

the Southwest ECONOMY

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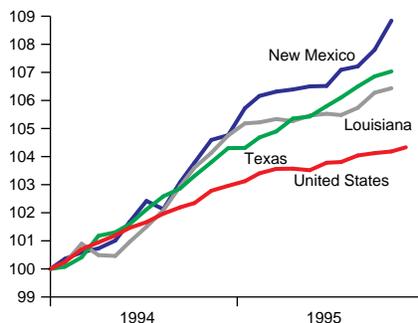
Southwest Expansion To Continue In 1996

“The Southwest economy is likely to see its 10th consecutive year of economic expansion.”

The Southwest economy's expansion during 1995 nearly matched its historical average and remained strong relative to the national average (*Chart 1*). All three states in the region—Louisiana, New Mexico and Texas—benefited from strength in the construction sector. Strong growth in the *maquiladora* industries and in exports to countries other than Mexico allowed Texas to avoid the potentially large negative effects of the peso devaluation. The gaming industry remained the key source of activity in the Louisiana economy. New Mexico continued to be propelled forward by expansions in high-tech manufacturing.

Chart 1
Southwest's Employment Grows
Faster than the Nation's

Index, January 1994 = 100



SOURCE OF PRIMARY DATA: Bureau of Labor Statistics.

In 1996, the Southwest economy is likely to see its 10th consecutive year of economic expansion. Sluggish overall growth in the U.S. economy and some tightness in regional labor markets, however, could restrain growth. After growing at an annual rate of 3 percent in 1995,¹ combined nonfarm employment in Louisiana, New Mexico and Texas should slow to about 2.4 percent in 1996. Of the three states, New Mexico is likely to have the fastest rate of growth, followed by Texas and Louisiana.

Southwest Construction Activity Strong in 1995

While the sources of strength varied throughout the region, the construction sector generally was strong in all three states (*Chart 2*). The residential sector benefited from lean inventories at the start of the year and a sharp decline in mortgage rates throughout the year. While nationally the average value of residential construction was lower in the first 10 months of 1995 than in 1994, it was higher by 5.8 percent in New Mexico, 5.3 percent in Texas

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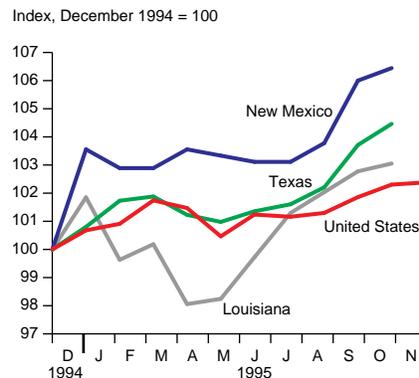
and 1.4 percent in Louisiana. Non-residential contract values also increased, particularly in Louisiana, where the retail sector saw steady growth and a major flood in New Orleans triggered construction activity.

Texas Shakes Off Peso Effects

Texas nonfarm employment slowed from a strong 4.5-percent growth rate in 1994 to a more moderate rate of 3.2 percent in 1995. Employment growth in 1995 was equal to its historical average and was stronger than national growth of 1.4 percent. The strength of the Texas economy in 1995 was somewhat surprising in light of the peso devaluation and ensuing sharp recession in Mexico. Because exports to Mexico represent about 40 percent of Texas exports and Mexican shoppers are responsible for much of the retail activity along the Texas border, events in Mexico can have a significant impact on the Texas economy.

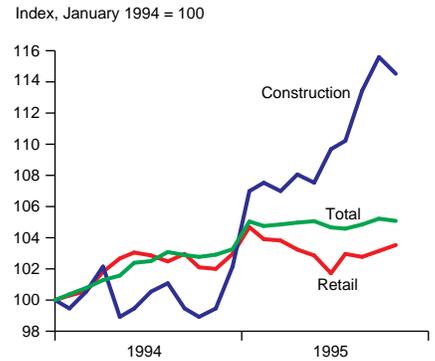
Although the Mexican peso’s devaluation hit the border retail industry hard, strength in the maquiladora industry offset much of the blow. The maquiladora companies on the Mexican side of the border, whose budgets are dollar-denominated but whose costs are in pesos, received a boost

Chart 2
Southwest Construction Employment Shows Robust Growth



SOURCE OF PRIMARY DATA: Bureau of Labor Statistics.

Chart 3
Border Employment Stable in 1995



SOURCE OF PRIMARY DATA: Bureau of Labor Statistics.

from the devaluation. The thriving maquiladora industry resulted in greater warehousing, distribution and manufacturing needs on the Texas side of the border. Federally mandated intrastate trucking deregulation, which began in January 1995, also added some stimulus to the region. The deregulation put downward pressure on trucking rates in the state, stimulating demand for warehouse space along the border and throughout the state. The increased demand for warehouses and other commercial and industrial space led to a surge in construction activity that offset much of the decline in the retail sector (Chart 3).

While the peso devaluation resulted in a significant decline in exports to Mexico, a surge in exports to other countries largely offset the reduction. While exports to Mexico declined at an annual rate of 13.8 percent during the first three quarters of 1995, Texas exports to other countries increased at an annual rate of 23.1 percent, resulting in an overall export gain of 8.4 percent (Chart 4).

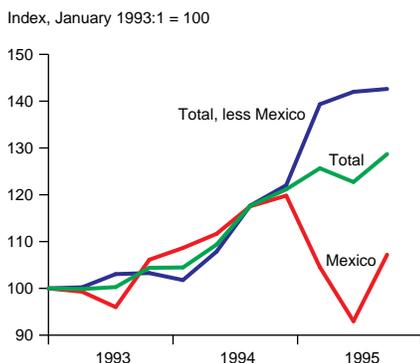
The petrochemical industry has been particularly successful in shifting export markets for its products. While exports of chemical and allied products from Texas to Mexico slowed sharply during the first three quarters of 1995, total exports from this industry surged

44 percent. The value of chemical and allied product exports in the first three quarters of 1995 was \$11.1 billion, which led all other industries and represented 22 percent of the value of total Texas exports.

Electric and electronic equipment manufacturers in Texas were also successful at shifting exports. A worldwide surge in demand for semiconductors and telecommunications equipment allowed Texas manufacturers of these products to compensate for reduced demand from Mexico with increased shipments to countries around the world. Although Mexican exports have been an important source of strength for Texas electric and electronic equipment manufacturers,² employment and exports in this industry accelerated in 1995 despite the reduced demand from Mexico.

The growth in the electronics industry contributed to Texas high-tech industries' overall strength. While the share of high-tech industries in the state is about the same as the national average, Texas' employment growth in the high-tech sector over the past six years has been twice as strong as the nation's.³ Texas' strongest relative performance has been in computer- and telecommunications-related industries such as computer, semiconductor, cellular phone manufac-

Chart 4
Texas Exports Expand in 1995



SOURCE OF PRIMARY DATA: Massachusetts Institute for Social and Economic Research.

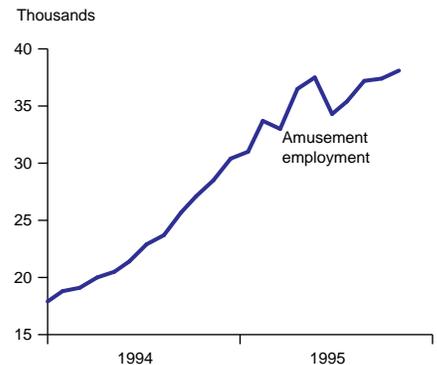
turing and service firms that provide programming and data processing. While the monthly employment data are too aggregated to measure recent growth in the high-tech sectors, anecdotal evidence and movements in broader employment categories suggest that the high-tech sector grew strongly in Texas in 1995.⁴

Gaming Industry Remains The Driver in Louisiana

Employment growth in Louisiana slowed from a strong 5.1-percent rate of growth in 1994 to a more moderate pace of 1.9 percent in 1995. Employment growth in 1995 was just slightly below its historical average rate of 2.1 percent. The gaming industry, despite some setbacks in 1995, remained the major driving force behind growth in the Louisiana economy. After rapid expansion in 1994, the gaming industry slowed in 1995 as two riverboat casinos and one temporary land-based casino in New Orleans closed their doors. Also, plans for a permanent land-based casino in New Orleans were put on hold. Even with these setbacks, however, employment in the amusement industry in Louisiana increased 31.1 percent in 1995 after growing 64.3 percent in 1994 (Chart 5).

The energy industry was also a positive force in the Louisiana economy in 1995. Improvements in offshore drilling techniques and strong expectations about future natural gas consumption resulted in a December-to-December gain of 15.3 percent in the rotary rig count, which indicates oil and gas exploration activity. Employment in oil and gas extraction increased at an annual rate of 2.6 percent through the first 10 months of the year. Increased profit margins and exports for petrochemicals led to continued strong capital expansion in this industry throughout the Texas/Louisiana Gulf Coast region in 1995.

Chart 5
Louisiana Gaming Industry Strong Despite Setbacks



SOURCE OF PRIMARY DATA: Bureau of Labor Statistics.

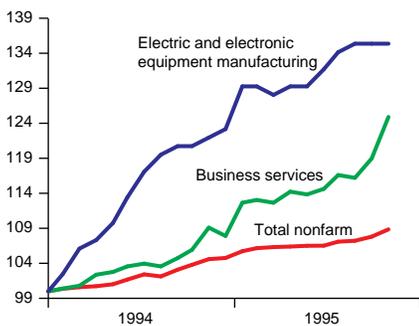
High-Tech Industries Fuel Strong Growth in New Mexico

New Mexico nonfarm employment increased 4.7 percent in 1995, only slightly less than the state's strong 5.1-percent growth rate in 1994. In 1995 and for the fourth consecutive year, New Mexico's growth surpassed its historical average of 3.3 percent. While Texas businesses were concerned about the impact of the peso devaluation in 1995, businesses in New Mexico worried about how downsizing in the defense sector would affect employment at the two national labs, Sandia and Los Alamos. Employment at Los Alamos declined by about 1,000 jobs, while Sandia experienced only slight employment losses.

Job losses at the two national labs have been more than offset by strength in New Mexico's high-tech industries. High-tech firms such as Intel, Motorola, Philips Semiconductor and Intuit have had an important impact on growth in the New Mexican economy. While high-tech jobs represent about 3.1 percent of total U.S. employment, high-tech employment in New Mexico represents about 5.4 percent of total jobs. Announced expansions at many of the large high-tech firms in the state and growth in broad employment cate-

Chart 6
High-Tech Employment
Surges in New Mexico

Index, January 1994 = 100



SOURCE OF PRIMARY DATA: Bureau of Labor Statistics.

gories suggest that the New Mexican high-tech sector grew strongly in 1995. As a rough measure of high-tech growth, 1995 employment increased 12.1 percent in electric and electronic equipment manufacturing and 17.9 percent in business services (*Chart 6*).

Other sources of strength in New Mexico include expansions in bus manufacturing, food processing and retail trade. An important source of weakness in New Mexico in 1995 was a decline in the mining sector. Employment in both mineral mining and oil and gas extraction declined. The devaluation of the Mexican peso also had a negative effect on the New Mexico economy, although total exports and exports to Mexico represent a much smaller share of the economy in New Mexico than in Texas.⁵

Southwest Economy's Growth Likely to Slow in 1996

While growth should remain positive in Louisiana, New Mexico and Texas, a sluggish national economy and other factors may slow the region's growth in 1996. In late 1995, business contacts in Texas reported a significant increase in labor market tightness across a wide range of occupations. The market for skilled workers—such as mechanics, electricians, machinists, engineers and software devel-

opers—remained tight. Contacts also noted that wages were being bid up for accountants and lawyers from top-tier schools. Several contacts also noted difficulty finding lower skilled workers with basic reading, writing, math and communications skills. Slow U.S. growth and the apparent mismatch between the skills of the unemployed and the skills demanded by the growing industries in the state may hinder growth in Texas. Recent movements in the Texas leading index suggest that growth in Texas nonfarm employment will likely slow from 3.2 percent in 1995 to 2.4 percent in 1996.

Reduced construction activity may result in slower growth in the Louisiana economy. Although gaming activity is likely to remain level in 1996, subsiding expectations about its profitability should diminish capital investment. A colder than normal winter would bode well for natural gas producers in the state, who are already benefiting from improved offshore drilling technology.

After growing in excess of 4.5 percent for three consecutive years, nonfarm employment will probably slow somewhat in New Mexico in 1996. Construction activity is likely to slow from the strong pace in 1995, due to a reduction in high-tech capital expansions. Continued declines in defense spending should also be a significant drag on the state.

—Keith R. Phillips

Notes

I wish to thank Loren Scott at Louisiana State University and Andrew Krikelas at the Federal Reserve Bank of Atlanta for helpful discussions about the Louisiana economy and Brian McDonald and Lawrence Waldman at the University of New Mexico for information on the New Mexico economy.

¹ In this article, 1995 employment growth refers to the annualized rate of growth from December 1994 to October 1995, the most recent data available. All data used are seasonally adjusted. The state

employment data are adjusted using the Berger/Phillips two-step technique, and the Texas employment data is benchmarked through March 1994. These employment adjustments are described in the July/August 1993 issue of *Southwest Economy*.

² In Issue 1, 1995, of *Southwest Economy*, Lori Taylor and Rhonda Harris find that the electronics and electric equipment industry is the third most sensitive Texas manufacturing industry to changes in the value of the Mexican peso.

³ For the definition of high-tech industries and a description of their importance to the Texas economy, see D'Ann M. Petersen and Michelle Thomas in "From Crude Oil to Computer Chips," *Southwest Economy*, Issue 6, 1995.

⁴ For example, employment increased at an annual rate of 5.9 percent in electric and electronic equipment manufacturing, 8.7 percent in nonelectrical equipment and computer manufacturing, and 9.8 percent in business services. While each of these employment categories contains some industries that are not classified as high-tech, it is likely that the high-tech industries in these categories are responsible for much of the overall growth. Although the high-tech component of business services is small, anecdotal evidence suggests that high-tech industries are responsible for much of the growth in temporary employment agencies, which is a large share of business services.

⁵ In 1992, total exports as a share of nominal gross state product was 12 percent in Texas and 1.2 percent in New Mexico. Also, 1994 exports to Mexico represented 40 percent of Texas exports and only 17.9 percent of New Mexico exports.