



Midyear Update: Major Metros Driving Texas Expansion

By D'Ann M. Petersen

In 2005, the Texas economy posted its strongest performance since 2000, and it remains on track for a solid showing in 2006. Most indicators point to an economy on an expansionary path through the first six months of the year, and interviews with business executives suggest broad-based strength.

Texas' major metros don't always move in tandem, nor in sync with the state's economy as a whole. Each possesses distinct attributes that determine its growth path. During the tech-induced downturn that began in 2001, for instance, the tech-intensive centers of Austin and Dallas suffered dramatic job losses, while the San Antonio, Houston and Fort Worth economies mostly held their ground.

The metro economies are currently moving in tandem—or at least in the same expansionary direction. Still, the pace of growth varies by metro. In 2005, Austin was the job-growth leader and San Antonio was close behind. Dallas trailed the two, caught in a sluggish stretch following the recession. Houston matched the state average in job creation, while Fort Worth grew at a slower pace.

Midyear 2006 numbers show Austin and Dallas in a virtual dead heat. Both cities are benefiting from a high-tech turnaround, with Dallas getting an extra boost from surging service employment. The three other major metros are slightly below the state average in job growth. In the major border metros, employment growth has been robust, largely because a strong peso has encouraged retail sales and the growing Mexican maquiladora sector has created jobs on both sides of the border.

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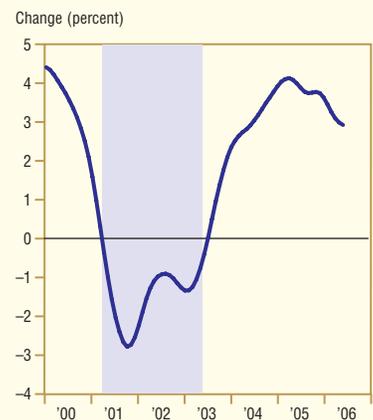
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Moving Forward in 2006

One of the best barometers of the state's underlying trend is the Dallas Fed's Texas Business-Cycle Index—a composite of indicators that include employment, the unemployment rate and gross state product. So far this year, the index has grown at a fairly strong 3.2 percent, slower than last year's 3.9 percent but indicative of an expanding economy (*Chart 1*). At the same time, Texas' per capita income has risen relative to the U.S. average, another sign of increased prosperity (*Chart 2*).

Anecdotal reports also suggest a healthy Texas economy. The Dallas Fed's July Beige Book survey of business executives reported strong activity, with a tight labor market and high demand for skilled workers. Moreover, respondents to the Dallas Fed's latest Texas Manufacturing Outlook Survey noted that industrial

Chart 1
Texas Business-Cycle Index
Stays in Positive Territory

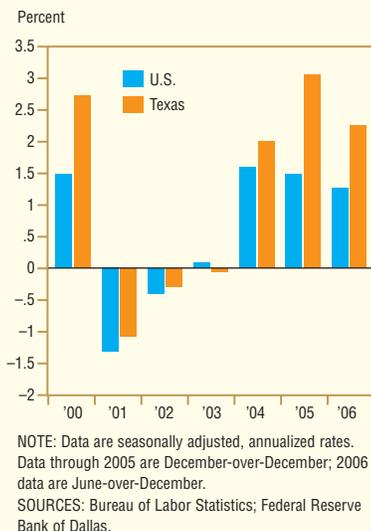


NOTE: Data are month-over-month, seasonally adjusted, annualized rates. The shaded area indicates a recession.
SOURCE: Federal Reserve Bank of Dallas.

Chart 2 Texas' Share of Per Capita Income on the Rise



Chart 3 National, State Job Growth Slower in 2006



activity continues to expand.

Despite the positive reports, 2006 employment data—which are subject to revision—show job growth slowing markedly from last year's rapid tempo (*Chart 3*). Texas jobs were up 2.3 percent the first half of 2006, building on an increase of 3.1 percent in 2005.

The upbeat Beige Book responses and other indicators of healthy economic activity suggest job growth estimates will be revised upward when more detailed benchmark data become available later this year. Texas employment statistics tend to understate job gains during expansions. Over the past five quarters, the initial estimate has been revised upward an average 1.3 percentage points. Based on current conditions, the Dallas Fed expects employment growth of 2.5 to 3 percent in 2006.

Metros Show Diversity

The state's major metros share attributes that help propel growth, such as low living costs and a welcoming business climate. Just as important in today's increasingly globalized economy, Texas sits at the center of North America, with port access, trade and distribution channels, and proximity to Mexico, its largest trading partner.

The major metros' business-cycle indexes—broad-based measures calculated using employment, the unemployment rate and retail sales—are currently moving together in expansion (*Chart 4*). But the big urban economies retain differences that affect the rate and composition of economic growth.

Austin Rebounds. The capital city experienced a remarkable comeback in 2005, outpacing the other major Texas metros in job growth (*Chart 5*). The turnaround followed a deep, prolonged high-tech bust that shrank employment from 2001 through 2003 and held back job growth in 2004. Last year's strength was partly due to a rebound in the high-tech sector. Austin's economy continues strong in 2006, maintaining its momentum with employment growth that just barely surpasses Dallas' to hold the state lead for the second straight year.

Compared with other high-tech centers across the country, Austin has advantages that are spurring relocations and business expansion. These include the low cost of living and doing business. A key factor is relatively affordable housing—a

median home price of \$167,200, compared with \$390,400 in Boston and \$746,800 in San Jose. Texas' lack of a state income tax gives Austin and other state metros an edge. Austin is also home to the University of Texas, the country's largest university, which with other schools supplies a ready workforce for the metro's growing firms.

The companies and people flocking to Austin are fueling job growth in high-tech and other sectors. Manufacturing employment has risen this year, spurred by machinery production tied to the semiconductor and computer-related industries.

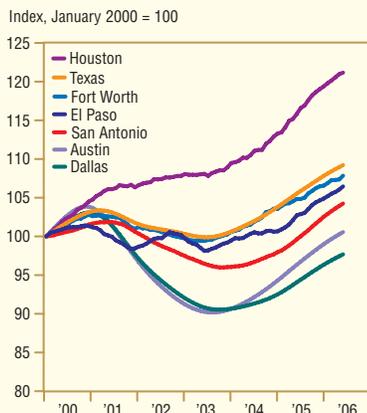
Samsung's recent announcement of a new \$3.5 billion chip manufacturing plant bodes well for continued high-tech employment growth. Other indicators point to the sector's dynamism. The June Austin Purchasing Managers Index shows manufacturing in expansion mode, with production, new orders and order backlogs growing. The metro should also benefit from U.S. high-tech production remaining in positive territory (*Chart 6*).

Austin has seen robust job growth in construction and trade, transportation and utilities (*Chart 7*). The growing metro economy is boosting construction of all types. Housing demand is at record highs, and strong sales growth is encouraging retail expansion. Several major players—Ikea, Neiman Marcus and Macy's—have scheduled store openings for later this year.

Although on the upswing, venture capital spending has yet to return to Austin in a big way. Start-up funding has revived in places like Silicon Valley and New England, but in 2005 Austin managed to raise just a fifth of what it did in 2000, according to Pricewaterhouse Coopers/National Venture Capital Association. Given its heavy reliance on semiconductor and computer-related high tech, Austin would likely benefit from further diversifying into nano- and biotechnology and related fields, thereby tapping into new forms of venture capital.

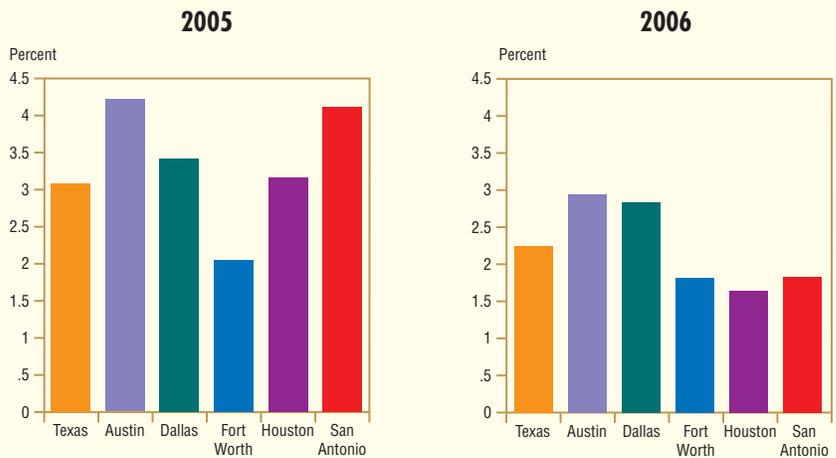
Dallas Stages Comeback. Dallas suffered mightily when the 2001 tech bust decimated one of its fastest-growing industries—telecommunications services. The reverberations sounded through the Dallas economy, causing manufacturing jobs to dry up in such industries as semiconductors and communications equipment and bringing construction activity to a standstill. While overall employment stopped falling in mid-

Chart 4
Metro Business Cycles
Moving Together



SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Chart 5
Job Growth in Major Texas Metros: Austin, Dallas in the Lead



NOTE: Data are seasonally adjusted, annualized rates. 2005 data are December-over-December; 2006 data are June-over-December and subject to revision.

SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

2003, Dallas saw only tepid job growth the rest of that year and all of the next.

The Dallas economy has restructured, making way for renewed growth. The attributes that have served the city well in the past—a central location within Texas and the United States, a large global trade and transportation network, a sophisticated financial sector and a reputation for entrepreneurship—are again spurring impressive growth. After lagging other major Texas metros for several years, Dallas finally gained momentum in employment growth in 2005. This year, it nearly matched Austin, the state leader (*Chart 5*).

Dallas retains roughly 40 percent of the state's jobs in both telecom services and high-tech manufacturing; yet these sectors' combined share of the metro's total employment fell from almost 7 percent in 2000 to just under 4 percent in 2006. Although job losses in these fields have mostly leveled off, productivity increases have limited the need to hire workers. But demand for high-tech products remains strong, according to the Beige Book. Furthermore, a recent survey by the *Dallas Morning News* suggested several area telecom companies are planning to add jobs for the first time in years.

Professional and business services employment has grown at a torrid 10.3 percent in Dallas this year, eclipsing all other categories in any of the Texas metros

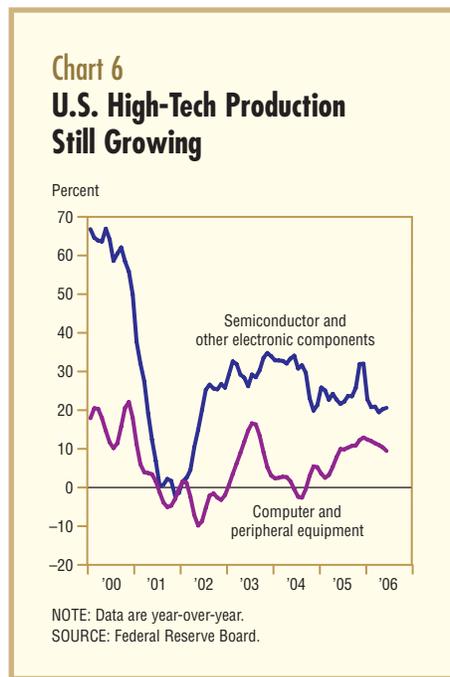
(*Chart 7*). This sector, which makes up 16 percent of Dallas' job base, includes technical and scientific professions, accounting, legal occupations, architecture and engineering, and computer design. Growth in this sector, along with financial services and health care, is boosting demand for office space.

Fort Worth on Steady Course. The Dallas and Fort Worth economies are intertwined, but Fort Worth is less volatile than its neighbor to the east. Major defense-related manufacturing firms have attracted other high-tech companies to Fort Worth, but the share of these jobs is not as large as in Dallas. As a result, Fort Worth's economy avoided the large declines that hit Dallas and grew at a pace near the state average during the most recent recession and recovery, despite significant losses in airline employment following 9/11.

Fort Worth's economy expanded moderately in 2005 and has grown slightly slower than the rest of the state in 2006 (*Chart 5*). The upbeat prospects for many Fort Worth industries bode well for steady growth. As the metroplex's global transportation hub, the city complements Dallas' huge trade industry. Dallas/Fort Worth International Airport, Alliance Airport, American Airlines and Burlington Northern Santa Fe Railway call the Fort Worth area home. The trade-transportation-utilities sector has added jobs at a solid clip this year.

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The leisure and hospitality industry is a major player in the Fort Worth metro economy. Six Flags Over Texas in Arlington and Gaylord Texas Resort and Convention Center in Grapevine are big attractions. The industry has seen job growth of 5 percent this year, making Fort Worth No. 1 in this category (*Chart 7*).

Construction has been one of Fort Worth's leading industries in 2006. Affordability is spurring housing demand, and the retail and apartment markets are strong both downtown and in the outer suburbs. While Dallas still has one of the country's highest downtown office vacancy rates—23 percent—Fort Worth has one of the lowest—6 percent.

Pier 1 and RadioShack have left the central city for their own campuses, but Fort Worth's office market has benefited from such downtown redevelopment as Sundance Square and the former Bank One tower's conversion to apartments. Energy firms are leasing downtown space as natural gas drilling in the nearby Barnett Shale has intensified. Job growth in professional and business services is also adding to the demand for office space.

Fort Worth's history as a leader in defense electronics is important. Lockheed Martin—along with Bell Helicopter, one of the metro's two largest employers—reports relatively steady employment, with production increases of the Joint Strike Fighter offsetting declines related to the F-16. While

job gains in defense and other tech manufacturing have been modest this year, increases in transportation equipment manufacturing are helping keep factory employment positive.

Houston Benefits from Energy. The energy sector is again pumping up the Houston economy. Despite diversifying after the oil and gas bust of the mid-1980s, Houston remains the world's energy capital, with roughly half the city's jobs tied directly or indirectly to the industry.

Houston's economy made it through the most recent Texas downturn without a major drop in employment, largely because the city relies less than Dallas and Austin on high-tech jobs. Following relatively modest job growth in 2004, the Houston economy finally picked up the pace last year, increasing employment 3.2 percent (*Chart 5*). A prime factor was a change in the way oil producers and operators view high energy prices—going from skepticism to the belief that they're a long-term factor thanks to global demand. In 2006, the Houston economy remains in good shape, with job growth in key sectors (*Chart 7*).

As expected, oil and gas extraction employment is rising, but the pace is restrained by difficulty finding skilled workers. Still, the number of drilling support jobs was up a healthy 14 percent for the 12 months that ended in June. Buoyed by demand for scientists and engineers, the professional and business services sector

has seen job growth of 5.6 percent in 2006, and construction is strong across the board. Houston finished third in the country in metro single-family building permits in 2005 and is on track to rank near the top again this year.

The Port of Houston, the country's second-busiest deepwater facility, plays a major role in the local and state economies. The Port Authority, which accounts for 15 to 20 percent of Houston's overall port activity, reported in May that shipments were up about 20 percent from the same month last year, with petroleum-related products accounting for the bulk of exports and imports.

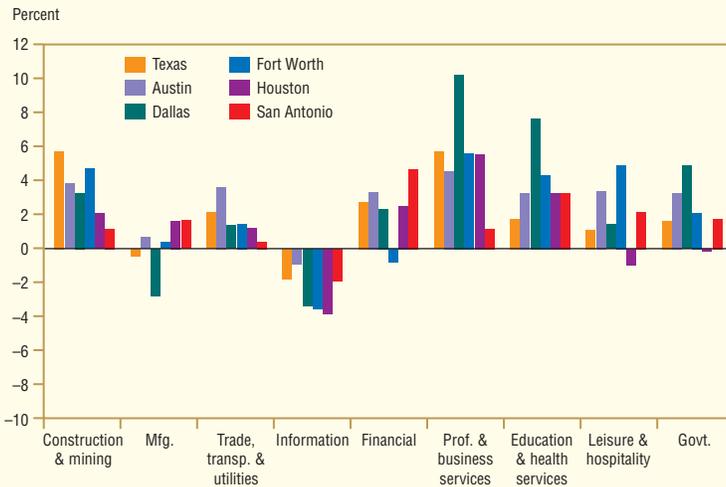
San Antonio Gains Steadily. Because of its reliance on such cyclically stable industries as the military and health care, the Alamo City's economy has historically experienced milder swings than other metros. San Antonio mirrored the state's overall performance during the recent recession and recovery, while Austin and Dallas saw large swings.

San Antonio's economy continues on a steady upward path, even though the military presence has diminished over the years and biosciences and related high-tech fields have come to the fore. In 2005, job growth accelerated to just over 4 percent, thanks to relocations and expansions in health care, financial services and manufacturing. Employment increases are more moderate this year, but most major sectors important to San Antonio's economy are still expanding (*Chart 5*).

Financial services jobs are growing at 4.7 percent, leading all other major metros, and Washington Mutual's multiple hiring announcements bode well for further increases (*Chart 7*). With the Alamo and the River Walk the state's most popular tourist destinations, the leisure and hospitality sector remains a mainstay of the metro economy. Industry employment is up moderately, and according to the Convention and Visitors Bureau, the city is on track for one of its best convention years since 2001. Employment in education and health services is climbing, and an increased focus on biotech has drawn new businesses.

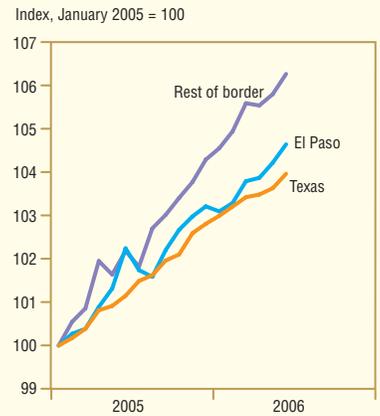
Manufacturing job growth has been modest this year, but stronger gains are expected as the new Toyota truck plant goes into production this fall and suppliers add to the workforce.

Chart 7
2006 Employment Growth Broad-Based Across Metros and Sectors



NOTE: Data are June-over-December, seasonally adjusted, annualized rates.
 SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Chart 8
Border Seeing Faster Job Growth Than Texas Overall



SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas.

Even the military stands to see employment growth in 2006. Last year, San Antonio gained a satellite campus of the National Security Agency, which plans to hire several hundred employees and may attract military contractors. In addition, the Defense Department's plans to shutter bases across the country will benefit San Antonio, which will add up to 3,500 military and civilian positions. Even with the increases, the government sector would make up just over 18 percent of total employment, compared with 23 percent in 1990.

Border Cities Add to Growth. Texas' border economies, with their strong ties to Mexico, continue to be a source of strength for the state. Following rapid expansion last year, border employment growth is exceeding the state average so far in 2006 (*Chart 8*).

The exception is El Paso, the largest of the border metros, where job growth has been closer to the state average. El Paso's economy continues to move from its historical reliance on apparel manufacturing to a more diversified, service economy. In 1990, overall manufacturing made up 19 percent of total employment. Today, the share stands at almost 8 percent.

As the maquiladora sector grows just across the border in Ciudad Juárez, El Paso has converted its remaining manufacturing to smaller, intermediate-goods suppliers. The maquiladoras are boosting service jobs

in El Paso, especially professional and business services. The Fort Bliss expansion under the Defense Department's military realignment is also stimulating the city's economy.

Because of their location, border towns rely heavily on the transportation, trade and utilities sectors. They've also benefited from strong retail sales to Mexican nationals and increases in U.S.–Mexico trade. While some uncertainty exists following Mexico's divisive July election, the peso's strength and the country's economic growth should continue to boost Texas' border towns.

What Lies Ahead

With all its major metros showing solid gains, the Texas economy appears poised for continued growth the rest of 2006 and into 2007. As with any forecast, however, unforeseen factors could speed up or slow the expansion. Global demand for high-tech products will impact economic activity in Austin, Dallas and Fort Worth. San Antonio and the border metros will be influenced by the peso's value and growth in Mexico.

The U.S. economy bears watching, too. The Blue Chip Economic Indicators, a survey of top forecasters, anticipates a slowing at the national level. The consensus envisions the U.S. economy growing at

3.5 percent this year and 2.8 percent in 2007. Indeed, second-quarter GDP growth came in at 2.5 percent, considerably slower than the first quarter's 5.6 percent. Behind the slowdown are the pinch on consumer spending from higher energy prices and softening housing markets.

These factors could take some of the steam out of the Texas economy. On the flip side, the state is helped somewhat by rising energy prices. While consumers still feel the brunt, royalties help offset the pocketbook impact, and increased drilling spurs output gains, boosting Houston in particular. Texas' major metros didn't see large run-ups in home prices during the recent housing boom, and they're unlikely to see much of a bust, although residential construction could ease.

Ultimately, the metros will benefit from their individual advantages as well as their shared attributes. The state's low costs and favorable tax and government policies should continue to allow the metros to attract workers and companies from other parts of the U.S. and overseas. Their central location and expanding trade capabilities should also enable them to profit from the global economy.

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