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DISTRICT HIGHLIGHTS

Federal Reserve Bank of Dallas September 1986

Declines in Nonresidential Construction Contracts Portend Texas Employment Losses

Recent declines in nonresidential construction contracts in Texas bode ill for construction employment in the state. The slowdown in new nonresidential construction has already resulted in heavy employment losses. Moreover, because of the lead relationship between contracts and construction employment, the negative employment effects of the slump in contracts will worsen over the near future. As a result, Texas construction employment is likely to decline further this year.

Contracts Lead Employment

Because a substantial share of nonresidential construction is on a large scale, an increase in nonresidential construction contracts in any given month generally implies heightened construction activity for a prolonged period of time. An increase of 1 million square feet in nonresidential construction contracted in Texas lasting one month has an estimated positive effect on construction employment of 715 workers during the same month, reaches its peak effect of 1,174 workers seven months later, and continues to stimulate employment for another seven months (Chart 1). The same pattern of employment effects holds for a decline in contracts but in a negative, rather than positive, direction.

Contract Declines Hurt Employment

New nonresidential construction in Texas has dropped sharply. Nonresidential square footage contracted in Texas has been below its level a year earlier every month since October last year. For the first six months of 1986, the level was 34 percent lower than for the same period in 1985. The declines occurred in response to high vacancy rates and have left nonresidential square footage contracted at its lowest levels since 1977.

Based on the estimated lead relationship between contracts and construction employment, the declines in contracts led to a loss of 24,000 construction workers from October 1985 to June 1986. This negative effect is reflected in the steep decline in actual construction employment over the first half of this year (Chart 2). Because contracts lead construction employment, the employment reductions through June represent only part of the full effect of the slump in nonresidential contracts. If the square footage of nonresidential construction contracted remains near recent low levels, the slump in contracts will result in an estimated loss of 57,000 construction workers from October 1985 to the first

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Impact of Defense Outlays Changing in District

The notion that defense spending is a more important stimulus to economic activity in the Eleventh District than in the rest of the United States is losing its validity. Per capita defense expenditures in the District states of Texas, Louisiana, and New Mexico no longer exceed those in other parts of the country by as much as in the 1970s. Although military purchases will continue to have important effects on District states' economies, reliance on such purchases is likely to be no greater than in the rest of the country. This trend means that potential declines in military expenditures will not have a disproportionate effect on the District economy.

Stimulus from Defense Spending

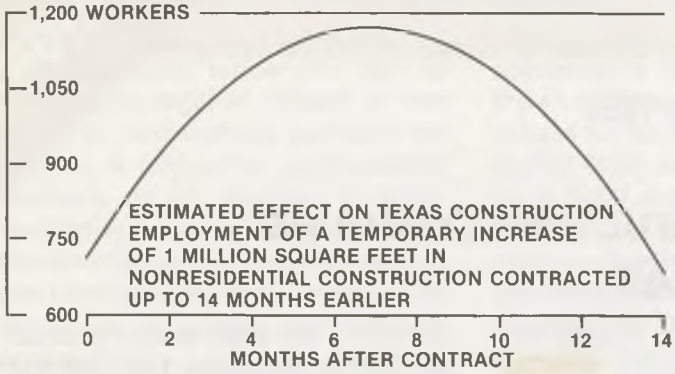
Purchases for defense are a substantial portion of total Federal Government purchases, but some areas of the country, including the Eleventh District, receive a larger share than others. For example, 1985 outlays by the U.S. Defense Department constituted 37 percent of total Federal Government expenditures in Texas, compared with slightly under 30 percent for the nation as a whole. These include payments for goods and services under procurement contracts, as well as payments to individuals for wages, salaries, and benefits.

The economic effect of defense expenditures, like other government purchases, goes beyond the initial goods and services purchased. Those receiving the payments spend the money on yet other goods and services. Such so-called multiplier effects, while not limited to the states in which the money is initially spent, have the greatest effect in those states.

The magnitude of defense spending in the Eleventh District states masks

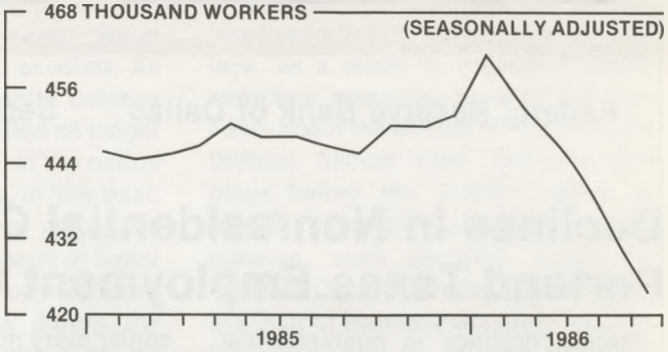
(Continued on back page)

Chart 1
RELATIONSHIP OF TEXAS NONRESIDENTIAL CONSTRUCTION CONTRACTS AND CONSTRUCTION EMPLOYMENT



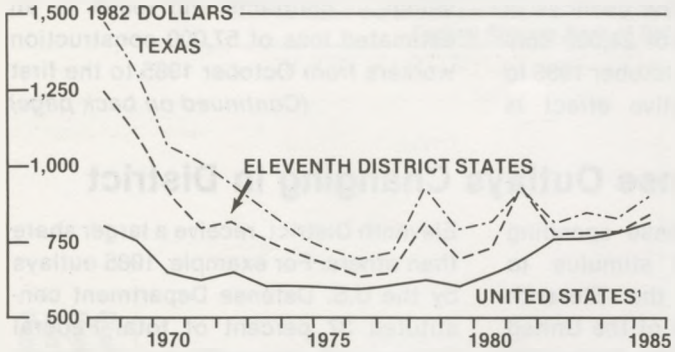
NOTE: Contract data came from McGraw-Hill Information Systems Company, F. W. Dodge Division.
SOURCE: Federal Reserve Bank of Dallas.

Chart 2
TEXAS CONSTRUCTION EMPLOYMENT



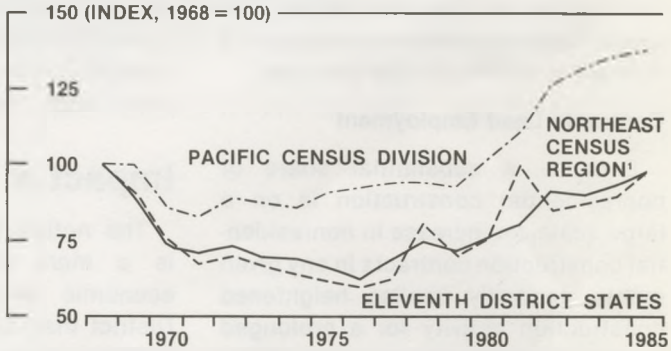
SOURCES: U.S. Bureau of Labor Statistics.
Federal Reserve Bank of Dallas.

Chart 3
REAL PER CAPITA DEFENSE SPENDING



1. Except the Eleventh District states of Texas, Louisiana, and New Mexico.
SOURCES: U.S. Department of Defense.
Federal Reserve Bank of Dallas.

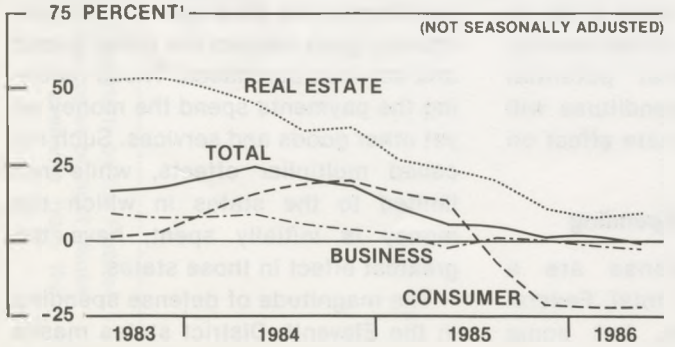
Chart 4
REGIONAL COMPARISON OF REAL DEFENSE SPENDING



1. Northeast Census Region comprises the Middle Atlantic and New England Census Divisions.
SOURCES: U.S. Department of Defense.
Federal Reserve Bank of Dallas.

LOANS—LARGE WEEKLY REPORTERS

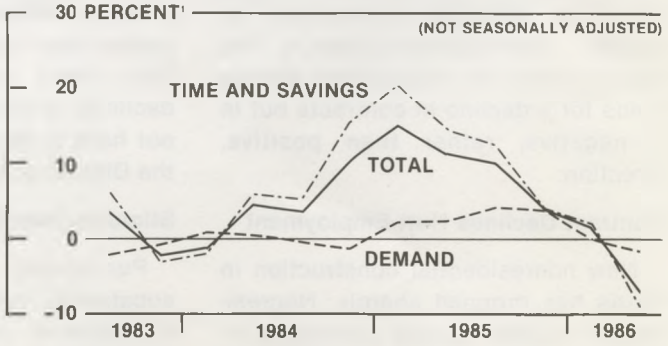
Eleventh Federal Reserve District



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

DEPOSITS—LARGE WEEKLY REPORTERS

Eleventh Federal Reserve District



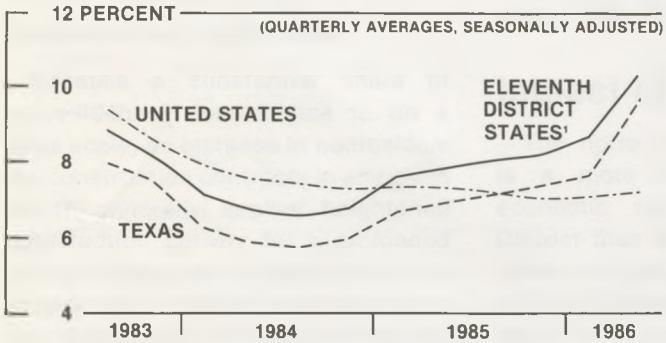
1. Percent change from same quarter in previous year.
SOURCE: Federal Reserve Bank of Dallas.

DISTRICT BRIEFS

The Eleventh District economy appears to be stabilizing as the declines in energy and construction are arrested.

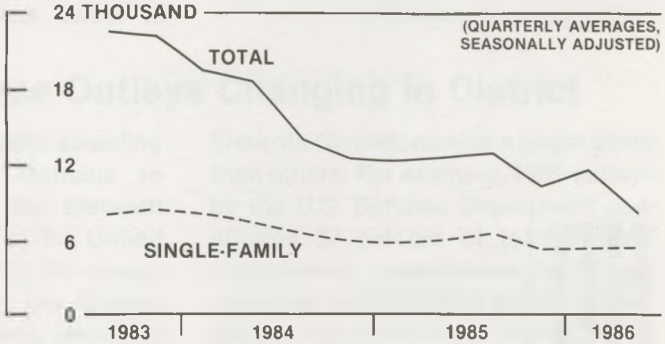
- After declining several months, nonagricultural employment in Texas grew in July. The service-producing sector has been increasing steadily, more than offsetting losses in oil and gas extraction, manufacturing, and construction. The large proportion of energy employment in Louisiana is contributing to the persistent declines in employment there. In New Mexico, the least energy-intensive state in the District, employment has been more resilient.
- The agreement by the Organization of Petroleum Exporting Countries to restrain production has lifted oil prices. OPEC hopes that production restraint will result in an oil price of about $17 to $20 per barrel. The likelihood of success is uncertain as the agreement could be undermined by cheating on production quotas, a persistent problem for OPEC.
- Drilling appears to be stabilizing. The rig count bottomed in June, before the OPEC agreement, and has since grown gradually. Employment in oil and gas extraction, however, continues to decline. Even if OPEC should be successful, the estimated level of prices is not likely to lead to much of a resurgence in drilling in the District states.
- Construction employment is declining in the wake of a sharp decrease in office building construction. The value of total construction contracts was steady from May through July but substantially below the year-earlier levels.
- Manufacturing in the District is faring worse than in the nation as a whole because of the weakness in energy and construction. Depreciation of the dollar promises some aid to the beleaguered manufacturing sector, but there is no evidence of improvement yet.
- The weak District economy is reflected in the balance sheets of the large banks. Loan volume has continued to decline. Real estate lending is still growing, but the rate of expansion has slowed dramatically. As a result of the reduced economic activity in the District, total deposits have contracted further.

UNEMPLOYMENT RATE



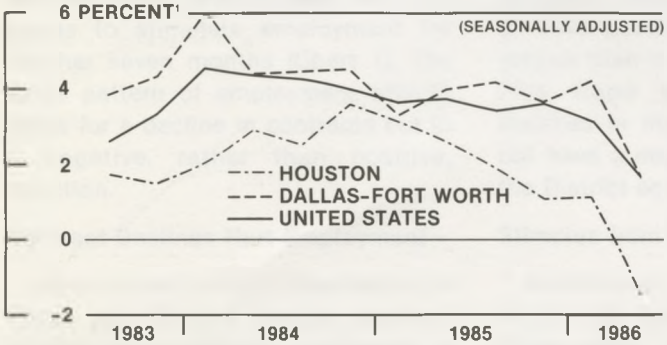
1. Louisiana, New Mexico, and Texas.
SOURCES: Texas Employment Commission.
U.S. Bureau of Labor Statistics.
Federal Reserve Bank of Dallas.

HOUSING PERMITS IN TEXAS



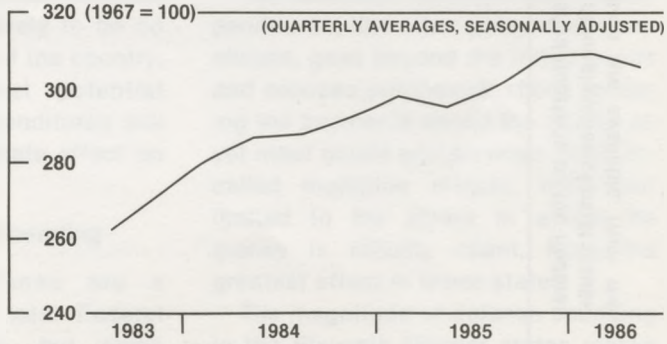
SOURCES: U.S. Bureau of the Census.
Federal Reserve Bank of Dallas.

CONSUMER PRICE INDEX



1. Percent change from same quarter in previous year.
SOURCES: U.S. Bureau of Labor Statistics.
Federal Reserve Bank of Dallas.

TEXAS INDUSTRIAL PRODUCTION INDEX



SOURCE: Federal Reserve Bank of Dallas.

Contracts (cont.)

quarter of 1987. This loss is equivalent to a 12.6-percent decline in construction employment.

Employment Reductions Likely

Texas construction employment will probably decline further this year as the lagged negative effects of the slump in nonresidential contracts are realized. A rebound in nonresidential contracts or an increase in either residential or non-building construction contracts would stimulate employment and possibly offset the negative effects of the recent low levels of nonresidential contracts. However, given past overbuilding and the current weakness in the regional economy, any stimulus from increases in contracts will likely not be sufficient to prevent some further declines in Texas construction employment.

—Jeffery W. Gunther

Defense Outlays (cont.)

the changing relative importance of this stimulus. Although Texas, the major recipient of defense dollars in the District, ranked third in total defense spending among all states in 1985, its ranking falls to fourteenth when population is taken into account. As shown in Chart 3, per capita defense outlays for the District states no longer exceed those for the rest of the nation by as great a margin as in the past. Much of this narrowing of per capita defense spending is the result of faster population growth and economic diversification in the region during the economic expansion before 1982. As indicated in Chart 4, however, defense spending growth in the District states compared with some other regions has been unexceptional. Growth in inflation-adjusted defense spending in these states has been about equal to that for the Northeastern United States and has not been as rapid as in the states along the Pacific Coast.

Effect of Defense Spending Changes

The prospects of cutbacks in government spending, including defense outlays, as a result of proposed deficit reduction measures have raised concerns about the effects on the Eleventh District. Should such cutbacks take place before the District begins to recover from the current economic malaise, such recovery would be delayed. Over the longer run, however, the District economy will likely become less dependent on defense spending, just as it is becoming less dependent on the energy industry. As this adjustment occurs, the ripple effects of future defense spending changes will be no more serious in the District than in the rest of the country.

—William T. Long III

District Highlights is published quarterly by the Federal Reserve Bank of Dallas. Additional copies of most issues and subscription information are available from the Public Affairs Department.