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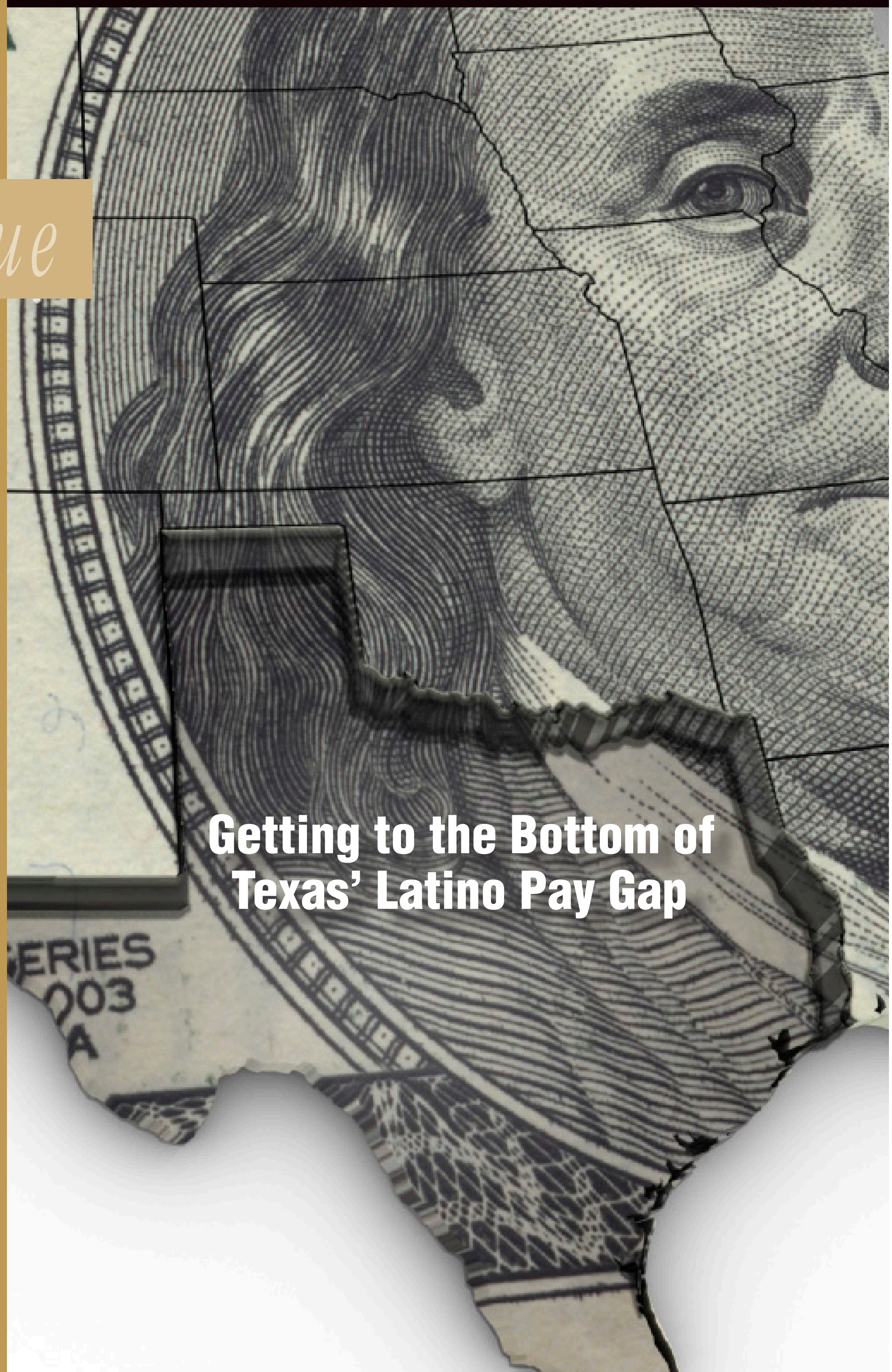


Getting to the Bottom of Texas' Latino Pay Gap

In This Issue

President's Perspective

In hard times, properly targeted and timely government spending can act as a short-term crutch, serving as temporary support until the private market is again able to stand on its own. The crutch has been sorely needed the past two years as we have dealt with a severe financial crisis and deep recession.

Help in averting an even worse economic malady has come at substantial cost. We at the Dallas Fed calculate that this year's spending by federal, state and local authorities—net intragovernmental transfers, in economists' lingo—will sum to more than a third of our gross domestic product. Federal deficits alone are projected to total between $7 trillion and $9 trillion for the next 10 years. These are truly startling figures.

The Federal Reserve does not, and should not, involve itself in the planning or execution of the federal budget. Taxing and spending is the business of those serving in the legislative and executive branches.

We at the Fed will keep a watchful eye on fiscal policy's effects as we monitor the growth and price dynamics of the economy.

Yet, deficit spending does have the potential to impact the conduct of monetary policy.

Historically, fiscal deficits that loom too large for too long come with a significant long-term price tag: the potential for higher interest rates and higher tax rates. As these deadweights bog down economic growth, fiscal authorities may look to the central bank to monetize the debt and inflate away government largess.

I know of no member of today's Federal Open Market Committee who has any intention of acquiescing to such pressures, should they materialize.

Maintaining a balance between necessary fiscal stimulus and long-term fiscal health is a task for the folks we elect to represent us. But we at the Fed will keep a watchful eye on fiscal policy's effects as we monitor the growth and price dynamics of the economy.

We will also continue to monitor the fiscal health of states. When national economic conditions deteriorate, state governments typically face budget squeezes, forcing them to choose between painful program cuts and tax hikes. This downturn has proven particularly difficult for state budgets, as senior research economist Jason Saving tells us in *Southwest Economy's* "On the Record" interview (*see page 8*). Fortunately, he finds Texas to be more fiscally fit than other states.

Richard W. Fisher
President and CEO
Federal Reserve Bank of Dallas

Getting to the Bottom of Texas' Latino Pay Gap

By Pia Orrenius, Madeline Zavodny and Emily Kerr

We consider a host of factors that may be keeping Latino wages relatively low in our region. Key among these factors is education.

FIRST OF TWO PARTS

Among Latinos, the U.S. born make up a majority in Texas but a minority in the rest of the country.[1] Because natives typically earn more than immigrants, a state with a large, established population of U.S.-born Latinos might be expected to have relatively high Latino wages.

That's not the case in Texas. The Latino wage gap—the difference between the wages of Latinos and non-Hispanic whites—is significantly larger in Texas than in the rest of the nation.

What drives the gap in Texas? To find out, we look at Latinos' recent contributions to the state's labor force and trends in their wages in the state and nation. Then we consider a host of factors that may be keeping Latino wages relatively low in our region.

Key among these factors is education. Texas Latinos have fewer years of schooling than non-Hispanic whites in Texas and Latinos living in other parts of the U.S. This poses a critical challenge as the Texas economy moves forward—improving the educational attainment of an increasingly significant segment of its population.

The Latino Workforce

Texas is home to 8.9 million Latinos—second only to California among the states. Texas' Latino population more than doubled between 1990 and 2008, increasing faster than any other major demographic group.

This rapid growth partly reflects international and domestic migration. The newcomers are largely attracted by Texas' strong economy. State employment has increased an average of 2.3 percent a year since 1990, about a percentage point faster than in the nation.[2] A relatively low cost of living is another pull factor. Housing costs are much lower in Texas than in other large states, both in absolute terms and relative to income.

A high fertility rate also contributes to the growing Latino population. In 1996, José replaced Michael and Christopher as Texas' most popular male baby name, and it has remained on top ever since, according to the Social Security Administration. Texas stands as the only state to have a predominantly Hispanic baby name ranked No. 1; no Latino baby names made it into the U.S. top 25 in 2008.[3]

The Latino population's increase has transformed Texas' labor force and led to faster economic growth. Latinos accounted for 76 percent of the state's labor force growth between 1994 and 2008.

We can look at Latino wages and the makeup of the labor force through the Census Bureau's Current Population Survey (CPS), a large-scale monthly poll of about 50,000 U.S. households.[4] It yields a wealth of individual-level data on wages, employment, household composition and demographic characteristics. Individuals identify themselves as being of Hispanic origin or descent. The CPS has included a question on country of birth since 1994.

The Latino share of the Texas labor force rose from 27 percent in 1994 to more than 38 percent in 2009 (*Chart 1*). In the rest of the country, Latinos were 8 percent of the labor force in 1994 and 12 percent in 2009.

Native Latinos accounted for slightly more than half the increase in Texas, rising from 17 percent of the Texas labor force in 1994 to 23 percent in 2009. Foreign-born Latinos increased from 10 percent to 15 percent.[5] At the national level, most of the growth in Latino labor force share came from immigrants.

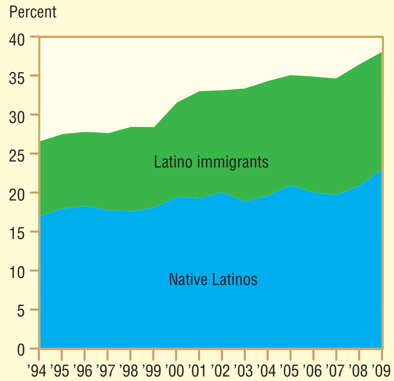
The Latino Wage Gap

Texas Latinos' median hourly earnings were $11.54 in 2007–09, about 64 percent of what the state's non-Hispanic whites earned (*Table 1*).[6] Latinos in the rest of the U.S. did better, earning $12.42, or about 71 percent of non-Hispanic whites' earnings.

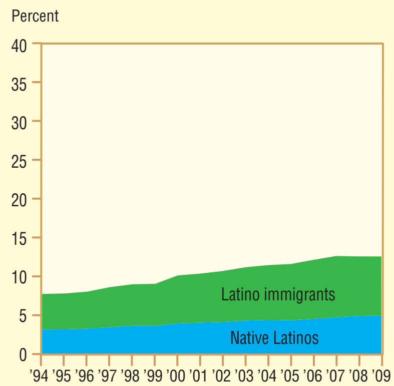
Native-born Latinos earn 17 percent less per hour in Texas than in other states—$12.46 versus $15.10.

Chart 1
Latino Share of Labor Force Larger in Texas than U.S.

A. Texas



B. United States



NOTE: U.S. figures exclude Texas.

SOURCE: Authors' calculations using 1994–2009 Current Population Survey data.

Median weekly earnings showed a similar pattern. Latinos received $468.16 a week in Texas, or about 60 percent of the non-Hispanic white median. Nationally, their pay was higher at $498.42 a week, or about 68 percent of non-Hispanic whites' earnings.

By both measures, Latinos have lower wages in Texas than in the rest of the country—in absolute terms and relative to non-Hispanic whites. Comparing relative wages provides a way of controlling for state-specific factors, such as Texas' lower cost of living.

Why do Texas Latinos earn less? For starters, they're younger than the state's non-Hispanic whites, which suggests fewer years of work experience. Texas Latinos age 25 and over also have considerably less education. About 40 percent didn't graduate from high school, compared with just 5 percent of Texas non-Hispanic whites. Eleven percent earned college degrees, well below the 38 percent of non-Hispanic whites.

Texas Latinos are less likely to work. Two-thirds are employed, compared with 74 percent of the state's non-Hispanic whites. This stems largely from women's decisions about working outside the home. Texas' Latino women are about 13 percentage points less likely than non-Hispanic white women to be employed.

Texas' high income inequality also plays a role.[7] The disparity between high- and low-wage earners exacerbates Texas' Latino wage gap when compared with states that have more uniform earnings distributions.

These comparisons help explain the in-state earnings differences, but what about the Latino wage gap between Texas and the rest of the nation? The state's non-Hispanic whites contribute to it because they have higher earnings and more years of education than non-Hispanic whites in the rest of the U.S. At the same time, Texas Latinos differ from Hispanics elsewhere in important ways that depress their relative earnings.

Native-born Latinos earn 17 percent less per hour in Texas than in other states—$12.46 versus $15.10 (*Table 2*). Foreign-born Latinos in Texas also earn less, but the difference is only 9 percent—$10.28 versus $11.25. Texas tops the nation in share of native born in the Latino population. When combined with the pay disparities, this suggests the native born are largely behind Texas Latinos' wider wage gap.

On the upside, native-born Texas Latinos are more likely to work than their national counterparts. However, this factor is

Table 1
Texas Latinos Differ from Non-Hispanic Whites and Other Latinos

	Latinos		Non-Hispanic whites	
	Texas	Rest of U.S.	Texas	Rest of U.S.
Hourly earnings ($)	11.54	12.42	17.90	17.56
Weekly earnings ($)	468.16	498.42	776.27	733.78
Age	36	35	40	40
Female (%)	49	47	50	50
Immigrant (%)	41	58	3	4
Education				
Less than high school (%)	40	36	5	6
High school (%)	29	30	26	30
Some college (%)	20	20	31	29
College (%)	11	14	38	35
Employment status				
Employed (%)	67	68	74	73
Unemployed (%)	5	8	4	5
Not in labor force (%)	29	26	24	23

NOTES: Shown are weighted sample means of monthly data from 2007–09 for individuals age 16 to 64. Education variables include only individuals age 25 and older. Earnings are medians and are deflated using the consumer price index for urban workers (June 2009 = 100).

SOURCE: Authors' calculations using 2007–09 Current Population Survey data.

Table 2

Whether Foreign or Native Born, Latinos Earn Less in Texas

	Foreign-born Latinos		Native-born Latinos	
	Texas	Rest of U.S.	Texas	Rest of U.S.
Hourly earnings ($)	10.28	11.25	12.46	15.10
Weekly earnings ($)	413.01	445.08	508.25	614.37
Age	37	37	35	32
Female (%)	45	45	51	51
Education				
Less than high school (%)	60	48	23	14
High school (%)	23	28	34	33
Some college (%)	10	13	28	33
College (%)	8	11	14	20
Employment status				
Employed (%)	68	71	67	64
Unemployed (%)	5	7	6	9
Not in labor force (%)	29	24	29	29
Citizen (%)	22	27	–	–
Born in Mexico (%)	85	62	–	–
Born in C. America (%)	10	15	–	–

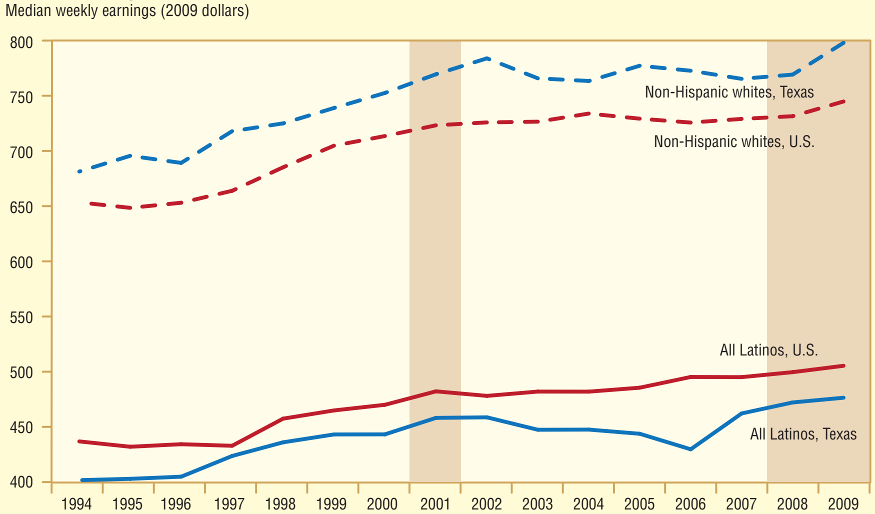
NOTES: Shown are weighted sample means of monthly data from 2007–09 for individuals age 16 to 64. Education variables include only individuals age 25 and older. Earnings are medians and are deflated using the consumer price index for urban workers (June 2009 = 100).

SOURCE: Authors' calculations using 2007–09 Current Population Survey data.

Chart 2

Latino Wages Rise over Time

Median weekly earnings (2009 dollars)



NOTE: Shaded areas represent U.S. recessions.

SOURCE: Authors' calculations using 1994–2009 Current Population Survey data.

more than offset by educational differences. In Texas, 23 percent of native-born Latinos age 25 to 64 are high school dropouts, compared with 14 percent in the rest of the nation. And 14 percent have college degrees, well below the 20 percent of native-born Latinos elsewhere.

Texas' Latino immigrants are also very different from their U.S. counterparts. Only 22 percent in Texas are U.S. citizens, compared with 27 percent elsewhere. Perhaps more telling, 85 percent in Texas were born in Mexico, compared with 62 percent in the rest of the country. Research shows that Mexican immigrants tend to have lower skill levels than Latino immigrants from other countries. They're also more likely to lack legal status—the case for more than half of Mexican-born Hispanics in the U.S.[8]

Other factors may contribute to Texas' wide Latino wage gap. One is that a significant number of the state's Latinos live along the Texas–Mexico border—about 23 percent, or roughly 2 million people. Hispanics in these border areas earn lower wages than Hispanics in the state's interior, depressing average earnings for Latinos in the state.[9]

Research has found that Latino immigrants tend to earn less than native-born workers even at similar education levels. They often lack English fluency, institutional knowledge and social capital. For some, illegal immigrant status is a barrier to better-paying jobs.

The lower wages might also be policy related. Some states with large Latino populations set their minimum wages above the federal standard. For example, California raised its minimum from $5.15 in 1997 to $7.50 in 2007, while the federal minimum held steady during this 10-year period at $5.15. By contrast, Texas tied its minimum wage to the federal rate. This put low-wage Texans at a disadvantage in cross-state comparisons.

It should be noted that Texas' lower cost of living makes up for a portion of the Latino earnings deficit relative to Latinos elsewhere, although it does nothing to mitigate the in-state wage gap relative to non-Hispanic whites.[10] According to the American Chamber of Commerce Research Association's state survey, Texas had the fourth-lowest cost of living in 2009, trailing Oklahoma, Tennessee and Kentucky.

An important factor in the lower cost of living is housing affordability. In 2008, the median value of an owner-occupied home in Texas was $126,800. By comparison, median values were $467,000 in California, $318,900 in New York and $218,700 in Florida.[11]

In Texas metropolitan areas, 70 to 75 percent of homes sold are considered affordable for a family with a median household income.[12] Other major Latino immigrant destinations are far behind—New York at 21 percent, Los Angeles at 42 percent and Miami at 53 percent.

The Wage Gap over Time

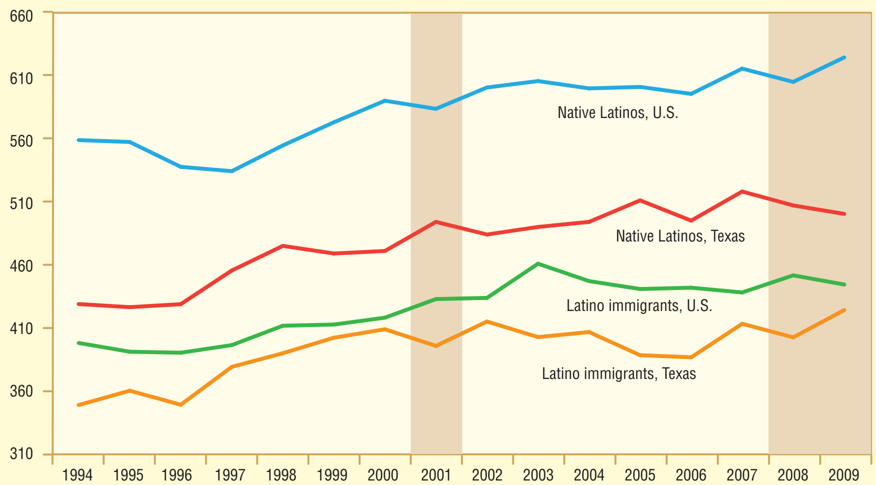
The Latino wage gap has persisted but hasn't gotten worse. Latino and non-Hispanic white workers saw real weekly earnings rise at roughly the same pace from 1994 to 2009 in the U.S. and Texas (*Chart 2*).

The bulk of Latino wage growth, particularly in Texas, occurred during the booming 1990s. Immigration was high at the time, making the wage increases even

Chart 3

Wages Rising for Latino Natives and Immigrants

Median weekly earnings of Latinos (2009 dollars)



NOTE: Shaded areas represent U.S. recessions.

SOURCE: Authors' calculations using 1994–2009 Current Population Survey data.

By 2030, Latinos are expected to make up the majority of the Texas population, a prospect that increases the importance of understanding the social and economic factors behind the wage gap.

more impressive. Newcomers typically affect wages in two ways—by increasing labor market competition and by diluting the average wage.

Hispanic wage growth stalled as a result of the 2001 recession. Over the next four years, real wages fell in Texas, while they were flat in the rest of the country. Texas had participated in the high-tech boom, and the 2001 bust hit the state hard. As a result, the recession was more severe in Texas and recovery was slower.[13] While few Latinos may have worked in the high-tech sector itself, they benefited when the overall Texas economy was up and suffered when it was down.

Recent movements have been more favorable. Texas Latinos' wages recovered in 2007–09, moving back toward the U.S. trend.

Unemployment rates confirm that labor market conditions have improved for Latinos over the past 15 years. The fraction of the Texas Latino labor force actively seeking work but not employed was more than 8 percent in 1994, but it had fallen to 5 percent by 2007–09, converging to the rate for non-Hispanic white workers, according to CPS data.

Both Latino natives and immigrants experienced rising wages in 1994–2009 (*Chart 3*). The disparity between Texas and U.S. Latino wages is much larger for natives than for immigrants. In fact, wages for foreign-born Latinos in Texas and the U.S. almost converged in 2009, while wages for natives diverged further.

Latino wage performance can also be judged relative to other workers' pay. Expressed as a share of non-Hispanic whites' earnings, wages of Latino workers were essentially flat from 1994 to 2009, both in Texas and the rest of the U.S. (*Chart 4*).

The Latino wage gap vis-à-vis non-Hispanic whites hasn't closed, but it hasn't worsened either. This can be regarded as good news because several factors could have led to a widening during the 1990s, a period of massive immigration of less-educated Latinos, or afterward, a time marked by a general rise in U.S. income inequality.

The enduring gap between the relative wages of native-born Texas Latinos and their U.S. counterparts remains disconcerting. For at least 15 years, native Latinos' relative wages have been 20 percentage points lower in Texas than in the rest of the country.

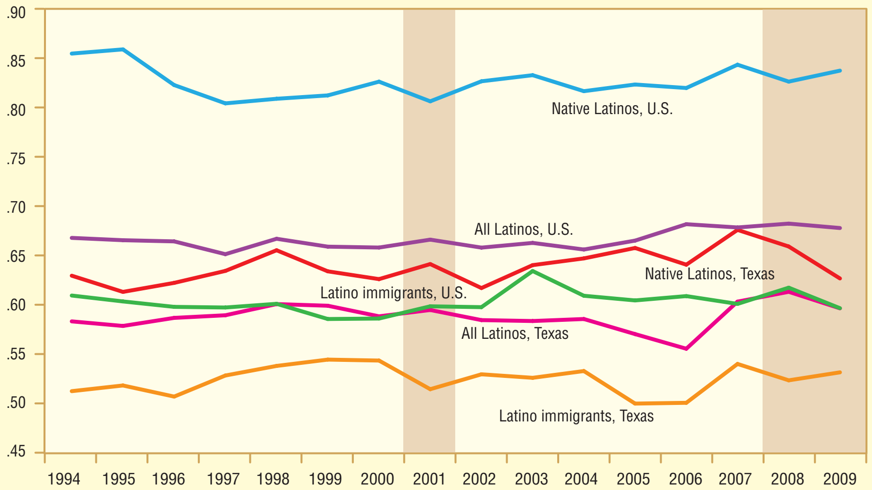
Differences across groups of U.S.-born workers are much harder to explain than native–immigrant disparities. After all, measured against non-Hispanic whites, the Latino second generation is no different in terms of legal status. All children born in the U.S. are automatically citizens. We also see no differences in language acquisition because second-generation Latinos are overwhelmingly fluent English speakers. What hasn't equalized is education. The big differences in years of schooling translate into big disparities in earnings.

Closing the Gap

Latinos represent the state's fastest-growing demographic group and 38 percent

Chart 4
Latino Wage Gap Persists but Doesn't Widen

Latinos' median weekly earnings, as a share of non-Hispanic whites' earnings



NOTE: Shaded areas represent U.S. recessions.

SOURCE: Authors' calculations using 1994-2009 Current Population Survey data.

of its labor force. By 2030, they're expected to make up a majority of the state's population, a prospect that increases the importance of understanding the social and economic factors behind the Latino wage gap.[14]

Education deficits are clearly a key reason Texas' Latinos haven't narrowed the wage gap with non-Hispanic whites. Even so, it's puzzling why native-born Latinos have a much lower average educational attainment in Texas than in other states.

National research on Latino educational outcomes offers a few clues about what may be inhibiting education. Most important, schooling may be interrupted by the need to work or take care of family responsibilities. Latinos tend to have higher poverty rates, lower incomes and larger families than non-Hispanic whites.[15]

Latinos are also more likely to lack health insurance, and sickness or accidents in a family could push students out of school and into work. In a recent Pew Hispanic Center poll, 74 percent of young Latino respondents who had not gone on to college said they left school to help support their families.[16]

Young Latinos are also more likely than non-Hispanic whites of similar age to be neither in school nor at work; Latinas in particular are more likely to leave school to raise children.[17]

Native-born Latinos are often the children of immigrants. Latino respondents in the Pew survey cited a lack of parental involvement and a poorer knowledge of English as major reasons Latinos don't perform as well in school as other demographic groups. Respondents also cited no need for further schooling to pursue their chosen line of work.

In Texas, more and better education—specifically, in the areas of degree completion and English fluency—are keys to achieving higher wages among Latino workers. A more diversified immigrant stream would also contribute to this aim. Complementarities among high- and low-skilled migrants suggest this would improve living standards for both groups.

Comprehensive immigration reform in conjunction with higher education would help Latinos access more high-paying occupations. Minimum-wage policies may help raise incomes for low-wage workers who stay on the job but can hurt employment prospects for teenagers and other young and inexperienced workers.

Orrenius is a research officer and senior economist and Kerr is a research analyst at the Federal Reserve Bank of Dallas. Zavodny is a professor of economics at Agnes Scott College in Decatur, Ga.

Notes

1 Most U.S. surveys ask individuals if they are Hispanic, not Latino. We therefore treat the two as equivalent. However, we note that individuals of Spanish ancestry might identify themselves as Hispanic but usually would not be considered Latinos, while individuals of Brazilian ancestry might not identify themselves as Hispanic but usually would be considered Latino. All Hispanic population data cited in this article are from the Census Bureau.

2 Texas employment data come from the Texas Workforce Commission and Bureau of Labor and Statistics, with seasonal adjustments by the Federal Reserve Bank of Dallas.

3 Data are available at www.ssa.gov/OACT/babynames.

4 We use the merged outgoing rotation group files of the Census Bureau's Current Population Survey.

5 We use the terms foreign born and immigrant interchangeably. We define immigrants as people born abroad who are not U.S. citizens at birth (that is, not born abroad to parents who are U.S. citizens).

6 The earnings data are based on median hourly or weekly earnings to avoid the influence of outliers on average wages; at the median, half of all observed wages lie above and half below.

7 See "Pulling Apart: A State-by-State Analysis of Income Trends," by Jared Bernstein, Elizabeth McNichol and Karen Lyons, Economic Policy Institute and Center on Budget and Policy Priorities, January 2006.

8 See "Mexican Immigrants in the United States, 2008," Pew Hispanic Center Fact Sheet, April 15, 2009.

9 See "Differences Between Mexican Migration to the U.S. Border and the Interior," by Pia M. Orrenius, Madeline Zavodny and Leslie Lukens, in *Labor Market Issues Along the U.S.–Mexico Border*, Marie T. Mora and Alberto Dávila, ed., Tucson: University of Arizona Press, 2009.

10 We use the national Consumer Price Index (CPI) to deflate wages because there is no state-level CPI. A state-level CPI would capture the differential growth in living costs and would be preferable.

11 Values are from the Census Bureau's 2008 American Community Survey and are the most recent available at the state level. Other data suggest home prices have dropped since 2008.

12 Affordability shares are from the Wells Fargo Housing Opportunity Index, which assumes a family can afford to spend 28 percent of its gross income on housing costs.

13 See "Texas in the Most Recent Recession and Recovery," by Mine Yücel, Federal Reserve Bank of Dallas *The Face of Texas: Jobs, People, Business, Change*, October 2005.

14 See "Population Change in Texas: Implications for Human, Socioeconomic and Natural Resources in the 21st Century," speech by Steve H. Murdock, University of Texas at San Antonio, April 29, 2004, http://recenter.tamu.edu/speeches/land04Murdock.pdf.

15 See "Statistical Portrait of Hispanics in the United States, 2007," Pew Hispanic Center, March 2009.

16 See "Latinos and Education: Explaining the Attainment Gap," by Mark Hugo Lopez, Pew Hispanic Center, October 2009.

17 See "The Changing Pathways of Hispanic Youths into Adulthood," by Richard Fry, Pew Hispanic Center, October 2009.

OnTheRecord

A Conversation with **Jason Saving**

Texas in Better Fiscal Shape than Most Other States

The hardships of recession aren't confined to the private sector. Dallas Fed regional economist Jason Saving takes a look at how state budgets are faring in the long, deep slump—starting with Texas.

Q. What can you tell us about Texas' state finances?

A. Texas hasn't had the same tax revenue losses as many other states. Our economy has generally fared better than the nation's during this recession. The state unemployment rate has been a percentage point or more below the national rate. Job losses have been smaller. Personal income has fallen at a slower rate, and the same is likely true for total output.

Faring better hasn't meant escaping recession, and the state did confront some fiscal turbulence in 2009. Several one-time revenue gains, including $6 billion in federal stimulus funding, offset declining tax receipts and enabled Texas to maintain services without drawing down the state's rainy-day fund.

State sales tax revenue has softened considerably during the recession—for example, the second quarter saw a 6.5 percent decline from the same period last year. At the same time, outlays in key programs, including Medicaid, continue to increase. This suggests a more challenging fiscal environment in 2010 as policymakers attempt to reconcile greater demand for state services with shrinking revenue.

Q. Has the recession been as hard on states as it's been on the federal government?

A. The federal deficit has more than tripled, going from $454 billion in 2008 to $1.4 trillion in 2009. This expansion has had two main causes—a dramatic increase in spending aimed at getting the economy moving again and a dramatic reduction in tax revenues as firms and individuals face lower profits and incomes.

Almost every state has had to confront—or is still confronting—budgetary shortfalls since the start of the recession. Taken together, the shortfalls are in the neighborhood of $100 billion in fiscal 2009, and they're expected to total about $170 billion in fiscal 2010.

At first glance, it might seem the recession has been far easier on states than the federal government. But this would be incorrect. It's important to remember that states, with the exception of Vermont, are required to balance their budgets year-in and year-out.

The federal government can spend more as revenues decline, but states have to make difficult decisions that often impose real and immediate pain on ordinary citizens. When revenues can't cover expenditures, states are required to raise taxes or scale back spending—typically at a time when cash-strapped citizens need all the help they can get.

Q. Why has Texas had fewer fiscal problems than most other states?

A. Several factors are at work. One is a business-friendly environment, which has helped keep alive firms that might have succumbed to the recession elsewhere. Another is a rise in state government spending that was slower than the national average after the 2001–02 recession, creating less of a spending overhang to pare back in hard times. Yet another is that the Texas economy entered recession later than other states, partly due to such factors as high energy prices and the friendly business climate.

But a key factor often missed in these kinds of discussions is Texas' reliance on sales taxes rather than income taxes. Income takes a much bigger hit than consumption during economic downturns because people try to maintain their living standards while enduring temporary wage cuts or unemployment spells. So income tax revenue tends to fall further than sales tax revenue during recessions, leaving income-tax-reliant states facing deeper fiscal shortfalls.

We've seen this during the recession. In the second quarter, overall revenue from state income taxes fell 15 percent from the same period last year, whereas sales tax revenue across the 50 states was down only 6 percent. The flip side is that income-tax-reliant states have greater room to increase spending during recoveries. That's not receiving a lot of play at the moment—for obvious reasons.

Q. Does Texas face any significant budget issues?

A. Texas certainly faces fiscal challenges. A short-term issue is the newly reformed franchise tax, which is generating about $1 billion less in annual revenue than forecast. Only part of that gap can be attributed to the recession. Recent changes to the tax have actually further reduced revenue—for example, by raising the income threshold at which taxes must be paid. The franchise tax provides less than 10 percent of state revenue, but this is still an issue the state will have to deal with in the near future.

An intermediate-term issue is Medicaid, which has almost doubled in size over the last decade in Texas and now consumes a quarter of the state's overall budget. Getting those outlays under control would free up money for other priorities, but virtually every state has struggled to reach this goal in an era of rapid increases in health care costs. The federal government's health care reform has the potential to slow the rise in costs, but most

"A key factor is Texas' reliance on sales taxes rather than income taxes. Income takes a much bigger hit than consumption during economic downturns."

proposals now on the table would also dramatically expand Medicaid rolls. If not properly handled, reform could actually worsen Texas' fiscal strains.

Over the longer term, the most important fiscal issue will be improving education and infrastructure without sacrificing the low taxes and business-friendly climate that have helped the state's economy grow faster than the nation's. If the state fails to improve graduation rates among Hispanics or fails to modernize its highway network, for example, economic growth and tax revenue could suffer over time. On the other hand, failing to maintain a low-tax policy environment may also slow growth and exacerbate state fiscal imbalances.

Q. Besides Texas, are other states doing reasonably well on the fiscal side?

A. A number of Great Plains-area states managed to get through fiscal 2009 without significant fiscal shortfalls, including Arkansas, Iowa, Kansas, Montana, Nebraska and the Dakotas. Most are states with the fewest job losses in this recession, including one—North Dakota—that has actually gained jobs over the past nine months.

But the best available estimates suggest that even these states face significant fiscal pressures in 2010 and 2011, partly because of the sheer depth of the recession and partly because of fluctuations in the food and energy prices that help drive their economies.

Q. Which states are facing the biggest budget messes?

A. The state facing the greatest fiscal challenge—bar none—is California, where legislators wrestled with a shortfall of almost $40 billion in fiscal 2009 and face even greater fiscal pressures in 2010. Spending in the previous five years rose 3 to 4 percentage points faster than inflation and population growth. Then the recession hit. Revenue from the state's steeply progressive income tax has fallen by a whopping 20 percent over the past year, so the spending levels simply couldn't be maintained with available revenue.

Other states that face an especially challenging 2010 include Arizona, Nevada and New York. Each of these states increased spending at a relatively rapid rate during expansion, and each is now struggling to close very substantial shortfalls.

Q. When states cut spending, what usually gets the ax?

A. State spending is divided into three broad categories of roughly equal size: social services, education and criminal justice. All are valuable and all tend to be trimmed when states face recession-induced budget shortfalls. Eligibility requirements are tightened for welfare programs and checks are reduced; funding for schools is curtailed and elementary and high school class sizes are increased; judicial backlogs grow and enforcement efforts can suffer.

Unfortunately, these cutbacks often occur at precisely the time the programs are needed most, when poor job market prospects induce individuals to seek social assistance, return to school or perhaps even commit crimes.

Q. How can states prepare themselves for the fiscal shock of recession?

A. They can do a couple of things to be better prepared for adverse economic circumstances. One is to lessen reliance on taxes that are strongly tied to current economic conditions, so that tax revenues will be less likely to plunge precisely when demands for state services are greatest.

Another is to resist the temptation to dramatically ramp up spending during recoveries, so that fewer cuts will be needed during recessions. Balancing the budget over time requires saving during booms—whether we're talking about states or individuals. The strategy can be hard to do at times but pays dividends when the economy worsens.

The most important thing a state can do to prepare for the fiscal shock of recession is offer a business-friendly environment. Doing so helps states enter recession with a relatively strong tax base and helps sow the seeds of a relatively quick recovery because startups can make profits earlier in the business cycle.

Texas has done relatively well along most of these dimensions, generally relying on taxes that don't swing wildly with current economic conditions and providing a conducive tax and regulatory environment for business. It's important to bear in mind, though, that no state can fully insulate itself from recession or its fiscal consequences.

Q. Will economic recovery be enough to resolve most states' budget troubles?

A. It typically takes two to three years for state fiscal pressures to abate, in part because firms don't hire as quickly as consumers would like and consumers don't open their pocketbooks as quickly as firms would like. Going by historical record, it wouldn't be at all surprising to see further tax hikes or spending cuts at the state level in 2010 or even 2011 as policymakers struggle to get back on an even keel.

Some analysts believe the depth and breadth of the current recession could extend these postrecession blues by an additional year or two beyond the norm. It's too early to say whether this scenario will play out, but it's fair to say the onset of economic recovery won't immediately take care of state fiscal woes.

SpotLight

Farm Real Estate Values
Texas Holds Steady in 2008, Bucking U.S. Trend

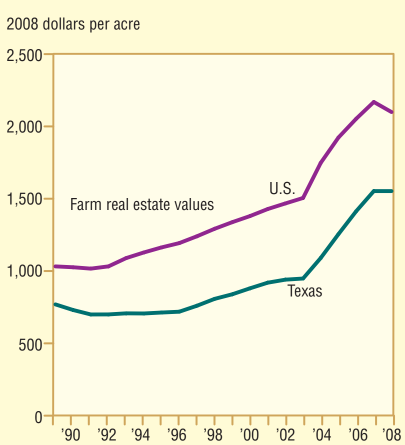
The value of Texas agricultural land has followed national trends since the early 1990s. Last year, however, the state's average price per acre remained unchanged, a sharp contrast to the nation's first decline in 17 years. Texas was one of only eight states that didn't see falling farm values in 2008.

The most recent Department of Agriculture report shows U.S. farm real estate, adjusted for inflation, was worth an average of $2,100 an acre in 2008, down 3.2 percent from the previous year (*Chart 1*). Farm real estate values include land and buildings.

The average value of Texas agricultural land remained at $1,550 an acre in 2008. Texas trails the nation because much of its farmland is arid with poor soil, so it can't match other states' crop yields. Some states, like California, have good growing conditions for high-value permanent crops like fruits and nuts.

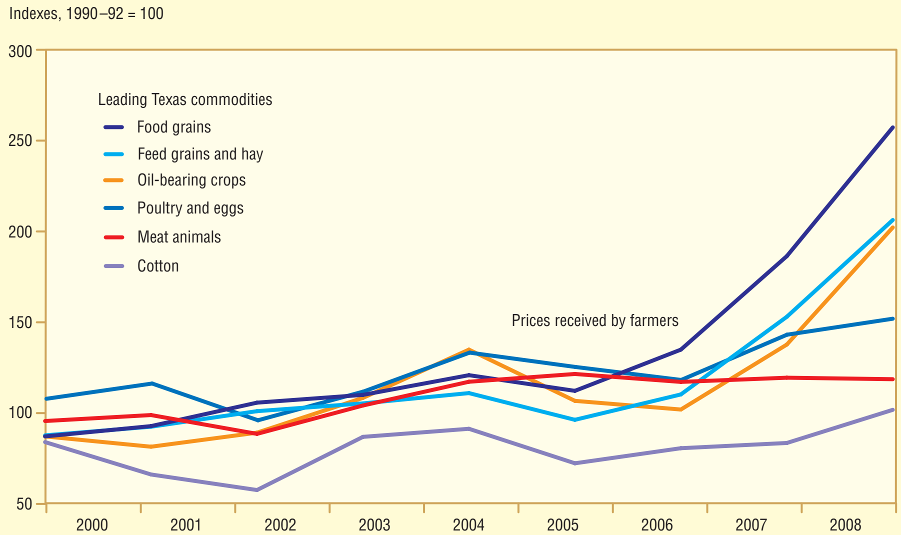
Nearly 80 percent of Texas' land is devoted to agriculture. Pastureland accounts for two-thirds of the total, supporting a livestock industry that ranked No. 1 in the nation with more than $10.5 billion in sales in 2007. Cropland takes up most of the rest of Texas' rural acreage, with corn, cotton and hay—the top three crops—combining for production of more than $3.3 billion in 2008. Texas trails only California in total agricultural production.

Chart 1
Texas Farmland Values Flat in 2008



SOURCE: U.S. Department of Agriculture.

Chart 2
Rising Agricultural Prices Support Texas Land Values



SOURCE: U.S. Department of Agriculture.

Several factors most likely contributed to the resiliency of Texas farm values in 2008. First, the Texas economy performed better than the national average, and it wasn't hurt as badly by a residential real estate crisis that elsewhere slowed the conversion of farmland into nonagricultural development.

Second, prices for Texas' most important agricultural products have held up better than the prices for the leading farm products in other states. Livestock prices remained steady in 2008 and grain prices increased, supporting land values by providing healthy incomes for Texas ranchers and farmers (*Chart 2*). Meanwhile, prices dropped for dairy products and vegetables, harming the farm sectors in states heavily invested in those commodities.

Hunters a Plus

A third factor bolstering farm real estate values arises from Texans' passion for hunting, a source of lucrative lease income for many landowners. From 1996 to 2006, the number of hunters fell 10 percent nationally but rose 21 percent in Texas, according to a U.S. Fish and Wildlife Service survey. Over the decade, spending by Texas hunters increased 22 percent.

Federal Reserve Bank of Kansas City research found that for each 4 percent increase in hunting lease rates, Texas land values rise 1 percent. In comparison, livestock receipt increases of the same magnitude lead to a 0.56 percent increase in land values. For crop receipts, the gain is only 0.11 percent.

Looking ahead, it's likely that farmland values will be flat to slightly down this year. Several factors are putting downward pressure on land values—a sharp weakening of the Texas economy, tighter credit conditions, weaker commodity prices and severe drought conditions in much of the state.

The Dallas Fed's third quarter agricultural survey found that farmland sales continued to weaken. More than a third of agricultural lenders responding to the survey expected a continued decline in farm real estate loans in the near term. "The trend in farmland prices remains negative, with nearly all respondents expecting either no change or a decline in farmland values over the next three months," the survey reported.

— Emily Kerr and Keith R. Phillips

Texas Dodges Worst of Foreclosure Woes

By D'Ann Petersen and Laila Assanie

Texas bucked the national housing downturn—for a while. A strong economy and low costs of living and doing business attracted firms and new residents. The in-migration helped buoy the housing sector, and home construction, prices and sales held up in Texas even as they began to decline nationally.[1]

In time, Texas' housing market followed the nation's downward path. Home construction began plummeting in the second half of 2006—several months behind the nation. Texas existing-home sales started falling in mid-2007. The picture worsened considerably in 2008 as labor markets weakened and a troubled financial environment made mortgages more difficult to obtain.

The housing bust leaves in its wake elevated foreclosure levels in Texas and the U.S. Like other consequences of the bust, foreclosures have been less severe in Texas. While the nation's foreclosure rate has grown nearly sixfold over the last four years, Texas' has climbed only marginally.

Housing markets in Texas and the U.S. have shown signs of stabilizing in recent months. Home sales and construction starts are beginning to tick up, thanks in large part to low mortgage rates and the first-time homebuyer tax credit. Despite the improvement, segments remain weak, especially the higher-priced move-up market.

Foreclosures are likely to persist in 2010—a concern because they can add to inventories and put downward pressure on home values. However, expectations are for Texas' foreclosures to remain low compared with the nation as a whole.

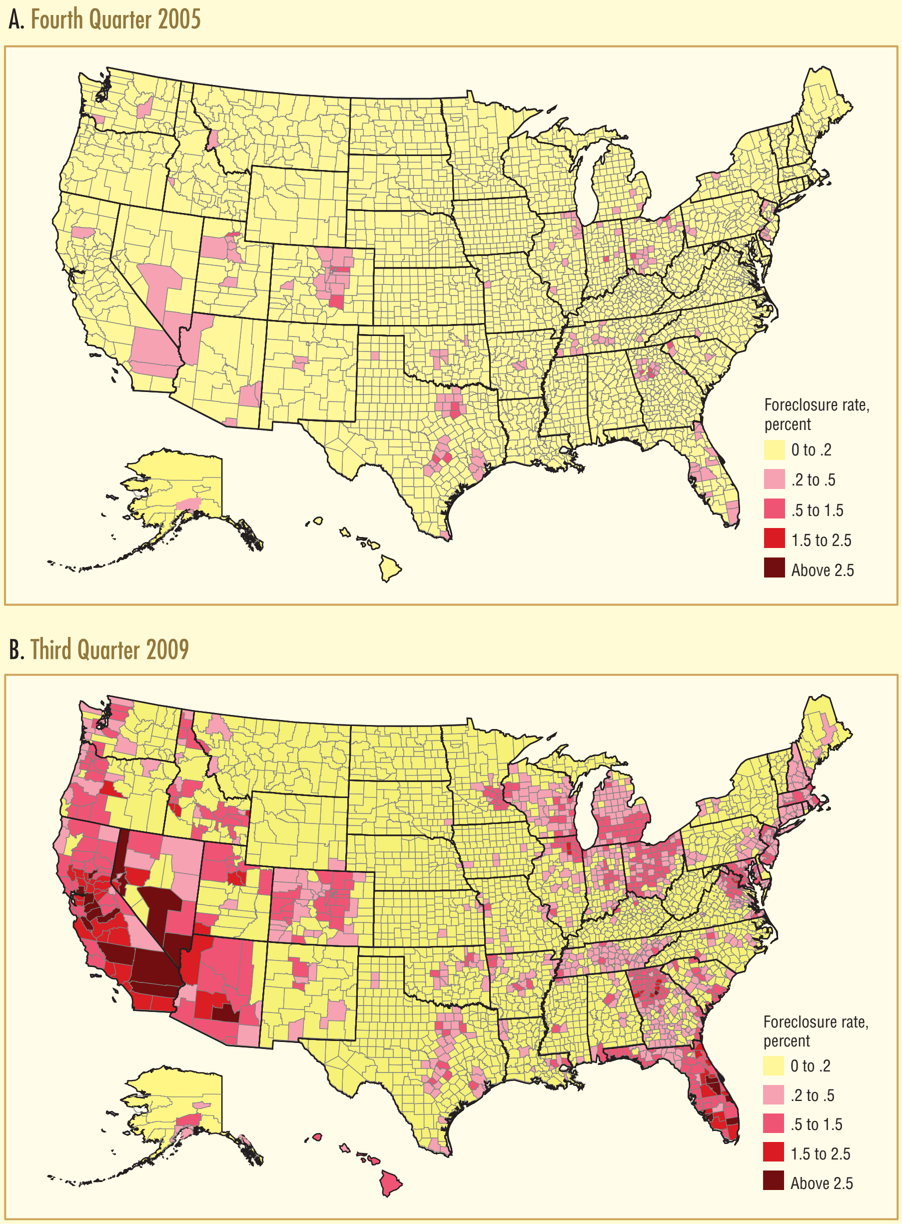
Geography of Foreclosures

The foreclosure crisis has hit some parts of the country much harder than others. Most of the distressed housing activity is currently concentrated in just a few states. Texas isn't one of them. Its foreclosure rate ranks 28th in the nation and last among big states.

RealtyTrac data show foreclosure activity by county. We mapped foreclosures relative to the number of households in each county as of fourth quarter 2005, when the national housing crisis had yet to unfold and the foreclosure rate was a mild 0.13 percent (*Chart 1A*).

At that time, only a few states showed clusters of counties with somewhat high foreclosure rates. These included California, Florida and Colorado—states that had a high incidence of risky, high-cost loans. According to the Mortgage Bankers Association, the three states' share of subprime adjustable-rate mortgage (ARM) loans was above 8 percent

Chart 1
Foreclosure Rates by County—Before Housing Crisis and Now



NOTE: The foreclosure rate is the number of foreclosure filings divided by the number of households in each county times 100.

SOURCE: RealtyTrac.

in fourth quarter 2005, compared with 6.7 percent for the nation.

In Texas, foreclosure rates were elevated in several parts of the state in 2005, even though the economy was expanding and the housing market was still on an upswing. As a result, Texas' foreclosure rate of 0.26 percent was double the national average. Several areas of the state, especially counties within the Dallas–Fort Worth and Austin metropolitan areas, were still feeling the aftereffects of a high-tech bust that persisted for several years after 2001 and left a significant share of white-collar workers without jobs. In fact, some counties in the two metro areas were among the top 25 in the U.S. for foreclosure rates in fourth quarter 2005.

Fast-forwarding to third quarter 2009, Texas looks pretty much the same (*Chart 1B*). Overall, the state's foreclosure rate edged up to 0.32 percent, and a few more counties saw foreclosures rise.

But the picture looks strikingly different elsewhere. Falling home prices, rising unemployment and resets on risky loans spread and intensified the foreclosure crisis. By the third quarter of this year, the nation's foreclosure rate had hit 0.73 percent, up from 0.13 percent in fourth quarter 2005.

Many areas are showing signs of distress, including the manufacturing belt, as the downturn in the auto industry feeds high unemployment. While foreclosure-rate increases are widespread, Nevada, Arizona, California and Florida account for most of the foreclosure activity. More than 40 percent of the counties with rates above the U.S. average are in these four states.

Texas is now faring better in the foreclosure crisis in part because of a healthier economy. The state outperformed the nation in job growth in 2006 and 2007. Even as the U.S. economy was mired in recession in 2008, Texas saw modest job growth. This year, the pace of job losses steepened in Texas, closely matching the U.S. rate.

Another key for the state is a housing market that didn't see the price escalation other big states did during the boom years. As a result, Texas didn't experience a price-bubble bust. In fact, home values have held up relatively well.

The purchase-only home price index, issued by the Federal Housing Finance Agency (FHFA), shows that home values appreciated 4.6 percent in Texas from the end of 2006 to second quarter 2009 while they fell 10.3 percent nationwide (*Chart 2*).[2] Among the hardest hit states were Nevada, Arizona, California and Florida—those with the highest third-quarter foreclosure activity. Several metropolitan areas in these states saw prices plummet more than 40 percent.

A large share of borrowers had little or no equity at origination, so the rampant depreciation left many of them owing more than their home's value and unable to sell or refinance without taking a loss. These so-called underwater mortgages began to increase, putting even more downward pressure on home prices. Because of its more stable home values, Texas has had a relatively low share of homeowners with negative equity, ranking 35th among states.[3]

Moreover, Texans didn't rely on risky loans as heavily as borrowers in other states during the boom years. Fewer interest-only and negatively amortized loans were taken out in the state, according to a Dallas Fed study.[4] And only 43.1 percent of Texas subprime borrowers used cash-out refinancing, compared with 57.3 percent for the nation.[5] More equity has made Texas homeowners less vulnerable to default in cases of economic or personal adversity.

Texas Hot Spots

Many factors influence foreclosure rates. Recent research shows that differences in U.S. counties' foreclosure rates are associated with unemployment, housing affordability, changes in home prices and the share of minority homeowners with high-cost loans. This also holds true in Texas.[6]

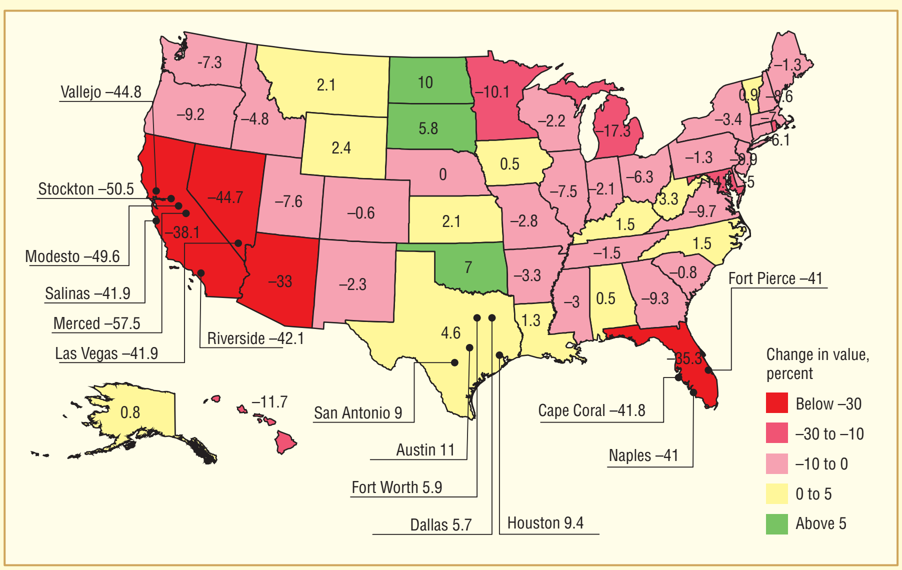
Of the 254 counties in Texas, only four had foreclosure rates exceeding the national average in third quarter 2009. Twenty-six reported rates higher than the state average (*Table 1*). Economic and demographic characteristics common to these hot spots help explain why their foreclosure rates are somewhat higher:

Unemployment. A weak economy can make it difficult for households to keep up with mortgage payments. One-earner and low-income households are particularly vulnerable to economic or financial shocks.

While Texas' unemployment rate has remained well below the nation's, most hot-spot counties saw joblessness increase by more than the state average between December 2006 and September 2009. Johnson County, which has the third-highest foreclosure rate in Texas, saw the largest increase in unemployment, probably because of the sharp fall in Barnett Shale natural gas drilling activity in the area.

Galveston saw its unemployment rate rise significantly as devastation from Hurricane Ike in September 2008 forced businesses to close. Along the Mexican border, Cameron and Hidalgo counties also saw above-average increases in unemployment.

Chart 2
Home Values Holding Up Better in Texas than Nation
(House price index, fourth quarter 2006 to second quarter 2009)



NOTE: Metro data are from the House Price Index (HPI), which includes refinances, while state data are from the purchase-only HPI.
SOURCE: Federal Housing Finance Agency.

Table 1
Economic and Demographic Characteristics of Texas Hot Spots

County	Foreclosure rate, 2009:Q3 (%)	Change in unemployment rate, Dec. 2006 to Sept. 2009 (pct.pts.)	Home purchase loan-to-income ratio, 2006	Home price appreciation, 2006:Q4 to 2009:Q2 (%)	Change in housing units, 2000 to 2008 (%)	Higher-priced loans, blacks, 2006 (% of all home-purchase loans)	Higher-priced loans, Hispanics, 2006 (% of all home-purchase loans)
Kaufman	.90	4.3	2.0	5.7	21.1	70.2	45.1
Bastrop	.84	4.2	2.0	11.0	12.5	82.1	46.5
Johnson	.82	5.2	1.9	5.9	16.0	57.1	47.4
Rockwall	.76	4.0	2.3	5.7	66.0	63.6	31.4
Comal	.57	3.1	2.2	9.0	40.2	35.3	28.7
Williamson	.56	4.5	2.2	11.0	48.3	33.9	31.9
Parker	.53	4.5	2.0	5.9	13.4	75.0	34.7
Fort Bend	.52	4.5	2.0	9.4	33.9	60.2	41.5
Collin	.50	4.2	2.2	5.7	45.0	47.3	39.6
Kendall	.48	2.7	2.2	9.0	40.1	0.0	14.0
Ellis	.46	4.6	2.1	5.7	30.9	38.3	42.3
Montgomery	.45	4.3	2.0	9.4	43.3	60.9	39.8
Tarrant	.44	4.1	2.1	5.9	20.5	61.3	43.5
Dallas	.43	4.3	2.1	5.7	10.4	67.7	55.6
Hays	.43	3.4	2.2	11.0	42.0	40.4	33.8
Cameron	.43	5.0	2.0	7.0	20.8	42.9	55.3
Denton	.42	4.1	2.1	5.7	32.6	50.1	41.2
Bell	.41	2.8	2.0	8.5	24.6	59.6	42.8
Hidalgo	.40	4.7	2.0	.2	30.4	39.3	57.6
Harris	.39	4.4	2.1	9.4	21.4	69.6	51.7
Burnet	.38	3.0	2.0	10.7	26.1	50.0	57.9
Galveston	.38	4.2	1.9	9.4	18.8	64.3	46.5
Guadalupe	.37	3.1	2.1	9.0	26.6	36.9	30.0
Bexar	.37	3.3	2.1	9.0	16.9	39.9	41.6
Travis	.35	3.7	2.3	11.0	26.9	43.2	33.2
Brazoria	.33	4.7	2.1	9.4	27.3	55.4	39.5
Texas avg.	.32	3.6	1.6	7.8	17.1	36.5	48.3
U.S. avg.	.73	5.4	2.2	–5.6	11.0	31.8	30.7

NOTES: The loan-to-income ratios and the higher-priced-loans data are simple averages for Texas and the U.S. Home price appreciation reflects combined metro/nonmetro series.

SOURCES: RealtyTrac; Bureau of Labor Statistics; Pew Hispanic Research Center; Federal Housing Finance Agency; Census Bureau.

The border region often sees higher unemployment during economic downturns because average households are younger and less educated than in other parts of the state.

Housing affordability. Loan-to-income ratios are a good proxy for determining owners' ability to repay mortgages. The higher the ratio, the more likely the borrower is to default in cases of sudden change in financial or economic circumstances. The average loan-to-income ratio for Texas counties is 1.6, compared with 2.2 for U.S counties—an indication that affordability is high in the state.[7]

All hot-spot counties have loan-to-income ratios above the state average, however, suggesting relatively high household spending on mortgages. Nonetheless, ratios for most Texas counties are below the national average and much lower than the more expensive areas of the country, such as California's Santa Clara County at 3.5 and San Francisco County at 3.3.

Home prices. County-level home-price data are difficult to come by, so we assigned each county the FHFA's house-price index value for its metro area.[8] Using this proxy, three of the four counties with the highest foreclosure rates are in the DFW area, where home-price appreciation was the slowest among major Texas metros. Indeed, county-level Realtor data for DFW show prices fell over the past year in these three counties—Kaufman, Johnson and Rockwall—and existing-home inventories are higher than the state average.

Deteriorating prices are a significant reason for high foreclosures in other parts of the country but are a less-important factor in Texas. Average Texas home prices have been relatively stable, despite declines in some pockets. The state's modest appreciation, however, hasn't led to significant equity gains for homeowners, either.

New construction activity. The 26 hot-spot counties have posted significant new construction since 2000. The number of housing units grew an average of 22.7 percent from 2000 to 2008, compared with 17.1 percent for Texas and 11 percent for the U.S.

The biggest increases were in the suburbs—for example, Rockwall County saw a 66 percent gain. Its foreclosure rate is the state's fourth highest. Six other hot-spot counties recorded construction increases of 40 percent or more.

Because of a strong pullback in construction in the past two years, new-home inventories have recently come down in Texas, which should mitigate the impact of higher foreclosures.

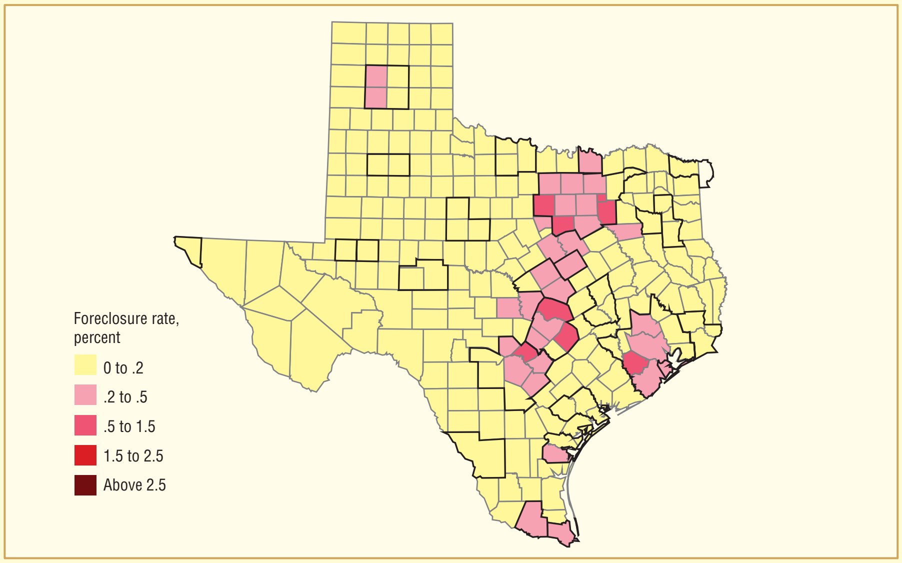
Ethnicity and loan cost. Ethnicity plays a role in the likelihood of foreclosure partly because minority homeowners on average are younger, have lower incomes and have fewer years of schooling than non-Hispanic white homeowners. These factors make job losses more likely in economic downturns. The same factors make qualifying for a mortgage more difficult, often raising the cost of home loans for minorities.

In the U.S. and Texas, minorities have been hit hardest by the current recession. National unemployment rates stand at 15.6 percent for blacks and 12.7 percent for Hispanics, compared with 9.3 percent for non-Hispanic whites. In the U.S., 31 percent of both black and Hispanic households have higher-cost loans, compared with 26 percent of non-Hispanic white households.[9]

Texas has a large Hispanic population. For this demographic group, pricey loans are common in most Texas counties, not just in the hot spots. Statewide, the share of higher-cost loans among Hispanics is 48.3 percent. The share of costly loans among black Texans is more than 60 percent in many hot-spot counties, compared with the state average of 36.5 percent and national average of 31.8 percent.

Overall, the analysis shows that Texas counties with high foreclosure rates generally have sharp jumps in unemployment, high

Chart 3
Texas Foreclosure Hot Spots
(Third quarter 2009)



NOTE: The foreclosure rate is the number of foreclosure filings divided by the number of households in each county times 100.

SOURCE: RealtyTrac.

Foreclosures will likely be a headwind for the housing sector and overall U.S. economy well into 2010.

loan-to-income ratios, slower home-price appreciation, significant new construction and a greater prevalence of high-priced lending to minorities. By and large, most counties with these characteristics are found within the state's four most heavily populated metro areas (*Chart 3*).

A Look Ahead

Most homeowners are current on their mortgage payments, but a rising share have seen their finances shaken as home values have fallen, mortgage interest rates have reset upward and job losses have reduced family income. Foreclosures will likely be a headwind for the housing sector and overall U.S. economy well into 2010.

Indeed, several factors suggest the national foreclosure situation may worsen before it gets better.

First, the U.S. economy remains weak and the unemployment rate is high.

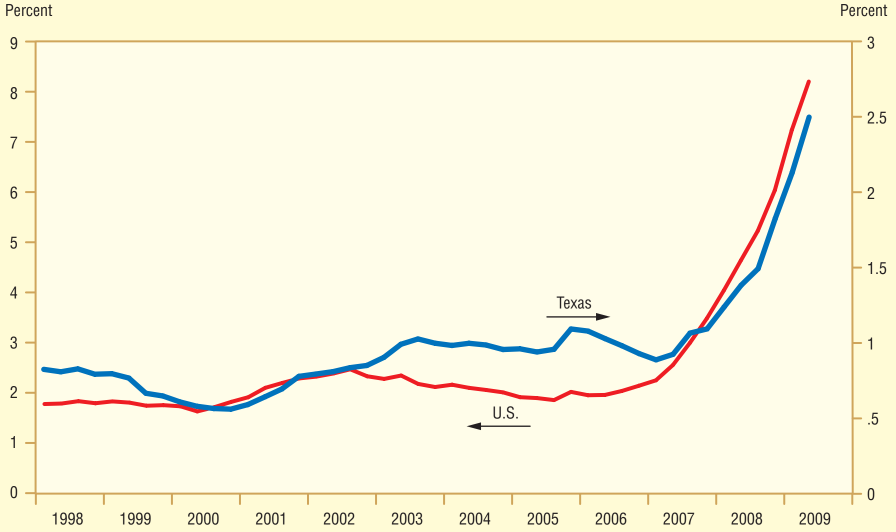
Second, mortgage delinquencies are increasing. While the worst of the subprime troubles are behind us, a wave of alt-A and option ARM resets in 2010 will hit hard in states with high shares of those riskier mortgages.[10] Delinquency rates on even "safe" prime loans—the lion's share of outstanding mortgages—are climbing (*Chart 4*).

Third, moratoriums put in place in late 2008 and early 2009 have slowed the foreclosure process and pushed activity into late 2009 and early 2010.

Counteracting these factors are falling prices and the first-time homebuyer tax credit, which are boosting sales in most areas of the country. In addition, government agencies have launched efforts such as the Home Affordable Modification Program that may resolve some of the pending foreclosures. Unfortunately, the share of

(*Continued on back page*)

Chart 4
Prime Delinquencies Elevated and Rising



SOURCES: Mortgage Bankers Association; seasonal adjustments by the Dallas Fed.

NoteWorthy

QUOTABLE: *"Texas entered recession a bit later than the nation, but once it did, we went from boom to bust in a terrible hurry."*

–Pia Orrenius, Research Officer and Senior Economist

HOUSEHOLD INCOME: Texas Posts Gain in Otherwise Tough Year

Texans' real median household income rose 1.3 percent in 2008, making the state one of only five with increases in the first calendar year of the U.S. recession. During better times, 33 states posted income gains in 2007 and only Michigan suffered a decline.

Texas was already in recession before this year began, so an increase in household income is less likely for 2009.

U.S. Census Bureau data based on the American Community Survey show that the U.S. recession, which began in December 2007, led to household income decreases in five states and no significant change in 40 others in 2008. The U.S. as a whole saw a 1.2 percent decline.

Texas ranked third in household income gains in 2008. Louisiana led the nation at 3.7 percent, followed by Kansas at 1.7 percent. Income also rose in New Jersey and New York.

Texas' median household income was $50,043 in 2008, just below the nation's $52,029. Maryland had the highest income at $70,545, Mississippi the lowest at $37,790.

A relatively healthy labor market kept Texans working in 2008, propping up the state's household earnings.

Buoyed by high energy prices and growing exports, Texas employment continued to expand for more than six months after the nation sank into recession. The state ended 2008 with job growth of 0.6 percent, while U.S. employment fell 2.2 percent.

—Emily Kerr

POPULATION TRENDS: Texas' Strong Economy Still a Draw for Immigrants

Texas' foreign-born population increased in 2008 by 58,320, or 1.5 percent, according to newly released data from the U.S. Census Bureau's American Community Survey.

Many of the state's metropolitan areas saw notable gains. Austin was up 5.9 percent, El Paso 3.4 percent and Dallas–Fort Worth and Houston 2.7 percent each.

Texas' increases occurred despite a 0.26 percent decline in the nation's foreign-born population—a rare occurrence that's attributable to the recession, which began in December 2007.

The economic slump weakened demand for foreign labor, discouraging would-be migrants from coming to the U.S. Indeed, foreign-born population declines were steep in states hit hardest by recession—4.4 percent in Michigan and 1.4 percent in both Florida and Nevada.

For the U.S., the decline in Mexican immigrants was particularly sharp, falling 2.8 percent to 11.4 million. Many Mexicans work in construction, a sector in which employment fell 9.1 percent in 2008.

Some U.S.–Mexico border states recorded significant losses in immigrant stocks, with Arizona down nearly 6 percent and California off 1.6 percent.

The recession didn't hit as hard in Texas as in many other states. Texas employment edged up in 2008, and construction employment fell only 1.1 percent.

—Mike Nicholson

COMMERCIAL REAL ESTATE: Recession Takes Toll, Banks Put at Risk

Texas' commercial real estate market steadily worsened as recession took hold in 2009.

Third-quarter office vacancy rates hit 22.7 percent in Dallas and 15.3 percent in Houston—both high by recent standards. Most major metros saw absorption—the rate at which markets soak up inventory—turn negative in the retail, warehouse and office sectors. The metros' August investment activity, measured by the dollar volume of completed sales, was down 80 percent year over year, roughly in line with the U.S. decline.

Commercial real estate's woes don't bode well for banks already struggling with losses from residential loans. The number of distressed properties—those in foreclosure, in bankruptcy or restructured—is rising.

The Eleventh Federal Reserve District, which includes Texas, has heavy exposure to commercial real estate loans. As of the second quarter, these loans accounted for 28 percent of district banks' gross assets, compared with 14 percent for banks nationally. Thus far, the district share of nonperforming loans has been below the U.S. average.

Financing for new projects remains tight. September contract values for retail, warehouse and office projects fell 71 percent year over year. Anecdotal reports suggest investors have been on the sidelines, ready to act once the market bottoms out. A slowly improving economy offers hope that the market will stabilize in 2010.

—Jackson Thies

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Texas Dodges Worst of Foreclosure Woes

(*Continued from page 14*)

homeowners who have taken advantage of such programs is small, and redefault rates on modified mortgages remain high.[11]

In Texas, foreclosure trends will bear watching. Many Texans have lost their jobs during the current recession—a development showing up in rising delinquencies on prime loans.

On the bright side, the foreclosure landscape looks better in Texas than in most other states. Home values have held up, and foreclosure inventories are lower than the national average. According to the Mortgage Bankers Association, 2 percent of Texas mortgages were in the foreclosure process in third quarter 2009, compared with the national share of 4.5 percent. In addition, fewer risky loans were made in Texas.

While Dallas Fed forecasts call for only a slow rebound in employment, Texas businesses are growing more optimistic and signs are pointing to a recovery in economic activity.

Petersen is a business economist and Assanie is an associate economist in the Research Department of the Federal Reserve Bank of Dallas.

Notes

The authors thank RealtyTrac for foreclosure data and Michael Nicholson for research assistance.

[1] See "Hot Housing Market Catching Cold in Texas," by D'Ann Petersen, Federal Reserve Bank of Dallas *Southwest Economy*, no. 1, 2008, http://dallasfed.org/research/swe/2008/swe0801c.cfm.

[2] Other indexes, such as Case-Shiller, suggest even more deterioration nationally. Case-Shiller is a value-based index that reflects movements in higher-priced homes more accurately but, unlike the Federal Housing Finance Agency (FHFA) index, is not available at the state or metro level.

[3] Data are from Equifax and Moody's Economy.com. See the *Wall Street Journal* blog Developments, Aug. 11, 2009, http://blogs.wsj.com/developments/2009/08/05/more-homeowners-upside-down-on-mortgages.

[4] See "Why Texas Feels Less Subprime Stress than U.S.," by Anil Kumar, Federal Reserve Bank of Dallas *Southwest Economy*, no. 6, 2008, http://dallasfed.org/research/swe/2008/swe0806b.cfm.

[5] Data are from First American CoreLogic, LoanPerformance and the Federal Reserve Bank of New York, June 2009.

[6] See "Through Boom and Bust: Minorities, Immigrants and Homeownership," by Rakesh Kochhar, Ana Gonzalez-Barrera and Daniel Dockterman, Pew Research Center report, May 2009.

[7] U.S. and Texas loan-to-income figures are simple averages of all counties in each.

[8] The metro house price index includes refinanced properties as well as purchases, thus its values may overstate appreciation (or underestimate depreciation) compared with the FHFA's state purchase-only index.

[9] See note 6. U.S. figures are simple averages of all counties.

[10] Alt-A mortgages are loans for which the risk profile of the borrower falls between prime and subprime. The borrowers have inadequate documentation and high loan-to-value and debt-to-income ratios. An option ARM is an adjustable-rate mortgage that offers borrowers the flexibility of four monthly payment options to help with cash flow. Options include a specified minimum payment, an interest-only payment and 15- and 30-year fully amortizing payments.

[11] See "Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization," by Manuel Adelino, Kristopher Gerardi and Paul S. Willen, Federal Reserve Bank of Boston, Public Policy Discussion Papers no. 09-4, July 2009.

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