



# The Texas Economy: Almost a Boom

By **Fiona Sigalla**

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**T**he Texas economy turned in a robust performance in 2006. Initial estimates suggest employment increased 3.2 percent and output growth could approach 5 percent. For most any other state, an expansion this strong would constitute a boom. But everything is bigger in Texas, and so are the booms.

Overall 2006 economic activity was not on par with the great bursts of growth ignited by construction and energy in the 1970s and 1980s or high tech in the 1990s. Still, the current expansion is impressive, even by Texas standards.

In 2006, the economy grew rapidly to accommodate heavy demand for energy and construction. Adding 316,000 jobs, the state surpassed 10 million workers for the first time. Homebuilding and exports reached record levels.

According to Fed contacts throughout the state, shortages of equipment and qualified labor prevented growth from being even stronger.

Activity was also restrained by weakening demand from a slowing U.S. economy and by high energy costs that dampened consumer spending. The Texas expansion began to moderate in the second half of 2006, and the state's economy will likely grow more slowly in 2007.

Somewhat slower growth in the U.S. economy in 2007 will soften demand for Texas products and services. Still, strong global ties should boost Texas sales, buoyed by healthy foreign economies.

The energy industry likely will keep humming in the coming year as the state continues to supply the world's drilling industry with equipment and services. The construction industry will also remain busy, although the boost will come more from nonresidential building as housing markets continue to slow. Overall, the Texas economy has enough momentum to fuel another good year in 2007. Job growth is projected to be between 2 percent and 2.5 percent.

## **Fast Job Growth, Labor Shortages**

Texas' employment tends to grow about 1 percentage point faster than the nation's, and the margin widened in 2006. Texas job growth finished above the 37-year average of about 2.8 percent. At the same time, the U.S. slowed to just under its 37-year average of 1.8 percent (*Chart 1*).<sup>1</sup>

All major sectors of the Texas economy added workers at a pace faster than the rest of the country in 2006. The state's private employment increased 3.4 percent, compared with 1.7 percent for the United States excluding Texas. Government employment expanded 2.1 percent in Texas and 1 percent in the rest of the nation.

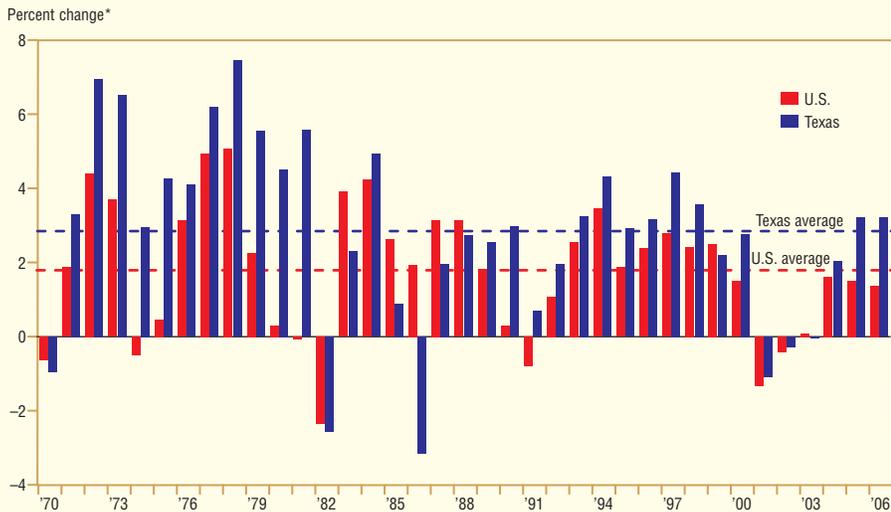
Employing nearly 80 percent of the state's nongovernmental workforce, the private service-producing sector added the bulk of new jobs. Its 2.9 percent increase eclipsed the 2 percent rise in the rest of the U.S.

While comparatively smaller, the Texas goods sector grew vigorously in 2006. The sector, which includes manufacturing, construction and energy, was stimulated by low interest rates and high oil and natural gas prices. Employment swelled 5.4 percent in the state, while the rest of the U.S. managed a meager gain of 0.1 percent.

The strength of Texas' goods sector compared with the rest of the country is due in part to the ease with which firms can expand in the state. With a fast-growing workforce and copious land, the construction industry can build quickly to accommodate demand. Employment in the state's construction sector surged 7 percent in 2006—an additional 40,800 workers. Excluding Texas, U.S. construction employment was up just 1.5 percent—102,200 workers.

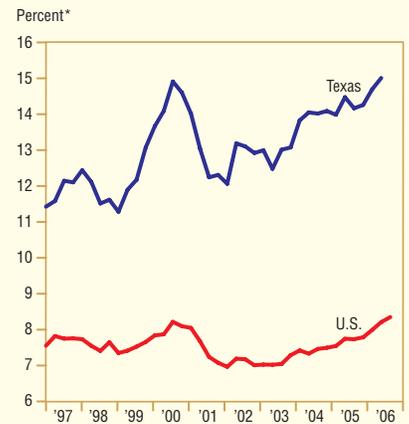
Texas' manufacturing sector has outperformed the nation for over a decade (see "*Made in Texas: The Natural Selection of Manufacturing*" on page 12). In 2006, the state added 26,300 factory jobs, an increase of 2.9 percent. Meanwhile, manufacturers in the rest of the country cut

**Chart 1**  
**Texas and U.S. Employment Growth**



\*December over December.  
SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal adjustment by Federal Reserve Bank of Dallas.

**Chart 2**  
**Share of Output Exported, Texas and U.S.**



\*Seasonally adjusted.  
SOURCES: Bureau of Economic Analysis; WiserTrade.

110,300 positions, a decline of 0.8 percent.

The energy industry grew strongly across the country, as mining jobs increased 13.1 percent in Texas and 7.5 percent in the rest of the nation.

With Texas employers adding workers at a swift pace in 2006, competition for employees has been stiff. Seasonally adjusted initial claims for unemployment insurance declined to 54,635 in October 2006, a level not seen in the state since January 1982. The seasonally adjusted unemployment rate fell to 4.5 percent in December 2006, the lowest level since March 2001.

Companies reported hiring difficulties in the construction, service, manufacturing, finance and energy industries. Throughout the year, the Fed's Beige Book reported hot demand for many types of skilled and semiskilled workers, including engineers, electricians, high-tech technicians, truckers, certified mechanics and accountants. The need was particularly acute in the energy industry, where a decade of high unemployment discouraged potential workers from training to be roughnecks, engineers and geologists. Some employers reported difficulty finding relatively unskilled workers with basic qualifications.

As the state's unemployment rate pushed lower, labor shortages intensified and, in some areas, companies resorted to

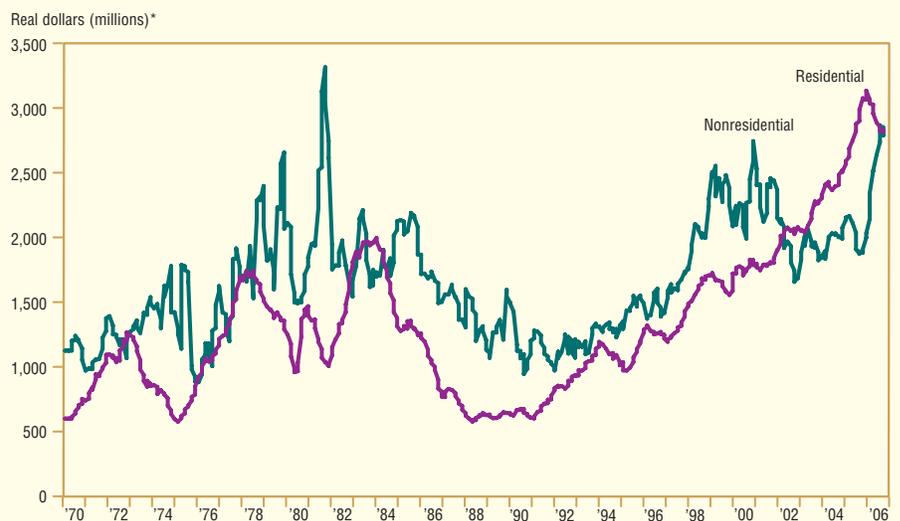
posting billboards in an attempt to attract workers. Anecdotal reports suggest job growth could have been stronger with a more educated workforce. Firms took on the challenge of educating and training their own workforces. Business leaders say they've developed training programs to help workers enter their industries. Some

reached out to a local high school, community college or university to create programs to boost supplies of qualified workers.

### Hearty Export Growth

Trade has become increasingly important to the Texas economy. Exports have been a larger share of the state's output

**Chart 3**  
**Texas Construction Contract Values**



\*Seasonally adjusted, five-month moving average.  
SOURCES: McGraw-Hill Dodge Construction; Bureau of Labor Statistics.

than the nation's. In 2006, U.S. exports were just over 8 percent of output, but Texas exports were 15 percent of state production (*Chart 2*).

As the nation's number one export state, Texas has been buoyed by expanding world trade. In 2006, the state shipped more goods to international customers than ever. Seasonally adjusted Texas exports rose to a record \$12.1 billion in November. In the first 11 months, shipments were up 14 percent, which annualized is the strongest growth since 1999.

International demand has been spurred by stronger economic growth overseas and declines in the dollar's value that lowered the relative cost of U.S. products. Since peaking in 2002–03, the Dallas Fed's Texas Value of the Dollar has dipped 13 percent. This measure is weighted by export shares to account for movements in real exchange rates for the 44 countries that make up the large majority of Texas trade.

In the past three years, Texas shipments have increased 10 percentage points faster than shipments from the overall U.S. The state's relatively strong exports have been driven by both the favorable composition of Texas industries and fast growth in the nation's strongest trading partners.

Exports to the European Union have increased mightily, accounting for 28 percent of the trade growth in the first three quarters of 2006. Sales to Asia (excluding China) contributed 24 percent, while 18 percent came from shipments to Latin America, excluding Mexico. Breaking it down further, 8 percent was from goods shipped to China, a small but fast-growing trading partner. Another 8 percent went to Mexico, the state's largest trading partner.

Energy products helped drive last year's export surge. These included petroleum, chemicals, and oil and gas extraction equipment. Chemical sales accelerated toward the end of the year as falling natural gas prices lowered the cost of Texas petrochemicals and made them more attractive to strong Asian economies. Computer and electronics shipments also surged during the year.

Recent increases in exports bode well for the coming year. Changes in exports tend to lead changes in goods-producing jobs, suggesting that the state could see continued strength in coming months.

Whether it's because of movements in the dollar's value or modifications to trade

agreements, changes in world trade will have a greater impact on the state than on the rest of the country.

### Vigorous Construction

In the early 1980s, construction cranes dotted Texas skylines. At the time, Texans joked that these cranes were the new state bird. In 2006, this bird made a bigger comeback than the whooping crane.

Construction of large projects took off in 2006, including office buildings, condominiums, hospitals, hotels, schools and entertainment venues. Nonresidential contract values jumped 52 percent in 2006, their strongest growth since 1981 (*Chart 3*).<sup>2</sup>

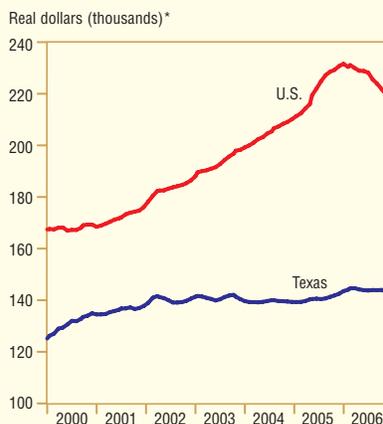
Following the 1980s boom, the state was plagued by years of oversupply. As the current construction boom shows signs of cooling, demand appears to be sufficient to absorb most new space, leaving builders with fewer hangovers from overdoing it.

Texas' most recent building boom took a quiet backseat to the house-price boom that occurred elsewhere in the country. While concerns grew that home prices along the coasts were soaring beyond fundamentals, inflation-adjusted median sales prices in Texas were relatively unchanged. As a result, some people were left with the impression that construction in the state also hadn't accelerated (*Chart 4*).

That wasn't the case.

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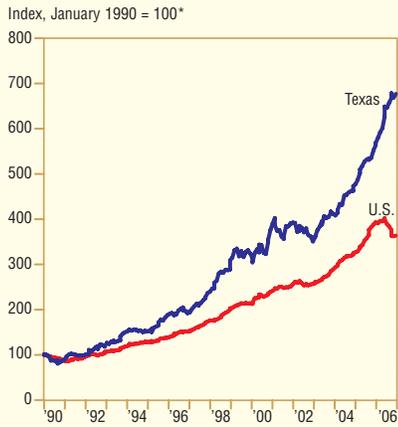
**Chart 4**  
**Texas and U.S. Median Existing Home Prices**



\*Seasonally adjusted.

SOURCES: Texas A&M Real Estate Center; Bureau of Labor Statistics.

**Chart 5**  
**Total Construction Contract Values**



\*Seasonally adjusted, five-month moving average, real dollars.  
SOURCES: McGraw-Hill Dodge Construction; Bureau of Labor Statistics.

Median home prices in the state didn't rise very much because, with available land and labor, Texas builders worked quickly to meet demand. The supply of homes increased rapidly and kept home prices in check.

Inflation-adjusted total construction contract values increased faster in Texas than in the nation (*Chart 5*). The state's surge in investment was tremendous but not unprecedented. Measured as percent of output, residential contract values remained below the levels of the 1970s and early 1980s building boom.

Residential markets began to downshift nationally in late 2005 but remained robust in Texas until mid-2006. Homebuilding was driven largely by the state's strong economy, but sales also received a boost from investors, who turned to Texas amid news reports that real estate was a better value there than in other parts of the country.

Texas residential real estate activity will likely continue to edge down in 2007. After climbing 24 percent in 2005, single-family housing permits dropped 18 percent in 2006. Although growth is expected to be slower than in 2006, nonresidential building should remain strong through much of the year, keeping the construction cranes busy.

### Burst of Energy

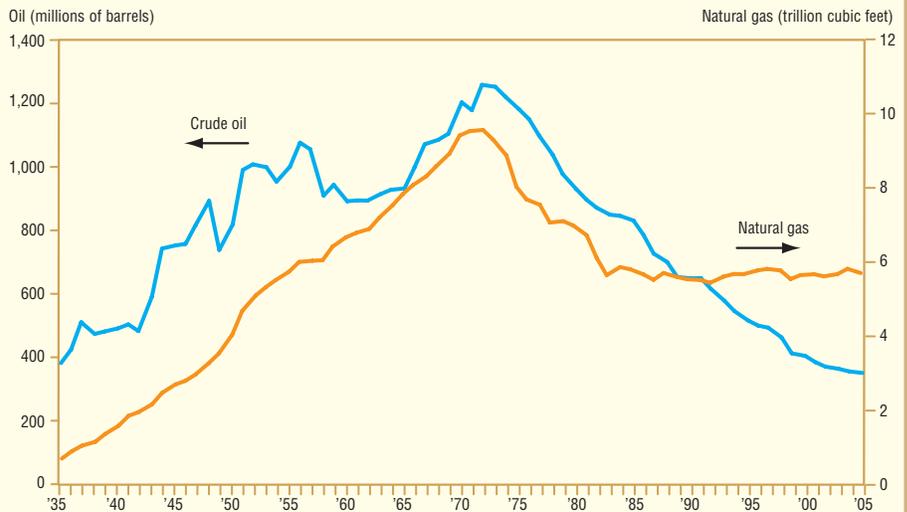
The construction industry wasn't the only sector to relive memories of the 1980s

**Chart 6**  
**Texas Oil and Gas Rig Count**



\*Seasonally adjusted.  
SOURCE: Baker Hughes International.

**Chart 7**  
**Texas Oil and Natural Gas Production**



SOURCE: Texas Railroad Commission.

boom. Persistently high energy prices encouraged a worldwide surge in investment in oil and natural gas extraction, creating new business for Texas energy service firms and manufacturers. Royalty payments filled mineral owners' pockets, boosting consumer spending. Taxes from natural gas and oil production poured into state coffers.

Drilling activity pushed the state's rig count to nearly 800 in 2006, the highest level since 1984 (*Chart 6*). However, the rise in working rigs was not accompanied by a similar increase in Texas oil and natural gas production. Both remain on a long-term decline as reserves dwindle (*Chart 7*). High prices and new technologies

made it cost-effective for drillers to venture into territories previously thought impenetrable, such as the Barnett Shale natural gas field near Fort Worth. Because some Texas fields are expensive to drill, business leaders say these fields will be the first discontinued if prices fall or costs rise.

Fears of higher costs and a price collapse slowed the growth of drilling activity in the fall of 2006. The energy industry has been constrained by a scarcity of rigs, equipment and labor. These shortages pushed up drilling costs and led to backlogs of orders for services and equipment. The backlogs should keep the industry busy in 2007, even as energy prices drift lower.

### Mixed Blessing for Texans

Not all Texans own mineral rights or work in the energy industry. For them, relentlessly high gasoline prices and air-conditioning bills dampened consumer spending and caused financial strain.

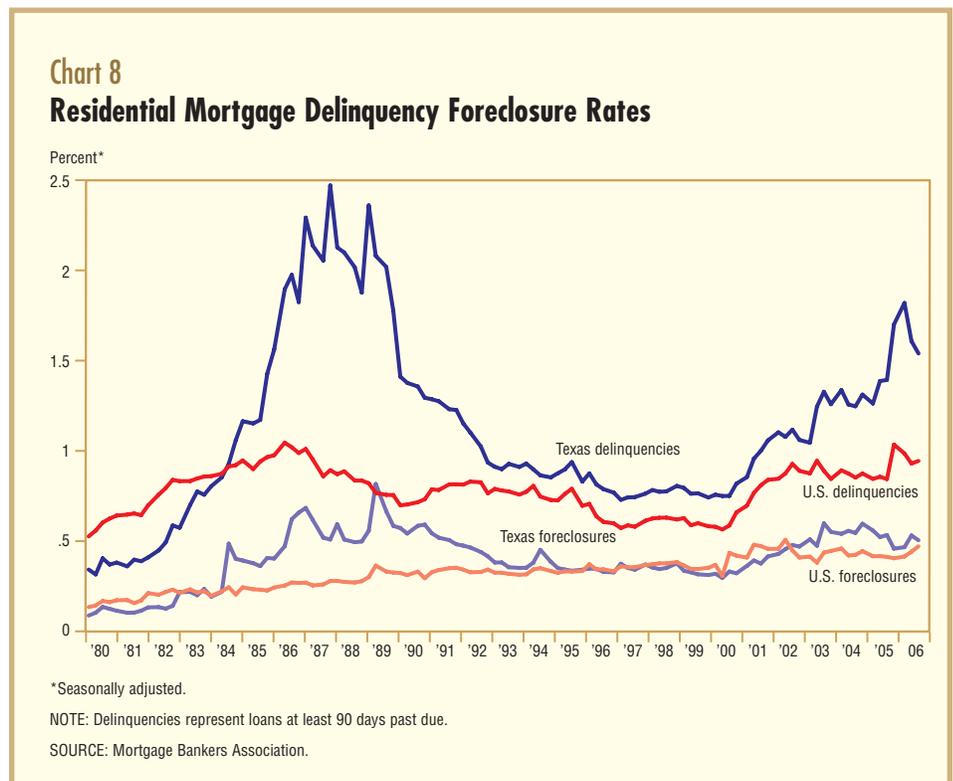
On average, Texans spend more than other Americans on energy bills.<sup>3</sup> Electricity prices tend to be higher in Texas than in other parts of the country because state utilities rely more on natural gas for electricity generation. In the third quarter of 2006, monthly outlays on gasoline, residential natural gas and electricity were \$206 per capita in the state, compared with \$171 for the nation. And these higher energy bills come out of smaller income; per capita personal income was \$34,816 in Texas, compared with \$36,506 in the U.S.

Slow home price appreciation relative to other parts of the country has also made it tougher for the average Texan and dampened consumer spending. In parts of the country with rapidly rising real estate prices, homeowners can extract equity to finance consumer spending or pay down bills. With stagnant home prices, Texas homeowners tend to have less equity from which to draw.<sup>4</sup> Any decline in home prices quickly eliminates equity, making foreclosure more likely and putting further pressure on consumers' pocketbooks.

Texas mortgage delinquencies—loans 90 days past due—and foreclosures have drifted up over the past few years, rising faster than those in the U.S. (*Chart 8*).

### Slower Growth in 2007

In late 2006, the economy started decelerating from the robust pace posted through most of the year. Activity likely



will continue to downshift in 2007.

The Texas Leading Index has been sluggish since peaking in March 2006 (*Chart 9*). The index suggests continued expansion but slower job growth, just below the state's trend over the past 37 years.

The construction sector remains quite strong, and a substantial amount of building will continue to finish projects already under way. Even if the state experiences a pullback in exploration, its energy industry is expected to remain busy, filling backlogged orders and supplying drilling activity around the world. Exports should continue to support the state's goods sector. Shortages of skilled workers will likely be the primary constraint to expansion.

Despite slower growth, Texas will remain one of the fastest-growing areas of the country.

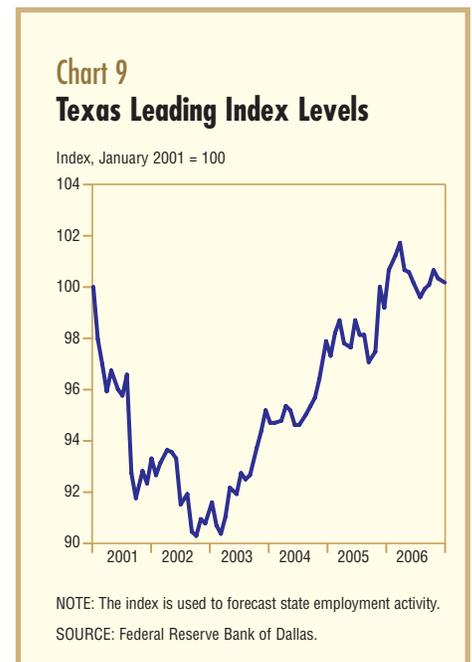
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### Notes

The author thanks Keith Phillips, D'Ann Petersen, Frank Berger, Mine Yücel and Raghav Virmani for helpful comments. Virmani provided excellent research assistance.

<sup>1</sup> U.S. and Texas employment data are estimates as of the publication date. Both are subject to revision.

<sup>2</sup> Contract values are a seasonally adjusted, five-month mov-



ing average. In this analysis, nonresidential values include nonbuilding, which is largely highway and road construction.

<sup>3</sup> This calculation is based on methodology first used in "Regional Update" by Mine Yücel, Federal Reserve Bank of Dallas *Southwest Economy*, September/October 2006.

<sup>4</sup> "Has the Housing Boom Increased Mortgage Risk?" by Jeffery W. Gunther and Robert R. Moore, Federal Reserve Bank of Dallas *Southwest Economy*, September/October 2005.