The Montana Recovery

What's on Track and What's Not

by Patrick M. Barkey

In many important respects, the art of economic forecasting has returned to "normal" in recent years. In most years, the economy grows, so forecasting growth is "normal." In ordinary times, that growth is spread out across the state like a checkerboard, with faster and slower growth in individual counties occurring with no obvious geographic pattern. And for several decades, the performance of the Montana economy has been only loosely connected to the trends that dominate national economic growth.

To say that the behavior of the economy deviated from normal during the 2008-09 recession would be an understatement. The downturn was long and severe, and it left no county in Montana untouched. And its timing and its origins in our state were identical to the U.S. economic contraction. So even if the slow speed of the current economic recovery has been a disappointment, it is heartening to see the more familiar patterns of differing local and state economic growth re-emerging as we study our most recent economic performance.

For the third consecutive year, the nation's economy has stumbled at mid-year. Anemic consumer spending has brought the overall growth rate in national Gross Domestic Product to less than 2 percent in the second quarter of 2012. Many countries in Europe are in recession, in some cases severely. And the wind in the sails of the high-flying Asian and Latin American economies has tempered noticeably, with countries like India, Brazil, and even China pondering or implementing policies to stimulate faster growth. What do these developments portend for the Montana economy?

The Montana Economy in 2012

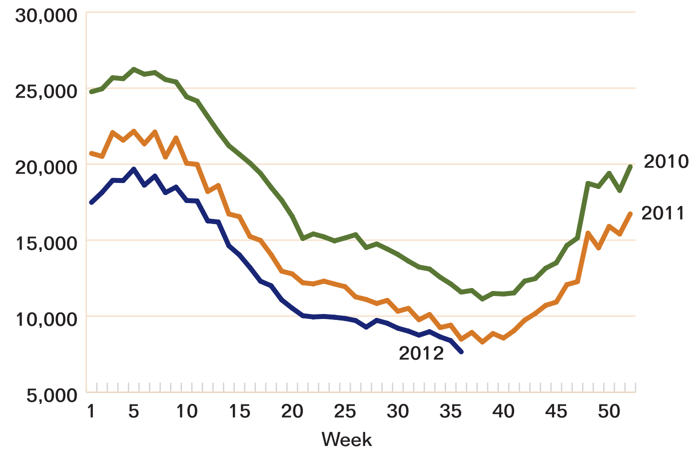
The current status of the Montana economy, as well as it can be gleaned from the partial data available, remains consistent with our forecast of modest recovery. If anything, the data suggest that actual growth in 2012 may outperform the projection of 2 percent growth in total inflation-adjusted nonfarm earnings we made at the beginning of the year. Among the more encouraging signs of strengthening recovery are:

- Strong income growth. Since November of last year, income tax withholding revenues collected by the Montana Department of Revenue have grown at an 11 percent annual rate. Since these revenues adjust automatically to changes in the wage and salary base, they suggest that this component of total nonfarm earnings has enjoyed healthy growth.

- Job market improvement. The most recent data on employment are preliminary and subject to substantial revision. A more robust statistic is the number of Montanans who receive unemployment insurance benefits. The data through the end of August show that there has been a 10 percent reduction in unemployment by this measure (Figure 1).

- Healing housing markets. After experiencing cumulative price declines of as much as 10 percent in some markets since the pre-recession peak, housing prices across the state have been on a slight upward trajectory since the spring of 2011. This is a critical first step in re-starting the state's moribund housing construction industry, whose improvement is expected next year.

Figure 1
Montana Unemployment Claims, 2010-2012



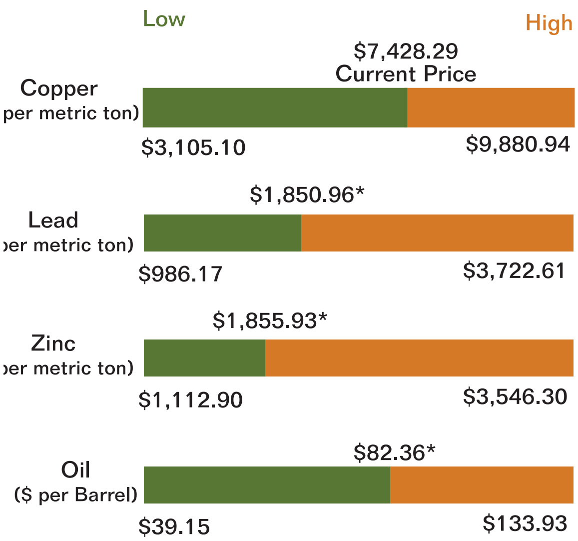
Source: U.S. Department of Labor.

- Robust energy investment. A wide variety of significant energy projects, from completion of the Montana Alberta Tie Line (MATL) electrical transmission line to the increased drilling activity in the Elm Coulee oil fields in the Bakken, have continued at full pace throughout the year. These developments continue to be supported by high energy prices, particularly for crude oil, as well as other supportive conditions.

The more comprehensive data needed to assess whether our forecast is on track over the first half of 2012 won't be available until next year. The fragmentary data we do have suggest that 2012 will end up as a year of at least respectable growth.

Figure 2

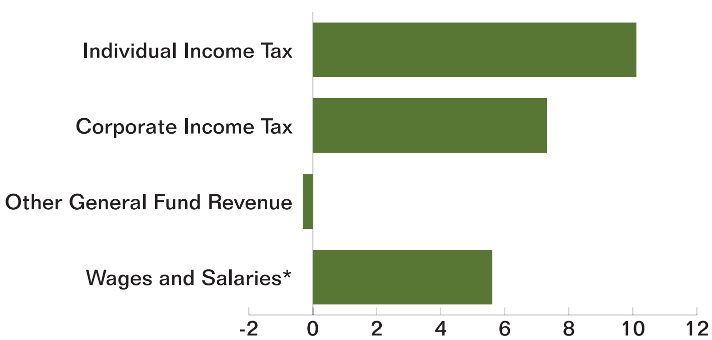
Metals and Energy Prices, June 2012 Averages Compared to Five-Year High and Low



* Current price.
Source: International Monetary Fund.

Figure 3

Percent Growth in Montana General Fund Revenues, FY 2011-2012



*Percent change computed using data from March 2011 to April 2012.
Source: Montana Legislative Fiscal Division.

Yet there have been some less promising developments thus far in 2012 that are less heartening, including (i) the extraordinarily dry and hot weather of the spring and summer, which have impacted both agricultural costs and yields, (ii) the continued weakness of the retail sector, even in faster growing parts of the state, and (iii) the fall back in many commodity prices, including metals important to Montana, as global economic growth expectations are adjusted downward.

Are Commodity and Energy Markets Cooling?

The outlook for the global economic growth, particularly in the faster growing economies of the developing world, has deteriorated markedly over the first half of 2012. The World Bank now expects the list of the fastest growing economies – headed by China, India, and Brazil – to collectively cool off to under 6 percent growth this year, from double-digit rates just three years ago. And the next two years are projected to be more of the same.

Compared to the anemic 2 percent growth rate of the U.S. economy, such growth still seems stratospheric. But it represents a significant departure from the rates of the past decade, and it has altered the trajectory of many commodity prices important to Montana.

Between mid-spring and early summer of this year, metals prices swooned significantly, with copper (down 14.2 percent), aluminum (down 5 percent), lead (down 18.5 percent), and zinc (down 14.8 percent) price declines of particular importance to Montana. During this same period, crude oil prices declined significantly as well.

But the behavior of commodity prices since mid-summer has exemplified why any statement about the future of commodity markets is usually punctuated with a question mark. Metals prices have largely bounced back to equal or surpass their spring levels, with some analysts attributing the recovery to the steps by central banks around the world to support easier credit. As Figure 2 shows, the up-down ride for prices this year has left most prices still high enough to support continued investment and production in Montana's natural resource reserves.

Interpreting Montana Tax Collection Data

Perhaps one of the most encouraging developments in the Montana economy this year has been a marked improvement in state government's fiscal picture. Most media attention has focused on the steady increases in the projected surplus in the state's general fund at the end of the 2011 biennium, now estimated at about $400 million at the close of June next year. This is approximately $260 million more than was officially projected during the last legislative session.

Less noticed is the fact that almost 40 percent of this unanticipated increase was due to spending levels that were smaller than expected, with only 60 percent due to higherthan-forecasted tax and other revenue collections. As shown in Figure 3, the growth in taxes over the July 2011 – June 2012 period was dominated by hefty gains in individual income tax and corporate tax collections, which increased by 10.3 percent and 7.7 percent, respectively.

These data appear to support the conclusion that the state has swung to much faster growth. But the connection between tax collections and growth in the underlying base is less than perfect, for at least three reasons. First, the data do not correct for inflation. That was a major difference a year ago, when inflation briefly peaked at near 4 percent. It is less of an issue this year.

Secondly, tax collections can reflect losses or gains that occurred in the past, carried into the tax year through estimated payments and refunds. This makes the corporate income tax, in particular, an unreliable indicator of current economic conditions. Even the withholding portion of the individual income tax, which fluctuates automatically with the amount of income subject to tax, can be affected by financial events like pension disbursements or the exercising of stock options that are not related to current economic activity.

The available data on Montana's wages and salary base – through March 2012 as of this writing – only enable us to compute growth using a 12-month period that is lagged by three months from the state's fiscal year. The 5.6 percent growth in wages and salary statewide in the most recent 12 months, not corrected for inflation, is strong, but not quite as strong as income tax collections would suggest.

Updating the Outlook for 2013

Three months ago, the Bureau released its mid-year update to its annual forecast for Montana and its major cities, which was released at the beginning of the year. Based on the strong growth in income tax withholding, the continued strength in agricultural and oil prices, and evidence of more oil drilling activity along the eastern border, we revised our forecast for growth in inflation-adjusted nonfarm earnings upward for 2012, to 2.4 percent. It now appears that actual growth will easily hit that mark, although our first glimpse at comprehensive estimates of growth won't come until late spring of next year.

The question is: What do new economic developments portend for growth next year? Although we remain three months away from preparing our annual outlook scheduled for January, some trends that will figure prominently in that forecast are already shaping up. These include:

- continued sluggish growth in the national economy, with faster growth put off until after 2013,
- a slight cooling in Asian economic growth, especially in India, which will reduce the upward pressure on energy and commodity prices,
- improving housing markets across the state, with an end to declines in prices and the restart of new construction activity.

The continued lackluster performance of the U.S. economy, especially along with any significant cooling of the faster-growing Asian economies, does not bode well for making 2013 a break-out year for Montana's economic growth. Our forecast of moderate growth of 2 to 3 percent in inflation-corrected nonfarm earnings statewide still looks realistic, given the current economic environment. That growth will be surpassed by the rural eastern parts of the state affected by energy development, as well as by Yellowstone and Gallatin counties.

Perhaps the biggest uncertainty to this forecast has nothing to do with the private sector economy – namely, the fiscal cliff of budget cuts and tax hikes now set to take effect by law in January. Depending on a lame-duck Congress to make the necessary decisions to avoid the drastic and damaging budget cuts and tax hikes that could disrupt a still-fragile economy is clearly a dangerous and unnecessary risk, but it is what we are facing as these words are written. ❑

Patrick M. Barkey is the director of the Bureau of Business and Economic Research at The University of Montana.

Update on Montana's Energy Boom

by Patrick M. Barkey

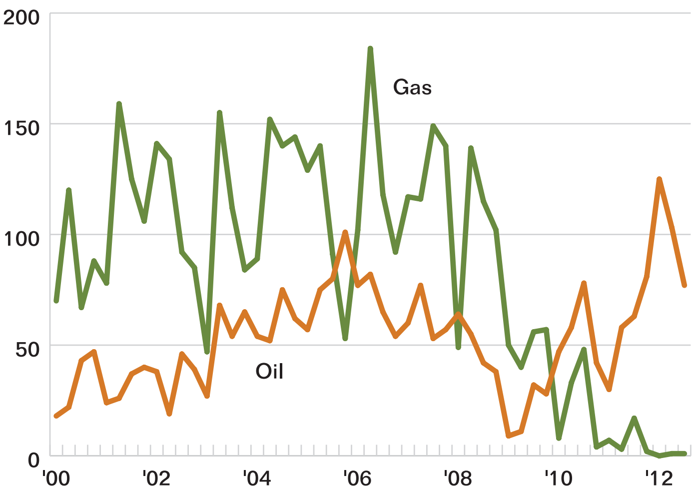
Forget about going to deep oceans or despotic countries. The most promising developments in the oil and gas business have been in the continental 48 states of the United States. Horizontal drilling and the shale gas revolution have turned the global trends in exploration and development around 180 degrees, with big new domestic finds in recent years – particularly in natural gas – shining an entirely different light on our energy future in the coming years.

How have those changes affected Montana in 2012? As we prepared our forecast last January, the promise for increased oil production in Montana's portion of the Elm Coulee field along our eastern border seemed especially bright. With North Dakota moving ahead of Alaska to become the second-leading largest oil producing state, there was much talk of drilling rigs moving across the border to exploit Montana's adjoining reserves. Has this in fact happened?

The data are incomplete, but there is evidence of an uptick in oil activity. As the accompanying graph shows, the trend in oil well permitting in Montana is strongly upward, although the permit count's surge to more than 120 in the second quarter of this year was not sustained. Despite the price discount Bakken producers must accept to get their product shipped to distant markets, activity appears to be on track with expectation. Natural gas activity, on the other hand, has been held in check by low prices. On balance, Montana's energy future still looks reasonably bright.❑

Patrick M. Barkey is the director of the Bureau of Business and Economic Research at The University of Montana.

Figure 4
Montana Oil and Gas Wells Permitted, 2000 – 2012



Source: Montana Board of Oil and Gas Conservation.