Economic Outlook Update
The Boom Begins to Slow

by Patrick M. Barkey

The interesting thing about economic trends is that by the time they become understood by the public at large, they've often changed. As we assess the performance and the outlook for the Montana economy well past the halfway point in the year, new data call into question two trends that many Montanans have become familiar with: the stronger-than-average performance of our state economy and the natural resource boom that has played such an important part in that performance. There are signs that growth in the Montana economy has been slowing, and it will be important for decision makers to take these new trends into account.

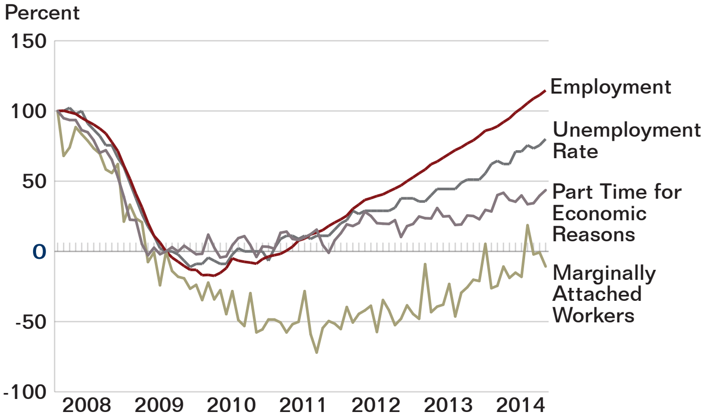
Swings in momentum and confidence are fairly typical in most economic recoveries, of course. And in a national economic recovery that is now reaching average age – the average length of recovery between recessions since World War II is 56 months – fluctuations in growth are closely watched for signs of more serious issues. But the 2007-09 recession was much more severe, and the subsequent recovery has been much weaker than historical experience, and much of the repair work on the economy remains unfinished.

The U.S. Economy at Midyear

Those who see every glass as half full can take to heart the fact that the national economy turned in its best growth quarter of the last two and a half years in the spring of 2014. The bad news is that it followed a winter quarter with the worst decline in economic output since the recession. The net result of a 1 percent annual rate of growth in Gross Domestic Product in the first half of the year for the world's largest economy was certainly disappointing, even if the first half of the year continued to produce steady job gains and falling unemployment rates.

The performance of new home construction, so important for jump-starting local economies throughout the western region of the country, was particularly disappointing. Despite very low mortgage rates, signs of price growth in existing housing, and a pick-up in rents, U.S. housing starts barely surpassed 1 million units (annual rate) in the late spring, with no growth posted over most of the summer. This is less than half the rate of peak activity before the housing bust and considerably lower than the 1.5 million-unit rate some had forecast.

Figure 1
Decline and Recovery of U.S. Labor Market Indicators
Index: December 2007 = 100, June 2009 = 0



Source: U.S. Bureau of Labor Statistics.

This has kept the policy spotlight squarely on the Federal Reserve. So far the new leadership of Janet Yellen has not produced any different policies, with the short-term interest rates controlled by the Fed held near zero just as they have for the last five years. Weakness in housing and the deteriorating economic performance of trading partners in Europe has kept the pressure on for very low interest rates to continue longer.

The Crux of the Problem: Labor Markets

For two and a half years beginning in January 2009, the rate of new homebuilding nationally remained at a sickly 500,000 per year pace, a stark contrast to the 2 million per year rate experienced during the housing boom and just above the estimated level of building necessary to replace the number of older units demolished every year. When growth in home building finally resumed in mid-2011 it was decidedly tepid, with few sustained gains registered since the spring of 2013.

Consumer appetites for all types of debt-financed consumption, with the exception of cars and trucks, have been restrained throughout the recovery, and the performance of housing is only the most prominent symptom of this malady. But in an economy with low interest rates and consistent job growth, we must ask, why is this so?

A big part of the answer comes from the labor market. Figure 1 shows that two of the most closely watched labor market indicators, payroll employment and the unemployment rate, are now approaching (or exceeding, in the case of employment) their pre-recession levels. But the kinds of jobs being created in the economy that are bringing about this outcome are not as high-paying or secure as those that were lost.

That can be seen from the behavior of two other labor market indicators shown in Figure 1. The number of people who report that they are working part time but would prefer a full-time job remains high, with less than half of the recession-induced increases whittled away. And the number of marginally attached workers, defined as those not actively searching but who say they want jobs, remains as high today as when the recession officially ended in June 2009.

Montana's Housing Markets Recovering

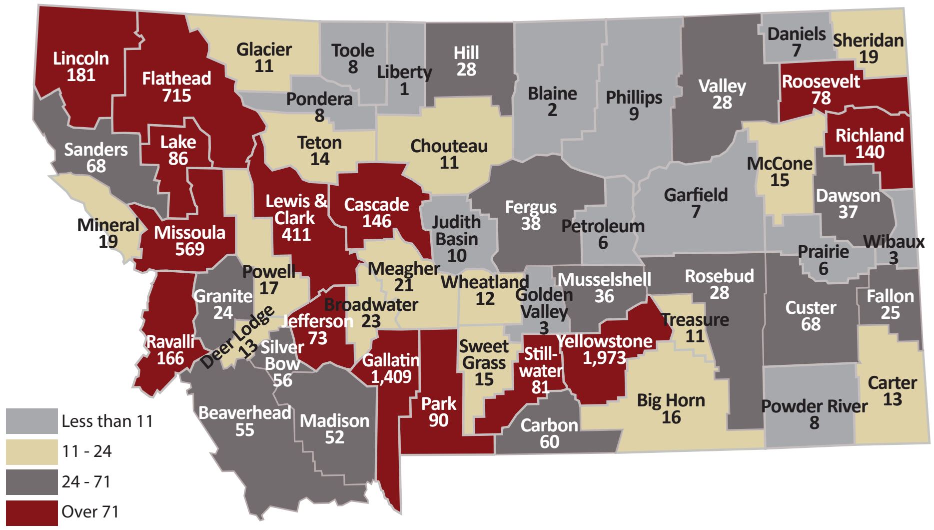
There has been considerable recovery in Montana's housing markets since the low point of the recession in 2009. The average sale price of homes purchased in 2013 was $230,244, up from the average price of $203,668 of transactions in 2009. In the more populous western counties, median sales prices have risen back close to their 2008 levels, while sales prices in Yellowstone County and many eastern Montana counties have substantially surpassed that mark.

Accompanying this rebound in prices has been a long-delayed pick-up in demand for new homes. Calendar year 2013 saw respectable levels of home-building activity across the state. Housing starts, which are estimated by BBER based upon both building permits as well as utility hookups, were highest in the state's more urbanized counties last year, as shown in Figure 2 on page 4.

Yellowstone County had almost 2,000 units started, thanks to a big increase in new multi-unit dwellings started last year. Gallatin County's 1,409 units started in 2013 was second highest in the state, with a larger proportion of single-family homes. There is also considerable building activity in oil-dominated counties such as Richland and Roosevelt counties in the east.

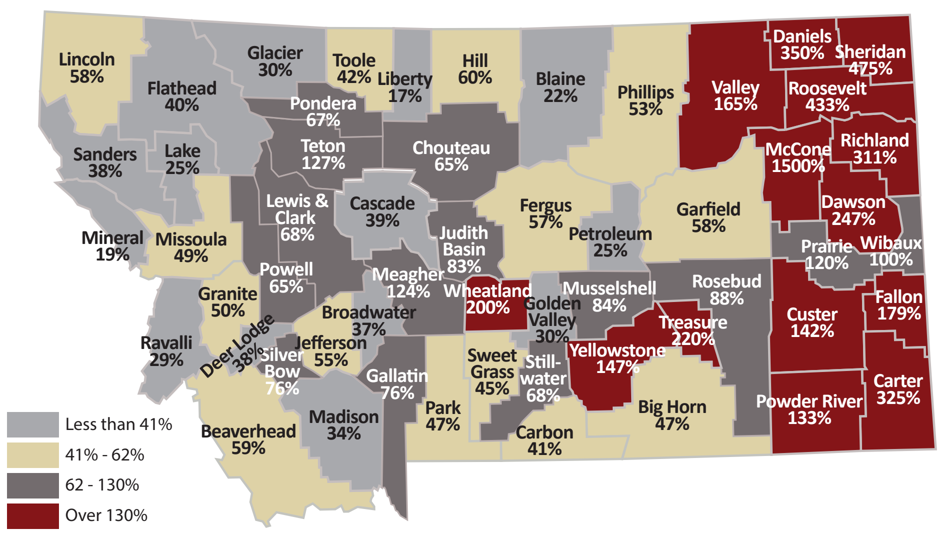
But a comparison of home-building activity to what was experienced during the pre-recession housing start peak shows a markedly different pattern. Most western counties remain well off their levels of building activity in 2004, when more than 10,000 new units were built statewide. Among the western counties most affected by the housing bust, Ravalli County remains in perhaps the worst shape, building only 29 percent as many homes in 2013 as it did during the housing peak. In contrast, Yellowstone County's housing starts in 2013 were 47 percent higher than 2004, with the eastern counties also experiencing much higher levels of home-building (Figure 3, page 4).

Figure 2
Housing Starts, 2013



Source: Bureau of Business and Economic Research, University of Montana.

Figure 3
Housing Starts, 2013, as a Percent of 2004



Source: Bureau of Business and Economic Research, University of Montana.

Updating Montana's Recent Economic Performance

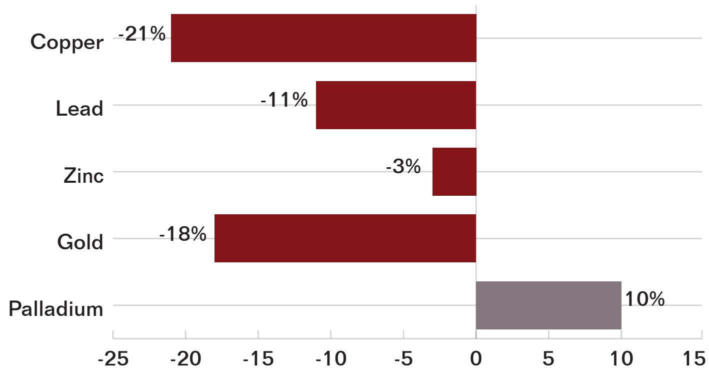
As recently as last January, Montana's economy was continuing to outperform the nation. Some of this was due to our proximity to the Bakken oil boom unfolding in North Dakota, especially for the eastern third of the state. Continued strong years for Montana's agricultural producers, especially cattle ranchers, were another contributing factor. And strong appetites for metals and other natural resources from buyers in Asia also breathed extra life into many parts of the state.

New data call that assessment into question. Inflation-corrected growth in nonfarm earnings increased by 2.2 percent in 2013, significantly down from the upwardly revised 3.2 percent growth registered in each of the previous two years. This slower growth comes about as two important drivers of state economic activity, metal mining and government, experienced significant contraction.

Over the last two and a half years the situation in global commodities markets has performed an about face. The nearly decade-long advance in metals prices – especially for copper – thanks to the insatiable appetite of rapidly industrializing countries like China, ended in 2011. The price retreats since then have hurt Montana suppliers. The only important metals for Montana to buck this trend have been platinum

Figure 4

Percent Change in Commodity Prices Since 2011



Source: International Monetary Fund.

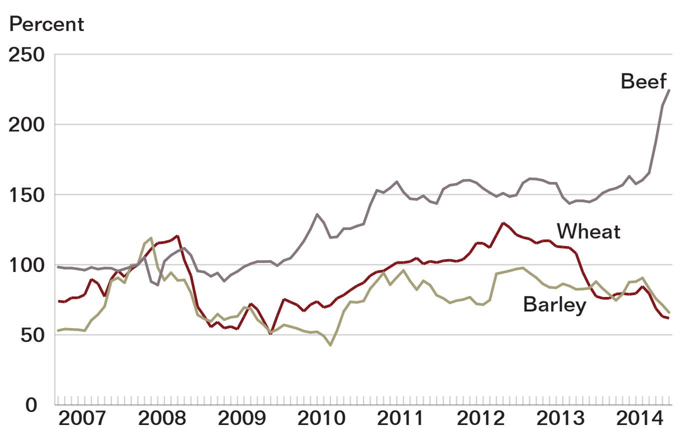
and palladium, whose recent price surges are attributable to worldwide sanctions on Russian production (Figure 4).

Federal government declines are not as easily explained. During 2013 federal payrolls in Montana declined by almost $80 million after correcting for inflation. Most of the declines were in Bureau of Land Management and National Forest Service activities, partially because of less firefighting activity. For the third consecutive year overall government earnings shrank in 2013, down 1.8 percent for the year.

The pattern of growth across the state has continued to evolve. Gallatin and Yellowstone counties continue to pace growth among the state's urbanized counties, but energy and agriculture have continued to cause non-urban growth to be very strong outside of western Montana. Construction growth is strongest in Gallatin County, which alone accounted for half of the state's overall earnings increase in that industry. Earnings in Butte-Silver Bow have been impacted by commodity prices, while Flathead County growth has begun to accelerate.

Figure 5

Agricultural Commodity Prices, 2007-14
Index: January 2008 = 100



Source: International Monetary Fund.

Revising the Short-Term Outlook

This midterm reassessment of the short-term prospects for Montana's economy comes at a time when there are plenty of new developments in the state economy's key drivers:

- As these words are written, crude oil prices are in significant retreat, calling into question the pace of drilling activities in the Bakken. Evidence of maturation and cost-cutting in ongoing activities there predates the recent price drop and should help producers better cope with what are certainly new challenges for developing new production.
- Wheat and barley prices have fallen back from their recent highs, but prices for Montana calves continue to push the envelope (Figure 5). It is shaping up to be a respectable year for agricultural producers overall and an outstanding year for ranchers.
- Montana's smaller but more competitive wood products manufacturers have benefited from the best lumber prices in recent years, but production has been impacted by timber availability.
- Both tourism and manufacturing are turning in another year of steady growth. Transportation and manufacturing have both benefited from oil activity, while visitor spending appears to be coming back with overall U.S. consumer spending.
- Government spending remains mildly contractionary, as the once stable federal spending continues to decline and state and local spending slowly recovers from recession-induced austerity.

Pulling all of these changes together presents a more mixed outlook for the overall state economy than existed just six months ago. The commodity boom that pushed natural resource prices up to dizzying heights as recently as 2011 has clearly come to an end. The energy boom in the Bakken and other places is maturing, although market conditions for Montana cattle producers remain extremely favorable. The most current indicators on economic activity statewide, such as Montana income tax withholding receipts, show slower growth continued into the first half of 2014. Together with what appears to be unspectacular growth in the national economy, our assessment is that the state's overall economic growth will be hard pressed to hit the 3 percent mark we forecast for 2014 in January. ❑

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