

TEXAS

UNIVERSITY
TEXAS AT AUSTIN
MAY 19 1988
GENERAL LIBRARIES

BUSINESS REVIEW

Bureau of Business Research
College and Graduate School of Business, University of Texas at Austin

June 1988

The Texas Economy: The Numbers Continue to Look Good

Most of the statistical indicators of economic conditions in Texas and the United States continue to look good. The most encouraging signs are the continued strength in exports, consumer demand, and investment spending.

The trade statistics released on April 14 upset the stock market with an unexpected jump in the trade deficit. However, the bad news was mitigated by the fact that exports were still increasing. Evidently, the weak dollar is having the desirable effect of increasing international demand for American goods, especially commodities. Texas stands to gain from this trade both because of our production of commodities and because of our providing port services for international trade.

The April trade report raised concern because imports had risen when they were expected to fall. It is risky to infer too much from one month's data, but the stubbornness of imports in the face of the weakening dollar suggests that our demand for imports is inelastic—we have not lowered our demand for them by as great a percentage as their dollar price has risen. Unless we can break our addiction to foreign manufactured goods, imports will continue to upset our foreign trade balance.

For Texas, there is a silver lining in the import figures. One of the components was the increase in the value of imports of oil. This value increase is the result of higher oil prices induced by the uncertainty of the political situation in the Middle East. High oil prices are good for Texas.

Other economic indicators look good too. U.S. unemployment is less than 6 percent, and while Texas unemployment is higher than we would like to see it, it appears to be on the way down. Texas employment and income growth are both on the increase again, and initial claims for unemployment insurance are substantially lower than they were at this time last year.

The Stock Market

Even with all this good news, many analysts are cautious about the future. In the April issue of this publication, I cited parallels between the market crashes of 1929 and 1987 and warned that we were not out of the woods yet. Similar features appeared in *Time* on April 4 and *Business Week* on April 18, suggesting that others share my interest in ancient history.

One of the primary themes in both of these articles was the idea that the likelihood of economic disaster is substantially lower today than it was in 1929 because of the automatic regulation mechanisms that have become part of our economy since the depression. For example, in 1929 there was no unemployment insurance. When people lost their jobs, their loss of spending power induced a reduction in demand for goods that caused other people to lose their jobs—a downward vicious spiral. Now, unemployment insurance benefits paid to the jobless help sustain the demand for goods. Unemployment insurance thus adds stability to the economy.

The advantage of these automatic stabilizers is that they require no timely action by Congress. The corrective action is triggered by the unemployed person's reaction to current economic stimuli.



Of course there are limits to these automatic stabilizers. In Texas, when unemployment jumped in 1982, the unemployment insurance fund was drawn upon so heavily that special measures were required to balance the account. Ultimately, payroll taxes on employers were increased substantially to keep the fund solvent. In a period of sustained high unemployment, these payroll tax increases would tend to counteract the stimulative effects of the benefits they finance.

Another structural difference between 1929 and 1987 is the regulation of buying stock on the margin. In 1929 it was common to buy stocks with four-fifths of the purchase price being borrowed funds. At that time, banks could both offer stocks for sale *and* lend money to buy stock. Under these rules, stock demand and margin lending could ratchet each other upward in a spiral of speculation completely unrelated to real growth in the physical assets or earnings of the firms whose stock was being traded.

When stocks are bought on the margin, a fall in the price of the stock can force the stockholder to sell the stock at the current price, no matter how low it may be. In addition to losing the stock, the investor is still liable to pay back any remaining balance on the loan used to buy it. Buying stock on the margin is one of the few gambles where you can lose more than you bet.

In the time before the crash of 1929, the average margin level for all stocks was 40 percent. For an investor leveraged at 40 percent, a forced liquidation at 50 percent of the original stock purchase price would leave the investor owing ten dollars for every hundred dollars of stock owned. Another way of putting it, for every ten dollars of his own money originally invested, the stockholder would now owe an additional \$2.50 to the lender. If the margin were 20 percent, the investor would owe \$7.50 for every ten originally invested.

The low margin requirements for stock purchases contributed to the downward spiral of stock prices in 1929. As prices fell, people were forced to sell their holdings, and these forced sales caused further declines in the stock prices. In response to the crash of 1929, margin requirements were increased, and as a result, margin calls were not a major factor in the crash of 1987.

The change in the margin requirement substantially reduced a major source of instability

in the stock market. However, other sources of instability remain. Program trading, for example, still concerns many stock market experts. On April 14 the rapid decline of stock prices prompted authorities to deny program traders the use of the stock exchange's computerized trading network. This denial was intended as a "circuit breaker" mechanism to reduce instability. The mechanism failed to accomplish its goal because program traders were able to process their orders outside the system. Further, the very action of suspending trading was thought to have contributed to the price decline—that sort of thing doesn't exactly build investor confidence.

Nobody knows the solution to stock market instability. Various postcrash study groups have submitted conflicting reports and recommendations, but every scheme has unacceptable elements. As the memory of the crash fades in the public mind, it becomes less and less likely that any definite action will be taken.

Financial Institutions

Another structural change often cited as a source of stability for our economy is the emergence of FDIC and FSLIC deposit insurance. Deposit insurance gives people confidence that their money is safe, even in times of financial crisis.

So far, deposit insurance has been very effective in sustaining public confidence because the insurance corporations have adequately covered all insured losses in failing banks and S&Ls. In the current crisis, the S&L insurance fund was substantially depleted, and special funding had to be arranged to restore it. The FDIC fund has been less hard-hit. It currently holds approximately \$20 billion—enough to cover about 1 percent of the insured deposits in commercial banks. In comparison, the nonperforming assets of the ailing First RepublicBank, approximately \$4 billion, equal 20 percent of the total FDIC fund. First Republic's total assets are actually larger than the entire FDIC fund.

There is some doubt whether the insurance funds alone would be adequate to maintain public confidence during a major financial crisis. Most insurance is designed to spread the risk of a predictable loss among a population. The premium for the insurance is based on expected losses for the population, as determined by actuarial methods. Most insurance contracts con-



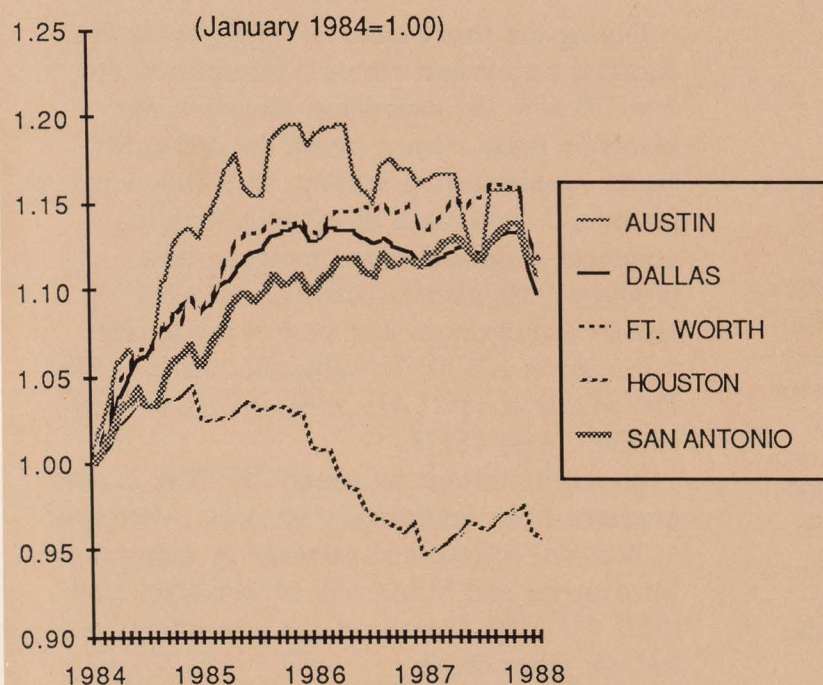
Employment and Unemployment Rate by Metropolitan Area

Area	Total nonagricultural employment (thousands)			Total employment (thousands)			Unemployment rate
	Mar. 1988	Mar. 1987	Percentage change	Mar. 1988	Mar. 1987	Percentage change	
Abilene	49.1	49.0	0.2	49.8	49.1	1.4	7.6
Amarillo	77.7	77.2	0.7	92.2	91.0	1.3	6.5
Austin	351.5	356.6	-1.4	394.8	396.1	-0.3	6.9
Beaumont-Port Arthur	126.5	128.2	-1.3	139.3	138.9	2.9	11.7
Brazoria	57.9	56.7	2.1	73.2	70.8	3.4	9.3
Brownsville-Harlingen	67.0	65.2	2.8	82.5	79.2	4.2	15.0
Bryan-College Station	47.8	47.6	0.4	55.5	52.7	5.3	5.0
Corpus Christi	124.6	124.1	0.4	142.9	140.1	2.0	10.7
Dallas	1,324.0	1,324.4	0.0	1,339.4	1,325.1	1.1	6.4
El Paso	187.1	183.8	1.8	206.6	200.5	3.0	11.5
Fort Worth-Arlington	513.6	511.0	0.5	622.4	611.9	1.7	7.0
Galveston-Texas City	70.2	70.9	-1.0	95.4	95.4	0.0	10.3
Houston	1,395.9	1,369.0	2.0	1,457.7	1,417.7	2.8	7.8
Killeen-Temple	70.4	68.8	2.3	85.4	82.9	3.0	8.3
Laredo	35.6	35.1	1.4	38.7	37.3	3.8	17.0
Longview-Marshall	65.2	63.5	2.7	70.7	68.4	3.4	9.9
Lubbock	92.0	90.8	1.3	105.2	103.0	2.1	6.0
McAllen-Edinburg-Mission	90.8	88.9	2.1	121.3	117.5	3.2	19.7
Midland	44.2	43.2	2.3	45.5	44.4	2.5	7.1
Odessa	43.5	41.1	5.8	48.9	46.7	4.7	8.4
San Angelo	36.5	36.2	0.8	42.2	41.5	1.7	6.2
San Antonio	507.5	499.3	1.6	561.6	546.0	2.9	8.3
Sherman-Denison	38.2	37.3	2.4	45.6	43.7	4.4	7.5
Texarkana	45.6	44.9	1.6	53.4	51.6	3.5	8.4
Tyler	61.0	60.2	1.3	69.8	69.0	1.2	8.2
Victoria	27.8	26.6	4.5	33.7	32.5	3.7	7.7
Waco	78.5	77.1	1.8	85.3	82.8	3.0	8.0
Wichita Falls	50.2	49.4	1.6	52.7	51.2	2.9	7.5
Total Texas	6,531.7	6,468.2	1.0	7,493.0	7,347.9	2.0	8.3
Total United States	103,698.0	100,462.0	3.2	112,867.0	110,229.0	2.4	5.9

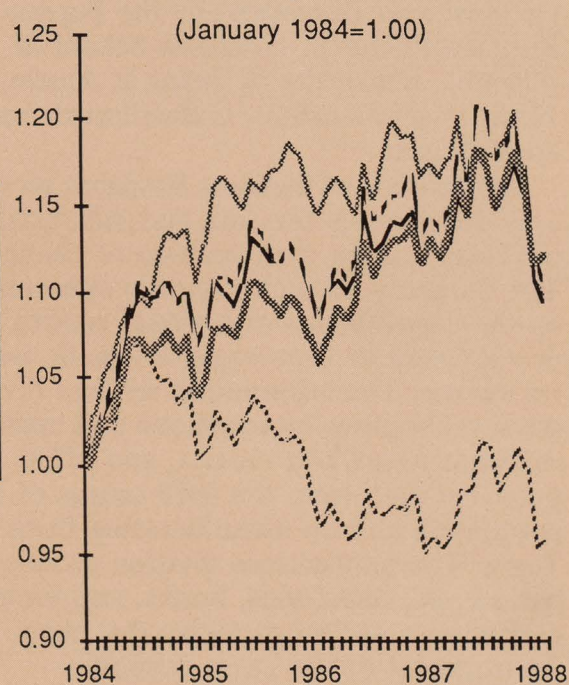
Note: These data reflect the Bureau of Labor Statistics' redefined metropolitan areas in Texas. Data are not seasonally adjusted. Figures for 1987 have undergone a major revision; previously published 1987 figures should no longer be used. Revised figures are available upon request. All 1988 figures are subject to revision, with the exception of Texas and U.S. total employment.

Sources: Texas Employment Commission and U.S. Bureau of Labor Statistics.

Nonagricultural Employment in Five Largest Texas Metropolitan Areas



Total Employment in Five Largest Texas Metropolitan Areas

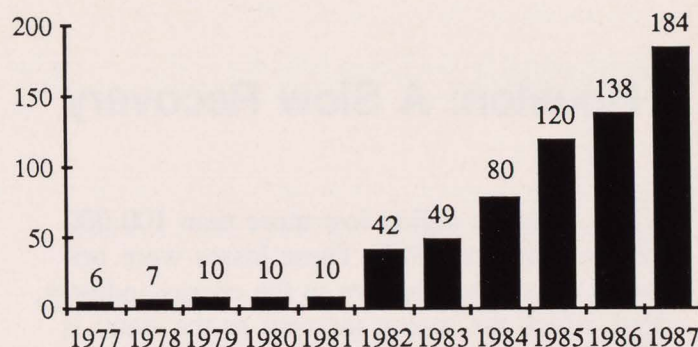


tain escape clauses to protect the insurer against extraordinary risks that are likely to affect the entire covered population. For example, life insurance policies usually contain a clause letting the company off the hook in the event of nuclear war.

Unlike life insurance, where expected losses for the insured population are predictable and only a small part of the population will be making claims simultaneously, deposit insurance is designed to guard against a one-time calamity that would affect every depositor at the same time. In this sense, the FDIC and FSLIC deposit insurance is not really insurance at all, since no risk is being spread. Furthermore, the correct size of the fund and the premiums paid cannot be determined by studying rates of bank failures in normal times, because the fund is not insuring against normal times.

Since the insurance funds are quite small compared to the deposits they protect, it is unlikely that they would be adequate at a time of financial crisis. If a wave of bank failures depleted the fund, the federal government itself would probably become the ultimate guarantor of deposits.

U.S. Bank Failures



The accompanying figure shows a time series for bank failures in the United States. The upward trend of this series suggests the banking system is being sorely tried by the energy, real estate, agricultural, and third-world loans we have heard so much about. In addition to portfolio problems, fraud figured in about a third of the failures. With almost 10 percent of all banks on the FDIC's list of problem banks, we are certain to see the trend of bank failures continue.

—Jerry Olson
Economist
Johnston, Olson, & Associates

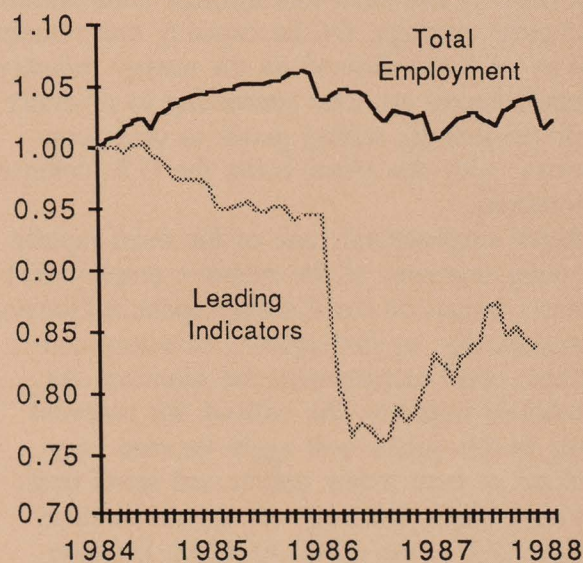
Components of the Texas Index of Leading Economic Indicators (December 1987–February 1988)

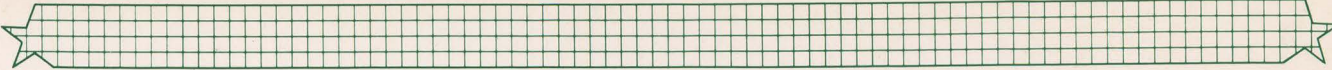
Measure	Dec.	Jan.	Feb.
Manufacturing weekly hours	41.98	41.90	41.40
Retail sales (billions of 1967 dollars)	2.61	2.53	2.65
New housing permits (thousands)	2.16	2.40	2.67
U.S. wellhead price of oil (1967 dollars per barrel)	4.13	3.93	3.86
Initial claims for unemployment insurance (claims per thousand employees)	10.63	8.45	10.47
Leading indicators index (January 1984=1)	0.83	0.83	0.82

Note: All figures are seasonally adjusted.

Sources: Texas Employment Commission, U.S. Bureau of the Census, and U.S. Department of Energy.

Texas Index of Leading Economic Indicators (January 1984=1.00)





Houston: A Slow Recovery

The Houston region lost more than 100,000 jobs in 1986 and 1987. These losses were primarily caused by changes in the energy industry, upon which the region (as well as the state) is still largely dependent. A slow recovery appears to be taking hold in the seven-county consolidated metropolitan statistical area. The speed with which conditions improve will depend on a host of issues. Volatile operating environments for the oil and gas industries will continue to affect the Houston economy. Additionally, the region is now more vulnerable to instability at the national level. Conditions such as the twin deficits and overburdened consumers are more likely to affect Houstonians than they might have been in the past. These issues should be examined in light of the employment sectors they influence most.

Houston's durable manufacturing sector has been dominated by activity in the energy business, where key products consist of drilling rig parts and components. With the plunge in prices that commenced in 1981, the region's manufacturing activity may bring back some of the employment in this sector. However, much of the capacity has been lost through consolidations and plant closings. Of the capacity that remains, not all of it can depend on the energy industry. Manufacturers are thus attempting to diversify their markets by selling goods to other consumers, with one client being the U.S. defense community.

Retail employment, one of the most rapidly growing segments of the region's employment picture, hinges on retail dollars spent in Houston. Consequently, as the region's economy contracted, retail employment did likewise. As conditions improve, the outlook for renewed gains in this sector will again become very positive as both major outlets and small businesses expand. Two caveats should be mentioned. One is the extent to which Houston

region consumers mirror U.S. consumers in debt leveraged per household. The second is the extent to which Houston consumers might postpone major purchases in the face of a national recession. Should increased inflation precede a national recession, consumers might speed up purchasing decisions in anticipation of higher prices.

Finally, the growth sector capturing the attention of most Houstonians is services. This sector embraces both personal and business services and also includes health care and engineering. In the case of health care, Houston is well-poised to enjoy continued advances in both direct delivery of health care systems and advances in biotechnology spawned by the region's world-renowned facilities. Biotechnology spin-offs, coupled with engineering services and spin-offs from activities at NASA's Johnson Space Center, add to the potential for growth in these sectors. Cuts in federal spending in these areas could stymie growth and generate a more pessimistic outlook. Federal spending is a critical issue especially as it relates to NASA.

It is worth noting that Houston is, even more so than in the past, the center of the U.S. oil and gas industry. As technological advances are made, the region could become home to businesses based on these advances and enjoy great benefits. The region should be able to capture activity from advances in both upstream (exploration and production) and downstream (refining and chemicals) operations. In some cases, this might take on the cloak of diversification; for example, much of the chemicals business is in intermediate goods so that opportunities may exist for final goods production.

—Michelle Michot Foss
Senior Associate
Center for Economic and
Demographic Forecasting,
Rice Center





Bureau of Business Research

P.O. Box 7459

Austin, TX 78713-7459

General Libraries
PCL 1.114
Serials Records
CAMPUS

NONPROFIT ORG.
U.S. Postage
PAID
Austin, Texas
Permit No. 1630

Editor: Lois Glenn Shrout

Texas Business Review is published six times a year (February, April, June, August, October, and December) by the Bureau of Business Research, Graduate School of Business, University of Texas at Austin. *Texas Business Review* is distributed free upon request.

The Bureau of Business Research serves as a primary source for data and information on Texas and on the dynamics of change. The Bureau's research program concentrates on the determinants of regional growth and development and investigates specific issues for clients. The information services division answers inquiries by telephone and mail, responds to walk-in visitors, and offers computerized data from the 1980 census of the population and on manufacturing firms in Texas. The publications division produces periodicals, directories, books, and monographs on a variety of topics that shape the development of the Texas economy.



Announcements

During the first quarter of 1988, **Texas Industrial Expansion** reported information on over 70 new and expanding manufacturing plants in Texas. Every month the newsletter tracks manufacturing activity, including new plants and expansions of existing facilities, contracts, acquisitions and mergers, new products, maquiladora activity, and plant layoffs and closings. The cost of a one-year subscription is \$30. To subscribe, call or write Dan Hardy at (512) 471-5179, P.O. Box 7459, Austin, Texas 78713.

Per capita income by county for 1986 is now available from Information Services. After July 1, personal income and earnings by industry for counties and MSAs will be available. Call (512) 471-5180 or write to the post office box address given above.