Texas continued to do well after the U.S. went into recession in December 2007. As we end 2008, mounting evidence suggests that the state’s economy has begun to falter.

The Dallas Fed’s Texas Business-Cycle Index flashed a warning of possible recession in October, posting a negative monthly change for the first time since July 2003 (Chart 1).

The statewide index moves in tandem with its three components—Texas employment, unemployment and gross domestic product. Its recent movements reflect a slowdown in job growth and a jump in the unemployment rate from 5 percent in August to 5.6 percent in October.

Beige Book, the Dallas Fed’s anecdotal report on regional economic activity, revealed broad and sometimes deep deterioration in November. Almost all respondents noted declining business conditions and worsening prospects for the economy.

Since firms often cut temporary jobs before permanent staff, demand at staffing firms often falls before overall jobs decline. In the Beige Book, staffing firms reported a falloff in demand for personnel and a large number of layoffs across many industries, including manufacturing, financial services, information technology and accounting.

The Dallas Fed’s Texas Manufacturing Outlook Survey suggests that production, shipments, new orders and capacity utilization measures all declined sharply in November. Many respondents said tightening credit conditions were impacting their businesses.

Texas exports have declined on net over the past three months due to the dollar’s rising value and faltering growth overseas.

Housing inventories, foreclosures and delinquencies continue to look better in Texas than the nation. Home prices, which grew year-over-year in the third quarter, helped boost the state’s relative performance (Chart 2). Even so, Texas housing markets continue to erode. Homebuilding and residential construction employment are likely to remain weak for some time.

Energy prices have plunged in recent months, and the rig count has begun to respond. These declines will likely put downward pressure on Texas job growth in the months ahead.

Financial-sector employment has been shrinking nationally for almost two years; in Texas, it has flattened out and will likely decline in coming months (Chart 3). Troubled bank loans are increasing in the state.

The Texas Leading Index, a gauge of economic prospects for the next three to six months, has fallen broadly and sharply in recent months (Chart 4). Six of the index’s eight components have declined.

Despite these unsteady signs, Texas will likely continue to outperform the nation. Its housing sector is in better shape, the cost of living and doing business is lower, and energy still plays a positive role in the economy. Continuing declines in oil and natural gas prices, however, could erode the state’s relative strength.

—Keith R. Phillips and Mike Nicholson