

the Southwest ECONOMY

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Southwest to Dodge Recession

Growth of nonfarm employment in the Southwest is likely to slow slightly in 1991—to about 1.1 percent. Growth in the region is likely to be weakest in early 1991 and stronger as the year progresses (*Chart 1*). In this article, *Southwest* refers to Louisiana, New Mexico and Texas. (See page 6 for a national economic outlook.)

The Southwest economy continued a weak expansion during 1990, in contrast to a sharp slowdown in the national economy. While the growth rate for U.S. employment slowed from 2.3 percent in 1989 to about 1 percent in 1990, Southwest employment increased in both years by approximately 1.3 percent.

In 1991, weakness in the U.S. economy may retard growth in most of the Southwest's goods-producing sectors. Declines in Southwest manufacturing employment may become steeper, and gains in construction employment may be reversed. Slipping oil prices are likely to slow growth in mining employment. Improved performance in two components of the service-producing sector—finance, insurance and real estate (FIRE) and trade—will likely cause the growth rate of the service-producing sector to increase slightly in 1991.

For this outlook, we assume that the national recession ends by the

third quarter of 1991 and that oil prices slip downward toward \$20 per barrel by the end of 1991.

Growth in Service-Producing Industries May Accelerate

The service-producing sector, which has more jobs than any other economic sector in the Southwest (*Chart 2*), appears poised for stronger growth in the second half of 1991. The service-producing sector encompasses diverse industries, including wholesale and retail trade, personal and business services, government, FIRE, and transportation, communications and public utilities (TCPU). Much of the income and employment in these industries depends on sales to and income generated in other sectors

Chart 1
Nonfarm Employment in the Southwest

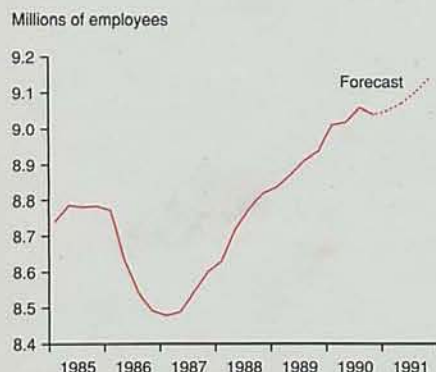
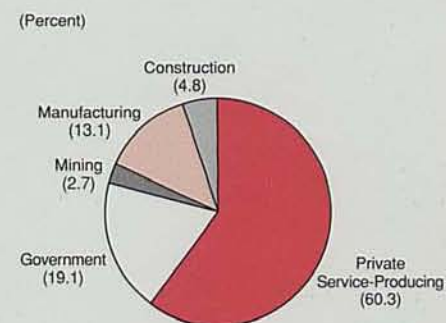
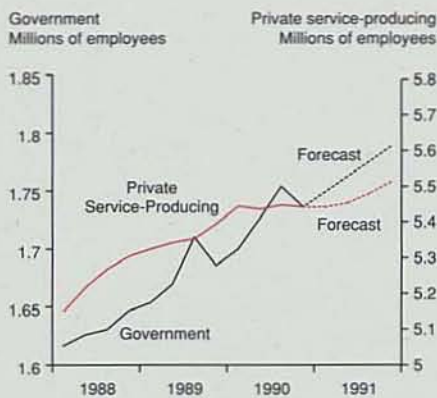


Chart 2
Southwest Nonfarm Employment by Sector



“Between the fourth quarter of 1990 and the fourth quarter of 1991, Southwest manufacturing employment is likely to decline about 1.7 percent and Texas manufacturing output will be essentially unchanged.”

Chart 3
Service-Producing Employment in the Southwest



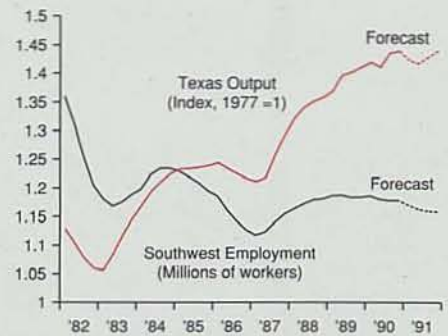
of the Southwest economy. However, businesses in the Southwest export a growing proportion of service-sector output to other states and other countries.

In 1988 and 1989, service-producing employment in the Southwest grew at an annual average of 2.5 percent (*Chart 3*). During 1990, growth of private service-producing employment slowed, while growth of government employment accelerated. Government employment grew an estimated 3 percent in 1990, while private service-producing employment grew 0.9 percent. Government is the only service-producing sector in the Southwest that did as well as or better than its national counterpart in 1990.

During 1990, a sharp slowing in business services and continued weakness in FIRE and wholesale and retail trade led to slow employment growth in private-sector service production. In the second half of the year, higher energy prices battered the energy-dependent transportation and utilities industries, adding to the slowdown.

In 1991, we expect property values to stabilize somewhat, which will bolster employment in FIRE. Court-ordered hirings in social services are likely to generate continued robust expansion in government hiring. Health services probably will continue to grow strongly. Subsiding oil prices should reduce the drag on the transportation and utilities industries. Lingering income effects from higher oil prices should improve the outlook for wholesale and retail trade. Nonetheless, a slowdown in national economic activity is likely

Chart 4
Southwest Manufacturing Performance



to dampen regional service-sector growth in the first half of 1991.

Overall, we expect government employment to increase 3 percent in 1991 and private service-producing employment to increase 1.3 percent.

U.S. Recession Will Hurt Southwest Manufacturing

From 1987 through 1989, the growth rate of Southwest manufacturing employment decreased (*Chart 4*). Even so, the rate of growth was faster in the Southwest than in the nation. We estimate that during 1990, manufacturing employment in the Southwest declined 0.5 percent and Texas output increased 2 percent. (Texas is the only Southwest state for which manufacturing output estimates are available.)

During early 1991, the Southwest's manufacturing sector is likely to deteriorate further as the national recession reduces the demand for goods produced in the region. Manufacturing in the Southwest, however, is likely to fare better than in the nation. Although the national economic downturn is likely to hurt all manufacturing industries, some will fare better than others. The industries with brighter prospects represent a larger share of the manufacturing sector in the Southwest than in the nation. Examples include food processing, chemicals and oil field equipment.

Construction-related manufacturing industries also are likely to fare better in the Southwest than in the

nation because construction is likely to decline less in the region than in the nation.

Between the fourth quarter of 1990 and the fourth quarter of 1991, Southwest manufacturing employment is likely to decline about 1.7 percent and Texas manufacturing output will be essentially unchanged.

Construction May Decline After First Quarter

Strong growth in nonresidential construction in the Southwest improved overall contract values slightly in the first three quarters of 1989 (Chart 5). That growth induced a strong increase in construction employment in the fourth quarter of 1989 and the first quarter of 1990. A subsequent fall in contract values, however, led to weaker employment growth beginning in the second quarter of 1990.

The value of Southwest construction contracts has increased since mid-1990 and should motivate increases in construction employment at least through the first quarter of 1991. After the first quarter, however, construction employment is likely to decline.

Falling petrochemical plant construction and the overall weakness in the manufacturing sector will likely trigger declines in nonresidential construction. Also, the slow economic growth projected for the Southwest would provide only slight increases in demand for new

Chart 5
Southwest Construction Performance



residential construction. By the fourth quarter of 1991, construction employment likely will have declined about 1 percent from the fourth quarter of 1990.

Growth May Slow in the Energy Industry

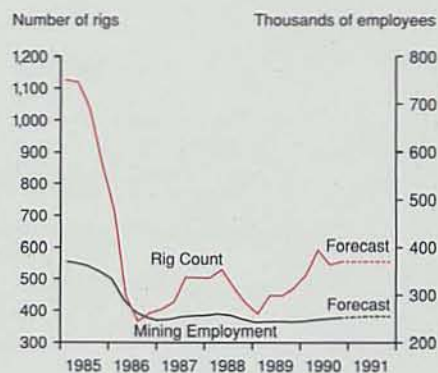
The Southwest's energy industry appeared mixed up in 1990. In the first half of the year, oil prices declined and the rig count rose. In the second half of the year, oil prices rose and the rig count slipped.

Unusually warm winter weather depressed world oil demand and prices in the first half of 1990. Nonetheless, during the first half of 1990, the Southwest's rig count rose more than 25 percent on a seasonally adjusted basis and employment in oil and gas extraction grew nearly 4 percent. The energy industry was becoming increasingly optimistic about the long-term outlook for oil and natural gas prices. Data for 1989 that became available in late 1989 and early 1990 revealed that non-OPEC oil production was falling below expectations and that world oil consumption was growing faster than expected. While the growth of consumption was particularly strong in the newly industrialized Pacific rim countries, growing oil consumption in the developed countries provided increasing evidence that lower oil prices were stimulating oil consumption.

At the same time, many analysts expected natural gas prices to begin rising. In prior years, a glut of natural gas had held its price below parity with oil products. Many analysts, expecting a gradual reduction of the glut, predicted that natural gas prices would rise to parity with oil. Therefore, expectations of higher oil prices led to expectations of higher natural gas prices.

Although oil prices rose sharply in the second half of 1990, the Southwest's rig count slipped more than 5 percent (Chart 6). Employment in the energy extraction

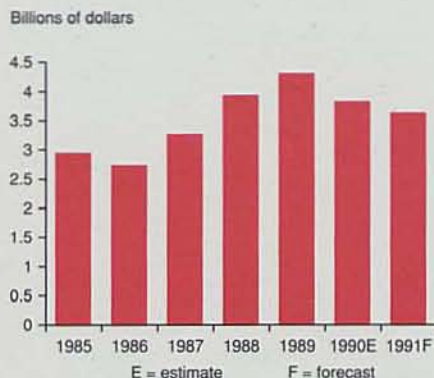
Chart 6
Southwest Mining Performance



"The value of Southwest construction contracts has increased since mid-1990 and should motivate increases in construction employment at least through the first quarter of 1991."

"If war breaks out in the Middle East, the sharply higher oil prices likely to follow probably would stimulate only a mild increase in drilling in the Southwest."

Chart 7
Net Cash Income for Texas Farmers and Ranchers



industry rose about 1 percent in the second half of 1990 as a result of earlier gains in the rig count.

As oil prices rose, they left natural gas prices behind. During much of the second half of 1990, natural gas prices were lower than in corresponding months of 1989. The failure of natural gas prices to move with oil prices provided evidence that the surplus of natural gas was more extensive than anticipated. While drilling for oil in the Southwest rose moderately in the second half of 1990, drilling for natural gas declined. Gains in oil drilling were only moderate because the energy industry viewed the high oil prices that followed Iraq's invasion of Kuwait as temporary.

As of mid-December, the futures market for West Texas Intermediate crude oil predicted a slip toward \$20 per barrel in 1991. Unless expectations change, the rig count is likely to remain relatively constant in 1991. Earlier gains in the energy industry are likely to stimulate gains in energy extraction employment during 1991.

If war breaks out in the Middle East, the sharply higher oil prices likely to follow probably would stimulate only a mild increase in drilling in the Southwest. (The region's drilling activity would be greater, however, if the war altered perceptions about future oil supplies from the Middle East.) A peaceful solution in the Middle East probably would lead to a temporary collapse in oil prices. Such a collapse also is unlikely to affect drilling activity very much in the Southwest, unless the solution altered expectations about future oil supplies from countries in the Middle East.

Lower Government Payments Will Reduce Agricultural Income

We expect Texas agricultural net cash income to be just under \$4 billion in 1990 (*Chart 7*). Cash receipts should increase nearly 3 percent, but this increase is less

than in previous years and will be easily offset by rising expenses and falling government payments.

The outcome and possible repercussions of the General Agreement on Tariffs and Trade (GATT) negotiations will have a significant effect on agriculture. If GATT negotiations are successful, farm subsidies and trade barriers for agricultural products will be reduced. Failure of GATT negotiations will trigger provisions in the 1990 farm bill that could greatly increase government payments and trade barriers for agricultural products.

Assuming the levels of government support and trade barriers dictated in the 1990 farm bill and assuming that the bill's trigger provisions are not enacted, we forecast a 5-percent decline in net cash income for Texas farmers and ranchers in 1991. The primary cause of the decline will be continuing reductions in direct government payments to agricultural producers.

Summary

During 1990, employment in the Southwest economy continued to grow at the sluggish pace experienced in 1989. In 1991, growth in the Southwest economy should be close to zero in the first quarter but should gradually pick up throughout the year. While slightly weaker than in 1990, the Southwest's economic growth should be stronger than the nation's throughout 1991.

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