NoteWorthy

QUOTABLE *"Cross-border shopping accounts for a lot of jobs along the border, and it's significant even in places like San Antonio and Houston."*

—Keith Phillips, Senior Economist

NATURAL GAS: After a Big Price Jump, Falling Back to Reality

The price of natural gas rose to its highest levels on record in December, prompting widespread fears of even further price hikes.

Stephen P. A. Brown, Dallas Fed assistant vice president and senior economist, attributes the market spike to a tight market and speculation based on three assumptions: (1) Gulf Coast gas production would be slow to recover from hurricane damage, (2) a colder-than-normal winter would add to demand and (3) higher prices wouldn't curtail consumption.

Only one of those assumptions has held. It has taken longer than expected to repair the damage done by Hurricanes Katrina and Rita.

The winter turned mild in January, reducing the need to burn gas for heat. The higher prices have dampened demand, largely in the industrial sector. The petrochemical industry, for example, hasn't restored production to pre-hurricane levels. And homeowners might be turning down their thermostats.

Since December, natural gas inventories have risen to 30 percent above their seasonal averages. And prices have come tumbling down—from the peak of $15.41 per million Btu on Dec. 13 to less than $8.50 in the third week of January.

Starting with Katrina, natural gas prices moved way above their historical relation to oil prices. With the declines since mid-December, they've fallen back in line with oil.

MEXICO: Chances Diminish for Election-Year Crisis

In the past, the run-up to Mexico's presidential elections has often been accompanied by economic crisis.

Looking at the upcoming election year, Dallas Fed economist Erwan Quintin concludes that Mexico is in much better shape than it was prior to the Tequila Crisis of 1995. Mexico ran into trouble a decade ago because its debt was large, mainly short-term, mostly in foreign hands and predominantly in U.S. dollars.

This year, fewer financial vulnerabilities loom. Mexico's debt-to-GDP ratio has fallen somewhat. Net public debt peaked at nearly 100 percent of GDP in the late 1980s. The ratio fell to 40 percent in 1995 and is now at around 30 percent.

Mexico has also been able to issue bonds with longer maturities. Mexico started issuing 20-year bonds in 2003, and today the weighted average maturity of the country's internal public debt is nearly three years. In 1995, the longest bond matured in one year.

Mexico's government now relies mainly on domestic borrowers. Two-thirds of net public sector debt is in domestic hands, compared with a third in 1995. Because a greater portion of Mexico's debt is peso-denominated, exposure to currency-market risks has been substantially reduced.

BEIGE BOOK: Rising Costs, Stiff Competition Squeeze Economy

Business activity continues to improve in the region, but January's Beige Book found growing concerns in the Dallas Federal Reserve District about high or rising costs.

Prices are going up for a number of inputs, including health insurance, shipping, paper, metals and property insurance. Most construction-related materials costs are rising, too. Homebuilders say they're paying more for steel, concrete, copper, roofing and framing.

Energy prices remain high by historical standards. After falling steadily through mid-December, retail gasoline prices rebounded at month-end because of escalating crude prices and fears that reviving regulations on fuel additives could reduce supplies, particularly imports.

Some firms managed to pass the increased costs along to customers, but many Beige Book contacts report that stiff competition limited their ability to raise prices. Builders, for example, say that home prices aren't going up as fast as they'd like. Wage and fuel costs have risen faster than shipping rates, particularly for state and federal government contracts whose rates were set three or four years ago.

Not all recent readings involve higher prices. Reduced consumption and warmer weather pushed natural gas prices down sharply in January. Prices declined for most petrochemical products, including styrene, polystyrene, polypropylene, bottle resins, benzene and ethylene glycol. Contract ethylene prices have held up, but spot prices are down significantly.

Details of the latest Beige Book report can be found at **www.dallasfed.org**.