

Economic Commentary

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The Regional Implications of a National Economic Slowdown

The trend toward slower rates of growth of the U.S. economy is likely to continue through the end of 1990. But Louisiana, New Mexico, Oklahoma, and Texas should see improvement relative to the nation.

National Economy Is Slowing

The slowdown of the national economy can be attributed partly to resource constraints. Capacity utilization is near its highest level since the early 1970s. The labor market has also tightened.

Substantial increases in national economic activity would likely rekindle inflation. But while inflation remains a concern, slower economic growth coupled with monetary and fiscal policy restraint should alleviate inflationary pressures.

Indeed, preliminary signs indicate that the inflation rate is slowing while the economy expands at a moderate pace. Data released for the late summer period suggest slightly more economic growth nationally than is implied by the term "soft landing." In any case, a national recession seems unlikely in the near future.

Recovery Underway in the Southwest

An economic recovery is already underway in the Southwest, despite continued weakness in construction and energy. But the continued weakness in these two sectors draws attention away from the emerging health of the remainder of the Southwest economy. There is no doubt that the Southwest economy was hurt by downturns in these two sectors, but now construction declines have moderated and the energy industry appears to be mending. More importantly, the region's two largest sectors—services and manufacturing—are growing at rates close to that of the nation.

Shifting Economic Forces Favor the Southwest

Economic fortunes are shifting in favor of the Southwest. The national slowdown is likely to cut unevenly. Some states that experienced strong economies over the past five years are now showing signs of potential weakness. Far from seeing a soft landing, some Northeastern states could see a bumpy landing as the national economy slows. In contrast, the Southwest should see continued recovery.

Five factors that shaped regional performance in recent years—energy prices, the value of the dollar, defense spending, construction, and the financial health of the banking industry—are changing, affecting regional economic performance. Overall, the Southwest should benefit. Some other states should be affected adversely. Let's consider each factor in turn.

Energy prices. During much of the 1980s, lower energy prices stimulated economic growth in forty states of the United States while hurting the ten energy-exporting states. The effects of lower energy prices on economic growth are behind us, however, and energy prices can be expected to rise over the next five to ten years. Other parts of the country, particularly the oil-consuming states in the Northeast, will experience reduced economic growth while much of the Southwest benefits.

The dollar. The dollar depreciated some 30 percent from March 1985 to April 1988, stimulating growth in the manufacturing centers of the Northeast and the Midwest. But with their plants operating near capacity limits and the dollar's recent appreciation, further gains are unlikely. Any remaining expansion will occur where resources are available; excess capacity and abundant labor suggest the Southwest.

Defense spending. National defense spending is declining, which could mean problems for the defense-dependent states in New England. Growth in defense-dependent New Mexico is likely to be hurt as well. For states such as Texas that are not excessively dependent on defense, cuts in defense spending should impose a lighter economic burden. The Dallas-Fort Worth metroplex, however, contains an abundance of defense-related manufacturing that will be adversely affected by the anticipated reductions in defense spending.

Construction. Much of the Southwest suffers from overbuilding. But it is largely a known and quantifiable problem in the Southwest, and declines in construction over the last few years have helped reduce the problem. Overbuilding is just now becoming evident in the Northeast and other parts of the country. A shrinking construction sector in these areas will reinforce other negative trends.

Banking. Recent events in the Southwest have revealed the difficulties that problems in the banking industry can cause for other sectors of the economy. Recapitalization of the banking and thrift industries with private and federal funds is beginning to resolve apparent capital shortages in Texas, Oklahoma, New Mexico, and Louisiana. However, the early signs of banking problems are now becoming evident in other parts of the country.

In summary, changes in five critical factors, together with excess capacity and abundant labor in the Southwest, suggest continued expansion and the possibility of stronger economic growth in the Southwest—even as the national economy slows. In fact, parts of the Southwest may lead the nation in overall economic performance during the next five years.