

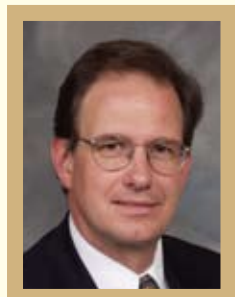
Taking the Economy's Pulse at Midyear

With Texas facing hard times, four of the Dallas Fed's regional experts give an update on the state's economic performance in 2009, looking at the key areas of employment, manufacturing, housing and energy.

At the start of 2009, Texas' economy had already sunk into recession. Employment had begun to decline. The nation's downturn and declining exports took a toll on manufacturing. Housing prices were falling. The energy sector sagged due to falling oil and gas prices.¹

We've now passed the year's midpoint—with the state still searching for an end to the recession. However, Dallas Fed economists see some signs of hope that the downturn may end sometime in the second half of 2009.

Here's a review that focuses on employment and three key sectors.



Keith R. Phillips:
Employment

Q. So far this year, what trends are you seeing in employment?

A. Texas non-farm employment peaked in October 2008 and has declined sharply since then. During the second quarter of this year, the number of jobs fell at an annual pace of 2.7 percent, milder than the 5.2 percent decline in the first quarter.

Q. Are any signs of recovery starting to emerge?

A. While broad measures of economic activity continue to decline, leading indicators have improved recently. The Texas Leading Index rose in the second quarter following 11 consecutive months of decline. The three-month gain was particularly broad-based, with six of the eight indicators showing positive movements.

Our surveys of business leaders tell a similar story. The Dallas Fed's Beige Book, an anecdotal survey of business conditions, noted in July that demand was beginning to stabilize, and the respondents to the July Dallas Fed manufacturing survey expressed op-

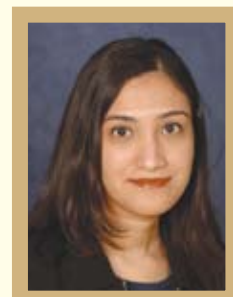
timism that their business outlook would be positive by the end of 2009.

Q. What's the employment outlook for the rest of the year and into 2010?

A. In *Southwest Economy's* first-quarter issue, I forecasted that in 2009 Texas employment would decline by 2.8 percent, or 296,000 jobs. During the first seven months of this year, jobs fell by approximately 186,000. The current forecast suggests employment will bottom out during the current quarter and then begin a gradual increase.

Overall, the forecast is slightly stronger than the beginning-of-year one, suggesting a decline of about 2 percent, or 212,000 jobs.

I'm hesitant to forecast 2010 so far in advance since many things can change between now and the end of the year. But the current momentum in the economy and recent changes in the Texas Leading Index suggest a mild rebound in job growth next year to about 1 percent to 1.5 percent. The 30-year average for Texas job growth is 2.8 percent.



Laila Assanie:
Manufacturing

Q. What has been happening in the manufacturing sector?

A. Early in 2008, slumping demand for products related to construction and autos curtailed Texas manufacturing output. Factory jobs fell by 14,000 in the first three quarters of the year. Since then, the state's factories have seen production decline further as domestic demand diminished more broadly and overseas sales plunged. Between October 2008 and June 2009, statewide factory payrolls shrank by another 74,800 jobs, or 10.7 percent.

The Texas Manufacturing Outlook Sur-

vey—the Dallas Fed's monthly survey of industry trends—reflected the industry's deterioration with accelerating contraction in the last quarter of 2008 and first two months of this year.

Recent readings haven't been as bad, suggesting that the decline in the state's factory activity has moderated over the past five months. In June and July, the Beige Book also reported signs of stabilization in the state's manufacturing. Some firms were even seeing a pickup in new orders as well as revived export demand.

Q. Do you have some specifics?

A. All the manufacturing survey's indexes of current activity have come off their record lows. But there's no real pickup in activity. In July, about half the respondents said growth in new orders was flat and 43 percent said production and shipments were little changed from the previous month.

In the July Beige Book, petrochemical producers reported a rise in export demand. High-tech firms said production had increased.

The pace of layoffs has tempered as well. Two-thirds of executives responding to the manufacturing survey noted stable staffing, and a nearly equal share reported no change in work hours. In a similar vein, the July Beige Book reported that most manufacturers were no longer downsizing operations because they'd already "right sized" their staff levels.

Q. What does the industry expect for the rest of the year and into 2010?

A. Although factory output and employment are still contracting, the worst seems to be behind us. The manufacturing survey's readings on expectations six months ahead have turned positive. Indexes for future production, capacity utilization, new orders and growth rate of orders have been improving since hitting record lows in November 2008, suggesting manufacturers expect business to firm up by the end of 2009 or early 2010.

In the July survey, more than 36 percent of producers noted that they expected

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increases in production, capacity utilization and new orders six months from now. Moreover, the future company outlook index was positive for the second consecutive month, and 30 percent of manufacturing executives foresee improvement in their firm's outlook six months from now.



D'Ann Petersen:
Housing

Q. What are the recent trends in housing?

A. While the downturn in home sales and construction began several years ago, conditions worsened in late 2008 as economic and financial issues became more pressing and homebuyers moved purchasing a home to the bottom of their to do lists. In 2009, the downward trend in sales and construction continued although at a slower pace.

During the downturn, home values held up much better in Texas than in other parts of the country. The Federal Housing Finance Agency's purchase-only price index shows Texas prices shrank less than 1 percent over the past year, compared with declines of more than 20 percent in Florida, California, Arizona and Nevada. Texas homes remain affordable compared with the national average.

Q. Do you see any hopeful signs for housing?

A. Texas housing shows some signs that the worst may be over. Homebuilders and Realtors reported homebuyer traffic picked up in the first half of the year, thanks to low mortgage interest rates and lower housing prices. Both sales and construction appear to be bottoming out in the second quarter.

New home construction remains at very low levels, but permits rose 14 percent and contract values increased 22 percent in the second quarter. At the same time, existing home sales were up almost 5 percent from the first quarter. Most of the activity has been in the lower-priced entry-level market as first-time homebuyers take advantage of the

\$8,000 tax credit available until Dec. 1 (see “Noteworthy,” page 14).

Q. What's the outlook for the rest of the year and into 2010?

A. It's uncertain whether the recent pickup in sales will continue after the expiration of the tax credit. Housing industry executives are more optimistic in their outlooks, but they're not quite sure whether a turnaround has begun or conditions have just bottomed out. For now, those in the industry appear thankful housing markets are no longer deteriorating.

The good news is that inventories aren't too out of line—especially compared with other areas of the country—partly because builders have pulled back strongly on new construction. When the Texas economy emerges from recession and job growth picks up, a rebound in home sales should lead to higher levels of homebuilding activity.



Mine Yücel:
Energy

Q. What are you seeing in the oil and gas markets?

A. Weak demand continues to plague both markets. The global recession has led to a tremendous contraction in oil demand, with the greatest declines in Europe, Japan and the U.S. On the supply side, OPEC continues to rein in output, albeit with limited success. As a result, oil prices are less than half what they were a year ago. Since the beginning of the year, oil prices have come up off their low points, nearly doubling to around \$65 per barrel.

The demand for gasoline usually picks up in the summer driving season between Memorial Day and Labor Day. This summer, however, is shaping up to be quite feeble, with gasoline consumption lower than a year ago. Soft demand for gasoline is leading to low refinery capacity utilization, which fell to 84 percent at the end of July.

On the natural gas side, weak demand and plentiful supply have bloated inventories

to seasonal records and depressed prices to less than \$4 per million Btu, down from more than \$9 a year ago.

Q: How has all this affected Texas?

A. The weaker prices have curtailed the region's energy activity. The Texas rig count was 347 in July, about a third of what it was a year earlier. The Texas oil and gas industry lost 24,200 jobs in the first half of the year.

If there's a silver lining, it's the boost the domestic petrochemical industry is getting from the wide differential between oil and natural gas prices. At the beginning of August, crude was trading at an 18-1 ratio to natural gas, instead of the 6-1 ratio that would be warranted on a Btu basis. U.S. plants use natural gas as an input, while most foreign producers rely on crude oil. The cost advantage has spurred U.S. petrochemical exports.

Q. Are any signs of recovery starting to emerge?

A. Given the recent strengthening of oil prices, the rig count has started to inch back up, with most new drilling directed at oil. However, most indicators of energy demand remain depressed.

Q. What's the outlook for the rest of the year and into 2010?

A. As the U.S. and global economies improve, we should see both oil and natural gas prices firm up and energy activity strengthen. If crude stays above \$70–\$80 a barrel, it should bring increased investment into the oil sector. A recovering economy may not boost natural gas prices as much because supply is ample and inventories are near record highs.

Recovering demand for oil products will help refinery capacity utilization and producers' margins. The prospect of new environmental regulations creates some uncertainty. Whatever the shape of these new regulations, they'll likely increase costs for refiners and lower consumer demand.

Note

¹ See “Recession Arrives in Texas: A Rougher Ride in 2009,” by Keith R. Phillips and Jesus Cañas, Federal Reserve Bank of Dallas *Southwest Economy*, First Quarter 2009.