reauthorization legislation, providing a minimum estimated increase in federal funding of \$700 million per year for six years for Texas roadways and bridges. School construction has also been strong.

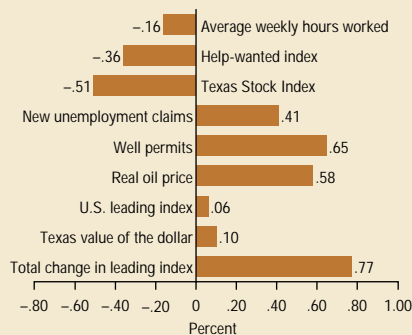
Manufacturing, typically interest rate-sensitive, has been dominated in recent years by international demand and energy markets. Despite higher overall interest rates, manufacturing activity has improved since the second quarter of 1999, even in some of the more interest-sensitive sectors such as transportation equipment and the construction-related industries—stone, clay and glass, fabricated metal products, and lumber and wood products (*Chart 11*). The construction-related industries will likely weaken in the near future if construction activity continues to soften.

Expansion Likely to Continue in 2000

While strengthening international demand and current high energy prices should result in increased opportunities for Texas businesses in 2000, labor market tightness should dampen overall job growth. As Dallas Fed economist Lori Taylor discusses in the September/October 1999 issue of *Southwest Economy*, many of the large metropolitan areas of the state have very low unem-

Chart 12
Leading Indicators Pointing
to Growth

(Net contributions of components to change in index, July–October 1999)

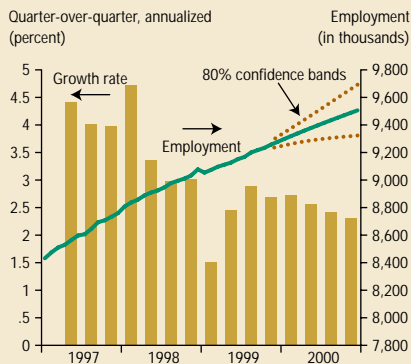


SOURCE: Federal Reserve Bank of Dallas.

ployment rates and very high rates of labor force participation.³ Thus, getting employment growth in excess of the working-age population growth (about 2.2 percent for Texas in 1998) will require gains in net in-migration. This may be difficult in an environment where almost all regions of the nation are expanding strongly.

Recent movements in leading indicators of the Texas economy confirm a positive outlook for 2000 (*Chart 12*). The Texas Leading Index increased from July to October 1999, with five of the eight components showing gains. A slight decline in the Texas inflation-adjusted export-weighted value of the dollar (inverted in the index) indicates a generally lower international price for products produced in Texas. A lower

Chart 13
Job Growth to Continue
at Moderate Pace



SOURCE: Bureau of Labor Statistics.

price should help the state's international competitiveness.

A rise in the U.S. leading index signaled continued strength in the U.S. economy. Gains in permits to drill oil and gas wells and in the oil price reflect improvements in the energy industry. New unemployment claims declined, suggesting that fewer individuals are expecting to be unemployed for an extended period. A stock price index based on companies with significant employment in the state declined, but it will likely show a pickup in the last two months of the year. Help-wanted advertising and average weekly hours worked signaled some weakness.

A forecasting model based on the movements in the index suggests that job growth should slow only slightly in 2000 from the pace set in the second half of 1999 (*Chart 13*). Because of the weakness in the first quarter of 1999, however, the model predicts that annual employment growth will increase slightly from 2.2 percent in 1999 to 2.5 percent in 2000. Based on the model's past forecasting accuracy, there is only about a 2 percent chance that employment will be lower in either April 2000 or October 2000 than it was in October 1999. Thus, the probability is very high that the Texas economy will remain un-sinkable for at least another year.

—Keith Phillips

Phillips is senior economist at the San Antonio Branch of the Federal Reserve Bank of Dallas.

Notes

¹ For a more complete description of the detrended employment series and the relationship between oil prices and the Texas economy, see "The New Texas Economy," Federal Reserve Bank of Dallas *Southwest Economy*, Issue 1, January/February 1999, p. 5.

² David Gould, "Can Mexico Weather Its Next Election Cycle?" Federal Reserve Bank of Dallas *Southwest Economy*, Issue 6, November/December 1999, pp. 10–14.

³ Lori Taylor, "The Economics of Prosperity: A Texas Tale," Federal Reserve Bank of Dallas *Southwest Economy*, Issue 5, September/October 1999, pp. 1–4.