Outlook for the Texas Economy

Since the last recession, the recovery of the Texas economy has been weaker than for the U.S. economy. The Texas economy slowed to a virtual standstill during 1985 as increased uncertainty about oil prices led to a marked deterioration in the energy sector. Although the energy sector will remain a drag on the Texas economy, growth in the service-producing sector and manufacturing is likely to offset weakness in oil and gas extraction. Nevertheless, the rate of advance will probably be less than the nation's.

Texas Grows Slower Than the Nation

Evidence that growth in Texas has lagged the nation's throughout this recovery can be seen in the state's slower rate of employment growth (Chart 1). Both economies slowed in 1985, but in the latter half of the year, employment growth in the United States accelerated while the employment level remained flat in Texas. The gains in employment growth have not kept up with increases in the labor force; as a result, during 1985 the Texas unemployment rate rose above the nation's for the first time since 1970.

The prime reason for the lag in the Texas economy is the deterioration in the energy sector. Continued weakness in oil prices and expectations of additional oil price declines have left the drilling rig count in Texas about 25 percent below the already depressed level in 1984. Weakness in drilling spilled over to nearly all other sectors of the Texas economy but has been particularly troublesome for manufacturing. Like manufacturing in the rest of the nation, the Texas manufacturing sector has been constrained as the strong value of the dollar has aided foreign competitors.

Despite the weakness in manufacturing and energy, several sectors of the Texas economy have been strong. The non-goods-producing, or service-producing, industries created nearly all the new jobs in 1985 (Chart 2). Nevertheless, growth in this sector lagged that of the nation's service-producing industries during 1985. The growth of construction activity in Texas has also been strong, surpassing the nation's in 1985. There are concerns, however, that office vacancy rates will signif-

Services Aid the Texas Recovery

Expansion in the service sector has been an important source of growth in Texas during the 1970s and 1980s. In the 1972-84 period, service employment in Texas rose more rapidly than in the nation as a whole, and it also outpaced the state's overall nonfarm employment (Chart 3). Growth in the service sector has helped the Texas economic recovery to proceed despite continued weakness in the energy sector. During 1985, however, while Texas service employment continued to grow faster than the state's total nonfarm employment, it rose more slowly than service employment nationally.

Some Service Growth Tied to Energy

During the 1970s and early 1980s, the rapidly expanding energy sector contributed significantly to the strong service-sector growth in the state. More recently, service employment has continued to increase despite weakness in energy. The influence of the energy sector upon the state's service growth has been isolated by using input-output analysis. Chart 4 compares an index of actual service employment growth for Texas with an index of service employment growth that excludes the effects of post-1972 energy-sector expansion. As the chart shows, from 1972 through 1980, Texas service employment growth would have been on a par with the nation's even without expansion in the energy sector. Between 1980 and 1984, the gains in service employment that are unrelated to energy would have been enough to allow faster service growth in Texas than in the nation.

Non-Energy-Related Service Growth Helps Drive the Texas Recovery

Because a large portion of demand for services has come from outside the troubled energy industry, the service sector has played a major part in the Texas recovery from its inception to the present. Between the November 1982 cyclical trough and December 1984, employment expansion in services accounted for slightly more than
Chart 1
TEXAS AND U.S. NONAGRICULTURAL EMPLOYMENT

Federal Reserve Bank of Dallas.

Chart 2
EMPLOYMENT IN TEXAS SERVICE-PRODUCING, MANUFACTURING, AND ENERGY INDUSTRIES

NOTE: Service-producing employment consists of services, finance, insurance, and real estate, wholesale and retail trade, and transportation and public utilities.
Federal Reserve Bank of Dallas.

Chart 3
EMPLOYMENT GROWTH IN TEXAS AND UNITED STATES

NOTE: Service employment consists of services, finance, insurance, and real estate.
Figures for 1985 are averages of seasonally adjusted data for the first nine months.
Federal Reserve Bank of Dallas.

Chart 4
EFFECT OF ENERGY GROWTH ON SERVICE EMPLOYMENT IN TEXAS

NOTE: Service employment consists of services, finance, insurance, and real estate.
Figures for 1985 are averages of seasonally adjusted data for the first nine months.
Federal Reserve Bank of Dallas.

LOANS—LARGE WEEKLY REPORTERS
Eleventh Federal Reserve District

1. Percent change from same quarter in previous year.
SOURCE: Federal Reserve Bank of Dallas.

DEPOSITS—LARGE WEEKLY REPORTERS
Eleventh Federal Reserve District

1. Percent change from same quarter in previous year.
SOURCE: Federal Reserve Bank of Dallas.
DISTRICT BRIEFS

- Overall nonagricultural employment in Texas rose sharply in November. With the labor force stable, the state's unemployment rate fell to 6.9 percent after an unusually sharp rise to 8.1 percent in October. Sluggish economic growth relative to that in the nation, however, is maintaining the upward trend in the Texas unemployment rate. In contrast, the seasonally adjusted unemployment rates in Louisiana and New Mexico have fallen since midsummer.
- The manufacturing sector in Texas continued to lose jobs in September, with much of the decline coming in nondurable goods industries. The weak energy industry and slowing construction activity led to employment reductions in both durable and nondurable manufacturing, however.
- After defying predictions of a downturn for most of 1985, nonresidential construction, particularly of offices, has slowed recently. The value of nonresidential construction contracts declined in both August and September to fall below a year earlier. Nevertheless, the upward trend in overall nonresidential building continues, partly because construction of stores and commercial buildings maintains its high level.
- Single-family residential construction continues to rise in response to lower interest rates, but the modest recovery of multifamily units has apparently ended. Issuance of single-family permits is trending upward despite declines in August and September. The number of multifamily permits renewed its decline in the same two months after strengthening earlier in 1985.
- Inflation in Texas remains modest but varies across the state. Prices in the Dallas-Fort Worth area increased more rapidly than the national average as a result of faster growth in housing prices. Declining housing prices and stable energy costs have held down price increases in Houston.
- Slower economic growth in Texas led to slower loan growth at large Eleventh District banks in the third quarter of 1985. Total loans declined at these institutions in October. Special financing packages offered by automakers induced a large drop in consumer lending. Business loans also fell, but real estate lending increased.

**UNEMPLOYMENT RATE**

![Unemployment Rate Chart]

**HOUSING PERMITS: TEXAS**

![Housing Permits Chart]

**CONSUMER PRICE INDEX**

![Consumer Price Index Chart]

**TEXAS INDUSTRIAL PRODUCTION INDEX**

![Industrial Production Index Chart]
Outlook (cont.)

Significantly increase owing to vigorous construction levels.

Weakness Continues in 1986

Even if the Texas economy should pick up somewhat from the poor performance of 1985, growth is likely to be slow. The service-producing sector will continue to provide the great majority of new jobs. Manufacturing activity should also increase as a result of the recent declines in the dollar and continued strength of defense spending. Continuing uncertainty about oil prices will still act as an inhibitor in the Texas economy, and construction spending will probably be slower. Unless oil prices fall sharply, the expected net effect is for the Texas economy to grow modestly next year, but even then, the weak energy sector is likely to keep growth in Texas below that in the nation.

—Roger H. Dunstan

Services (cont.)

one-half of all Texas employment growth, even though total service employment never amounted to much more than one-fourth of the state's nonfarm jobs. In 1985, however, service employment in Texas rose more slowly than in the nation—with or without the influence of energy.

With a generalized weakening in the Texas economy in 1985, service employment growth declined markedly. Between November 1982 and December 1984, the state's service employment grew 12.4 percent, compared with a national increase of 10.1 percent for such employment. Between December 1984 and September 1985, however, Texas service employment rose 1.1 percent, compared with a national increase of 4.0 percent. Despite this decline, expansion in service employment still outpaced that for the state's nonfarm employment. Job gains in services accounted for slightly more than one-third of total Texas nonfarm employment growth in the first three quarters of 1985. In 1986, paced by computer and management services, service employment should grow at a rate below that of national expansion but faster than Texas nonfarm employment.

Summary

In the 1970s, service employment rose faster in Texas than in the United States in response to the needs of a surging energy sector. During much of the early 1980s, however, Texas service-sector growth would have outpaced the national expansion even without the influence of energy. This pattern of higher than national growth was reversed in 1985. Continued weakness in the Texas economy next year is likely to keep employment growth in services below that in the nation.

—William C. Gruben

The views expressed are those of the authors and do not necessarily reflect the positions of the Federal Reserve Bank of Dallas or the Federal Reserve System.