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TD Economics

Special Report

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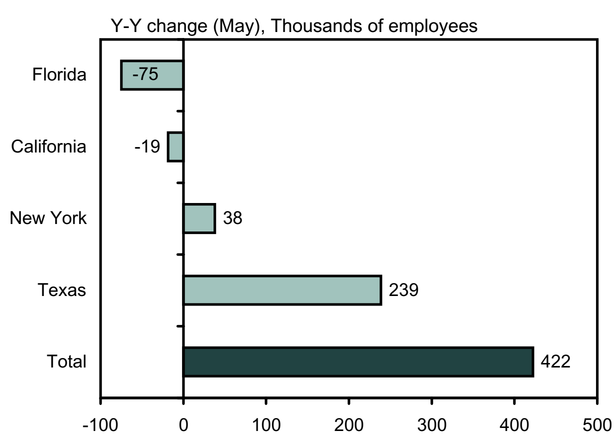
A REGIONAL LOOK AT U.S. LABOUR MARKETS: DON'T MESS WITH TEXAS!

The U.S. economy confounds most forecasters. Amidst an unprecedented financial crisis and the worst housing downturn since the Great Depression, the economy has failed to produce a single negative quarter for activity. However, after six consecutive months of national job losses, it is common knowledge among market participants that the cracks in the foundation are running deep. It is less well known how the employment markets of individual U.S. states are faring. Our findings reveal that job conditions are worse than they appear at the bird's eye level of national statistics. Four states make up nearly one-third of the entire U.S. job market: California (11%), Texas (8%), Florida (6%), and New York (6%). Only one of these states is driving job growth in the country – Texas. On a year-over-year basis, Texas chalked up 239,000 new jobs in May, accounting for nearly 60% of all American jobs created over the past year! By comparison, New York came in a distant second with an annual gain of only 38,000 jobs, while Florida and California topped the losers' list with 75,000 and 19,000 fewer jobs respectively. Tallying it up, 14 of 50 American states are already in the red on a year-over-year basis and an equal number are holding on by the finger nails with annual growth of 0.4% or less.

HIGHLIGHTS

- **U.S. state data show that job conditions are deteriorating broadly across the nation.**
- **Employment growth in 14 of 50 states is already in the red on a Y/Y basis and an equal number are holding on by the finger nails.**
- **The exception is Texas, which has accounted for 60% of all American jobs created in the past year.**
- **Most states continue to experience strong hiring in government and health industries, which are more resistent to the business cycle.**
- **Corporate America has waning appetite to hire workers in the service sector, especially in the big states of California, Florida and New York.**

NON-FARM PAYROLLS



Source: Bureau of Labor Statistics

Clearly, Texas is grossly buoying national employment figures with the divergence in performance largely linked to the positive impact the oil boom has on the Texas economy. In the rest of the country, two forces appear to be at work. In the goods sector, accelerated losses in the construction sector are taking a toll on a number of states, and in many cases this is occurring in conjunction with worsening conditions in manufacturing. In the service sector, Corporate America has dramatically scaled back its appetite to hire workers. Texas has largely shrugged off both of these impacts, widening the disparity between the performance of its job market and that of the rest of America. While Texas remains a stronghold in the job market, it's only a matter of time before the weakness across the rest of the country bleeds into the national economy, tipping real GDP growth into the red.

The lone star state shines bright

The number of jobs created in Texas is nearly identical to that recorded in the previous year. Its position as the nation's leading crude oil-producing state in the current boom environment has shielded it from many of the economic hardships being felt in the rest of the nation. Texas accounts for more than one-quarter of the national refining capacity in the United States.[1] The share of real gross state product related directly to oil & gas mining and manufacturing is more than four times greater than for the nation as a whole – and this naturally feeds into incomes, employment and output across industries in Texas. For instance, in 2004, the Federal Reserve Bank of Dallas estimated that for every 10% increase in oil prices, real gross state product is boosted by 0.4 percentage points. By extension, the Texas housing market has also proven to be more resilient. As an example, the supply of home inventories in Houston was sitting at 6.5 months in May, compared to a supply glut of 11 months at the national level.[2] The better position in housing has prevented a mass exodus from residential construction and tempered the knock-on effects to other areas of the economy. Also in the plus column is the fact that Texas is an exporting hub of goods in the United States, which has allowed the state to benefit disproportionately from the boost to exports from a depreciated greenback.

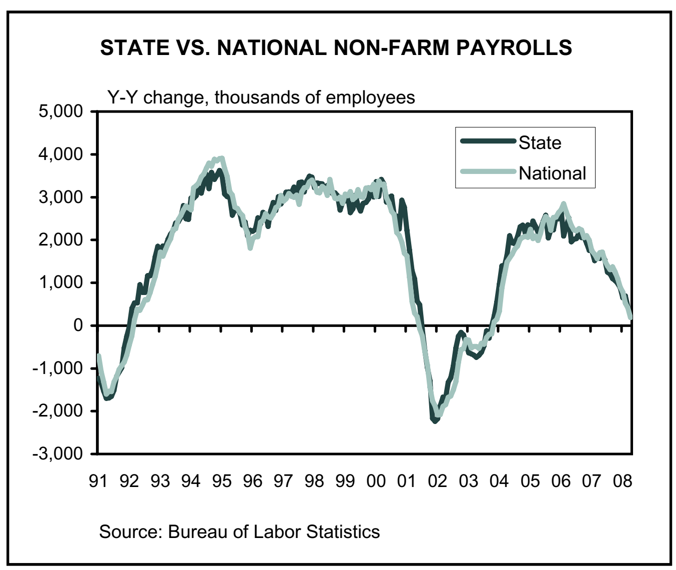
The battle of goods vs. services

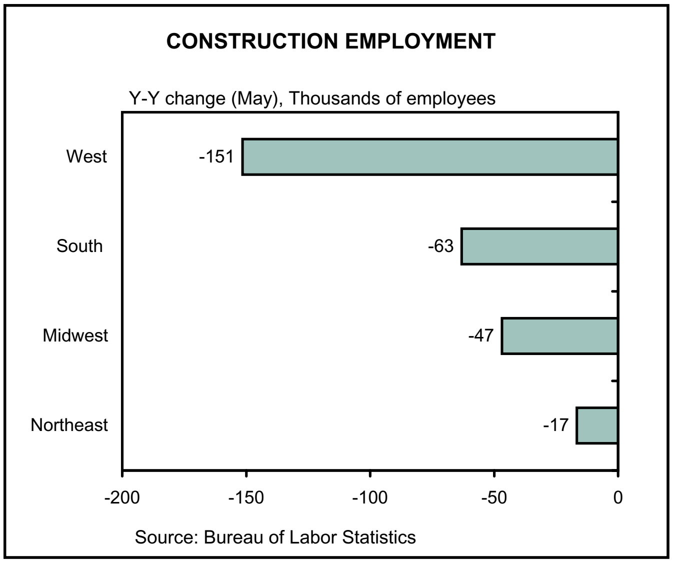
The majority of states are losing jobs in the goods sector hand over fist, but not Texas. More than a half million jobs were put on the chopping block in the past year across the nation, with 37 states in the red and the rest barely in positive territory. Worst off were California and Florida, each losing over 100,000 goods jobs and each accounting for the bulk of the job losses in the entire West and South regions. The Midwest region also fared poorly, with 152,000 job losses spread across a broad swath of states. And, the Northeast region was down 63,000 jobs in the goods sector relative to a year ago. Although all but one of the 9 Northeastern states cut payrolls, the larger states of New York (-19,500) and Pennsylvania (-16,000) led the losses. And how did Texas do? While hiring momentum in Texas has slowed dramatically from previous years to less than half the pace, it bucked the trend and added 32,000 workers.

The reasons for the job losses in the goods sector differ depending on the state, but accelerated losses in construc-

Box 1: State versus National Employment Data

Although state employment data are computed by the same statistical agency as the national statistics, adding up state employment does not match the national statistics due to differing surveys and methodology. As a result, to maintain accuracy and consistency, the national figures cited in this paper reflect the sum of all state employment, rather than the more familiar national non-farm payrolls survey. As a result, the year-over-year gain in total U.S. nonfarm payrolls amounts to 422,000 jobs with the state employment data, compared to 184,000 new jobs under the national survey. This may seem to be a large difference, but as the adjacent graph demonstrates, there is a tight correlation between the two series and the trend in employment is identical, so the state data remain a reliable source of information.



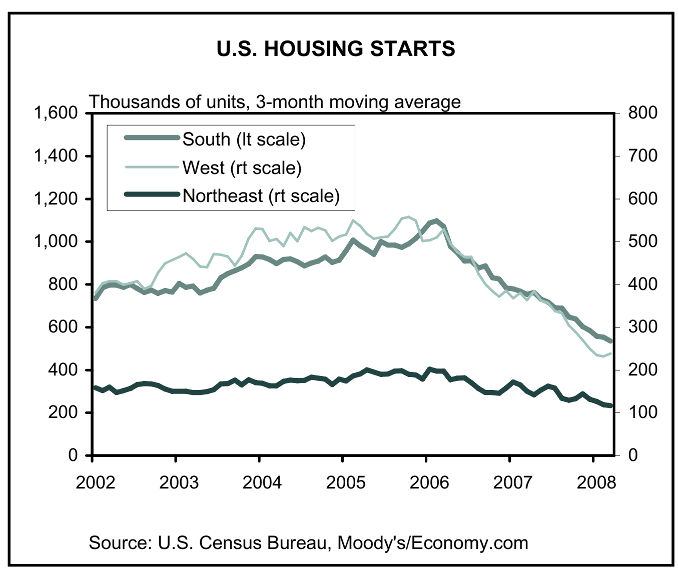


tion is the new kid on the block for most states. While firms have been widely cutting manufacturing jobs, pink slips to construction workers are highly concentrated in California and Florida. These two states account for about 60% of the construction jobs shed across the entire United States since May of last year. Not to be forgotten, Nevada and Arizona have also aggressively chopped construction workers. The four states combined have shed more than 200,000 workers in the sector, which is the predominant impact behind the overall job weakness in those states. Of course, this development is hardly a surprise given that these states were among those most exposed to residential overbuilding and the subprime mortgage market.

In the Midwest region, the manufacturing sector poses the greatest downdraft on goods jobs, but the construction sector has added a new dimension. A pull-back in manufacturing workers is not a new development for this region. Since the beginning of the decade, manufacturing jobs in the automotive-intensive states of Indiana and Michigan have been in a tailspin. However, job market conditions have worsened over the past year, and other states such as machinery-intensive Wisconsin have also picked up the pace in shedding manufacturing workers. A total of 106,000 manufacturing jobs has been slashed from payrolls in the Midwest. In addition to this, the employment picture has darkened with 47,000 construction jobs also landing on the chopping block in May relative to last year, which is double the loss seen this time in 2007. And, the pace of job losses is heating up. Since the start of this year, 31,000 workers were given their walking papers, leaving the region on track to outdo losses posted in the prior year.

The Northeast is also feeling the pain of manufacturing job cuts (-47,000), but no more so than in the prior year. Meanwhile, in the construction sector, about 17,000 jobs have been cut, twice as many as this time last year. This doesn't seem like much in comparison to other areas in the U.S., but the Northeast has a slight advantage on the housing front. Although home prices rose with the best of them in the region, it had lower subprime exposure, and also had generally less growth driven by housing starts activity. This has shielded the region from the larger downdraft occurring in other parts of America. The loss in construction jobs represents only 6% of all construction jobs shed in America, which is less than half the share of the Northeast construction labour market in the country.

How does Texas compare on the manufacturing and construction front? Texas is not immune to the troubles in manufacturing, but as of May it had only seen 5,000 workers laid off relative to the prior year. Up until now, Texas has been safegaurded from deeper manufacturing losses due in part to its heavy trade reliance. Texas is the largest exporter of U.S. goods and nearly one-quarter of all manufacturing workers in the state depend on exports for their jobs.[3] This offers Texas a competitive advantage relative to other states, as the depreciated U.S. dollar has boosted export demand to the point where exports have been adding nearly one percentage point to the annual growth in U.S. real GDP since 2004. Furthermore, hiring in construction has more than made up for the losses in manufacturing, with 23,000 new workers added to the payrolls.

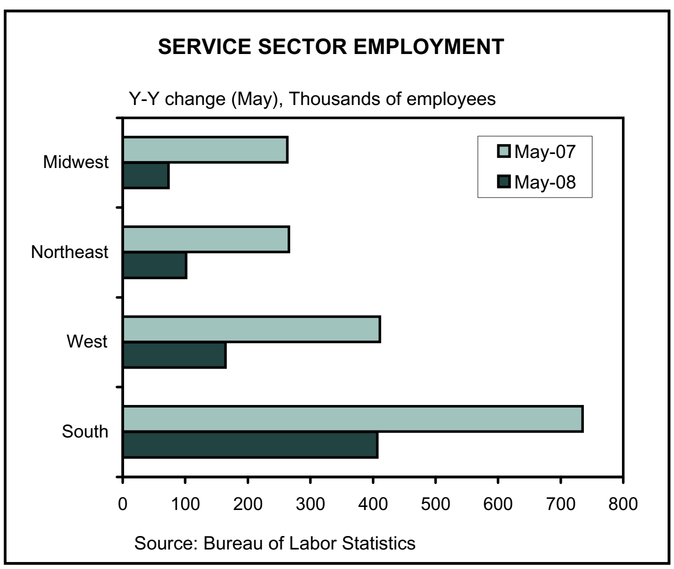


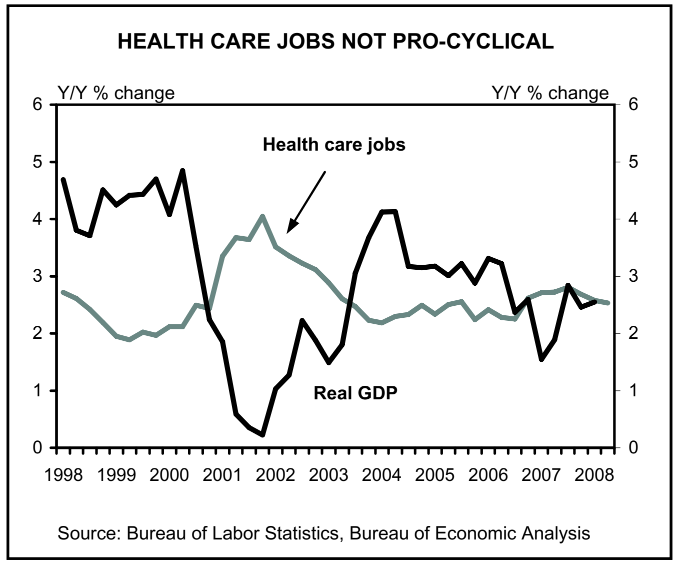
Texas is one of the fortuitous states where the housing market has outperformed the nation, and jobs have also benefited from activity in non-residential construction. In addition, employment in the broader goods sector is getting a boost from other areas, such as natural resources and mining.

America's waning appetite for service jobs

When it comes to the service sector, where 8 out of 10 are employed, most states are experiencing a sharp deceleration in hiring relative to last year, but not Texas, which accounted for 20% of all service sector hiring in the past year. For instance, California added 91,000 workers this year, half the pace of last year. Likewise, Florida added 27,000 workers over the past year, but this is a hundred thousand fewer workers than this time last year. New York has added nearly 60,000 workers, which is less than half the pace of last year. All together, there were almost a million fewer workers hired in the service sector in May of 2008 relative to 2007. Texas was holding up comparably well, adding 206,500 service sector workers. This is about 28,000 fewer than last year, which is not a big discrepancy.

And, momentum is certainly something to keep an eye on. Focusing only on the hiring that has taken place this year (December 2007 to May 2008), Florida has actually lost 13,100 service sector jobs – a pattern not seen since the 2001 recession. Meanwhile, California has scraped together only 25,000 jobs, while New York has seen a mere 300 jobs added in the entire state. In the Northeast region, firms have cut workers in four of the nine states – Connecticut, Maine, New Jersey, Rhode Island – since the end of last year. It is the only area where the tally for the service sector is in the red for the region as a whole. Texas, on the other hand, boasts over 86,000 new positions, which is leaps and bounds ahead of any other state.





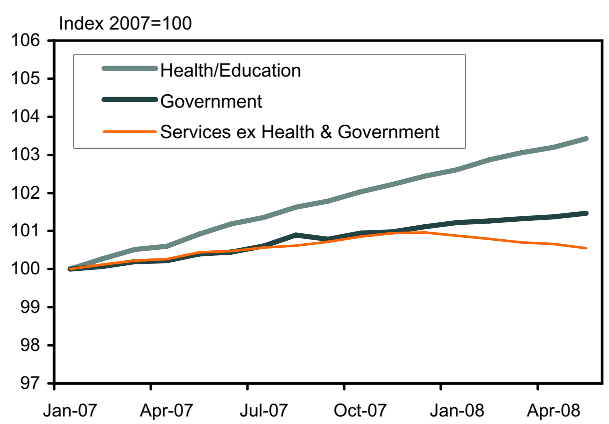
Going against the grain

Hiring within two industries is proving to be incredibly resilient: government and health/education. It's not a coincidence that both industries tend to be more insulated from the business cycle. As the graph above shows, health and education jobs in particular have little variability on a year-to-year basis and momentum is not pro-cyclical with real GDP growth. The average annual gain over the past decade has been 421,000, and so far 2008 beats that estimate with 456,000 new jobs in May relative to last year. In the big three states – California, Florida and New York – health/education employment is actually marginally higher this year relative to 2007, while Texas comes close to matching its prior year gains. Meanwhile, government jobs are pulling their weight with 240,000 new employees, nearly identical to the annual rate of job creation that occurred in May of last year. Interestingly, among the big 4 states, government jobs are shy of levels seen last year, but there has been broad based strength in hiring within the Midwest and West regions. The bottom line is that the source of deceleration in service sector hiring is not coming from these two industries.

The culprits all reside in private sector jobs, where every single major industry is hiring fewer workers than this time last year. The obvious area to finger-point is the financial and real estate industry, which has lost just over 88,000 jobs in comparison to May of last year. All regions and 35 states are in the red on a year-over-year basis, but none more so than California (-35,000), New Jersey (-8,300) and Arizona (-8,000). The Northeast has particularly heavy exposure to financial services, which represent about 7% of the job market (compared to 6% for the nation), and all but the small market of New Hampshire are in the red this year, amounting to nearly 22,000 in job losses. This is probably just the tip of the iceberg for this region, as ongoing difficulties in the credit markets will crimp financial services this year and next, likely resulting in sharper job cuts as the year moves forward. As Moody's Economy.com notes, the more muted pace of job losses so far may be reflective of generous severance packages, in which laid-off employees remain on company payrolls for several months while severance is paid.[4] How did Texas do? The state added 6,000 jobs, though this was a considerable drop-off from levels seen last year.

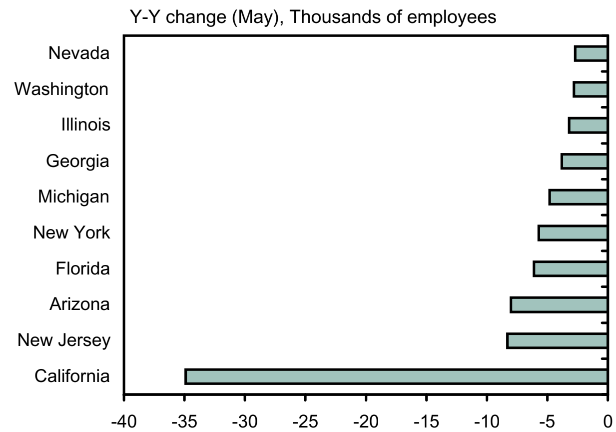
Although the financial industry has chalked up the greatest job losses thus far in the service sector, the biggest swing in hiring relative to the performance of the previous year is in the industries of retail and leisure. The former has a year-over-year tally of 30,000 job losses, compared to a gain of 173,000 in May of last year. The Northeast region had the most challenging job environment, shedding a total of 21,000 retail jobs. Although you might be tempted to think that the biggest job market in the region – New York – led the losses, they in fact stemmed largely from

U.S. NON-FARM PAYROLLS



Source: Bureau of Labor Statistics

BIGGEST 10 JOB LOSSES IN FINANCIAL SECTOR



Source: Bureau of Labor Statistics

Pennsylvania (-7,500), Massachusetts (-5,000), Connecticut (-2,800) and New Jersey (-2,700).

In the leisure industry, hiring slowed considerably to 156,000 new positions, which is less than half the pace seen in May last year. Sticking with the theme of this report, Texas again bucked the trend, maintaining the same level of hiring in both the retail and leisure industries in May 2008, as it did in the prior year.

Conclusion

The U.S. has typically depended on the four largest states of California, Florida, New York and Texas to support job growth in the country, but broadening economic strains have placed that burden largely on the shoulders of Texas. The annual rate of job growth in Texas is decelerating, but at a year-to-date average of 2.4%, it far surpasses the ex-Texas national rate of 0.3%. Although few states are immune to the troubles in the goods sector related to construction and manufacturing, most states are also showing vastly less appetite for jobs in the service sector. And, employment conditions are probably going to get worse before they get better. There are a number of layoffs in the financial industry working through the pipeline and this will disproportionately affect the Northeast region, which has the greatest national exposure to the industry. Meanwhile, no state will be impervious to the weakening in consumer spending that is already underway and will directly impact jobs in the retail, wholesale and leisure industries. Also, we suspect that it will be difficult to retain strong employment momentum in one of the stronghold industries - government - as budgets feel the strain from

Year-over-Year Change in Non-farm Payrolls (May 2007-May 2008)	Midwest	Northeast	South	West	U.S.	U.S. ex Texas
TOTAL	-54	60	358	83	422	183
Goods	-152	-63	-146	-179	-544	-576
Manufacturing	-106	-47	-103	-35	-296	-291
Construction	-47	-17	-63	-151	-270	-293
Resources/Mining	0	1	20	7	24	10
Services	98	123	505	263	967	761
Private Services	73	101	407	164	727	533
Financial	-7	-22	-6	-53	-88	-177
Retail	-15	-21	13	0	-30	-58
Wholesale	4	-1	24	9	36	23
Transporation	5	3	3	6	17	17
Leisure	-5	19	103	41	156	118
Health/education	79	93	168	117	456	418
Government	25	22	98	98	240	228

Source: Bureau of Labor Statistics, Moody's Economy.com

less personal and corporate tax revenue growth. By the end of this year, we believe America will have close to 800,000 fewer workers on the job relative to the end of 2007, and this impact will be broadly felt across the country. There are no periods in post-war history when employment contracted broadly across the nation and an economic recession did not ensue. We doubt this time will be any different. As for Texas, the stabilization of oil and gas prices should narrow some of the divergence in employment growth between the state and the nation, and there is a risk that if oil prices head south, so too will economic activity and employment in Texas.

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Endnotes

1. Energy Information Administration, "State Energy Profile Texas", July 2008
2. Hot Stats – Texas State and Metro Economic Indicators, Federal Reserve Bank of Dallas, July 9, 2008
3. http://www.trade.gov/td/industry/otea/state_reports/texas.html
4. Moody's Economy.com, June 2008